

The Advantage Requirement in Sequestration Applications: A Call for Relaxation

by

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Submitted in partial fulfillment of the requirements for the degree

LLM (Mercantile Law)

In the Faculty of Law,
University of Pretoria

October 2012

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Acknowledgements

I wish to gratefully acknowledge all the help that was rendered to me by all I contacted in the process of producing this work. Genuine appreciation goes to Prof Melanie Roestoff, for the great supervision and guidance in all the stages of producing this work. May God bless you abundantly.

I am highly indebted to my critical reader Ms Ndaty Andrews, who read through the draft. Special thanks for her valuable contribution. Many thanks, to my family for the immense sacrifice and support. Without you, my stay in South Africa would have been impossible.

Above all, I give all the glory and honour to the loving God, the giver of wisdom, for the source of strength. Without His divine grace, this work would not have been accomplished.

Summary

In South African insolvency law, inasmuch as debt relief measures are contained in three pieces of legislation, a discharge from debt is only available to an insolvent debtor whose estate has been sequestrated and he is eventually rehabilitated. The history of South African insolvency law indicates a developmental change from a 'harsh creditor-orientated' approach to a 'debtor-friendly' approach. However, the advantage for creditors' requirement is now firmly embedded in the Insolvency Act 24 of 1936. This requirement is not defined in the Insolvency Act but has been largely interpreted by the courts and stringently applied. It is only once the applicant for the sequestration order has extinguished the burden of proving this requirement, amongst others, will the court exercise its judicial discretion to grant or refuse the order. Consequently, this requirement creates a stumbling block for debtors wishing to use the sequestration process as a debt relief measure and force discharge of their debts on their creditors.

The sequestration process is aimed at the advantage of creditors and not the relief of debtors. Overburdened debtors seeking debt relief who cannot prove advantage of creditors are therefore not considered in sequestration applications. However, although debt relief is not a primary object of the Insolvency Act, it is an indirect consequence of the sequestration process when the insolvent debtor is rehabilitated. The Insolvency Act almost deals with every aspect of the different classes of creditors while there is no provision of the different classes of debtors who can and those who cannot prove an advantage to creditors. This serves as an indication that there is an imbalance between creditors' and debtors' interests. The study seeks to analyse the effect of the advantage requirement on sequestration applications from a debtor's perspective. The alternative debt relief measures available to debtors when pursued by their creditors as contained in

the Magistrates` Court Act 32 of 1944 and the National Credit Act 34 of 2005 are examined. It is submitted that South Africa does not provide the required sufficient debt relief because the administration orders and debt review in addition to other deficiencies, do not provide debtors with a statutory discharge from debts.

The South African Law Reform Commission in the 2000 Insolvency Bill has recommended that the advantage for creditors` requirement be retained in the new Insolvency Act. In a comparative survey, various legal systems are considered to investigate how the issue of finding a balance between debtors` and creditors` interests in insolvency law is dealt with. To accommodate all debtors, it is then submitted that the advantage requirement should not be retained in the Insolvency Act.

Key Words

Insolvency

Bankruptcy

Sequestration

Voluntary Surrender

Compulsory Sequestration

Advantage of Creditors

Friendly Sequestrations

Administration Orders

Pre-liquidation Compositions

Debt Review

Rehabilitation

Discharge

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CHAPTER 1

Introduction

1 1 Background Information

Commercial transactions both on the large and small scale date long back and considering the fact that people are free to agree on the mode of payment, debt is inevitable. Due to happenings of events beyond the debtors' control, many of them end up in financial difficulties and a consequent inability to pay debts. Swimming out of debt can be a nightmare because a discharge from debt is only possible through the sequestration and rehabilitation processes. However, a glimpse in the history of South African insolvency law indicates that there has been developmental changes from a 'harsh creditor-orientated' approach to a 'debtor friendly' approach. As opposed to past practices where the creditors recovered their debts by getting the debtor killed, have his body dismembered amongst them and then selling the parts to the debtor's families for a proper burial, action is now against the insolvent estate and there is provision for a debtor's discharge from debt after some years.¹ Clearly then, gone are the days when insolvency law was used as a form of punishment against the debtor. As Rochelle² aptly puts it,

“[t]hose who fail would not become modern lepers, but instead would receive another chance to be productive for themselves and society”.

¹ Loubser “Ensuring Advantage to Everyone in a Modern South African Insolvency Law” 1997 *SA Merc LJ* 325. See also generally Duncan “From Dismemberment to Discharge: The Origins of Modern American Bankruptcy Law” 1995 *Commercial Law Journal* 191.

² 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 *TSAR* 315 315.

It is now observed that insolvency is considered a possible pitfall for taking risk, second to loss and “the taking of legitimate business risks is the very cornerstone of our system”.³

Weighing up the debt relief measures at the debtors’ disposal, the sequestration procedure under the South African Insolvency Act⁴ seems the only accommodative mechanism where a discharge from debt is a possibility. However, the primary object of sequestration is the advantage of creditors and not the relief of debtors.⁵ It follows therefore that the sequestration procedure is only put into motion if, in an application for voluntary surrender, amongst others, it is proved that acceptance will be to the advantage to creditors and in cases of compulsory sequestration, that there is reason to believe that sequestration will be to the advantage of creditors.⁶

Evidently, the advantage requirement constitutes a cornerstone of the South African insolvency law. Establishing this requirement in practice has proved to be difficult resulting in a vast refusal of sequestration orders, especially in voluntary surrender of estates where it is more stringent as opposed to compulsory sequestration where the petitioning creditor is only required to prove that there is reason to believe sequestration will be to the advantage of creditors.⁷ Loubser notes that in South Africa debtors can only obtain a discharge of debts when their estates are sequestrated and they are eventually rehabilitated.⁸ This is a clear indication that the South African insolvency law, in comparison to other legal systems, is still ‘creditor-orientated’. The American bankruptcy system for example is aimed at

³ Slomowitz AJ in *Kruger v The Master; Ex Parte Kruger* 1982 1 SA 754 (W) 758. See also Smith “Problem Areas in Insolvency Law” 1989 SA Merc LJ 103 104.

⁴ 24 of 1936 hereafter “the Act”.

⁵ Bertelsmann *et al Mars: The Law of Insolvency in South Africa* (2008) 6. See also *Fesi v ABSA Bank Ltd* 2000 1 SA 499 (C) 502 and *Ex parte Ford and Two Similar Cases* 2009 3 SA 376 (C) 383.

⁶ See ss 6(1) and 9(1) of the Act.

⁷ See for example *Ex Parte Bouwer* 2009 6 SA 382 (GNP); *Ex Parte Steenkamp* 1996 3 SA 822 (W) and *Ex Parte Ogunlaja* 2011 JOL 27029 (GNP).

⁸ Loubser 1997 SA Merc LJ 325 327.

“[relieving] the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from obligations and responsibilities consequent upon business misfortunes.”⁹

As indicated earlier, it appears that the advantage requirement constitutes undue hardship on legitimate insolvent debtors who wish to take the initiative of surrendering their estates but cannot establish the advantage that creditors are required to receive from sequestration. Rochelle¹⁰ frames it in the words to the effect that one can be too poor to be declared insolvent in South Africa.

1 2 Aim of Study

Loubser¹¹ expresses a view that:

“South Africa cannot remain untouched by developments in Europe and the United States of America, and the signs are there that in South African insolvency law, too, more emphasis is gradually being placed on the plight of the insolvent debtor and the opportunity he should be given to make a fresh start.”

Notwithstanding the recommendations by various scholars¹² towards a neutral approach into which a balance is struck between the interests of creditors and debtors, the advantage requirement remains entrenched in the Act. A discharge of debtors from debts is a dream yet to be realised if the advantage requirement is not relaxed. Although the Act does not outline what constitutes an advantage of creditors, the courts have interpreted it to encapsulate a benefit to creditors, pecuniary in nature.¹³ Considering the fact that a sequestration order is a pre-condition to a discharge of pre-sequestration debts to enable debtors a fresh start,

⁹ *Local Loan Co v Hunt* 1934 292 US 234 244. See also Boraine and Roestoff “Developments in American Consumer Bankruptcy Law: Lessons for South Africa (Part 1)” 2000 *Obiter* 33 35.

¹⁰ Rochelle 1996 *TSAR* 315 319.

¹¹ Loubser 1997 *SA Merc LJ* 325 326.

¹² For example Rochelle 1996 *TSAR* 315 319, who suggests that barriers to entry such as the advantage of creditors should be abandoned to achieve a statute with a broader social utility.

¹³ See for example *Meskin & Co v Friedman* 1948 2 SA 555 (W) 559.

elements hindering the granting of such orders cannot be undermined. An investigation and the identification of the policies that dictated the need to retain this requirement in the Act is thus necessary, through an analysis of the historical background of South African insolvency law in light of the advantage requirement.

The main objective of this dissertation is to undertake a situational analysis of the effect the advantage requirement has on sequestration applications, especially on voluntary surrender. The study strives to provide an in-depth understanding of the advantage requirement from a practical angle and the factors considered by the courts in determining whether or not it is proved are explored. The central research question is formulated around the courts' interpretation of this requirement and whether it should be relaxed in the Act taking into account worldwide developments towards a discharge of the debtors' pre-sequestration debts. The relevant provisions of the Act and case law, both local and foreign, are analysed to provide a comparative insight on the issue. A critical assessment of the choices debtors are left with under the Magistrates' Court Act 32 of 1944 and the National Credit Act 34 of 2005 will also be done.

1 3 Structure of Dissertation

The dissertation is organised as follows: In chapter 2, the historical background of South African insolvency law is discussed in light of the advantage requirement. A brief outline of the sequestration process and rehabilitation is provided. Chapter 3 focuses on the advantage of creditors' requirement in sequestration applications and the alternative debt relief measures. Firstly, a discussion on the attitude of the courts in the interpretation of the advantage requirement will be made. Secondly, the so-called 'friendly sequestrations' are also discussed. Alternative debt relief mechanisms are then briefly explored to determine the choices the debtors are left

with. This chapter gives an understanding on the approaches adopted by the courts in exercising their judicial discretion and the factors that are put into consideration in granting or refusing a sequestration order. In chapter 4, a broad comparative survey is done to reflect how other legal systems deal with the issue of finding a balance between debtors' and creditors' interests in insolvency. Without going into detail, the alternatives insolvent debtors have to obtain a discharge from debts are discussed. The findings of the study are then summarised in chapter 5 and conclusions are drawn there from. Finally some recommendations are made for future law reform.

CHAPTER 2

Historical Background, Sequestration and Rehabilitation in terms of the Insolvency Act

2 1 Introduction

As opposed to past practices where the insolvent debtors were long regarded with extreme disfavour by society and chances of dismemberment, today, debtors have a number of debt relief measures available with a possibility of discharge from debt liability.¹⁴ The sequestration process in terms of the Act may provide an individual debtor with debt relief because following a sequestration order, the debtor may be rehabilitated. Consequently, the debtor obtains a discharge from pre-sequestration debts.¹⁵ However, a discharge to a South African debtor appears to be more of an academic theory as a number of debtors fail to get their estates sequestrated. This is due to the entrenched advantage for creditors' requirement in the Act that must be established before a court can exercise its discretion of granting or refusing a sequestration order. This chapter will provide a historical background of South African insolvency law, which is necessary to understand how aspects that led to the entrenchment of the advantage requirement in the Act evolved. A brief outline of the sequestration process and rehabilitation as contained in the Act is then provided.

2 2 Historical Background of South African Insolvency Law

Generally, insolvency law relates to the rights of creditors and debtors. South African insolvency law has its basis in Roman-Dutch law and English law. However, since the main principles of these systems were borrowed from Roman

¹⁴ Duncan 1995 *Commercial Law Journal* 191 191.

¹⁵ S 129(1)(b).

law, the foundations of both systems are to be found in Roman law. During the Twelve Tables' times in Roman law, Table III provided a creditor in the event of the debtor's inability to pay debts with two options.¹⁶ The first option involved a seizure of the debtor into the creditor's slavery.¹⁷ Where the debtor was delivered to more than one creditor, the creditors were permitted to divide his body into pieces without incurring liability if one cut off more or less than his share.¹⁸

Between 326 and 313 BC, a new law was passed referred to as the *Lex Poetelia* with the effect, amongst others, of prohibiting the sale of the debtor into slavery in execution of a judgment debt.¹⁹ Imprisonment in a public prison then took over which was only abolished in AD 320 except where the debtor was flagrantly disobedient or rebelliously refused to pay.²⁰ This seizure against the person of the debtor was known as the *legis actio injectioem*. However, it became difficult for the creditors in the execution of their debts against the debtor's person, since some debtors succeeded in concealing themselves.

To remedy this, the praetor in 167 or 104 BC made provision for another means of execution against the debtor's property known as the *missio in possessionem*.²¹ This procedure was characterized by three decrees. The first decree authorized creditors to take possession of, protect and advertise for sale all assets of the debtor. The second one empowered creditors to choose from their number a *magister bonorum* to supervise the sale of the assets. The final decree then authorized the sale *en masse* to the highest bidder.²² This three-staged process was known as the *bonorum emptio*. Later, for what was most convenient, the *bonorum emptio* was

¹⁶ Countryman "A History of American Bankruptcy Law" 1979 *Commercial Law Journal* 226 226.

¹⁷ *Ibid.* See also Johnson *et al Ancient Roman Statutes* (1961) 10; Smith *Law of Insolvency* (1988) 5 and Bertelsmann 6.

¹⁸ *Ibid.*

¹⁹ Bertelsmann 6.

²⁰ *Ibid.*

²¹ *Ibid.*

²² *Idem* 7.

modified to the *bonorum distractio* where instead of a *magister bonorum*, a curator was appointed by creditors subject to the sanction of the praetor who then sold the debtor's estate in lots.²³

Another measure referred to as the *Lex Julia* was introduced in the time of Julius Caesar which allowed an insolvent debtor to make a *cessio bonorum*, that is, to surrender his estate to his creditors in lieu of execution against his body.²⁴ Such surrender did not discharge the debtor of his debts but provided him with exemption from arrest, imprisonment, slavery and *infamia*.²⁵ The *cessio bonorum* could be claimed as a right by the debtor by way of a simple declaration or letter to his creditors of his intention to avail himself of the benefit.²⁶

The *cessio bonorum* was introduced in Holland towards the end of the fifteenth century or early part of the sixteenth century, but has ceased to be a right and was regarded as a privilege extended to the debtor by the court at its discretion and only if insolvency was due to a misfortune alone.²⁷ It was also accompanied in some of the cities of Holland with a degree of humiliation or degradation. In Rotterdam and Leyden no cession was granted unless the debtor appeared and stood before the town house

“in his undermost clothes for three successive days, at a spot three or four steps high each day for one hour”.²⁸

²³ *Ibid.*

²⁴ *Ibid.*

²⁵ *Ibid.*

²⁶ *Ibid.*

²⁷ *Idem* 8.

²⁸ Smith 6; Kotzé *Simon Van Leeuwens Commentaries on Roman-Dutch Law* (1923) 334.

The Amsterdam Ordinance of 1777 is regarded as the basis of the South African insolvency law as it established a chamber charged with the administration of debtors' estates who stopped payment or who obtained a *cessio bonorum*.²⁹ In section 41 and 42 of the Amsterdam Ordinance the principle of rehabilitation was recognized. Rehabilitation provided the debtor with an opportunity of a discharge from all pre-sequestration debt if the prescribed majority of the creditors voted in favour thereof.³⁰

From 1826 to 1831, various ordinances were passed in the Cape Colony. The Cape Ordinance 64 of 1829 was introduced under the English influence and regulated the administration of insolvent estates until repealed by the consolidating Ordinance 6 of 1843.³¹ This ordinance repealed the Roman-Dutch procedure known as the *cessio bonorum*,³² and provided for a debtor surrendering his estate for the benefit of his creditors.³³ This Ordinance is described as a “landmark in the South African law of insolvency”,³⁴ and as such was adopted in Natal, Orange Free State and Transvaal with some amending provisions of the Cape Act 15 of 1859 in different formats.³⁵

In 1916, all insolvency statutes in all the provinces were repealed by the Insolvency Act 32 of 1916.³⁶ This Act made provision for an assignment of the debtor's estate for the benefit of creditors. The assignment was effected when the third quarter of creditors in value and in number agreed that the debtor could transfer his estate to an assignee, who then realized it and distributed the proceeds amongst the

²⁹ Bertelsmann 9. See also *Fairlie v Raubenheimer* 1935 AD 135 146.

³⁰ *Ibid.*

³¹ *Idem* 11.

³² Nathan *South African Insolvency Law* (1928) ix.

³³ Evans “Friendly Sequestrations, the Abuse of the Process of Court and Possible Solutions for Overburdened Debtors” 2001 SA *Merc LJ* 485 488.

³⁴ South African Law Commission “Review of the Law of Insolvency: Prerequisites for and Alternatives to Sequestration” Project 63 Working Paper 29 (March 1989) 10.

³⁵ Bertelsmann 11.

³⁶ Hereafter “the 1916 Act”.

creditors.³⁷ The debtor then immediately received a discharge from debt without the court's involvement or any effect on his contractual capacity.³⁸ The 1916 Act also provided two ways in which the estate of a person who is insolvent may be sequestrated, namely, voluntary surrender of the insolvent estate by the debtor himself and compulsory sequestration on the creditor's petition.³⁹

It was a requirement under the 1916 Act that the debtor's petition for voluntary surrender stated that the debtor is insolvent and that the surrender is tendered for the benefit of his creditors.⁴⁰ At the hearing of the petition, the court could, in exercising its discretion, accept the surrender of the debtor's estate if it was satisfied that the preliminary provisions of section 4 have been complied with and that there was a sufficient free residue to defray all costs of sequestration.⁴¹ On the other hand, a petition for compulsory sequestration was required to be accompanied by an affidavit stating, amongst others, that the creditor has a liquidated claim of at least £50 or an aggregate claim of at least £100 where two or more creditors were petitioning. Further, an act of insolvency by the debtor or factual insolvency of the debtor's estate and that it will be to the advantage of creditors if the estate be placed under sequestration had to be proved.⁴² This was the first time that the advantage requirement was required in any of the South African statutes. The court would then make a provisional sequestration order if those grounds existed, with a rule *nisi* calling on the debtor to appear on the stated date and show cause why his estate should not be placed under final sequestration.⁴³ On the return date, a final sequestration order was then granted if the creditor proved his claim, the ground of

³⁷ See ss 116 and 123 of the 1916 Act.

³⁸ S 126.

³⁹ Ss 3 and 9.

⁴⁰ S 3(a).

⁴¹ S 5.

⁴² S 9.

⁴³ S 11.

sequestration and if it was satisfied that it will be to the advantage of the creditors to place the estate under sequestration.⁴⁴

In terms of the 1916 Act, it is clear that proving advantage to creditors was only a requirement in compulsory sequestration cases but not in voluntary surrender.⁴⁵ The effect of section 3(a)⁴⁶ has been interpreted to mean that where the debtor was insolvent, he could apply for voluntary surrender and have his property distributed to creditors for their benefit, without an implication that surrender could be refused unless the creditors received a benefit.⁴⁷ All that was required was proof of insolvency through no fault or dishonesty of the debtor and that there were sufficient assets to cover sequestration costs. In this regard, it was emphasized in *Ex parte Robinson*⁴⁸ that the courts do not sit for the relief of reckless debtors and the surrender of an estate where the assets were worth £50 and liabilities nearly £23 000 was refused. However, Searle JP as he then was stated in *Ex parte Burger*⁴⁹ as follows:

“The court should not be too astute to ascertain what benefit the creditors are going to derive, because very often it is a difficult thing to settle. Where the insolvent’s conduct has been fair and reasonable, and where there is sufficient [assets] to pay for the costs of administration, the court usually accepts the surrender.”

In contrast to the application of voluntary surrender, the court would not grant a compulsory sequestration order unless it was shown that it would be for the benefit of creditors.⁵⁰

⁴⁴ S 12(1)(c).

⁴⁵ See ss 5 and 9.

⁴⁶ S 3(a) empowered the debtor to voluntarily petition for the surrender of his estate for the benefit of his creditors.

⁴⁷ Nathan 16. See also *Ex parte Terblanche* 1924 TPD 168.

⁴⁸ 1921 CPD 450.

⁴⁹ 4 PH C 5 CPD/July 1924 (unreported) quoted in Nathan 16.

⁵⁰ See *Smiedt Bros v Fourie* NO 1915 OPD 53; *Nicholl v Nicholl* 1916 WLD 22 and *Cragg v Scanlam* 1931 WLD 93.

The 1916 Act was later repealed by the Insolvency Act 24 of 1936, the principal Act currently in force. This Act was promulgated to consolidate and amend the law relating to the insolvent persons and their insolvent estates.⁵¹ It abolished, amongst others, the law relating to statutory assignments. The advantage requirement in both sequestration procedures was also amended. It is now required that the debtor's application for voluntary surrender contains an allegation that sequestration will be to the advantage of creditors. For voluntary surrender, the relevant provisions of the Act are couched in the following terms:

“3(1) An insolvent debtor ... may petition the court for the acceptance of the surrender of the debtor's estate for the benefit of his creditors.”

“6(1) If the court is satisfied that the provisions of section four have been complied with, that the estate of the debtor in question is insolvent, that he owns realizable property of a sufficient value to defray all costs of the sequestration which will in terms of this Act be payable out of the free residue of his estate and that it will be to the advantage of creditors of the debtor if his estate is sequestrated, it may accept the surrender of the debtor's estate and make an order sequestrating that estate.”

In compulsory sequestration applications, the legislature relaxed the burden of proof that petitioning creditors previously bore. Currently, a petitioning creditor merely needs to establish that there is a reason to believe that sequestration will be to the advantage of creditors. In *Amod v Khan*⁵² the court stated that:

“A debtor knows all about his own affairs and can easily prove the advantage of the creditors. On the other hand, the creditor has normally little knowledge of the exact position of the debtor ... the legislature knowing this, and knowing also that the advantage of the creditors is, and always has been, a consideration of great importance in relation to the question whether a debtor's estate should be sequestrated, altered the position in 1936, and made it much easier than it had been for the creditor to make a case in relation to the benefit of the creditors.”

⁵¹ See the preamble and s 1 of the Act.

⁵² 1947 2 SA 432 (N) 438.

More specifically, the advantage requirement as it pertains to compulsory sequestrations is set out in relevant sections of the Act as follows:

“10 If the court to which the petition for the sequestration of the estate of a debtor has been presented is of the opinion that *prima facie*—

- (a) ...
- (b) ...
- (c) there is reason to believe that it will be to the advantage of creditors of the debtor if his estate is sequestrated, it may make an order sequestrating the estate of the debtor provisionally.”

“12(1) If at the hearing pursuant to the aforesaid rule nisi the court is satisfied that—

- (a) ...
- (b) ...
- (c) there is reason to believe that it will be to the advantage of creditors of the debtor if his estate is sequestrated, it may sequester the estate of the debtor.”

2 3 A Brief Outline of the Sequestration Process

Insolvency law developed as a collective debt enforcement procedure to facilitate a just distribution of the proceeds of a debtor’s estate amongst the creditors, where the debtor’s assets are inadequate to settle all his debts in full.⁵³ Although an inability to pay debts is at most evidence of insolvency, a debtor who has insufficient assets to discharge his liabilities is not treated as insolvent for legal purposes until his estate has been sequestrated by an order of court.⁵⁴ A sequestration order is therefore a formal declaration that the debtor is insolvent.⁵⁵ A legal test of insolvency is provided in *Venter v Volkskas Ltd*⁵⁶ where the court stated that a debtor is insolvent when after the realisation of his assets, fairly valued, are exceeded by his liabilities, fairly estimated.

⁵³ Bertelsmann 2; Nagel *et al Commercial Law* (2011) 485.

⁵⁴ Bertelsmann 2.

⁵⁵ *Ibid.*

⁵⁶ 1973 3 SA 175 (T) 179.

As indicated, the Act makes provision for two procedures in which an insolvent debtor's estate may be sequestrated, namely, voluntary surrender or compulsory sequestration. Both proceedings are instituted by way of an application to the High Court for a sequestration order and are regulated by Rule 6 of the High Court Rules.⁵⁷ An application for voluntary surrender is made *ex parte* in accordance with form 2 of the Uniform Rules directed to the Registrar of the High Court, while in compulsory applications, form 2A of the Uniform Rules is used.⁵⁸

2 3 1 Voluntary Surrender

Under this procedure, the debtor himself, his expressly authorised agent, the *curator bonis* of a person who is incapable of managing his own affairs and the executor of a deceased estate may apply to court for the acceptance of the surrender of the insolvent estate.⁵⁹ Because the definition of a debtor in the Act includes a partnership or the estate of a partnership, ordinary members to a partnership must jointly apply and simultaneously apply individually for the voluntary surrender of their own personal estates.⁶⁰ Spouses married in community of property must both apply because they are equal owners of the joint estate.⁶¹

The applicant's affidavit must in terms of section 6(1), firstly, establish that the preliminary formalities have been complied with by attaching documentary evidence to the application. These formalities as contained in section 4(1) require the applicant to publish a notice of intention to surrender in the Government Gazette and in a local newspaper that enjoys a widespread circulation in the

⁵⁷ S 149(1) provides that the court has jurisdiction if (a) the debtor is domiciled or owns or is entitled to property within the jurisdiction of the court on the date when the application is lodged with the registrar of the court and (b) when the debtor ordinarily resided or carried on business within the court's area of jurisdiction at any time within the 12 months immediately preceding the lodging of the application. See in general in respect of jurisdiction with sequestration applications Nagel 491.

⁵⁸ Nagel 491.

⁵⁹ S 3(1) and (2).

⁶⁰ S 13(1) read with s 3(2).

⁶¹ S 17(4)(a) of the Matrimonial Property Act 88 of 1984.

magisterial district in which he resides or if he is a trader, in the district where his principal place of business is, not more than 30 days and no less than fourteen days, before the date on which the application for surrender will be made to court.⁶² The notice must correspond with Form A of the First Schedule to the Act and must be signed by either the debtor or his attorney.⁶³

Further, in terms of section 4(2), the applicant shall, within a period of seven days as from the date of publication of the notice of intention to surrender, personally deliver or send by registered post copies of the published notice of intention to surrender to all known addresses of the creditors, South African Revenue Services, trade unions and the debtor's employees.⁶⁴ The applicant must also prepare a statement of affairs in accordance with Form B of the First Schedule to the Act and lodge it in duplicate at the Master of the High Court's office in the district where he resides or carries on business. The statement of affairs must lie open for inspection for fourteen days before the advertised date of surrender.⁶⁵

The preliminary formalities are aimed at protecting the interests of creditors in the insolvent estate should they wish to oppose the application. In *Ex parte Henning*⁶⁶ it was emphasised that it is peremptory that the debtor before approaching the court with an application of voluntary surrender must comply with the prescribed formalities. However, section 157(1) provides that a court may condone non-

⁶² S 5 provides for the consequences of publishing a notice of surrender. Sales in execution are stayed and the Master may appoint a *curator bonis* to manage the insolvent estate until the trustee is appointed. It also constitutes an act of insolvency in terms of s 8(f), if the debtor fails to apply on the stated date, unless the notice has been properly withdrawn in terms of s 7(2).

⁶³ Bertelsmann 49.

⁶⁴ A notice to employees is effected in terms of s 4(2)(b)(ii) by affixing the notice to the notice board which employees have access to, or on the front gate of the premises from which debtor conducted business.

⁶⁵ S 4(6).

⁶⁶ 1981 3 SA 843 (O) 844.

compliance if such constitutes a formal defect and where no prejudice which an order of court cannot rectify has thereby been done.⁶⁷

Secondly, the applicant's affidavit must establish actual insolvency on the part of the debtor.⁶⁸ Thirdly, that there is a sufficient free residue⁶⁹ in the estate to pay the costs of sequestration and that the acceptance of the application of surrender will be to the advantage to creditors.⁷⁰ In *Ex parte Smith*⁷¹ it was affirmed that an application must contain a specific allegation supported by facts, unless figures speak for themselves, that the sequestration will be to the advantage of the creditors of the estate and not merely an allegation that the petitioner is desirous of surrendering his estate for the benefit of his creditors.

Even when all the requirements are proved, the court is not bound to grant the sequestration order but still has a discretion on whether to grant or dismiss the application.⁷² An order refusing the surrender cannot be appealed against. However, an order that accepts the surrender of an estate can be appealed against in terms of section 150. The court also has the authority to postpone or refuse the application where, for example, it was brought with an improper motive or amounts

⁶⁷ See *Ex parte Oosthuysen* 1995 2 SA 694 (T); *Ex parte Henri* 1974 3 SA 717 (N); *Ex parte Van Rensburg* 1977 4 SA 604 (O) and *Ex parte Harmse* 2004 1 All SA 626 (N) for an insight on the effect of non-compliance with s 4. See also Roestoff and Burdette "Premature Publication of a Notice of Surrender of an Insolvent Estate – Is it Fatal to the Application?" 2005 *THRHR* 681.

⁶⁸ S 6(1). See also *Ex parte Van den Berg* 1950 1 SA 816 (W) and *Ex parte Deemter* 1962 2 SA 228 (E).

⁶⁹ "Free residue" is defined in s 2 to mean that portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothec, pledge or right of retention. In *Ex parte Van Heerden* 1923 CPD 279 it was indicated that it is necessary to consider whether the surplus of the proceeds of the immovable property, after satisfying all bonds which have a preferential claim thereon can be considered as a free residue. The construction of the concept was relaxed to ensure that the creditors of the insolvent estate will have a claim for the payment of the debts out the amount realised from the burdened property, after the burden has been discharged.

⁷⁰ S 6(1).

⁷¹ 1958 3 SA 568 (O) 570-571. See also *Ex parte Alberts* 1937 OPD 2 4.

⁷² *Bouwer supra* 384; *Bertelsmann* 76.

to an abuse of process and where material facts regarding insolvency are not disclosed.⁷³

2 3 2 Compulsory Sequestration

Section 9(1) grants one or more creditors the right to apply for the compulsory sequestration of the debtor's estate. The application is also preceded by certain formalities in that the petitioning creditor must furnish security to the Master of the High Court to defray all costs of sequestration until a trustee is appointed.⁷⁴ The petitioning creditor must obtain a certificate in that regard, confirming that security has been given not more than ten days before the date of application. A copy of the application must also be furnished to the trade unions, employees, South African Revenue Service and the debtor.⁷⁵

In the supporting affidavit, the petitioning creditor must firstly, establish that he has a liquidated claim against the insolvent debtor of at least R100 or where two or more creditors apply jointly, the total claim in aggregate should at least be R200.⁷⁶ Secondly, the applicant must prove that the debtor has committed an act of insolvency in terms of section 8⁷⁷ or alternatively, that he is factually insolvent. Thirdly, the applicant must prove that there is a reason to believe that the sequestration of the debtor's estate will be to the advantage of creditors.⁷⁸ In

⁷³ Bertelsmann 70; Nagel 495. See also *Van den Berg supra*.

⁷⁴ S 9(3)(b).

⁷⁵ S 9(4A)(a)(i)-(iv).

⁷⁶ S 9(1).

⁷⁷ These are: (a) absence from the Republic or dwelling with the intent of evading or delay payment of his debts; (b) failure to satisfy the judgment (*nulla bona return*) by paying or indicating sufficient disposable property to satisfy the judgment or where none can be found by the Sherriff at the debtors residence; (c) Disposition of property or attempts thereof to prejudice creditors or to prefer one creditor above another; (d) Removal of property or attempts thereof from where it is stored to another place with the intention of prejudicing creditors; (e) Offers to make arrangements for release from debts; (f) Failure to comply with the requirements of s 4(3) or lodging incomplete statement of affairs; (g) Notice of inability to pay debts to any of his creditors; and (h) Inability to pay debts when they are due after publishing a notice of his intention to transfer his business in terms of s 34(1).

⁷⁸ See ss 10(c) and 12(1)(c).

*Hillhouse v Stott; Freban Investments (Pty) Ltd v Itzkin; Botha v Botha*⁷⁹ the court explained that “reason to believe” means it is not required to prove that sequestration will be advantageous to the creditors, only a reasonable belief that it will be so. However, the belief must be rational and the court must be furnished with sufficient facts to support it.

If the court sequestrates the estate of the debtor, it simultaneously issues a provisional order in which the debtor is ordered to advance reasons why his estate should not be finally sequestrated on the return date.⁸⁰ This order is served on the debtor and is also published in the Government Gazette.⁸¹ The court still has the discretion whether to make a final sequestration order or not.⁸² It is only the final order and the order setting aside the provisional order which may be appealed against by any person aggrieved.⁸³ If the court is satisfied that an application for compulsory sequestration is an abuse of the court’s procedure, malicious or vexatious, it may award damages to the debtor which he may have sustained by reason of the provisional sequestration of his estate.⁸⁴

2 4 Rehabilitation

Save for the setting aside of the provisional order under section 12 and the subsequent setting aside of a sequestration order under section 151(1), the only way that the insolvent debtor may obtain release of his estate from sequestration is when he is rehabilitated.⁸⁵ The effect of rehabilitation, amongst others, is that

⁷⁹ 1990 4 SA 580 (W) 585.

⁸⁰ S 11(1) and (2).

⁸¹ S 17(4); Rules 4 and 5(3) of the Uniform Rules of Court. In respect of service of the rule *nisi*, see in general Bertelsmann 125.

⁸² See *Amod supra* where the order was refused because the petitioning creditor was abusing the court’s procedure.

⁸³ S 150(1). See also *Gottschalk v Gough* 1997 4 SA 562 (C) and *Moch v Nedtravel Travel (Pty) Ltd t/a American Express Travel Service* 1996 3 SA 1 (A). Although there is no right of appeal over provisional orders, s 149(2) provides that they may be set aside in extraordinary circumstances.

⁸⁴ S 15.

⁸⁵ Nathan 338.

sequestration is terminated and all pre-sequestration debts are discharged, thus affording the insolvent debtor a fresh start.⁸⁶ This means that the debtor is released from all debts which were provable in his insolvency, so that if there is any balance of indebtedness remaining after deducting the dividends paid or yet to be paid to the creditors by the trustee, the creditors enjoy no further right to enforce them by means of any legal process.⁸⁷

An insolvent debtor is automatically rehabilitated after a lapse of ten years where no previous rehabilitation order was granted.⁸⁸ However, any interested party may apply to court with notice to the insolvent before the expiry of ten years to prevent automatic rehabilitation.⁸⁹ In terms of section 124, rehabilitation within ten years is still possible by way of a court order. A rehabilitation order may be granted at the instance of the insolvent's application to court. The insolvent applicant must furnish security to the value of at least R500, should any interested party oppose the application.⁹⁰ The court has a discretion whether to grant a rehabilitation order or not.⁹¹ This discretion is usually exercised by determining whether the insolvent is worthy to be allowed to trade as any other honest person.⁹² The grounds of rehabilitation that a debtor may rely on are discussed below.

2 4 1 Section 124(1) Application

Where the insolvent debtor and his creditors have agreed to a composition in terms of which a dividend of at least 50c in the Rand is paid or a security for such payment is furnished with the Master, the insolvent may immediately apply for a

⁸⁶ S 129(1)(b).

⁸⁷ Fletcher *The Law of Insolvency* (2011) 48.

⁸⁸ S 127A(1).

⁸⁹ *Ibid.*

⁹⁰ S 125.

⁹¹ S 127(2).

⁹² Bertelsmann 575. See also *Ex parte Heydenreich* 1917 TPD 657 658 and *Ex parte Le Roux* 1996 2 SA 419 (C) 424.

rehabilitation order. This application is preceded by publishing in the Government Gazette and serving on the trustee of a three weeks' notice of intention to apply for rehabilitation.⁹³

2 4 2 Section 124(2) Application

This subsection provides for three instances in which the insolvent may apply for rehabilitation. A notice of intention to apply for rehabilitation must have been given to the trustee and published in the Government Gazette in not less than six weeks. The insolvent may apply after twelve months have elapsed from the date of confirmation of the trustee's first account by the Master.⁹⁴ Where the insolvent had been previously sequestrated, he may apply for rehabilitation after three years from the date of confirmation of the trustee's first account.⁹⁵ The insolvent debtor who has been convicted of any fraudulent act in relation to his previous or existing insolvency or of any offence under section 132, 133, 134 and other provisions of the Act, may only apply after five years have lapsed from the date of his conviction.⁹⁶ A court will not grant a rehabilitation order within four years after sequestration without the Master's recommendation.

2 4 3 Section 124(3) Application

The insolvent may apply for rehabilitation six months after his application for sequestration provided that no claims against his estate were proved by any creditor, he has not been convicted of an offence stated in section 129(2)(c) and it is the first time that his estate has been sequestrated. Six weeks' notice as above must be given to the trustee and published in the government gazette.

⁹³ S 124(1).

⁹⁴ S 124(2)(a).

⁹⁵ S 124(2)(b).

⁹⁶ S 124(2)(c).

2 4 4 Section 124(5) Application

Where all the creditors' claims are paid in full with interest and a three weeks' notice is given, the insolvent may at any given time apply for rehabilitation after confirmation of the trustee's distribution account.

2 5 Conclusion

The history of the South African insolvency law indicates that earlier laws were aimed at the rights of creditors to the repayment of claims, without any reference to the debtors' rights. An inability to pay debts induced the delivery of the debtor into slavery or capital punishment. However, as times went on these gross measures evolved to debtor-friendly approaches aimed at a form of a compromise, for example when the debtors surrendered their estates to the creditors and in return were exempted from slavery and imprisonment.⁹⁷ The principle of rehabilitation of the debtor was also later introduced in the Union of South Africa as we have it today.

The 1916 Act granted both the debtor and creditors the right to apply for the sequestration of the insolvent debtor's estate. It introduced the concept of the advantage of creditors in the South African insolvency law as it required proof of an advantage to creditors in compulsory sequestration cases but not in voluntary surrender.⁹⁸ This Act was more liberal as it also provided for an assignment of the debtor's estate for the benefit of creditors, which once the majority of creditors agreed, the debtor immediately obtained a discharge from debts. The current 1936 Act repealed the 1916 Act. It maintained the two procedures of obtaining the sequestration order.⁹⁹ However, it extended the advantage of creditors' requirement to voluntary surrender applications as well. A sequestration order may not be

⁹⁷ See par 2 2.

⁹⁸ *Ibid.*

⁹⁹ Par 2 3.

granted unless the advantage of creditors available once the estate is sequestrated is established. In terms of the Act, a real advantage to creditors must be established in voluntary surrender applications.¹⁰⁰ In compulsory sequestrations on the other hand, the Act only requires proof of a reasonable belief that sequestration will be to the advantage of creditors.¹⁰¹ Although the sequestration process is not primarily for the debtor's relief, it may provide debt relief to the debtor. Once the debtor's estate has been sequestrated, he may be rehabilitated with the effect that pre-sequestration debts are discharged and the insolvent debtor obtains a fresh start.¹⁰² An insolvent may apply for a rehabilitation order after an expiry of a certain period of time. Any insolvent not rehabilitated by an order of court is deemed to be automatically rehabilitated after ten years.¹⁰³

¹⁰⁰ See par 2 3 1.

¹⁰¹ *Ibid.*

¹⁰² Par 2 4.

¹⁰³ *Ibid.*

CHAPTER 3

Advantage for Creditors and Alternative Debt Relief Measures

3 1 Introduction

Debt relief to a South African debtor can be obtained through sequestration and rehabilitation processes as provided for in the Act, as well as in the alternative debt relief measures aimed at repaying debts from income. As indicated above, in addition to complying with the technical formalities in a sequestration process, the applicants for sequestration orders are expected to prove an advantage that will accrue to the creditors before the court exercises its discretion in granting or refusing a sequestration order.¹⁰⁴ The burden of proving the advantage requirement in voluntary surrender application is more stringent because an actual advantage must be established as opposed to compulsory sequestration cases where only a reasonable belief needs to be established.¹⁰⁵ However, the principles guiding the courts in determining whether or not it is established remain the same.¹⁰⁶

This chapter discusses the courts' approach towards the advantage requirement through a cross-section of cases dealing with it. A synopsis of the court's attitude towards friendly sequestrations will also be provided, followed by a discussion of the Law Reform Commission's proposal to retain the advantage requirement in the new insolvency Act. Noting that the debtor who cannot make use of the sequestration process because of its requirements is at liberty to consider the alternative debt relief measures to obtain debt relief, an analysis of the extent of alternative debt relief measures available to debtors is finally made.

¹⁰⁴ See par 2 3 1 and 2 3 2.

¹⁰⁵ *Idem* ss 6(1), 10(c) and 12(1)(c).

¹⁰⁶ Boraine and Van Van Heerden "To Sequestrate or Not To Sequestrate in View of the National Credit Act 34 of 2005: A Tale of Two Judgments" 2010 *PER* 84 88. For a comparative discussion of the advantage requirement in sequestration applications see Kunst *et al Meskin: Insolvency Law and its Operation in Winding-up* (2011) 2.1.4 and 3.2.

3 2 The Advantage Requirement

The court may only grant a sequestration order if sequestration of the debtor's estate will be to the advantage of creditors.¹⁰⁷ The applicant for a sequestration order must therefore satisfy the court that there will be such an advantage. This advantage requirement is not defined in the Act. However, the courts in the ascertainment of its meaning have provided an insight on its elements. In *Lotzof v Raubenheimer*¹⁰⁸ the court pointed out that the expression 'advantage of creditors' means an advantage of all the creditors or at least the general body of creditors. This is referred to as a *concursum creditorum*, which literally is the concourse or the coming together of all creditors who have proved claims and have rights to share in the proceeds of the insolvent estate, with the effect that the rights of the creditors as a group are preferred to the rights of individual creditors.¹⁰⁹

In *Walker v Syfret NO*¹¹⁰ it was stated that the effect of a winding-up order is to establish a *concursum creditorum* and the rights of the creditors are considered as they existed at the time of granting the order. In the same case, Innes J affirmed that:

“The sequestration order crystallises the insolvent's position. The hand of the law is laid upon the estate and at once the rights of the general body of creditors have to be taken into consideration. No transaction can therefore be entered into with regard to estate matters by a single creditor to the prejudice of the general body of creditors. The claim of each creditor must be dealt with as it existed at the issue of the order.”¹¹¹

It is therefore common cause that the concept 'advantage of creditors' involves the orderly and equitable sharing of all creditors in the assets of the insolvent estate.

¹⁰⁷ See ss 6(1), 10(c) and 12(c).

¹⁰⁸ 1959 1 SA 90 (O) 94. See *Stainer v Estate Bukes* 1933 OPD 86 and *Amod supra*. See also Smith 1985 MBL 27; Bertelsmann 74.

¹⁰⁹ *Ibid*. See also *Richter v Riverside Estates (Pty) Ltd* 1946 OPD 209 223.

¹¹⁰ 1911 AD 141 160.

¹¹¹ *Idem* 166.

3 2 1 Interpretation of the Advantage Requirement by the Courts

With reference to case law, the court's determination of whether or not sequestration will be to the advantage of creditors depends on the reasonable prospect of some pecuniary benefit to the general body of creditors. Roper J stated in *Meskin & Co v Friedman*¹¹² that:

“The right of investigation is given, as it seems to me, not as an advantage in itself, but as a possible means of securing ultimate material benefit for the creditors in the form, for example, of the recovery of property disposed of by the insolvent or the disallowance of doubtful or collusive claims. In my opinion, the facts put before the Court must satisfy it that there is a reasonable prospect – not necessarily a likelihood, but a prospect which is not too remote – that some pecuniary benefit will result to creditors. Even if there are none at all, but there are reasons for thinking that as a result of the enquiry under the Act some may be revealed or recovered for the benefit of creditors, that is sufficient...”

Similarly, in *London Estates (Pty) Ltd v Nair*¹¹³ it was stated that sequestration is only to the advantage of creditors when it results in some payment in respect of the claims of the creditors as a body and there will be no advantage for creditors if no dividend or only a negligible dividend is available after the costs of sequestration have been met.¹¹⁴ In *Gardee v Dhanmanta Holdings*¹¹⁵ it was held that in addition to establishing the likelihood of a not negligible advantage to creditors, a single creditor who uses sequestration proceedings as a mode of execution must also demonstrate some reasonable expectation that an amount recovered under sequestration will exceed the likely proceeds of ordinary execution.

In determining whether there is an advantage to creditors, the courts consider the facts and circumstances placed before it in the application. Whether sequestration

¹¹² 1948 2 SA 555 (W) 559.

¹¹³ 1957 3 SA 591(D) 593.

¹¹⁴ See also *Braithwaite v Gilbert* 1984 4 SA 717 (W) 717.

¹¹⁵ 1978 1 SA 1055 (N) 1069-1079.

is advantageous to all the creditors or not, must clearly depend on the circumstances, which ranges from the value and number of assets available for liquidation, the amount of the claims and sequestration costs.¹¹⁶ Only if the court is satisfied on a balance of probabilities that there is a reasonable prospect that creditors will receive some financial benefit, will it consider granting a sequestration order.¹¹⁷ The essence of advantage for creditors is therefore 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 non-negligible dividend to creditors. In this regard courts have insisted more stringently on exact information regarding the debtor's affairs being placed before them and to demand a realistic calculation of the potential dividend that will be paid to creditors.¹¹⁸ The reason for this stringent approach arose from the court's 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.¹¹⁹

In *Ex parte Bouwer*¹²⁰ different applications for voluntary surrender of the applicants' estates were heard by the court. Common in all applications was that the reasons for insolvency were inadequate and tersely stated. All applicants alleged that they owned no movable assets. No particulars of income and expenditure were furnished and their valuation reports provided inadequate evidence.¹²¹ Makgoka AJ after outlining the preliminary formalities in section 4 and the substantive requirements in section 6(1) that have to be complied with by the applicants stated that the attitude of the applicants seem to be that, once the formal requirements have been complied with, the court should grant the order. It was emphasised that that approach is incorrect because the court is not a rubber stamp

¹¹⁶ *London Estates supra* 593. See also *Trust Wholesalers and Woollens (Pty) Ltd v Mackan* 1954 2 SA 109 (N) and *Julie Whyte Dresses (Pty) Ltd v Whitehead* 1970 3 SA 218 (D).

¹¹⁷ *Meskin supra* 559; *London Estates supra* 593 and *Braithwaite supra* 717.

¹¹⁸ Bertelsmann 63

¹¹⁹ *Ibid.*

¹²⁰ 2009 6 SA 382 (GNP).

¹²¹ *Idem* 384.

and still has a discretion which must be exercised judiciously.¹²² To enable the court to do so, the applicants must be candid by disclosing all material facts because surrender of an estate involves, amongst others, a financial enquiry. For the court to determine whether the acceptance would be to the advantage of creditors, regard should be had to various factors, among which is the current income of the applicant.¹²³

The court referred to *Fesi v ABSA Bank Ltd*¹²⁴ where it was stated that failure by the applicants to disclose their salaries disregards the good faith expected in *ex parte* applications.¹²⁵ The valuations that accompanied the applications save for the erf numbers and owners were identical. The valuers did not lay a basis for the amounts ascribed to the valuation on each property nor reveal how the amounts were arrived at. The court concluded that they were clearly bald assertions of value, creating doubt whether the properties were indeed inspected individually.¹²⁶ Indicating that the major consideration in section 6(1) is the advantage of creditors, it was held that applicants were not candid with the court and therefore the applications were dismissed.

In *Ex parte Mattysen Et Uxor*¹²⁷ there was an application for voluntary surrender which was opposed by First Rand bank, the intervening creditor. The applicants were married in community of property and in their founding affidavit alleged *inter alia* that they owned household items comprising of an immovable property and a certain movable property.¹²⁸ Their liabilities, including a mortgage bond which was registered over the immovable property in favour of First Rand Bank, exceeded

¹²² *Idem* 385.

¹²³ *Ibid.*

¹²⁴ 2000 1 SA 499 (C).

¹²⁵ *Idem* 385.

¹²⁶ *Idem* 386.

¹²⁷ 2003 2 SA 308 (TPD).

¹²⁸ *Idem* 310.

their assets. They annexed two valuations by a property valuator who fixed the forced sale value of the immovable property at R85 000 and for the movable property at R9 400. The valuator indicated in the report that the valuation was based on information received from estate agents from the area regarding recent transactions involving sales of comparable properties in the immediate area and that, to her knowledge the information was true and correct.

The applicants also averred that no steps had been taken by their creditors to sell the immovable property by sale in execution. This was denied by First Rand Bank, who had obtained the attachment order and sold the property on public auction. Though at the time of hearing of the application, transfer had not yet taken place. It was held that the valuator did not have personal knowledge of the relevant facts because the report was prepared using information provided to her by other unspecified persons.¹²⁹ There was no indication in either the report or the affidavit that the valuator visited the property and inspected it for the purposes of the valuation because the valuator was not even aware that the immovable property was sold in auction.¹³⁰

Ultimately, it was held that the valuation of the property was a bald statement which was not supported by facts or reasons and standing on its own, proved nothing. Further, that the valuation contained no description of each item such as age, make, method of manufacture and so on. The expert witnesses called were found to be of no value whatsoever, because the court is not a rubber stamp for acceptance of the expert's opinion.¹³¹ It was emphasised that testimony of the facts relied upon as well as reasons upon which the valuation is based must be placed

¹²⁹ *Idem* 313.

¹³⁰ *Idem* 314.

¹³¹ *Idem* 312.

before the court.¹³² A mere statement of condition reasonable is not sufficient and amount to a defective valuation, which is an exercise in futility. Without an acceptable basis for calculating the dividend, the court could not conclude that the surrender would be to the benefit of creditors.¹³³

In *Ex parte Steenkamp*¹³⁴ the court was faced with five applications for the sequestration of estates as well as two applications for the surrender of the applicant debtors' estates. Each application suffered one or more of the following inadequacies. There was failure to show that sequestration would be to the advantage of creditors. Furthermore, the value given to the properties was not the market value but an exaggerated value given to enable the applicant to surmount the difficulty of showing advantage to creditors.¹³⁵ Amounts owed on the mortgage bond and other charges over the property concerned were not set out in the founding affidavit, with the result that there was seldom any free residue available for distribution amongst creditors. There was also a heavy reliance on ownership of insurance policies which were said to enjoy a particular value if surrendered and thus yield an advantage to creditors.

The court pointed out that all applications suffered similar deficiencies where the advantage of creditors was alleged to lie in a small amount of assets protected against execution.¹³⁶ It cautioned that an end must be put to this procedure because it is a way of circumventing the provisions of the Act.¹³⁷ The valuations filed with the applications were held useless because there was only one figure given to a series of assets, a clear indication that they were prepared in a perfunctory manner.

¹³² *Ibid.*

¹³³ *Idem* 315-316.

¹³⁴ 1996 3 SA 822 (W).

¹³⁵ *Idem* 823.

¹³⁶ *Idem* 827.

¹³⁷ *Ibid.*

Further, it was held that there was no slightest evidence as to whether there is any prospect of success in recovering the debts.¹³⁸ All matters were then postponed *sine die* with leave to the applicants to renew their applications.

In *Ex parte Ogunlaja*¹³⁹ the court had to consider six applications for the acceptance of the voluntary surrender of estates. All applicants were represented by the same attorney and the applications were set down for hearing on the same day. The founding affidavits were drawn using computer templates and according to the applicants' statement of affairs, they all owned immovable property.¹⁴⁰ In each of the applications, the valuation establishing an ostensible value of the assets sufficiently large to provide a real advantage to creditors was prepared by the same valuator, a candidate valuator who was working under the supervision of her mentor. The court made reference to Southwood J in *Mattysen* and *Steenkamp* as well as to Leveson J in *Nel v Lubbe*¹⁴¹ concerning the valuations and affirmed that the court had to naturally adopt a more cautious approach in considering the property valuator's report who is in training.¹⁴² Such report should provide sufficient detail of a professional engagement in the valuation of each asset. However, the court in this case found that the valuations did not, because they were verbatim copies of each other, clearly having been enacted from a single computer.¹⁴³

It was stated that the valuation report in each application fell short of demonstrating an acceptable measure of expertise and consequently no proof was provided that the liquidation of assets of the insolvent estates would render an

¹³⁸ *Idem* 830.

¹³⁹ 2011 JOL 27029 (GNP).

¹⁴⁰ Par 5-7.

¹⁴¹ 1999 3 SA 109 (W) 111.

¹⁴² Par 8.

¹⁴³ *Idem* 18.

advantage to creditors.¹⁴⁴ The court further stated 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 estate will have to be disposed of in a forced sale situation in order to guarantee an advantage to creditors.¹⁴⁵ To facilitate this, it was indicated that the valuator should certify under oath that they had prepared the valuation without knowledge of the facts of the relevant application. The applications were consequently dismissed.

In *Ex parte Kelly*¹⁴⁶ the applicant applied for the acceptance of the surrender of her insolvent estate and the order accepting and sequestrating it was granted. Having regard to the provisions of section 6(1), it was stated that the advantage requirement is accepted to be satisfied if it is shown that creditors will receive at least ten cents in the Rand.¹⁴⁷ The applicant alleged that after the deduction of costs, sequestration would yield a dividend for creditors of at least twenty cents in the Rand. On review for taxation the court stated that in voluntary surrender applications, common practice is for the applicant to allege the amount of the attorney's costs in the application.¹⁴⁸ The dividend to be paid to the creditors is calculated on the strength of that allegation and the sequestration order is granted in the belief that those figures are correct and that the dividend will indeed be paid to the general body of creditors. It was held that an application must be understood to contain an undertaking by the attorney to limit his fees and expenses to those stated in the application and the subsequent order must be understood to contain such a limitation.¹⁴⁹

¹⁴⁴ *Idem* 33.

¹⁴⁵ *Idem* 38.

¹⁴⁶ 2008 4 SA 615 (TPD).

¹⁴⁷ *Idem* 617.

¹⁴⁸ *Idem* 615.

¹⁴⁹ *Idem* 619.

The provisions of section 23(5)¹⁵⁰ may also be taken into account where the advantage of creditors is alleged to rest in future income. In *Ressel v Levin*¹⁵¹ the court stated that a debtor who has no assets and solely bases his application on the allegation that the creditors will obtain an advantage from his salary has not discharged the onus of proving that there is a real likelihood of dividends becoming available to creditors because a salary is not sufficient information to prove the advantage requirement. Similarly, in *Ex parte Veitch*¹⁵² it was stated that where the applicant's income is the only source of advantage to creditors, a mere possibility of a surplus out of it becoming available is not sufficient. There must be at least a probability that a surplus will become available.

In *Ex parte Henning*¹⁵³ the debtor's wife to whom he was married out of community of property, made a monthly contribution from her salary to pay the debtor's creditors. The court then had to decide whether this fact should have been taken into account to determine whether sequestration would be to the advantage of the creditors. It was held that it is too vague to be taken into account in deciding whether surrender would be to the advantage of creditors because it was uncertain that she would continue with the employment which enables her to make the monthly contribution.¹⁵⁴ Furthermore, the court stated that she would not be compelled either to make such monthly contributions because her husband's creditors were not her creditors.

¹⁵⁰ This section provides that the trustee is entitled to revenue which the insolvent may receive from any profession if the Master is of the opinion that such is not necessary for the support of the insolvent and his dependants.

¹⁵¹ 1964 1 SA 128 (C) 130.

¹⁵² 1965 1 SA 667 (W) 668.

¹⁵³ 1981 3 SA 843 (O).

¹⁵⁴ *Idem* 845.

The suitability of alternative procedures like those provided for under the National Credit Act are also considered. In *Ex Parte Ford*¹⁵⁵ for example, it was stated that an order accepting the estates cannot be granted when debt review under the National Credit Act is the appropriate mechanism to be used. The following observation made by Didcott J in the *Gardee* decision¹⁵⁶ may provide a justification for the decision in *Ford*:

“The notion of advantage to creditors is a relative and not an absolute one. Sequestration cannot be said to be to the creditors’ advantage unless it suited them better than any feasible and reasonably available alternative course. It follows that the enquiry postulates a comparison.”

The considerations emerging from the perusal of these cases indicate that a court will only grant a sequestration order when the facts and the relevant circumstances indicate that there will be an advantage to creditors. The court’s consideration of all the relevant circumstances in determining proof of the advantage requirement is aimed at ensuring a realistic calculation of the dividend to be distributed amongst the general body of creditors so that the *concursum creditorum* is not defeated.¹⁵⁷ Because many debtors do not have sufficient assets to constitute a significant dividend for the creditors, the consequence is a vast refusal of the sequestration orders.

3 2 2 Friendly Sequestrations and the Advantage Requirement

A friendly sequestration is like any other application for compulsory sequestration brought by the debtor’s relative or friend usually at the debtor’s request, who also has a claim against the debtor and relies mostly on the act of insolvency in terms of

¹⁵⁵ 2009 3 SA 372 (W) 382.

¹⁵⁶ *Supra* 1070.

¹⁵⁷ See Smith “Friendly and Not so Friendly Sequestrations” 1981 *MBL* 58 60.

section 8(g).¹⁵⁸ Following the strict approach by the courts in determining whether the advantage requirement has been proved in voluntary surrender applications, many debtors cannot successfully surrender their estates. Still relying on sequestration proceedings to force a discharge of debts on their creditors, debtors request their family members or friends to apply for their compulsory sequestrations, where the applicant creditor needs only to prove a reasonable belief that sequestration will be to the advantage of creditors.¹⁵⁹ The petitioning creditor usually has the benefit of the debtor in mind. However, the primary object of sequestration is to benefit creditors and not to relieve debtors.¹⁶⁰

Initially, there was a remarkable increase in the number of friendly sequestrations. However, friendly sequestrations have not gone without a reaction from the courts. Where a family of friendly relationship exists between the debtor and the petitioning creditor, the courts have taken a firm stance with regard to the granting of the order, making it clear that the court has the duty to scrutinize the application with great care to ensure advantage to creditors and to prevent prejudice to them.¹⁶¹ In *Vermeulen v Hubner*¹⁶² it was stated that debtors in co-operation with creditors abuse friendly sequestration proceedings in order to escape the formality requirements in voluntary surrender. The court decided that although a friendly sequestration remains a compulsory sequestration, it still falls under section 3 of the Act and should be in the form of voluntary surrender. The applicant creditor must therefore produce adequate information with regard to the claim against the respondent debtor, sufficient evidence in respect of the assets of the debtor and a list of the respondent's creditors. The applicant must furthermore send notice of the

¹⁵⁸ Loubser "Making Friends with Friendly Sequestrations" 1997 *Codicillis* 23 23.

¹⁵⁹ Boraine and Roestoff "Developments in American Consumer Bankruptcy Law: Lessons for South Africa (Part 2)" 2000 *Obiter* 241 261; Loubser *SA Merc LJ* 325 327.

¹⁶⁰ *Ibid.*

¹⁶¹ See for example, *Klemrock (Pty) Ltd v De Klerk* 1973 (3) SA 925 (W) 927; *Epstein v Epstein* 1987 4 SA 606 (C) 610; *Streicher v Viljoen* 1999 3 All SA 257 (NC) 258 and *Van Rooyen v Van Rooyen* 2000 2 All SA 485 (SE) 490.

¹⁶² Case number 1165/1990 (T) (unreported).

application to such creditors by registered post stating the place where the documents will lie open for inspection at least ten days before the application.¹⁶³

In *Sellwell Shop Interiors CC v Van der Merwe*¹⁶⁴ the *Vermeulen* judgment was criticised by stating that the courts are not empowered to usurp the functions of the legislature by setting further requirements in addition to those imposed by existing legislation. It was pointed out that the applicant's motive to assist the debtor does not necessarily amount to an abuse of the legal process because there is nothing sinister in a friendly sequestration and the fact that a special relationship exists between the debtor and the petitioning creditor does not prevent the granting of a sequestration order if all requirements are met.¹⁶⁵ It appears that an application should however fail, if it is only meant to benefit the debtor and not his creditors. Tindall J phrased it in *Yenson & Co v Garlick*¹⁶⁶ as follows:

“Now a friendly creditor, seeing other creditors pressing the debtor and in that way obtaining payment of their debts in instalments, may think it desirable to sequester the estate of the debtor; the fact that one of his motives in doing that may be to assist the debtor does not necessarily prove that the application is collusive. If he makes the application not only with that object but also with the object of coming in and sharing pro rata in any dividends which may be obtained by means of sequestration, I do not think that an application of that kind could be described as collusive.”

With reference to *Klemrock (Pty) Ltd v De Klerk*¹⁶⁷ where it was stated that it is not a requirement in the Act for the applicant in a friendly sequestration to comply with

¹⁶³ See also Nagel 502.

¹⁶⁴ Case number 27527/1990 (W) (unreported).

¹⁶⁵ *Ibid.* See also *Jhatam v Jhatam* 1958 4 SA 36 (N) 39-40 and *Beinash & Co v Nathan* 1998 3 SA 540 (W) 541.

¹⁶⁶ 1926 WLD 53 57.

¹⁶⁷ 1973 3 SA 925 (W) 927.

the provisions of section 4, Leveson J in *Dunlop Tyres (Pty) Ltd v Brewitt*¹⁶⁸ observed:

“[I]n the case of an arm’s length transaction a sequestrating creditor does not have to set out in its founding affidavits the detail and intensity of averments required when the nature of the claim is under scrutiny ... It will be sufficient if the creditor in an overall view on the papers can show, for example, that there is reasonable ground for coming to the conclusion that upon a proper investigation ... a trustee may be able to unearth assets which might then be attached, sold and the proceeds disposed of for distribution amongst creditors.”

To prevent possible abuse of the process in friendly sequestrations, the court in *R v Meer*¹⁶⁹ indicated that the courts can guard against abuse firstly, by paying more attention to the element of advantage to creditors in the petition and secondly, by refusing to grant repeated adjournments of the rule *nisi* unless it is satisfied on affidavit that such would be to the advantage of creditors. Recently, it is observed that there has been a decrease in the number of friendly sequestration applications, with debtors reverting back to voluntary surrender applications. This inevitably means that the insolvent debtors without sufficient assets to amount to an advantage of creditors cannot successfully get their estates sequestrated.

In *BP Southern Africa (Pty) Ltd v Furstenburg*¹⁷⁰ it was stated that

“[T]he whole tenor of the Insolvency Act inasmuch as it directly relates to sequestration proceedings is aimed at obtaining a pecuniary benefit for creditors.”

This view matches the Smith’s viewpoint that the advantage for creditors’ requirement runs a continuous course throughout the Act as a dominant thread, if thread is used in the sense of something that runs a continuous course through

¹⁶⁸ 1999 2 SA 580 (W) 583.

¹⁶⁹ 1957 3 SA 614 (N) 619.

¹⁷⁰ 1966 1 SA 717 (O) 720.

anything.¹⁷¹ In this regard, Bertelsmann J made the following observation in *Ogunlaja*¹⁷²:

“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 burdens 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, debt relief for overburdened debtors is not a consideration under the sequestration procedure because it is primarily aimed at obtaining a pecuniary benefit for the creditors. Evans¹⁷³ concludes that the Act almost overreaches itself in regulating the position of the different classes of creditors while a debtor is only defined. He explains that although the Act does not provide for the different classes of debtors for the differential treatment, it does differentiate between the rich debtors who can prove advantage for creditors and the poor who cannot. Roestoff and Coetzee¹⁷⁴ submit that the advantage requirement should be retained in the Act because the sequestration process is expensive to follow and should only be resorted to if it would be cost-effective to do so. They suggest that where the overburdened debtor is unable to prove the advantage for creditors, the solution should be found in alternative debt relief measures aimed at restructuring the income of the debtor.

¹⁷¹ Smith 1985 *MBL* 27.

¹⁷² *Ogunlaja supra* 36.

¹⁷³ Evans 2001 *SA Merc LJ* 485 508.

¹⁷⁴ Roestoff and Coetzee “A Critical Evaluation of Consumer Debt Relief in South Africa – Lessons from the United States of America, England and Wales and Suggestions for the Way Forward” Accepted for publication in 2012 *SA Merc LJ*. Hereafter “Roestoff and Coetzee 2012 *SA Merc LJ*”.

3 2 3 South African Law Reform Commission's Proposals

The South African Law Reform Commission in the 2000 Bill has recommended that the advantage for creditors' requirement be retained in the Act with regard to all liquidation applications.¹⁷⁵ An application for the liquidation of the debtor's estate may be made by the debtor or by the creditor who has a liquidated claim against the debtor of not less than R2 000.¹⁷⁶ In either application, the court may grant a provisional order for the liquidation of the debtor's estate if there is reason to believe that the liquidation will be to the advantage of his creditors.¹⁷⁷ Pursuant to the rule *nisi*, the final liquidation order may be granted if the court is satisfied that there is reason to believe that liquidation will be to the advantage of creditors.¹⁷⁸

As an attempt to ensure that a not-negligible dividend will indeed be available to creditors and that contribution instances are avoided, it is also proposed that provision be made for the granting of a provisional order in all liquidation applications as it has always been case in compulsory sequestrations.¹⁷⁹ Before the return date, creditors at the first meeting will then consider whether liquidation will be to the advantage of the general body of creditors.¹⁸⁰ Furthermore, it is proposed that applicants in all liquidation applications provide security for the payment of all costs of the application and the liquidation costs not recoverable from other creditors of the estate.¹⁸¹

¹⁷⁵ South African Law Commission Report "Review of the Law of Insolvency" Project 63 (Vol 1) Explanatory Memorandum and (Vol 2) Draft Bill (February 2000). Hereafter, "the 2000 Bill". The 2010 version of the Insolvency Bill also did not change the proposal of retaining the advantage for creditors' requirement in the Act. See cls 3(8)(a)(ii), 10(1)(c)(i) and 11(1)(c) of the 2010 Insolvency Bill.

¹⁷⁶ See cls 3(1) and 4(1) of the 2000 Bill.

¹⁷⁷ Cl 7(1)(b).

¹⁷⁸ Cl 8(1)(c).

¹⁷⁹ See cls 3(7) and 7(1).

¹⁸⁰ Cl 38(6).

¹⁸¹ Cls 3(3)(b) and 4(3)(c).

3 3 Alternative Debt Relief Measures

In South Africa, a debtor who is weighed down by debt may have recourse to two major debt relief procedures, namely, an assets liquidation procedure and a procedure aimed at repaying income from income.¹⁸² The former procedure pertains to sequestration in terms of the Insolvency Act but as explained above,¹⁸³ its primary object is not debt relief *per se*. However, debt relief is consequent when the debtor's estate is sequestrated and he is eventually rehabilitated. In addition to the sequestration and rehabilitation procedure, a debtor may apply for an administration order under the Magistrates' Courts Act¹⁸⁴ or opt for debt review as provided for in the National Credit Act.¹⁸⁵ These procedures take the form of repayment plans as they provide a debtor with a debt-rearrangement with his creditors.

3 3 1 Administration Orders

Administration orders are regulated by section 74 of the MCA. Boraine¹⁸⁶ describes an administration order as a debt relief measure available to some debtors that find themselves in financial distress and which affords them the opportunity to obtain a statutory rescheduling of debt sanctioned by a court order. In *Madari v Cassim*¹⁸⁷ the court characterised the administration orders procedure as a "modified form of insolvency" available to debtors owning small estates in which a *concursum creditorum* is created easily and cost-effectively allowing for a court-sanctioned debt rearrangement.¹⁸⁸

¹⁸² Nagel 486.

¹⁸³ Par 2 3.

¹⁸⁴ 32 of 1944, hereafter "the MCA".

¹⁸⁵ 34 of 2005, hereafter "the NCA".

¹⁸⁶ Boraine "Some Thoughts on the Reform of Administration Orders and Related Issues" 2003 *De Jure* 217 217-218.

¹⁸⁷ 1950 2 SA 35 (D) 38.

¹⁸⁸ In this regard the court referred to Jones and Buckle *Civil Practice of the Magistrates' Courts in South Africa* (1946) and *Weiner NO v Broekhuysen* 2003 4 SA 301 (SCA) 305.

The administration order is obtained after an application to the Magistrates' Court in the prescribed form and a fully prepared statement of affairs is lodged with the clerk of the court.¹⁸⁹ A copy of the application must also be delivered to all the creditors at least three days prior to the hearing of the application.¹⁹⁰ When the order is granted, the amount the debtor is obliged to pay to the administrator is set and an administrator is appointed.¹⁹¹ The administrator then collects the payments in terms of the order and distributes them *pro rata* amongst creditors.¹⁹² Once all the payments are made, the administrator lodges a certificate at the clerk of the court whereupon the order lapses.¹⁹³

The administration procedure is only available to estates whose debts or claims do not exceed R50 000.¹⁹⁴ Therefore, a debtor who cannot show advantage to creditors to apply for the sequestration of his estate is automatically excluded from applying for an administration order when his liabilities exceed R50 000. It is also not an ideal procedure for debtors with no income and no assets because the order's debt repayment plans are made on the considerations of the debtor's ability to pay in instalments. No provision is made for a statutory discharge of debts since the order only lapses once all the listed creditors and the administration costs are fully paid.¹⁹⁵ Furthermore, there is also no maximum time limit set for the lapse of the administration order. It follows therefore that debtors may be subject to the "debt trap" for an indefinite long period.¹⁹⁶

¹⁸⁹ S 74(1) read with s 74A(1) and (5) of the MCA.

¹⁹⁰ *Ibid.*

¹⁹¹ Ss 74C(1)(a) and 74E.

¹⁹² S 74J.

¹⁹³ S74U.

¹⁹⁴ S 74(1).

¹⁹⁵ S 74U.

¹⁹⁶ Boraine and Roestoff "Fresh Start Procedures for Consumer Debtors in South African Bankruptcy Law" 2002 *International Insolvency Review* 1 2.

Moreover, future debts are also not included in the administration order.¹⁹⁷ Debtors may, therefore, be required to make other arrangements for such repayments. In practice, it is observed that most administration orders are unsuccessful because debtors do not keep up with the regular payments.¹⁹⁸ Concern has been raised regarding a high risk of misappropriation of funds by administrators because the MCA does not provide for their regulation nor are they required to be members of a certain profession where they are bound by the code of ethics.¹⁹⁹

The Law Reform Commission has proposed that a new section 74X should be inserted in the MCA.²⁰⁰ The clause provides for a pre-liquidation composition in terms of which if the debtor proves an inability to pay debts and the composition is accepted by the majority in number and in value of the voting concurrent creditors, it is binding on all creditors. In the 2010 version of the Insolvency Bill, it is proposed that the pre-liquidation composition be included in the new unified insolvency Act and not in the MCA.²⁰¹ A discharge from debts is not inherent from the provision therefore consensus amongst creditors is essential to provide a debtor with debt relief.²⁰² Taking into account other proposals, a remarkable development in this regard was made by the Centre of Advanced Corporate and Insolvency Law²⁰³ at the University of Pretoria in May 2011 when it proposed that section 74 must provide for a discharge after eight years subject to specified conditions.²⁰⁴

¹⁹⁷ Van Loggerenberg *Jones and Buckle: The Civil Practice of the Magistrates' Courts in South Africa* (2011) 306-307. See also *Cape Town Municipality v Dunne* 1964 1 SA 741 (C) 746.

¹⁹⁸ Boraine and Roestoff 2000 *Obiter* 241 263.

¹⁹⁹ Kelly-Louw *et al The Future of Consumer Credit Regulation Creative Approaches to Emerging Problems* (2008) 199.

²⁰⁰ CI 118 of the 2000 Bill.

²⁰¹ CI 118 of the unofficial working copy of the 2010 Insolvency Bill (June 2010). See in general Roestoff and Coetzee 2012 *SA Merc LJ*.

²⁰² Roestoff and Coetzee 2012 *SA Merc LJ*.

²⁰³ The Centre was instructed by the Standing Advisory Committee on Company Law in April 1998 to investigate the reform of the administration procedure in July 2000 but its actions were suspended pending the promulgation of the NCA.

²⁰⁴ Roestoff and Coetzee 2012 *SA Merc LJ*.

3 3 2 Debt Review

The NCA was promulgated to promote responsibility in the credit market by introducing measures to prevent over-indebtedness of consumers and to prevent reckless credit granting.²⁰⁵ It achieves this by providing a debt reorganisation measure for over-indebted debtors, thereby affording them debt relief. The debtor who is over-indebted may apply to be declared as such and be placed under debt review for his debts to be eventually rescheduled and to enable him to pay the creditors over an extended period of time.²⁰⁶ The effect of reckless credit agreements may also be set aside, consequently granting debt relief to the debtors.²⁰⁷

In terms of section 79, a debtor is over-indebted when he is unable to satisfy all his obligations under all his credit agreements in a timely manner having regard to his financial means, obligations and history of debt repayment. On the other hand, section 80 makes provision for two instances of reckless credit:

1. If the creditor failed to conduct an assessment as required by the Act irrespective of what the outcome of such an agreement might have been;²⁰⁸ or
2. Where the creditor conducted an assessment but concluded a credit agreement with the debtor notwithstanding the fact that the information available to him indicated that the debtor did not generally understand or appreciate the risks, costs or obligations under the proposed credit agreement; or if entering into the credit agreement would make the debtor over-indebted.²⁰⁹

²⁰⁵ S 3 of the NCA.

²⁰⁶ S 86.

²⁰⁷ Ss 83(2) and 84(1).

²⁰⁸ S 80(1)(a).

²⁰⁹ S 80(1)(b)(i)-(ii).

However, debt relief under the NCA is of limited application as it only applies to credit agreements defined therein.²¹⁰ Credit agreements where the creditors have proceeded to take steps to enforce them in terms of section 130(1) are also excluded from the debt review procedure.²¹¹ The NCA also does not provide a discharge from debt to over-indebted debtors. In *Collett v FirstRand Bank*²¹² it was stated that the purpose of debt review is not to relieve the debtors of their obligations but to achieve a debt re-arrangement.²¹³ It must be mentioned that there is no maximum repayment period prescribed in the NCA, with the effect that debtors may be subject to the order indefinitely. Roestoff *et al*²¹⁴ suggest that the debt counselling process is not functioning effectively thereby denying many debtors the protective measures afforded by the NCA. This, *inter alia* is related to the fact that the effectiveness of debt review is dependent on the co-operation between debtors, creditors and debt counselors.²¹⁵ It is indicated that creditors do not take responsibility for the negative consequences of credit granting and they continue pursuing the debt regardless of the fact that debt review precludes credit providers from taking legal action to enforce the debt.²¹⁶ Furthermore, the debt counselors do not properly inform the debtors of the whole process of debt review and the consequences thereof.²¹⁷

While it may appear as though the debtors have a choice between these debt relief measures, it is not always case in practice. In the *Ford* case²¹⁸ the debtors chose to have their estates sequestrated through the process of voluntary surrender rather

²¹⁰ See ss 4(1) and 8.

²¹¹ S 86(2).

²¹² 2011 4 SA 508 (SCA) 514.

²¹³ See also *First Rand Bank Ltd v Olivier* 2009 3 SA 353 (SE) 357.

²¹⁴ Roestoff *et al* "The Debt Counseling Process – Closing the Loopholes in the National Credit Act 34 of 2005" 2009 *PER* 247 247-248.

²¹⁵ S 86(5)(a) provides that debtors and creditors must "comply with reasonable requests by the debt counselors to facilitate the evaluation of the consumer's state of indebtedness and the prospects for responsible debt-rearrangement". See also Roestoff *et al* 2009 *PER* 247 248.

²¹⁶ Roestoff *et al* 2009 *PER* 247 250.

²¹⁷ *Idem* 359.

²¹⁸ *Supra*.

than have their credit agreements dealt with under debt review. The court held that an application for voluntary surrender should not be granted when the machinery of the NCA was the appropriate mechanism to be used.²¹⁹ It was furthermore suggested that the insolvents whose misfortunes arise out of a credit agreement would be well advised to take into account the policy and objects of the NCA before opting to apply for the voluntary surrender in terms of the Act.²²⁰ This was stated regardless of the applicants testimonies that debt repayment plans would not be financial practicable.²²¹ The court also rejected an argument that the applicants had a constitutional right to the acceptance by the court of the surrender of their estates by confirming the principle in *Ex parte Pillay; Mayet v Pillay*²²² that the primary object of the machinery of voluntary surrender is not the relief of harassed debtors.²²³ An applicant for voluntary surrender must satisfy the court that the acceptance of the surrender in question will be to the advantage of creditors.

Similarly, in *Investec Bank Ltd v Mutemeri*²²⁴ the respondent debtors opposed an application for compulsory sequestration of their joint estate. The ground of sequestration involved debts based on credit agreements under review in terms of section 86 of the NCA. The issue before court was therefore whether an application for the sequestration of the debtor's estate based on a credit agreement is a proceeding to enforce a credit agreement within the meaning of section 130(1). The court held that an application for sequestration is not a process where the creditor enforces payment of a debt and therefore not a legal proceeding that is barred by the debt review process in terms of section 129.²²⁵ The debtors' estate was therefore compulsorily sequestrated despite the fact they had opted for an alternative debt

²¹⁹ *Ibid* 384.

²²⁰ *Idem* 382.

²²¹ *Ibid*.

²²² 1955 2 SA 309 (N) 311.

²²³ 383.

²²⁴ 2010 1 SA 265 (G).

²²⁵ *Idem* 266.

relief measure. This decision was confirmed in *Naidoo v ABSA Bank Ltd*²²⁶ where it was further held that a credit provider need not comply with section 129(1)(a)²²⁷ before instituting sequestration proceedings against the debtor.

3 4 Conclusion

It is evident from the above discussion that in all sequestration proceedings, the applicant must prove an advantage that will accrue to the general body of creditors. It has been held that there will be no advantage for creditors if no dividend or only a negligible dividend is available to creditors after meeting sequestration costs.²²⁸ The sequestration order is only granted if the court is satisfied that there is a reasonable prospect that the creditors will receive a financial benefit. Proving all the requirements outlined in the Act is not the only criteria for the granting of the sequestration order because the courts still have to exercise their judicial discretion.²²⁹ The applicants are therefore expected to be candid by disclosing all material facts. Where the property valuations accompany an application, they must demonstrate an acceptable measure of expertise and that the property was individually inspected for purposes of the valuation.²³⁰

The debtors sometimes rely on friendly sequestrations as a form of debt relief and to escape the degree of proof regarding the advantage of creditors in voluntary

²²⁶ 2010 4 SA 597 (SCA) 601-602.

²²⁷ S 129(1)(b) provides that a credit provider may not commence any legal proceeding to enforce the credit agreement before providing the s 129(1)(a) notice and meeting any further requirements in s 130. S 129(1)(a) stipulates that where the debtor is in default, the creditor may notify the debtor in writing with a proposal to refer the credit agreement to a debt counselor, alternative dispute resolution agent, consumer court or Ombud with jurisdiction. See in general in respect of the effect of the NCA on sequestration Maghembe "The Appellate Division Has Spoken – Sequestration Proceedings Do Not Qualify as Proceedings to Enforce a Credit Agreement under the National Credit Agreement 34 of 2005: *Naidoo v ABSA Bank* 2010 4 SA 597 (SCA)" 2011 *PER* 171; Boraine and Van Heerden 2010 *PER* 84; Van Heerden and Boraine "The Interaction Between the Debt Relief Measures in the National Credit Act 34 of 2005 and Aspects of Insolvency Law" 2009 *PER* 22.

²²⁸ See par 3 2 1.

²²⁹ *Ibid.*

²³⁰ See par 3 2 1.

surrender.²³¹ However, friendly sequestrations are also approached with care to prevent abuse of the process and ensure an advantage to creditors.²³² This inevitably means that insolvent debtors who cannot prove an advantage to creditors cannot successfully get their estates sequestrated. Consequently, the advantage requirement creates a stumbling block for the debtors wishing to use the sequestration process as a debt relief measure and force a discharge of their debts on their creditors.²³³

As pointed out above, the Law Reform Commission has proposed in the 2000 Bill that the advantage for creditors' requirement be retained in the Act with regard to all liquidation applications.²³⁴ One of the submissions in support of this proposal is the fact that the sequestration process is expensive and should only be resorted to if it is cost-effective. For the overburdened debtors who are unable to prove an advantage for creditors, it is suggested that relief be sought in the alternative debt relief measures.²³⁵ However, as indicated above,²³⁶ alternative debt relief measures are of limited application and have a number of inherent deficiencies. Administration orders are only available to debtors whose liabilities do not exceed R50 000 and who can pay debts in instalments.²³⁷ They also do not provide debt relief by providing a debtor with a discharge from debts. Debt review is also of limited application and does not seek to address over-indebtedness by providing a statutory discharge.²³⁸ In sum, alternative debt relief measures do not provide a sufficient alternative to sequestration. The debtors are therefore left without a choice but to rely on the sequestration process provided, they are able to prove advantage to creditors. To provide debt relief to debtors who are excluded from the

²³¹ *Idem* par 3 2 2.

²³² *Ibid.*

²³³ Roestoff and Renke "Solving the Problem of Overspending by Individuals: International Guidelines" 2003 *Obiter* 1 13.

²³⁴ Par 3 2 3.

²³⁵ See par 3 2 2.

²³⁶ Par 3 3.

²³⁷ See par 3 3 1.

²³⁸ *Idem* par 3 3 2.

liquidation process because of the inability to prove an advantage to creditors, the Law Reform Commission has proposed that a pre-liquidation composition be inserted in the new Insolvency Act.²³⁹ However, the majority of the creditors voting must agree for the debtor to obtain relief because it is not inherent from the provision.²⁴⁰

²³⁹ Par 3 3 1.

²⁴⁰ *Ibid.*

CHAPTER 4

Comparative Survey

4 1 Introduction

Consumer over-indebtedness is a worldwide phenomenon. Bearing that in mind, most countries have adopted remedial measures to curb it and ensure that the debtors are given a clean slate from debt.²⁴¹ As pointed out above,²⁴² South African debtors only have a possibility of obtaining a discharge when their estates are sequestrated and they are subsequently rehabilitated. However, debtors who cannot prove an advantage to creditors will not be able to obtain such relief. In this chapter, a broad comparative survey will be done in order to ascertain how the United States of America, England and Wales, Canada and the Netherlands' legal systems have addressed the challenge of balancing debtors' and creditors interests. The purpose of this chapter is not to give a detailed discussion of the insolvency systems of the countries discussed. It is merely intended to indicate the philosophy behind the several systems and the alternatives insolvent debtors have with a possibility of obtaining a discharge from debt.

4 2 United States of America

The American bankruptcy laws are said to have their roots in English bankruptcy laws, which historically provided for creditor remedies only and involved imprisonment of debtors who tried to avoid their financial obligations.²⁴³ The law was designed to prevent fraudulent acts by the debtors and did not provide for the

²⁴¹ Efrat "Global Trends in Personal Bankruptcy" 2002 *American Bankruptcy Law Journal* 81 81. See also Huls "Alternatives to Personal Bankruptcy" 289 in Hörmann *Consumer Credit and Consumer Insolvency Perspectives for Legal Policy from Europe and the USA* (1986).

²⁴² Par 2 3 and 2 4.

²⁴³ Boraine and Roestoff 2000 *Obiter* 33 36.

rehabilitation of the honest but unfortunate debtor.²⁴⁴ This position changed when the discharge concept appeared in English law in the early eighteenth century and at the time of the American constitutional convention, compliant debtors had the option of a discharge and retained some property.²⁴⁵ Following subsequent developments in an attempt to establish uniform federal bankruptcy legislation, the United States bankruptcy system is currently regulated by the *1978 Bankruptcy Reform Act*.²⁴⁶ Sullivan *et al*²⁴⁷ explain the whole evolution of the American bankruptcy statutes as

“more than a series of brief, legislative fiats, alternatively pro-creditor and pro-debtor, accompanied by a growing awareness that a uniform compromise law would better serve everyone.”

The debtors seeking relief from their debts may have a remedy in terms of one of the two procedures under the *Code*, namely, the liquidation of assets in chapter 7 and the rescheduling of debt in chapter 13. In the former, the debtor liquidates his non-exempt assets and the proceeds are distributed amongst the creditors.²⁴⁸ The bankruptcy petition can be initiated both voluntarily by the debtor and involuntarily by the petitioning creditor. There is no need to prove insolvency or any advantage to creditors. All that is required is that the debtor qualifies as a debtor in terms of section 301. An individual only qualifies as a debtor if he has, during the 180-day period preceding the date of filing of the Chapter 7 or Chapter 13, received from an approved credit counselling agency a briefing outlining the opportunities for available credit counselling and assistance in performing a related budget analysis.²⁴⁹ Under the chapter 13 procedure, the debtor has the option of retaining

²⁴⁴ Lewis “Can’t Pay Your Debts, Mate? A Comparison of the Australian and American Personal Bankruptcy Systems” 2002 *Bankruptcy Development Journal* 297 299.

²⁴⁵ *Idem* 300.

²⁴⁶ Hereafter “the *Code*” as it is commonly referred to.

²⁴⁷ Sullivan Warren and Westbrook “Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors’ Data” 1983 *Wisconsin Law Review* 1091 1099; Boraine and Roestoff 2000 *Obiter* 33 39-40.

²⁴⁸ Lewis 2002 *Bankruptcy Development Journal* 297 305.

²⁴⁹ S 109(h).

all his assets and to obtain a court-approved payment plan to the creditors for a period of three to five years.²⁵⁰ The granting of the discharge is postponed until the plan is complete.²⁵¹ It is required that the debtor must pay the creditors at least as much as they would have received in a chapter 7 liquidation case.²⁵²

Prior to the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*²⁵³ amendments, a debtor had an open access to bankruptcy and could freely choose between a chapter 7 bankruptcy and the chapter 13 plan. However, to prevent abuse of the Chapter 7 procedure, the *BAPCPA* limits it to debtors who cannot afford to pay all their debts under Chapter 13. The court can now dismiss a Chapter 7 case or change it to a Chapter 13 plan upon finding abuse under either the ‘means test’ or other grounds including bad faith.²⁵⁴ The ‘means test’ provides that a debtor may not be eligible for a discharge when his median income exceeds the state median income, regardless of the debt amount.²⁵⁵ Before filing for bankruptcy, the debtor files a statement of current income. The debtor’s median income is then calculated and compared to the median income for a similarly sized family in the state.²⁵⁶ If it exceeds the median income for the state, the means test must be satisfied for a debtor to be eligible to file a chapter 7 bankruptcy or the chapter 13 plan.²⁵⁷ This is aimed at ensuring that the debtors with the gross income above average repay the creditors in full.²⁵⁸ The debtors are also no longer free to propose their own repayment plans under Chapter 13 because the “means test” determines the debtor’s disposable income which must be used to repay the creditors.²⁵⁹

²⁵⁰ S 1322.

²⁵¹ S 1328(a).

²⁵² S 1325(a)(3).

²⁵³ Hereafter “*BAPCPA*”.

²⁵⁴ S 707(b)(2)(A) and (3)(a).

²⁵⁵ S 707(b)(2).

²⁵⁶ S 707(b)(6).

²⁵⁷ Calitz “Developments in the United States’ Consumer Bankruptcy Law: A South African perspective” 2007 *Obiter* 397 405.

²⁵⁸ *Ibid.*

²⁵⁹ White “Bankruptcy Reform and Credit Cards” 2007 *Journal of Economic Perspectives* 175 175.

The focus in the United States is not only on using bankruptcy as a collective-debt procedure for the creditors groups but also on upholding the desires of the debtor's groups.²⁶⁰ Freely-available and immediate procedural discharges from debt for the 'honest' individual debtors and the right to exempt property have always been the system's theoretical foundation.²⁶¹ Frey *et al*²⁶² point out that during the 1898 *Bankruptcy Act*²⁶³ era, it has been observed that

“no significant connection existed between payments to creditors and the eligibility for discharge. Deserving debtors received discharges notwithstanding that there were no dividends for creditors.”

In *Local Loan Co v Hunt*²⁶⁴ it was stated that bankruptcy

“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.”

It is worth noting that although the discharge under the *Code* is broad, it has never been without an unlimited effect. Section 523(a) provides for certain individual debts which may be non-dischargeable as well as debts owed to the creditors who did not receive proper notice of bankruptcy.²⁶⁵ Some debtors are also denied a discharge upon proof of a statutory ground in section 727(a) evidencing the debtor's failure to cooperate in connection with the bankruptcy case.

²⁶⁰ Martin “Common-Law Bankruptcy Systems: Similarities and Differences” 2003 *American Bankruptcy Institute Law Review* 367 367-368; Ho and Chan “Is Debtor-in-Possession Viable in Hong Kong?” 2010 *Common Law World Review* 204 208. See also Roestoff and Renke 2003 *Obiter* 1 2.

²⁶¹ Tabb “The Death of Consumer Bankruptcy in the United States?” 2001 *Bankruptcy Development Journal* 1 6.

²⁶² Frey McConnico and Frey *An Introduction to Bankruptcy Law* (1990) 1 9. See also Boraine and Roestoff 2000 *Obiter* 33 40.

²⁶³ The predecessor Act to the *Code*. It was the second bankruptcy Act designed to be permanent in the US, after repealing the *Bankruptcy Act of 1867*. For an in-depth discussion of the US bankruptcy law developments see Boraine and Roestoff 2000 *Obiter* 33

²⁶⁴ 1934 292 US 234 244. See also Lewis 2002 *Bankruptcy Development Journal* 297 331.

²⁶⁵ Tabb 2001 *Bankruptcy Development Journal* 1 7-8.

4 3 England and Wales

The treatment of over-indebtedness in England and Wales includes not only bankruptcy but also court administration orders, informal moratoria and repayment plans where the debtors have a possibility of discharge from debts.²⁶⁶ The bankruptcy procedure is provided for in the *1986 Insolvency Act*, in terms of which the petition to the bankruptcy court may be made by the debtor personally or by any creditor whom the debtor owes at least £750.²⁶⁷ For an order to be granted, the insolvent person to be declared bankrupt must qualify as a debtor. The definition of a debtor is ascertained with reference to the type of the bankruptcy petition. In voluntary bankruptcy petitions, the sole criterion of inability to pay debts must be established.²⁶⁸ But for the involuntary petitions, the creditor must prove that the debt or liability owed to him is one which admits of legal enforceability to give rise to an award of the pecuniary damages, or specific delivery or transfer of property with a quantifiable value.²⁶⁹ Furthermore, the debtor must be unable to pay the debt specified in the statutory demand.²⁷⁰ Once the order is granted, a debtor is conferred the status of being bankrupt. The bankruptcy status is only released upon gaining a discharge or when the order is annulled.²⁷¹

The discharge of the bankrupt debtor from debt normally takes place automatically a year after the commencement of bankruptcy and under certain circumstances, in less than a year.²⁷² Where the obligations are not likely to be completed in one year, the official receiver or trustee may apply to court for an order suspending the

²⁶⁶ Ramsay "Functionalism and Political Economy in the Comparative Study of Consumer Insolvency: An Unfinished Story from England and Wales" 2006 *Theoretical Inquiries in Law* 625 630; Adler "The Overseas Dimension: What Can Canada and the United States Learn from the United Kingdom?" 1999 *Osgoode Hall Law Journal* 415 420.

²⁶⁷ S 267(4) of the *Insolvency Act*.

²⁶⁸ S 272(1).

²⁶⁹ S 267(2).

²⁷⁰ Ss 267(2)(c) and 268.

²⁷¹ Fletcher 47.

²⁷² S 279(1) and (2).

running of time towards the gaining of an automatic discharge.²⁷³ If the bankrupt had committed criminal offences in terms of the *Insolvency Act*, such may be taken into account in determining whether and when the bankrupt will obtain a discharge.²⁷⁴

Debtors who have no income or no assets can also apply to the official receiver for a debt relief order.²⁷⁵ For the order to be granted, it is required that the debtor's assets should be less than £300 and if he owns a vehicle, its value should be less than £1 000.²⁷⁶ The maximum disposable income should also be less than £50 after paying normal household expenses and the total liabilities should not exceed £15 000.²⁷⁷ While the order is in force, the debtor is under an obligation to disclose every material fact to the official receiver and is only allowed to apply for this order once in every six years.²⁷⁸

4 4 Canada

Consumer bankruptcy in Canada is regulated by the *Bankruptcy and Insolvency Act R.S., 1985*.²⁷⁹ Under the *BIA*, the insolvent person can become bankrupt in three ways. Firstly, when the insolvent on own accord and with leave of the court makes an assignment in the prescribed form, for the general benefit of creditors of all his property.²⁸⁰ The offer to file an assignment is only refused by the official receiver when it is not in the prescribed form and not accompanied by the sworn statement.

²⁷³ S 279(3).

²⁷⁴ Fletcher 48.

²⁷⁵ S 251A(1) and B(1).

²⁷⁶ Sch 4ZA(8).

²⁷⁷ Sch 4ZA(6) and (7).

²⁷⁸ S 251J read with sch 4ZA(5).

²⁷⁹ Hereafter "the *BIA*". For purposes of the *BIA*, a distinction is made between the insolvent and bankrupt debtor. S 2 defines a "bankrupt" as a person who has made an assignment or against whom a bankrupt order has been made or the legal status of that person. An "insolvent" is a person who cannot extinguish his liabilities to creditors when they are due and his assets are not sufficient for such payment and may subsequently become bankrupt.

²⁸⁰ S 49(1) and (2) of the *BIA*.

However, the official receiver can cancel the assignment after giving five days notice, if he is unable to find a licensed trustee willing to act.²⁸¹

Secondly, an insolvent person may be involuntarily declared bankrupt when one or more creditors file in court an application for a bankruptcy order, alleging that the debtor owes him at least \$1 000 and that the debtor committed an act of bankruptcy within six months preceding the filing of the application.²⁸² At the hearing of the application, proof of the facts alleged in the application and of the service of the application to the relevant parties is required. If the court is satisfied with the proof, the order may be granted and a licensed trustee is appointed.²⁸³

Thirdly, where the insolvent person's proposal in terms of section 50 read with section 53 and 54,²⁸⁴ is not accepted by his creditors or where the court declared it to be deemed to have been refused by creditors, the insolvent is deemed to have made an assignment.²⁸⁵ However, acceptance by the creditors and a subsequent approval by the court of the proposal will nullify the bankruptcy, provided it was made after bankruptcy.²⁸⁶ This renders the proposal binding on all creditors in respect of their claims. However, it does not release a debtor from any particular debt unless the proposal explicitly provides for the compromise of that debt.²⁸⁷

²⁸¹ S 49(5).

²⁸² See s 43 which confers creditors a right to petition if the debtor commits any of the acts of bankruptcy in s 42(1)(a)-(j).

²⁸³ S 43(6) and (9).

²⁸⁴ S 50 provides that an insolvent may make a proposal to the creditors proposing, amongst others, terms for the treatment of their claims and the extent to which the claims would be paid under the proposal. S 53 states that creditors who have proved their claims may assent or dissent from the proposal. S 54 stipulates that creditors may resolve to accept or refuse the proposal as made or as altered at any meeting of creditors.

²⁸⁵ S 61(2)(a).

²⁸⁶ S 61(1).

²⁸⁷ See S 62(2.1).

Like the American bankruptcy system, the Canadian bankruptcy system also shares the common philosophy that the honest but unfortunate debtor should be allowed to make a fresh start.²⁸⁸ It is very easy for a Canadian consumer to go bankrupt. For instance, once the assignment's paperwork is in order, the official receiver cannot refuse to accept it.²⁸⁹ Equally, in the bankruptcy application, the only requirements to be proved are that the consumer is insolvent, his debts amount to \$1 000 or more and that an act of bankruptcy has been committed.²⁹⁰ When the bankruptcy order is granted, the bankruptcy court makes the final decision about the discharge of the debtor's pre-bankruptcy debts.²⁹¹ This is done by relying also on the trustee's recommendation indicating whether or not a discharge should be conditional. The recommendation is made having regard to the debtor's compliance with section 68 requirements for the remittance of the bankrupt's surplus income, the total amount paid over by the debtor to the estate and whether the debtor could have made a viable proposal under Part III, Division II of the *BIA*.²⁹² If the debtor could have made a viable proposal and the trustee reports so to the bankruptcy court, the court will not be able to grant the debtor an unconditional discharge.²⁹³ Depending on whether or not the bankrupt has been declared bankrupt at one time, section 168.1 of the *BIA* makes provision for the automatic discharge of a bankrupt on the expiry of the period ranging between nine to 36 months after the date of bankruptcy.

²⁸⁸ Ziegler "The Philosophy and Design of Contemporary Consumer Bankruptcy Systems: A Canada-United States Comparison" 1999 *Osgoode Hall Law Journal* 205 236-237.

²⁸⁹ *Idem* 217.

²⁹⁰ *Ibid.*

²⁹¹ *Idem* 237.

²⁹² S170.1(1), (2)(a)-(c). This section and s 68 were introduced as a form of means testing by the 1997 amendments to the *BIA* to compel debtors with surplus income to repay debtors over three years before getting a discharge. For a detailed discussion of the Canadian "means test", see Ziegler "What Can the United States Learn from the Canadian Means Testing System?" 2007 *University of Illinois Law Review* 195 and Braucher "Means Testing Consumer Bankruptcy: The Problem of Means" 2002 *Fordham Journal of Corporate & Financial Law* 407.

²⁹³ S 170.1(2)(c).

Addressing the argument that there may be abuse of the bankruptcy system since going bankrupt is too easy and bankruptcy has lost its stigma, Ziegler²⁹⁴ contends that no independent statistical studies are cited to support such allegations. He indicates that there is a considerable low percentage of objections from the Canadian creditors in the debtors' discharge cases.²⁹⁵ In *Westmore v McAfee*²⁹⁶ the criteria of the need to balance the public interest with the debtor's need to be rehabilitated and start a new economic life was set out as follows:

“[R]egard must be had to the interests of the public, the bankrupt and the creditors. [I]t is undesirable that a citizen should be weighed down by debt as to be incapable of carrying out the regular duties of citizenship; ... as one of the object of the BIA is to enable an honest debtor to secure a discharge to get on with his life ... and the success of any bankruptcy system depends on the administration of the discharge provisions.”

In addition to bankruptcy, an insolvent Canadian debtor seeking debt relief has other options under the *BIA* of either selecting a statutory consolidation of his debts under Part X or making a proposal to his creditors under Part III, Division II.²⁹⁷ Another route open and strongly supported by the Canadian creditors is where the debtor seeks the assistance of a non-profit debt repayment agency and credit counselling service thus acquiring a manageable financial position.²⁹⁸

4 5 Netherlands

The main source of bankruptcy law in the Netherlands is the Bankruptcy Act known as the “*Faillissementswet*”.²⁹⁹ It makes provision for three insolvency proceedings, namely, the suspension of payment, the bankruptcy process and the

²⁹⁴ Ziegler 1999 *Osgoode Hall Law Journal* 205 232.

²⁹⁵ *Idem* 234.

²⁹⁶ 1988 23 BCLR 273; See also Ziegler 1999 *Osgoode Hall Law Journal* 205 236-237.

²⁹⁷ See s 217 which provides for the orderly payments of debts in Part X and s 66.12 for the Part III, Division II Proposal.

²⁹⁸ Ziegler 1999 *Osgoode Hall Law Journal* 205 249.

²⁹⁹ Hereafter the “Fw”.

debt reorganisation of natural persons.³⁰⁰ The suspension of payment procedure provides a debtor with an opportunity to reorganise new repayment plans. It is available to the debtor on request, if he foresees that he will not be able to satisfy his creditor's claims when they fall due.³⁰¹ However, it is not available to natural persons who do not conduct an independent profession or business.³⁰² The bankruptcy mechanism on the other hand is placed in motion when the debtor has stopped payment of his debts, with the effect that all his assets are liquidated for the advantage of his creditors.³⁰³ A bankruptcy petition can be filed voluntarily by the debtor himself, involuntarily by one or more creditors or by the public prosecutor in exceptional cases for the public interest.³⁰⁴ All that is required is that the debtor must be a Netherlands resident and that he has ceased to pay his debts. Where it is the creditor applying, *prima facie* evidence of his claim must be provided and that there is at least one other creditor.³⁰⁵ Once all the requirements for bankruptcy under the *Fw* are fulfilled, the court will always declare the debtor bankrupt.

Before the *Wet Schuldsanering Natuurlijke Personem* was included in the *Fw* in 1998, the *Fw* did not provide for a discharge from debts. The debtor was therefore subject to life-long liability of debts. The inclusion of the *Wet Schuldsanering Natuurlijke Personem* thus constitutes the landmark development in the history of the Netherlands bankruptcy system, taking into account the fact that the Netherlands was known for having an “extremely conservative” approach towards

³⁰⁰ Declercq *Netherlands Insolvency Law: The Netherlands Bankruptcy Act and the Most Important Legal Concepts* (2002) 1.

³⁰¹ *Idem* 2.

³⁰² INSOL Europe “Insolvency proceedings in the Netherlands” at

http://www.google.co.za/url?sa=t&rct=j&q=insolvency%20proceedings%20in%20the%20netherlands&source=web&cd=1&cad=rja&sqi=2&ved=0CB4QFjAA&url=http%3A%2F%2Fwww.insol-europe.org%2Fdownload%2Ffile%2F827&ei=00CDUKngHcO5hAe894HoDg&usg=AFQjCNGYbHXK7cMy_0We9GIVMb-EPjatuA

(accessed 2012-09-27) 6. Hereafter “INSOL Netherlands”.

³⁰³ Declercq 59.

³⁰⁴ INSOL Netherlands 1.

³⁰⁵ Declercq 63.

the debtors.³⁰⁶ It provides for the debt reorganisation of natural persons, with the aim of liquidating the debtor's assets for the benefit of creditors and the immediate discharge from debts after meeting the obligations under the debt reorganization.³⁰⁷ It also serves the purpose of reducing the number of bankruptcies of natural persons and to increase the willingness of the natural persons' creditors to conclude settlements with them.³⁰⁸

A petition for the debt reorganisation scheme must include a reasoned statement issued by the executive body of the authorities of the municipality of the residence of the debtor, explaining why there is no realistic possibility of an extra-judicial debt rearrangement and the extent to which the applicant debtor is able to settle his debts.³⁰⁹ If the reorganisation order is granted, the court appoints an administrator. The provisions of the order are also set out, which may include an obligation to find a job.³¹⁰ At a meeting of creditors, the debtor may propose a composition and if it is accepted, the scheme ends.³¹¹ If it is not accepted, the scheme only terminates in three years. However, it may be extended to a maximum of five years, considering whether or not the debtor has fulfilled all the obligations under the scheme. If all obligations are met, the debtor is granted a fresh start.³¹²

4 6 Conclusion

It is trite that the systems adopted by the countries discussed in this chapter allow both creditors and debtors to commence bankruptcy proceedings. Some action on the part of the debtor to disclose pertinent financial matters when filing for the

³⁰⁶ Roestoff and Renke 2003 *Obiter* 1 3.

³⁰⁷ Declercq 3.

³⁰⁸ *Ibid.*

³⁰⁹ INSOL Netherlands 6.

³¹⁰ *Idem* 7.

³¹¹ *Ibid.*

³¹² *Ibid.*

bankruptcy relief is also required. No advantage to creditors is required in bankruptcy petitions and going bankrupt is reasonably easy. Most significant is the fact that the debtors have a variety of mechanisms through which debt relief in a form of a discharge is consequent. The United States bankruptcy system for example, strikes a balance between both creditors and debtors by making provision for the liquidation of assets of the debtor and repayment plans for the benefit of creditors, followed by the honest debtor's discharge from debts. Although the United States does not specifically require proving the advantage of creditors, abuse by fraudulent debtors of the Chapter 7 liquidation has rendered going bankrupt difficult. As pointed above,³¹³ the fresh start policy is now qualified by the *BAPCPA* amendments. Before relief is sought, the debtor has to undergo the 'means test' to determine the eligibility of Chapter 7 bankruptcy. If a debtor can afford a Chapter 13 payment plan, relief can only be obtained from there.

In England and Wales, high reliance of debt relief is placed on alternative debt enforcement by the courts. Debtors are advised to obtain relief from court administration orders and other repayment plans and to only resort to bankruptcy as a last resort remedy.³¹⁴ The bankruptcy procedure is only available to debtors with liabilities exceeding £750, with an automatic discharge within a year. Debt relief is also extended to no income and no assets debtors, provided their assets and liabilities are within the prescribed limits.³¹⁵

The Canadian jurisdiction provides a debtor with three options of going bankrupt, which are characterised by the least formalities.³¹⁶ It operates on the common philosophy that the honest but unfortunate debtor should be able to make a fresh

³¹³ See par 4 2.

³¹⁴ *Idem* par 4 3.

³¹⁵ *Ibid.*

³¹⁶ See par 4 4.

start. The *BIA* therefore makes provision for an automatic discharge from debts within three years.³¹⁷ At the same time, bankrupts with surplus income are compelled to relinquish it by repaying their creditors, thus striking a balance between the debtors' and creditors' interests.³¹⁸ A debtor also has other debt repayment plans under the *BIA* making it easy to obtain a manageable financial position.

In the Netherlands, a debtor weighed down by debt has an option between the bankruptcy process and the reorganisation plans under the *Fw*.³¹⁹ All that is required to initiate a bankruptcy process is proof of residence in the Netherlands and the stopping of payment of debts. The debtor's assets are then liquidated for the benefit of creditors. No discharge from debt is granted to the bankrupt. One of the consequences of bankruptcy is therefore long-term liability of debts.³²⁰ Relief can however be obtained from the debt reorganisation plan which was included in the *Fw* in 1998. This inclusion represents a shift from a 'typical' civil law bankruptcy system in favour of creditors for years to a system more accommodative of the debtors' interests.³²¹ Once all the obligations under the plan are fulfilled, the debtor obtains a discharge.

³¹⁷ *Ibid.*

³¹⁸ *Ibid.*

³¹⁹ See par 4 5.

³²⁰ *Ibid.*

³²¹ *Ibid.*

CHAPTER 5

Conclusion

This dissertation sought to undertake a situational analysis of the advantage requirement on sequestration applications. It also investigated the alternative debt relief measures under the MCA and the NCA that the debtors seeking relief may have recourse to. As indicated throughout the dissertation, one of the consequences of the sequestration process in the Act is debt relief, because the insolvent debtor may be rehabilitated. The effect of rehabilitation is that sequestration is terminated and all pre-sequestration debts are discharged.³²² However, the process of obtaining a sequestration order is characterised by technical formalities,³²³ and furthermore requires proof of the advantage to creditors. Most studies describe the advantage requirement as a gateway to bankruptcy,³²⁴ a state of affairs that cannot be undermined.

South Africa has a hybrid legal system as it contains traces of both the civil law and common law systems. Chapter 2 dealt with the historical development of the South African insolvency law. Earlier laws were associated with embarrassment to the insolvent debtor and were only aimed at repaying the creditors' claims.³²⁵ Today, these laws have evolved to debtor-friendly procedures aimed at realising the debtor's estate for the benefit of creditors and a discharge of a debtor from debt if rehabilitated.³²⁶ The 1916 Act provided two ways in which a sequestration order can be obtained, namely voluntary surrender and compulsory sequestration. It also introduced the concept of the advantage of creditors in the South African insolvency

³²² See par 2 4.

³²³ *Idem* par 2 3.

³²⁴ *Idem* par 2 5.

³²⁵ *Idem* par 2 2.

³²⁶ *Idem* 2 3 and 2 4.

law as it required proof of an advantage to creditors in compulsory sequestration cases but not in voluntary surrender.³²⁷ This was the most liberal piece of legislation to South African debtors because it also provided for an assignment of the debtor's estate for the benefit of creditors. Once the majority of creditors voting agreed, the debtor immediately obtained a discharge from debts.³²⁸

In terms of the Act, the advantage of creditors must be proved in all applications for an order sequestrating a debtor's insolvent estate to be granted.³²⁹ Establishing this requirement is not easy as it involves a financial enquiry in the assets of the insolvent. Disclosure of all material facts is expected and where the debtor owns certain property, the applications are accompanied by the expert's valuations.³³⁰ It is common cause that since the concept 'advantage of creditors' involves the orderly and equitable sharing of all creditors in the assets of the insolvent estate, sequestration is only to the advantage of creditors when there is a realistic prospect that it would yield a financial benefit to the general body of creditors.³³¹ It is therefore submitted that the debtors with no assets sufficient to constitute an advantage to creditors are excluded from the opportunity of debt relief. The advantage requirement thus continues to be a stumbling block for the debtors hoping to use the sequestration process for debt relief.³³²

Although the South African sequestration process is not for the relief of debtors, it is the only measure that places the debtor in a position to compel a discharge of debts on his creditors and obtain a fresh start.³³³ The alternative debt relief measures are not available to all debtors. Administration orders are only available

³²⁷ *Ibid.*

³²⁸ *Ibid.*

³²⁹ See par 2 3.

³³⁰ Par 3 2.

³³¹ *Ibid.*

³³² See par 2 5.

³³³ *Idem* par 3 4.

to debtors whose liabilities do not exceed R50 000 and who can afford to pay debts in instalments.³³⁴ They also do not provide debt relief by providing a debtor with a discharge from debts. Debt review also does not provide debtors with a statutory discharge.³³⁵ The credit agreements where creditors have taken steps to enforce them are also excluded from debt review. It is observed that the debtors in South Africa do not have sufficient discharge measures because the sequestration process where discharge is a possibility is out of reach of many debtors as they cannot prove the advantage of creditors. This indicates that the South African insolvency system does not strike a balance between creditors' and debtors' interests insofar as it requires proof of the advantage of creditors. In this regard, Evans³³⁶ concludes the current position as follows:

“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 to be 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.”

To provide a remedy to the debtors who cannot prove an advantage of creditors, the South African Law Reform Commission has proposed that a pre-liquidation composition provision be inserted in the new Insolvency Act.³³⁷ A discharge from debt is however not inherent from the provision and the debtor can only obtain the needed relief when the majority of the creditors voting on the composition agree thereto.³³⁸

³³⁴ See par 3 3 1.

³³⁵ *Idem* par 3 3 2.

³³⁶ Evans 2001 *SA Merc LJ* 485 508.

³³⁷ Par 3 3 1.

³³⁸ *Ibid.*

It is reasonable to contend that a debtor's insolvency is not a right compared to the creditors' rights of having their claims paid and therefore sequestration should not be considered in the debt relief realm unless there is an advantage to creditors. However, it is not reasonable to hold the debtors captive to their debts because the alternative debt relief measures do not provide the adequate relief. Appreciating that the doctrine of freedom of contract requires that an individual bears the consequences of their promises, some honest debtors through no fault of their own fail, therefore the moral case for holding such debtors to their promise largely disappears.³³⁹ Little relief is offered to troubled debtors. Ramsay³⁴⁰ expresses a view that

“one does not have to be a visionary to see that any decline in social protections will create new pressure to liberalize insolvency regulation”.

Yet, the South African Law Reform Commission has proposed in the 2000 Bill that the advantage for creditors' requirement be retained in the Act with regard to all liquidation applications.³⁴¹

The problematic aspect of the South African insolvency system is that insolvent debtors only have a possibility of debt relief in a form of discharge depending on their ability to prove the advantage of creditors. Calitz³⁴² submits that

“South Africa has become isolated and has ignored global trends with regards to developments in international consumer insolvency law.”

A review of the United States, England and Wales, Canada and the Netherlands' bankruptcy systems questions whether a time has not come for South Africa to relax the advantage requirement in order to achieve an insolvency system accessible by all debtors. It is clear from the comparative survey in Chapter 4 that

³³⁹ Czarnetzky “The Individual and Failure: A Theory of the Bankruptcy Discharge” 2000 *Arizona State Law Journal* 393 398.

³⁴⁰ Ramsay 2006 *Theoretical Inquiries in Law* 625 633-634.

³⁴¹ See par 3 2 3.

³⁴² Calitz 2007 *Obiter* 397 399.

in all countries, no advantage to creditors is required in bankruptcy petitions and going bankrupt is reasonably easy. The debtors also have a variety of mechanisms through which debt relief in a form of a discharge is consequent.

The United States operates on the philosophy that honest but unfortunate debtors should be allowed to make a fresh start. Its bankruptcy system seeks to strike a balance between both creditors and debtors by making provision for the liquidation of assets of the debtor and repayment plans for the benefit of creditors.³⁴³ In England and Wales, debtors with no income and no assets are now afforded the opportunity to obtain debt relief.³⁴⁴ The Canadian bankruptcy system has three ways of going bankrupt with the least formalities.³⁴⁵ An automatic discharge from debts within three years is provided.³⁴⁶ However, bankrupts with surplus income are required to use it to repay creditors before obtaining a discharge, thus striking a balance between the debtors' and creditors' interests.³⁴⁷ Even the Netherlands which maintained a civil law bankruptcy system for years adopted the debt re-organisation of natural persons with an opportunity of a discharge from debts once all obligations are met.³⁴⁸

In the true sense of the word, the South African insolvency system is 'creditor-orientated'. Although the 'means test' in the Canadian and the United States' bankruptcy systems operates as the advantage requirement in the South African insolvency system, at least the debtors have other alternatives to obtain a discharge.³⁴⁹ In South Africa however, a fresh start is not always available because of the advantage requirement in sequestration applications. It can roughly be said

³⁴³ See par 4 2.

³⁴⁴ *Idem* par 4 3.

³⁴⁵ *Idem* par 4 4.

³⁴⁶ *Ibid.*

³⁴⁷ *Ibid.*

³⁴⁸ See par 4 5.

³⁴⁹ *Idem* 4 2 and 4 4.

that the historical ‘punitive’ aspects against the South African debtor still operates. If the Draft Bill is passed into law, it would not help the poor debtors’ predicament at all because obtaining liquidation orders will remain difficult. It is therefore recommended that the advantage requirement should not be retained in the new insolvency Act to relax the means to the much needed debt relief in South Africa.

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