

Consumer Debt Relief in South Africa; Lessons from America and England; and Suggestions for the Way Forward*

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1 Introduction

In *Ex parte Ford and Two Similar Cases*¹ the Court, in response to the argument advanced on behalf of the applicants that they had a ‘constitutional right’ to the acceptance of the surrender of their estates, confirmed that the primary object of the South African Insolvency Act² is to benefit creditors and not to grant debt relief to harassed debtors.³ The Court also pointed out that there is a consonance between the objects of the relevant provisions of the National Credit Act⁴ and the Insolvency Act, namely, ‘not to deprive creditors of their claims but merely to regulate the manner and extent of their payment’.⁵

One of the purposes of the National Credit Act is to protect consumers by providing mechanisms for resolving over-indebtedness.⁶ The Act thus provides debt relief to over-indebted consumers by allowing them to apply to a debt counsellor to conduct a debt review and to be declared over-indebted.⁷ However, although s 3(g) lists the resolving of over-indebtedness as one of its purposes, this purpose is still subject to the principle of ‘satisfaction by the consumer of *all* responsible financial obligations’.⁸ As pointed out below, the debt review procedure does not offer the consumer an opportunity to obtain a discharge from pre-existing indebtedness.

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¹ 2009 (3) SA 376 (WCC) at 383.

² 24 of 1936.

³ The Court referred to *Ex parte Pillay; Mayet v Pillay* 1955 (2) SA 309 (N) at 31. See also *R v Meer and Others* 1957 (3) SA 614 (N) at 619; *Fesi and Another v Absa Bank Ltd* 2000 (1) SA 499 (C) at 502.

⁴ 34 of 2005.

⁵ In this regard the Court in *Ford* referred to *Nel NO v Body Corporate of the Seaways Building and Another* 1996 (1) SA 131 (A) at 138.

⁶ See s 3(g).

⁷ See s 86(1).

⁸ See s 3(g) – our emphasis. See also s 3(i).

Since June 2007 the number of consumers in ‘good standing’ has continued to deteriorate. At the end of June 2011, credit bureaux had records of 18.84 million credit active consumers, of which 8.8 million had impaired credit records. Thus, at present only 53.3 per cent of credit-active consumers are in ‘good standing’.⁹ These numbers should be understood against the backdrop of challenging economic conditions, job losses and income reduction experienced by South Africans during the economic down-turn.¹⁰ However, they also clearly indicate the urgent need to afford some form of relief to overburdened consumers. Unfortunately, debt review has not provided the necessary solution in this regard. At the end of August 2011, more than 269 000 consumers had applied for debt review, with an average of 6 000 new applications made each month. Of the 269 000 consumers under debt review, between 65 000 and 70 000 are making regular payments. Only an estimated 50 per cent of registered debt counsellors are active in the profession, and there are huge back-logs in the courts to approve new debt repayment plans.¹¹

Apart from sequestration in terms of the Insolvency Act and the debt relief measures provided for by the National Credit Act, South African insolvency law provides for administration orders in terms of s 74 of the Magistrates’ Courts Act.¹² Furthermore, the South African Law Reform Commission (‘the Commission’) has proposed that provision be made for a pre-liquidation composition with creditors.¹³ The aim of this article is to discuss the current state of affairs with regard to consumer debt relief in South Africa and to address the question of whether current procedures provide adequate relief for over-indebted consumers. By briefly referring to relevant aspects of the insolvency system of the United States of America and recent developments regarding debt relief measures in England and Wales, we also aim to suggest a way forward for law reform regarding consumer debt relief in South Africa.

⁹ National Credit Regulator Credit Bureaux Monitor Second Quarter (June 2011), available at www.ncr.org.za.

¹⁰ See the remark of Peter Setou, former senior manager for Education and Strategy at the National Credit Regulator on statistics for 2010 (referred to by Bronwynne Jooste ‘10 Million have Debt Hangover’ *Daily News* (15 July 2010)). In 2010, 8.3 million of the 18.2 million credit-active consumers had impaired credit records.

¹¹ Statistics provided by Ismail Kharwa, Acting Debt Counselling Manager at the National Credit Regulator on 21 September 2011.

¹² 32 of 1944.

¹³ The Law Reform Commission has proposed that provision be made for such composition by inserting a new section, s 74X, in the Magistrates’ Courts Act (South African Law Commission *Report on the Review of the Law of Insolvency* (Project 63) Vol 1 (Explanatory Memorandum) and Vol 2 (Draft Bill) (February 2000) Sched 4 – hence the ‘2000 Explanatory Memorandum’ and ‘2000 Insolvency Bill’ respectively). This proposal has also been included in the report of the Centre for Advanced Corporate and Insolvency Law (SACIL) at the University of Pretoria entitled *Final Report Containing Proposals on a Unified Insolvency Act* (January 2000) and in the latest version of the Insolvency Bill dated 30 June 2010 – see cl 118 of the unofficial working copy, on file with the authors (hence the ‘2010 Insolvency Bill’). In the two last-mentioned documents it is envisaged that the proposed measure should be included in the new unified Insolvency Act and not the Magistrates’ Courts Act. The Commission’s initial proposal has also been amended with regard to the powers of the court if the composition is not accepted by the required majority of creditors (see the discussion of the latest proposal in par 3.3 below).

2 Sequestration in terms of the Insolvency Act

2.1 'Advantage to Creditors' and the Dilemma of the 'Poor' Debtor

The primary object of the South African Insolvency Act is to ensure an orderly and fair distribution of the debtor's assets in circumstances where these assets are insufficient to satisfy all the creditors' claims. Once a sequestration order has been issued, a *concursum creditorum* comes into being and the rights of the creditors as a group are preferred to the rights of individual creditors.¹⁴ Although it is not a primary object of the Insolvency Act to grant debt relief to debtors, one of the Act's consequences is that debt relief is granted to the consumer debtor, because rehabilitation in terms of the Act results in a discharge of all pre-sequestration debts.¹⁵

In current South African insolvency law a debtor's estate may be sequestrated by way of voluntary surrender¹⁶ or after a successful application by a creditor or two or more creditors for the compulsory sequestration of his estate.¹⁷ These procedures are expensive and require a High Court application.¹⁸ Moreover, the South African Insolvency Act lays down 'advantage to creditors'¹⁹ as a prerequisite for sequestration applications and in so doing places a stumbling-block in the way of debtors wishing to use the process as a debt relief measure.²⁰

The requirement of 'advantage to creditors' is fundamental to the South African Insolvency Act. As Erasmus J remarked: '[T]he whole tenor of the Act, inasmuch as it directly relates to sequestration proceedings, is aimed at obtaining a pecuniary benefit for creditors.'²¹ What we shall refer to as 'the advantage to creditors requirement' is a golden thread running through the Act, for, as Smith explains:²²

'In considering the provisions of the Act it becomes apparent that there is a recurrent motif or dominant thread (if "thread" is used in the sense of something that runs a continuous course through anything) and that is the advantage of creditors, not one creditor, or some creditors but the creditors as an entity or the *concursum creditorum*.'

The phrase 'advantage to creditors' is not defined in the Insolvency Act. According to case law, the advantage to creditors requirement entails a 'reasonable prospect of some pecuniary benefit to the general body of

¹⁴ *Walker v Syfret* 1911 AD 141 at 166; Eberhard Bertelsmann et al *Mars The Law of Insolvency* 9 ed (2008) at 2 ('Mars').

¹⁵ Section 129(b) of the Insolvency Act and see Mars op cit note 14 at 3.

¹⁶ Sections 3–7 of the Insolvency Act.

¹⁷ Sections 9–12 of the Insolvency Act.

¹⁸ See Melanie Roestoff & Stéfán Renke 'Debt Relief for Consumers – Insolvency and Consumer Protection Legislation' (Part 2) (2006) 27 *Obiter* 98 at 99.

¹⁹ See ss 6, 10 and 12 of the Insolvency Act.

²⁰ See Roestoff & Renke op cit note 18 at 99.

²¹ *BP Southern Africa (Pty) Ltd v Furstenburg* 1966 (1) SA 717 (O) at 720.

²² CH Smith 'The Recurrent Motif of the Insolvency Act – Advantage for Creditors' (1985) 7 *Modern Business Law* 27. In this article Smith points out that the term 'advantage of creditors' is to be found in numerous sections of the Act. She examines these sections as well as the sections which are clearly designed for the advantage of creditors, although they do not use the actual term (eg ss 13(1), 19, 21, 23, 26, 29, 30, 65, 119 and 152).

creditors'.²³ With reference to case law,²⁴ Smith²⁵ points out that sequestration also confers upon creditors certain 'indirect' advantages inherent in the sequestration process, such as the possibility of finding more assets after a comprehensive investigation of the debtor's affairs. However, she submits that the majority of the decisions of our courts²⁶ indicate that these 'indirect' advantages alone cannot constitute advantage to creditors and have to be linked to a possible monetary advantage.²⁷

Because sequestration can eventually afford a debtor a discharge of his debts, the process of compulsory sequestration has in the past been used – or according to some, abused²⁸ – by debtors in the form of an application for a so-called friendly sequestration²⁹ to obtain debt relief. However, over the past fifteen years our courts have taken a firm stance with regard to the granting of friendly applications, making it clear that the court has a duty to scrutinise the application with great care to ensure advantage to creditors and to prevent prejudice to them.³⁰ Adequate and accurate information with regard to the claim against the respondent debtor and sufficient evidence in respect of the assets of the debtor and their valuation are insisted on to remove any impression that the parties are abusing the process.³¹ Some decisions³² have also set additional minimum requirements for friendly sequestration applications and have been criticised for exceeding the powers of the court and encroaching on the legislature's territory.³³

²³ See *Meskin & Co v Friedman* 1948 (2) SA 555 (W) at 559; *Lynn & Main Inc v Naidoo and Another* 2006 (1) SA 59 (N) at 68; *Ex parte Bouwer and Similar Applications* 2009 (6) SA 382 (GNP) at 386.

²⁴ *London Estates (Pty) Ltd v Nair* 1957 (3) SA 591 (N); *Stainer v Estate Bukes* 1933 OPD 86; *Meskin & Co v Friedman* supra note 23; *Awerbuch, Brown & Co (Pty) Ltd v Le Grange* 1939 OPD 20.

²⁵ Smith op cit note 22 at 31–2.

²⁶ Smith op cit note 22 at 32 refers to *Meskin & Co v Friedman* supra note 23 at 559; *London Estates (Pty) Ltd v Nair* supra note 24 at 593; and *BP Southern Africa (Pty) Ltd v Furstenburg* supra note 21 at 720.

²⁷ Smith op cit note 22 at 32 and see also *Lynn & Main Inc v Naidoo* supra note 23 at 68 et seq.

²⁸ See Roger G Evans 'Friendly Sequestrations, the Abuse of the Process of Court, and Possible Solutions for Overburdened Debtors' (2001) 13 SA Merc LJ 485. See also *Esterhuizen v Swanepoel and Sixteen Other Cases* 2004 (4) SA 89 (W) at 92.

²⁹ This phenomenon has developed in practice because of the fact that the onus of proving advantage in the case of a compulsory sequestration application is less onerous than in the case of a voluntary sequestration application. Unlike voluntary surrender, which requires positive proof of advantage to creditors, compulsory sequestration requires only a 'reasonable prospect' that it will be to the advantage of creditors: compare the wording of ss 10(c) and 12(1)(c). Furthermore, no formal requirements are prescribed with regard to compulsory sequestration (Catherine Smith 'Friendly and Not So Friendly Sequestrations' (1981) 3 *Modern Business Law* 58 at 59).

³⁰ See, eg, *Craggs v Dedekind; Baartman v Baartman and Another; Van Aardt v Borrett* 1996 (1) SA 935 (C) at 937; *Ex parte Steenkamp and Related Cases* 1996 (3) SA 822 (C) at 825; *Van Eck v Kirkwood* 1997 (1) SA 289 (SE) at 290; *Van Rooyen v Van Rooyen (Automutual Investments (EC) (Pty) Ltd, Intervening Creditor)* [2000] 2 All SA 485 (SE) at 490; *Beinash & Co v Nathan (Standard Bank of South Africa Ltd Intervening)* 1998 (3) SA 540 (W) at 542; *Lemley v Lemley* 2009 JDR 0445 (SE) at 4. See also Alastair Smith ' "Cast a Cold Eye": Some Unfriendly Views on Friendly Sequestrations' (1997) 5 *Juta's Business Law* 50 and idem 'Caution Without Bias: The Court's Treatment of Opposition to a Friendly Sequestration' (1998) 6 *Juta's Business Law* 157.

³¹ *Craggs v Dedekind* supra note 30; *Streicher v Viljoen* [1999] 3 All SA 257 (NC); *Ex parte Steenkamp* supra note 30; *Meyer v Batten* 1999 (1) SA 1041 (W).

³² See *Mthinkhulu v Rampersad & Another (BOE Bank Ltd, Intervening Creditor)* [2000] 3 All SA 512 (N); *Vermeulen v Hubner* (unreported, TPD case no 1165/1990, date unknown).

³³ See *Sellwell Shop Interiors v Van Der Merwe* (unreported, WLD case no 27527/1990, 16 November 1990); Evans op cit note 28 at 501.

Also in respect of applications for voluntary surrender our courts have of late tightened their approach in order to thwart abuse of process. According to recent case law, the essence of ‘advantage to creditors’ is that the court must make a decision on the evidence presented that there are sufficient assets in the estate with sufficient value to pay the costs of sequestration and a not-negligible³⁴ dividend³⁵ to creditors.³⁶ In this regard, our courts have recently insisted more stringently on exact information regarding the debtor’s affairs being placed before them and on demanding a realistic calculation of the potential dividend.³⁷ The reason for this stringent approach is explained as follows by Mars:³⁸

‘The requirement that all information presented to the court in an application for surrender must be accurate and that the valuations must be exact arises from the courts’ insistence that a debtor who is pressed by his creditors does not over-estimate the value of his estate in order to obtain relief from his financial burdens. The administration of insolvent estates has over the years developed into a very lucrative and therefore competitive profession. The pressure has therefore increased to identify debtors whose sequestration or liquidation may render a lucrative return to lawyers, trustees, liquidators, valuers and auctioneers. Advertisements in the media canvassing debtors who are desirous of ridding them of their financial burdens have become commonplace. This has increased the risks for debtors and creditors alike. Debtors who might be able to meet their obligations if they were given the opportunity to properly arrange their affairs, are pressurized into opting for insolvency proceedings instead, often if not always losing their homes and motor vehicles as a result thereof, suffering the consequences of a bad credit record for many years thereafter. On the other hand, insolvency practitioners are tempted to present a rosy picture of the debtor’s affairs that bears little semblance to reality, resulting in an estate being declared insolvent that renders little or no dividend for creditors once the fees of the various participants in voluntary surrender proceedings have been deducted and the administration costs have been paid.’

In *Ex parte Mattysen et Uxor (First Rand Bank Ltd Intervening)*³⁹ the Court held that it could not conclude that the application for voluntary surrender

³⁴ See *London Estates v Nair* supra note 24 at 591; *Absa Bank Ltd v De Klerk and Related Cases* 1999 (4) SA 835 (E) at 840; *Ex parte Anthony en 'n Ander en Ses Soortgelyke Aansoeke* 2000 (4) SA 116 (C) at 121; *Ex parte Mattysen et Uxor (First Rand Bank Ltd Intervening)* 2003 (2) SA 308 (T) at 316; *Ex parte Kelly* 2008 (4) SA 615 (T) at 617.

³⁵ The Act does not prescribe the size of the dividend, and in the past our courts have set, as a rule of practice, the minimum dividend on 10 cents in the Rand for each concurrent creditor (*Nieuwenhuizen and Another v Nedcor Bank Ltd* [2001] 2 All SA 364 (O) at 367; *Ex parte Kelly* supra note 34 at 617). In recent times, however, a dividend of 20 cents in the Rand is generally regarded as the minimum benefit that would have to be established before a sequestration application will be granted (*Ex parte Ogunlaja & Others* [2011] JOL 27029 (GNP) par 9).

³⁶ *Ex parte Mattysen* supra note 34 at 316; *Ex parte Anthony* supra note 34 at 124; *Nel v Lubbe* 1999 (3) SA 109 (W) at 112.

³⁷ Mars op cit note 14 at 63; *Ex parte Bouwer* supra note 23.

³⁸ Op cit note 14 at 63, quoted with approval in *Ex parte Bouwer* supra note 23 at 384.

³⁹ Supra note 34 at 316.

would be to the advantage of creditors as an acceptable basis for calculating the dividend had not been provided. The Court held that it was apparent from the report of the applicant's valuator that she did not have personal knowledge of the relevant facts. Ultimately, her valuation of the property was a bald statement that was not supported by any facts or reasons and, standing on its own, proved nothing.⁴⁰ In *Ex parte Ogunlaja and Others*⁴¹ the Court pointed out that the valuator, who functions as an expert witness, should be completely independent and 'completely in the dark regarding the amount that the insolvent's assets will have to be disposed of in a forced sale situation in order to guarantee an advantage to creditors'. Therefore, the Court held that valuers should certify under oath that they had prepared the valuation without knowledge of the facts of the relevant application. The applicants and their attorneys should likewise confirm that the valuator was not made privy to the value of the assets to be realised in order to constitute advantage to creditors.⁴²

It is thus clear that a debtor wishing to utilise the sequestration process as a form of debt relief needs to overcome the obstacle created by the advantage to creditors requirement. In this regard Bertelsmann J remarked in *Ex parte Ogunlaja*:⁴³

'Unless and until the Insolvency Act is amended, the South African insolvency law requires an advantage to creditors before the estate of an individual can be sequestrated. Much as the troubled economic times might engender sympathy for debtors whose financial burden has become too much to bear, the insolvency law seeks to protect the interests of creditors at least to the extent that a minimum advantage must be ensured for the concurrent creditor when the hand of the law is laid on the insolvent estate.'

Accordingly, as was aptly explained by Rochelle,⁴⁴ a consumer debtor in South Africa can be 'too poor to go bankrupt'. As to the dilemma of the overburdened debtor seeking debt relief, Evans⁴⁵ comes to the following conclusion regarding current insolvency legislation:

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

Therefore, the question arises whether the advantage to creditors requirement should be retained and whether, as Flemming J remarked in

⁴⁰ *Idem* at 313 et seq; *Nel v Lubbe* supra note 36 at 112; *Ex parte Anthony* supra note 34 at 124; *Ex parte Bouwer* supra note 23 at 389; *Ex parte Ogunlaja* supra note 35 in pars 16, 23.

⁴¹ *Supra* note 35 in par 16.

⁴² *Idem* in pars 38, 39.

⁴³ *Idem* in par 36.

⁴⁴ Michael R Rochelle 'Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth; the American Experience, and Possible Uses for South Africa 1996 *Tydskrif vir die Suid-Afrikaanse Reg* 315 at 319.

⁴⁵ Evans op cit note 28 at 508.

Sellwell Shop Interiors v Van der Merwe,⁴⁶ ‘insolvency legislation has fallen behind the needs of present times and merits reconsideration in so far as it requires advantage to creditors in all cases’.

2.2 Advantage to Creditors and/or Advantage for the Debtor?

The Commission has recommended that the advantage to creditors requirement be retained.⁴⁷ From the 2010 Insolvency Bill it would appear that the Commission has not changed its mind in this regard.⁴⁸

As the sequestration process is expensive to follow, we believe that it should only be resorted to if it would be cost effective to do so: that is, if the proceeds of the free residue would be sufficient to cover the costs of sequestration and to provide a not-negligible dividend to creditors.⁴⁹ The advantage to creditors requirement fulfils an important function in this regard, and the solution to the situation where the overburdened debtor is unable to prove advantage to creditors should in our view rather be found in an alternative measure aimed at restructuring the income of the debtor.

Retaining the advantage to creditors requirement would, however, call for measures to ensure that a not-negligible dividend will indeed be available to creditors. A survey conducted in the office of the Master of the High Court, Pretoria, revealed that concurrent creditors received dividends in only 28,6 per cent of the cases included in the survey, while creditors were liable to pay contribution in 40,6 per cent of the cases.⁵⁰ These statistics signify that sequestration would in many instances probably not be to the advantage of creditors, even though the Act requires this to be proved.

The Commission proposed that provision be made for the granting of a provisional order in the case of a voluntary surrender application as is currently the case with regard to compulsory liquidation⁵¹ applications.⁵² According to the Commission, the first meeting of creditors should ideally be held before the return date so that creditors can in terms of cl 38(6) consider whether liquidation would be to the advantage of creditors.⁵³ Clause 38(1) of

⁴⁶ Supra note 33.

⁴⁷ See cl 7(1)(b) and 8(1)(c) of the 2000 Insolvency Bill and the 2000 Explanatory Memorandum at 15.

⁴⁸ See cl 3(8)(a)(ii), 10(1)(c)(i) and 11(1)(c) of the 2010 Insolvency Bill.

⁴⁹ See also Barend Hendrik Swart *Die Rol van 'n Concurfus Creditorum in die Suid-Afrikaanse Insolvensiereg* (unpublished LLD thesis, University of Pretoria (1990)); Melanie Roestoff *'n Kritiese Evaluasie van Skuldverligtingsmaatreëls vir Individue in die Suid-Afrikaanse Insolvensiereg* (unpublished LLD thesis, University of Pretoria (2002)); Evans op cit note 28 at 488.

⁵⁰ South African Law Commission *Review of the Law of Insolvency: Prerequisites for and Alternatives to Sequestration* (Working Paper 29 Project 63) (1989) Sched 3 (hence ‘Working Paper 29’). See also *Hillhouse v Stott*; *Freban Investments (Pty) Ltd v Itzkin*; *Botha v Botha* 1990 (4) SA 580 (W) at 586.

⁵¹ The Commission uses the term ‘liquidation’ in respect of the estate of a natural person. Hereafter, the term ‘liquidation’ will only be used in relation to the Commission’s proposals; otherwise the term ‘sequestration’ will be used.

⁵² See cl 3(7) read with cl 7 of the 2000 Insolvency Bill; 2000 Explanatory Memorandum at 45.

⁵³ Clause 38(6) provides as follows:

‘If the first meeting of creditors is held before a final order is given, the liquidator’s report shall deal with the question whether the liquidation of the debtor’s estate will probably be to the advantage of his

the Bill provides that the first meeting should be convened to be held within 60 days after the appointment of the liquidator.⁵⁴ If the court insists on a report before a final order is granted, the Commission suggests that the return date for the final order may be extended or fixed to ensure that the meeting can be held in time.⁵⁵ We believe that the Commission's proposals in this regard could help to ensure that sequestration would be implemented only if it would be cost effective to do so. However, we are of the view that Parliament should in all applications require, in all applications and before the return date, both a first meeting and a report dealing with the question whether liquidation would be to the advantage of creditors.

The Commission also proposed that applicants in liquidation applications must provide security for the payment of all costs of the application and all costs of liquidation that are not recoverable from other creditors of the estate.⁵⁶ The Commission suggests that less-expensive remedies should be followed if there are insufficient assets to make liquidation worthwhile.⁵⁷

One of the reasons why concurrent creditors often do not receive any dividends is the fact that the Insolvency Act provides for an extensive list of preferential rights for the state and certain other creditors with regard to the free residue of an insolvent estate.⁵⁸ The Commission recommends that the only preferences that should be retained are those pertaining to the costs of sequestration, claims for arrear salary and maintenance, and the claims of general bondholders.⁵⁹

We believe that insolvency legislation providing for a compulsory first meeting of creditors before the return date, the implementation of the Commission's proposals regarding the applicant's obligation to provide security for costs, and the proposals regarding the abolition of certain preferential rights of creditors could help to ensure that estates will be sequestrated only in instances where sequestration would ultimately yield a not-negligible dividend to creditors.

In order to ensure that a dividend will be available to creditors, our courts have limited attorneys' fees in applications for voluntary surrender.⁶⁰ In these applications the practice is for the applicant to allege the amount of the attorney's fees and expenses. In *Ex parte Kelly*,⁶¹ Southwood J held that the applicant's attorneys were not entitled to tax fees and expenses that would

or her creditors and the said question shall be considered at the said meeting or at a subsequent meeting of creditors and the liquidator shall submit a report to the court and the applicant on this question before the court considers whether a final liquidation order should be made.'

⁵⁴ In terms of cl 38(2) the Master must appoint the liquidator nominated by creditors 48 hours after granting of the first liquidation order (2000 Explanatory Memorandum at 102).

⁵⁵ See 2000 Explanatory Memorandum at 113. See also Working Paper 29 at 128 et seq and MW Lynn 'Inadequacies Insolvency Act' (1988) March *De Rebus* 171 at 172.

⁵⁶ See cll 3(3)(b) and 4(3)(c) of the 2000 Insolvency Bill.

⁵⁷ 2000 Explanatory Memorandum at 46.

⁵⁸ See ss 97–102.

⁵⁹ See cl 80 of the 2000 Insolvency Bill and Explanatory Memorandum at 16 and 204.

⁶⁰ See Mars op cit note 14 at 63; *Ex parte Kelly* supra note 34 at 619; *Ex parte Ogunlaja* supra note 35 in pars 40–3.

⁶¹ Supra note 34 at 619.

exceed those alleged. The Court pointed out that the dividend to be paid to creditors is calculated on the strength of the allegation and the court eventually grants the order in the belief that those figures are correct and that the dividend will be paid. In the present case, if the full amount of the bill of costs (which amounted to almost seven times the fees and expenses alleged in the application) were to be allowed by the Court, concurrent creditors would have received no dividend and might have been liable for a contribution to the costs of sequestration. The Court accordingly held that where the amount of the attorney's fees is alleged in the application, it must be understood to contain an undertaking by the attorney to limit his fees and expenses to the amount alleged and that the subsequent order must also be understood to contain such a limitation.⁶²

Mars⁶³ suggests that insolvency legislation should provide for judicial oversight of the actual results of the liquidation process:

'Judges have no insight into the liquidation and distribution process and are never informed whether the dividend that was held up to creditors in the application was in fact realized. Nor do the courts have any insight into the fees and commissions that are paid to the various practitioners involved in the liquidation process and can therefore never assess whether the body of creditors is properly protected by the present system.'⁶⁴

We believe that the solution to the overburdened debtor's dilemma of not being able to prove advantage is not to be found in a mere abolition of the advantage to creditors requirement. Proof of advantage should still be the gateway to sequestration as a form of debt relief. However, the Court in *Ex parte Ford*⁶⁵ created a further prerequisite for voluntary surrender applications: debt review in terms of s 86 of the National Credit Act.⁶⁶ In *Ford* the Court refused to exercise its discretion in favour of the applicants for an order for the voluntary surrender of their respective estates, because it found that debt review was the appropriate mechanism to be used.⁶⁷ The major portion of the applicants' debt arose out of credit agreements in terms of the National Credit Act and, according to the Court, it was remarkable how disproportionately high the amount of this debt was compared to the relatively modest incomes of the applicants. The Court therefore concluded that grounds for suspicion that the credit was granted recklessly presented themselves strongly on the facts

⁶² *Ex parte Kelly* supra note 34 at 618–9. See also *Ex parte Ogunlaja* supra note 35 in pars 40–3.

⁶³ Mars op cit note 14 at 64.

⁶⁴ *Ibid.*

⁶⁵ Supra note 1. For a detailed discussion of *Ford*, see C van Heerden & A Boraine 'The Interaction Between the Debt Relief Measures in the National Credit Act 34 of 2005 and Aspects of Insolvency Law' (2009) 12 *Potchefstroom Electronic LJ* 161.

⁶⁶ A Boraine & C 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 *Potchefstroom Electronic LJ* 84 at 112–3 submit that in *Ford* the Court did not elevate debt review to an additional prerequisite for voluntary sequestration but that the applicant debtor who bears the onus of proving advantage to creditors should consider whether a debt restructuring as a result of debt review might not be more advantageous than sequestration. However, the Commission's latest proposal regarding the prerequisites for a debtor's application for the liquidation of his or her estate is that an application for debt review must be concluded or the debtor must satisfy the court that such an application would not serve a useful purpose (see the 2010 Insolvency Bill, cll 3(8)(a)(iii), 10(1)(c)(iii) and 11(1)(d)).

⁶⁷ *Ex parte Ford* supra note 1 at 384.

disclosed in each of the applications.⁶⁸ The Court pointed out that a referral of the matter to a debt counsellor in terms of s 85 of the National Credit Act might eventually result in the credit agreements being declared reckless credit, and being set aside or suspended.⁶⁹

However, it would appear that the reckless credit provisions are not truly valuable from the point of view of debt relief.⁷⁰ Boraine and Van Heerden⁷¹ submit that it would not afford a lasting solution to the overburdened debtor's financial problems, because setting aside the agreement would not preclude the creditor from claiming restoration. Furthermore, although suspension may bring some relief regarding the repayment of finance charges, the debtor will once again be liable to repay at least the capital amount of the credit once the suspended period has elapsed.⁷² None the less, it would appear that the Court's main consideration in emphasising the importance of an investigation into possible reckless extension of credit was not to accommodate the applicant debtors trying to find a solution for their financial dilemma, but rather perhaps to attain an advantage to those creditors who acted responsibly, and not recklessly, when granting credit.⁷³

Be that as it may, the Court refused to grant the sequestration order, despite the fact that creditors did not intervene to oppose the matter⁷⁴ and despite the fact that the applicants testified that debt review in terms of the National Credit Act would not be a workable solution for their debt problems.⁷⁵ Moreover, the Court indicated that the applicants had no choice in the matter, because it found that they had no 'constitutional right' to acceptance by the Court of the surrender of their estates 'as the primary object of the machinery of voluntary surrender is not the relief of harassed debtors'.⁷⁶

It is submitted that the Court in *Ford* essentially placed a new stumbling-block in the way of debtors wishing to use the sequestration process as a form of debt relief. However, as a result of the decision in *Investec Bank Ltd and Another v Mutemeri and Another*,⁷⁷ a debtor who opts for debt review as a form of debt relief may be barred from continuing with this process when a creditor decides to apply for the compulsory sequestration of his or her estate. In *Mutemeri*, Trengove AJ held that an application for compulsory sequestration did not amount to debt enforcement in terms of the

⁶⁸ Idem at 378–9.

⁶⁹ Idem at 380.

⁷⁰ Boraine & Van Heerden supra note 66 at 97.

⁷¹ Idem at 98.

⁷² Ibid.

⁷³ Ex parte *Ford* supra note 1 at 383 and see Boraine & Van Heerden supra note 66 at 95.

⁷⁴ See Boraine & Van Heerden supra note 66 at 116.

⁷⁵ Ex parte *Ford* supra note 1 at 382.

⁷⁶ Idem at 383.

⁷⁷ 2010 (1) SA 265 (GSJ). See also *FirstRand Bank Ltd v Evans* 2011 (4) SA 597 (KZD) and *Naidoo v Absa Bank Ltd* 2010 (4) SA 597 (SCA), confirming the decision in *Mutemeri* and the discussion of *Naidoo* by N 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' (2011) 14 *Potchefstroom Electronic LJ* 171.

National Credit Act⁷⁸ and therefore did not preclude the applicant creditor from proceeding with an application for sequestration.⁷⁹

Decisions such as *Ford* and *Mutemeri* are typical of our courts' creditor-oriented approach when exercising their discretion to grant a sequestration order. The debtor is given no choice as to how he or she wishes to deal with his or her financial dilemma, and his or her interests as to what would be the best solution for his or her financial affairs are not really taken into consideration. The only consideration seems to be whether sequestration will be to the advantage of creditors.

The result of *Mutemeri*⁸⁰ is that a debtor will be precluded from continuing with a pending debt review when his or her estate is sequestered. This means that the debtor will be forced to lose his or her assets and be subjected to the social stigma of being insolvent.⁸¹ As a result of *Ford*, debtors electing for voluntary surrender as a form of relief may be compelled to consider debt review even though it may probably not provide a workable solution to their debt problems.

The Insolvency Act vests the court with a discretion that is to be exercised judicially upon a consideration of *all* the facts and circumstances.⁸² It is submitted that the court, when exercising its discretion to grant a sequestration order, should follow a balanced approach taking into consideration the interests of the debtor regarding the choice of debt relief. This raises the further question of whether the time has not come that insolvency legislation should specifically require an advantage for the debtor as a prerequisite for compulsory sequestration applications. It is submitted that in voluntary applications Parliament should expressly provide that the court, when exercising its discretion to grant a sequestration order, should take into consideration the debtor's interests regarding what the best solution for his or her debt problems would be.

3 Current Alternatives to Sequestration – Adequate Debt Relief for Over-indebted Consumers?

3.1 Administration Orders

Administration orders are regulated by s 74 of the Magistrates' Courts Act.⁸³ This involves a relatively simple and inexpensive procedure whereby

⁷⁸ See s 130(1) of the National Credit Act.

⁷⁹ *Investec Bank v Mutemeri* supra note 77 at 274–7. See also Boraine & Van Heerden op cit note 66 for a detailed discussion of the *Mutemeri* case.

⁸⁰ See also *FirstRand Bank Ltd v Evans* supra note 77.

⁸¹ See Maghembe op cit note 77 at 177–8. Maghembe suggests that the National Credit Act should be amended to prohibit credit providers from proceeding with compulsory sequestration proceedings once a debt restructuring order has been granted in terms of the National Credit Act.

⁸² (Emphasis supplied.) See *Julie Whyte Dresses (Pty) Ltd v Whitehead* 1970 (3) SA 218 (D) at 219.

⁸³ See in general LTC Harms et al *Civil Procedure in the Magistrates' Courts* (ed DR Harms) (1997-) in pars 37.1-37.10; TJM Paterson *Eckhard's Principles of Civil Procedure in the Magistrates' Courts* 5 ed (2005) at 318; M Roestoff & L Jacobs 'Statutêre Akkoord voor Likwidasie: 'n Toereikende Skuldenaar Remedie' (1997) 30 *De Jure* 189 at 204.

overcommitted debtors' obligations are rescheduled. These orders are intended for smaller estates where sequestration would 'swallow the assets'⁸⁴ and the aim is mainly to assist the debtor during a period of financial embarrassment.⁸⁵ Boraine⁸⁶ describes the order as 'a debt relief measure available to some debtors that find themselves in financial distress, which affords them the opportunity to obtain a statutory rescheduling of debt sanctioned by a court order'.

In *Madari v Cassim*⁸⁷ Caney AJ accurately described the nature of these orders:

'Administration orders under sec. 74 of the Magistrates' Courts Act have been described, I think correctly, by the learned authors of Jones and Buckle on the *Civil Practice of the Magistrates' Courts*, as a "modified form of insolvency". This is designed, it seems to me, as a means of obtaining a *concursum creditorum* easily, quickly and inexpensively, and is particularly appropriate for dealing with the affairs of debtors who have little assets and income and genuinely wish to cope with financial misfortune which has overtaken them. Creditors have certain advantages under such an order, including the appointment of an independent administrator and the opportunity of examining the debtor. They are not debarred from sequestrating the debtor if the occasion to do so arises.'

The administration procedure may thus be seen as a form of insolvency⁸⁸ or even as an alternative to sequestration under certain circumstances.⁸⁹ Administration orders are intended to be utilised where the debtor is unable to satisfy a judgment debt or to meet his financial obligations and where he does not have sufficient assets to attach in satisfaction of such judgment or obligations.⁹⁰ A condition for employing this procedure is that the total amount of all debts due should not exceed the amount determined by the Minister by notice in the *Gazette*.⁹¹ The amount is currently set at R50 000.⁹² In *Cape Town Municipality v Dunne*⁹³ it was held that the term 'debts' means debts 'due and payable' and does not include in futuro debts.

The process of obtaining an administration order entails an application to the Magistrate's Court in the prescribed format⁹⁴ coupled with a full statement of affairs⁹⁵ whereby the debtor seeks an order providing for the administration of the estate and payment of debts in instalments or otherwise.⁹⁶ The

⁸⁴ *Fortuin v Various Creditors* 2004 (2) SA 570 (C) at 573.

⁸⁵ *Cape Town Municipality v Dunne* 1964 (1) SA 741 (C) at 744.

⁸⁶ André Boraine 'Some Thoughts on the Reform of Administration Orders and Related Issues' (2003) 36 *De Jure* 217 at 217.

⁸⁷ 1950 (2) SA 35 (D) at 38.

⁸⁸ HJ Erasmus & DE Van Loggerenberg *Jones and Buckle The Civil Practice of the Magistrates' Courts in South Africa* 9 ed (1996-) at 305 ('Jones & Buckle'); *Weiner NO v Broekhuysen* 2003 (4) SA 301 (SCA) at 305. See also CP Joubert 'Artikel 74 – Magistraatshowewet 32 van 1944 Soos Gewysig' (1956) 19 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 135 at 138 for a diverging opinion.

⁸⁹ Paterson op cit note 83 at 318.

⁹⁰ Section 74(1)(a).

⁹¹ Section 74(1)(b).

⁹² Government Notice R3441 in *Government Gazette* 14498 of 31 Dec 1992 with effect from 1 January 1993.

⁹³ *Supra* note 86 at 745. See also *Carletonville Huishoudelike Voorsieners (Edms) Bpk v Van Vuuren en 'n Ander* 1962 (2) SA 296 (T) and MA Greig 'Administration Orders as Shark Nets' (2000) 117 *SALJ* 622 at 624 for a discussion of in futuro debts as well as criticism of their exclusion.

⁹⁴ Section 74A(1).

⁹⁵ Section 74A(1) read with s 74A(2).

⁹⁶ Section 74(1).

application is lodged with the Clerk of the Court, and a copy is delivered to each creditor at least three days prior to the hearing.⁹⁷ At the hearing, the Court considers the circumstances and may then grant an administration order⁹⁸ whereby the estate is placed under administration, an administrator is appointed⁹⁹ and an amount that the debtor is obliged to pay to the administrator is set.¹⁰⁰ Subject to certain exceptions, once the order is in force no creditor can commence enforcement proceedings for outstanding debt¹⁰¹ and if the proceedings have been instituted, they will be suspended by the administration order.¹⁰² After his or her appointment the administrator will collect payments in terms of the order and distribute them proportionately amongst creditors at least every three months.¹⁰³ In certain circumstances the Court may authorise the realisation of an asset of the estate.¹⁰⁴ Once the costs of administration and listed creditors have been paid in full, the administrator lodges a certificate at the Clerk of the Court, whereupon the order lapses.¹⁰⁵

An administration order is no bar to the sequestration of a debtor's estate.¹⁰⁶ There are two schools of thought relating to the interplay between these two procedures. On the one hand, it was held in *Madari v Cassim*¹⁰⁷ that where a debtor has lodged an application for an administration order and a court thereafter has to decide whether to grant a sequestration, the position of creditors under an administration order versus the position under sequestration has to be considered. However, in *Trust Wholesalers v Woollens (Pty) Ltd v Mackan*¹⁰⁸ the Court came to a contrary conclusion and held that the 'methods of dealing with the debtor's affairs' should not be compared. Therefore, according to this line of thought, the proposed sequestration should be considered in a vacuum. Jones and Buckle prefer the former approach:¹⁰⁹

'In comparing the situation of creditors under an administration order and their situation if there is a sequestration the court will take into consideration the fact that an administration order is eminently suited to deal with the estates of small debtors who have little income and assets, while sequestration is more suitable in the case of elaborate estates where the transaction of the debtor might have been complex and where there is reason to believe in all the circumstances that, after the costs of sequestration are paid, it will result in a payment in respect of the claims of the creditors as a body which is not negligible.'

Considering the nature and consequences of the administration procedure, the vital question seems to be whether it provides for an adequate alternative

⁹⁷ Section 74A(5).

⁹⁸ In accordance with s 74C.

⁹⁹ Section 74E.

¹⁰⁰ Section 74C(1)(a).

¹⁰¹ Section 74P(1).

¹⁰² Section 74P(2).

¹⁰³ Section 74J.

¹⁰⁴ Section 74K.

¹⁰⁵ Section 74U.

¹⁰⁶ Section 74R.

¹⁰⁷ *Supra* note 87 at 38. See also *Gardee v Dhanmanta Holdings and Others* 1978 (1) SA 1066 (N) at 1070.

¹⁰⁸ 1954 (2) SA 109 (N) at 112.

¹⁰⁹ *Op cit* note 89 at 325.

debt relief measure, because it seems that it was intended as an alternative to the sequestration procedure, especially for smaller estates in financial distress.

It is clear from the discussion above that not all debtors in financial distress can apply for administration, the most obvious reason being that the procedure is only available to estates where the claims do not exceed R50 000. Therefore, a debtor who cannot show an advantage to creditors will also be excluded from employing the administration procedure where the debt amounts to more than R50 000. Another limitation is that in futuro instalments due under existing and enforceable contracts are excluded, and this prevents a holistic approach towards solving the debtor's financial problems.

The procedure does not provide for any discharge of debts or costs, and no maximum time limit is set. The order will only lapse once all listed creditors as well as the cost of administration have been paid in full.¹¹⁰ An unintended consequence is thus that in theory a debtor may be subject to such an order indefinitely. Debtors under administration therefore suffer a disadvantage compared to those whose estates are under sequestration where, subject to certain conditions, a discharge of debt is guaranteed.¹¹¹ What is more, consumers with no income and no assets will not qualify for this procedure.

Considering the limitations and shortcomings discussed above, it is submitted that administration does not provide a sufficient alternative to sequestration. In many instances, consumers will not qualify for either of the procedures and, even if they do qualify for administration, it has serious deficiencies. Moreover, besides the policy considerations discussed above, an administration order poses various practical problems.¹¹²

In July 2000, the Department of Justice and the Law Society of South Africa requested the Centre for Advanced Corporate and Insolvency Law at the University of Pretoria to investigate the reform of the administration procedure. The research conducted was incorporated in a report submitted to the Department of Justice as the *Interim Report on the Review of Administration Orders in terms of Section 74 of the Magistrates' Courts Act 32 of 1994*. The matter was referred to the South African Law Reform Commission for investigation, and a reform project was consequently registered as Project 127.¹¹³ This project was suspended, pending the promulgation of the National Credit Act. However, contrary to expectations, the National Credit Act did not deal with administration orders, and on 31 May 2011 a workshop was held at the University of Pretoria where various role-players were consulted on proposed amendments of the process provided for by s 74. The suggested amendments focused mainly on technical and procedural aspects. However, the proposal does provide for a discharge after

¹¹⁰ Section 74U.

¹¹¹ Section 129 of the Insolvency Act.

¹¹² See in this regard Boraine op cit note 86 at 218.

¹¹³ Idem at 219.

eight years subject to specified conditions, which is certainly a step in the right direction for debt relief.¹¹⁴

3.2 Debt Review

One of the aims of the National Credit Act is to provide for debt relief through debt re-organisation in cases of over-indebtedness.¹¹⁵ However, the Act does not strive to address over-indebtedness by providing a discharge to over-indebted consumers.¹¹⁶ In this regard the Supreme Court of Appeal in *Collett v FirstRand Bank Ltd*¹¹⁷ recently stated that ‘the purpose of the debt review is not to relieve the consumer of his obligations but to achieve either a voluntary debt re-arrangement or a debt re-arrangement by the Magistrate’s Court’.

Chapter 4, Part D of the National Credit Act deals with consumer credit policy and more specifically with over-indebtedness and reckless credit.¹¹⁸ Section 86 contains the major debt relief mechanism introduced by the NCA, namely, debt review.¹¹⁹ The process commences with the application of a consumer to a debt counsellor to be declared over-indebted and to be placed under debt review.¹²⁰ Once the consumer has applied, the debt counsellor must inform all the consumer’s creditors as well as all registered credit bureaux of the application.¹²¹ The debt counsellor has 30 business days to determine whether the consumer is over-indebted.¹²² Credit providers and credit bureaux must be notified of the outcome of such determination.¹²³ If a consumer is found to be over-indebted, the debt counsellor may issue a proposal to the Magistrate’s Court recommending that the consumer’s obligations be re-arranged.¹²⁴ The debt counsellor has 60 business days from the date of application to refer the matter to the Magistrate’s Court,¹²⁵ and may propose that the Court declare one or more of the credit agreements to be reckless

¹¹⁴ See the proposed amendment to s 74U and 74(1A)(d) in workshop documents on file with the authors.

¹¹⁵ See the preamble to the Act. See also *Standard Bank of SA Ltd v Panayiotts* 2009 (3) SA 363 (W) at 375; *FirstRand Bank Ltd v Olivier* 2009 (3) SA 353 (SE) at 357; JM Otto ‘Over-indebtedness and Applications for Debt Review in terms of the National Credit Act: Consumers Beware! *FirstRand Bank Ltd v Olivier*’ (2009) 21 *SA Merc LJ* 272.

¹¹⁶ See ss 3(g) and (i) referred to in par 1 supra.

¹¹⁷ 2011 (4) SA 508 (SCA) at 514. See also *Ex parte Ford* supra note 1 at 138.

¹¹⁸ Sections 78 to 88.

¹¹⁹ For a detailed discussion of the debt review process, see Melanie Roestoff et al ‘The Debt Counselling Process – Closing the Loopholes in the National Credit Act 34 of 2005’ (2009) 1 *Potchefstroom Electronic LJ* 247 at 255 et seq; JW Scholtz et al *Guide to the National Credit Act* (2008) at 11-7; JM Otto & R-L Otto *The National Credit Act Explained* 2 ed (2010) at 58.

¹²⁰ Section 86(1) read with reg 24(1). See *BMW Financial Services (SA) (Pty) Ltd v Donkin* 2009 (6) SA 63 (KZD) where the moment of application for debt review was considered, and the discussion by Corlia van Heerden & Hermie Coetzee ‘Debt Counselling v Debt Enforcement: Some Procedural Questions Answered – *BMW Financial Services (SA) (Pty) Ltd v Donkin* 2009 6 SA 63 (KZD)’ (2010) 31 *Obiter* 756.

¹²¹ This should be done within five business days (s 86(4)(b) read with reg 24(2)).

¹²² Section 86(6) and reg 24(6).

¹²³ Also within five business days (reg 24(10)).

¹²⁴ Section 86(7)(c)(ii).

¹²⁵ Section 86(10).

credit.¹²⁶ Once the Magistrate's Court has made an order rescheduling the consumer's debt, the consumer must abide by it. A credit provider may terminate a debt review under certain circumstances and then proceed to enforce the debt.¹²⁷

The debt review procedure places no monetary limitation on the total outstanding debt. This, among other things, distinguishes debt review from administration and allows more consumers to qualify for debt relief in terms of the National Credit Act. Secured credit agreements are also included in the review, but the Act does not provide any preference as to the repayment thereof.

If debt review is evaluated as a debt relief measure intended to serve as an alternative to sequestration, one cannot ignore its intrinsic shortcomings. In the first place, the Act only applies to credit agreements as defined in s 8. Debts that are not incurred under these agreements will therefore be excluded from the debt review procedure. These may include delictual claims, clothing accounts, professional services as well as municipal accounts where no interest is charged. Another exclusion relates to agreements where the credit provider has proceeded to take steps to enforce the agreement.¹²⁸ In this regard, the Supreme Court of Appeal in *Nedbank Ltd and Others v National Credit Regulator and Another*¹²⁹ has recently held, in our view incorrectly,¹³⁰ that the provisions of s 86(2)¹³¹ would bar the consumer from including that specific agreement in the debt review procedure as soon as a s 129(1)(a) notice¹³² has been delivered in respect of that specific credit agreement. A credit provider will thus in effect be able to prevent a consumer from including a particular credit agreement in the debt review by merely

¹²⁶ Section 86(7)(c)(i).

¹²⁷ Section 86(10). See C van Heerden & H Coetzee 'Perspectives on the Termination of Debt Review in terms of Section 86(10) of the National Credit Act 34 of 2005' (2011) 14 *Potchefstroom Electronic LJ* 37 for a detailed discussion of the intricacies regarding the termination of debt review and resulting conflicting judgments. See also C van Heerden & H Coetzee '*Wesbank v Deon Winston Papier and the National Credit Regulator* (unreported Western Cape High Court case no 14256/10 (WCC)) – Termination of debt review in terms of section 86(10) of the National Credit Act 34 of 2005' (2011) 44 *De Jure* 463 for a discussion of *Papier*. The Court held that once a matter has been referred to the Magistrate's Court for determination, a credit provider may no longer terminate and subsequently attempt to enforce the agreement. This decision was followed in *FirstRand Bank Limited v Sewsunker* 2011 JDR 0128 (KZP). However, the Supreme Court of Appeal came to the contrary conclusion in *Collett v Firstrand Bank Ltd* supra note 117 – see the discussion below.

¹²⁸ Section 86(2).

¹²⁹ 2011 (3) SA 581 (SCA) at 590.

¹³⁰ Commentators interpret s 86(2) differently. See, eg, A Boraine & S Renke 'Some Practical and Comparative Aspects of the Cancellation of Instalment Agreements in terms of the National Credit Act 34 of 2005 (Part 2)' (2008) 41 *De Jure* 1 at 9 n186; Danie Van Loggerenberg, Leon Dicker & Jacques Malan 'Aspects of Debt Enforcement under the National Credit Act' (2008) January/February *De Rebus* 40 at 40; Roesstoff et al op cit note 119 at 260; Hermie Coetzee *The Impact of the National Credit Act on Civil Procedural Aspects Relating to Debt Enforcement* (unpublished LLM dissertation, University of Pretoria (2009)) at 86.

¹³¹ Section 86(2) states:

'An application in terms of this section may not be made in respect of, and does not apply to, a particular credit agreement if, at the time of that application, the credit provider under that credit agreement has proceeded to take the steps contemplated in section 129 to enforce that agreement.'

¹³² The s 129(1)(a) notice is a letter which a credit provider must send to a defaulting consumer before such credit provider may commence legal proceedings to enforce the agreement.

forwarding a s 129 notice to this consumer once he or she is in default. However, the major shortcoming of debt review as a form of debt relief is that it does not provide for any form of discharge.¹³³ Moreover, no time limit is prescribed in respect of the payment plan,¹³⁴ and a consumer can thus be bound to the plan for an excessively long period as opposed to sequestration where definite time periods are set. In this regard, Johnson and Meyerman observe that the National Credit Act, despite its aims to assist over-indebted consumers, only ‘perpetuates the over-indebtedness by not providing a simple debtor discharge mechanism’.¹³⁵

Although the process does not require the consumer to show an advantage to credit providers, it will only assist the mildly over-indebted consumer, because the courts will confirm viable plan proposals only.¹³⁶ This links to the Act’s emphasis on ‘satisfaction by the consumer of all responsible financial obligations’ and ‘eventual satisfaction of all responsible consumer obligations under credit agreements’.¹³⁷ Debt review, like administration, therefore amounts to no more than a reorganisation of the consumer’s credit agreement debt without providing any discharge.

At a procedural level, debt review poses various difficulties that are due mainly to the limited and somewhat inelegant provisions of the Act in this regard.¹³⁸ One such example is s 86(10), which provides for the termination of the review 60 business days after the date on which the consumer applied for debt review. A number of divergent decisions have recently been given on whether a debt review can be terminated once a debt counsellor (having determined that a consumer is indeed over-indebted) has referred the matter to a Magistrate’s Court, but before the matter is heard by the Court in terms of s 87.¹³⁹ The Supreme Court of Appeal finally clarified the issue in *Collett v FirstRand Bank Ltd*,¹⁴⁰ a decision that may prove to be detrimental to debt-stricken consumers. It was held that a referral of a debt review to the magistrate’s court does not bar a credit provider from terminating the debt review. A credit provider may therefore terminate the process in respect of a specific agreement as soon as 60 business days have lapsed, irrespective of

¹³³ See also Gordon W Johnson & Gerald E Meyerman *Insolvency Systems in South Africa – Strengthening the Regulatory Framework* (a publication produced for review by the US Agency for International Development for Chemicon International Inc (December 2010) at 24 (available at <http://www.fisp.org.za/blog/wp-content/uploads/SOUTH-AFRICA-INSOLVENCY-SYSTEMS1.pdf>).

¹³⁴ If the process is not abandoned or terminated, it seems that the issue of a clearance certificate by a debt counsellor, ‘rehabilitating’ the consumer will be the only means of concluding the procedure. Regulation 27 states that a debt counsellor must issue a clearance certificate if the consumer has fully satisfied all the debt obligations under every credit agreement that was subject to the debt rearrangement order or agreement, in accordance with that order or agreement.

¹³⁵ Johnson & Meyerman op cit note 133 at 25.

¹³⁶ Ibid.

¹³⁷ Section 3(g) and (i).

¹³⁸ See Roestoff et al op cit note 119 at 47 for a detailed discussion of practical problems experienced with the debt review procedure. See also Johan Grobler ‘Debt Review Referrals in the Magistrate’s Court’ (2010) April *De Rebus* 22.

¹³⁹ See Van Heerden & Coetzee *Potchefstroom Electronic LJ* op cit note 127 at 37 for a discussion of cases decided prior to *Collett* supra note 118. See also Van Heerden & Coetzee *De Jure* op cit note 127.

¹⁴⁰ Supra note 117.

whether the matter is pending in court. A mere termination notice in terms of s 86(10) may thus derail the entire process.

In addition, the debt review procedure is not aligned with existing civil procedure. Consequently, credit providers often use procedural gaps to oppose applications for debt review solely on technical grounds. According to a research report¹⁴¹ by the Law Clinic of the University of Pretoria in collaboration with the University's Bureau for Statistical and Survey Methodology on the reasons for the ineffectiveness of the debt counselling process, vagueness and insufficiency of the Act and its regulations were second on the list of major obstacles in the process.¹⁴² Because of the uncertainty pertaining to the interpretation of the Act's provisions on the procedure to follow, the National Credit Regulator has been compelled to lodge an application with the High Court for a declaratory order in terms of s 16(1)(b)(ii).¹⁴³

3.3 Pre-liquidation Composition with Creditors

The Commission has proposed that provision be made for a pre-liquidation¹⁴⁴ composition with creditors.¹⁴⁵ The Commission regards the pre-liquidation composition as one of the substantive changes envisaged by the Insolvency Bill. The proposed measure is supposed to afford debt relief to debtors who cannot show an advantage to creditors and are therefore excluded from the liquidation process.¹⁴⁶

The 2010 Insolvency Bill provides for a binding composition between a debtor and creditors if accepted by the required majority in number and two-thirds in value of the concurrent creditors who vote on the composition.¹⁴⁷ The debtor initiates the process by lodging a signed copy of the composition and a sworn statement with the magistrate's court of the district where he or she normally resides or carries on business.¹⁴⁸ The composition is supervised by the court, and provision is made for an investigation into the affairs of the debtor.¹⁴⁹

Between the determination of a date for a hearing and the conclusion thereof no creditor may without the permission of the court institute action or

¹⁴¹ Commissioned by the National Credit Regulator.

¹⁴² Credit providers not co-operating was first on the list (Franciscus Haupt, Melanie Roestoff & Mareesa Erasmus *The Debt Counselling Process: Challenges to Consumers and the Credit Industry in General* (2009) at 307 (available at http://www.ncr.org.za/archives/The_debt_counselling_process.php).

¹⁴³ *National Credit Regulator v Nedbank Ltd and Others* 2009 (6) SA 295 (GNP).

¹⁴⁴ The title of the proposed provision is confusing, because it could mistakenly be interpreted to require a composition as a precondition for insolvency proceedings.

¹⁴⁵ See Roestoff & Jacobs op cit note 83 and M Roestoff 'Eenvormige Insolvensiewetgewing in Suid-Afrika: Moet die Administrasiebevel Ingesluit word?' (2000) 33 *De Jure* 127 at 131 et seq for a discussion of the proposal in the 2000 Insolvency Bill.

¹⁴⁶ See 2000 Explanatory Memorandum at 5.

¹⁴⁷ Clause 118(17).

¹⁴⁸ Clause 118(1).

¹⁴⁹ Clause 118(10)(e).

apply for liquidation of the debtor's estate.¹⁵⁰ The claims or rights of secured or preferent creditors are only subject to the composition if those creditors consented thereto in writing. After the court has certified that the composition is accepted, it will be binding on all creditors who have been informed of the hearing or appeared at the hearing.¹⁵¹ The composition does not constitute a bar to the liquidation of the debtor's estate.¹⁵²

If the required majority does not accept the composition and the debtor cannot pay substantially more than what is offered in the composition, the court must declare that the proceedings have ceased and that the debtor is in the position that he was in prior to commencement thereof. Alternatively, the court must determine whether s 74 of the Magistrates' Courts Act can be applied to the debtor and, if so, apply the provisions accordingly and within the discretion of the presiding officer.¹⁵³

One commentator remarked that the officials of the magistrate's court are not suitably competent or experienced to deal with such a procedure, and that they do not have the time or capacity needed for the successful administration thereof.¹⁵⁴ However, it is submitted that the main deficiency of this proposed measure as a viable option for a debtor seeking debt relief is that it would not, in its current format, provide such a debtor with a discharge if the composition is not accepted by the required majority of creditors.¹⁵⁵

4 A Brief Exposition of Relevant Aspects of the Insolvency Systems of the United States of America and England and Wales

4.1 United States of America

The American insolvency law system has two aims: the rehabilitation of overburdened debtors and the equal treatment of creditors.¹⁵⁶

Unlike the South African insolvency system, debt relief is one of the main aims of the American system, and it is obtained by providing for a discharge of debt resulting in a fresh start.¹⁵⁷ In *Local Loan Co v Hunt*¹⁵⁸ the Court declared:

¹⁵⁰ Clause 118(23).

¹⁵¹ Clause 118 (17).

¹⁵² Clause 118(21).

¹⁵³ See cl 118 (22)(a) and (b). The Commission's proposal in the 2000 Insolvency Bill afforded the debtor the option of converting to liquidation and rehabilitation in terms of the proposed Insolvency Act in instances where the composition was not accepted by the required majority (see the discussion of this proposal by Roestoff & Jacobs op cit note 83 at 207 et seq).

¹⁵⁴ See 2000 Explanatory Memorandum in par 124.2.

¹⁵⁵ As pointed out above, administration in terms of s 74 of the Magistrates' Courts Act does not provide for any discharge of debt obligations.

¹⁵⁶ Thomas H Jackson & Robert E Scott 'On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain' (1989) 75 *Virginia LR* 155. For a detailed discussion of the American insolvency system, see André Boraine & Melanie Roestoff 'Developments in American Consumer Bankruptcy Law: Lessons for South Africa' (Parts 1 & 2) (2000) 21 *Obiter* 33 and 241.

¹⁵⁷ Karen Gross *Failure and Forgiveness: Rebalancing the Bankruptcy System* (1997) at 91.

¹⁵⁸ 292 US 234 244 (1934).

‘One of the primary purposes of the Bankruptcy Act is to “relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes”. . . . This 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.’

The fresh start is thus available only to the honest but unfortunate creditor,¹⁵⁹ and certain debts are not susceptible to a discharge.¹⁶⁰

As regards natural persons, the Bankruptcy Reform Act of 1978 (The Bankruptcy Code) provides for two forms of debt relief: liquidation under Chapter 7 and rehabilitation under Chapters 11¹⁶¹ and 13.

Chapter 7 contains the most common form of bankruptcy.¹⁶² Petitions may be filed both involuntarily and voluntarily. Most petitions are, however, filed voluntarily.¹⁶³ The debtor who files for bankruptcy must surrender all non-exempt property to the trustee. The trustee sells the property and distributes the proceeds to creditors. Chapter 7 has two goals, namely, liquidation of the debtor’s assets and the granting of a discharge.¹⁶⁴ There is no link between eligibility for a discharge and the amount which creditors receive, but the discharge relates only to unsecured debts. The debtor has a choice whether to pay secured debts, sign reaffirmation agreements¹⁶⁵ or surrender the property that serves as security.¹⁶⁶

Chapter 13 provides for the rescheduling of debts of an individual with a steady and regular source of income.¹⁶⁷ This procedure may only be initiated voluntarily. It entails a payment plan in terms of which future income is utilised for the total or partial satisfaction of claims. The maximum duration of a repayment plan is usually not more than three years. However, a court may approve a plan for longer, but never for longer than five years.¹⁶⁸ The debtor need not surrender his or her assets as is the case under a Chapter 7 bankruptcy. A Chapter 13 discharge is granted only when the debtor has made full payment in terms of the payment plan. A debtor may, however, request a

¹⁵⁹ Ibid.

¹⁶⁰ See ss 523 and 1328(a) of the Bankruptcy Reform Act 1978. Successful completion of a Chapter 13 plan entitles a debtor to a discharge broader than the one available in Chapter 7.

¹⁶¹ Chapter 11 provides for a reorganisation process similar to that of Chapter 13. But the Chapter 11 process is more expensive and complicated than the Chapter 13 one and therefore generally only used by businesses (see Boraine & Roestoff op cit note 156 at 48).

¹⁶² Often referred to as ‘straight bankruptcy’.

¹⁶³ David L Balsler ‘Section 707(b) of the Bankruptcy Code: A Roadmap with a Proposed Standard for Defining Substantial Abuse’ (1986) 19 *University of Michigan Journal of Law Reform* 1011 at 1013.

¹⁶⁴ Ibid.

¹⁶⁵ Reaffirmation, in essence, entails a promise by the debtor to pay a debt despite its discharge. Reaffirmations are apparently only appropriate when a debtor is in arrears with payments of secured debts and does not wish to pursue Chapter 13 to deal with the problem. Acceptance of the offer of reaffirmation enables the debtor to keep the encumbered property and pay the debt over time. Reaffirmations of unsecured debts would, however seldom, if ever benefit the debtor (see Boraine & Roestoff op cit note 156 at 49 and authority quoted there).

¹⁶⁶ See in general Jeff Ferriell & Edward J Janger *Understanding Bankruptcy* 2 ed (2007) at 603.

¹⁶⁷ Section 101(29).

¹⁶⁸ Section 1322(d).

Chapter 13 ‘hardship discharge’. In such a case the Court may grant a discharge only if:¹⁶⁹

- the debtor’s failure to complete the plan is due to circumstances for which the debtor should not justly be held accountable.
- the creditors have received at least the liquidation value of their unsecured claims.
- modification of the plan is not practicable.

A discharge in terms of Chapters 7 and 13 serves as a prohibition against any attempt to collect, recover or offset any discharged debt as a personal liability of the debtor.¹⁷⁰

Unlike the South African system, which requires advantage to creditors, the Bankruptcy Code does not base the right to a discharge on a certain level of payment to creditors. However, the Bankruptcy Abuse Prevention and Consumer Protection Act 2005 (BAPCPA) has revised the liberal ‘fresh-start’ philosophy of the American system by denying the debtor relief under Chapter 7 in instances where it appears that he or she is able to pay a portion of his or her debt from future income. The Act introduced a means test to determine whether a debtor qualifies for Chapter 7 bankruptcy or whether he or she should rather opt for Chapter 13 bankruptcy. The means test is applied only when the consumer’s gross income exceeds the median income in his or her state of residence. If the debtor’s income exceeds the median and his or her disposable monthly income is more than allowed, he or she will not qualify for Chapter 7 bankruptcy.¹⁷¹

4.2 England and Wales

In England and Wales, provision is made for debtors who have no income or no assets (the ‘No Income No Assets (NINA) debtors’) by allowing them to apply for a debt relief order.¹⁷² This measure became effective on 6 April 2009 and was inserted into the Insolvency Act 1986 through the Tribunals, Courts and Enforcement Act 2007.¹⁷³

Fletcher describes the purpose of this procedure as follows:¹⁷⁴

¹⁶⁹ Section 1328(b).

¹⁷⁰ Section 524 of the Bankruptcy Code. See in general Ferriell & Janger op cit note 166 at 641.

¹⁷¹ See Iain Ramsay ‘Comparative Consumer Bankruptcy’ 2007 *University of Illinois LR* 241 at 266; J Calitz ‘Developments in the United States’ *Consumer Bankruptcy Law: A South African Perspective* (2007) 28 *Obiter* 397 at 399 and 405 et seq.

¹⁷² The filing fee is currently £90, which may be paid in instalments. However, the official receiver would not consider an application before the fee has been paid in full (s 251B(4)(b) read with s 251C(4)(a) of the Insolvency Act 1986 (c. 45); <http://www.bis.gov.uk/insolvency/personal-insolvency/dro-debtors> 1).

¹⁷³ Debt relief orders were created by s 108(1) of the Tribunals Courts and Enforcement Act 2007 (c. 15) and were detailed in Schedules 17 to 20 of the Act. The new provisions are contained in part 7A of the Insolvency Act 1986 and consist of ss 251A to 251X read with the relevant schedules thereto. See also Roestoff & Renke op cit note 18 at 108 et seq for a discussion of this provision when it was still in its proposed form.

¹⁷⁴ Ian F Fletcher *The Law of Insolvency* 4 ed (2009) at 386.

'The objective of the new procedure is to provide debt relief for people who owe relatively little, have no income and no assets to repay what they owe, and who cannot afford the cost of petitioning for their own bankruptcy adjudication.'

The procedure essentially allows an individual who is unable to pay his or her debts to apply to the official receiver,¹⁷⁵ through an approved intermediary,¹⁷⁶ for a debt relief order.¹⁷⁷ The order will be granted if the following criteria are met:¹⁷⁸

- The debtor should have total liabilities of less than £15 000.
- The debtor should have a maximum surplus income of £50 per month after paying normal household expenses
- The debtor should have assets of no more than £300. If the debtor owns a motor vehicle, it may not be worth more than £1 000.

The order is intended to operate with no court involvement,¹⁷⁹ and only qualifying debts may be included in the order.¹⁸⁰ Once the official receiver has made the order, a moratorium is placed on the commencement of enforcement procedures in relation to each qualified debt specified in the order. A creditor may not commence bankruptcy procedures during this period.¹⁸¹ Generally, the moratorium will be in force for one year, after which qualifying debts will be discharged.¹⁸²

Creditors' interests are also taken into consideration, and the debtor is only allowed to apply for a debt relief order once every six years.¹⁸³ Provision is also made for creditors to object to the making of the order or to the inclusion of a debt on the list of qualifying debts.¹⁸⁴ If the debtor experiences a change in circumstances during the period in which the order is in force – for example, an increase in income – he or she would be obliged to disclose this to the official receiver.¹⁸⁵ While the order is in force, the debtor is subject to restrictions similar to those in bankruptcy. For example, the debtor is not allowed to obtain credit over £500 without disclosing to the creditor that he or she is subject to a debt relief order.¹⁸⁶ Should it be found that the debtor was dishonest before or during the period of the debt relief order, the official receiver can apply for a debt relief restriction order which will extend the period of restriction for up to 15 years.¹⁸⁷

¹⁷⁵ The official receiver is an official of the Insolvency Service of the Department of Trade and Industry as well as the court to which he is attached.

¹⁷⁶ Section 251B(1).

¹⁷⁷ See ss 251A(1) and 251B(1) of the Insolvency Act 1986.

¹⁷⁸ See Sched 4ZA(6) – (8); <http://www.bis.gov.uk/insolvency/personal-insolvency/dro-debtors> 1.

¹⁷⁹ Unless an interested party decides to intervene on one of the grounds mentioned in s 251G.

¹⁸⁰ 'Qualifying debt' is a debt which '(a) is for a liquidated sum payable either immediately or at some certain future time; and (b) is not an excluded debt' (s 251A(2)).

¹⁸¹ See s 251G.

¹⁸² Sections 251H, 251I and 251M.

¹⁸³ See Sched 4ZA(5).

¹⁸⁴ Section 251K.

¹⁸⁵ Section 251J.

¹⁸⁶ Section 251S.

¹⁸⁷ See Sched 4ZB.

5 The Way Forward and Concluding Remarks

Despite the worldwide trend to accommodate overburdened debtors seeking debt relief, the South African insolvency system has remained largely creditor orientated. It has also developed in an incoherent way, resulting in a multiplicity of regulators,¹⁸⁸ forums,¹⁸⁹ intermediaries¹⁹⁰ and procedures, while the interrelationship among these various procedures is not dealt with by the relevant statutes. Moreover, legal uncertainty exists with regard to the interpretation of many of the provisions of the different statutes, and the procedures are mainly court driven, making them expensive to use.

It is submitted that current procedures do not provide adequate debt relief to consumers. Because sequestration is an expensive procedure to follow and because of the dilemma of 'poor' debtors not being able to prove advantage to creditors, sequestration in terms of the Insolvency Act would in many cases not provide an outcome to debtors seeking debt relief. Furthermore, the alternative remedy of debt review in terms of the National Credit Act does not provide for the possibility that the court could force a discharge of a part of the consumer's debt obligations on the debtor's creditors. Consequently, the process will not provide debt relief to debtors who do not have sufficient income to repay their debt. In practice debt review has proved to be effective only for consumers who can be described as 'mildly' over-indebted. A consumer may therefore also be too 'poor' to go under debt review.¹⁹¹ The application procedure for debt review is cumbersome, costly and slow and it only provides debt relief in respect of debt which qualifies as 'credit agreements' in terms of the National Credit Act. As regards the administration procedure in terms of the Magistrates' Courts Act, it should be clear that it is of limited scope, since it is only available to debtors whose claims do not exceed R50 000. The procedure furthermore does not provide for a discharge of debts, because the administration order only lapses once the cost of administration and the listed creditors have been paid in full.

We submit that South African insolvency law needs a complete overhaul of its debt relief procedures. South African lawmakers should learn from the American example in terms of which all consumer debt relief measures are contained in a single statute, the Bankruptcy Code. Existing South African procedures should be streamlined by doing away with the overlapping between the different procedures and the unnecessary duplication of regulators, forums and intermediaries. Three procedures should be provided for: an assets liquidation procedure, an income-restructuring procedure and

¹⁸⁸ These are the National Credit Regulator and the Master of the High Court in terms of the National Credit Act and Insolvency Act respectively.

¹⁸⁹ These are the High Courts and the lower courts as well as the National Consumer Tribunal provided for by the National Credit Act.

¹⁹⁰ In South Africa, they are the debt counsellors, administrators and insolvency trustees in terms of the National Credit Act, Magistrates' Courts Act and Insolvency Act respectively.

¹⁹¹ Ngwaru Maghembe & Melanie Roestoff 'Bankruptcy and Alternative Debt Relief for Consumers in Tanzania – A Comparative Investigation' (2010) 43 *Comparative and International Law Journal of Southern Africa* 292 at 311.

lastly, by following the example of England and Wales, a procedure affording relief to debtors with no income and no assets (the ‘NINA cases’).¹⁹²

The long-established creditor-orientated approach of our courts when exercising their discretion to grant a sequestration order should be brought to an end. The new assets-based procedure should specifically require the court to take into consideration the debtor’s interests when exercising its discretion.

When devising a new income-restructuring procedure that provides for all debt repayment cases, lawmakers should build on the existing and well-established system of debt counselling provided for by the National Credit Act. Instead of providing for a separate voluntary pre-liquidation composition,¹⁹³ provision should be made for negotiations as a precondition for relief in terms of the new income-based procedure.¹⁹⁴ Out-of-court negotiations are valuable as they save costs. This will also relieve the work-load of our courts, which have to deal with huge back-logs. Should the debtor’s proposed repayment plan not be accepted by the creditors, provision should be made for the possibility that the court could impose the debtor’s proposal on dissenting creditors. Of paramount importance is that provision be made for a maximum duration of the repayment plan and for a discharge of remaining debt obligations at the conclusion of the plan. Proper provision should be made to prevent abuse of the process by debtors, and debt counsellors should provide follow-up support to debtors to ensure that they continue to meet their obligations under the approved plan.

As regards the ‘NINA cases’, the measure in England and Wales seems preferable to the ‘hardship discharge’ provided for by the American Bankruptcy Code.¹⁹⁵ We suggest that it is pointless to put a debtor through a costly court process which clearly has no likelihood of success.

In justifying its proposal for a pre-liquidation composition, the Commission had the following to say:¹⁹⁶

‘[I]t is accepted that a debtor may become insolvent through no fault of his or her own and that such a debtor should be given the opportunity to make a fresh start. Creditors sometimes contribute towards insolvencies by giving credit to debtors who cannot repay it. A balance must be struck between the rights of creditors and giving a debtor an opportunity to make a fresh start.’

Unfortunately, the current proposals for insolvency law reform do not, in our view, achieve such a balance.

¹⁹² See the facts in *Van Rooyen v Van Rooyen* supra note 30, which illustrate the need for such a debt relief measure.

¹⁹³ See the discussion of the Commission’s proposals in par 3.3 above.

¹⁹⁴ The National Credit Act provides for voluntary negotiations (see ss 86(5)(b), (7)(b) and (8)(a)), but practice has proved that creditors are not willing to negotiate.

¹⁹⁵ See the discussion in par 4 above.

¹⁹⁶ See 2000 Explanatory Memorandum at 17.