ENFORCEMENT OF A CREDIT AGREEMENT WHERE THE CONSUMER HAS APPLIED FOR DEBT REVIEW IN TERMS OF THE NATIONAL CREDIT ACT 34 OF 2005

First Rand Bank v Smith (unreported case number 24208/08 (WLD))

1 Introduction

Section 86 of the National Credit Act 34 of 2005 (NCA) provides for the debt relief mechanism envisaged in section 3(g) of the Act by affording the over-indebted consumer the opportunity to apply to a debt counsellor for a review of the credit agreements to which he or she is a party and eventually to be declared over-indebted by the court (see Van Heerden in Scholtz (ed) *Guide to the National Credit Act* (2008) 11-6 and 14-1 *et seq* for a discussion of the debt review process in terms of the NCA). The effectiveness of the debt review process obviously depends on a positive working relationship between all role players, namely the over-indebted consumer, credit providers and debt counsellor, but also on the extent in which the legislator has succeeded to regulate all aspects of the said process properly. According to a recent newspaper report ("Hulp Met Skuld Sukkel Nog" 5 May 2009 *Sake Rapport* 8) more than 58 000 consumers have applied for debt review in terms of section 86. However, hardly any of these cases have managed to proceed through our courts (see "Providers Accused of Stalling Consumers' Bid to Renegotiate their Debts" 19 January 2009 *Cape Argus* 6). Apart from the lack of co-operation between the said role players, it is commonly accepted that legislative gaps contribute to the ineffectiveness of the debt counselling process (*cf* Van Heerden 14-16 *et seq*). In *First Rand Bank v Smith* (unreported case no 24208/08 (WLD)) the court, however, indicated a *lacuna* in the Act which, it is submitted, was not in actual fact present in the Act. The court had to interpret section 88(3) of the Act which provides as follows:

> "Subject to section 86(9) and (10), a credit provider who receives … notice in terms of section 86(4)(b)(i), may not exercise or enforce by litigation or other judicial process any right or security under that credit agreement until –
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> (a) the consumer is in default under the credit agreement; and
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> (b) one of the following has occurred:
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> (i) An event contemplated in subsection (1)(a) through (c); or

(ii) the consumer defaults on any obligation in terms of a re-arrangement agreed between the consumer and credit providers, or ordered by a court or the Tribunal."

The events referred to in subsection (3)(b)(i) quoted above, are those mentioned in section 88(1)(a) through (c):

"(a) The debt counsellor rejects the application and the prescribed time period for direct filing in terms of section 86(9) has expired without the consumer having so applied;

(b) the court has determined that the consumer is not over-indebted, or has rejected a debt counsellor's proposal or the consumer's application; or

(c) a court having made an order or the consumer and credit providers having made an agreement re-arranging the consumer's obligation, all the consumer's obligations under the credit agreement as re-arranged are fulfilled, unless the consumer fulfilled the obligations by way of a consolidation agreement."

Although section 88(3) is explicitly made subject to section 86(10) the court interpreted and applied section 88(3) to the facts of the case, without taking cognisance of the possible application of section 86(10). Section 86(10) provides as follows:

"If a consumer is in default under a credit agreement that is being reviewed in terms of this section, the credit provider in respect of that credit agreement may give notice to terminate the review in the prescribed manner to

(a) the consumer;

(b) the debt counsellor; and

(c) the National Credit Regulator,

at any time at least 60 business days after the date on which the consumer applied for the debt review."

The effect of section 86(10) is therefore that the debt counsellor is given 60 business days to complete the debt review process in terms of section 86. Since section 88(3) is subject to section 86(10) it is submitted that the credit provider may proceed with the enforcement of the specific credit agreement after the credit provider has given notice to terminate the review in terms of section 86(10) even though the events contemplated in section 88(1)(a) through (c) have not occurred.

In what follows, the facts and decision in *Smith* will be analysed and commented on with a view to interpret the Act's provisions regarding the power of a credit provider to approach the court to enforce a credit agreement in instances where a consumer has consulted a debt counsellor.

2 Facts and decision

The plaintiff applied for summary judgment against the defendants. This application was brought after the plaintiff had instituted action against the defendants, on 31 July 2008, for payment of the amount of R940 095.28. This debt was claimed pursuant to monies lent and advanced to the defendants, whose loan was also secured by a mortgage bond. The court

pointed out that the NCA therefore applied to the agreement between the plaintiff and defendants (par 3). It should be noted, that the Act applies to all *credit agreements* (s 4(1) – see with regard to the scope of application of the NCA, Van Zyl in Scholtz (ed) *Guide to the National Credit Act* (2008) 4-1 *et seq*). The agreement *in casu* constitutes a *credit transaction* in terms of section 8(4) as it is a *mortgage agreement* in terms of section 8(4)(c). A *mortgage agreement* is defined in section 2 as a "credit agreement that is secured by a pledge of immovable property" (see in general with regard to the types of credit agreements in terms of the NCA, Otto in Scholtz (ed) *Guide to the National Credit Act* (2008) 8-3 *et seq*).

On 3 September 2007, approximately 11 months before institution of the action, the defendants approached a debt counsellor to whom they submitted an application for debt review in terms of section 86(1) of the Act. More than two months later, on 12 November 2007, the debt counsellor notified *inter alia*, the plaintiff of the debt review application. This notification purported to be a notification in terms of section 86(4)(b)(i) of the Act. It should be noted, that this notification was not done as prescribed in terms of section 86(4)(b)(i), as this subsection read with regulation 24(2) requires the debt counsellor to deliver the notice (*ie*, the required Form 17.1) to all credit providers within *five* business days after receiving the application for debt review. However, it appears that the legislator has not provided any sanction for a failure to comply with the prescribed time period. From the facts of the case, it appears that this notice was also meant to serve as a notice of the debt counsellor's determination of the over-indebtedness of the defendants in terms of section 86(6) of the Act. Yet again, the debt counsellor did not comply with the prescribed time frames, as regulation 24(6) requires the debt counsellor to make such an determination within 30 business days after receiving the debt review application in terms of section 86(1) of the Act. Furthermore, the debt counsellor must, after completion of the assessment, submit Form 17.2 to all credit providers and registered credit bureaux within five business days (see reg 24(1)). Again, however, no sanction for the failure of complying with the prescribed time frames is provided for in the Act. Clearly, the purpose of the prescribed time frames is to ensure that the debt review process would be completed within the 60 business day period provided for in section 86(10). However, if no sanction is connected to the non-compliance with these time frames, it would obviously not be effective in attaining this purpose.

The notice of the debt review application *in casu* also contained settlement proposals and a recommendation by the debt counsellor as follows (par 6):

> "Should acceptance be obtained from all credit providers a consent order will be obtained, alternatively proceedings will be continued in terms of section 86(8) of the National Credit Act."

The court suggested that section 86(8) provides for the procedure to be followed by the debt counsellor once a recommendation (in terms of s 86(7)) has been made. According to the court, one of two possible courses of

action (*ie*, the filing of a consent order or referral of the matter to the Magistrate's Court) could be followed, depending on whether the credit providers consented to the proposal or not. However, as pointed out by the court, no further steps were taken by the debt counsellor or the defendants after the notice had been given (par 7).

It is submitted that section 86(8) contains one of the many loopholes in the Act. Section 86(8) does not refer to the procedure to be followed when a recommendation in terms of section 86(7)(c) is made (*ie*, a recommendation following on a determination by the debt counsellor that the consumer is indeed over-indebted). Section 86(8) only pertains to a recommendation in terms of subsection (7)(b) (*ie*, a recommendation following on a determination by the debt counsellor that the consumer is not over-indebted, but is nevertheless experiencing difficulty to satisfy all his or her obligations under credit agreements in a timely manner). Section 86(8) provides as follows:

> "If a debt counsellor makes a recommendation in terms of subsection (7)(b) and –
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> (a) the consumer and each credit provider concerned accept the proposal, the debt counsellor must record the proposal in the form of an order, and if it is consented to by the consumer and each credit provider concerned, file it as a consent order in terms of section 138; or
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> (b) if paragraph (a) does not apply, the debt counsellor must refer the matter to the Magistrate's Court with the recommendation."

It should be clear that section 86(8) in actual fact only provides for a consent order or a referral to the Magistrate's Court where the debt counsellor has made a recommendation in terms of subsection (7)(b). The court, however, avoided this *lacuna* by merely assuming that section 86(8) applied *in casu*. Clearly, the failure to refer to subsection (7)(c) was a mere oversight by the legislator. Unfortunately loopholes in the Act are increasingly being exploited by credit providers to oppose debt review matters which are referred to court (*cf* 19 January 2009 *Cape Argus* 6). It is therefore submitted that section 86(8) should be amended to refer also to subsection (7)(c) and thereby to clarify any uncertainty in this regard.

Although the Act prescribes time periods in respect of certain actions that have to be taken by the debt counsellor, the court pointed out that the Act does not prescribe any time frames within which the debt counsellor has to proceed in terms of section 86(8). Moreover, it appears that there is no sanction for the failure of taking these steps (par 8). The court pointed out that section 88(3) contains the prohibition on the plaintiff's right of institution of action until certain events have occurred (par 9). According to the court, the events contemplated in section 88(3) cannot, however, occur unless the next step, namely the filing of a consent order or referral of the matter to the Magistrate's Court, in terms of section 86(8) was taken (par 11). The court explained as follows (par 12):

> "In the present matter no agreement has been concluded, neither has there been any order made. Accordingly the provisions of section 88(3)(a) and

> 88(3)(b)(ii) do not apply. The provisions of section 88(3)(a) and section 88(1)(a) through to 88(1)(c) are not relevant: (There is no agreement, the debt counsellor did not reject the application, there is no determination by a court either as to indebtedness or as to rearrangement.)"

The court therefore found that the debt counsellor, by not having taken the next step in terms of section 86, has enabled the defendants (par 13)

> "to frustrate … the fulfilment of the events set out in section 88(3) which otherwise would occur. This has resulted in the credit provider being unable to take steps to institute proceedings to recover the debt. The inactivity of the counsellor and/or consumer resulted in the creation of a moratorium."

With regard to the interpretation of section 88(3) and the stay it created with regard to the institution of proceedings the court suggested that (par 14):

> "The true enquiry is whether or not the section should be read as meaning that the notice is to be seen in isolation or whether it should be seen meaning that after commencement of the process by the publication of the notice and provided the process is pursued as required by the section the stay will operate."

An interpretation that the notice should be seen in isolation would, according to the court, create a *lacuna* in the Act, as the consumer would then be able to prevent the consumer from ever instituting action against it. According to the court, such an interpretation would in fact enable the consumer to abuse the process provided for in the Act in terms of section 86. The court explained as follows (par 15):

> "A dishonest debtor could frustrate the rights of legitimate creditors by starting the process and then stopping it in mid-stride as happened in this matter. There would then be a permanent moratorium. The credit provider would never [be] able to obtain relief and is forever unable to exercise or enforce by litigation his rights to payment. This situation arises as a result of matters which are beyond the creditor's control and in circumstances in which he plays no role. It is the debt counsellor who applies to court, it is the debt counsellor who rejects the application. It is the court which determines the consumer to be not over-indebted or which rejects the application made by the debtor or debt counsellor. It is the consumer who pays or does not pay all of his debts."

Accordingly, the court found that the legislature could not have intended such an absurd result, and although the court must refrain from legislating, it should in interpreting the legislation have regard to the well known principle of avoiding absurdity (the court referred to *Bastian Financial Services (Pty) Ltd v General Hendrik Schoeman Primary School* 2008 5 SA 1 (SCA)). The court therefore found that the notice would become ineffective to stay proceedings and that the process will lapse if it is not followed to its conclusion within a reasonable time (par 19, 22, 23 and 27). A reasonable time for taking the steps under section 86(8) is, according to the court, no more than three months (par 24). In this regard the court referred to the "right of termination on 60 days' notice" provided for in the Act which in its

view would translate to a period of three months (par 24). It would appear that the court here had the provision of section 86(10) in mind. The court, however, did not refer to this section specifically, neither did it discuss or explain the application of this subsection in the present matter.

Finally, the court found, that if it was wrong in its interpretation, the provision was in any event in direct conflict with section 25(1) of the Constitution of the Republic of South Africa, as it enables the debtor to escape his payment obligations and thereby amounts to an arbitrary deprivation of property in terms of section 25(1) (par 25).

The defendants *in casu* relied on the provisions of section 130(3)(c)(i) to submit that the plaintiff was precluded from instituting action against them. Section 130(3)(c)(i) precludes the court from determining a matter unless it is satisfied, *inter alia*, "that the credit provider has not approached the court … during the time that the matter was before a debt counsellor". From this subsection it should be clear that the legislator intended to prevent the credit provider from taking steps to enforce an agreement for as long as the "matter is before a debt counsellor". It is submitted, that these words refer to the period which commences when the consumer approaches the debt counsellor, and ends when the actual debt review application is submitted to a debt counsellor. This, in the author's view, is apparent from section 130(4) which distinguishes between the powers of a court where it determines

(a) that the credit provider has approached the court in circumstances contemplated in section 130(3)(c) (see s 130(4)(b)); and

(b) where the court determines that a credit agreement is subject to a pending debt review (see s 130(4)(c)).

In casu, the defendants argued that the credit provider was precluded from instituting action against them as it approached the court during the time that the matter was before a debt counsellor in terms of section 130(3)(c)(i). According to the court, the matter *in casu* was, however, not "before a debt counsellor" as the matter in its view ceased to be before a debt counsellor as soon as the debt counsellor had considered the application and published the notice in terms of section 86(8) (par 29). In this regard it should be noted that section 86(8) does not provide for any notice and it would therefore appear that the court actually meant to refer to section 86(6) and the notice which had to be submitted to all credit providers in terms of regulation 24(10) after completion of the assessment in terms of section 86(6).

The court finally held that the plaintiff was entitled to institute action when it did so in July 2008 and that the notice in terms of section 86 no longer barred the process. Accordingly an order for summary judgment was granted (par 30-31).

3 Interpretation of relevant provisions of the Act and concluding remarks

It is submitted that section 130(3)(c)(i) was not applicable *in casu.* It is submitted that the real reason for the plaintiff not being able to institute action against the defendants, was the fact that the relevant credit provider had not proceeded to terminate the debt review as provided for in section 86(10) of the Act. Although the Act does not expressly prescribe a time frame within which the debt counsellor had to proceed to apply for a consent order or to refer the matter to court in terms of section 86(8), it is submitted that a time period is indirectly prescribed by the provisions of section 86(10). If a debt counsellor fails to proceed in terms of section 86(8), the credit provider may proceed to terminate the debt review process in terms of section 86(10). The events set out in section 88(3) need not occur. It is therefore submitted that section 88(3) does not lead to an absurd result. There is no *lacuna* in the Act and the interpretation followed by the court, that the debt review should automatically lapse if the process was not followed to its conclusion, was therefore unnecessary. Credit providers' interests are protected by the provisions of section 86(10) which enables them to terminate the debt review process and thereafter continue to enforce the agreement.

The effect of the court's decision is that the onus is placed on the debt counsellor to proceed to either apply for a consent order or refer the matter to the court in terms of section 86(8) within a reasonable time, which is, in the opinion of the court, no more than three months. If he fails to do so the debt review will automatically terminate after a reasonable time has expired, without any notice required. If this interpretation is correct, one would then wonder what the purpose of section 86(10) is.

It is submitted that the court's interpretation is incorrect as it has the effect of rendering section 86(10) redundant. In the author's view, the provisions in sections 130(3)(c), 88(3), 86(10) and 130(1)(a) should be read together in order to determine the intention of the legislator regarding a credit provider's power to approach the court to enforce a credit agreement in cases where the consumer has consulted a debt counsellor. Where the consumer has not consulted a debt counsellor a credit provider would be able to continue with enforcement after he has complied with the requirements in section 129(1) and the relevant requirements of section 130 of the Act (see Van Heerden 12-4; and Boraine and 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 *De Jure* 1 for a detailed discussion of s 129 and 130). The following interpretation is suggested where the consumer has consulted a debt counsellor:

(a) In terms of section 130(3)(c)(i) the credit provider is precluded from taking steps to enforce an agreement during the time that a "matter is before the debt counsellor". It is submitted that these words refer to the period which precedes the actual debt review application. Additionally, in

terms of section 130(3)(c)(ii), the credit provider is also prevented from approaching the court in respect of a credit agreement to which the Act applies where the consumer has taken and fulfilled any of the steps mentioned in section 129(1)(a), that is, where the consumer

(i) agreed to a proposal that the consumer shall refer the credit agreement to a debt counsellor and has acted in good faith in fulfilment of that agreement (*cf* s 130(3)(c)(ii)(bb)) or;

(ii) complied with an agreed plan to bring the payments under a credit agreement up to date (*cf* s 130(3)(c)(ii)(cc)); or

(iii) brought the payments under the relevant credit agreement up to date (*cf* s 130(3)(c)(ii)(dd)).

(b) For as long as the debt review process is pending the credit provider would be able to enforce an agreement once the events set out in section 88(3) have occurred.

(c) Where the debt counsellor did not proceed in terms of section 86(8) the credit provider would be able to enforce the agreement after he has given notice to terminate the review in terms of section 86(10) (see s 129(1)(b)(i)) and after complying with the requirements in section 130(1)(a). In terms of section 130(1)(a) a credit provider may only approach the court for an order to enforce a credit agreement, if

(i) at that time the consumer is in default and has been in default under that credit agreement for at least 20 business days; and

(ii) at least ten business days have elapsed since the credit provider delivered a notice to the consumer in terms of section 86(10) (the Act refers to s 86(9), which is submitted to be wrong – *cf* Van Heerden 12-5 fn 37; and Boraine and Renke 2008 *De Jure* 6 fn 32).

If the credit provider who gave notice of termination in terms of section 86(10) has proceeded to enforce the agreement, it should be noted that the court may in terms of section 86(11) still order that the debt review resume on any conditions the court considers to be just in the circumstances.

It is hoped that the National Credit Regulator's application to the High Court for a declaratory order in terms of section 16(1)(b)(ii) of the NCA (*National Credit Regulator v Nedbank* unreported case no 19638/08 (TPD)) would shed some light on the many practical problems currently experienced with the debt counselling process. Unfortunately the decision of the High Court in the *Smith* case has, in the author's view, only contributed to the legal uncertainty which currently exists with regard to the process of debt review in terms of the NCA.

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