

A Proposed Discharge Dispensation for Consumer Debtors in Tanzania

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Abstract

The Tanzanian private sector is growing, partly due to the state's efforts to conform to the global economy. As the economy expands and the National Microfinance Policy of 2001 is realised, more and more credit has been made available to consumers. As a direct consequence of the increase of credit, the number of over- indebted consumers in Tanzania is on the rise. The current debt relief system is regulated by the Tanzanian *Bankruptcy Act* no. 9 of 1930, a piece of colonial legislation. Unfortunately this law is ineffective, costly and outdated. Some of the problems identified in this study with this debt relief regime include the lack of a cost- effective alternative to bankruptcy and its total reliance on the judiciary, an institution that is itself overburdened and requires reform. The purpose of this study is to make recommendations for the reform of the current debt relief system and propose a debt relief dispensation for consumer debtors in Tanzania that will efficiently cure over- indebtedness.

A wide comparative investigation was undertaken in this study of selected common law, civil and mixed legal systems that have substantial experience with the boom in over-indebted consumers now facing Tanzania. A number of solutions were borrowed from these systems that may potentially solve Tanzania's debt relief problem. One of the main findings of this thesis is that, over time, developed jurisdictions that rely on credit in the private sector appear to be converging on the same type of procedures and moderate philosophies for consumer debt relief. These include less judicial supervision for debt relief procedures, less freedom of choice for over-indebted consumers when it comes to the type of procedures available, and mandatory surplus income repayments for debtors who can afford it.

In order to address the problems of the Tanzanian debt relief system, this thesis proposes a complete overhaul of the administration of debt relief procedures in Tanzania and the introduction of a combined alternative to bankruptcy that consists of three joint procedures. A number of amendments are also proposed for the *Bankruptcy Act* no.9 of 1930.

This thesis states the status of legal developments as they were in the selected jurisdictions on 31 December 2012.

CHAPTER 1

INTRODUCTION

SUMMARY

- 1.1 Background
 - 1.2 Research Statement
 - 1.3 Research Objectives
 - 1.4 Overview of Chapters
 - 1.5 Scope of the Research
 - 1.6 Limitations of the Study
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“Wars in old times were made to get slaves. The modern implement of imposing slavery is debt.” Ezra Pound.¹

1.1 Background

A majority of sub-Saharan African countries today are in the process of implementing changes in policy aimed at integration with the global economy.² These countries have made large-scale macroeconomic reforms, changed their political policies in some cases and opened up their markets to foreign investors.³ This type of liberalisation of the private sector in the United Republic of Tanzania⁴ has been encouraging.⁵ There are, however, some

¹Mullins *This difficult individual*, Ezra Pound 223.

²Jovanović *International handbook on the economics of integration: General issues and regional groups* 457 and Lwiza and Nwankwo 2002 *The International Journal of Bank Marketing* 38.

³*Ibid.* See also Aiyeku and Nwankwo *Dynamics of marketing in African nations* 17 and Basu and Srinivasan *Foreign direct investment in Africa: Some case studies* 34.

⁴The United Republic of Tanzania will hereinafter be referred to as “Tanzania.”

⁵Basu and Srinivasan *Foreign direct investment in Africa: Some case studies* 34.

shortcomings that are yet to be resolved, notably in the legal sector where some of the laws and practices are behind the times and hinder further private sector development.⁶ While there are a number of areas identified by scholars and commentators that require legal reform,⁷ this thesis aims to provide solutions to Tanzania's overwhelmed and obsolete consumer debt relief system that was inherited from the country's former colonial masters and remains unchanged to this day.

Tanzania has been making reforms since the mid-1980s in an effort to transform its economy from one that was driven by socialist ideas through state-owned enterprises, to the modern free market model driven by competition in the private sector⁸ and individual innovation.⁹ Public sector reforms have been made in all sectors of the state to support this goal and as a result there has been a strong increase in productivity and involvement by the private sector in the economy.¹⁰ The Real Gross Domestic Product growth in Tanzania has increased by six per cent steadily every year between 2001 and 2010 and it appears that the country is moving in the right direction.¹¹

The main assumption that underlies this thesis is that law is part of society and thus laws change and progress along with society.¹² In order to explain why Tanzania needs a new debt relief system at this point in its history, it is therefore necessary to explain the changes that have occurred in Tanzania specifically with regard to public policy since independence. These changes have affected the nature of the private sector's role in the economy and are

⁶Ndulu *et al Tanzania at the turn of the century: Background papers and statistics* 152.

⁷*Idem* 151; Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 294 and Temu and Due 2000 *The Journal of Modern African Studies* 683.

⁸For the purposes of this study the definition of the private sector will include only that part of the economy that is not state-controlled and is run for profit by both natural and juristic persons. See Lienert *Where does the public sector end and the private sector begin* 18.

⁹Lwiza and Nwankwo 2002 *The International Journal of Bank Marketing* 38.

¹⁰Temu and Due 2000 *The Journal of Modern African Studies* 683.

¹¹Ibp USA *Tanzania foreign policy and government guide, volume 1*. As good as these statistics are this growth in the real gross domestic product has not been enough to significantly change the lives of the average Tanzanian. For the purposes of this thesis the Real Gross Domestic Product is a macroeconomic measure of the quantity of goods or services produced by the private sector in a country in a given time period. See Lequiller and Blades *Understanding national accounts* 341.

¹²Papendorf *et al Understanding law in society: Developments in socio-legal studies* 114.

the reason why legal reform is needed in the current consumer debt relief system.

Tanzania gained its independence and the right to govern itself in 1961.¹³ This country is one of a few that has experienced both socialist and capitalist driven market economics.¹⁴ The Arusha Declaration of 1967, introduced by its first president Julius Nyerere, launched a socialist development programme that was informed by the African socialist movement and characterised by policies based on state control of the economy.¹⁵ Implementation of the Arusha Declaration morphed the Tanzania economy into one that was centrally planned and completely run by the state with negligible involvement from the private sector.¹⁶ In accordance with the socialist manifesto, 91 per cent of Tanzanians were organised into self-governing communities known as “ujamaa villages”.¹⁷ Any produce by the small scale farmers in these villages was sold through government-run crop authorities, making the farmers in essence contract workers for the state.¹⁸ In other sectors besides agriculture all the major commercial projects and utilities were nationalised and became state-owned.¹⁹ The participation of the country’s private sector in the economy was limited to a narrow range of activities such as the retail business which was controlled by Tanzanians of Asian descent.²⁰ While this type of trade was allowed, these merchants had to endure heavy competition from state-owned regional trading companies.²¹

¹³Ndulu *et al Tanzania at the turn of the century: Background papers and statistics* 48.

¹⁴Barkan *Beyond capitalism vs. socialism in Kenya and Tanzania* 7 and Okoko *Socialism and self-reliance in Tanzania* 31–32.

¹⁵Temu and Due 2000 *the Journal of Modern African Studies* 684 and Mwakikagile *Tanzania under Mwalimu Nyerere: reflections on an African statesman* 38.

¹⁶*Ibid.*

¹⁷Hydén *Beyond ujamaa in Tanzania: Underdevelopment and an uncaptured peasantry* 16.

¹⁸Temu and Due 2000 *The Journal of Modern African Studies* 684.

¹⁹Ibhawoh and Dibua 2003 *African Journal of Political Science* 68. The nationalisation of economic activities in Tanzania was central to the Ujamaa socialist philosophy. Economic activities were divided into three types: those that only the state could operate, those in which the state had to have a major share, and activities that private individuals could operate with no or limited government involvement. After the 1967 Arusha Declaration all banks and large agricultural projects were nationalised.

²⁰Temu and Due 2000 *Journal of Modern African Studies* 684.

²¹*Ibid.*

In an effort to subdue the private sector in line with socialist ideals, the state took several steps to undermine private enterprise. One such step was labelling commercial persons and merchants capitalist exploiters, or in the local vernacular, *mabepari*.²² The civil service even went so far as to round up local merchants who were considered conmen for trying to run businesses for profit.²³ As a result of these deliberate measures the private sector shrunk considerably and its contribution to the Gross Fixed Capital Formation dropped by more than 23 per cent from 1968 to 1971.²⁴ These policies are now often blamed for the recession and the macroeconomic imbalance of the 1970s.²⁵ Some authors hold the opposite view that the excessive state control of the economy exercised throughout this period negatively affected what appear to be viable economic ideas.²⁶

It must be noted at this juncture that allowing persons and firms to fail at business and enter bankruptcy goes against the fundamental principles of socialist societies.²⁷ This is one of the main reasons why socialist societies advocate state ownership and management of productive assets, not only to ensure equality among citizens but also the right of all workers to employment and welfare benefits, to which bankruptcy may signal an end.²⁸ Enterprise bankruptcy especially is viewed as a practise of capitalist societies.²⁹ It is submitted that this may be one of the reasons why the socialist regime between 1961 and 1985 did not develop the colonial debt relief system left to them.

²²Adejumobi and Olukoshi *The African union and new strategies for development in Africa* 193.

²³Temu and Due 2000 *the Journal of Modern African Studies* 685.

²⁴Ndulu *et al Tanzania at the turn of the century: Background papers and statistics* 119. For the purposes of this thesis the Gross Fixed Capital Formation is defined as a macroeconomic concept used in national accounts as part of the gross domestic product expenditure. This concept is an indicator of how much of the new value added in the economy is invested rather than consumed. See Lequiller and Blades *Understanding national accounts* 5.

²⁵See Fischer *Rent-seeking, institutions and reforms in Africa: Theory and empirical evidence for Tanzania* 306 for a discussion on what the author describes as Tanzania's "inappropriate economic policies".

²⁶Berg and Whitaker *Strategies for African development: A study for the committee on African development strategies* 66 and Ahluwalia *Politics and post-colonial theory: African inflections* 59.

²⁷Solinger *China's transition from socialism: Statist legacies and market reforms* 130.

²⁸*Ibid.*

²⁹Jayasuriya *Law, capitalism and power in Asia: The rule of law and legal institutions* 140.

After years of economic crisis the socialist experiment came to an end in Tanzania in the early 1980s.³⁰ This was due in part to the poor performance of the public sector and pressure from the International Monetary Fund.³¹ The civil service exhausted government revenue that should have been allocated to social services.³² As a result welfare services such as health and education which the state was responsible for declined dramatically.³³ Further, in 1981 and 1982 Tanzania's food security was heavily threatened by a severe drought. This was compounded by the hostility of donors led by the International Monetary Fund who refused to provide aid unless structural adjustment programmes were adhered to.³⁴ This resulted in a lack of funds for state agencies that imported goods, leaving the Tanzanian domestic market in turmoil as essential commodities became scarce. People in towns became accustomed to rationed essential goods, a strategy employed mainly to contain civil unrest.³⁵ In summary, the economic situation and the state of the United Republic in the mid-1980s demanded a major makeover in the country's public policy.

The move towards capitalist economic reform in Tanzania began in 1986 with a structural adjustment agreement with the World Bank, and another separate standby agreement with the International Monetary Fund.³⁶ These agreements culminated in the Economic Recovery Programmes Part I and II that started in Tanzania in 1986.³⁷ These programmes introduced a number of policies that aimed to facilitate external and internal trade, restore financial responsibility and unify the exchange rate.³⁸ Under the plans all restrictions on

³⁰Aminzade 2003 *Studies in Comparative International Development* 43.

³¹Havnevik and Isimika *Tanzania in transition: from Nyerere to Mkapa* 77.

³²Temu and Due 2000 *the Journal of Modern African Studies* 685.

³³*Ibid.*

³⁴Havnevik and Isimika *Tanzania in transition: from Nyerere to Mkapa* 77.

³⁵Temu and Due 2000 *The Journal of Modern African Studies* 685. The goods rationed included all manner of commodities such as sugar, soap, kerosene and even beer.

³⁶Bigsten and Danielson *Tanzania: Is the ugly duckling finally growing up?* 19.

³⁷*Ibid.*

³⁸Nord *et al* 2009 www.imf.org/external/pubs/ft/books/2009/tanzania/tanzania.pdf 3.

private economic activities were eventually lifted and state ownership and interference in productive projects was halted.³⁹

By 1994 the benefits of the turnaround in economic policy really began to show as the economy stabilised.⁴⁰ The steps taken to increase imports and stabilise the exchange rate allowed the private sector to conduct trade at will, stimulating an enormous increase in exports that restored the state's foreign exchange reserves.⁴¹ What followed on the country's new consumerist agenda were the privatisation of state-owned entities and a complete restructuring of the financial sector that focused on financing private investment and included inviting foreign banks to the country.⁴² All in all, these policies have been relatively successful; private investment has fuelled economic development which in turn has increased tax revenues.⁴³ The state of the economy in Tanzania has even been likened to that preceding the arrival of institutional financial investors in emerging markets in South East Asia in the 1980s.⁴⁴

Notwithstanding the major strides taken by Tanzania in the past 25 years to ensure that the private sector is the main engine behind economic growth, there are still major challenges confronting development in the private sector.⁴⁵ Several commentators have reached consensus that the following factors are hindering the further expansion of the Tanzanian private sector:⁴⁶

- (a) The poor quality of the physical infrastructure in the country;

³⁹ *Ibid.*

⁴⁰ Wobst *Structural adjustment and intersectoral shifts in Tanzania: A computable general equilibrium analysis* 1.

⁴¹ Nord *et al* 2009 www.imf.org/external/pubs/ft/books/2009/tanzania/tanzania.pdf 3.

⁴² *Ibid.*

⁴³ *Ibid* and Wobst *Structural adjustment and intersectoral shifts in Tanzania: A computable general equilibrium analysis* 1.

⁴⁴ Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 293.

⁴⁵ Utz *Sustaining and sharing economic growth in Tanzania* 19.

⁴⁶ *Idem* 207 and Ndulu *et al Tanzania at the turn of the century: Background papers and statistics* 133. See also Chuhan-Pole and Angwafo *Yes Africa can: Success stories from a dynamic continent* 375–377 and Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 293.

- (b) the costly tax regime;
- (c) the high cost of credit and its limited access;
- (d) the insufficiency of the current legal system especially the high cost of enforcing contracts; and
- (e) other costs of doing business.⁴⁷

In addition to these shortcomings Tanzania must also compete with newly industrialised countries like South Africa, India and China for foreign investors in the global economy. The abovementioned failings regrettably do their part in scaring away investors. The cost of doing business in Tanzania compounded by the cost of credit,⁴⁸ taxes and corruption is estimated at 25 per cent of the investors' sales.⁴⁹ In China, for example, where a majority of these factors have been controlled the cost estimate is eight per cent of the investor's sales.⁵⁰ In order for Tanzania to compete with these nations at some level, it must undertake further reforms. This thesis deals with the possible reform of the Tanzanian *Bankruptcy Act* no. 9 of 1930 which may significantly correct challenges (c) and (d) above. Why this Act requires reform and how it will increase the efficiency of the legal system and access to credit to the private sector will now be explained.

A shift in public policy from socialist to capitalist ideas like the one undertaken in Tanzania will always bring about the necessity for legal reform.⁵¹ This being because a free market economy requires laws to protect the private property rights of natural and juristic persons transacting in the private sector.⁵² In this policy transition the laws that are most often revised because they affect private sector transactions are the laws of contract, labour laws, the laws of

⁴⁷Corruption in the civil service ranks the highest of the other costs of doing business. For a further discussion see Temu and Due 2000 *The Journal of Modern African Studies* 692.

⁴⁸Credit in Tanzania is still mostly secured with real security and subject to high interest rates. See Temu and Due 2000 *the Journal of Modern African Studies* 692.

⁴⁹Chuhan-Pole and Angwafo *Yes Africa can: Success stories from a dynamic continent* 375 to 377.

⁵⁰*Ibid.*

⁵¹Guo *The political economy of Asian transition from communism* 156 and Finnegan 2008 LLD Thesis 14–15.

⁵²This differs in socialist economies where these laws are not prioritised since the majority of commercial dealings involve and are controlled by the state. See Jayasuriya *Law, capitalism and power in Asia: The rule of law and legal institutions* 64.

corporations and enterprise organisation, bankruptcy laws and of course competition and anti-trust laws.⁵³ To this end the Tanzanian legislature has recently already enacted the following pieces of legislation:

- (a) the *Labour and Employment Relations Act* of 2004;⁵⁴
- (b) the *Companies Act* of 2002; and⁵⁵
- (c) the *Fair Competition Act* of 2003.⁵⁶

However, no bill has yet been brought to parliament to amend the Tanzanian *Bankruptcy Act* of 1930.⁵⁷ This outdated statute leaves a crucial deficiency in the enforcement of private property rights in Tanzania. Consequently, financial institutions that offer credit to the private sector face major problems when claiming repayment of debt from individual debtors, and realising their securities when these debtor's default.⁵⁸ The major complaints about the current debt relief system include the lack of predictability of the system and the length of the Court process, which averages three years and is too long and too expensive.⁵⁹ Understandably, these problems with the debt relief system are part of the reason why financial institutions limit private sector access to credit.⁶⁰

⁵³Jayasuriya *Law, capitalism and power in Asia: The rule of law and legal institutions* 64.

⁵⁴No. 6 of 2004.

⁵⁵No. 12 of 2002. This act came into operation in 2006 and has based its debt relief measures for corporations on those in England and Wales in force just before the English *Enterprise Act* of 2002.

⁵⁶No. 8 of 2003.

⁵⁷Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 294. Revision of the country's *Bankruptcy Act* is purportedly under way. See Ndulu *et al Tanzania at the turn of the century: Background papers and statistics* 153.

⁵⁸Ndulu *et al Tanzania at the turn of the century: Background papers and statistics* 143 and 144.

⁵⁹World Bank Doing Business 2011 *Doing business in Tanzania* 45. On average a bankruptcy proceeding costs 22% of the debtor's estate in Tanzania.

⁶⁰Ndulu *et al Challenges of African growth: Opportunities, constraints and strategic directions* 69 to 71; Ndulu *et al Tanzania at the turn of the century: Background papers and statistics* 144; Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 294 and Nkya 2003 *Journal of Entrepreneurship* 63. Poor bankruptcy laws are, however, not the only factor causing lenders to limit access to credit. A study done by the Business Climate Legal and Institutional Reform (BizCLIR) project shows that the lack of a national identification system and poor credit information contribute to lenders' lack of trust, so to speak, in consumers. See www.bizclir.com/cs/countries/africa/tanzania/gettingcredit (last accessed 2012-06-10) for the full discussion on this matter.

Unfortunately there are no statistics that indicate the total number of over-indebted consumers in Tanzania. However, there are other indicators of the growing consumer debt problem in Tanzania. The current statistics pertaining to the Cooperative Rural Development Bank (CRDB) of Tanzania, one of the premier banks in the country, provide a practical illustration of the problem of private sector debt in Tanzania. The Tanzania Chamber of Commerce ranks the CRDB Bank as the second-largest bank in Tanzania with respect to the size of its assets, and third in terms of the number of employees and its market share.⁶¹ The bank extended 1.12 trillion Tanzanian shillings worth of credit to both natural and juristic persons in 2010.⁶² In that year 11 per cent of that figure constituted what bankers refer to as non-performing loans or bad loans.⁶³ A non-performing loan is a loan that is in default or close to being in default.⁶⁴ With the increase of private sector commerce and access to credit in Tanzania, non-performing loans have naturally also trended upwards.⁶⁵ In the case of the CRDB Bank the amount of bad loans held by both juristic and natural persons more than doubled between 2006 and 2010.⁶⁶

Another illustration of the current private sector debt problem in Tanzania comes from the Agricultural Inputs Trust Fund of Tanzania. This trust fund came into being on the passing of the *Agricultural Inputs Trust Fund Act* No. 9 of 1994. The purpose of the fund is to make loans available for the importation and distribution of so-called agricultural inputs by natural persons.⁶⁷ In 2011

⁶¹www.tccia.com (last accessed 2012-06-10). See also www.crdbbank.com (last accessed 2012-06-10).

⁶²CRDB BANK plc *2010 Annual Report* 20. 1.12 trillion Tanzanian shillings amounts to approx. 707 million United States dollars on 10-06-2012. It is noted that the majority of credit in Tanzania issued to natural persons is issued to them as sole proprietors to invest in their businesses rather than as consumers.

⁶³*Ibid.*

⁶⁴Dash Wu *Quantitative financial risk management* 125 and 126.

⁶⁵See par 2.1 below for a discussion on the directly proportional link between credit and the increase of consumer debt.

⁶⁶Serengeti advisers *Tanzania Banking Survey 2011* 5. CRDB Bank's loans in default made up 5 per cent of the total loans to the private sector for both juristic and natural persons in 2006 but by 2010 that rate had more than doubled to 11 per cent of the total loans. See also www.tccia.com/tccia/wp-content/uploads/2011/07/Tanzania-Banking-Survey-2011-Sample.pdf (last accessed 2012-06-10) in this regard.

⁶⁷S 4 of the *Agricultural Inputs Trust Fund Act*, 1994. Agricultural inputs include agricultural fertilizers, certified seeds, drugs and chemicals for livestock and agrochemicals. For a more exhaustive list see s 1 of the *Agricultural Inputs Trust Fund Act*, 1994.

approximately 47 billion Tanzanian shillings was made available to the private sector by the trust through numerous banks, for various agricultural inputs.⁶⁸ 10.6 per cent of the loans given have turned out to be non-performing loans, where the debtors have been issued letters of demand and in some cases been issued summons to initiate court-supervised debt enforcement proceedings.⁶⁹

Furthermore, in line with its new private sector driven economy, Tanzania also implemented a National Microfinance Policy. This programme began in 2001, its purpose to increase micro-loans to low income Tanzanians and enable them to participate in the private sector as entrepreneurs and consumers.⁷⁰ It is to be expected that as in South Africa, because of the directly proportional relationship between credit and bankruptcy,⁷¹ these micro loans will increase consumer debt.⁷²

It is clear that the Tanzanian debt relief regime requires reform in order to stay in touch with the progression and expansion of the Tanzanian free market economy. What this study seeks to determine is precisely what is lacking in the Tanzanian system and to make recommendations that may solve these problems. In order to evaluate the Tanzanian debt relief system and determine the exact shortcomings that require reform, this study aims to analyse the Tanzanian system in comparison with modern systems that have evolved for decades as a direct result of the same free market forces facing Tanzania now. This will be accomplished by reviewing the leading concepts

⁶⁸Tanzanian Ministry of Finance 2011 *Report of the ministry of finance on 50 years of freedom for Tanzanian mainland* 74. See also www.tanzania.go.tz/wizara/fedha.pdf (last accessed 2012-06-10). 47 billion Tanzanian shillings amounts to approx. 30 million United States dollars on 10-06-2012.

⁶⁹*Ibid.*

⁷⁰National microfinance policy of 2002 is a poverty reduction strategy that provides a foundation for an efficient microfinance system in Tanzania that serves low-income Tanzanians. This policy's objectives are met by establishing a framework within which microfinance operations will develop, serving as a guide for coordinated intervention by the respective participants in the system and describing the roles of the implementing agencies and tools to be applied to facilitate development. See www.tanzania.go.tz/administration.html (accessed 2010-08-26).

⁷¹See par 2.1 below.

⁷²Boraine 2003 *De Jure* 236.

and solutions for debt relief shared by the prominent capitalist nations to formulate a list of considerations used to inform legislatures on debt relief reforms in the modern age. These considerations will then be used to uncover the shortcomings of the Tanzanian debt relief system.

Once the problems of the Tanzanian system have been identified, an investigation will ensue of selected debt relief systems in order to find the best normative solutions to these problems. The comparative systems will be chosen on a number of different grounds ranging from recent advances from legislative overhauls in their jurisdictions to being part of the same legal family as Tanzania.

While the reasons for the choice of each jurisdiction are explained in each relevant chapter, it is necessary to explain the underlying comparative philosophy upon which the choice of each jurisdiction is based. In Oderkerk's discussion on a context-based method for selecting legal systems for comparative study, she hypothesises that all legal systems of the world are in theory available for comparative research.⁷³ However, in order to reduce the number of systems eligible for practical reasons, Oderkerk's recommends that where the ultimate goal of the study, as is the case in this thesis, is to improve the laws of a nation, the comparative investigation must at least include one system that can "teach you something".⁷⁴ Secondly, the legal system that has been selected should not be integrated into a completely different political and economic structure as compared to the system whose laws you are trying to improve.⁷⁵

Being that Tanzania is a developing country, all the jurisdictions selected in this thesis for comparative study are systems that are either newly industrialised countries or developed jurisdictions.⁷⁶ These selected

⁷³Oderkerk *Netherlands International Insolvency Law Review* 317.

⁷⁴*Idem* 313.

⁷⁵*Ibid.* In other words, the systems that are to be compared must have a number of comparative contact points.

⁷⁶Reddy *Global innovation in emerging economies: Implications for innovation systems* 193 and Klein and Pritchard *Relatedness in a global economy* 101 and 149.

jurisdictions therefore fulfil the first requirement and are able to “teach” Tanzania, a relative newcomer to the world of credit and debt relief, using their broad experience of how better to resolve the issue of consumer over-indebtedness. With regard to the second requirement, all the countries selected, like Tanzania, are constitutional democracies and to varying extents have free market economies.⁷⁷ Thus these selected jurisdictions will be able to provide lessons to Tanzania that may be converted into feasible recommendations due to their similar economic and political models. Other reasons for the selection of these jurisdictions will also become clear once the Tanzanian system has been discussed and the exact nature of the system’s shortcomings is identified. This is due to the fact that the systems have also been chosen based on the solutions that are required for the Tanzanian system.

In view of the similarities required between jurisdictions for a comparative study of this nature, the South African legal system has been chosen as the main comparative model for this thesis. This is because of the many comparative contact points between the Tanzanian and South African jurisdictions. Both Tanzania and South Africa are developing countries and members of the Southern African Development Community (SADC), which is a block of countries situated in the same region, whose main goal is to further socio-economic cooperation.⁷⁸ Both countries’ legal systems to varying extents have their origins in the common law, which will help ensure that any transfer of laws or procedures, where applicable, is feasible.⁷⁹ Furthermore, South Africa has been in the process of reviewing its debt relief system for more than twenty years.⁸⁰ This review process has resulted in the draft *Insolvency Bill* of 2000 and the promulgation of the *National Credit Act* of

⁷⁷It is noted that while Sweden and Germany, discussed in Chapter 6, are committed to a free-market economy, their philosophies are combined with comprehensive social welfare programmes. These social contributions play a major role in the economy alongside the free market system. See Wright *Consumer behaviour* 243.

⁷⁸www.sadc.int (last accessed 2013-02-27) and par 4.1 below.

⁷⁹See par 4.1 and 3.2 below.

⁸⁰Bertelsmann *et al Mars: The Law of insolvency in South Africa* 4.

2005.⁸¹ A survey of the South African system will therefore enable Tanzania to learn lessons on debt relief from a neighbour that not only has more experience grappling with over-indebted consumers, but also understands the numerous challenges associated with law reform in developing countries. It is submitted that the South African experience with debt relief will provide realistic lessons for Tanzania as its socio-economic situation, while much better off, is closer to the latter than to the developed jurisdictions.

This thesis will also look into how the developed common and civilian legal families deal with the phenomenon of consumer debt relief. Dealing with these developed jurisdictions as legal families rather than studying a few individual developed systems, it is suggested, may provide this study with the opportunity to gain an understanding of a larger number of developed legal systems and in so doing, provide more solutions for Tanzania.

1.2 Research Statement

The purpose of this thesis is to recommend a suitable discharge dispensation for over-indebted consumers in Tanzania by evaluating the present system for flaws against the modern best practises on debt relief and surveying a number of highly developed systems for progressive solutions.

1.3 Research Objectives

In order to assist in further defining the scope of this study the following research goals have been formulated:

- (a) Firstly, this thesis seeks to create a list of best practice that is agreed upon by bankruptcy researchers, legislators and the like, as the preeminent ideas that should inform the creation of a modern debt relief system. These concepts will be used as the study's theoretical base.

⁸¹ *Ibid.*

- (b) Secondly, this study will carefully evaluate the Tanzanian debt relief system against what an efficient debt relief system should encompass, and determine what flaws are causing the system's inefficiency.
- (c) Thirdly, in an effort to formulate solutions for the shortcomings in Tanzania's debt relief system, this study will investigate a number of debt relief systems in conventionally more advanced jurisdictions in order to make recommendations that may inform legislative reform efforts to modernise Tanzania's debt relief regime.
- (d) Lastly, along with making recommendations for reform, this study will make an effort to propose a new model for the Tanzanian debt relief dispensation.

1.4 Overview of the Chapters

- (a) Chapter 1 outlines the historical and legal reasons for this study and explains the proper context under which the study should be carried out. The aims of the study and how the thesis will accomplish these aims are also addressed in this chapter.
- (b) Chapter 2 introduces the subject of bankruptcy and debt relief before embarking on a discussion of the current philosophies, ideas and trends on the subject of debt relief that are shared worldwide. The chapter culminates by formulating a list of the leading considerations or characteristics that should, according to the literature, be considered or present respectively in a modern debt relief system. These principles are the benchmark upon which the Tanzanian system will be assessed.
- (c) Chapter 3 sets out in detail the procedures available to financially burdened consumers in Tanzania. In this chapter the Tanzanian system will be analysed for weaknesses as per the criteria laid out in Chapter 2.

- (d) Chapter 4 will survey the South Africa jurisdiction for solutions to the short comings in Tanzania. The South Africa debt relief system is discussed and contrasted with its Tanzanian counterpart and lessons are learned from how this newly industrialised nation is coping with rising debt levels of its own.
- (e) Chapter 5 surveys four developed jurisdictions that come from the same legal family as Tanzania: the common law jurisdictions. A survey of the United States, Australia, Canada, and England and Wales will be undertaken with specific focus on the structure of the system, their alternatives to bankruptcy, and automatic discharge provisions.
- (f) Chapter 6 will investigate the position in selected jurisdictions from continental Europe by surveying the legal position in two civilian legal systems, the Netherlands and Germany, as well as one Scandinavian system, Sweden. These jurisdictions selected by the author are surveyed with particular interest as to how they have managed to maintain their conservative stance on debtors paying what they owe, with provisions on providing a fresh start for honest debtors.
- (g) Chapter 7 contains a discussion of all the findings of the study, and some concluding remarks and recommendations for Tanzania for when they choose to embark on law reform of the current debt relief system.

1.5 Scope of the Research

In order to do a uniform survey of the laws relating to debt relief in the chosen jurisdictions, the correct method would be to use a uniform analysis process throughout the investigation of each system. This may, however, not always be practical, firstly because the similarities of the procedures in a particular legal family, for example, the common law systems, would cause a lot of

repetition throughout the thesis. Secondly, the procedures in the different legal families are sometimes so different that it may not be possible to study one aspect in one group of systems, as it is not present in the other.⁸² Therefore, in order to conduct a relatively similar and impartial survey across all the jurisdictions, a non-fixed analysis process which is generally uniform will be used to survey these regimes. The following issues will be addressed about each system, as they represent the structure and most debated features of current debt relief systems:⁸³

- (a) Which requirements must be complied with before a debtor may be declared bankrupt or enter bankruptcy as the case may be?
- (b) Which authority must the parties apply to and what are the potential costs for the debtor if any?
- (c) When may the debtor be fully discharged and what requirements must he or she meet before a discharge is granted?
- (d) What alternatives to bankruptcy are available in the jurisdiction? How the alternative procedures interact with the straight bankruptcy procedure and what requirements are required to engage in a successful alternative procedure?

The previously mentioned Tanzanian *Companies Act* of 2002 has already reformed the debt relief procedures of the majority of corporations in Tanzania. As a result, this thesis will deal with the debt relief procedures of natural persons only.

1.6 Limitations of the Study

The shortage of literature available on debt relief in some of the jurisdictions selected in this study presented a methodological challenge. The continental European jurisdictions especially have quite a bit of literature available in their official languages, some of which was inaccessible. With regard to language,

⁸²Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 9. A good example would be the fact that the majority of continental European countries do not contain automatic discharge provisions, while the majority of common law jurisdictions do.

⁸³*Ibid.*

the main difficulties were experienced while making translations. Due to the fact that most of the continental states official laws are in a language unfamiliar to the author and the intention of the legislature was deduced through translations and secondary sources, this may to some degree have limited the study.

While empirical studies involving socio-economic surveys on bankruptcy in Tanzania would be valuable in providing recommendations for law reform in this particular area,⁸⁴ the goal and focus of this study is to provide a critical analysis of debt relief measures in Tanzania.

This thesis reflects the law as is in all the selected jurisdictions, including Tanzania, on 31 December 2012.

⁸⁴ See Boraine 2003 *De Jure* 245 for a similar argument for South African reforms in bankruptcy.

CHAPTER 2

AN OUTLINE OF THE PHILOSOPHIES AND TRENDS IN MODERN BANKRUPTCY LAW

SUMMARY

- 2.1 Introduction
 - 2.2 Brief Orientation of the Law of Bankruptcy
 - 2.3 An Exposition on Modern Bankruptcy Law Theory
 - 2.4 The American Fresh Start Principle
 - 2.5 Current Trends and Guidelines for Reforming Bankruptcy Laws
 - 2.6 Conclusion
-

“The need to think about the purposes and perspectives of the law of bankruptcy is felt most vividly when the law is being revised.”¹

2.1 Introduction

Fundamentally, the law of bankruptcy deals with the situation where the debtor is unable to meet his or her financial commitments.² This state of affairs is best evidenced where a debtor’s liabilities honestly estimated exceed his or her assets, which in turn have also been fairly valued.³ This situation is known as factual bankruptcy.⁴ The law of bankruptcy also applies where the debtor’s liabilities do not exceed his or her assets, but he or she cannot meet

¹Flessner *Philosophies of bankruptcy law: An international overview* 19.

²Hilliard *A treatise on the law of bankruptcy and insolvency* 2 and Fletcher *The law of insolvency* 1.

³Smith *The law of insolvency* 1 and Jurinski *Bankruptcy step-by-step* 83.

⁴Fletcher *The law of insolvency* 29.

his or her obligations as they fall due.⁵ The latter state of affairs is known as commercial bankruptcy. Where commercial or factual bankruptcy exist the law of bankruptcy offers collective protection to the debtor's creditors who, it is assumed, want a fair and convenient means to recover their claims.⁶ Bankruptcy law also seeks to preserve the value of the debtor's assets and, although not always the primary goal in some jurisdictions, offers some assistance to debtors seeking relief from the burden of their obligations.⁷

At the centre of every bankruptcy system around the world lie two competing themes.⁸ First, every legislature must attempt to balance the interests of the bankrupt debtor who wishes to make a fresh start against his or her creditors' honest claims to get repaid.⁹ Second, the relevant legislative body must also balance the interests of creditors with righteous claims against the debtor's assets that are, by definition of bankruptcy, not sufficient to compensate every creditor.¹⁰ Each jurisdiction around the world weighs and deals with these interests in accordance with their own unique socio-political landscape. It is submitted however, that in modern times bankruptcy law deals with more than the mechanics of group debt collection procedures.

Three decades ago most countries, even the developed jurisdictions, did not consider consumer bankruptcy as an important social or economic problem.¹¹ But, as the economies of these countries grew into increasingly credit driven economies, the link between credit and bankruptcy was felt and understood.¹² Put bluntly, the issuance of credit to consumers is the main cause of

⁵Smith *The law of insolvency* 2.

⁶Queensland University Staff *International trade & business law annual, Volume 3* 143 and Ayer and Bernstein *Bankruptcy in practice* 15.

⁷*Ibid.*

⁸Ferriell and Janger *Understanding bankruptcy* 1.

⁹*Ibid.*

¹⁰*Ibid.*

¹¹Calitz 2007 *Obiter* 398; Neimi-Kiesilainen *et al Consumer bankruptcy in global perspective* 3 and Neimi-Kiesilainen 1999 *Osgoode Hall Law Journal* 473.

¹²Gross *Failure and forgiveness: Rebalancing the bankruptcy system* 6 and Ziegel 1999 *Osgoode Hall Law Journal* 207.

bankruptcy.¹³ Bankruptcy has far-reaching consequences on the lives of consumers, the society and the economy as a whole.¹⁴ The following passage by Woods aptly describes the undesirable effects of bankruptcy:¹⁵

Bankrupts and their directors are disqualified from working. Property is seized and sequestered. Assets are expropriated without compensation. Contracts are shattered and their terms interfered or negated. Security interests are frozen or avoided or debased. The cost of credit is increased or credit, the life blood of modern economics is withdrawn. People lose their jobs and their pensions. The collapse of banks and insurance companies destroys the savings of the citizen. The economy of the state itself may be sapped. Bankruptcy is a destroyer and spoliator.

In addition, due to the close relationship between the economy and bankruptcy laws, it has been hypothesised that bankruptcy laws have an important role to play in improving the consumer's economic position.¹⁶ As a result many countries following the example of the United States of America¹⁷ have begun taking an interest in bankruptcy ideology.¹⁸

Due to the global increase of available credit in the credit industry, consumer bankruptcy is on the rise.¹⁹ Consequently, many countries are in the process of or have already reviewed their bankruptcy legislation.²⁰ It would appear that since the introduction of the *Bankruptcy Act* of 1930,²¹ Tanzania has become isolated and has ignored the modern trends and developments in consumer bankruptcy around the globe. Under the shadow of increasing debt-stressed consumers,²² the time for reform has come. Therefore it is necessary to think about the purposes, perspectives and modern philosophies behind the law of

¹³Jackson *The logic and limits of bankruptcy law* 7. The correlation between increased access to credit and the rise in debt levels in the Tanzanian private sector has already been demonstrated in par 1.1 above and is in part the reason for this study.

¹⁴Woods *Principles of international insolvency* 3 and Kumar *et al* 1998 *Economic Papers* 18.

¹⁵*Ibid.*

¹⁶Gross *Failure and forgiveness: Rebalancing the bankruptcy system* 91 and 116 and Rochelle 1996 *Tydskrif vir die Suid-Afrikaanse Reg* 315.

¹⁷Hereinafter referred to as the "United States."

¹⁸Boraine 2003 *De Jure* 236 and Calitz 2007 *Obiter* 398.

¹⁹Boraine 2003 *De Jure* 235.

²⁰*Ibid.*

²¹Act no. 9 of 1930 Cap 25 Revised Edition 2002. Hereinafter referred to as the Act.

²²See the discussion in par 1.1 above.

bankruptcy, with the view of bringing the Tanzanian bankruptcy dispensation in line with modern bankruptcy models.

This chapter investigates in some detail the developments, underlying rationales and consequences that are associated with modern debt relief procedures catering for natural persons. The purpose of this investigation is to attempt to create a closed list of the preeminent and salient features a modern debt relief regime should include. This list of features will be used during the study as a benchmark to examine the debt relief regime in the United Republic of Tanzania and to determine how it measures up to the current global standard. In order to achieve this outcome, paragraph 2.2 of this chapter will provide a brief orientation of the law of bankruptcy to set the scene for the main theoretical discussion. Paragraphs 2.3, 2.4 and 2.5 will provide a detailed account of the philosophies, guidelines and trends that are currently associated with a majority of the debt relief procedures available. Paragraph 2.6 concludes with observations on the theories and guidelines discussed in previous paragraphs.

2.2 Brief Orientation of the Law of Bankruptcy

2.2.1 Historical Development of Bankruptcy

As previously stated, the main assumption upon which this thesis is based is that the law is part of society and therefore the changes in society inform the creation and reform of the law. This relationship is explained with some ease by Kleyn and Viljoen who note, simply, that law presupposes a society.²³ Therefore, in order to understand the nature of bankruptcy law today it is necessary to study how this law evolved throughout history and how it catered for the needs of individuals and society as a whole and also how it was moulded by the socio-political process. Due to the heavy influence of English law on Tanzania's legal system,²⁴ this historical narration will be observed through an English lens.

²³Kleyn and Viljoen *Beginner's guide for law students* 12.

²⁴See par 3.1 below.

Early English law historically did not concern itself with the bankruptcy of the individual, which was a procedure under the so-called Law Merchant, specifically used for traders.²⁵ The Law Merchant was a body of customary rules and principles governing trade between merchants during the middle ages, and was adopted by these traders to regulate their commercial transactions.²⁶ These rules were based primarily on Roman law.²⁷ The Law Merchant gradually spread through Europe as the traders began trading from place to place.²⁸ The merchants set up their own Courts at trade fairs or in cities that administered this one law.²⁹ The administration of the Law Merchant was consistent throughout Europe, regardless of differences in national law and languages.³⁰ The bankruptcy procedures under the Law Merchant evolved from, *inter alia*, the Roman law procedure known as *cessio bonorum*, meaning assignment of property for the benefit of creditors.³¹ Initially during the eleventh century the Law Merchant enjoyed very little influence in England, due in part to the fact that back then it was applicable only to merchants.³² However, in the fourteenth century the centralisation process ordered by King Henry the Eighth and overseen by the Common Law Courts, absorbed large parts of the Law Merchant into the Common law, thus making Roman law bankruptcy procedures part of English Law, and gradually as time went on it became applicable to all natural persons.³³

In 1572 the first English *Bankruptcy Act* was enacted specifically to deal with absconding debtors.³⁴ In the modern sense of bankruptcy law this Act cannot be seen as a bankruptcy statute. In fact it was similar to a criminal statute

²⁵Trakman *The law merchant: The evolution of commercial law* 8 and Thomas, Van der Merwe and Stoop *Historical foundations of South African private law* 88.

²⁶Levinthal 1918 *University of Pennsylvania Law Review* 5 and Trimble 1948 *Harvard Law Review* 982.

²⁷Trakman *The law merchant: The evolution of commercial law* 8.

²⁸Fletcher *The law of insolvency* 6.

²⁹*Ibid.*

³⁰Mitchell *An essay on the early history of the law merchant* 22 and Levinthal 1918 *University of Pennsylvania Law Review* 16.

³¹Smith *The law of insolvency* 7.

³²Bauer 1980 LLM Thesis 33 and Levinthal 1918 *University of Pennsylvania Law Review* 17.

³³Teply and Whitten *Civil procedure* 375 and Thomas, Van der Merwe and Stoop *Historical foundations of South African private law* 81.

³⁴Levinthal 1918 *University of Pennsylvania Law Review* 1.

directed against men who indulged in wasteful expenditure and then absconded.³⁵ However, at this early stage the two main principles of modern bankruptcy law, collective participation of the creditors and *pro rata* distribution of the assets of the debtor among them, were present in this Act.³⁶

The early bankruptcy statutes of the sixteenth and seventeenth century were particularly rigid and harsh in their operation.³⁷ Under these laws no provision was made for a bankrupt merchant to apply for his own bankruptcy, and once he was declared bankrupt there was no procedure whereby, having surrendered all his property, he could later apply for a discharge from the status of bankruptcy.³⁸ Some provisions for bankruptcy discharge were however introduced later in the seventeenth century by the *Bankruptcy Act* of 1705. However, the hostile policy of the law towards bankrupt traders, which considered them to be species of criminals, continued to be reflected in the penalties that they were subject to.³⁹ These even included the death penalty, which could be ordered in the case of fraud by the bankrupt.⁴⁰ Fletcher notes that the law during this period was characterised by its failure to make any distinction between the honest but unfortunate debtor on the one hand, and the dishonest or irresponsible debtor on the other.⁴¹ At this stage of its development bankruptcy law had not developed into a procedure that balanced rehabilitating debtors and provided a collective remedy for creditors; this lay in the future.⁴²

During the nineteenth century a succession of bankruptcy laws laid the foundation of the modern law of bankruptcy as we know it today. In 1813 non-traders could be declared bankrupt and a Court for 'the relief of insolvent debtors' was established for the purpose of resolving their issues.⁴³ The

³⁵ *Ibid.*

³⁶ Fletcher *The law of insolvency* 7.

³⁷ Goode *Principles of corporate insolvency law* 10.

³⁸ *Ibid.*

³⁹ Tabb 1991 *American Bankruptcy Journal* 3.

⁴⁰ Bauer 1980 LLM Thesis 33 and Tolmie *Corporate and personal insolvency law* 8.

⁴¹ Fletcher *The law of insolvency* 9.

⁴² *Idem* 10.

⁴³ Tolmie *Corporate and personal insolvency law* 10.

Bankruptcy Act of 1861 permanently changed the position as to who could be declared bankrupt and decreed that all debtors, whether they were traders or not, could be declared bankrupt under the Act.⁴⁴

Fletcher observes that the motivation behind the rapid development in the field of bankruptcy law during the first half of the nineteenth century was due to the growth of the national economy through the industrial revolution.⁴⁵ It was during this period that the influential developments of the law companies took place.⁴⁶ In addition, the adverse effects of the Napoleonic wars were troubling all sectors of society both inside and outside the sphere of commerce.⁴⁷ This produced periods of great economic difficulty during which many debtors and their creditors experienced much financial distress, which the law was incapable of dealing with in an appropriate manner.⁴⁸ Eventually, with the introduction of the *Bankruptcy Act* of 1883, the law of bankruptcy reached a state of development which is still recognisable today.⁴⁹ The English *Bankruptcy Act* of 1914 made very few amendments to the *Bankruptcy Act* of 1883, and was amended again only in 1986 by the promulgation of the English Insolvency Act of 1986.⁵⁰ The English *Bankruptcy Act* of 1914 forms the basis of the current Tanzanian *Bankruptcy Act* as a result of Tanzania being a former British Protectorate.⁵¹

2.2.2 Conventional Objectives of Bankruptcy Law

Where a debtor has numerous creditors and not enough assets to pay off all his or her debts, a situation may likely arise that the vigilant creditor, being aware of the debtor's indebtedness, may rush to claim his or her monies.⁵²

⁴⁴ *Ibid.*

⁴⁵ Fletcher *The law of insolvency* 11.

⁴⁶ *Ibid.*

⁴⁷ Giddens *The constitution of society: Outline of the theory of structuration* 321.

⁴⁸ Fletcher *The law of insolvency* 11.

⁴⁹ *Ibid.* This law provided for the administration of bankruptcy using the office of the Official Receiver rather than leaving the debtor's fate to the creditors. The debtor's bankruptcy was also subject to thorough investigation by the Official Receiver in the public interest. These measures are still in place today.

⁵⁰ Bauer 1980 LLM Thesis 32 and Tolmie *Corporate and personal insolvency law* 11.

⁵¹ Macneil *Bankruptcy law in East Africa* 14. See also par 3.2 below.

⁵² Jackson 1982 *Yale law Review* 857; Jackson *The logic and limits of bankruptcy law* 12; Goode *Principles of corporate insolvency law* 61; Bhandari and Weiss *Corporate bankruptcy*: Footnote continues on next page.

This first come first served situation will often result in some of the debtor's creditors being left with scraps once the sharper creditors have sold the debtor's assets in execution.⁵³ The purpose of bankruptcy laws is thus to treat all the creditors' interests as one and force a compulsory joint debt collecting process on them in order to avoid the previously explained state of affairs.⁵⁴ This is the reason conventionally hailed as the main objective of bankruptcy law.⁵⁵ There are, however, other objectives. Sealy and Hooley⁵⁶ summarise the objectives of every bankruptcy system as follows:

- (a) To ensure that all creditors participate equally in the estate except in so far as they have priority as secured creditors or a statutory right to preference;
- (b) to ensure that secured creditors deal fairly in realizing and enforcing their security, *vis-à-vis* both the debtor and the other creditors;
- (c) to investigate impartially the reasons for failure and to see that such disabilities and penalties as are appropriate are imposed on the bankrupt for the interests of the society; and
- (d) Where the assets of the insolvent have been improperly dealt with prior to the onset of insolvency, to recover the assets for the benefit of the general estate.

Jackson theorises that in order for a joint debt collection procedure to solve the problem of creditors grabbing assets, certain features must be present in all bankruptcy systems.⁵⁷ He observes that in order for the joint debt collection method to work, all these bankruptcy laws must deprive a debtor's multiple creditors their rights to individually claim against the debtor. Furthermore, the collective proceeding, once required, must be compulsory for all creditors, and

Economic and legal perspectives 342; Hyun Lee *et al* 2007 *The Academy of Management Review* 257-258 and Jones *The foundations of English bankruptcy: Statutes and commissions in the early modern period* 12 .

⁵³ *Ibid.*

⁵⁴ *Ibid.*

⁵⁵ Ginsberg and Martin *Ginsberg and martin on bankruptcy* 3–4.

⁵⁶ Sealy and Hooley *Text and materials in insolvency law* 898.

⁵⁷ Jackson *The logic and limits of bankruptcy law* 17.

the debtor must not be allowed to contract with one creditor or group of creditors to the other's detriment.⁵⁸ Jackson also observes that the collective process should supplement existing individual creditor remedies rather than be the measure of first instance.⁵⁹ It would appear that these features are essential in every bankruptcy system. Woods⁶⁰ summarises these essential features as follows:

- (a) The individual process of piecemeal seizure of assets by disappointed creditors through attachment or execution is stayed and replaced by a right to claim for a dividend against a pool of the debtor's assets;
- (b) all assets of the bankrupt belong to the pool which is available to pay creditor claims; and
- (c) creditors are paid *pro rata* out of the assets according to their claims.

It is accepted that bankruptcy laws across the globe do have similar features. However, how these statutes protect the interests of creditors and debtors is dependent on the socio-economic factors in each specific jurisdiction.⁶¹ It therefore stands to reason that while bankruptcy laws will have similar features, there will also be a number of unique provisions and procedures in each jurisdiction. Bearing this in mind Woods classifies bankruptcy systems into three categories, depending largely on their positive attitude towards creditors or the debtor. These categories are pro-creditor systems, pro-debtor

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

⁶⁰ Woods *Principles of international insolvency* 3. Woods notes that the first feature is universally true with a few exceptions. These exceptions include jurisdictions that allow secured creditors to proceed against the debtor regardless of a bankruptcy order. He further notes that he is not persuaded that the second feature is absolute as it has been eroded by exceptions. These exceptions include the growing number of exempt assets in each jurisdiction that are supposed to provide the bankrupt with some means of subsistence. The third feature that the creditors are paid *pari passu* out of a pool of the debtor's assets he notes is wishful thinking and not honoured in its true sense anywhere. It is suggested that this is because of the different preferences created by the legislature in each jurisdiction. Duns *Insolvency law and policy* 12 concurs mostly with this list but adds that pre-bankruptcy rights generally remain unaltered by insolvency or bankruptcy.

⁶¹ See par 2.1 and 2.2.1 above.

systems, and the systems that are not interested in insolvency, such as those in communist states.⁶²

Another aim of bankruptcy law is to provide the debtor with a fresh start.⁶³ A debtor who has fulfilled his or her obligations under a bankruptcy order is entitled to be released from his or her pre-bankruptcy debts. While freeing the debtor is not always the goal in pro-creditor regimes, it is often a by-product of the bankruptcy process.⁶⁴ In pro-debtor regimes such as the United States, releasing the debtor from his or her debts is viewed as one of the fundamental goals of bankruptcy law.⁶⁵

2.3 An Exposition on Modern Bankruptcy Law Theory

Until fairly recently, apart from a few limited works and publications on the history of the legal discipline, bankruptcy law existed without much theoretical background.⁶⁶ However, because of the relaxation of the rules governing access to credit a startling increase in the number of bust debtors accrued, shaking even the strongest economies. Consequently many jurisdictions have been forced to re-evaluate their bankruptcy philosophies.⁶⁷ As a result of this new impetus an effort has also been made to conduct empirical studies on bankruptcy practice and to examine the impact of bankruptcy policies and law in consumer markets.⁶⁸ In fact some authors go so far as to say that we are now possibly suffering from an excess of theories.⁶⁹

Due to the almost infinite number of theories and literature available on bankruptcy law, it would be impossible to expound on all the available

⁶²Woods *Principles of international insolvency* 61. In a communist regime with largely state-owned businesses and no market economy there would obviously be little need for a bankruptcy system. See par 1.1 above and Gross *Failure and forgiveness: Rebalancing the bankruptcy system* 6.

⁶³Milman *Personal insolvency law, regulation and policy* 3.

⁶⁴*Ibid.*

⁶⁵Hall and Clark *The oxford companion to American law* 401.

⁶⁶Herbert *Understanding bankruptcy* 7; Calitz 2007 *Obiter* 398 and Ramsay 2007 *University of Illinois Law Review* 241.

⁶⁷*Ibid.*

⁶⁸*Ibid.* See Lackey 1993 *Columbia Law Review* 720 for an example of a good empirical study applied to bankruptcy in practice.

⁶⁹Herbert *Understanding bankruptcy* 8.

hypotheses.⁷⁰ What will be discussed is what Ferriell and Janger call, “the two most influential strains of bankruptcy theory.”⁷¹ These theories are generally known as the traditionalist and proceduralist schools, most of the other theories on bankruptcy are derived from one of these two theoretical approaches.⁷² The ideas presented by these schools have often influenced legislation and court decisions.⁷³ Whereas other theories have their own advantages and merits, these two theories have had the most impact on everyday bankruptcy practice.⁷⁴ Consequently it is the goal of this discussion to first, in a concise manner, examine the ideas behind these passionately debated theories.⁷⁵ Secondly, after evaluating the ideas presented, to suggest the correct theoretical foundation upon which the Tanzanian bankruptcy regime should be evaluated and its reform should follow.

Janger⁷⁶ states that bankruptcy academic circles have been split into two groups, the so-called proceduralists and traditionalists. The traditionalist school of thought on bankruptcy is made up of academics, legal practitioners and judges who write and are active in legal reform.⁷⁷ This school’s approach to bankruptcy law stems from its firm belief that bankruptcy law plays a distinctive role in a legal system and promotes substantive goals that are both important and unique.⁷⁸ In other words traditionalists believe that the laws regarding bankruptcy are distinguishable from other laws, like those of

⁷⁰For a comprehensive discussion on the theories of bankruptcy law see Tabb *Bankruptcy anthology* 51–130. Some of the theories discussed by this author include the “creditors’ bargain theory”. This theory views bankruptcy as a straightforward response to the problem of the sharp creditor grabbing all the assets of the debtor to the detriment of the other creditors of the estate. Another theory is the application of “Murphy’s law” to bankruptcy which states that bankruptcy scholars should strive to understand failure and whether non-economic factors should be taken into account when formulating bankruptcy policy.

⁷¹Ferriell and Janger *Understanding bankruptcy* 8.

⁷²Azar 2008 *Emory Bankruptcy Developments Journal* 383; Baird 1998–1999 *Yale Law Journal* 576 and Janger 2001 *Arizona Law Review* 562. Baird cautions that it is a dangerous affair splitting legal scholars into different groups as their ideas are often very complex and do not always fit perfectly in a single mould.

⁷³*Ibid.*

⁷⁴*Ibid.* See also Janger 2001 *Arizona Law Review* 567.

⁷⁵For a well-articulated discussion of the animated debate between these schools see Baird 1987 *University of Chicago Law Review* 815

⁷⁶Janger 2001 *Arizona Law Review* 566.

⁷⁷Baird 1998–1999 *Yale Law Journal* 576.

⁷⁸*Ibid.*

succession, or contract law.⁷⁹ On the other side of the coin are the proceduralists. This group consists almost completely of academics, including a large number of scholars whose expertise lies elsewhere and apart from bankruptcy.⁸⁰ As evidenced by the name of this school of thought, proceduralists focus first and foremost on the procedural aspects of the insolvency processes, attempting to diminish the supposed uniqueness of the bankruptcy rules.⁸¹ For this group it is essential that any debt relief or collection mechanism such as a debt restructuring order be consistent with the rest of the laws within the jurisdiction, and also that the bankruptcy laws of a legal system should fit flawlessly within “a vibrant market economy”,⁸² like a cog in a machine.⁸³

Baird, one of the founding advocates of the proceduralist school, submits that the differences between these two distinct schools of thought on bankruptcy can be demonstrated by the way each school answers three specific questions.⁸⁴ He attributes the schools’ contradictory answers to their different opinions on the appropriate theoretical context upon which bankruptcy laws should be based.⁸⁵ The questions asked by Baird accurately demonstrate the underlying values and beliefs of these two schools of thought on bankruptcy. Furthermore, this discussion leads into the next discussion, on the American fresh start theory of debt relief. The questions and the answers given by the respective schools are as follows:⁸⁶

(a) What role should bankruptcy law play in keeping a business intact as a going concern?

Though this question relates primarily to the traditionalists’ and proceduralists’ views on the failure of businesses, its discussion in

⁷⁹Sedlak 2003–2004 *University of Pennsylvania Law Review* 1504.

⁸⁰Azar 2008 *Emory Bankruptcy Developments Journal* 383.

⁸¹Sedlak 2003–2004 *University of Pennsylvania Law Review* 1504.

⁸²Baird 1998–1999 *Yale Law Journal* 577.

⁸³*Ibid.*

⁸⁴Sedlak 2003–2004 *University of Pennsylvania Law Review* 1505.

⁸⁵Baird 1987 *University of Chicago Law Review* 577.

⁸⁶For the purposes of this study the term “business” means an enterprise operated by natural persons for profit that is not incorporated into a juristic person.

this study is warranted as it sheds some light on the two main purposes of consumer bankruptcy law. Namely, to maximise returns to creditors and to afford the debtor the opportunity to make a fresh start. Furthermore, while this question is essentially based on the failure of businesses, another reason for its inclusion in this thesis on consumer financial failure is that the vast majority of businesses are run by sole traders.⁸⁷ In addition, consumers receive a large portion of credit to invest in their own business endeavours. Any subsequent failure to these businesses may result in the consumer's financial ruin. Thus the law's attitude to the rescue of these businesses is an important part of consumer debt relief, as it may provide consumers with an opportunity to avoid bankruptcy.

Plainly explained, proceduralists are of the opinion that the bankruptcy rules have an important function in a market economy. The scope of that function is, however, narrow.⁸⁸ The proceduralists take a very strict stance on the role that bankruptcy should play in rescuing businesses that can no longer meet their financial obligations.⁸⁹ This group does not believe in keeping a business alive that cannot function competitively in the market and survive.⁹⁰ The advocates of the proceduralist theory support this argument by contending that bankruptcy law cannot change the market reality that most businesses fail.⁹¹ This is not to say that this group of scholars believes completely that businesses should not be given a lifeline; there are exceptions.⁹²

⁸⁷March *Business organisation for construction* 212 and Needle *Business in context: An introduction to business and its environment* 194

⁸⁸Baird 1998–1999 *Yale Law Journal* 580.

⁸⁹*Ibid.*

⁹⁰Herbert *Understanding bankruptcy* 8 and Sedlak 2003–2004 *University of Pennsylvania Law Review* 1506.

⁹¹*Ibid.*

⁹²With regard to rescuing businesses, proceduralists differentiate between businesses that are under so-called “financial and economic” distress. Economic distress is explained by Baird as the situation where a business is troubled because it cannot generate sufficient income to pay its debts. This is often the case because the business cannot succeed in the
Footnote continues on next page.

The traditionalist school of thought does not for the most part concern itself with the type of distress a failing business is in.⁹³ For them, saving the business is a fine idea, autonomous of the pure economic rationale advocated by the proceduralists.⁹⁴ This school is more concerned with protecting the business so that it benefits the society or the community it is in.⁹⁵ A business, to these scholars, is more than a commercial entity for profit but also an employer, a source of trade for its suppliers, and may also be a provider of services.⁹⁶ Their logic is that when a business fails these persons, natural or otherwise, who rely on that business for survival, will also suffer. Therefore, a business should not be liquidated merely so that creditors can pursue their own “narrow self-interests”.⁹⁷ This school consequently argues that bankruptcy law should be used to give distressed businesses a second opportunity. This “second chance” also serves as a buffer against the normally harsh forces of the market.⁹⁸ However, this point of view does not imply that every business should be prevented from failing, but rather that the distressed business should be given every opportunity to succeed.⁹⁹

marketplace as a result of competitors producing better services or a certain product at a better price. Financial distress only exists when the business is not making enough money to pay back what it has borrowed to finance the business. This type of distress is directly linked to the business's capital structure, meaning that if a business in financial distress did not have any creditors it would not be troubled anymore. Proceduralists are of the opinion that only businesses experiencing financial distress should be saved; those experiencing economic distress must be left alone to be destroyed by the winds and forces of the free market economy. See Baird 1998–1999 *Yale Law Journal* 580 and Janger 2001 *Arizona Law Review* 567.

⁹³Sedlak 2003–2004 *University of Pennsylvania Law Review* 1507.

⁹⁴*Ibid.*

⁹⁵Korobkin 1991 *Columbia Law Review* 745.

⁹⁶*Ibid.*

⁹⁷Baird 1998–1999 *Yale Law Journal* 583.

⁹⁸*Ibid.*

⁹⁹Sedlak 2003–2004 *University of Pennsylvania Law Review* 1507.

(b) To what extent can one consider bankruptcy as a closed or an open system?

The point of this question is to determine the extent to which the two schools believe that bankruptcy law and its precedents have effects beyond the immediate case.¹⁰⁰ Proceduralists are of the opinion that bankruptcy law affects behaviour outside the sphere of bankruptcy, especially the investment decisions of creditors.¹⁰¹ They argue that traditionalist policies that would give a failing business a “second chance” instead of allowing creditors to salvage what belongs to them would harm the economy, as creditors would be more reluctant to invest.¹⁰² Secondly the proceduralists argue that if valuable, autonomous, substantive principles really do exist in bankruptcy law, the question arises as to why these values are absent from other areas of the law.¹⁰³ The analogy often given is that if bankruptcy policy should save a failing business from collapsing to benefit the community that benefits from it, then it should also be possible in law to stop a business from relocating or voluntarily closing down.¹⁰⁴ The impact is, after all, probably the same on the community. The law will not impede a business owner’s freedom to conduct commerce as he or she pleases, yet according to traditionalists it should interfere with the creditor’s rights to reclaim what is theirs.¹⁰⁵ To the proceduralists this kind of bias negatively affects the consistency of the law.

Traditionalists rebut the argument that bankruptcy policy affects investors’ decisions by arguing that there is very little empirical evidence to show that there is a correlation between the two.¹⁰⁶ Therefore, since there is no evidence that bankruptcy policy affects

¹⁰⁰ *Idem* 1506.

¹⁰¹ Baird 1998–1999 *Yale Law Journal* 582–584.

¹⁰² *Ibid.*

¹⁰³ Baird 1998–1999 *Yale Law Journal* 578.

¹⁰⁴ *Ibid.*

¹⁰⁵ *Ibid.*

¹⁰⁶ Sedlak 2003–2004 *University of Pennsylvania Law Review* 1507.

investment, there is no need to factor it in when determining policy. Sedlak explains, furthermore, that it is not the intention of the traditionalists to down-play the interests of creditors and investors, but rather that they view the social cost of failing businesses to be more important.¹⁰⁷ Consequently they argue that Courts should make decisions that balance the interests of all the parties immediately before them, and not be too troubled by the interests of creditors. In conclusion on this point, the proceduralists call for consistency in the legal system, while the traditionalists state that such arguments are not serious. They argue that bankruptcy is not a tool to keep the market operating well. Therefore judges and policymakers should rather concentrate on non-market factors when dealing with bankruptcy.¹⁰⁸

(c) Once a society settles on a particular substantive policy, how does it implement that policy?¹⁰⁹

Traditionalists are of the view that bankruptcy judges are different from other judges in that they are vested with a higher discretion than is usual, in order to see to it that the substantive goals of bankruptcy are implemented.¹¹⁰ In the traditionalist mind the bankruptcy judge's task is to use the law to lead all the parties in the bankruptcy suit toward the desired outcomes of bankruptcy policy.¹¹¹ The following quotation from Warren demonstrates a traditionalist's view on some of the powers of the bankruptcy Court:¹¹²

Bankruptcy Courts also directly influence efforts to enhance the value of the bankruptcy estate. These Courts enjoy enormous

¹⁰⁷ *Ibid.*

¹⁰⁸ *Ibid.*

¹⁰⁹ Janger 2001 *Arizona Law Review* 566 phrases this question as to whether bankruptcy judges are capable of distinguishing likely candidates for reorganisation from firms that are destined to fail.

¹¹⁰ Baird 1998–1999 *Yale Law Journal* 579.

¹¹¹ *Ibid.*

¹¹² Warren 1987 *University of Chicago Law Review* 351.

discretionary power that they can use to enhance the value of a failing business. Judges must make countless decisions [...] whether to permit the assumption of an executory contract, to appoint an examiner, or to approve the terms of a post-petition financing agreement [...] based on their assessment of what will yield the largest returns for the estate.

To the contrary, proceduralists believe that the judge is not best positioned to intervene or guide and should instead be “a disinterested arbiter.”¹¹³ When explaining this position Baird uses the analogy of a re-organisation of a business and states that none of the involved parties alone has the entire complement of skills to get the business doing well again.¹¹⁴ The creditors are more concerned with liquidating the business and reclaiming their investment. The new managers, although they may have the skill to run the business, are hardly ever neutral. Therefore the judge, rather than being committed to any particular outcome, should control the process to ensure that the biases of the parties are taken into account and all relevant information is gathered and disclosed.¹¹⁵ In so doing, the parties and not the judge should be allowed to make their own decisions regarding the course of the bankruptcy.¹¹⁶

The traditionalist school is more in line with the notion underlying this thesis that the law does not develop separately from society.¹¹⁷ It would appear that the proceduralist school is concerned more than anything with whether bankruptcy laws increase or diminish the creditors’ collective benefits.¹¹⁸ This explains why this school is not in favour of bankruptcy policies that will in the first instance look to rescue a business from failing. They would rather differentiate between businesses they perceive are beyond help and those that can be assisted. Such differentiation is made because they believe that

¹¹³Baird 1998–1999 *Yale Law Journal* 579.

¹¹⁴*Ibid.*

¹¹⁵*Ibid.*

¹¹⁶*Ibid.*

¹¹⁷See pars 1.1 and 2.2.1 above.

¹¹⁸*Cf* Warren 1987 *University of Chicago Law Review* 375.

bankruptcy laws should first of all maximise the collective returns of the creditors.¹¹⁹ This also explains why they are against the concept that bankruptcy laws serve a larger purpose than keeping the economic market operating well by removing stragglers. Proceduralists do not acknowledge that creditors may sometimes be required to give up some portion of their claim for the benefit of the debtor and his or her employees. Their need to maximise returns also explains why they believe that judges should remain neutral and not give force to policy considerations. In other words, according to the proceduralists, bankruptcy law is a tool with simple objectives, namely to keep the market operating well by removing defaulters and to maximise returns to creditors.

With regard to consumer debt relief, proceduralist ideas appear to govern creditor-orientated systems where the main emphasis of their debt relief policy is to maximise the returns to creditors, treating bankruptcy merely as a debt collection procedure.¹²⁰ Traditionalist viewpoints are seen in the debtor-orientated systems that place more importance on the debtor's role in society and the economy.

As previously explained, bankruptcy has extensive consequences on the lives of consumers, society and the economy as a whole.¹²¹ Thus it would be wrong when formulating policy or delivering a judgement for example, not to take into consideration the interests, say, of a community of small independent miners that lives around an insolvent diamond processing plant. Furthermore, the idea that a bankruptcy judge should be an indifferent arbiter and should not impress on the parties any decisions that are informed by policy considerations inspired by that jurisdiction's substantive goals for bankruptcy is impractical. Firstly, studies have shown that policy considerations or preferences almost always affect a judge's decision-

¹¹⁹ *Ibid.*

¹²⁰ Mooney 2004 *Washington and Lee Law Review* 931.

¹²¹ Woods *Principles of international insolvency* 3 and White *When worlds collide: bankruptcy and its impact on domestic relations and family law* 31.

making.¹²² Secondly, by the time parties reach the stage where they would rather have a Court decision to settle their dispute it seems against good reason to let them decide their own disagreement with the judge acting as a mediator. More often than not, they have already tried this in mediation or negotiations before opting for a ruling.

Traditionalists' ideas appear sounder firstly, in light of the unpleasant effects bankruptcy can have on consumers, jobs and communities. Bankruptcy policy must play a role in determining how bankruptcy law will protect the consumer and not focus purely on creditor returns.¹²³ Secondly, creditors may sometimes be required to give up portions of their claims to allow the bankrupt consumer to start over, especially when his or her financial predicament is beyond his or her control.¹²⁴ The ideas of traditionalists, it is submitted, should inform bankruptcy policy and supplement the core aims of bankruptcy law, namely recovery of the creditors' claims and freeing the debtor of his or her burden.

In what follows a bankruptcy theory which was developed in the United States around the traditionalist ideals will be discussed. The main concept it adheres to is that bankruptcy laws should also be viewed as a tool to buffer consumers and the society from the fallout of bankruptcy. This theory is known as the American fresh start. This view of bankruptcy law came into prominence in the middle and late twentieth century owing to the huge increase of consumer debt.¹²⁵

2.4 The American fresh start principle

The theory known as the "fresh start" principle in bankruptcy is unique to American bankruptcy law prior to 2005.¹²⁶ It has also been described as the

¹²²Klein *Making law in the United States courts of appeals* 15.

¹²³Baird 1987 *University of Chicago Law Review* 815.

¹²⁴*Ibid.*

¹²⁵Hallinan 1986–1986 *University of Richmond Law Review* 51.

¹²⁶Brown 2005 *American Bankruptcy Law Journal* 419. Any discussion or indication that the American fresh start principle is applicable in the United States in par 2.4 refers to the Footnote continues on next page.

main theory on consumer bankruptcy in America.¹²⁷ Despite its omnipresence in bankruptcy literature, the fresh start remains a somewhat obscure concept.¹²⁸ Porter and Thorne¹²⁹ note that contemporary authors often connect the fresh start policy with the economic rehabilitation of debtors through bankruptcy's discharge of debt.¹³⁰ The fundamental idea behind this theory is the promise attached to this rehabilitation that life after bankruptcy will be free of financial hardship. This is because the discharge, in theory, empowers these debtors to be productive again by freeing their debts and allowing them to acquire credit.¹³¹

Technically explained the principle on which this theory is based is that once the honest debtor has released, for the benefit of his or her creditors, his non-exempt assets, he or she receives a discharge of all, or the majority of his or her debts.¹³² This release allows the debtor another chance to engage in economic activity unburdened by his or her previous financial burdens.¹³³ Under this theory the objectives of the bankruptcy law are not only to protect debtor and creditor interests, but also to provide the debtor with a “fresh start” or another go in the economy.¹³⁴ Hallinan points out however that in practice this is not always what occurs.¹³⁵ Before 2005 when the fresh start principle was at the height of its application, the American system always produced the discharge of the debtor but more often than not, little or no payments to creditors.¹³⁶ Consequently, Hallinan suggests that the reality in practice was that the debtor’s discharge is not one of the numerous objectives of a “fresh

American Bankruptcy Code after the *Bankruptcy Act* of 1889 and prior to the *Bankruptcy Abuse Prevention and Consumer Protection Act* of 2005.

¹²⁷ *Ibid.*

¹²⁸ Jackson 1984–1985 *Harvard Law Review* 1394 and Hallinan 1986–1986 *University of Richmond Law Review* 51.

¹²⁹ Porter and Thorne 2006–2007 *Cornell Law Review* 68.

¹³⁰ Howard 1987 *Ohio State Law Journal* 1047.

¹³¹ Jackson *The logic and limits of bankruptcy law* 225.

¹³² *Ibid.* See also Evans 2008 LLD Thesis 149.

¹³³ *Ibid.*

¹³⁴ Hallinan 1986–1986 *University of Richmond Law Review* 51.

¹³⁵ *Ibid.*

¹³⁶ Porter and Thorne 2006–2007 *Cornell Law Review* 71.

start” orientated bankruptcy system, but rather the main object of the whole process.¹³⁷

What now follows is a short account of the development of the fresh start concept in American bankruptcy law. The aim is to illustrate that the progression of the fresh start theory is to some extent directly proportional to the development of the American society through its various economic trials and tribulations.

2.4.1 Brief Historical Overview

Before a chronological exposition on the major pieces of bankruptcy legislation and how they slowly embodied the fresh start theory is given, it is necessary to explain the social and political background upon which the development of these laws was taking place and why such development occurred. Prior to the development towards a debtor-orientated system in the 1800s, the American bankruptcy regime, like its English parent, was strictly pro-creditor.¹³⁸ The demand for credit and its importance in the American economy during the 1800s is commonly cited as the cause of the corresponding increase in the acceptance of debtor protection and the release of debt as a legislative objective during this period.¹³⁹ The increase of credit in the economy was accompanied by the growth in popularity of business persons such as traders and the working class, the so-called “debtor class”.¹⁴⁰ Simultaneously, chronic financial crises coupled with widespread business failures during this period highlighted the idea that risk of failure when involved with commercial activity was not due to the debtor’s irresponsibility, but rather to the grim circumstances of the time.¹⁴¹ Public opinion towards taking credit, economic failure, and bankruptcy changed. Hallinan¹⁴² explains the resulting effect on legislation:

¹³⁷Hallinan 1986–1986 *University of Richmond Law Review* 51.

¹³⁸Tabb 1991 *American Bankruptcy Journal* 344 and 370.

¹³⁹Evans *The American economy* 3 and Hallinan 1986–1986 *University of Richmond Law Review* 51.

¹⁴⁰Evans *The American economy* 3

¹⁴¹*Ibid.*

¹⁴²Hallinan 1986–1986 *University of Richmond Law Review* 54.

There was rather, an increasingly strong perception of the significant possibility that economic failures were produced by economic forces no more controllable or predictable than visitation by a tornado or the bite of a wild dog. This severing in public consciousness of the hitherto close relation between fault and default easily found its way into legal rhetoric and theory and provided a legitimizing framework for legislation shielding insolvent debtors from coercive collections activity.

The large number of over-indebted consumers led the American Congress to pass into law numerous bankruptcy statutes in an attempt to remedy the situation. In the year 1800 the first federal bankruptcy legislation was passed in the United States of America.¹⁴³ The *Bankruptcy Act* of 1800 resembles the English 1732 *Statute of 5 George 2*.¹⁴⁴ The *Bankruptcy Act* of 1800 was meant to be a short-term measure intended to deal with the national financial crisis during the 1790s.¹⁴⁵ Like its English parent, it was essentially a pro-creditor solution for the insolvency of the debtor. The important features for this discussion of the Act are that only merchants were eligible debtors and only creditors could institute bankruptcy proceedings.¹⁴⁶ More importantly, a discharge could be obtained only with permission from the creditors and bankruptcy commissioners.¹⁴⁷

The Bankruptcy Act of 1841 is considered to be a landmark towards the debtor-orientated fresh start approach.¹⁴⁸ After “the panic”¹⁴⁹ of 1837 the legislature sought to protect debtors more openly. The major advancements were firstly that the bankruptcy process was available to the debtor at his or

¹⁴³Tabb 1991 *American Bankruptcy Journal* 346.

¹⁴⁴Jones *The foundations of English bankruptcy: Statutes and commissions in the early modern period* 69.

¹⁴⁵Tabb 1991 *American Bankruptcy Journal* 345.

¹⁴⁶Skeel 1998–1999 *Bankruptcy Developments Journal* 322.

¹⁴⁷Tabb 1991 *American Bankruptcy Journal* 346.

¹⁴⁸*Ibid.*

¹⁴⁹*Ibid.* The panic of 1837 was a financial crisis built on a speculative fever of housing properties. This to some extent resulted in the death of the Second Bank of the United States which in turn produced a period of runaway inflation. The Panic was followed by the failure of many major banks and a five year depression and very high unemployment levels. See also Markham *A financial history of the United States* 149.

her own volition.¹⁵⁰ Secondly, all debtors, and not only merchants, could now use the bankruptcy process. However, widespread discontent among creditor groups saw the Act repealed after only a year. Regardless of the repeal, the idea of voluntary bankruptcy for debtors had already been established and was not even debated in Congress when the next bankruptcy bill was passing through the house.¹⁵¹

After the repeal of the *Bankruptcy Act* of 1878, twenty years passed before financial crises or the panic of 1884 and 1893 necessitated the enacting of the *Bankruptcy Act* of 1898.¹⁵² The 1898 Act was a giant step in the advancement towards the current state of affairs in American bankruptcy.¹⁵³ With the introduction of limited liability through corporate legal entities, the emphasis on the discharge of debt focused on the individual consumer rather than on the merchant or so-called commercial persons.¹⁵⁴ More importantly, the long-standing qualification of a certain minimum dividend payable to the debtors¹⁵⁵ or consent from the creditors for a discharge of the debtor, were removed.¹⁵⁶ With respect to the major changes seen in the 1898 Act, a committee report debating the 1898 Bill cited by Tabb, states the following:¹⁵⁷

Under this bill no assent is required from the creditors. If the debtor has acted dishonestly by committing certain acts forbidden in the bill he will not be discharged; if he has acted honestly he will be. The granting of a discharge is justified by wise public policy. The granting or withholding of it is dependent upon the honesty of the man, not upon the values of his estate.

As a result of the 1989 Act, the principles central to the fresh start theory were formally recognised as law. These being firstly that the debtor's discharge does not depend on the impact the discharge would have on the interests of the group of creditors. Secondly, that the discharge should not be

¹⁵⁰Tabb 1991 *American Bankruptcy Journal* 349.

¹⁵¹*Idem* 351.

¹⁵²Markham *A financial history of the United States* 149 and 150.

¹⁵³*Ibid.*

¹⁵⁴Tabb 1991 *American Bankruptcy Journal* 363.

¹⁵⁵This type of provision is still applicable in Tanzania today. See par 3.3.6 below.

¹⁵⁶Tabb 1991 *American Bankruptcy Journal* 364.

¹⁵⁷*Ibid.*

viewed as an incentive for the debtor to cooperate with his or her creditors, but rather that the public interest of the American society in the discharge of the honest debtor should take precedence over what had been traditionally creditor oriented policies.¹⁵⁸

A variety of other liberal developments took place after the repeal of the 1898 Act to add to the character of the fresh start policy. These amendments included slackening of the penal provisions against debtors and making compositions widely available. However, the development of the main characteristics of the fresh start theory has been chronicled above.¹⁵⁹

2.4.2 Theoretical Justifications behind the Fresh Start Policy

As explained above, the main outcome of a fresh start-influenced bankruptcy is a discharged debtor, and not the fulfilment of his or her obligations to his or her creditors.¹⁶⁰ In the USA, studies have shown that bankruptcies yield dividends for creditors in roughly five per cent of all applications.¹⁶¹ Clearly this type of bankruptcy discharge undermines the most important concept at the heart of contract law, namely that contracts ought to be upheld.¹⁶² As a result, American scholars and other interested parties have proposed an assortment of rationales as to why the law should provide such unusual relief to debtors who have legitimate and legal obligations to their creditors.¹⁶³ Insolvency intellectuals have worked diligently towards developing convincing explanations for how the principle of the sanctity of contracts is reconcilable with the fresh start policy. Kilborn notes that these official defences of the theory have proliferated because the notion of allowing individuals to escape their obligations does not seem right.¹⁶⁴ An analysis of the current research on this subject reveals two rationales which would appear to be the traditional justification of the fresh start policy, namely the “mercy” rationale and the

¹⁵⁸ *Ibid.*

¹⁵⁹ Tabb 1995 *American Bankruptcy Institute Law Review* 28.

¹⁶⁰ See par 2.3.1 above and Hallinan 1986–1986 *University of Richmond Law Review* 50.

¹⁶¹ Tabb 2001 *Bankruptcy Developments Journal* 6.

¹⁶² Kilborn 2003 *Ohio State Law Journal* 860.

¹⁶³ *Ibid.*

¹⁶⁴ *Ibid.*

“rehabilitation” rationale.¹⁶⁵ Czametzky and Kilborn¹⁶⁶ mention a third rationale known as the “collection” or “creditor protection” rationale. These rationales are now discussed.

2.4.2.1 *The creditor protection rationale*

The “creditor protection” rationale for granting a discharge of debt is the oldest of the three. This reasoning reflects the rationale behind the granting of the very first discharge, in the English *Statute of 4 Anne* in 1705, which was to facilitate creditor recovery of claims.¹⁶⁷ The creditor protection justification is one of the rationales behind most, if not all bankruptcy systems.¹⁶⁸ This rationale accepts that the prospect of a discharge is meant to encourage the debtor to cooperate with his or her creditors to pay his or her debts.¹⁶⁹ With the debtor cooperating to make all his or her property available to the general group of creditors, in anticipation of his or her discharge, we are able to avoid an inefficient multiplicity of collection actions by the debtor’s creditors.¹⁷⁰ This system also provides for an equitable distribution of the debtor’s property among all the creditors who have proved their claims.¹⁷¹

Kilborn dismisses the creditor protection rationale as having little or no relevance for individual bankruptcy under the fresh start policy in America.¹⁷² His rationalisation for this is that individual debtors usually own nothing legally available for collection and distribution to creditors. Consequently, this rationale applies in only the most limited way to American individual bankruptcy.¹⁷³

Considering the evidence presented by Kilborn in support of his dismissal of this rationale, it is submitted that his hypothesis is correct. A study done by

¹⁶⁵Hallinan 1986-1986 *University of Richmond Law Review* 57.

¹⁶⁶Czametzky 2000 *Arizona State Law Review* 432; Kilborn 2003 *Ohio State Law Journal* 860 and Ayotte 2007 *Journal of Law Economics and Organisation* 163.

¹⁶⁷Levinthal 1918 *University of Pennsylvania Law Review* 8.

¹⁶⁸Czametzky 2000 *Arizona State Law Review* 432.

¹⁶⁹Kilborn 2003 *Ohio State Law Journal* 860.

¹⁷⁰*Ibid.*

¹⁷¹Czametzky 2000 *Arizona State Law Review* 432.

¹⁷²Kilborn 2003 *Ohio State Law Journal* 865.

¹⁷³Blum *Bankruptcy and debtor/creditor: Examples and explanations* 102.

White indicates that on average only three per cent of creditors received a return on their claims in the fresh start inspired Chapter 7 bankruptcies before 2005.¹⁷⁴ These alarmingly low statistics show that the main result of these bankruptcies is not to assist or protect the creditor, but rather just to secure the debtor's discharge or fresh start.

2.4.2.2 *The mercy rationale*

When discussing the starting point or basis of the fresh start policy, many bankruptcy scholars are uncomfortable with discussions of decency and morality in place of economics.¹⁷⁵ However, on occasion, the fresh start policy has been the basis for alleging that there is a moral foundation to discharge of the debtor's debt.¹⁷⁶ Put simply, the mercy rationale advocates that discharging the debtor from a large debt burden is ethically the right thing to do when the debtor was honest and got into that debt as a result of misfortune.¹⁷⁷ Furthermore, it entails that basic humanity requires the law to show compassion and provide mercy to the suffering debtor, who is in anguish through no fault of their own.¹⁷⁸ Thus the basis of the fresh start principle is that society is willing to forgive debtors by allowing them a discharge and letting them rehabilitate themselves.¹⁷⁹

In order to understand the fruition of the mercy rationale it is necessary to understand its origins. The idea behind mercy as a reason for debt discharge first developed in Roman times.¹⁸⁰ During this period it was limited to leniency from prison, slavery, torture and the like.¹⁸¹ The procedure known as *cessio bonorum* was introduced, most likely, during 48 BC in the *Lex Julia*.¹⁸² This procedure first introduced the idea upon which modern bankruptcy law is

¹⁷⁴White 1987 *Indiana Law Journal* 38 which shows a return to unsecured creditors in only three per cent of Chapter 7 liquidation cases in the 1970s and early 1980s.

¹⁷⁵Herbert *Understanding bankruptcy* 3.

¹⁷⁶Sedlak 2003-2004 *University of Pennsylvania Law Review* 1440.

¹⁷⁷Kilborn 2003 *Ohio State Law Journal* 863.

¹⁷⁸*Ibid.*

¹⁷⁹Gross *Failure and forgiveness: Rebalancing the bankruptcy system* 93.

¹⁸⁰Kilborn 2003 *Ohio State Law Journal* 870.

¹⁸¹*Idem* 871.

¹⁸²Smith *The law of insolvency* 7 and Sharrock *et al Hockly's insolvency law* 12.

based.¹⁸³ In terms of this procedure a debtor could obtain some form of relief from his or her debts by admitting insolvency and turning over all of his or her property to his or her creditors. However, under *cessio bonorum* there was no discharge from the debt, thus the debtor could only avoid prison and corporal punishment.¹⁸⁴ Roman mercy was therefore limited to securing release from what is termed debt slavery.¹⁸⁵

In England, until the early 1800s bankrupts could still be jailed by reason of their insolvency.¹⁸⁶ It was only in 1813 that the Crown created a Court specifically to deal with insolvent debtors.¹⁸⁷ This Court however, like the procedure of *cessio bonorum*, only offered freedom from jail and not a discharge from debt.¹⁸⁸ When the English colonised America, they brought with them the institution of imprisonment for debt.¹⁸⁹ However as time went on, the terrible conditions in American debtors' prisons¹⁹⁰ and, as a result of the financial crises described above,¹⁹¹ the large number of unlucky debtors imprisoned for debt made mercy a persuasive basis for the fresh start theory.

Kilborn dismisses the relevance of the mercy rationale as a basis for the modern fresh start theory by noting that, although mercy arguments initially made undeniable sense in the context of debt slavery and imprisonment, they had lost all potency by the twentieth century.¹⁹² He attributes this to the fact that all forms of debt slavery and imprisonment had been abolished by this time, making the mercy rationale redundant.¹⁹³

¹⁸³ *Ibid.*

¹⁸⁴ Kilborn 2003 *Ohio State Law Journal* 872.

¹⁸⁵ *Idem* 871.

¹⁸⁶ Tabb 1991 *American Bankruptcy Journal* 12.

¹⁸⁷ Johnson *Making the market: Victorian origins of corporate capitalism* 49.

¹⁸⁸ Fletcher *The law of insolvency* 10.

¹⁸⁹ *Ibid.*

¹⁹⁰ Images of debtor prisons where inmates were shown suffering within them supported the "mercy" rationale in national bankruptcy debates throughout the nineteenth century. See Kilborn 2003 *Ohio State Law Journal* 872.

¹⁹¹ See also par 2.3.1.

¹⁹² Kilborn 2003 *Ohio State Law Journal* 872.

¹⁹³ *Ibid.*

Evans also dismisses this argument.¹⁹⁴ He observes that the proponents of this rationale lost sight of the fact that other than taking the law into one's own hands, bankruptcy is the only choice that society has as far as workable debt collection procedures go.¹⁹⁵ If forgiveness is truly the rationale behind the fresh start approach then why go through the complicated and expensive bankruptcy procedure?¹⁹⁶ Evans theorises that the rationale behind the fresh start approach is curative and aims to manage as reasonably as possible the interests of all the role-players.¹⁹⁷

2.4.2.3 *The rehabilitation rationale*

When describing the goal of current bankruptcy law in America, Howard fittingly states that these laws function to facilitate future access to credit, and to return consumers and entrepreneurs to the credit economy.¹⁹⁸ It is submitted that this viewpoint embodies the spirit of the rehabilitation rationale. In principle this justification of the fresh start theory holds that discharging the debtor of the large financial burden of his or her debts allows him or her to return to actively participate in the economy.¹⁹⁹ Additionally, the release of the debtor gives new energy to the debtor's economic efforts which had previously been derailed by the huge debts he or she had.²⁰⁰ The classic argument by proponents of this rationale is that a debtor will not work as hard if he or she knows that most of the money he or she earns will go to his or her creditors.²⁰¹ Thus, as Jackson explains:²⁰²

The debtor ... [will] devote more of his energies and resources to leisure, a consumption item that his creditors cannot reach which decreases the debtor's productive contributions to society. By doing less work and enjoying more leisure, the individual undoubtedly decreases his productive contributions to society.

¹⁹⁴Evans 2008 LLD Thesis 150.

¹⁹⁵*Ibid.*

¹⁹⁶*Ibid.*

¹⁹⁷Evans 2008 LLD Thesis 151.

¹⁹⁸Howard 1987 *Ohio State Law Journal* 55.

¹⁹⁹Porter and Thorne 2006-2007 *Cornell Law Review* 71.

²⁰⁰*Ibid.*

²⁰¹Jackson 1984–1985 *Harvard Law Review* 1393 and 1394.

²⁰²Kilborn 2003 *Ohio State Law Journal* 864.

In chorus with rejuvenating the debtor, this rationale also holds that the discharge provides a liability safety net which encourages entrepreneurial persons to take commercial risk for the benefit of society.²⁰³ In other words, entrepreneurs are more comfortable taking business risk knowing that they have the fresh start inspired discharge to fall back on. Tabb states the following in this regard:

In order to encourage risk-taking, which was in the good of the nation, exposure to such enterprise risk needed to be limited. Since the corporate form of organisation was not then generally available as a risk-limiting device, the bankruptcy discharge was used to perform the same function.

Of the three, the rehabilitation rationale is by far the more common justification used to defend the fresh start theory.²⁰⁴ Kilborn, however, presents the following three arguments against this rationale.²⁰⁵

- (a) Bankruptcy is not the main safety net limiting liability in commerce today. From the turn of the nineteenth century all commercial persons could avoid the liability of business failure by applying for a company.²⁰⁶ Today protection against personal liability for business failure for these commercial persons is as simple as filling in a few forms to incorporate a company or a close corporation.²⁰⁷ Consequently the justification that it provides a safety net is no longer as persuasive.
- (b) The ordinary debtor in the United States is not so burdened with debt or stripped of his or her assets by collection actions that he or she requires a painless discharge as advocated by the rehabilitation rationale.²⁰⁸ In addition to the emergence of the corporate protection described above, creditors in the United States have never actually been able to deprive debtors of all their

²⁰³ Jackson 1984–1985 *Harvard Law Review* 1393.

²⁰⁴ Hallinan 1986–1986 *University of Richmond Law Review*.

²⁰⁵ Kilborn 2003 *Ohio State Law Journal* 878.

²⁰⁶ See also LoPucki 1996 *Yale Law Journal* 106.

²⁰⁷ Hallinan 1986–1986 *University of Richmond Law Review* 57.

²⁰⁸ Kilborn 2003 *Ohio State Law Journal* 878.

property.²⁰⁹ Exemption laws have been around since the Country was colonised by the English.²¹⁰ Furthermore the bankruptcy legislation in each State spares from attachment most of the average debtor's property from collection actions by creditors.²¹¹ Moreover, since the collection and realisation costs often exceed the resale value of most consumer property, these costs regularly discourage creditors from engaging in collection actions.²¹²

- (c) Proponents of this rationale also argue that a heavily burdened debtor has less incentive to work. Here Kilborn argues that the debtor's salary is an important property interest because it is one of the only assets on which he or she can rely to meet his or her immediate responsibilities.²¹³ Since the *Federal Consumer Credit Protection Act* of 1968 provides protection against a significant fraction of the debtor's salary from his creditors,²¹⁴ there is no reason why the debtor should have less incentive to work.

Kilborn makes some valid points against all three rationales. His viewpoint is that the American fresh start policy prior to 2005 is on its own no longer a practical model for modern debt relief systems as it relied on outdated rationales that irreconcilably undermined the country's sanctity of contract principles.²¹⁵

2.4.3 Remarks on the success of the fresh start theory

With regard to the debtor, one of the central ideas that the fresh start theory is based on is that a straight discharge offers the debtor and his or her family a better financial future.²¹⁶ A study on a substantial sample size of debtors one year after they filed for a discharge showed that more than one third of these

²⁰⁹Evans 2010 *Comparative and International Law Journal of Southern Africa* 68. Evans notes that the fresh start policy helps debtors to re-build their estate by allowing them to keep a considerable number of their assets.

²¹⁰*Ibid.*

²¹¹Jurinski *Bankruptcy step-by-step* 121.

²¹²Kilborn 2003 *Ohio State Law Journal* 878.

²¹³*Idem* 880 and Shimm 1971 *Duke Law Journal* 879.

²¹⁴Kilborn 2003 *Ohio State Law Journal* 881.

²¹⁵*Idem* 898.

²¹⁶See par 2.3.1 above.

debtors reported that their finances were the same as or worse than at the time they applied for a discharge.²¹⁷ Two thirds of these debtors did however report that their financial affairs were better after acquiring a discharge. The study also noted a correlation between the lack of a stable income and the debtors who continued to struggle after receiving a discharge.²¹⁸ The study thus concluded that the fresh start policy is an inadequate solution for chronic income problems and does not protect families from future financial disasters.²¹⁹

With regard to the study above and its criticism of the fresh start policy, from the debtor's point of view the criticism should be taken with a pinch of salt. Almost seven out of every ten debtors that apply for a discharge are "living a better life" after the discharge. It is suggested that this is a fairly good success rate. The legislature surely did not intend the fresh start discharge to be the final solution for the economic woes of its citizens. This piece of policy is merely part of a multifaceted economic solution. In light of evidence linking inconsistent income to a less than successful rehabilitation rate, the failure of other measures intended to lower the unemployment rate and increase wages taken by the state must also share in the blame as to why the fresh start policy is not 100 per cent efficient.

From a creditor's viewpoint the fresh start policy in a bankruptcy system may have less favourable consequences. In the United States of America when the bankruptcy system was rooted in the fresh start policy, studies show that unsecured creditors receive dividends in only five per cent of bankruptcies.²²⁰ It is submitted that this is very low and hardly seems fair considering the willingness of the creditor to extend credit to the debtor. Furthermore, such a low return rate to creditors in exchange for a discharge may suggest to the public that one can trade off burdens for benefits.²²¹ This sends out a

²¹⁷Porter and Thorne 2006–2007 *Cornell Law Review* 69 and 86.

²¹⁸*Idem* 70.

²¹⁹*Ibid.*

²²⁰Tabb 1991 *American Bankruptcy Journal* 6 and Kilborn 2003 *Ohio State Law Journal* 884.

²²¹*Ibid.*

dishonest message regarding financial responsibility.²²² It is expected in any society that people must pay their debts or at least make a valiant effort in that regard. Jones and Zywicki put it best when they say:²²³

Bankruptcy should not merely be a means of violating promises willy-nilly. A promise to repay money is an important legal and moral obligation, neither lightly to be undertaken nor cast away. Filing bankruptcy represents a decision to repudiate promises made in exchange for goods, services and other promises. Of such promises and reciprocity is the fabric of civil society woven.

Looking at the fresh start policy from both the debtor's and creditor's viewpoint, brings us back to the dilemma experienced by every legislature when debating bankruptcy legislation,²²⁴ this being how to balance the interests of the bankrupt debtor who wishes to make a fresh start against his or her creditors' honest claims to get paid.²²⁵ Although the fresh start policy has its advantages, a balance is required between discharging honest debtors and the debtor making good on his or her obligations to the creditor within reason.

In 2005 amendments were made to *the American Bankruptcy Code* in order to redress some of the inequities brought on by years of implementing the fresh start policy.²²⁶ These amendments, in short, reinforced the rights of secured creditors, and a compulsory means test was introduced to identify debtors who are able to follow a repayment plan to increase dividends to creditors.²²⁷

A discussion now ensues of recommendations and guiding principles for reform from studies by important role players that have attempted to identify the essential elements of a well-organised and cost-effective consumer

²²² *Ibid.*

²²³ Jones and Zywicki 1999 *Brigham Young University Law Review* 181.

²²⁴ See par 2.1.

²²⁵ *Ibid.*

²²⁶ Herbert *Understanding bankruptcy* 2. These American attempts to meet this balance will be further discussed in Chapter 5.

²²⁷ *Idem* 4.

bankruptcy regime. These recommendations and reports have attempted to find a middle ground in balancing all the interests of the parties involved in bankruptcy proceedings. It is evident from a plain reading that these recommendations and guiding principles to reform find their basis in the pool of theories discussed above.

2.5 Current Trends and Guidelines for Reforming Bankruptcy Laws

As previously noted, several jurisdictions have had to review their debt relief dispensation because of the relaxation of access to credit and the ensuing increase in bankrupt consumers and businesses.²²⁸ As a result of these reform projects a number of constructive reports and recommendations have been made by various specialists in practice, and academic bodies discussing guidelines for reforms and essential components of modern debt relief regimes.²²⁹ Although these recommendations originate from the experience of other jurisdictions with over-indebted consumers, it is submitted that these considerations can provide valuable standards from which the Tanzanian debt relief system can learn and compare with. While this discussion reflects the results of numerous studies and reports that were consulted, only the more prominent guidelines on the subject are mentioned below.

When consumers in any country find themselves overwhelmed and unable to pay their debts, it is important that they choose the most suitable debt relief procedure available.²³⁰ Furthermore, it is important at this juncture that these consumers do not unfairly infringe on the rights of creditors. Ziegel states that at this point in the relief process, debt relief regimes can be evaluated by a series of probing questions:²³¹

- (a) What are the formalities and requirements the debtor must comply with in order to voluntarily place him or herself into bankruptcy?

²²⁸ See par 2.1 above.

²²⁹ *Ibid.* See also Boraine 2003 *De Jure* 235 for a discussion of a number of these reports.

²³⁰ Boraine 2003 *De Jure* 235.

²³¹ Ziegel 1999 *Osgoode Hall Law Journal* 211.

Consideration must also be had on how the process will be administered;

- (b) What property will be exempt from the bankrupt estate?
- (c) What is the discharge dispensation of the jurisdiction? For example is it automatic or dependent on a certain dividend to the creditors?
- (d) What alternatives to bankruptcy are available to debtors?
- (e) What role does counselling and education play in rehabilitation of debtors?
- (f) Does the system allow a reaffirmation of debts that accrued before bankruptcy?

In 1982 the United Kingdom insolvency law review committee on insolvency law and practice published a report, also known as the Cork Report.²³² This report addressed various issues concerning balancing the interests of creditors, debtors and other interested parties in bankruptcy.²³³ Addressing the concerns previously raised in this chapter on balancing these interests, the Cork Report notes the following issues that ought to be considered during the process of law reform:²³⁴

- (a) Even though it is important to punish the fraudulent or reckless debtor, it is just as important to create a system that deals with concern and sympathy with the honest but unfortunate debtor. The system must enable an insolvent to rehabilitate him or herself quickly, at low cost and with as little commotion as possible;
- (b) debt relief for the debtor is exchanged for a contribution to his or her debts from the realisation of his or her assets and future earnings. This contribution from future earnings must be reasonably declared in order not to strain the debtor's family too much or deprive the debtor of the incentive to work;

²³²The United Kingdom Insolvency law Review Committee 1982 *Insolvency Law and Practice* pars 20–30 and 187–191. This report is hereinafter referred to as the “Cork Report”.

²³³Boraine 2003 *De Jure* 236.

²³⁴See pars 20–25 and 191–192 of the Cork Report.

- (c) the relationship between the interests of the society, debtor and creditor must always remain at the forefront of law reform. It should always remain the aim of bankruptcy law to promote the fulfilment of contractual obligations. On the flip side of that coin society must be concerned and remedy through legislation the harassment of debtors by their creditors and facilitate the debtor's fresh start;
- (d) even though most transactions involving credit are completed smoothly to the terms of the contract, it is the nature of all things that some are bound to fail;
- (e) the economic and social consequences of the relationship between debtors, creditors and society as a whole require a legal system that gives the creditor confidence to extend credit to the public, but at the same time encourages the debtor to act responsibly;
- (f) in the complicated area of credit there remains the problem experienced by the legislature of creating a balance between the interests of creditors and debtors; and
- (g) the importance of credit in today's economy and the importance of fulfilling ones obligations should be recognized.

Paragraphs (a) to (c) above all harbour social ideals that go beyond the scope of recouping the creditors' claims from the debtor in a typical traditionalist fashion, whereas paragraphs (e) to (g) all foster principles promoting the fulfilling of one's obligations to his or her creditors in a manner distinctive of the proceduralists, who are of course more concerned with maximising creditor returns.

After the Cork Report the first large-scale investigation into consumer over-indebtedness was commissioned by the Directorate General of the Consumer Policy Services of the European Commission in November 1991.²³⁵ This investigation was conducted by Huls and a team of prominent academics and

²³⁵Kilborn *Expert recommendations and the evolution of European best practices for the treatment of over-indebtedness, 1984–2010* 2.

specialists in the field of debt relief across Europe.²³⁶ The team was commissioned to develop proposals for legislative responses to over-indebtedness.²³⁷ During this period the level of over-indebtedness was rising and few European states had a debt relief procedure that resulted in the complete discharge of the debtor.²³⁸ The team recommended that both creditors and debtors would benefit from a collective system that motivated the debtor to be productive and fulfil their obligations.²³⁹ Under this system the debtor's motivation would be the granting of a complete discharge of debt in exchange for a number of payments made in installments over a fixed period of time. Huls points out that this type of debt restructuring benefits creditors who will end up receiving better dividends, while debtors benefit by receiving a fresh start.²⁴⁰ This type of debt relief system avoids "the well-documented social costs of allowing debtors to languish in over-indebtedness".²⁴¹

Ten years after the European Commission instigated the 1991 study on consumer debt relief, it commissioned another study lead by Reifner, through the Directorate General of Health and Consumer Protection.²⁴² This report catalogues the debt relief practices in numerous regimes across Europe and formulates five principles of European debt relief:²⁴³

- (a) The debtor may be rehabilitated by way of a general discharge of debt;
- (b) the debtor must earn the fresh start through a payment plan, which tends to be quite severe to avoid public resistance to the idea of writing of debt as these jurisdictions are traditionally conservative;

²³⁶ *Ibid.*

²³⁷ Huls 1993 *Journal of Consumer Policy* 215.

²³⁸ Niemi-Kiesiläinen 1999 *Osgoode Hall Law Journal* 475.

²³⁹ Kilborn *Expert recommendations and the evolution of European best practices for the treatment of over-indebtedness, 1984-2010* 4.

²⁴⁰ Huls 1999 *Osgoode Hall Law Journal* 221–23.

²⁴¹ *Ibid.*

²⁴² This report is hereinafter referred to as Reifner *et al Principles from 15 European states*. See Kilborn *Expert recommendations and the evolution of European best practices for the treatment of over-indebtedness, 1984-2010* 4 for a discussion on this report.

²⁴³ *Ibid.*

- (c) the proceedings leading up to a discharge of debt are open to all consumers who acted in good faith while becoming over-indebted;
- (d) debt counselling is available to all the consumers; and
- (e) the European jurisdictions prefer to resolve all disputes over debts through out-of-court proceedings first.

The idea of an “earned fresh start,” as opposed to the American “fresh start,” is implemented by the continental European jurisdictions.²⁴⁴ The term “earned fresh start” denotes a system where the debtor’s discharge is dependent on an extensive repayment plan and his or her behaviour during that plan.²⁴⁵ This term will be discussed further in some detail below.²⁴⁶

Inspired by the large consumer debt in multiple jurisdictions, the International Association of Restructuring, Bankruptcy and Insolvency Professionals (Insol International) published a report in 2001 clarifying the principles on which consumer bankruptcy laws should be founded.²⁴⁷ The second edition of this report was published in 2011 and is a further expansion and clarification of the 2001 report.²⁴⁸ The principles noted by Insol International should ideally be uniformly applied in all countries.²⁴⁹ The recommendations are intended to assist all those jurisdictions establishing processes for reducing and avoiding consumer bankruptcies and to address any resulting social and psychosomatic consequences. According to Insol International the principles that would bring about the resolution of consumer debt problems are the following:²⁵⁰

- (a) the system must provide fair allocation of consumer credit risks;

²⁴⁴Reifner *et al Principles from 15 European states* 258. See also 6.1 below.

²⁴⁵*Ibid.*

²⁴⁶See par 6.1 below.

²⁴⁷Insol international 2011 *Consumer debt report II: Report of findings and recommendations* 1 hereinafter referred to as the “consumer debt report.” See also the www.insol.org/page/38/consumer-debt-report (last accessed 2012-06-10).

²⁴⁸Insol international 2001 *Consumer debt report: Report of findings and recommendations* 3.

²⁴⁹*Ibid.*

²⁵⁰*Ibid.*

- (b) the legal system must provide for some type of discharge of the debtor or a “fresh start” for the debtor;
- (c) provisions should also be made for alternatives to formal Court Proceedings;
- (d) with alternative procedures to bankruptcy the legislature must hinder creditor actions to block debt settlements, especially when such efforts are unreasonable; and
- (e) the jurisdiction must focus on prevention to reduce the need for corrective intervention.

Insol International also lays down what has to be achieved by government through its legislative and executive branches in these jurisdictions in order to accomplish these principles. According to Insol International the Legislature is required to:²⁵¹

- (a) pass laws to provide for a fair, efficient, cheap and accessible settlement discharge of the consumer and small businesses;
- (b) provide for suitable alternative procedures to bankruptcy that are sensitive to the debtor’s state of affairs; and
- (c) promote the development of extra-judicial proceedings in order to resolve the problems of consumer debts.

The executive branch of government, semi-governmental and other organisations should:²⁵²

- (a) Make available knowledgeable and independent debt counsellors for both before and after bankruptcy;
- (b) set up educational programmes to give advice on the risks of consumer credits;
- (c) encourage both debtors and creditors to participate in extra-judicial settlement of debt to resolve debt collection issues; and

²⁵¹ Insol international 2011 *Consumer debt report II: Report of findings and recommendations* 13.

²⁵² *Ibid.*

- (d) ensure the appropriate quality and impartial service is provided by the professional bodies that provide debt relief in each particular jurisdiction.

The consumer debt report also recommends that the organisations of lenders and consumers should:²⁵³

- (a) Re-evaluate the way credit is made available to consumers, the amount of information that is made available to the public by lenders and the method in which debts are collected;
- (b) review the credit industry's credit reporting on consumers to make it more accurate and make the information available to the consumers concerned; and
- (c) make information on consumer rights available to the public and easily understood.

The World Bank developed the “Principles for effective insolvency and creditor/debtor regimes” in 2001 in response to a request from the international community as a result of the financial crisis engulfing emerging markets in the late 1990s.²⁵⁴ These principles have been revised at length through the years; the latest version was published in 2011.²⁵⁵ The gist of this publication is that any standardised system of credit should be accompanied by debt relief procedures that provide a consistent and efficient means of debt collection.²⁵⁶ While a majority of the issues discussed by this publication focus on corporate insolvency and strengthening the regulatory institutions associated with insolvency procedures, some of the recommendations made may be taken into account for consumer debt relief. It is noted in this report that although approaches to debt relief vary from jurisdiction to jurisdiction, effective insolvency regimes should aim to.²⁵⁷

²⁵³Insol international 2011 *Consumer debt report II: Report of findings and recommendations* 14.

²⁵⁴www.web.worldbank.org (last accessed 2012-06-10).

²⁵⁵See also Calitz 2011 *De Jure* 2.

²⁵⁶The World Bank 2011 *Principles for effective insolvency and creditor/debtor regimes* 5.

²⁵⁷*Idem* 8–15.

- (a) integrate well with the country's laws and commercial systems;
- (b) maximise the values of the creditors dividends during debt collection procedures;
- (c) provide for the equal treatment of creditors in similar preference groups;
- (d) provide for the efficient and unbiased resolution of all debt relief proceedings including bankruptcy; and
- (e) prevent the improper use of the debt relief system by all interested parties.

An element that appears to be in every report is that all debt relief regimes should have an alternative procedure to bankruptcy. Walters notes the advantages of having an extra-judicial alternative to the bankruptcy procedure as the following:²⁵⁸

- (a) Debtors through this informal procedure may avoid the publicity and stigma associated with bankruptcy;²⁵⁹
- (b) such a procedure will provide debtors in certain professional groups with a debt relief alternative that unlike bankruptcy will not impact their ability to continue with their chosen profession. Such employees usually include company managers;
- (c) debtors who have a large number of assets and a stable income are able to protect their assets which would otherwise be surrendered in bankruptcy; and
- (d) alternative debt relief measures such as individual voluntary arrangements²⁶⁰ have historically yielded better returns for the creditors involved.

²⁵⁸Walters 2009 *International Insolvency Law Review* 19.

²⁵⁹It should be noted however that any alternative measure will be a matter of public record and will be recorded by credit bureaus. However there is no need for the fact that a debtor is under a payment plan for example to be published in a local newspaper.

²⁶⁰See s 253 of the English *Insolvency Act* of 1986 and par 5.5.2 above.

In support of an alternative to bankruptcy, Grenville asserts that one of the aims of bankruptcy reform is to reduce the number of debtors who under the previous regime would have been subject to the full rigors of bankruptcy.²⁶¹ In doing so he claims we manage to reduce the administration costs associated with a full bankruptcy procedure and thus make larger dividends available to creditors.²⁶²

2.6 Conclusion

As explained above, access to credit is at an all-time high in Tanzania and the number of debtors defaulting on loans from financial institutions is increasing.²⁶³ Tanzania, like other jurisdictions where an increase in consumer insolvency has been an impetus for reform,²⁶⁴ is considering reforming its bankruptcy regime.²⁶⁵ When reform is on the horizon it becomes essential to dissect the purpose that law should serve and examine the theoretical context upon which this new substantive law should be based.²⁶⁶ Therefore, in this chapter a survey was undertaken of the most current trends and philosophies of modern consumer insolvency law. Based on this discussion a list of universal “best practices” will be formulated upon which the Tanzanian debt relief system will be assessed.

In order to attain an appropriate theoretical basis for the Tanzanian debt relief system a review of the two main schools of bankruptcy thought, the proceduralists and traditionalists, was undertaken.²⁶⁷ The proceduralist and traditionalist approaches are the two mainstream schools of thought that dominate the bankruptcy debate. These schools have different views with regard the main purpose of consumer bankruptcy law and how it should operate.

²⁶¹Grenville *Bankruptcy: the law and practice* 1.

²⁶²*Ibid.*

²⁶³Par 1.1 above.

²⁶⁴Par 2.1 above.

²⁶⁵Par 1.1 above.

²⁶⁶*Ibid.*

²⁶⁷Par 2.3 above.

According to proceduralists, bankruptcy law should deal exclusively with questions regarding the distribution of the debtor's assets by resolving procedural collection problems and maximising the creditors' recovery rate.²⁶⁸ This school of thought places a very high priority on the effects of judgments and policy on investors and creditor returns.²⁶⁹ Bankruptcy according to them is not an extraordinary remedy that can be used to address policy concerns; rather it is primarily a debt collection procedure.

Traditionalists, in contrast to the proceduralists, are of the opinion that substantive value choices intrinsic to bankruptcy take into account the interests of other parties to the bankruptcy such as the debtor, his or her employees, and the society.²⁷⁰ Traditionalists believe that because bankruptcy can potentially affect a society as a whole, all members of that society have a right to be represented in any decision-making on bankruptcy. Therefore, according to these proponents, bankruptcy policymakers and judges should focus on the interests of all the relevant parties rather than just on maximising creditor dividends.²⁷¹

It would appear that the traditionalists are correct. The proceduralists' view that bankruptcy should be seen purely as a debt collection procedure whose main goal is to maximise the value of the debtor's estate for the creditors, is too narrow and short sighted. The social consequences of bankruptcy and economic failure, it is submitted, are too grim and far-reaching to ignore.²⁷² It thus appears wise that bankruptcy law must be loaded with policy considerations intended to benefit all those party to a bankruptcy.²⁷³

²⁶⁸ *Ibid.*

²⁶⁹ *Ibid.*

²⁷⁰ Azar 2008 *Emory Bankruptcy Developments Journal* 383.

²⁷¹ Par 2.3 above.

²⁷² Par 2.1 above.

²⁷³ The outcome of having a system based predominantly on traditionalist philosophies was observed in the United States prior to 2005 when the "fresh start" theory was in practice in this jurisdiction. See par 2.4 above.

Following on the discussion of the two central theories of bankruptcy law, the American “fresh start” theory was evaluated.²⁷⁴ The reason for this evaluation lies in the fact that the “fresh start” theory has inspired numerous reforms across the globe and is by far the most influential theory in debt relief reform in the modern era.²⁷⁵ This theory is also based heavily on traditionalist values and it was important in this study to gauge the effectiveness of a system that was inspired by these ideals. The basis of this theory as it was implemented in the United States before 2005 was that it aimed at freeing the debtor of his or her debts and placing him or her back into the market economy to be productive once more.²⁷⁶ This theory aimed to buffer consumers from the fall-out of the financial crises that had occurred throughout this period of American history.²⁷⁷

The fresh start theory in place in the American bankruptcy regime before 2005 was not entirely successful.²⁷⁸ It succeeded in discharging a very large majority of the debtors who applied for the straight discharge, but had a very poor rate of return on the creditors’ claims.²⁷⁹ Fewer than ten per cent of these creditors received a return on their proven claims.²⁸⁰ As a result of this liberal approach that allowed numerous debtors to avoid fulfilling their obligations, the sanctity of contracts doctrine was brought into question in the United States.²⁸¹ This form of relaxed discharge clearly undermined the notion that contracts should be upheld. Scholars in the United States proposed a number of explanations as to why the law should allow debtors who have valid legal obligations, to discharge these obligations with such ease.²⁸² The creditor protection rationale theorised that debtors were more likely to cooperate with their creditors with the incentive of a discharge available. The mercy rationale hypothesised that a debtor’s discharge should be approved

²⁷⁴ Par 2.4 above.

²⁷⁵ Par 2.4 above.

²⁷⁶ *Ibid.*

²⁷⁷ *Ibid.* On this explanation alone the fresh start theory must be viewed as a traditionalist concept.

²⁷⁸ Par 2.4.2.4 above.

²⁷⁹ *Ibid.*

²⁸⁰ *Ibid.*

²⁸¹ Par 2.4.2 above.

²⁸² Par 2.4.2.1 above.

on moral grounds where he or she was a victim of circumstance.²⁸³ Finally, the rehabilitation rationale stated that allowing a debtor a discharge allowed him or her to be active again in the economy and encouraged risk-taking.²⁸⁴ While some of these arguments appeared compelling, it is submitted that the sanctity of contracts doctrine is irreconcilable with the fresh start approach in the United States prior to 2005.²⁸⁵ Therefore any reform efforts in Tanzania must cautiously strike a balance between offering an honest debtor a discharge and making repayments to creditors who willingly extended credit. In other words, a good debt relief system for the sake of effectiveness must have a balance between traditionalist and proceduralist values.

After a discussion of the central philosophies in bankruptcy law, a survey of a number of studies and recommendations for law reform in the area of debt relief was undertaken.²⁸⁶ These guidelines, it would appear, are the practical application of the theories discussed above; the correlation is quite evident. The Cork Report consists of both traditionalists and proceduralist views, and advocates taking into account the society, the blameworthiness of the debtor and the creditors' rights when formulating bankruptcy policy.²⁸⁷ The 1991 report instigated by the European Commission recommended that both creditors and debtors would benefit from a collective system that motivated debtors to be productive and fulfil their obligations, a proceduralist trait.²⁸⁸ Insol International took a pragmatic approach with both traditionalist and proceduralist ideas incorporated, and focused more on the prevention of over-indebtedness with their recommendations in both their 2001 and 2011 reports.²⁸⁹ Numerous other reports and recommendations were discussed in this chapter, and the following three themes or suggestions continuously appeared in every observer's recommendations in one form or another:

²⁸³ Par 2.4.2.2 above.

²⁸⁴ Par 2.4.2.3 above.

²⁸⁵ *Ibid.*

²⁸⁶ Par 2.5 above.

²⁸⁷ *Ibid.*

²⁸⁸ *Ibid.*

²⁸⁹ *Ibid.*

- (a) In the complicated area of credit there remains the problem experienced by the legislature of creating a balance between the interests of creditors and debtors, and the question arises as to how well this problem is tackled by the relevant system?
- (b) Even though it is important to punish the fraudulent or reckless debtor, it is just as important to create a system that deals with concern and sympathy with the honest but unfortunate debtor. The system must enable an insolvent to rehabilitate himself quickly, at low cost, and with as little commotion as possible.
- (c) Following on from point (b) above, provision should be made for an alternative(s) to bankruptcy for the debtor. This alternative to bankruptcy must be efficient, well supervised and cost-effective.

In view of the fact that these considerations appear consistently in every relevant commentator's observations of a modern debt relief regime, it is submitted that these are the preeminent considerations suggested by relevant commentators for a modern debt relief regime. They will be used in the next chapter as a tool to assist in the evaluation of the Tanzanian debt relief system, and to uncover its shortcomings.

CHAPTER 3

THE TANZANIAN DEBT RELIEF REGIME EXPOSED

SUMMARY

- 3.1 Introduction**
 - 3.2 Brief Historical Overview**
 - 3.3 Debt Relief Under the Bankruptcy Act**
 - 3.4 Alternatives to Bankruptcy and Reform Initiatives**
 - 3.5 Conclusion**
-

“Danger lurks in any attempt to set forth generally the purpose of any body of law ... even if the purposes can be accurately and simply stated, the implementation of those purposes is by no means simple. The existence of long statutes and hundreds of cases demonstrate without question the complexity of that implementation in the law of bankruptcy.”¹

3.1 Introduction

In the above quotation Macneil warns of the perils of creating a set list of purposes for any statute or body of law. The main dangers he cites are oversimplifying complex pieces of law and making omissions of relevant parts of the statute.² It is submitted that the same dangers lie ahead in this chapter, where an effort will be made to summarise and assess the debt relief processes available under the debt relief regime of the United Republic of Tanzania. Nevertheless, a review of the debt relief procedures under the Tanzanian regime is vital in order to analyse their efficiency and compare

¹Macneil *Bankruptcy law in East Africa* xiii.

²*Ibid.*

these processes against those available in other jurisdictions, which is the focus of this study. Another ground for detailing and reviewing the Tanzanian debt relief system, although less relevant, is the shortage of academic research in this area in Tanzania. This shortage places a burden on scholars to make available a working guide or summary of the debt relief measures in Tanzania for students, fellow scholars, practitioners, investors, government officials and even the avid reader.

Without credit there would also be no bankrupt consumers.³ As previously explained because of the worldwide boom in the credit industry, consumer bankruptcy is on the rise.⁴ Consequently many countries are in the process of, or have already reviewed their insolvency legislation.⁵ In Tanzania the number of over-indebted consumers is rising steadily.⁶ It is therefore the aim of this chapter to investigate the capability of Tanzania's debt relief processes in dealing with consumer debt by assessing them against the best practices developed by more economically advanced countries that have undergone legislative makeovers to suit the credit increase in their consumer markets. These practices were identified in Chapter 2. They are the availability of an efficient alternative to bankruptcy, a balanced approach to handling creditor and debtor interests during debt relief procedures and differentiating between the *bona fide* and *mala fide* debtor with regard to the debtor receiving a swift discharge of his or her pre-bankruptcy debt.⁷

The main aim of this chapter is to illustrate in detail the current remedies available for the Tanzanian consumer and to demonstrate that in light of the increase of insolvent consumers, the Tanzanian consumer debt relief system requires reform.

³Woods *Principles of international insolvency*. See also Jackson *The logic and limits of Bankruptcy law* 7.

⁴Boraine 2003 *De Jure* 236.

⁵*Idem* 235. See also par 2.1 above.

⁶Par 1.1 above and Bank of Tanzania Jan 2010 *Monthly Economic Review* 12.

⁷Par 2.6 above.

3.2 Brief Historical Overview

As discussed previously, law develops adjacent to and in relation to the society it is meant to govern; the two are entwined.⁸ Consequently, in order to understand the current state of the Tanzanian legal system, it is necessary to present a historical overview of the system.

The United Republic of Tanzania, known as Tanganyika before 1964, was a German colony between 1891 and 1919.⁹ The law of this territory, having been managed by the German East African Company prior to January 1891, was administered by the German Crown from that date to the end of the First World War.¹⁰ German colonial law distinguished between Europeans and Africans, the latter continued to be governed by the indigenous customary law administered by chiefs and other native organs.¹¹ The Europeans were governed entirely by German law.¹²

In the aftermath of the First World War Tanganyika was one of the former German colonies that under the Treaty of Versailles became a British protectorate.¹³ Twaib notes that as was the case with probably all British colonies and protectorates, Tanganyika found itself a recipient of the English common law.¹⁴ The British common law was imported into Tanzania via India by the British administration, where it had been long established and was in most sectors transplanted as is.¹⁵ As such, the basic structure of the present legal system is heavily influenced by the English legal system and remains, for the most part, unchanged from when it was first introduced into the territory in the early 1920s and 30s.¹⁶ It was during this period that the

⁸See par 2.2.1 above.

⁹Shivji *The law, state and the working class in Tanzania: C. 1920–1964* 22.

¹⁰Twaib *The legal profession: The legal profession in Tanzania* 18.

¹¹*Ibid.*

¹²*Ibid.*

¹³Ndulu *et al Tanzania at the turn of the century: Background papers and statistics* 152.

¹⁴Twaib *The legal profession: The legal profession in Tanzania* 20. The only German influence that currently exists in the legal system in Tanzania is in land law. With respect to bankruptcy the British bankruptcy tradition was transplanted into East Africa almost in its entirety. See Twaib *The legal profession: The legal profession in Tanzania* 16.

¹⁵www.tanzania.go.tz/administrationf.html (accessed 2010-08-27).

¹⁶*Ibid.* It was during this period that the *Bankruptcy Act* was promulgated in Tanzania.

Bankruptcy Act No. 9 of 1930 was promulgated in Tanzania. For this reason Tanzanian's legal system is fundamentally a common law legal system.

3.3 Debt relief under the *Bankruptcy Act*

The primary bankruptcy legislation in Tanzania is the *Bankruptcy Act* No. 9 of 1930.¹⁷ This *Bankruptcy Act* is largely identical to the English *Bankruptcy Act* of 1914, as a result of the territory's reception of English law explained above.¹⁸ This piece of legislation deals with the bankruptcy of natural persons, while the winding up provisions of the *Companies Act* 12 of 2006 deal with the insolvency of corporations.¹⁹ To this end section 118 of the *Bankruptcy Act* states that a receiving order shall not be made against any corporation or against any association or company registered under the *Companies Act* of 2006.²⁰ Tanzania's insolvency law is therefore not regulated by a unified statute catering for both corporate and personal insolvency, as is the modern trend.²¹

The main procedure available to indebted natural persons to secure a fresh start in Tanzania is bankruptcy under the *Bankruptcy Act*.²² The portal into bankruptcy depends on a specifically defined debtor under the Act committing an act of bankruptcy under the Act.²³ A debtor is defined under section 3(2) of the Act as any person who at the time when he or she committed an act of bankruptcy was:

- (a) personally present in Tanzania; or
- (b) ordinarily resided in Tanzania; or
- (c) had a place of residence in Tanzania; or
- (d) carried on business in Tanzania; or

¹⁷Cap 25 Revised Edition 2002. Hereinafter referred to as the *Bankruptcy Act* or the Act.

¹⁸See par 3.2 above and Macneil *Bankruptcy law in East Africa* 14. See also Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 3.

¹⁹Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 293.

²⁰*Ibid.*

²¹Burdette 1999 *International Insolvency Law Review* 170.

²²Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 297. See also Macneil *Bankruptcy law in East Africa* xiv.

²³Ss 3, 6 and 8 of the Act.

- (e) a member of a partnership which carried on business in Tanzania.²⁴

Under section 3 of the *Bankruptcy Act* the following are deemed to be acts of bankruptcy by the debtor:²⁵

- (a) If in Tanzania or elsewhere the debtor makes any conveyance or assignment of his property to his trustee for the benefit of his creditors generally, or if he makes a fraudulent conveyance, gift, delivery or transfer of his property, or if he makes a conveyance or transfer of his property, or creates a charge thereon which would be void as a fraudulent preference, should he be adjudged bankrupt;²⁶
- (b) If with the intent to defeat or delay his creditors he departs from Tanzania, or if he was outside Tanzania, remains outside Tanzania, or departs from his house or dwelling, or becomes inaccessible to creditors;²⁷
- (c) If execution against him has been levied by seizure of his goods in any civil proceedings in any Court and the goods have either been sold or held by the bailiff for 21 days;²⁸
- (d) If he files in the Court a declaration of his inability to pay his debts or presents a bankruptcy petition against himself;²⁹
- (e) If a creditor has obtained a final judgment or final order against him for any amount and he does not within seven days after service of the notice on the debtor in Tanzania either comply with the requirements of a bankruptcy notice under the Act,³⁰ or does not

²⁴S 3(2)(a)–(d). Under s 3(2) a person against whom bankruptcy proceedings have been instituted in a reciprocating country and who has property in her or his name in Tanzania may also in certain instances be classified as a debtor under the Act.

²⁵See also Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 293.

²⁶S 3(1)(a)–(c).

²⁷S 3(1)(d).

²⁸S 3(1)(e).

²⁹S 3(1)(f).

³⁰See s 4.

- satisfy the Court that he has a counter claim which equals or exceeds the amount of the judgment sum he was ordered to pay;³¹
- (f) If a debtor gives notice to any of his creditors that he has suspended or that he is about to suspend payment of his debts.³²

When a debtor as defined in the Act commits any of the acts of bankruptcy above the High Court of Tanzania³³ may, on being presented a petition by either the creditor or the debtor, make a receiving order for the protection of the assets of the estate.³⁴ Accordingly, bankruptcy can be sought by both the debtor and his or her creditor(s). When it is sought by the debtor it is more often than not an attempt to secure a fresh start even if the debtor petitions for bankruptcy under the direction of the creditors.³⁵ The petitions of the creditor(s) and debtor will be dealt with separately as different requirements and conditions are levied for each under the Act.

3.3.1 Creditor's Petition

Under section 6 of the Act certain prerequisite conditions must be present before a creditor may petition for bankruptcy. Firstly, the aggregate amount of debt or debts owing to the creditor or several petitioning creditors must amount to one thousand Tanzanian shillings.³⁶ The debt must also be a liquid sum, payable either immediately or at some certain future time.³⁷ The act of bankruptcy on which the petition is grounded must have occurred within three

³¹S 3(1)(g). Under this subsection the debtor must act within 7 days or within the time limit allowed by the Court order to effect service outside Tanzania.

³²S 3(1)(h).

³³Under s 97 the Chief Justice may delegate any part of the jurisdiction of the High Court to any subordinate Court, either generally or for the purpose of any particular case or class of cases. This was done in the Bankruptcy (Delegation of Power and Jurisdiction) Order GN 440 of 1957. Under this order the resident magistrates of Tanga, Mwanza and Arusha have been delegated the power to make receiving orders in bankruptcy petitions presented within their respective areas in which they exercise jurisdiction as district Registrars. According to the World Bank a Bankruptcy proceeding in Tanzania will cost on average 22 per cent of the Bankrupt estate. See www.doingbusiness.org/data/exploretopics/closing-a-business (last accessed 2011-02-10).

³⁴See s 5-13.

³⁵Macneil *Bankruptcy law in East Africa* 1.

³⁶S 6(1)(a). One thousand Tanzanian shillings amounts to approx. 0.67 dollars on 10-06-2012.

³⁷S 6(1)(b).

months of the date that the creditor wishes to present his or her petition.³⁸ In addition, if the petitioning creditor is a secured creditor, he or she must in the petition state that he or she is willing to give up his or her security for the benefit of the creditors in the event of the debtor being adjudged bankrupt, or give an estimate of the value of his or her security.³⁹ In the latter case he or she may be admitted as a petitioning creditor to the extent of the balance of the debt due to him or her, after deducting the estimated value of his or her security, in the same manner as if he or she were an unsecured creditor.⁴⁰ Once all these conditions are present a petition may be presented to the Registrar of the High Court.

In addition to the above requirements, a creditor's petition must also, prior to presentation, be verified by an affidavit of the creditor or some other person on his or her behalf who has knowledge of the facts. The petition must then be registered and served in the prescribed manner.⁴¹ After the presentation of a creditor's petition, before sealing the copies of the petition for service, the statements in the petition must be investigated by the Registrar and where some of the statements in the petition cannot be verified by affidavit, witnesses may be summoned to provide proof of the details in the creditor's petition.⁴²

³⁸S 6(1)(c).

³⁹S 6(2).

⁴⁰S 6(2).

⁴¹S 7(2). According R 118 to 120 of the Bankruptcy Rules GN 159 of 1931, a creditor's petition must be personally served by delivering to the debtor a sealed copy of the filed petition. The petition must be served upon the debtor by an officer of the Court, or by the creditor. If personal service cannot be effected the Court may extend the time for hearing the petition. Where the Court is satisfied by affidavit or other evidence on oath that the debtor is avoiding such service, service of any other legal process or for any other reason prompt personal service cannot be effected, it may order substituted service to be made by delivery of the petition to an adult individual at his usual or last known residence or place of business. Where a debtor petitioned against is not in Tanzania, the Court may order service to be made within such time and in such manner and form as it thinks fit. Service of the petition shall be proved by affidavit with a sealed copy of the petition attached, which will be filed in Court after the service.

⁴²R 117.

Section 5 provides that upon proper presentation of the petition the Court may issue a receiving order for the protection of the estate.⁴³ In the case of a creditor's petition a receiving order is issued only after a Court hearing.⁴⁴ A creditor's petition will not be heard until eight days have expired from the service of the petition on the debtor.⁴⁵ At the hearing the creditor must prove to the Court the following:

- (a) the debt owing to him or her;
- (b) proper service of the petition on the debtor; and
- (c) one of the acts of bankruptcy mentioned in section 3 of the Act.⁴⁶

Where the Court is satisfied with the proof presented by the petitioning creditor, it may issue a receiving order.⁴⁷

Under section 7(3) of the Act the Court may dismiss the petition if it is not satisfied that the aspects in section 7(2) have been proved. The Court may also dismiss the petition if it is satisfied by the debtor that he or she is able to pay his or her debts or for any other sufficient reason that necessitates no order be made.⁴⁸

If the act of bankruptcy relied upon is non-compliance with a bankruptcy notice the Court may stay or dismiss the petition.⁴⁹ In addition, if the debtor denies owing the petitioning creditor, the Court may stay the bankruptcy proceedings until the debtor's liability is determined by trial.⁵⁰ According to

⁴³Macneil *Bankruptcy law in East Africa* 60.

⁴⁴S 7(1).

⁴⁵R 129(2). Provided that where the act of bankruptcy alleged is that the debtor has filed a declaration of inability to pay his or her debts or where it is proved to the satisfaction of the Court that the debtor has absconded, or in any other case for good cause shown, the Court may on such terms as the Court may think fit, hear the petition at such earlier date as the Court may deem expedient.

⁴⁶S 7(2).

⁴⁷*Ibid.*

⁴⁸S 7(3).

⁴⁹S 7(4).

⁵⁰S 7(5). R 132 and 134 state that when a debtor intends to show cause against a petition he or she shall file a notice with the Registrar of the relevant Court specifying the statements in the petition which he or she intends to dispute. Three days before the hearing of the petition a copy of the notice must be delivered by post to the petitioning creditor and his or her

Footnote continues on next page.

section 7(6) however, when proceedings are stayed the Court may still make a receiving order on the petition of another creditor and dismiss the petition in which proceedings have been stayed.⁵¹ The Court may at any time “for sufficient reason” make an order staying the proceedings under a bankruptcy petition, either altogether or for a limited time, and on such terms and subject to such conditions as the Court may think fit.⁵² Macneil describes this as a “blanket authorisation” to stay proceedings.⁵³ The Court may in addition at any time after the presentation of a bankruptcy petition, stay any action against the property or person of the debtor in any Court in which such action is pending against the debtor.⁵⁴ On proof that a bankruptcy petition has been presented, the Court may either stay the proceedings or allow them to continue on such terms as it may think just.⁵⁵ When proceedings on a petition have been stayed for the trial on the validity of the petitioning creditor's debt and such question has been decided against the creditor, the debtor may apply to the Registrar to fix a day on which he or she may apply to the Court for the dismissal of the petition with costs. The Registrar, on the production of such judgment shall give notice to both the petitioner and debtor of the time and place fixed for the hearing of the application.⁵⁶

It is evident that under the Act the success of a creditor's petition rests solely on the discretion of the Court. It is submitted that because of the higher threshold in the requirements for the granting of a receiving order for a creditor's petition as compared to a debtor's petition, it is important to analyse briefly how these grounds for dismissal or stay of a creditor's petition work in practice. In *Janmohamed v Lobo*,⁵⁷ the Court on appeal had before it a bankruptcy notice placing an obligation on the debtor to pay a judgement

advocate. When the debtor appears in Court to show cause against the petition, the debtor will have given notice that he or she intends to dispute. If any new evidence of those matters or any witness or witnesses to such matters shall not be present for cross-examination and further time is required to show cause, the Court shall, if the application appears to the Court to be reasonable, grant such further time as the Court may think fit.

⁵¹ See also Macneil *Bankruptcy law in East Africa* 61.

⁵² S 108.

⁵³ Macneil *Bankruptcy law in East Africa* 61.

⁵⁴ S 11.

⁵⁵ *Ibid.*

⁵⁶ R 138.

⁵⁷ 1935 E.A.C.A 2 117, referred to also by Macneil *Bankruptcy law in East Africa* 60.

debt.⁵⁸ However, no oral evidence was adduced at the hearing of the bankruptcy petition regarding the debt.⁵⁹ Besides, no proof was given by the creditor that the judgment debt was still due at the time of the hearing.⁶⁰ The debtor asserted before the Court of appeal that formal proof of the debt was required at the Court *a quo*'s hearing on the creditor's petition for the creditor to have a claim against him.⁶¹ The Court held that the lack of proof of the creditor's debt was not relevant where the debtor failed to dispute the amount claimed by the creditor. It is therefore submitted that an obligation is placed on the debtor to dispute and adduce evidence of incorrect information given by the creditor whether it is about the debt, the act of bankruptcy relied upon or service of the petition. Failure to do so may be to the debtor's detriment.

With regard to what constitutes "sufficient cause" not to grant a receiving order under section 7(3) of the Act, the Court has the direct authority under section 108 to rule as it sees fit. For example, in the case of *In re Desaiibhai Patel*⁶² the Court held that it had the authority to dismiss a creditor's petition on the ground that it constituted an abuse of the Court's process. *In re Woodward*⁶³ the debtor was a soldier in World War II.⁶⁴ The Court allowed the petition but stayed the receiving order under the *Courts (Emergency Powers) Ordinance* 1944. This ordinance gave the Court the power to stay bankruptcy proceedings if the Court was convinced that the inability of the debtor to pay was due to circumstances directly or indirectly attributable to any war in which his majesty may be engaged.⁶⁵ It is therefore submitted that sufficient cause may be derived from another piece of legislation or any cause that the Court may think reasonable.

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

⁶⁰ 1935 E.A.C.A 2 118.

⁶¹ *Idem* 119.

⁶² 1924 KLR 10 119.

⁶³ 1945 KLR 2 9. See also *Macneil Bankruptcy law in East Africa* 61.

⁶⁴ *Ibid.*

⁶⁵ *Ibid.*

Case law suggests that section 11 is widely interpreted by the Courts. In *In re Somechand Boja*⁶⁶ the Court described its power under section 11 as completely optional and resting on the Court's learned discretion.⁶⁷ In this case the Court used its power under section 11 to release the debtor from jail where he was being held for failure to fulfil his debt.⁶⁸ In the case of *Arjan Sign v Mohamed Bux*⁶⁹ the Court held that a stay would not be granted where the action pending in another Court was a money claim that could be proved in bankruptcy.⁷⁰ In the case of *Official Receiver v United Stores Limited*⁷¹ the Official Receiver, acting as trustee for the property of one Mr Notra, brought an appeal to the East African Court of Appeal to appeal against a decision of the Tanzanian High Court not to allow a stay against garnishee proceedings pending against the debtor in another Court.⁷² The Court explained that proceedings against a defendant were not automatically stayed as a result of adjudication because the Court has a discretion vested in it under the Bankruptcy Act and that the pending proceedings continued until an order was made staying them.⁷³

It is observed that the granting of a creditor's petition as well as its dismissal lies solely at the mercy of the discretion of the Court in Tanzania. A possible explanation of why this wide discretion was given to the Courts by the legislature is to moderate against placing the debtor unnecessarily into a bankruptcy proceeding.

3.3.2 Debtor's petition

In order to allow a debtor to secure a fresh start even in the face of unified resistance by his creditors, the Bankruptcy Act makes provision for the debtor

⁶⁶1930 KLR 12 110.

⁶⁷*Ibid.*

⁶⁸Macneil *Bankruptcy law in East Africa* 62.

⁶⁹1933 KLR 15 84.

⁷⁰*Ibid.* See also *Nemchand Bros v Mohamedali Remanji* 1920 EALR 168 *et seq.*

⁷¹1962 EACA 180.

⁷²*Ibid.*

⁷³*Ibid.*

to petition himself into bankruptcy.⁷⁴ Before a receiving order may be issued the debtor must fulfil the following requirements:⁷⁵

- (a) the petition must allege that the debtor is unable to pay his or her debts;
- (b) the debtor must file with the Official Receiver his or her statement of affairs;⁷⁶
- (c) upon presentation of the petition the debtor must pay a deposit with the Clerk of the Court;⁷⁷ and
- (d) the petition must comply with the formal requirements in rules 106 to 110 of the Bankruptcy Rules.⁷⁸

A discussion of these requirements and how they operate in practice now follows. Under section 8 of the Act a debtor's petition must allege that the debtor is unable to pay his or her debts. The presentation of the petition where the debtor later withdraws the petition may serve as an act of bankruptcy.⁷⁹ The Court must, upon being presented with a properly filed petition, make a receiving order.⁸⁰

The order will, however, not be granted unless the debtor has filed with the Official Receiver his or her statement of affairs prepared in accordance with the provisions of section 16 of the *Bankruptcy Act*. To ensure that section 16 is taken heed of, a debtor's petition will not be accepted for filing unless the Registrar is satisfied that a certificate has been issued by the Receiver showing that the debtor has submitted his or statement of affairs in

⁷⁴Macneil *Bankruptcy law in East Africa* 147 and Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 294.

⁷⁵S 8(1).

⁷⁶Prepared in accordance with the provisions of s 16 of the Act.

⁷⁷R 111.

⁷⁸Macneil *Bankruptcy law in East Africa* 147.

⁷⁹S 8(1). Section 8 specifically states that presentation of the petition alone will suffice to be an act of bankruptcy, there is no need for the debtor to have previously filed a declaration of being unable to pay his debts. Under s 8(2) a debtor's petition may not, after presentation be withdrawn without the leave of the Court.

⁸⁰S 8(1).

accordance with the provisions of section 16 of the Act.⁸¹ Section 16 directs the debtor to submit to the Official Receiver a statement of his or her affairs in the prescribed form verified by an affidavit.⁸² When the debtor has made the submission, the Official Receiver will then certify to the Court that the statement has been duly submitted to him.⁸³ Any person who in writing claims to be a creditor of the bankrupt, may inspect the statement at all reasonable times at the office of the Official Receiver, and make a copy of it.⁸⁴ Any person who fraudulently claims to be a creditor will be guilty of contempt of Court.⁸⁵

3.3.3 General Formalities Required for Petitions

Upon the presentation of a petition the petitioning creditor or debtor is obliged to deposit with the Receiver a predetermined sum of money.⁸⁶ The creditor or debtor may also have to deposit a further sum, if any, as the Court may from time to time direct, to cover the fees and expenses incurred by the Receiver.⁸⁷ No petition shall be received unless the receipt for the deposit payable on presentation of the petition is produced to the Clerk of the Court.⁸⁸

After presentation of either a creditor's or debtor's petition where sufficient grounds are proved by affidavit, the creditor or the debtor may apply to appoint the Official Receiver as interim Receiver of the property of the debtor.⁸⁹ Where an order is made appointing the Receiver to be interim Receiver of the property of the debtor, the order shall bear the number of the petition in respect of which it is made, and shall state the locality of the property of which the Receiver is ordered to take possession, and may direct him or her to take immediate possession of all books of accounts and other

⁸¹R 112.

⁸²This statement must show the particulars of the debtor's assets, liabilities, the names residences and occupations of his creditors, the securities held by them respectively, the dates when the securities were respectively given and such further information as the Official Receiver may require – s 16.

⁸³S 16(2)(a).

⁸⁴S 16(4).

⁸⁵*Ibid.*

⁸⁶R 111.

⁸⁷*Ibid.*

⁸⁸*Ibid.*

⁸⁹S 10 and R 123.

papers and documents belonging to the debtor and relating to his or her business.⁹⁰ Where after an order has been made appointing an Interim Receiver, the petition is dismissed, an application may be made within twenty-one days from the date of the dismissal to adjudicate with regard to any damage or claim arising out of the appointment.⁹¹

On first glance, due to the number of formalities a debtor has to adhere to when presenting a petition, it may appear that a creditor's petition is easier to present to the Court. It is, however, suggested that this is not the case. On a reading of section 8 it is clear that in the case of a debtor's petition, no hearing needs to be held before a receiving order is issued by the Court. Indeed, all the debtor need do under section 8 to be awarded a receiving order is allege that he is unable to pay his or her debts, and properly present a petition to the Court by successfully complying with all the formalities. Upon a proper debtor's petition being presented, unlike in the case of the creditor's petition, the Court has no power to decide on the merits of the case and must issue a receiving order. It is therefore submitted that it is easier for a financially stressed debtor to petition himself into bankruptcy than it is for a creditor to petition such a debtor into bankruptcy.⁹²

3.3.4 Receiving Order

The primary function of a receiving order is the protection of the estate of the debtor.⁹³ Once a receiving order has been made by the Court the Official Receiver is constituted as the Receiver of the property of the debtor.⁹⁴

⁹⁰R 124.

⁹¹R 128.

⁹²South Africa also has a similar provision allowing the debtor to apply for bankruptcy which is known as voluntary surrender in that jurisdiction. Unlike its Tanzanian counterpart this procedure is awash with technical formalities making it difficult for the debtor to obtain a sequestration order. This aspect is further discussed in par 4.3.1 below.

⁹³Macneil *Bankruptcy law in East Africa* 60.

⁹⁴S 9(1). See also Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 295. R 144 and 145 state that the Registrar shall arrange a copy of the receiving order sealed with the seal of the Court to be served on the debtor and the Official Receiver. Under r 142 when a receiving order is made on a creditor's petition it must be stated in the receiving order the nature and date or dates of the act or acts of bankruptcy upon which the order has been made. Every order shall contain at the foot thereof a notice requiring the debtor to appear before the Receiver at a place and date mentioned therein.

Thereafter, except as directed by the Act, no creditor to whom the debtor is indebted in respect of any debt provable in bankruptcy shall have a remedy against the property or person of the debtor, unless with the leave of the Court and on such terms as the Court may impose.⁹⁵ This section will not affect the power of a secured creditor to realise or otherwise deal with his or her security in the same manner as he or she would have realised it if the receiving order had not been granted.⁹⁶ Under the Tanzanian Bankruptcy Act a secured creditor's claim only forms part of the bankrupt estate if it is not completely covered by the creditor's security.⁹⁷

Every receiving order must state the particulars and description of the debtor, the date of the order and the Court which made the order.⁹⁸ When a receiving order is made the Receiver shall without delay send notice of the receiving order for insertion in the *Government Gazette* and in one of the local newspapers. The receiving order may be registered under the *Land Registration Act* 31 of 1997. This is optional but operates to prevent the registration of any disposition of the debtor's estate other than by the Official Receiver or any trustee appointed in the bankruptcy.⁹⁹ The Official Receiver of a debtor's estate may, on the application of any creditor and if satisfied that the nature of the debtor's estate or the interests of the creditors generally require the appointment of a special manager of the estate other than the Official Receiver, appoint a manager to act until a trustee is appointed.¹⁰⁰

⁹⁵S 9(1). Macneil *Bankruptcy law in East Africa* 63 and Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 5.

⁹⁶S 9(2).

⁹⁷R 4, 9 and 10 of schedule 2 of the *Bankruptcy Act* explain that where a creditor holds a mortgage charge or lien over a property of a debtor under a receiving order, he or she has a few options. He or she may choose not to prove a claim against the debtor's estate, if he or she does this, the trustee can either decide to pay him or her in full and in essence buy back the security or allow the creditor to retain the security in full and final settlement of his or her debt. Secondly, if the creditor has the right to realise the property under a contract or some other legal impetus he or she may realise the property. If there is still a surplus of debt over and above that realised in the security he or she may prove a concurrent claim against the debtor. The creditor may also opt to surrender the security and prove his or her whole debt as a concurrent creditor.

⁹⁸S 13 and R 149.

⁹⁹Macneil *Bankruptcy law in East Africa* 62.

¹⁰⁰S 12.

An application may be made to rescind a receiving order under bankruptcy rule 151. Such an application will however not be heard unless proof is shown to the Court that a notice of the proposed application, and a copy of the affidavits in support of that application, were served upon the Receiver.¹⁰¹ When this kind of application is made to the Court to rescind a receiving order on the ground that the debts of the debtor have been paid in full, the Receiver must file a report as to the debtor's conduct and affairs including a report as to his or her conduct during the proceedings.¹⁰² This must be done at least four days before the day appointed for hearing of the application. When the Court hears the application it must consider this report and any further evidence that is adduced by any party, and any objections which may be made by or on behalf of the trustee or creditors.¹⁰³ For the purposes of an application to rescind a receiving order, the report shall be *prima facie* evidence of the statements contained therein.¹⁰⁴

In the case of *re Ghela Ramji*¹⁰⁵ the Court held that only in exceptional circumstances would rescission of a receiving order be granted before the public examination of the debtor.¹⁰⁶ The application by the Receiver also contained a request for approval of a scheme of arrangement, which the Court held it could not hear until after the public examination. From a reading of the judgment, it appears the Official Receiver desired the rescission of the receiving order and simultaneous approval of the scheme of arrangement.

3.3.4.1 *Proceedings after the receiving order*

Proof of debt

Every creditor must prove his or her debt as soon as possible after the making of a receiving order.¹⁰⁷ A debt is proved by delivering a letter to the Official

¹⁰¹R 115(1).

¹⁰²For the purposes of this rule the expression "creditor" includes all creditors mentioned in the debtor's statement of affairs or who have notified the Receiver or trustee that they have, or at the date of the receiving order had, claims against the debtor – R 115(1).

¹⁰³*Ibid.*

¹⁰⁴*Ibid.*

¹⁰⁵1919 ULR 2 303 *et seq*, referred to by Macneil *Bankruptcy law in East Africa* 63.

¹⁰⁶*Ibid.*

¹⁰⁷Schedule 2 Rule 1(1) of the *Bankruptcy Act*.

Receiver or, if a trustee has been appointed, an affidavit verifying the debt.¹⁰⁸ The affidavit may be made by the creditor himself, or by some person authorised on behalf of the creditor.¹⁰⁹ The affidavit must contain or refer to a statement of account showing the particulars of the debt and specify the vouchers, if any, by which they can be substantiated.¹¹⁰

First meeting of creditors

As soon as possible after a receiving order has been made against a debtor a general meeting of his or her creditors must be held.¹¹¹ This first meeting is required to be summoned not later than sixty days after the date of the receiving order, unless the Court for any special reason deems it convenient that the meeting be summoned for a later day.¹¹² The Official Receiver must then summon the meeting by giving not less than six days' notice of the time and place of the meeting in the Government Gazette.¹¹³ The Official Receiver must also send to each creditor mentioned in the debtor's statement of affairs a notice of the time and place of the first meeting, accompanied by a summary of the debtor's statement of affairs including the cause of his or her failure, and any observation which the Official Receiver may think fit to make.¹¹⁴ The purpose of the first meeting is for the creditors to consider whether a proposal for a composition or scheme of arrangement shall be accepted, or whether it is convenient to rather adjudge the debtor bankrupt.¹¹⁵ At this first meeting the creditors also discuss the general mode of dealing with the debtor's property.¹¹⁶

Duties of the debtor

Every debtor against whom a receiving order is made must, unless prevented by a good reason, attend the first meeting of his creditors and submit to such

¹⁰⁸Schedule 2 Rule 1(2) of the *Bankruptcy Act*.

¹⁰⁹*Ibid.* If made by a person so authorised it shall state his authority and means of knowledge.

¹¹⁰Schedule 2 Rule 1(4) of the *Bankruptcy Act*.

¹¹¹S 14.

¹¹²Schedule 1 Rule 1(1) of the *Bankruptcy Act*.

¹¹³Schedule 1 Rule 1(2) of the *Bankruptcy Act*.

¹¹⁴Schedule 1 Rule 1(3) of the *Bankruptcy Act*.

¹¹⁵S 14.

¹¹⁶*Ibid.*

examination and give information as the meeting may require.¹¹⁷ The debtor is also required to do the following:

- (a) give an inventory of his or her property and a comprehensive account of his or her creditors and debtors;¹¹⁸
- (b) attend any other meetings of his or her creditors;¹¹⁹
- (c) execute powers of attorney, conveyances, deeds, instruments and generally do all such acts in relation to his property as required;¹²⁰
- (d) assist with the realisation of his or her property and the distribution of the proceeds amongst his or her creditors;¹²¹
- (e) keep the Official Receiver or trustee advised of his or her residential and business address;¹²²
- (f) submit a statement every three months concerning his employment and income.¹²³

Public examination of the debtor

The Court may order a public examination of the debtor.¹²⁴ The reasons for the public examination as they appear from sections 17 and 28 of the Act in general are the following:

- (a) obtaining information primarily from the debtor on his or her assets and liabilities;
- (b) uncovering offences and fraudulent conveyances;
- (c) determining whether there are other claims that may be made against the estate;
- (d) obtaining details of defences to claims without having to commence proceedings, and

¹¹⁷S 24(1).

¹¹⁸S 24(2).

¹¹⁹*Ibid.*

¹²⁰*Ibid.*

¹²¹S 24(3).

¹²²S 25(1).

¹²³*Ibid.*

¹²⁴A public examination is the ordinary name given to the process of external administrators such as the judge, the Official Receiver or the creditors formally examining various aspects of an insolvent estate. See also www.insolvency.gov.uk (accessed 2011-02-27).

- (e) generally, gathering information.

When a receiving order has been made the Court will hold a public sitting, on a day appointed by the Court, for the examination of the debtor.¹²⁵ The debtor must attend this Court date where his or her conduct, dealings, and assets will be scrutinised by the relevant parties discussed above.¹²⁶ If the debtor fails to attend the public examination at the specified time appointed by an order of the Court and no good cause is shown by him or her for his or her failure, the Court may find him or her in contempt without issuing a notice to the debtor.¹²⁷ The examination shall be held as soon as practically possible after the expiration of the time for the submission of the debtor's statement of affairs.¹²⁸ Any creditor who has tendered proof may question the debtor concerning his or her affairs and the causes of his or her failure.¹²⁹ The Official Receiver is required to take part in the examination of the debtor and for that purpose may employ an advocate if he or she so desires.¹³⁰ If the trustee is appointed before the conclusion of the examination, he or she may also take part in the examination of the debtor.¹³¹ In addition, the Court may pose any questions to the debtor that it considers to be convenient and relevant to the case.¹³² The debtor shall be examined under oath as it is his or her duty to answer all questions asked by the Court, or allowed to be put to him or her by the Court.¹³³ If the debtor refuses to answer or does not answer to the satisfaction of the Court any question put to him or her, the debtor shall be guilty of contempt of Court and may be punished accordingly.¹³⁴ Notes of

¹²⁵S 17(1). Under r 155 and 157 when a receiving order has been made against a debtor, it is the duty of the Receiver to make an application to the Court to appoint the time for the public examination of the debtor. When such an application is made the Court must appoint a day and time for the public examination. After the order is made appointing the time and place for the public examination of a debtor, the Registrar shall serve a copy on the debtor. The Receiver must also give the creditors notice of the order. Lastly, the Receiver must forward the notice of the order to be gazetted and advertised.

¹²⁶S 17(1).

¹²⁷R 156.

¹²⁸S 17(2).

¹²⁹S 17(4).

¹³⁰S 17(5).

¹³¹S 17(6).

¹³²S 17(7).

¹³³S 17(8).

¹³⁴S 17(9).

the examination have to be taken down in writing under the supervision of the Court.¹³⁵ These notes must be read over either to or by the debtor and signed by him, and may thereafter be used as evidence against him. The notes shall also be open to inspection by any creditor at all reasonable times.¹³⁶ When the Court is of the opinion that the affairs of the debtor have been sufficiently investigated, it will by order declare that his examination is over, but such order shall not be made until after the day appointed for the first meeting of creditors.¹³⁷ Where the debtor suffers from mental or physical affliction which in the opinion of the Court makes him unfit to attend his public examination, the Court may make an order dispensing with the examination or directing that the debtor be examined in such manner and at such place as the Court sees fit.¹³⁸ With regard to examination, section 28 also allows the Court on application of the Official Receiver or trustee at any time after a receiving order has been made against a debtor to summon before it:¹³⁹

- (a) the debtor or his wife;
- (b) any person suspected to have in his or her possession any of the belongings of the debtor;
- (c) a person alleged to be indebted to the debtor; or
- (d) any person whom the Court may deem capable of giving information with regard to the debtor, his dealings or property.

¹³⁵S 17(8).

¹³⁶*Ibid.*

¹³⁷S 17(10).

¹³⁸S 17(11). R163 states that an application for an order dispensing with the public examination of a debtor, or directing that the debtor be examined in some manner other than is usual, may be made by the receiver, or by any person who has been appointed by any Court having jurisdiction to manage the affairs of or represent the debtor, or by any relative or friend of the debtor who may appear to the Court to be a proper person to make the application. Where the application is made by the Receiver, it may be made *ex parte*, and the evidence in support of the application may be given by a report of the Receiver to the Court, the report shall be received as *prima facie* evidence of the matters therein stated. Where the application is made by some person other than the Receiver, it shall be made by motion. Notice shall be given to the Receiver and trustee, if any, and shall be supported by an affidavit of a duly registered medical practitioner as to the physical and mental condition of the debtor. Where the order is made on the application of the Receiver, the expense of holding the examination shall be deemed to be an expense incurred by the Receiver within the meaning of r 90. Where the application is made by any other person, he shall, before any order is made on the application, deposit with the Receiver such sum as the Receiver shall certify to be necessary for the expenses of the examination.

¹³⁹S 28.

The Court may require any one of these persons to produce any documents in their custody relating to the debtor, his or her dealings, or property.¹⁴⁰ In explaining the operation of section 28 when questioning the debtor in practice, it is necessary to look at the matter of *re Fazal Valji Virani*.¹⁴¹ The Court held that public examinations of the debtor were not occasions for the Official Receiver to unreasonably examine third parties involved with the debtor's affairs. The Court went on to suggest that if a third party was thought to have relevant information concerning the debtor's affairs they could be interviewed by the Court in chambers before the examination officially began.¹⁴² An exception to this rule, it is suggested, is when a third party is brought before the Court at the public examination by a subpoena in which the examination of the witness is limited to proof of the documents called in the subpoena.¹⁴³

3.3.5 Adjudication of Bankruptcy

After a receiving order has been granted the Court shall, having no discretion in the matter, adjudge the debtor bankrupt if:

- (a) the creditors at the first meeting resolve that the debtor be adjudged bankrupt, or pass no resolution or if no meeting is held;¹⁴⁴ or
- (b) a composition or scheme of arrangement is not approved within 14 days after conclusion of the public examination;¹⁴⁵ or
- (c) the debtor with the concurrence of the Official Receiver consents in writing to be adjudged bankrupt;¹⁴⁶
- (d) the Receiver satisfies the Court that the debtor does not intend to propose a composition or scheme of arrangement;¹⁴⁷
- (e) the public examination of the debtor is adjourned *sine die*;¹⁴⁸

¹⁴⁰ *Ibid.*

¹⁴¹ 1930 KLR 12 108.

¹⁴² *Ibid.* Also referred in Macneil *Bankruptcy law in East Africa* 64.

¹⁴³ 1930 KLR 12 116.

¹⁴⁴ S 20(1).

¹⁴⁵ *Ibid.*

¹⁴⁶ S 20(1).

¹⁴⁷ R 185.

¹⁴⁸ R 187.

- (f) the debtor without reasonable excuse fails to file the statement of affairs required by section 16; and¹⁴⁹
- (g) if the debtor absconds.¹⁵⁰

After the debtor has been adjudged bankrupt, the Receiver must cause a notice to be advertised and gazetted, in the same manner as is provided in the case of a receiving order.¹⁵¹

After the adjudication of bankruptcy, the creditors may by ordinary resolution appoint an appropriate person, whether a creditor or not, to fill the office of trustee of the property of the bankrupt.¹⁵² They may also resolve to leave his or her appointment to the committee of inspection.¹⁵³ A person is not considered fit to act as trustee of the property of a bankrupt under the Act if he or she has previously been removed as a trustee of a bankrupt's property for misconduct or neglect of duty.¹⁵⁴ Any person appointed as a trustee other than the Official Receiver must provide security to the satisfaction of the Court.¹⁵⁵ If the Court is satisfied with the security it will certify that the appointment was properly made. The Court may object to the appointment of the trustee on the following grounds:¹⁵⁶

- (a) that it has not been made in good faith by a majority in value of the creditors voting, or
- (b) that the person appointed is not fit to act as trustee, or
- (c) that his or her connection with the bankrupt or any creditor makes it difficult for the trustee to act with neutrality in the interests of the creditors as a group.

¹⁴⁹R 16(3).

¹⁵⁰R 185.

¹⁵¹S 20(2) and R 188.

¹⁵²S 21(1).

¹⁵³*Ibid.* See discussion below on the committee of inspection.

¹⁵⁴*Ibid.*

¹⁵⁵S 21(2).

¹⁵⁶*Ibid.*

The Official Receiver may also be appointed as the trustee by the creditors.¹⁵⁷ The appointment of a trustee will take effect only when the Court has certified the appointment.¹⁵⁸ If a trustee is not appointed by the creditors within four weeks from the date of the adjudication, or in the event of there being negotiations for a composition or scheme pending at the expiration of those four weeks, then within seven days from the close of those negotiations, the Official Receiver shall report the matter to the Court. The Court will then appoint a fit person to be trustee of the bankrupt's estate.¹⁵⁹

The creditors, who are qualified to vote may, by resolution at their first meeting, appoint a committee of inspection for the purpose of supervising the administration of the bankrupt's property by the trustee.¹⁶⁰ If the Official Receiver has been appointed the trustee by the creditors, the appointment of a committee of inspection can only be made provided the Official Receiver has consented to its formation.¹⁶¹ In the event that the Official Receiver rejects the formation of the committee of inspection, he will act as both the trustee and the committee of inspection.¹⁶² To be a qualified member of the committee of inspection, a person must either be a creditor who has proven his or her debt or a person holding some manner of legal proxy such as a power of attorney from such creditor.¹⁶³

¹⁵⁷ S 21(3).

¹⁵⁸ S 21(5).

¹⁵⁹ S 21(6).

¹⁶⁰ S 21(1). The relationship between the committee of inspection and the creditors is set out in section 81(1), which reads as follows: "Subject to the provision of this Act, the trustee shall, in the administration of the property of the bankrupt and in the distribution thereof amongst his creditors, have regard to any directions that may be given by resolution of the creditors at any general meeting or by the committee of inspection, and any directions so given by the creditors at any general meeting shall, in case of conflict, be deemed to override any directions given by the committee of inspection." For a further discussion on section 81(1) see *In re Ambalal Patel* 1932 5 KLR 13.

¹⁶¹ S 21(3).

¹⁶² *Ibid.*

¹⁶³ S 21(2).

3.3.6 Compositions and Schemes of Arrangement

3.3.6.1 Before filing of the bankruptcy petition

Ordinarily, if it is possible, a debtor will propose a composition shortly after the receiving order.¹⁶⁴ This type of composition must have Court approval before it is binding on all the creditors, and is discussed below¹⁶⁵ as a composition after the filing of a bankruptcy petition. This type of composition is regulated by the *Bankruptcy Act*. It is however also possible to achieve the same result by entering into a composition or a scheme of arrangement before the filing of the bankruptcy petition. The proper approval and registration of such a composition or scheme under the *Deeds of Arrangement Act* 10 of 1930 will prevent the adjudication of bankruptcy.¹⁶⁶

The registration of a deed of arrangement under the *Deeds of Arrangement Act* is done by filing with the Registrar a true copy of the deed and all its relevant annexures.¹⁶⁷ The deed must be presented to the Registrar within seven days of its execution, by the creditor(s) and debtor, together with an affidavit verifying the time of execution.¹⁶⁸ A trustee is appointed by the creditors specifically to administer the debtor's estate in line with the deed of arrangement.¹⁶⁹ The trustee must also file with the Registrar at the time of registration of the deed a statutory declaration by the trustee that the required majority of the creditors of the debtor have assented to the deed of arrangement; the declaration then serves as conclusive evidence of the facts declared under it.¹⁷⁰ A valid deed must have received the assent of a majority in number and value of the creditors of the debtor.¹⁷¹ When a deed is registered under the *Deeds of Arrangement Act* there will be a certificate

¹⁶⁴Macneil *Bankruptcy law in East Africa* 64.

¹⁶⁵Par 3.3.6.2 below.

¹⁶⁶S 25 of the *Deeds of Arrangement Act* and Ss 6(1) and 42(1) of *Bankruptcy Act*.

¹⁶⁷S 7 of the *Deeds of Arrangement Act*.

¹⁶⁸S 4 of the *Deeds of Arrangement Act*.

¹⁶⁹R 12 of the *Deed of Arrangement Rules GN 161 of 1931*

¹⁷⁰S 5 of the *Deeds of Arrangement Act*.

¹⁷¹*Ibid.*

issued stating that the deed was duly registered.¹⁷² The certificate will be sealed with the seal of the Registrar.¹⁷³

Under section 25 of the *Deeds of Arrangement Act* when a deed of arrangement is filed and served in the prescribed manner on a creditor, that creditor may not while the deed is in force, unless the deed becomes void, present a bankruptcy petition against the debtor based on the execution of the deed or any act committed by him or her as an act of bankruptcy.

3.3.6.2 *After filing of the bankruptcy petition*

After the filing of a bankruptcy petition, the debtor may wish to make a proposal for a composition in satisfaction of his or her debts, or a proposal for a scheme of arrangement of his or her affairs.¹⁷⁴ He or she must within four days of submitting his or her statement of affairs, or within any time fixed by the Official Receiver, lodge with the Official Receiver a proposal in writing detailing the terms of the composition or scheme.¹⁷⁵ This proposal must also set out the particulars of any sureties or security he or she proposes.¹⁷⁶ When such a proposal is submitted to the Official Receiver, the Receiver must hold a meeting of the creditors before the public examination of the debtor is concluded.¹⁷⁷ Before the meeting the Receiver must send each creditor a copy of the debtor's proposal with the Receiver's report on the proposal.¹⁷⁸ If at that meeting, a majority in number and three fourths in value of all the creditors who have proved their claims resolve to accept the proposal, it shall be deemed to be duly accepted by the creditors, and when approved by the Court shall be binding on all the creditors.¹⁷⁹

¹⁷²R 7 of the *Deed of Arrangement Rules GN 161 of 1931*.

¹⁷³*Ibid.*

¹⁷⁴Macneil *Bankruptcy law in East Africa* 118.

¹⁷⁵S 18(1). S 16(2)(a)–(b) show that the statement of affairs must be submitted to the Official Receiver prior to, but not more than 3 days before presentation of the debtor's petition and within 14 days after the receiving order in the case of a creditor's petition.

¹⁷⁶S 18(1).

¹⁷⁷S 18(2).

¹⁷⁸*Ibid.*

¹⁷⁹*Ibid.* According to r 165 where the creditors have accepted a composition or scheme, and the public examination of the debtor has been concluded, the Receiver or the debtor may apply to the Court to fix a day for the hearing of an application for the approval of the composition or scheme.

After the proposal is accepted by the creditors, the debtor or the Official Receiver may apply to the Court to approve the proposal.¹⁸⁰ Notice of the time appointed for the application will be given by the Receiver to each creditor who has proved their claim.¹⁸¹ The application will not be heard until after the conclusion of the public examination of the debtor.¹⁸² Any creditor who has proved his or her claim may be heard by the Court in opposition to the application, not considering that he or she may at the meeting of creditors have voted for the acceptance of the proposal.¹⁸³ Before approving the proposal the Court must hear the report of the Official Receiver as to the terms of the proposal, the conduct of the debtor and any objections which may be made by or on behalf of any creditor.¹⁸⁴ Having taken all the facts into consideration, if the Court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors,¹⁸⁵ the Court will refuse to approve the proposal.¹⁸⁶ It therefore appears that any proposal made after the filing of the bankruptcy petition must be calculated to be to the advantage of creditors. If it occurs that facts are proved that require the refusal or suspension of the debtor's discharge or the attachment of conditions to the discharge, the Court is obliged without exception, to refuse approval of the scheme or composition if there is no reasonable security provided to assure payment to the creditors of not less than five shillings in the pound on all the unsecured debts provable against the debtor's estate.¹⁸⁷ If the Court approves the proposal the approval will be witnessed by the seal of the Court being attached to the instrument containing

¹⁸⁰S 18(5). Under r 165 any person other than the Receiver who applies to the Court to approve a composition or scheme must, not less than ten days before the day appointed for hearing the application, send a notice of the application to the Receiver.

¹⁸¹S 18(5).

¹⁸²S 18(6).

¹⁸³*ibid.*

¹⁸⁴R 168. In an application to the Court to approve a composition or scheme, the report of the Receiver must be filed not less than four days before the time fixed for hearing the application.

¹⁸⁵This advantage for creditors' requirements is a similar feature to that found in the South African insolvency system where a creditor or debtor seeks a sequestration order. See par 4.3.1 below.

¹⁸⁶S 18(9).

¹⁸⁷S 18(10).

the terms of the proposed composition or scheme, or by the terms in an order of the Court.¹⁸⁸

A composition or scheme accepted and approved in accordance with section 18 will be binding on all the creditors with respect to any debts due to them from the debtor.¹⁸⁹ An accepted composition or scheme will not however release the debtor from liability arising under a judgment against him or her in an action for seduction, affiliation and a matrimonial cause.¹⁹⁰ When a composition or scheme is approved by the Court the Receiver will, on payment of all costs incidental to the proceedings, put the debtor back in possession of his or her property.¹⁹¹ The Court shall also discharge the receiving order.¹⁹²

Even after approving the composition or scheme the Court still has the discretion on application by the Official Receiver, the trustee or any creditor, to adjudge the debtor bankrupt and annul the composition or scheme.¹⁹³ This may occur for the following reasons:¹⁹⁴

- (a) If the debtor defaults on the payment of any instalment due under the composition or scheme.
- (b) On satisfactory evidence it appears to the Court that the composition or scheme cannot for any sufficient reason proceed without injustice or undue delay to the relevant parties.
- (c) The approval of the Court was obtained by fraud.

Section 23 provides that creditors may decide to accept a proposal for a composition or scheme of arrangement after bankruptcy adjudication. In these

¹⁸⁸S 18(12). A certificate of the Official Receiver that a composition or scheme has been duly accepted and approved shall serve as evidence of its validity.

¹⁸⁹S 18(13).

¹⁹⁰*Ibid.*

¹⁹¹R 175 states that where a composition or scheme is annulled, the property of the debtor shall automatically vest back in the Receiver.

¹⁹²*Ibid.*

¹⁹³But without prejudice to the validity of any sale, disposition or payment duly made under the composition or scheme. S 18(16).

¹⁹⁴*Ibid.*

cases the same proceedings and consequences will ensue as in the case of a composition that has been accepted before adjudication.¹⁹⁵ If the Court approves the composition or scheme it may, in terms of section 23(2) make an order annulling the bankruptcy and vesting the property of the bankrupt in him or her or any other person as the Court may appoint, and on such terms and conditions as the Court may deem fit.

In practice the Courts will not exercise their discretion to approve a composition or scheme until they are fully satisfied that the debtor will be able to follow through with the proposed plan. In *re Abdul Alibhai*¹⁹⁶ it was held that, the actuality that the creditors accepted the proposal for a composition and the proposed amount for security under the plan was irrelevant to the Courts discretion to accept a proposed composition.¹⁹⁷ The Court explained that each case had to be decided on its own merit. The Court stated that the history of trading failures by the debtor making the proposal was the decisive factor in its decision to deny the application. In *Trivedi v The Official Receiver*¹⁹⁸ the debtor had been in financial difficulties for five years before he petitioned himself into bankruptcy. The proposed composition offered the creditors complete payment of their claims. The plan made provision for the payment of six annual instalments. The payment was guaranteed by a son of the debtor who was a government employee. The proposal was approved by three fourths in value of the proven claims as required and supported by the Official Receiver's report to the Court. The Court *a quo* rejected the proposal. The East African Court of Appeal stated that the debtor was heavily indebted and at the time of the proposal his business showed no capital to be able to carry on business. The Court concluded that to permit him to carry on business would be as good as allowing him to conduct a business that was insolvent from its inception.¹⁹⁹ Doing so, the Court stated, was contrary to public policy.²⁰⁰ Further, the Court also mentioned the principle that the

¹⁹⁵ S 23(1).

¹⁹⁶ 1963 EA T 54.

¹⁹⁷ *Idem* 61.

¹⁹⁸ 1960 EACA 422.

¹⁹⁹ *Ibid.*

²⁰⁰ *Ibid.*

approval of the creditors is irrelevant as the Court has a higher duty to protect the public and the creditors, even from themselves.²⁰¹ In the case of *re Jaffer Ahamed*²⁰² the Court found that a large portion of the creditors voting on a scheme of arrangement presented by a debtor were his family members and, coupled with the claims against the debtor being of doubtful validity, the Court decided to refuse approval of the scheme.²⁰³

3.3.7 Discharge of the Bankrupt

A discharge order in favour of the bankrupt will release the bankrupt from all his or her debts proved by his or her creditors during the bankruptcy.²⁰⁴ Such an order will, however, have no effect on the following debts:

- (a) Any debt that the bankrupt may be charged under a suit by the United Republic of Tanzania, for example any branch of the Tanzanian Revenue Authority. The debtor will not be discharged from such debt unless the Chief Accountant General of the United Republic certifies in writing his or her consent to the bankrupt being discharged.²⁰⁵
- (b) Any debt or liability incurred by means of any fraud to which the bankrupt was a party.²⁰⁶
- (c) Any liability under a judgment against him or her in an action for seduction, affiliation or in a matrimonial cause, except under such conditions as the Court expressly orders in respect of such liability.²⁰⁷
- (d) Debts which were incurred by any person who at the date of the receiving order was a partner or co-trustee with the bankrupt, or

²⁰¹1960 EACA 425.

²⁰²1939 KLR 18 115.

²⁰³*Idem* 118.

²⁰⁴S 32(2).

²⁰⁵S 32(1)(a).

²⁰⁶S 32(1)(b).

²⁰⁷*Ibid.*

was jointly bound or had made any joint contract with him, or any person who was surety.²⁰⁸

The debtor who is at this stage legally bankrupt may, at any time after being adjudged bankrupt, apply to the Court for an order of discharge.²⁰⁹ The Court will then appoint a day for the hearing of the application, provided that the public examination of the bankrupt has been concluded.²¹⁰ After receiving the application, the Registrar must in not less than twenty-eight days before the day of the hearing, give notice of the hearing to the Receiver and trustee. In addition, before the date of the hearing the Receiver must file a report on the bankrupt's conduct and affairs, as well as on his or her conduct during the bankruptcy proceedings, a copy of which must be delivered to the bankrupt at least two weeks before the proceedings.²¹¹ In the case of *re Singh*²¹² the Court illustrated how it dealt with the Receiver's report. In this decision the report of the Receiver stated *inter alia* that "the bankrupt's conduct during the proceedings was not satisfactory".²¹³ The Court agreed with the bankrupt that the allegations by the Receiver were too vague to enable the bankrupt to resolve them and it appeared were calculated to defeat a fair trial on his application.²¹⁴ It appears from this judgement that the Receiver's report must be especially detailed when describing the conduct of the bankrupt and although an important factor in the judge's consideration of the discharge application, it is not in itself conclusive.

²⁰⁸S 32(4).

²⁰⁹S 29(1). Under R 190 when a bankrupt intends to apply for his discharge, along with the application, he must produce to the Registrar of the Court a certificate from the Receiver specifying the number of creditors that he is aware of. The Registrar will also cause a copy of the notice to be gazetted. The Receiver will in addition send a copy of the notice to each creditor not less than fourteen days before the day of the hearing.

²¹⁰S 29(1).

²¹¹S 29(2). Under R 193 when a bankrupt intends to dispute any statement with regard to his conduct and affairs contained in the Receiver's report, he must in not less than two days before the hearing of the application for discharge file in Court a notice in writing, specifying the statements in the report which he or she proposes to dispute and serve a copy of the notice upon the Receiver. Any creditor who intends to oppose the discharge of a bankrupt on grounds other than those mentioned in the Receiver's report will follow the same procedure as the bankrupt with the only addition to the procedure being notice to the bankrupt.

²¹²1945 KLR 1 39.

²¹³*Ibid.*

²¹⁴Macneil *Bankruptcy law in East Africa* 152.

At the hearing the Court may question the debtor and hear evidence as it sees fit.²¹⁵ Upon hearing the application the Court takes into consideration the report of the Official Receiver, or of any reciprocating country, as to the bankrupt's conduct and affairs. The Court within its own discretion may then make the following orders:²¹⁶

- (a) The Court may grant an absolute discharge. This is a discharge with no conditions and is equivalent to a complete rehabilitation of the bankrupt with no debts or obligations to anyone. An absolute discharge may be granted with a section 29(4) certificate stating that the debtor's bankruptcy was caused by misfortune. Macneil notes though, that it is unlikely that the Courts would be willing to grant an absolute discharge were it not willing to grant a section 29(4) certificate.²¹⁷ In *re Mohamed Din Buta*²¹⁸ the Court outlined certain situations where it would not grant an absolute discharge. Briefly, the facts were that the bankrupt applying for a discharge had previously been bankrupt.²¹⁹ The application for discharge was not resisted by the creditors but was opposed by the Official Receiver, who noted that the assets of the bankrupt did not amount to ten shillings in the pound, as required under section 29(3).²²⁰ There was in actual fact no dividend for distribution to the concurrent creditors.²²¹ The bankrupt had also not been able to keep proper accounts, again in contravention of section 29(3).²²² He had also previously entered into two failed compositions, one resulting in his finally being declared bankrupt again. The Court, taking all these factors into account, decided to refuse an order of

²¹⁵Section 29(7).

²¹⁶S 29(2).

²¹⁷Macneil *Bankruptcy law in East Africa* 153.

²¹⁸1938 KLR 1 27.

²¹⁹*Ibid.* Under section 29(3)(k) discussed below the Court is obliged to suspend or refuse a discharge order if it appears that the bankrupt has been bankrupt before or entered into a composition with his or her creditors before.

²²⁰1938 KLR 1 36. See the discussion below on section 29(3).

²²¹*Ibid.*

²²²*Ibid.* The Court noted on this point that the bankrupt was not a trader in the ordinary sense of the word and therefore his failure to keep proper books was not that serious.

absolute discharge stating that the law would be “sufficiently vindicated by an order suspending his discharge for three years from the date of his application”.²²³

- (b) The Court may refuse outright to grant a discharge. It was held in the case of *re Singh Chanan*²²⁴ that a Court refusing to grant a discharge must give reasons for the refusal.²²⁵ Failure to give reasons was considered an error by the East African Court of Appeal in this case.
- (c) The Court may suspend an order of discharge. The Court is authorised by the legislature to suspend the operation of the discharge order under the following circumstances:

- Under section 29(2) the Court is entitled to suspend the discharge for any such period as it thinks proper.
- The Court may suspend the discharge until the debtor has paid to his or her creditors any dividend the Court in its absolute discretion may determine.²²⁶
- Under section 30(b) if a fraudulent settlement is made with the intent of delaying payments to creditors the Court may suspend the order of discharge.

- (d) The Court may order a discharge subject to conditions. The Act allows the Court, through its own good judgment, to grant an order of discharge subject to any conditions with regard to future earnings or income of the bankrupt after he or she has become rehabilitated.²²⁷ In this regard the Act states the following under section 29(2):

the Court may [...] require the bankrupt as a condition of his discharge to consent to judgment being entered against him by

²²³ *Ibid.*

²²⁴ 1965 EACA 426.

²²⁵ *Idem* 432.

²²⁶ S 29(2).

²²⁷ S 29(2).

the Official Receiver or trustee for any balance or part of any balance of the debts provable under the bankruptcy which is not satisfied at the date of the discharge, such balance or part of any balance of the debts to be paid out of the future earnings or after-acquired property of the bankrupt in such manner and subject to such conditions as the Court may direct; but execution shall not be issued on the judgment without leave of the Court, which leave may be given on proof that the bankrupt has since his discharge acquired property or income available towards payment of his debts.

Such an order however, will not be granted by the Court without the permission of the bankrupt.²²⁸ If the bankrupt does not give the required consent within one month of the making of the conditional order the Court may, on the application of the Receiver or trustee, revoke the order or make another order as the Court may think fit.²²⁹ When such a conditional order has been granted, to get execution on the order an application must be made by the Receiver or trustee for leave to issue execution.²³⁰ Such an application must be in writing and shall state shortly the grounds on which the application is made.²³¹ When the application is lodged, the Registrar of the Court will fix a day for the hearing.²³² The Receiver or trustee must give notice of the application to the debtor not less than eight days before the day appointed for the hearing and shall at the same time furnish him or her with a copy of the application.

Where the bankrupt has committed an offence under the Act or where the occurrence of certain facts has been proved²³³ the Court may, at its own discretion in terms of the first proviso to section 29(2), either refuse or suspend the discharge, or suspend it subject to the condition of payment of a dividend to his or her creditors. Alternatively, the discharge may be granted on

²²⁸R 195(1).

²²⁹R 195(1).

²³⁰*Ibid.*

²³¹*Ibid.*

²³²*Ibid.*

²³³See s 29(3) and the discussion below.

condition that the bankrupt consent to judgment against him or her for any unpaid balance of the debts provable under bankruptcy.²³⁴ The facts mentioned above are the following.²³⁵

- (a) That the bankrupt's assets are not of a value equal to ten shillings in the pound on the amount of his or her unsecured liabilities, unless he or she satisfies the Court that the fact that the assets are not of a value equal to ten shillings in the pound on the amount of his or her unsecured liabilities, has arisen from circumstances for which he or she cannot justly be held responsible;
- (b) that the bankrupt omitted to keep proper books of accounts as is usual and proper in any other business carried on by him or her and failed to sufficiently disclose his or her business transactions and financial position within the three years immediately preceding his or her bankruptcy;
- (c) the bankrupt has continued to trade after knowing him or herself to be insolvent;
- (d) the bankrupt has contracted any debt provable in the bankruptcy without having at the time of contracting it any reasonable or probable ground of expectation of being able to pay it;
- (e) that the bankrupt has failed to account satisfactorily for any loss of assets or for any deficiency of assets to meet his or her liabilities;
- (f) the bankrupt has brought on, or contributed to, his or her bankruptcy by rash and hazardous speculations, or by unjustifiable extravagance in living, or by gambling, or by culpable neglect of his business affairs;
- (g) the bankrupt has amassed for his or her creditors unnecessary expense by a frivolous or vexatious defence to any action properly brought against him or her;

²³⁴Ito the second proviso to section 29(2) the Court has the discretion to modify the terms of the order ito the first proviso on application by the bankrupt at any time after the expiration of 2 years after granting of the order provided the bankrupt satisfies the Court that there is no reasonable probability that he will be able to comply with the terms of the order.

²³⁵S 29(3).

- (h) that the bankrupt has brought on or contributed to his bankruptcy by incurring unjustifiable expense in bringing any frivolous or vexatious action;
- (i) that the bankrupt has, within three months preceding the date of the receiving order, when unable to pay his or her debts as they become due, given an undue preference to any of his or her creditors;
- (j) that the bankrupt has, within three months preceding the date of the receiving order, incurred liabilities with a view of making his or her assets equal to ten shillings in the pound on the amount of his or her unsecured liabilities;
- (k) that the bankrupt has, on any previous occasion, been adjudged bankrupt, or made a composition or arrangement with his or her creditors;
- (l) the bankrupt has been guilty of any fraud or fraudulent breach of trust;
- (m) that the bankrupt has defaulted in payment of any sum ordered by the Court under the provisions of section 55 of this Act.²³⁶

In Tanzania as elsewhere, becoming bankrupt is not respectable in the eyes of the society.²³⁷ The legislature, with the intention of removing any legal disqualification or economic inopportunity as a result of bankruptcy, allows the Court on request to issue a certificate stating that the bankruptcy of the debtor was caused by misfortune without any misconduct on the part of the debtor.²³⁸ The Court may, if it thinks fit, grant such certificate. The refusal to grant such a certificate can be subject to an appeal.²³⁹

²³⁶Under section 55(2) and (3) where the debtor is earning a stable salary, the trustee may make an application to the Court for an order compelling the insolvent to pay a portion of his or her salary or wages to the insolvent estate.

²³⁷Macneil *Bankruptcy law in East Africa* 160.

²³⁸S 29(4).

²³⁹*Ibid.*

3.3.8 Administration of Small Estates (Summary Administration)

Summary proceedings are available where the estate of the debtor is less considerable in size. The purpose of these proceedings is to accelerate the handling of small estates.²⁴⁰ If the Court, on petition by a debtor or creditor is satisfied, by affidavit or otherwise, that the estate of the debtor qualifies as a small estate,²⁴¹ or if the Official Receiver reports to the Court that the estate qualifies as a small estate, it may make an order for the summary administration of the estate. Under these circumstances the provisions of the Act will apply as normal, subject to the following modifications:²⁴²

- (a) If the debtor is adjudged bankrupt the Official Receiver will act as trustee who will have all the powers of a trustee in terms of the Act;
- (b) Modifications may be made to the provisions of the Act as prescribed in terms of general rules²⁴³ with the view of saving expense and simplifying procedure. On the other hand the modification of the provisions relating to the examination and discharge of the debtor is not permitted.²⁴⁴

A small estate must be realised with all reasonable swiftness and where practicable, distributed in a single dividend when realised.²⁴⁵ Creditors may at any time, by special resolution, resolve that someone else be appointed trustee, whereupon the bankruptcy shall proceed as if an order for summary administration has not been made.²⁴⁶

This procedure is not unique to Tanzania; it appears in other jurisdictions that follow the English common law tradition. The Canadian bankruptcy regime

²⁴⁰Macneil *Bankruptcy law in East Africa* 77.

²⁴¹Under s 119 this is where the property of the debtor is not likely to exceed 12,000 Tanzanian Shillings approximately 8 United States Dollars. This amount clearly is too small and must be subject to review by the Ministry of Justice.

²⁴²See s 119(a)-(c).

²⁴³It is s 121 the Chief Justice may with the concurrence of the Minister for Legal Affairs, make general rules in complying with the objects of the Act. To date no rules have been made in this regard.

²⁴⁴S 119(c).

²⁴⁵R 253(k).

²⁴⁶S 119(c).

has a similar procedure to the administration of small estates in Tanzania.²⁴⁷ In England and Wales, summary administration was available for a number of years under *the Insolvency Act* of 1986.²⁴⁸ This procedure was, however, abolished by *the Enterprise Act* of 2002, due to the introduction of other measures.²⁴⁹

3.4 Alternatives to Bankruptcy and Reform Initiatives

In the United Republic of Tanzania, unlike in other jurisdictions, alternatives to bankruptcy have not been enacted into law.²⁵⁰ The only possible alternative remedy to the bankruptcy procedures discussed in this text occurs as a by-product of the operation of the *Civil Procedure Code*, 1966.²⁵¹ Under Order 8A Rule 3 of the *Civil Procedure Code*, all civil cases must first go through mediation where the Court acts as mediator in an attempt to first settle the dispute before adjudicating the matter.²⁵² Such mediation may be used by the parties to come to a compromise and agree on a composition or scheme of arrangement.

3.5 Conclusion

The debt relief dispensation in Tanzania consists almost entirely of procedures available under the *Bankruptcy Act* of Tanzania, the only exception being compositions and schemes of arrangement before the filing of a bankruptcy petition under *the Deeds of Arrangement Act*. The *Bankruptcy Act* outlines three procedures available to the financially stressed debtor and

²⁴⁷ See par 5.3.1 below.

²⁴⁸ Milman *Personal insolvency law, regulation and policy* 30. This procedure was available for bankrupts with debts less than 20,000 British Pounds Sterling. The procedure provided for no obligatory investigation by the Official Receiver and an automatic discharge was available after two years.

²⁴⁹ *Ibid.* The *Enterprise Act* of 2002 introduced a one-year automatic discharge which rendered the summary administration procedure redundant since the later procedure had an automatic discharge after two years under the procedure. S 269 and schedule 3 of the *Enterprise Act* of 2002 decreed that summary administration ceased to be available from the first of April 2004. See also par 5.5.1 below.

²⁵⁰ Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 11.

²⁵¹ *Ibid.*

²⁵² *Ibid.*

his or her creditor(s). These are bankruptcy, summary administration, and compositions or schemes of arrangements.

Bankruptcy is available to both the debtor and creditor on petition to the High Court. It is a feature of the Tanzanian system that the requirements set before one can acquire a receiving order under a creditor's petition, as compared to a debtor's petition, are much more strenuous.²⁵³ With a creditor's petition a hearing must be held on the merits of the creditor's case before a receiving order may be issued.²⁵⁴ The awarding of a receiving order in these petitions is based solely on the judge's discretion.²⁵⁵ In contrast the debtor's petition does not require a hearing and the Court, having no discretion on the merits, must award the receiving order if the petition is properly filed by the debtor.²⁵⁶ In practice this means that if the debtor properly files his or her petition he or she will be awarded a receiving order, plus the legal protection that comes with it, without any judicial scrutiny. It appears that this measure was inserted primarily to protect the debtor from being harassed by his or her creditors and secondly, to allow the debtor to eventually get a fresh start.

The debtor, who enters the cave of bankruptcy in Tanzania whether forcibly or by choice, can only be discharged by means of a Court order.²⁵⁷ Tanzania does not have an automatic discharge as a result of effluxion of time. For the bankrupt, one of the hurdles when applying for a discharge in Tanzania is the requirement that he or she must prove that his or her assets are equal to ten shillings in the pound on the amount of his or her unsecured liabilities.²⁵⁸ Where the debtor is not culpable for his or her financial predicament, the Court may waive this requirement.²⁵⁹ The right of waiver granted to the judge

²⁵³Par 3.3.3 above.

²⁵⁴Par 3.3.1 above.

²⁵⁵*Ibid.* See also Par 3.3.3 above.

²⁵⁶Par 3.3.2 above.

²⁵⁷Par 3.3.7 above.

²⁵⁸*Ibid.*

²⁵⁹*Ibid.*

notwithstanding, it appears that the discharge of the bankrupt in Tanzanian law is subject to payment of a fixed dividend to his or her creditors.²⁶⁰

While the summary administration of small estates in Tanzania may resemble an alternative to bankruptcy procedure, it is actually a modified version of the main bankruptcy procedure. It is submitted that the initiative of the legislature to have a procedure intended to ensure that debtors with small estates have them wound up with haste and at little expense is commendable. It is, however, noted that there are a few deficiencies in the current process. Firstly, the current threshold of US\$8 set by the legislature requires to be amended as it is far too low.²⁶¹ A higher threshold should be set to enable as many debtors as possible to take advantage of this procedure. Secondly, the procedure is not compulsory for debtors with small estates and may be vetoed by the creditors. In order to ensure that the cases of small debtors are not dragged through the long bankruptcy process it may be prudent to make summary administration compulsory for those debtors under the threshold.

The Tanzanian debt relief system has two types of compositions and schemes of arrangement. One is a composition or scheme of arrangement proposed after the filing of the bankruptcy petition. This procedure is regulated by the *Bankruptcy Act* and requires a high level of judicial examination before it is approved by the Courts.²⁶² This scheme of arrangement or composition, it is submitted, is the more difficult for a debtor to acquire due to the high level of judicial scrutiny and prior approval required. The second is a composition or scheme of arrangement before the filing of the bankruptcy petition regulated under the *Deeds of Arrangement Act*. The latter procedure does not have any judicial involvement. This second procedure is the only true alternative to bankruptcy for the debtor in Tanzania. However, as pointed out above, the process does contain one main flaw.²⁶³ This arrangement or composition

²⁶⁰This may be viewed as similar to the “advantage for creditors” requirement which is a core characteristic of the South African debt relief system. See pars 4.3 and 4.4 below.

²⁶¹See par 3.4 above.

²⁶²See par 3.2.6.2 above.

²⁶³*Ibid.*

does not require approval from the Court or a supervisory third party, and takes effect directly after registration with the Registrar of documents. As a result, there is no removed third party to scrutinise whether there is a chance that the proposed arrangement or composition will in fact work and if so, whether it benefits the creditors.²⁶⁴ Put differently, will the debtor realistically be able to carry out the plan or will his or her efforts end up back at the gateway to bankruptcy, as illustrated in the court cases discussed above?²⁶⁵

Using the considerations formulated above as a benchmark for best practice in the field of debt relief for consumers,²⁶⁶ the Tanzanian system can be evaluated as follows:

(a) A balanced approach to handling creditor and debtor interests during bankruptcy. How well is this problem tackled by the relevant system?

In the world of commerce the legislature will always experience difficulty balancing these interests of opposing parties.²⁶⁷ The Tanzanian legislator is no different. When placing the debtor's interests on this imaginary scale, the debtor-friendly nature of the Tanzanian *Bankruptcy Act* is immediately evidenced by the steeper requirements set for a creditor's petition as opposed to a debtor's petition. This is balanced by the advantage to the creditor's requirement²⁶⁸ when the debtor wishes to obtain a discharge. The presence of an administration of small estates procedure is also evidence of the legislature's attempt to balance these competing interests by providing for a speedy and cost-effective bankruptcy procedure for small debtors. This procedure benefits both creditors and debtors. As pointed out above this procedure does, however, require some amendment.

²⁶⁴ *Ibid.*

²⁶⁵ *Ibid.*

²⁶⁶ Par. 2.5 and 3.1 above.

²⁶⁷ See par 2.1 above. Boraime 2003 *De Jure* 235.

²⁶⁸ See S 25(3) and the discussion in par 3.3.7 above.

While the Tanzanian legislature has made an attempt to balance these interests, it is submitted that the lack of an alternative to bankruptcy procedure that would cut costs further for the debtor and provide better returns within a shorter time frame for the creditor,²⁶⁹ must be counted against the Tanzanian debt relief system and in the opinion of this evaluation, must be remedied.

(b) The system must be able to differentiate between *mala fide* and *bona fide* debtors by rehabilitating the latter group efficiently and at a low cost.

It is interesting to note that the Tanzanian *Bankruptcy Act*, a piece of colonial legislation enacted in 1930, had already entrenched the principle of protecting the *bona fide* debtor. The most inspiring of these provisions allows the discharged bankrupt to apply to the Court for a certificate stating that the bankruptcy of the debtor was caused by misfortune and without any misconduct on the part of the debtor.²⁷⁰ This type of provision suggests that the legislature understands the effect of a bankruptcy order on an individual's standing in society, on his or her business and even on his or her family.²⁷¹ This certificate can be seen as an attempt to remove the stigma surrounding bankruptcy that may influence his or her ability to do business post-bankruptcy, allowing for a fresh start. It is submitted in this regard that the legislator recognises the importance of allowing the honest debtor to make a fresh start, allowing him or her to again be a productive member of society.

The trend towards protecting the blameless debtor in the Tanzanian bankruptcy system is also seen in the provisions on discharge discussed in the paragraph above. Where the bankrupt cannot pay the statutorily fixed dividend to his or creditors the Court is obliged to refuse a discharge unless the bankrupt is able to

²⁶⁹ Par 3.3.7 above.

²⁷⁰ *Ibid* and s 29(4).

²⁷¹ Par 2.1 above.

convince the Court that this fact arose from circumstances for which he or she cannot justly be held responsible.²⁷² Such a discretion given to the Court, it is submitted, must be seen as an effort to protect the blameless debtor. The Court is also urged in section 29(3)(f) to suspend or refuse to grant a discharge order where the bankruptcy was brought about by the debtor's rash speculations or by unjustifiable extravagance in living, or by gambling, or by culpable neglect of his or her business affairs. This right of refusal of a discharge on grounds of the fault of the debtor in causing his or her own bankruptcy may be seen as the legislature's sword against the culpable debtor.

Although the legislature must balance the idea of allowing the debtor a fresh start with the commercial and legal need to have all the creditors paid in full, the Act in this instance shows sympathy for debtors who are not responsible for their financial distress and also allows the Courts to hold to task blameworthy debtors. It is submitted that this relaxed stance against honest or unfortunate debtors is in part in line with the modern trend towards protecting such debtors.²⁷³

While the Tanzanian system quite readily differentiates between debtors, the current measures are not cost and time effective. As noted above, currently a bankruptcy proceeding costs approximately 22 per cent of all the assets of the debtor's estate and takes on average three years.²⁷⁴ These statistics show that the Tanzanian debt relief system is not in line with the current ideas on consumer debt relief which advocate short cost-effective debt relief procedures. It is submitted that the Tanzanian procedures are

²⁷²Par 3.3.7 above.

²⁷³Par 2.4 above.

²⁷⁴Pars 1.1 and 3.3 above.

costly and time consuming partly because they are heavily dependent on an overworked judiciary.²⁷⁵

(c) Following on from point (b) above, provision should be made for an alternative(s) to bankruptcy for the debtor. This alternative to bankruptcy must be efficient, well supervised and cost-effective.

It is a feature of most modern bankruptcy systems to provide for an alternative to the main bankruptcy procedure.²⁷⁶ This allows the debtor to pay off his or her debts at low cost and avoid the stigma of bankruptcy.²⁷⁷ The Tanzanian system does not have an alternative to bankruptcy. It is submitted that this comes at too high a cost to the creditors and the debtor. An alternative to bankruptcy may save the creditors the costs of administering a bankruptcy procedure where the bankrupt estate cannot do so. Debtors who have a stable income would also not be required to enter bankruptcy.²⁷⁸ Furthermore, one of the aims of debt relief reform is to reduce the number of debtors who, under previous regimes, would have been subject to the full rigor of bankruptcy.²⁷⁹ Alternative procedures will assist the Tanzanian debt relief system to do exactly that after the reform process.

In 2011 the consumer debt committee of Insol International recommended that law-making bodies of countries undertaking law reform due to consumer over-indebtedness should provide for separate or alternative debt relief measures which take into consideration the debtor's specific needs.²⁸⁰ Furthermore, that these jurisdictions should include reforms that reduce costs and provide a timely solution for a debtor's financial woes. Taking this into account, it is submitted that the Tanzanian debt relief system requires reforms

²⁷⁵ *Ibid.*

²⁷⁶ Par 2.5 above.

²⁷⁷ *Ibid.* See also par 2.4 above.

²⁷⁸ Par 2.5 above.

²⁷⁹ *Ibid.*

²⁸⁰ *Ibid.*

to its structure and possibly the addition of entirely new procedures to cut costs and increase the efficiency of the system, which are its two main problems. More specifically, the Tanzanian system is in need of an informal debt relief measure to provide an alternative to bankruptcy and other reforms. This study will for that reason be limited in the subsequent chapters to investigating debt relief dispensations from different legal systems, with the view of assimilating the best solutions for the problems identified in the Tanzanian system.

CHAPTER 4

DEBT RELIEF SOLUTIONS IN SOUTH AFRICA

SUMMARY

- 4.1 Introduction
 - 4.2 Short History of Insolvency in South Africa
 - 4.3 The Nature of South African Insolvency law
 - 4.4 Debt Relief Measures in terms of the *Insolvency Act*
 - 4.5 Alternatives to Sequestration in South Africa
 - 4.6 Conclusion
-

4.1 Introduction

While it is correct that the choice of the South African debt relief system as the main comparative model in this study is in part linked to the author's own knowledge of the system, it is by no means an arbitrary selection.¹ As well as being somewhat closely situated geographically in sub-Saharan Africa, South Africa and Tanzania are both part of the Southern African Development Community (SADC).² SADC is an inter-governmental organisation of 15 Southern African States formed in 1992.³ The goals of this international community include promoting economic well-being, improving the standard of

¹See Oderkerk 2001 *Netherlands International Insolvency Law Review* 305 and Wolf 2003-2004 *Legal Education Law Review* 37 in respect of factors to be considered when selecting legal systems for comparative study.

²www.sadc.int (last accessed 2011-05-20). Take note of the map in figure 1 below.

³www.sadc.int. SADC began as a group of states whose primary purpose was the political liberation of Southern Africa in 1980. Approximately 10 years later in 1992 heads of state of Southern African countries signed the SADC Treaty and Declaration. The purpose of SADC shifted from political liberalisation to include economic integration. See also International Business Publications USA *Southern African development community: business law handbook* 7.

living and quality of life for the people of Southern Africa through various multi-lateral treaties, cross-border agreements, and in some instances common market goals.⁴

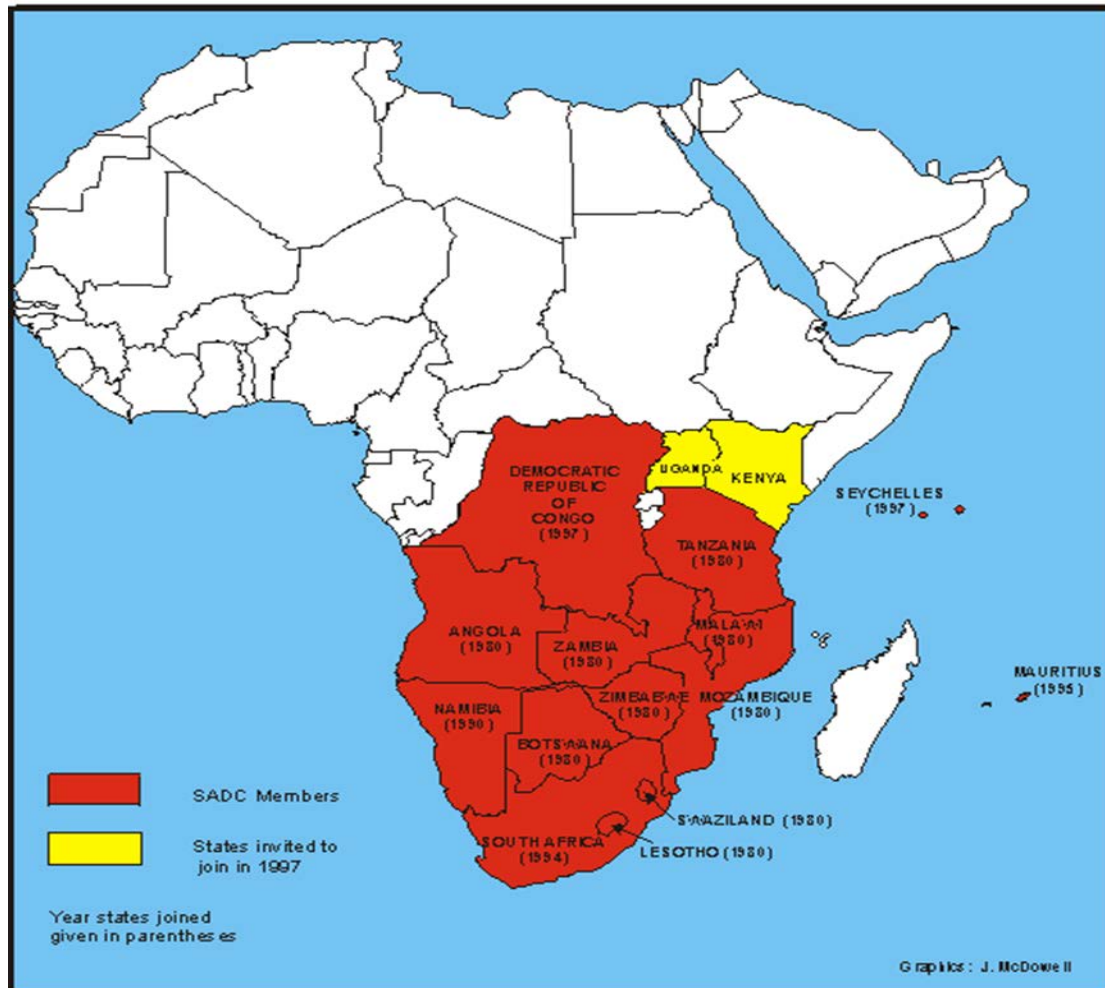


Figure 1: A map showing the countries of the Southern African Development Community on the Africa continent.⁵

Furthermore, Tanzania and South Africa are both developing countries; both have market-driven economies and are constitutional democracies.⁶

⁴*Ibid.* The overall aim is to as much as possible harmonise the 15 member states trade and economic policies with the intention to one day establish a common market with common regulatory institutions.

⁵www.imf.org/external/pubs (last accessed 2011-05-20). This source shows a map illustrating the geographical location of the SADC region in the southern region of Africa.

⁶Reynold *Election '99 South Africa: from Mandela to Mbeki* 213 and Havnevik and Isimika *Tanzania in transition: from Nyerere to Mkapa* 186.

Tanzania's legal system is based predominately on the common law.⁷ South Africa is categorised as a mixed legal system with both civil and common law elements.⁸ Although the legal systems differ somewhat, it is submitted that they are not so far removed as to make them incompatible of comparative study.

Though the main bankruptcy statutes of Tanzania and South Africa both came into force in the 1930s and remain relatively unchanged today, the South African legislature has endeavoured to advance its debt relief regime by introducing measures in the *Magistrates' Courts Act* 32 of 1944, and more recently in the *National Credit Act* 34 of 2005.⁹ The South African Law Commission has also been actively assessing the country's provisions on consumer insolvency and has made recommendations for reform in the Law Commission reports released in 2000 and 2010.¹⁰ Tanzania can thus learn from the South African system's recent advances to its debt relief system.

In addition, in a global survey by the World Bank of 183 jurisdictions in 2011, South Africa ranked second in the category "ease of acquiring credit for entrepreneurs" and ranked tenth in the "protecting investors" category.¹¹ The relevance of the "protecting investors" category to the discussion on bankruptcy and debt relief is self-explanatory. The "ease of acquiring credit" category is calculated by, among other variables, studying bankruptcy law in the way it facilitates lending by protecting the rights of borrowers and lenders.¹² This type of derivative calculation is appropriate considering the connection between credit and bankruptcy already discussed above.¹³

⁷See par 3.2 above.

⁸Wacks *Law: a very short introduction* 18. Thomas, Van der Merwe and Stoop *Historical foundations of South African private law* 6.

⁹Otto and Otto *National Credit Act explained* 87. The *National Credit Act* 34 of 2005 will hereinafter be referred to as the NCA.

¹⁰Calitz 2011 *De Jure* 304.

¹¹www.doingbusiness.org (last accessed 2011-05-20). Numerous developed countries are included in this survey Japan, the United States of America, Italy and France, to name a few.

¹²*Ibid.*

¹³See par 2.1 above.

Tanzania ranked eighty ninth in the ease of acquiring credit category and ninety third in the protection of investors' category.¹⁴ It may therefore be suggested that the debt relief procedures operate with a higher competence, relatively of course, in South Africa. Consequently, Tanzania could learn from the debt relief measures in place in South Africa that give the jurisdiction such a high score in the two categories mentioned above.

Taking all of the above into consideration it is proposed that the similarities between Tanzania and South Africa regarding their economic and political organisation make them ideal candidates for comparative investigation. Secondly, in light of the reforms made by the regime, the South African system has clearly made more strides to improve their debt relief regime than Tanzania, making a comparative investigation constructive. This chapter will analyse and dissect the South African debt relief regime. The main focus will be to uncover any lessons for Tanzania and alternative procedures that possibly may be incorporated into the Tanzania debt relief system.

4.2 Short History of South African Insolvency Law

The South African law on debt relief has its main roots in Roman-Dutch law.¹⁵ During the early fifteenth century, before the insolvency laws of Holland were transplanted to the Cape, these laws developed from and absorbed many ancient Roman law procedures.¹⁶ Although the Roman-Dutch debt relief measures can be traced back to numerous Roman procedures, the one that bears the most resemblance to certain modern procedures by far is *cessio bonorum*.¹⁷ *Cessio bonorum* was introduced almost in its complete form into Holland in the late fifteenth century and early part of the sixteenth century.¹⁸

¹⁴ *Ibid.*

¹⁵ Smith *The law of insolvency* 5 and Wessels *History of Roman-Dutch law* 663. For a more comprehensive discussion on the Roman law roots of South Africa bankruptcy. See also Bertelsmann et al *Mars: The law of insolvency in South Africa* 8.

¹⁶ Burton *Observations of the insolvent laws of the colony* 3 and Hahlo and Khan *The Union of South Africa: The development of its laws and constitution* 27.

¹⁷ Sharrock et al *Hockly's insolvency law* 11. See also par 2.4 above.

¹⁸ Smith *The law of insolvency* 5; Wessels *History of Roman-Dutch law* 662 and Bertelsmann et al *Mars: The law of insolvency in South Africa* 8. It would appear that *missio in possessionem* was also used in Holland. Here a curator was appointed to distribute the proceeds of a sale of the debtor's goods to the creditors.

The procedure of *cessio bonorum* was only granted in Holland if the debtor's insolvency had been caused by some or other form of bad luck or misfortune.¹⁹ Debtors that defrauded their creditors or that were reckless with their assets were not entitled to surrender their assets. The discretion for granting an order of surrender under the *cessio* procedure rested entirely on the Court hearing the application.²⁰ *Cessio bonorum* and all other aspects of insolvent estates were initially handled by the local Magistrates' Court, but, later on during the eighteenth century they were handled by the so-called "Desolate Boedelkamers".²¹ These were government chambers that were charged, *inter alia*, with the administration of insolvent estates.²²

In 1777 a key ordinance for South African insolvency law was passed in Amsterdam.²³ This piece of legislation is more often than not accepted as the basis of South African insolvency law.²⁴ The enactment of this statute is of great significance to South African insolvency law as it was the main source of insolvency practice at the Cape of Good Hope after its colonisation.²⁵ One of the important developments under the 1777 ordinance that was transplanted to South Africa is that a debtor could acquire a discharge of all pre-sequestration debts and become rehabilitated if a majority of his creditors agreed to it.²⁶ This and other principles of the Ordinance were introduced into the various colonial ordinances, and still form the basis of South African insolvency law today.²⁷

¹⁹Sharrock *et al Hockly's insolvency law* 11.

²⁰A petition was brought to the Court against him or her that included a full inventory of the debtor's assets and liabilities. This list was open to inspection by the creditors. Where the Court was satisfied that there was a benefit to the debtor surrendering his property, the Court was entitled to order so. Once an order of surrender was granted a trustee was appointed to sell the debtor's property. This process is the basis of South Africa's current voluntary surrender procedure discussed below in par 4.3.1.1. See Smith *The law of insolvency* 6.

²¹*Ibid.* See also Burton *Observations of the insolvent laws of the colony* 24 and 25.

²²Wessels *History of Roman-Dutch law* 664 and 669 and Sharrock *et al Hockly's insolvency law* 12.

²³Calitz and Burdette 2006 *Tydskrif vir die Suid Afrikaanse Reg* 724.

²⁴*Ibid.* Smith *The law of insolvency* 6; Bertelsmann *et al Mars: The law of insolvency in South Africa* 9 and Sharrock *et al Hockly's insolvency law* 13. See also *Fairlie v Raubenheimer* 1935 AD 135 146.

²⁵*Ibid.*

²⁶Bertelsmann *et al Mars: The law of insolvency in South Africa* 10.

²⁷Calitz and Burdette 2006 *Tydskrif vir die SuidAfrikaanse Reg* 725.

As in Holland in 1803, the commissioner-general of the Cape established a “Desolate Boedelkamer” for the administration of insolvent estates and the execution of civil sentences among other administrative responsibilities.²⁸ The “Desolate Boedelkamer” was abolished in 1818 in favour of the appointment of the office of the *sequestrator*, in which the same functions were vested.²⁹ This office proved ineffective and was abolished by the Ordinance 64 of 1829.³⁰ This was followed by Ordinance 6 of 1843 which is regarded as a landmark statute in South African bankruptcy law.³¹

Before the first piece of union legislation was passed in 1916, the Transvaal, Natal and the Orange Free State had their own insolvency³² ordinances.³³ They were the following, respectively:³⁴

- (a) Wet 13 van 1895 der Zuid-Afrikaansche Republiek;
- (b) Law 47 of 1887 in the Colony of Natal;
- (c) Hoofdstuk CIV van het Wetboek van den Oranje vrystaat.

After the establishment of the Union of South Africa, Act 32 of 1916 replaced the above statutory provisions and consolidated the bankruptcy law into one statute.³⁵ This piece of legislation was amended twice before it was replaced by the current insolvency legislation which is still in force today, the *Insolvency Act* 24 of 1936.³⁶

Smith notes that one aspect of South African bankruptcy law which is often omitted in a historical survey is the influence that English common law had on

²⁸ *Ibid.*

²⁹ *Ibid.* see also Bertelsmann *et al* Mars: *The law of insolvency in South Africa* 10.

³⁰ Bertelsmann *et al* Mars: *The law of insolvency in South Africa* 11.

³¹ Sharrock *et al* Hockly's *insolvency law* 12.

³² The term insolvency in South African law is used interchangeably to refer to both corporate and natural persons.

³³ Bertelsmann *et al* Mars: *The law of insolvency in South Africa* 13.

³⁴ *Ibid* and Smith *The law of insolvency* 6.

³⁵ Bertelsmann *et al* Mars: *The law of insolvency in South Africa* 12 and Smith *The law of insolvency* 7. Although the structure of this piece of legislation followed the Transvaal law 13 of 1895, Bertelsmann *et al* note that it was merely an adaptation of the Cape ordinance.

³⁶ Sharrock *et al* Hockly's *insolvency law* 13. Hereinafter the “*Insolvency Act*” or “Act.”

the early development of insolvency in the Colony.³⁷ She further notes that there is no doubt that the Courts, which were heavily influenced by English law, were much more involved then with the administration of insolvent estates than they are now.³⁸ The Courts clearly exerted the influence of English law through their judgments.³⁹

The history of South African bankruptcy law is to some extent similar to its Tanzanian counterpart. Both systems developed from the starting point of colonisation and the early English and Roman-Dutch bankruptcy laws were both, to various extents, based on Roman principles. The Tanzanian system was developed under the influence of the common law, as was most of East Africa, as a result of being British protectorates.⁴⁰ The South African system, on the other hand, was developed under the influence of both the common law and Roman-Dutch law because of annexation by both the British and the Dutch.⁴¹

4.3 The Nature of South African Insolvency law

Like Tanzania, South Africa does not have a unified Act for the administration of both insolvent natural and juristic persons.⁴² The *Insolvency Act* 24 of 1936 is the main source of South African insolvency law.⁴³ The *Companies Act* 71 of 2008 and certain other statutes deal with the winding up of insolvent juristic persons.⁴⁴ Unlike the American bankruptcy laws inspired by the fresh start policy discussed in Chapter 2,⁴⁵ it is not the main goal of the South African *Insolvency Act* to discharge the debtor of his or her debt.⁴⁶ The South African

³⁷Smith *The law of insolvency* 8.

³⁸*Gilbert v Bekker* 1984 3 SA 774 (W). See also Evans 2008 LLD Thesis 50.

³⁹*Ibid.*

⁴⁰See par 3.2 above.

⁴¹Zimmerman and Visser *Southern Cross: Civil law and common law in South Africa* 2.

⁴²Bertelsmann *et al Mars: The law of insolvency in South Africa* 3.

⁴³*Ibid.*

⁴⁴Nagel *et al Commercial Law* 403. Other legislation includes the *Close Corporations Act* 69 of 1984 and the *Banks Act* 94 of 1990.

⁴⁵See par 2.3 above.

⁴⁶Gibson *et al South African Mercantile and Company law* 543; Roestoff and Renke 2005 *International Insolvency Law Review* 94; Sharrock *et al Hockly's insolvency law* 4 and Smith *The law of insolvency* 4. Hereinafter the *Insolvency Act* 24 of 1936 will be referred to as "the *Insolvency Act*."

bias towards creditors is well summed up by the observation of Holmes J in *Ex parte Pillay*.⁴⁷

The procedure of voluntary surrender was primarily designed for the benefit of creditors, and not for the relief of harassed debtors.

In addition, although the South African debt relief regime has alternatives to the main insolvency procedure, none of these provide for an outright discharge of the debtor's debt.⁴⁸ Consequently many authors believe that the South African bankruptcy law is in essence creditor-orientated.⁴⁹

It is generally accepted that the primary aim of the sequestration⁵⁰ process in terms of the *Insolvency Act* is to provide for a debt collecting procedure for the creditors as a group, which guarantees them an orderly and fair method of distributing the debtor's assets in instances where it is insufficient to satisfy all their claims.⁵¹ This leads to one of the key concepts in South African insolvency: the *concursum creditorum*.⁵² This Latin term denotes the state of affairs immediately after a sequestration order is granted where the general interest of the group of creditors is given priority over the interests of the individual creditor.⁵³ The effect of the *concursum creditorum* is to stop an individual creditor from processing his or her claim through execution and receive payment to the detriment of the other creditors.⁵⁴ In addition, the debtor is also relieved of the control of his or her property in order to ensure

⁴⁷1995 2 SA 309 (N) 311.

⁴⁸Roestoff and Renke 2005 *International Insolvency Law Review* 94.

⁴⁹*Ibid.* See also Bertelsmann *et al Mars: The law of insolvency in South Africa* 4; Smith *The law of insolvency* 4; Wiggins' 1997 *New York Law School Journal of International and Comparative Law* 511 and Evans and Haskins 1990 *South African Mercantile Law Journal* 246.

⁵⁰The term "sequestration" in South African law refers to the process of bankruptcy in respect of individuals and partnerships whereas the term "liquidation" refers to the process of bankruptcy for corporate entities. The term insolvency in South Africa has the same meaning as bankruptcy in the common law jurisdictions. However, the term bankruptcy is not a formal term in South Africa.

⁵¹Bertelsmann *et al Mars: The law of insolvency in South Africa* 2; Sharrock *Business transactions law* 597; Roestoff and Renke 2005 *International Insolvency Law Review* 95 and Sharrock *et al Hockly's insolvency law* 4.

⁵²*Ibid.*

⁵³*Ibid.*

⁵⁴*Ibid.*

he or she does not act in a manner that would be detrimental to the interests of the group of creditors.⁵⁵ Innes JA's widely quoted words explain the effect of a *concursum creditorum* as follows:⁵⁶

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 thereafter be entered into with regard to estate matters via a single creditor to the prejudice of the general body. The claim of each creditor must be dealt with as it existed at the time of the issue of the order.

Although not its primary goal, one of the outcomes of the sequestration process in South Africa is the complete discharge of the debtor.⁵⁷ The sequestration process is therefore frequently used and in some cases abused by debtors in order to acquire a full release from their debts.⁵⁸ With this in mind, and the South African creditor-orientated philosophy, the legislature probably formulated the advantage to creditor requirement as a precondition to the granting of a sequestration order.⁵⁹ The South African debt relief regime also provides for alternative procedures that are separate from the main insolvency process and legislation.⁶⁰ These are administration orders under the *Magistrates' Courts Act* and debt review under the NCA.

In summary, for a financially strained debtor in South Africa who faces the prospect of being sued by his or her creditors, there are a number of options available to him or her.⁶¹

⁵⁵See Beukes 2002 *South African Mercantile Law Journal* 797–799 for a similar discussion on the *concursum creditorum* as it relates to companies under liquidation.

⁵⁶*Walker v Syfert* NO 1911 AD 141 166.

⁵⁷S 129 of the *Insolvency Act*; par 4.4.4 below; Bertelsmann *et al Mars: The law of insolvency in South Africa* 3 and Loubser 1997 *South African Mercantile Law Journal* 325.

⁵⁸See par 4.4.3 below on friendly sequestrations and Evans 2001 *South African Mercantile Law Journal* 492.

⁵⁹Roestoff and Renke 2005 *International Insolvency Law Review* 96. See also par 4.3.1.1 below.

⁶⁰Bertelsmann *et al Mars: The law of insolvency in South Africa* 3.

⁶¹Boraine and Roestoff 2002 *International Insolvency Law Review* 2. See also Nagel *et al Commercial Law* 401 and 402.

- (a) The debtor may apply for voluntary surrender under the *Insolvency Act*,
- (b) the debtor may wait until the creditor(s) apply for his or her compulsory sequestration under the *Insolvency Act*,
- (c) the debtor may offer his or her creditors a composition under section 119 of the *Insolvency Act* after an application for his or her sequestration;
- (d) the debtor may apply for an administration order in terms of section 74 of the *Magistrates' Courts Act* 32 of 1944.
- (e) the debtor may enter into a novation or a release agreement with all or some of his or her creditors; and
- (f) If the requirements under the NCA are met the debtor may apply for debt review in terms of section 86 of the NCA.

These procedures will be discussed below. The South African alternatives will be studied in the following paragraphs with emphasis on their operation, their effectiveness, and with the view of possibly incorporating these models and processes into the Tanzanian debt relief regime.

4.4 Debt Relief Measures in terms of the *Insolvency Act*

Under the *Insolvency Act* sequestration may be commenced by either voluntary surrender of the debtor's estate or his or her creditor(s) may apply for the compulsory sequestration of the estate.⁶² These procedures are both initiated by way of *ex parte* applications under the *Uniform Rules of Court*.⁶³ The *ex parte* procedure involves only one party, namely the applicant who is applying for an order with regard to himself. *Ex parte* applications are

⁶²See in general in respect of the process of sequestration Meskin *et al* *Insolvency law and its operation in winding-up* 56; Bertelsmann *et al* *Mars: The law of insolvency in South Africa* 23; Sharrock *et al* *Hockly's insolvency law* 15 and Nagel *et al* *Commercial Law* 406. Sequestration/bankruptcy orders in South Africa can only be obtained at the High Court. Although the situation is the same in Tanzania, the Chief Justice has the power to entrust this duty to lower Courts. See par 3.3.1 above and Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 297.

⁶³Herbstein *et al* *The civil practice of the supreme court of South Africa* 311. The uniform rules of Court are the rules regulating the conduct of the proceedings of the several provincial and local divisions of the High Court of South Africa. See also Kelbrick *Civil procedures in South Africa* 16.

characterised as relatively brief applications in which the evidence is normally placed before the Court in a written affidavit supported by further documentary evidence.⁶⁴

4.4.1 Voluntary Surrender

Voluntary surrender allows the debtor to relieve himself or herself of his or her debt in exchange for surrendering his or her assets. The acceptance of a voluntary surrender rests on the judge's sole discretion.⁶⁵ Borraine and Roestoff note that voluntary surrender is a debt relief measure in the sense that the debtor can call upon it when he or she is over-indebted.⁶⁶ That being said, it must be kept in mind that the voluntary surrender of a debtor's estate in South Africa should primarily be aimed at realising a dividend for the debtor's creditors that is not negligible.⁶⁷ In other words, as stated above, this remedy is initially aimed at benefiting the creditor and not the debtor *per se*.⁶⁸ Having an order for voluntary surrender granted in your favour is, however, no easy task. Even before the debtor can apply for an order of voluntary surrender, he or she must offset the following three formalities:

- (a) A notice of surrender must be published not more than 30 days and no less than 14 days before the application in the *Government Gazette* and a newspaper circulating in the magisterial district where the applicant resides, or where he or she is a trader, in the district where his or her principal business is located.⁶⁹
- (b) A copy of the notice of surrender must be sent to all known addresses of possible creditors within seven days from the date of publication in the *Government Gazette*.⁷⁰ A copy of the notice must be furnished by post to the South African Revenue Services and

⁶⁴Kelbrick *Civil procedures in South Africa* 16.

⁶⁵*Ex parte Hayes* 1970 4 SA 94 (NC); *Julie Whyte Dresses (Pty) Ltd v Whitehead* 1970 3 SA 218 (D); Bertelsmann *et al Mars: The law of insolvency in South Africa* 76 and Borraine and Roestoff 2002 *International Insolvency Law Review* 3.

⁶⁶*Ibid.*

⁶⁷*Ex parte Anthony* 2000 4 SA 116 (C). See also Bertelsmann *et al Mars: The law of insolvency in South Africa* 48.

⁶⁸See par 4.2 above.

⁶⁹S 4(1) of the *Insolvency Act*.

⁷⁰S 4(2) of the *Insolvency Act*.

every registered trade union that represents any of debtor's employees and also to the employees themselves.⁷¹

- (c) A statement of affairs must be prepared and must lie open for inspection at the master's office for 14 days from the date of notice of surrender.⁷²

The purported purpose of these formalities is to notify the creditors that the debtor is about to apply for voluntary surrender and allow them an opportunity to object to the application.⁷³ In addition, the formalities supply the creditors and other interested parties with important information about the debtor's estate.⁷⁴ These formalities, it would appear, must be adhered to strictly.⁷⁵ Although the Act allows the Court to condone mistakes,⁷⁶ where a mistake prejudices the creditors or their interests, it cannot be condoned.⁷⁷

In addition to the above formalities, the Court must be satisfied on a balance of probabilities that the other requirements described in section 6 of the *Insolvency Act* have been met. It is important to note at this juncture that even where all the requirements of section 6 have been fulfilled the Court still has the discretion to allow the order, refuse the order, or postpone the application.⁷⁸ Under section 6 the applicant must prove the following:

⁷¹ *Ibid.* With regard to employees, the debtor may give them notice of the impending application by affixing a copy of the notice to a notice board that can be easily seen by his or her employees – s 4(2).

⁷² S 4(3) of the *Insolvency Act*. The debtor is obliged to act in good faith when preparing the statement of affairs. Failure to make full disclosure of his or her finances can result in refusal of the order. In this regard see the case of *Ex parte Berman* 1972 3 SA 128 (R).

⁷³ Ss 3–5 of the *Insolvency Act*. See also Bertelsmann *et al Mars: The law of insolvency in South Africa* 79.

⁷⁴ Boraine and Roestoff 2002 *International Insolvency Law Review* 3.

⁷⁵ *Ibid.* *Ex parte Van Rensburg* 1977 4 SA 604 (O). Roestoff and Burdette 2005 *Tydskrif vir Hedendaags Romeins-Hollandse Reg* 681-683.

⁷⁶ S 157(1) of the *Insolvency Act*.

⁷⁷ Therefore late publication of a notice of surrender or premature publication is almost never condoned. In this regard see the decisions in *Ex parte Van Rooyen* 1975 2 SA 364 (O) and *Ex parte Oosthuizen* 1995 2 SA 694 (T). The case of *Kritzinger v Morelletta Motorhawe Projek* 1994 2 SA 717 (T) is an example of a case where non-compliance of the time periods set out in s 4 was condoned. See also the well-articulated discussion on this issue by Roestoff and Burdette 2005 *Tydskrif vir Hedendaags Romeins-Hollandse Reg* 681. See also Nagel *et al Commercial Law* 408.

⁷⁸ *Ex parte Van den Bergh* 1950 1 SA 816 (W) 823.

- (a) That he or she has fulfilled all the statutory formalities in section 4 of the *Insolvency Act* described above;
- (b) that he or she is factually insolvent;
- (c) that the free residue will be sufficient to cover the costs of sequestration,⁷⁹ and
- (d) that sequestration will be to the advantage of creditors.

The burden of proving that these requirements have been fulfilled lies with the debtor.⁸⁰ Documentary proof is required to substantiate that all the formalities under section 4 have been met.⁸¹ Secondly, the statement of affairs of the debtor plays a big role in determining whether the debtor is actually insolvent. Where the debtor's statement of affairs shows a positive balance meaning he or she is not insolvent on paper, the debtor must adduce further proof that he or she is insolvent.⁸² Thirdly, there is no set rule in legislation that governs how much free residue must be available. The Courts have, however, set the minimum dividend in this regard at 20 cents in the rand.⁸³

The debtor in South Africa applies for voluntary surrender of his or her assets to obtain a discharge and undo his or her financial distress.⁸⁴ Nonetheless, since the main idea underlying the sequestration regime in South Africa is that all procedures should aim to benefit the creditors, the debtor must satisfy the Court that the procedure will indeed be to the creditors' benefit before an order for voluntary surrender will be given.⁸⁵ To be more specific, the debtor must prove that the sequestration is to the advantage of the creditors as a

⁷⁹According to s 2 of the Act the free residue is that part of the insolvent estate that is not subject to any real security e.g. a pledge or a mortgage. This includes any surplus amounts remaining after secured claims have been paid from the sale of secured assets.

⁸⁰Bertelsmann *et al Mars: The law of insolvency in South Africa* 72 and 74. See also Nagel *et al Commercial law* 409.

⁸¹*Ibid.*

⁸²*Ibid.*

⁸³See the discussion below.

⁸⁴Bertelsmann *et al Mars: The law of insolvency in South Africa* 74 and *Ex parte Kitching* 1940 CPD 39.

⁸⁵*Ibid.* S 6(1) of the *Insolvency Act* and see also *Ex parte Henning* 1981 3 SA 834 (O) 842.

group.⁸⁶ The term “advantage” refers to a financial advantage.⁸⁷ Unfortunately the Insolvency Act does not set out exactly what factual situation or dividend amounts to an advantage for creditors, unlike in its Tanzanian counterpart.⁸⁸ In the cases of *Trust Wholesalers and Woollens (Pty) Ltd v Mackan*⁸⁹ and *ABSA Bank Ltd v De Klerk*,⁹⁰ precedents were set that in order to prove an advantage for the creditors the debtors must at the least receive a dividend.⁹¹ If no dividend is received by the creditor(s) or a dividend is received but it is negligible, the advantage for creditors’ requirement is not fulfilled.⁹²

The High Court division follows a strict approach when it comes to the advantage for creditors’ requirement in voluntary surrender. In the recent case of *Ex parte Bouwer*,⁹³ the creditor-orientated nature of the South African insolvency system was reaffirmed when the Court referred to the advantage requirement as the “key consideration” in awarding a sequestration order.⁹⁴ Since the Act does not provide guidance on what constitutes an advantage for creditors, different divisions of the High Court around the country have devised rules of practice in order to create some uniformity in their separate divisions.⁹⁵ Recently however, a precedent was passed in this regard in the High Court case of *Ex parte Ogunlaja*.⁹⁶ The High Court held that the advantage for creditors’ requirement requires that the unsecured creditors

⁸⁶*Stainer v Estate Bukes* 1933 OPD 86.

⁸⁷Evans 2001 *South African Mercantile Law Journal* 488. See the widely quoted case of *Meskin and Co v Friedman* 1948 2 SA 555 (W) where the Court held that “the facts put before the Court must satisfy it that there is a reasonable prospect not necessarily likelihood, but a prospect which is not too remote – that a pecuniary benefit will result to creditors”.

⁸⁸See par 3.3.6 above.

⁸⁹1954 2 SA 109 (N).

⁹⁰1999 4 SA 835 (SE).

⁹¹See also *Ex parte Matthysen et Uxor (First Rand Bank Limited intervening)* 2003 2 SA 308 (T) 316B–C; *Ex parte Anthony* 2000 4 SA 116 (C) par 11; *Ex parte Kelly* 2008 4 SA 615 (T) 3 and Bertelsmann *et al Mars: The law of insolvency in South Africa* paras 3.26 and 3.30.

⁹²*London Estates (Pty) Ltd v Nair* 1957 3 SA 591 (D) and *Trust Bank of Africa Ltd v Dempers* 1968 2 PH C13 (D).

⁹³2009 6 SA 382 (GNP)

⁹⁴*Idem* par 13.

⁹⁵See for example *Ex parte Anthony* 2000 4 SA 116 (C) where the Court held that the Master should make a report in this regard to guide the Court. The Transvaal Provincial Division and the Witwatersrand Local Division dealt with this issue in their Practice Manual by devising a formula of a minimum dividend for the so-called concurrent creditors. These are the creditors that do not rely on any security for a specific portion of their claim or their whole claim.

⁹⁶(GNP case no. 53146/09 unreported judgment delivered in January 2010).

receive at least 20 cents in the rand.⁹⁷ This precedent notwithstanding, in some cases, sequestration proceedings were found to be to the advantage of creditors if it suited the creditors better than any other practical and reasonably available alternative.⁹⁸

4.4.2 Compulsory Sequestration

The creditor(s) of the financially stressed debtor can also apply for the debtor's sequestration. The process is known as compulsory sequestration.⁹⁹ When applying for a compulsory sequestration order the debtor approaches the Court twice.¹⁰⁰ First to procure a provisional sequestration order and then, after some time has elapsed, to secure a final sequestration order.¹⁰¹ Before a creditor can apply for sequestration however, he or she must, like in the case for voluntary surrender, complete a few formalities.¹⁰² The formalities that are required to be offset are as follows:

- (a) The applicant/creditor must give security to the Master of the High Court to settle all the costs of sequestration until the trustee of the insolvent estate is appointed;¹⁰³
- (b) the applicant/creditor must furnish a copy of the application to the following persons:¹⁰⁴
 - the debtor;
 - every trade union that represents the debtor's employees;
 - the employees themselves; and

⁹⁷ *Idem* par 9.

⁹⁸ *Gardee v Dhanmanta Holdings and Others* 1978 1 SA 1066 (N) 1070 and *Boraine and Van Heerden* 2010 *PER* 509. These authors suggest that since each debt situation is unique, the Courts should follow a common-sense approach to decide whether sequestration will be the best solution to an individual debt situation.

⁹⁹ S 3–7 of the *Insolvency Act*.

¹⁰⁰ *Ibid.*

¹⁰¹ *Ibid.* It is important to note that a provisional sequestration order must precede a final sequestration order. Where the provisional order is declared null and void it stands to reason that any final order given on the same case is also null and void. In this regard see *Moch v Nedtravel (Pty) Limited t/a America Express Travel Service* 1996 3 SA 1 (A).

¹⁰² *Bertelsmann et al Mars: The law of insolvency in South Africa* 74.

¹⁰³ S 9(3)-(5) of the *Insolvency Act*. Once the security has been paid the master will issue the creditor with a certificate confirming the provision of the security. The certificate must be filed together with the application for compulsory sequestration.

¹⁰⁴ S 9(4A)(a)–(iv) of the *Insolvency Act*.

- the South African Revenue Service.

One difference that is immediately clear when comparing these formalities with those of voluntary surrender is that the latter has more technical formalities that must be complied with, than compulsory sequestration.¹⁰⁵

When the applicant has fulfilled the formalities and applied for compulsory sequestration in the prescribed manner, the Court is charged under the Act to determine if *prima facie* the requirements of section 10 of the *Insolvency Act* have been fulfilled.¹⁰⁶ Where these requirements have been *prima facie* met, the Court may grant a provisional order for the sequestration of the debtor's estate.¹⁰⁷ The requirements that the applicant must prove in order to be granted a provisional order under section 10 are the following:¹⁰⁸

- (a) That he or she has a liquidated claim of at least R100.¹⁰⁹ Where more than one creditor applies jointly, they must show that the total of their claims collective is not less than R200;¹¹⁰
- (b) that the debtor is actually insolvent or has committed an act of insolvency; and
- (c) that there is reason to believe that the sequestration will be to the advantage of creditors.

The creditor's claim against the debtor must be a liquidated claim and the source of the claim, whether a contract or delict, must have arisen before the sequestration date.¹¹¹ In order to prove the debtor's insolvency one can rely

¹⁰⁵ Boraine and Roestoff 2002 *International Insolvency Law Review* 4.

¹⁰⁶ *Ibid.*

¹⁰⁷ Ss 10–11 of the *Insolvency Act* and Smith *The law of insolvency* 66. Where the Court grants a provisional sequestration order it will also grant a rule *nisi* requiring the debtor on a later date to appear before the Court and show cause why the provisional order should not be converted to a final order of sequestration.

¹⁰⁸ *Ibid.*

¹⁰⁹ 100 South African rands was the equivalent of approximately 11 United States dollars on 2011.06.18.

¹¹⁰ 200 South African rands was the equivalent of approximately 22 United States dollars on 2011.06.18.

¹¹¹ Bertelsmann *et al Mars: The law of insolvency in South Africa* 391. A liquidated claim is a claim for an amount of money that is certain and determinable by an order of Court.

on adducing evidence of this fact, or proving that the debtor committed an act of insolvency. The South African Acts of insolvency under section 8 of the *Insolvency Act* are somewhat similar to those under its Tanzanian counterpart and therefore, for the purpose of this study, require no further investigation.¹¹²

The onus of proving the advantage for creditors' requirement in compulsory sequestration is on the applicant creditor.¹¹³ Unlike in voluntary surrender the applicant creditor does not need to prove an actual advantage to creditors, he or she simply needs to prove that there is reason to believe that there is such an advantage.¹¹⁴ In this regard the Court in *Meskin* held that with respect to the advantage for the creditors' requirement for compulsory sequestration:¹¹⁵

... the facts put before the Court must satisfy it that there is a reasonable prospect... not necessarily likelihood, but a prospect which is not too remote... that a pecuniary benefit will result to creditors...

The advantage for creditors' requirement is certainly less burdensome to prove in compulsory sequestration than in voluntary surrender. Case law on this subject shows that the troubled debtor need not even be in possession of a substantial amount of assets to prove the creditors' advantage; the fact that he or she has a good income that may be made available to the creditors will suffice.¹¹⁶

Nagel *et al* note that apart from this crucial difference the principles for calculating an advantage for the creditors remain the same as for voluntary surrender.¹¹⁷ The Courts use the same rules of practice to determine this

¹¹²Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 305.

¹¹³*Wilkins v Pieterse* 1937 CPD 165. See also Sharrock *et al Hockly's insolvency law* 40.

¹¹⁴*Bertelsmann et al Mars: The law of insolvency in South Africa* 138 and Borraine and Roestoff 2002 *International Insolvency Law Review* 4. In *Amod v Khan* 1947 2 SA 432 (N) it was explained that before the Court can grant such a provisional order it must be satisfied on the face of the application that there is reason to believe that it will be of some advantage to the creditors if the debtor's estate is placed under sequestration.

¹¹⁵*Meskin and Co v Friedman* 1948 2 SA 555 (W).

¹¹⁶*Ressel v Levin* 1964 1 SA 128 (C).

¹¹⁷*Ibid.*

advantage and will more often than not require proof that there will be a dividend of not less than 20 cents in the rand of concurrent creditors' claims.¹¹⁸

On the return date after a provisional order has been given, if the creditor can satisfy the Court that he or she has a liquidated claim, that there is a reasonable prospect that the sequestration process will be to the advantage of the creditors and that the debtor is actually insolvent or committed an act of insolvency, the Court may, using its own discretion grant a final sequestration order.¹¹⁹

4.4.3 Friendly Sequestrations

There is nothing to prevent a debtor from agreeing with a friendly creditor to have him or her sequester his or her estate.¹²⁰ In fact this often occurs where a creditor who is a friend or a relative of the debtor arranges with him or her to commit an act of insolvency.¹²¹ The act of insolvency is usually where the debtor delivers a letter in writing to the creditor informing him or her of his or her inability to pay his or her debt.¹²² Subsequently the creditor applies for compulsory sequestration. Such an application for compulsory sequestration brought by an amicable creditor is termed a "friendly sequestration" in South Africa.¹²³

¹¹⁸*Ex parte Ogunlaja* (GNP case no. 53146/09 unreported judgment delivered in January 2010). See also par 4.4.1 above and Bertelsmann *et al Mars: The law of insolvency in South Africa* 139.

¹¹⁹S 12 of the *Insolvency Act*. For the provisional sequestration order there is relaxation of the normal burden of proof for civil proceedings. It should be noted that the burden of proof for the granting of the final sequestration order is higher than for the provisional order as there is no formal relaxation of the normal burden of proof for civil proceedings. The creditor must "satisfy" the court on a balance of probabilities that the relevant requirements have been met. In this regard see *Trust Wholesalers and Woollens (Pty) Ltd v Mackan* 1954 2 SA 109 (N) 113 and *Lindhaven Meat Market CC v Reyneke* 2001 1 SA 454 (W). See also *Ganes v Telecom Namibia Ltd* 2004 3 SA 615 (SCA) with regard to the scope of the Court's discretion and more specifically if the Court has the discretion to allow further proof on the return date.

¹²⁰See also *Estate Logie v Priest* 1926 AD 312 and 319; *Sharrock et al Hockly's insolvency law* 40 and Smith *The law of insolvency* 74–77.

¹²¹*Ibid. Mthimkhulu v Rampersad (BOE Bank Limited, intervening creditor)* 2000 3 All SA 512 (N) 514. This is an act of insolvency under s 8(g) of the *Insolvency Act*. See also Evans 2001 *South African Mercantile Law Journal* 487 and Nagel *et al Commercial law* 416.

¹²²S 8(g).

¹²³Smith 1997 *Juta Business Law Journal* 50.

The first question that often comes to mind when considering friendly sequestrations is why conspire with your creditors to be declared insolvent when you can voluntarily surrender your estate? The following explanations have been offered:

- (a) Although it is possible to surrender your estate as a debtor under the *Insolvency Act*, this procedure's cumbersome formalities and the higher burden of proof required when proving "advantage to creditors" makes compulsory sequestration an easier option.¹²⁴
- (b) For compulsory sequestration there is the possibility of an act of insolvency. The creditor(s) do not have to prove that the debtor is actually insolvent like the debtor has to in a voluntary surrender application.¹²⁵

Furthermore, friendly sequestrations also occur as a result of inadequate debt relief measures for debtors in South Africa.¹²⁶ As a result debtors rely on sequestration proceedings to acquire a discharge. This contention is supported by the fact that although South Africa does have alternatives to sequestration, as noted above, none of these procedures force a discharge on the debtor's creditors.¹²⁷ Therefore debtors find themselves compelled to use the sequestration process to discharge their debts.¹²⁸ Once the decision has been made to use sequestration, it quickly becomes clear that an order for compulsory sequestration is easier to procure than one for voluntary surrender.

As noted above there are no provisions in the *Insolvency Act* prohibiting friendly sequestrations. However, there is a lot of room for abuse of the

¹²⁴Van Heerden and Borraine 2009 *Potchefstroom Electronic Law Journal* 44; Evans 2001 *South African Mercantile Law Journal* 490 and Nagel *et al Commercial Law* 416.

¹²⁵De Clerq *et al Insolvent estates* 13.

¹²⁶*Ibid.* See also Loubser 1997 *South African Mercantile Law Journal* 325 and Borraine and Roestoff 1993 *De Jure* 229.

¹²⁷See par 4.5.1 above.

¹²⁸Roestoff and Jacobs 1997 *De Jure* 89.

sequestration process.¹²⁹ Where the debtor and creditor are not at arm's length there is a potential for collusion and professional misconduct. How the sequestration process can or is being abused by creditors is well articulated by Combrinck J in the case of *Mthimkhulu v Rampersad (BOE Bank Limited, intervening creditor)*.¹³⁰

The steep increases in interest rates by Banks and other lending institutions over the past year or two has resulted in a steady if not fast flowing stream of so-called "friendly" sequestrations. Indeed, among certain attorneys it has become quite a cottage industry. The majority of applications are sparked off by the imminent sale of the respondents' property by the Bank. The respondent hurries off to an attorney who is well known for his expertise in these matters and is briefed on the requirements for a friendly sequestration. He duly finds a "creditor" to whom he purportedly is indebted by virtue of an unsecured oral loan in an insignificant amount. He then supposedly writes a letter to his "creditor" which could just as well be headed "Letter in terms of section 8(g) of the Insolvency Act" in which with suitable expressions of dismay and apology, he confesses to be unable to repay the so-called loan. It is not uncommon to find in different applications that the section 8(g) letter contains precisely the same wording which makes one suspect that the attorney specialising in these matters has these letters on a word processor. An application for the sequestration of the debtor is then drafted in which the friendly creditor makes the necessary allegations and in particular expresses his concern for the interests of the body of creditors if the property under attachment were to be sold by public auction. A value of the property on the open market is then given and duly supported by a valuer who also puts up an affidavit. It is also a feature of these applications that the same valuer is employed in each of them. Invariably the application is then moved as a matter of urgency on the afternoon of the day before the sale of the property. If a provisional order is granted, one has the curious phenomenon that the respondent who has co-operated so admirably up until that date cannot be served with the Court order for a variety of reasons including that he is evading service, is now living elsewhere, is away on business, etc. The result is that the return date is extended for a number of times until the genuine creditors have lost interest in the respondent and the rule is then discharged. Alternatively, the provisional order is confirmed, the friendly creditor makes no effort to have a trustee appointed or to prove his claim, no creditor takes steps to prove a claim because of a fear of

¹²⁹ Evans 2001 *South African Mercantile Law Journal* 489 and Sharrock *et al Hockly's insolvency law* 40.

¹³⁰ 2000 3 All SA 512 (N) 514.

contribution, the debtor waits for the dust to settle and with his old creditors off his back carries on business as normal.

It is understandable that a state of affairs exists with these types of applications that creditors may be prejudiced.¹³¹ Evans submits that it is in fact true that in South Africa friendly sequestrations are regularly used by debtors and colluding creditors to free debtors from the shackles of debt, unfortunately by deceitfully making submissions to the Court that the debtor's sequestration will be to the advantage of the creditors.¹³²

As a result of this state of affairs, the Courts have resolved as a matter of policy that all friendly sequestrations must be scrutinised with meticulous care to ensure that the requirements of the *Insolvency Act* are not fraudulently evaded or navigated to the detriment of the interests of creditors.¹³³ However, it is noted that the fact that an application for sequestration is brought forward by an amicable creditor is not by itself a precondition for that application to fail.¹³⁴ If all the requirements under section 10 are met then the sequestration order should be granted.¹³⁵ It should only fail when the amicable creditor intends only to benefit the debtor and not his or her fellow creditors of the debtor's estate.¹³⁶

4.4.4 Rehabilitation

The bankrupt debtor, known in South Africa as the insolvent, may be rehabilitated in one of two ways; either automatically after ten years from the date of sequestration or by means of a Court order.¹³⁷ With regard to the former where the debtor is still an unrehabilitated insolvent ten years after the

¹³¹Evans 2001 *South African Mercantile Law Journal* 491.

¹³²*Ibid.*

¹³³*Klemrock (Pty) Limited v De Klerk* 1973 3 SA 925 (W); *Epstein v Epstein* 1987 4 SA 606 (C); *Dunlop Tyres (Pty) Limited v Brewitt* 1999 2 SA 580 (W); *Van Rooyen v Van Rooyen* 2000 2 ALL SA 485 (SE); *Ex parte Steenkamp* 1996 3 SA 822 (C); *Van Eck v Kirkwood* 1997 1 SA 289 (SE); *Beinash & Co v Nathan* 1998 3 SA 540 (W) and *Lemley v Lemley* 2009 JDR 0445 (SE). See also Sharrock *et al Hockly's insolvency law* 42.

¹³⁴*Maritz t/a Maritz and Kie Rekenmeester v Walters* 2002 1 SA 689 (C) 703. See also the *locus classicus* on this issue *Jhatam v Jhatam* 1958 4 SA 36 (N).

¹³⁵*Ibid.*

¹³⁶*Esterhuizen v Swanepoel* 2004 4 SA 89 (W). In this case the Court stated that an application should not fail merely because there is goodwill between the parties.

¹³⁷S 124 of the *Insolvency Act*.

date of his or her sequestration, he or she is deemed rehabilitated.¹³⁸ An interested party may apply to the Court within that period to stop the automatic rehabilitation of the insolvent.¹³⁹

The *Insolvency Act* sets out instances under which the insolvent can apply to the Court for rehabilitation before the ten year period has elapsed.¹⁴⁰ When the application is made, even where all the required steps have been taken, the Court has an absolute discretion and is not obliged to grant a rehabilitation order.¹⁴¹ This is similar to the Tanzanian bankruptcy law which also gives the Court total discretion on rehabilitation.¹⁴² The Court's discretion to grant the order depends on if it determines that the insolvent is a person who should be allowed to trade with the public on the same basis as other honest people.¹⁴³ The Court will also only grant the rehabilitation order if the insolvent has "learned the lessons of insolvency" or where he or she has some appreciation of the hardship his or her sequestration has caused one or more of his or her creditors.¹⁴⁴ The insolvent can apply for rehabilitation on the following grounds:¹⁴⁵

- (a) The insolvent can apply for rehabilitation after 12 months have passed since the confirmation of the first trustee's account;¹⁴⁶
- (b) where the insolvent has previously been sequestrated he or she may only apply for rehabilitation after three years have passed since the confirmation of the first trustee's account;¹⁴⁷
- (c) if the insolvent has been convicted of a crime in relation to his or her existing or previous insolvency or a few other specific offences

¹³⁸ *Ibid.*

¹³⁹ S 127(A) of the *Insolvency Act*.

¹⁴⁰ S 124 of the *Insolvency Act*.

¹⁴¹ *Ex parte Woolf* 1958 4 SA 190 (N) and *Ex parte Hittersay* 1974 4 SA 326 (SWA). See also Sharrock *et al Hockly's insolvency law* 192

¹⁴² See par 3.5 above.

¹⁴³ *Greub v The Master and others* 1999 1 746 (C) 752.

¹⁴⁴ *Ex parte Hittersay* 1974 4 SA 326 (SWA).

¹⁴⁵ S 124 of the *Insolvency Act*.

¹⁴⁶ S 124(2)(a) of the *Insolvency Act*.

¹⁴⁷ S 124(2)(b) of the *Insolvency Act*.

under the *Insolvency Act* he or she may only apply for rehabilitation five years after the conviction is over and done;¹⁴⁸

- (d) where no creditor has proved a claim against the insolvent and he or she has not been previously sequestrated or committed any offences in connection with the sequestration, he or she can apply for rehabilitation after 6 months have passed since the date of sequestration;¹⁴⁹
- (e) where a composition is agreed to between the debtor and his or her creditors. The composition must pay at least 50 cents in the rand on all claims proved against the estate; and¹⁵⁰
- (f) where the insolvent has paid all claims in full including any levied interest he or she may apply for rehabilitation any time after confirmation by the Master of a plan of distribution providing for the relevant payments.¹⁵¹

Once the order by the Court for rehabilitation is granted the debtor's sequestration is terminated.¹⁵² The effect of the rehabilitation order is that all of the debtor's pre-sequestration debts are discharged,¹⁵³ apart from a few exceptions.¹⁵⁴ The debtor's rehabilitation has no effect on the debtor's sureties or any fines he or she may have incurred under the *Insolvency Act*.¹⁵⁵ The newly rehabilitated insolvent is also vested again with his or her full contractual capacity.

¹⁴⁸S 124(2)(c) of the *Insolvency Act*.

¹⁴⁹S 124(3)(a) of the *Insolvency Act*.

¹⁵⁰S 119(1) of the *Insolvency Act*.

¹⁵¹S 124(5) of the *Insolvency Act*.

¹⁵²Sharrock *et al Hockly's insolvency law* 200.

¹⁵³S 129(1)(a) of the *Insolvency Act*. See also Bertelsmann *et al Mars: The law of insolvency in South Africa* 591.

¹⁵⁴S 129(1)(b) and 129 (2) of the *Insolvency Act*. See also Bertelsmann *et al Mars: The law of insolvency in South Africa* 591.

¹⁵⁵S 129(1)(c) of the *Insolvency Act*.

4.4.5 Composition

A debtor who is struggling financially can prevent or terminate sequestration by entering into a compromise with his or her creditors.¹⁵⁶ The South African system has two forms of the procedure: one is known as the statutory composition and the other is the common law composition.¹⁵⁷

In order to achieve a common law composition the debtor must enter into a written contract with all of his or her creditors to pay a certain agreeable dividend on the creditors' claims.¹⁵⁸ Such an agreement may occur before or after the granting of the provisional sequestration order.¹⁵⁹ This agreement is only binding if it is agreed to and signed by all the creditors.¹⁶⁰ Further, the consent of the Court is not required for this type of composition.¹⁶¹

The insolvent debtor may also, under section 119 of the *Insolvency Act*, make an offer of composition to his or her creditors at any time after the first meeting of creditors.¹⁶² If the offer is accepted by 75 per cent of the creditors in number and in value, the composition is binding on all the creditors.¹⁶³ This composition also does not require consent or ratification by the Court.¹⁶⁴ The effect of the composition is that the rights and duties of the insolvent debtor and his or her creditors are determined by the composition agreement and relevant provisions in the *Insolvency Act*.¹⁶⁵

The South African Law Commission reviewed the law of insolvency in the 1990s. As a result of this review the commission planned that a new section

¹⁵⁶ *Mahomed v Lockhat Brothers and Co Ltd* 1944 AD 230.

¹⁵⁷ Bertelsmann *et al* *Mars: The law of insolvency in South Africa* 546.

¹⁵⁸ *Mahomed v Lockhat Brothers and Co Ltd* 1944 AD 230.

¹⁵⁹ In the case that it does occur after the granting of the provisional sequestration order, it is procedure that the provisional trustee be party to the compromise agreement. See Sharrock *et al* *Hockly's insolvency law* 188.

¹⁶⁰ *Prinsloo and another v Van Zyl NO* 1967 1 SA (T) 383.

¹⁶¹ Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 308.

¹⁶² The offer for a composition is made through the trustee who calls a creditor's meeting for this purpose, again similar to the Tanzanian system. See de Clercq *et al* *Insolvent estates* 120.

¹⁶³ S 119(7) of the *Insolvency Act*.

¹⁶⁴ Smith *The law of insolvency* 280.

¹⁶⁵ *Ilic v Parginos* 1985 1 SA 795 (A).

74X should be inserted into the *Magistrates' Courts Act*.¹⁶⁶ Upon drafting the *Unified Insolvency and Business Recovery Bill*¹⁶⁷ it was however decided that a similar procedure,¹⁶⁸ named the “pre-liquidation composition”, should rather be included in this unified Bill.¹⁶⁹ Thus the *Unified Insolvency and Business Recovery Bill* now contains a chapter dealing with pre-liquidation compositions.¹⁷⁰ Due to the nature of the bill, the provisions of the composition were amended to apply to both natural and juristic persons.¹⁷¹ The advantage of this type of composition is the fact that it can be dealt with in the lower Courts, making the process cheaper for all the parties concerned.¹⁷²

This new proposed composition procedure would only be available before sequestration.¹⁷³ Where the composition is accepted by a two thirds majority in value of the concurrent creditors at the relevant meeting, it will be binding on all the creditors who were notified about the meeting. This proposed pre-liquidation composition is supervised by a magistrate and takes place after an investigation of the affairs of the troubled debtor.¹⁷⁴ The pre-liquidation composition has no effect on the rights of creditors with real security or statutory preferent rights unless they consent.¹⁷⁵

Steyn is of the opinion that this pre-liquidation composition, where it has been modified, may provide a method for over-indebted debtors to save their

¹⁶⁶South African Law Commission 2000 *Review of the law of insolvency* 239. See Boraine 2003 *De Jure* 228 for a detailed discussion of this proposal.

¹⁶⁷In 2003 the *Unified Insolvency and Business Recovery Bill* was approved by cabinet but was never tabled before parliament, therefore it never became a public document. When discussing the *Unified Insolvency and Business Recovery Bill* this thesis refers to the 2010 “unofficial working draft” which is a modified version of the 2003 draft. The 2010 document is also not a public document.

¹⁶⁸Steyn 2012 LLD Thesis 354.

¹⁶⁹Burdette 2004 *South African Mercantile Law Journal* 251.

¹⁷⁰Kelly-Louw *The future of consumer credit regulation: Creative approaches to emerging problems* 232.

¹⁷¹Burdette 2004 *South African Mercantile Law Journal* 251.

¹⁷²*Ibid.*

¹⁷³Steyn 2012 LLD Thesis 354.

¹⁷⁴Boraine and Roestoff 2002 *International Insolvency Law Review* 8. This procedure is somewhat similar to the Tanzanian composition after the presentation of a bankruptcy petition, discussed above. See par 3.3.6 above.

¹⁷⁵S 118(6) of the unofficial working draft of the *Unified Insolvency Bill*.

homes from the hands of their secured creditors during sequestration.¹⁷⁶ She also reasons that one of the advantages of this procedure is that, unlike the current alternatives to sequestration in South Africa, it provides a measured discharge for the debtor of his or her pre-sequestration debts.¹⁷⁷ Steyn also hypothesises that because this procedure does not vary the rights of secured creditors without their consent, these creditors may be less likely to pursue the forced sale of the debtor's home.¹⁷⁸

4.5 Alternative Debt Relief Measures

A sequestration proceeding in its general form is a drastic and often harsh measure.¹⁷⁹ In addition it may not always be the most practical option for the creditor or the debtor. Where a debtor who is factually solvent has fairly few liabilities or where the debtor's assets are so small in value that he or she will be unable to prove advantage, sequestration is not always the best option.¹⁸⁰ In the latter scenario it would also be impractical for creditors to be liable for the costs of sequestration due to the miniature size of the estate, and after the sequestration process receive a negligible dividend.¹⁸¹ In such cases it may be more appropriate for the debtor to have recourse to procedures other than sequestration if they are available in that jurisdiction. In South Africa these alternative measures include compositions, already discuss above,¹⁸² and two other formal debt relief procedures, namely administration¹⁸³ and debt review.¹⁸⁴

¹⁷⁶Steyn 2012 LLD Thesis 355.

¹⁷⁷*Idem* 356.

¹⁷⁸*Ibid.*

¹⁷⁹Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 86. See also par 2.1 above, where the consequences of bankruptcy on the individual and society are discussed in some depth.

¹⁸⁰*Ibid.*

¹⁸¹S 106 of the *Insolvency Act* requires certain groups of creditors to contribute to the costs of sequestration in South Africa where the free residue is insufficient to cover sequestration costs. See also Burdette 2003 *Tydskrif vir Hedendaags Romeins-Hollandse Reg* 521 and 523.

¹⁸²Discussed in par 4.3.1.5 above.

¹⁸³See par 4.5.1 below.

¹⁸⁴S 74 of the *Insolvency Act* and s 86 of the NCA respectively.

4.5.1 Administration Orders

An administration order has frequently been described as a kind of sequestration proceeding.¹⁸⁵ However, unlike a sequestration, the debtor is not placed under sequestration and his or her assets are not sold for the creditors' benefit nor is his or her contractual capacity curtailed for the duration of the process.¹⁸⁶ With administration a third party, the administrator, takes control of the debtor's financial affairs.¹⁸⁷ In short, administration provides for a rescheduling of the financially stressed debtor's debts placing a third party in charge of making payments to the creditors.¹⁸⁸ Theophilopoulos neatly summarises the procedure as follows:¹⁸⁹

In terms of the order the debtor has an obligation to make regular payments to the administrator. The administrator, after deducting necessary expenses and a specified remuneration determined by tariff, will in turn make a regular distribution in weekly or monthly instalments or otherwise out of such received payments to all creditors.

This procedure is particularly useful where the debtor has a regular income, his or her debt is fairly small and he or she is not involved in large intricate business dealings.¹⁹⁰ If the debtor's finances on the other hand are particularly disorganised or complex and an investigation of the debtor and his or her estate are necessary, an administration order will not be granted as it is preferable that the debtor be placed under sequestration.¹⁹¹ Greig states that

¹⁸⁵ Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 318 and Theophilopoulos *et al Fundamental principles of civil procedure* 376. See also *Ex parte Van den Berg* 1950 1 SA 816 (W) 817 and *Ex parte August* 2004 3 SA (W).

¹⁸⁶ *Ibid.*

¹⁸⁷ *Ibid.* The administrator does not take control of the debtor's assets as would be the case in bankruptcy.

¹⁸⁸ *Ibid.*

¹⁸⁹ Theophilopoulos *et al Fundamental principles of civil procedure* 376.

¹⁹⁰ Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 318.

¹⁹¹ The sequestration procedure as opposed to the administration procedure has a large number of sections and regulations on the investigation of the debtor's affairs and transactions. These sections and provisions are not available for administration. Therefore where the debtor is involved in intricate dealings it is logical to have him or her placed under bankruptcy. See Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 318 and 319.

the legislature envisaged that administration orders would be a cheap and easy alternative to sequestration for debtors.¹⁹²

4.5.1.1 *Application for an administration order*

Under section 74(1)(a) of the *Magistrates' Courts Act* a debtor who receives a regular salary and is burdened by a reasonable sized debt may be granted an administration order from the Court in the district where he or she resides, is employed or carries on business. The order may be granted in the following instances:¹⁹³

- (a) Where a judgement debtor is not able to satisfy right away a judgment obtained against him or her;
- (b) where the debtor has insufficient funds or assets to meet his or her financial obligations; or
- (c) where the judgement debtor is before the Court under a section 65 investigation into his or her financial affairs and during this investigation he or she applies for an administration order.

Under section 74(1)(b) of the *Magistrates' Courts Act* only a debtor whose total debts do not exceed the amount determined by the Minister of Justice by notice in the Government Gazette can apply for administration. The current amount is ZAR 50,000.¹⁹⁴

The debtor must make an application in the prescribed form,¹⁹⁵ and must also submit a full statement of affairs in the prescribed form.¹⁹⁶ In the statement of affairs the debtor must affirm by oath the names of the creditors and the amounts owed to them, as well as other relevant statements and declarations.¹⁹⁷ When the application is complete the debtor lodges the

¹⁹²Greig 2000 *South African Law Journal* 626.

¹⁹³S 74(1)(a) of the *Magistrates' Courts Act*.

¹⁹⁴This amount was determined by *Government Notice* R3441 of 31 December 1992. This amount is equivalent to approximately 7,373.80 US dollars.

¹⁹⁵S 74(1) of the *Magistrates' Courts* and form 44.

¹⁹⁶S 74A(1) and (2) of the *Magistrates' Courts Act* and the form 45.

¹⁹⁷Theophilopoulos *et al Fundamental principles of civil procedure* 377.

application with the Clerk of the Court and delivers copies of the application to the creditors either personally or by registered post.¹⁹⁸ The delivery process must take place at least three calendar days before the hearing of the application.¹⁹⁹

The application for an administration order is normally heard in a section 65 Court before a magistrate.²⁰⁰ The parties present at this hearing are the debtor, the debtor's legal representative, the creditors, and their legal representatives.²⁰¹ Under section 74B(1)(b) every debt that is listed in the statement of affairs is regarded as being proved unless an amendment is made by the Court, a creditor rejects it, or such debt requires to be proved by adduction of evidence.²⁰² Where the debtor objects to any one of the creditors' claims, that creditor will have to prove his or her claim to the Court.²⁰³ The creditors, their legal representatives and of course the Court can question the debtor on the following issues:²⁰⁴

- (a) The debtor's assets and liabilities;
- (b) his or her present and future income including the income of his or her spouse;
- (c) the debtor's current standard of living and any possibility of economising; and
- (d) any other matter the Court may deem relevant.

The Court has a wide discretion when hearing administration applications. The Court may for example postpone proof of the debt and defer consideration of the application or to proceed to deal with the application.²⁰⁵

¹⁹⁸ *Ibid.* S 74A(3) of the *Magistrates' Courts Act*.

¹⁹⁹ *Ibid.*

²⁰⁰ S 74B(1)(a) of the *Magistrates' Courts Act*. See also Boraine *et al* 2012 *De Jure* 86.

²⁰¹ *Ibid.*

²⁰² S 74B(1)(a) of the *Magistrates' Courts Act*. See also Theophilopoulos *et al* *Fundamental principles of civil procedure* 377.

²⁰³ S 74B(1)(c) of the *Magistrates' Courts Act*.

²⁰⁴ S 74B(1)(e) of the *Magistrates' Courts Act* and *Els v Els* 1967 3 SA 207 (T) 210. See also Paterson Eckard's *principles of civil procedure in the magistrates' courts* 326.

²⁰⁵ Paterson Eckard's *principles of civil procedure in the magistrates' courts* 326.

4.5.1.2 *Granting, execution and effect of an administration order*

If the Court grants the administration order, it must make the order in the prescribed form.²⁰⁶ In short, the order will state that the debtor's estate will be placed under administration, and will nominate the administrator.²⁰⁷ The order must also state a weekly or monthly sum of money that will be paid over to the administrator by the debtor.²⁰⁸ Section 74C(2) formulates a calculation of the amount that is required to be periodically paid to the administrator by the debtor.²⁰⁹ It is noted that so-called *in futuro* debts, that is, debts that are only due in the future such as payments in respect of an instalment sale transaction that are not yet due, are barred from inclusion in an administration order.²¹⁰

Once the administration order has been granted the Court normally gives effect to that order by appointing an administrator.²¹¹ Where the prospective administrator is not a legal practitioner or an officer of the Court he or she must give security to the satisfaction of the Court.²¹² Once the newly appointed administrator receives a copy of the order the appointment becomes effective.²¹³ After his or her appointment one of the principle duties of the administrator is to as soon as possible draw up a list of the debtor's creditors and the amounts they were owed at the time of the granting of the administration order.²¹⁴ This list must then be delivered to the creditors and lodged with the Clerk of the Court where it will lie open for inspection during office hours.²¹⁵ Any creditor who wishes to object to this list must do so within 15 days after he or she receives the letter of administration.²¹⁶ Other duties of

²⁰⁶S 74C of the *Magistrates' Courts Act*.

²⁰⁷Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 328.

²⁰⁸S74I(1) of the *Magistrates' Courts Act* and Theophilopoulos *et al Fundamental principles of civil procedure* 378.

²⁰⁹*Ibid.*

²¹⁰Greig 2000 *South African Law Journal* 626 and s 74C(2) of the *Magistrates' Courts Act*.

²¹¹Theophilopoulos *et al Fundamental principles of civil procedure* 378 and Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 329.

²¹²*Ibid* and s 74E(4) of the *Magistrates' Courts Act*.

²¹³*Ibid.* If the administrator is required to give security the appointment only becomes effective after he or she has given such security.

²¹⁴Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 330.

²¹⁵Theophilopoulos *et al Fundamental principles of civil procedure* 378 and s 74G(10) of the *Magistrates' Courts Act*.

²¹⁶R 48(2) of the *Magistrates' Court Rules*.

the administrator include collecting the payments made by the debtor in terms of the administration order, and keeping the creditors list up to date.²¹⁷ He or she must also distribute the amounts received from the debtor in a *pro rata* fashion to the creditors at a minimum of at least once every three months.²¹⁸

During the period in which the order is in force, no creditor has a legal remedy against the debtor for fulfilment of his or her claim except with respect to a mortgage bond, a debt that was rejected by the Court at the hearing, and where the creditor has been granted leave by the Court to pursue that claim.²¹⁹

An administration order is, however, not a bar to the sequestration of the debtor's estate.²²⁰ Since administration is an appropriate remedy for a debtor dealing with a small debt problem and an uncomplicated financial situation,²²¹ sequestration will be the better alternative as soon as the financial situation of the debtor becomes complex, requiring investigations to resolve it, or the debt of the debtor exceeds ZAR 50,000.²²² This is because sequestration proceedings are better equipped with laws and structures to investigate complex financial situations.²²³

The administration order only lapses when all the costs of the administration and the creditors on the administrator's list have been paid in full.²²⁴ Once this occurs the administration order must lodge a certificate to that effect with the

²¹⁷Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 336. Under s 74H(1) of the *Magistrates' Courts Act* the debtor must pay the calculated amount periodically as determined by the administration order. If he or she fails to do so the same procedure is followed as when a judgement debtor fails to pay a judgement debt in instalments after that debtor was ordered to do so. The procedure involves a s 65 procedure by the Court where an investigation is conducted into the reasons for the debtor's failure.

²¹⁸*Ibid.* The administrator must first pay claims that would enjoy some sort of preference under the bankruptcy law of South Africa – S 74J(1) of the *Magistrates' Courts Act*.

²¹⁹S 74P(1) of the *Magistrates' Courts Act*. See also Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 341.

²²⁰S 74R of the *Magistrates' Courts Act*. See also Boraine *et al* 2012 *De Jure* 91.

²²¹Paterson *Eckard's principles of civil procedure in the Magistrates' Courts* 343 and *Cape Town Municipality v Dunne* 1964 1 SA 19 (C) 20.

²²²*Ibid.*

²²³*Ibid.*

²²⁴S 74U of the *Magistrates' Courts Act*

Clerk of the Court and deliver copies of the certificate to the creditors. This ends the administration process.²²⁵

4.5.1.3 *The effectiveness of administration orders*

In 2002 the Centre for Advanced Corporate and Insolvency Law completed a research report on behalf of the South African Department of Justice regarding the possible reform of administration orders.²²⁶ Boraine observes that in practice administration orders have been failures on more occasions than not.²²⁷ This is, among other reasons, because debtors fail to maintain regular payments.²²⁸ Administration does not provide for a fixed payment period or a fixed time within which the debtor may be discharged.²²⁹ The administrator may also charge a maximum of 12.5 per cent on the sum collected and consequently debtors often find themselves in a debt trap.²³⁰ Boraine also notes that the debt trap is compounded by the fact that administration orders do not include *in futuro* debts.²³¹ These amounts still need to be settled as they fall due and place more pressure on the debtor, causing him to default on his or her payments to the administrator.

As a result of the widespread growth of the micro lending industry in South Africa and the undeniable link between credit and financial ruin,²³² administration orders in the years leading up to 2002 increased in popularity.²³³ A report from the Banking Council of South Africa indicated that there were between 100,000 and 120,000 administration orders granted

²²⁵ Paterson Eckard's *Principles of civil procedure in the Magistrates' Courts* 344.

²²⁶ *Idem* 219. See also the University of Pretoria 2002 *Interim research report on the review of administration orders in terms of section 74 of the Magistrates' Courts Act 32 of 1944* volume I par 7.16. This report is hereinafter referred to as the "University of Pretoria 2002 *Interim report*."

²²⁷ Boraine 2003 *De Jure* 218.

²²⁸ *Ibid.* See also Kelly-Louw *et al The future of debtor credit regulation: Creative approaches to emerging problems* 187 and 190.

²²⁹ Boraine and Roestoff 2002 *International Insolvency Law Review* 2.

²³⁰ Boraine *et al* 2012 *De Jure* 90. In this regard *Weiner NO v Broekhuysen* 2002 4 All SA 96 (SCA) 102 stated in *obiter* that allowing administrators to charge administration fees was an unnecessary extra burden on a debtor.

²³¹ *Ibid.*

²³² See par 2.1 above.

²³³ Boraine 2003 *De Jure* 218.

annually in that time.²³⁴ Unfortunately, administrators were not thoroughly regulated and this led to a plausible suspicion that dishonest administrators were holding unsuspecting debtors to ransom. It was also suspected that many debtors that received credit from micro lenders during this period eventually found themselves in administration.²³⁵ As a result of these concerns, the Department of Justice instigated the administration order study referred to above.²³⁶

Boraine divides the complaints and criticisms levied against administration orders into two groups.²³⁷ In the first category administrators share their grievances on the practical difficulties of implementing section 74 of the *Magistrates' Courts Act*. These complaints can be summarised as follows:²³⁸

- (a) Several administrators complained about the lack of a uniform application process in Magistrates' Courts around the country.²³⁹ In addition they also complained about the Magistrates' Courts not having the capacity to cope with the administration applications which caused preventable delays. It is suggested that the latter problem can be addressed by allowing a special official in the Magistrates' Court to deal with these applications.²⁴⁰ Practitioners also voiced their concern on the length of the three day notice²⁴¹ to creditors stating that it was too short and should be increased to ten days or more.²⁴²

²³⁴ *Idem* 222.

²³⁵ Boraine 2003 *De Jure* 218.

²³⁶ *Ibid.*

²³⁷ Kelly-Louw *et al* *The future of debtor credit regulation: Creative approaches to emerging problems* 199.

²³⁸ See Boraine 2003 *De Jure* 232 to 234.

²³⁹ University of Pretoria 2002 *Interim report* volume I par 7.16.

²⁴⁰ *Idem* par 7.6.

²⁴¹ S 74A(5) of the *Magistrates' Courts Act*.

²⁴² *Ibid.*

- (b) Most of the administrators who participated in the study were of the opinion that the ZAR 50,000 debt limit for administration was too low and an increase would be more practical.²⁴³
- (c) Administration has no time limit and does not offer a discharge of debt obligations. Theoretically a person could thus be under administration for the rest of his or her life.²⁴⁴
- (d) Concerns were raised with regard to the marital status of debtors and how it was dealt with under the current dispensation.²⁴⁵ Apparently it frequently occurs that spouses of debtors who are married in community of property disappear, making it difficult for these debtors to apply for administration. Further, there is no uniform rule as to the income of spouses married out of community of property.²⁴⁶ Some Courts treat the other spouse's income as separate income while other Courts treat it as part of the financially distressed spouse's income.²⁴⁷
- (e) Several criticisms have been levied against administrators as referees to the administration process. The main complaint being that the administration order "industry" is not properly regulated.²⁴⁸ Other complaints include that the qualifications for being an administrator and the security required need to be revised.²⁴⁹ The fact that administrators that are not overseen by a professional

²⁴³ University of Pretoria 2002 *Interim report* volume I par 7.7. Boraine notes that any significant increase would require accompanying rules that deal with the protection of the creditors against issues such as impeachable transactions and may be even interrogation of the debtor to ensure that the complexities of his or her business are understood. The introduction of such rules is unnecessary with small debts that can easily be settled. It is submitted that this may defeat the purpose of administration which is to settle quickly and cheaply small debts that the debtor cannot quite shake off. See Boraine 2003 *De Jure* 234 for a further discussion.

²⁴⁴ *Ibid.*

²⁴⁵ University of Pretoria 2002 *Interim report* volume I par 7.8.

²⁴⁶ *Ibid.*

²⁴⁷ Where both incomes of couples married out of community of property are subject to a single administration order as a result of one spouse's financial problems, it is submitted that the Court has erred. This is because such a situation is clearly a misinterpretation of a well recognised principle, namely that both spouses in a marriage out of community of property own separate property and income that is excluded from the other spouse's estate. Under no circumstances should the Court make the debt-free spouse's income subject to an administration order. See in this regard *Erasmus v Erasmus* 1942 AD 265 and *Cuming v Cuming and Others* 1945 AD 201.

²⁴⁸ Boraine 2003 *De Jure* 218.

²⁴⁹ University of Pretoria 2002 *Interim report* volume I par 7.34.

body are allowed to operate trust accounts is also, according to some commentators, unacceptable.²⁵⁰

- (f) The current fee structure for administrators needs to be revised.
- (g) There is also debate as to whether a person who is under administration should be open to sequestration proceedings, as is the current position.²⁵¹

The second group of complaints deals with an assortment of suspected abuse of section 74 of the *Magistrates' Courts Act* by the administrators. The alleged abuse of the administration procedure given by creditors, debtors and consumer support groups can be summarised as follows:²⁵²

- (a) Due to the fact that there are a large number of under-regulated entities that provide administration to financially stressed debtors, there are many debtors who could benefit from other solutions. These debtors are instead lured into administration where the administrator's remuneration and administration fees deepen the debtor's debt. The appeal of administration is also caused by widespread advertising of administration which Boraïne²⁵³ notes should not be allowed by administrators who are also attorneys.
- (b) A lot of administrators are charging remuneration fees over the required tariff, thereby increasing the burden of debt on the debtor.²⁵⁴
- (c) The Courts are not properly looking into who they appoint as administrators. Some individuals are not fit to be appointed, for example persons who have been struck off the roll as attorneys.
- (d) The trust accounts of administrators who are not attorneys are not scrutinised by any regulatory bodies. Suspicion exists that some of

²⁵⁰*Ibid.* See also Boraïne 2003 *De Jure* 233.

²⁵¹University of Pretoria 2002 *Interim report* volume I par 7.77.

²⁵²Kelly-Louw *et al* *The future of debtor credit regulation: Creative approaches to emerging problems* 199.

²⁵³Boraïne 2003 *De Jure* 233.

²⁵⁴Administrators are charging over the 12.5 per cent cap confirmed by the Supreme Court of Appeal in *Weiner NO v Broekhuysen* 2002 4 All SA 96 (SCA). See also Boraïne *et al* 2012 *De Jure* 91.

these administrators are pilfering the interest earned on the trust account.

- (e) Numerous micro-lenders serve a dual role as both a provider of credit and offering administration services to their debtors who later become embattled by debt. An obvious conflict of interest exists here.
- (f) Administrators who are not attorneys often enter into arrangements with attorneys to accept appointments as administrators on their behalf so that they can avoid providing security to the Courts.
- (g) By and large it appears that debtors are being misinformed about the benefits and operation of administration as a debt relief process. They are not well informed as to the costs of the application process or the administration fees. While under administration the debtors are also not well informed by the administrators as to how much is going to creditors or how much the administrators are charging on the payments they make to them.

From the above it is quite clear that there was at this time an urgent need for reform or abolishment of the administration order procedure. In 2005 the South African Law Reform Commission proposed to the Department of Trade and Industry that amendments should be added to the *National Credit Act*, which at that stage was still a bill that would eventually lead to the abolishment of the administration order procedure.²⁵⁵ This however did not occur.²⁵⁶ The Department of Justice then suggested that it would consider the repeal of 74 of the *Magistrates' Courts Act*, which again did not occur. In 2007 the Department of Trade and Industry submitted a proposal for urgent

²⁵⁵South African law Commission 2009 *the South African Law Commission report 2008/2009* 41 hereinafter referred to as the "Law Commission report." www.justice.gov.za/salrc/anr/2008-09_ar.pdf (last accessed 2012-06-10). See also Kelly-Louw *et al The future of debtor credit regulation creative approaches to emerging problems* 200.

²⁵⁶*Ibid.*

amendments to the NCA and the *Magistrates' Courts Act*. The Commission reconsidered the matter and made the following suggestions:²⁵⁷

- (a) Firstly, that it would be to the disadvantage of debtors and other interested parties to completely abolish administration orders at this stage.
- (b) However, if administration orders are to be retained a complete review of the procedure must be undertaken. Amendments that can be readily dealt with urgently must be identified.
- (c) Administration orders should lapse and provide a complete discharge after a specified number of years. Creditors may, before the lapsing of the order, apply to the Court and show good cause as to why the debtor should not obtain a discharge for some or all of the outstanding debt.
- (d) The matter of administration orders requires further consultation and investigation.

With the inception of a new alternative to debt relief in the form of debt review in South Africa,²⁵⁸ the question arises as to whether there is actually any need for reform of the administration order procedure. In response to this question, Boraïne *et al* state that despite the numerous deficiencies of the administration order process it may still offer some relief under certain circumstances.²⁵⁹ It is suggested that this includes the situation where a debtor cannot fulfil the advantage for creditors' requirement for voluntary surrender, but has a simple estate and a small debt burden. Further, taking into account the extremely limited application of debt review as a remedy,²⁶⁰ the usefulness of administration orders as a remedy has not yet ceased. The value of this administration procedure may, however, change when the pre-

²⁵⁷ *Ibid.*

²⁵⁸ See par 4.5.2 below.

²⁵⁹ Boraïne *et al* 2012 *De Jure* 92.

²⁶⁰ See pars 4.5.2 and 4.6 below.

liquidation composition becomes available under the *Unified Insolvency Bill*.²⁶¹

4.5.2 Debt Review and Debt Restructuring Under the National Credit Act

The second formal debt relief measure in South Africa is debt review and debt restructuring under the *NCA*.²⁶² Otto remarks that this alternative procedure has had a large impact on the credit industry in South Africa.²⁶³ In the first two years after the introduction of this procedure more than 100,000 applications were made for debt counselling in South Africa.²⁶⁴

The main purpose of the *NCA* as set out in section three is to promote responsibility in the credit market by encouraging sensible borrowing, avoidance of over-indebtedness and fulfilment of financial obligations by debtors.²⁶⁵ The legislature, through the *NCA*, resolved to achieve this goal by discouraging both reckless credit granting by credit providers, and debtors defaulting on their obligations.²⁶⁶ In addition, the legislature hopes to achieve these goals by providing procedures to remedy the over-indebtedness of debtors, based on the central idea that debtors should meet all their obligations.²⁶⁷ The Act combats over-indebtedness by providing for debt review and restructuring of the debtor's credit agreement debt.²⁶⁸ Generally speaking this procedure involves reorganising the obligations of a financially stressed debtor by the Court, or by voluntary agreement between the debtor and all his or her credit providers.²⁶⁹ The re-organisation process entails extending the period of payment under the credit agreement and appropriately

²⁶¹ Kelly-Louw *et al* *The future of debtor credit regulation: Creative approaches to emerging problems* 200.

²⁶² While the *NCA* refers to this alternative procedure by the term debt review, the relevant regulations refer to it as debt counselling. Both words are used interchangeably in this study to denote debt review and the debt restructuring process under the *NCA*.

²⁶³ Otto and Otto *The National Credit Act explained* 58.

²⁶⁴ *Ibid.*

²⁶⁵ Scholtz *et al* *Guide to the National Credit Act* par 11-1; Kelly-Louw *et al* *The future of debtor credit regulation: Creative approaches to emerging problems* 206 and Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 22.

²⁶⁶ S 3(c) of the *NCA*.

²⁶⁷ S 3(g) of the *NCA*.

²⁶⁸ Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 23; Scholtz *et al* *Guide to the National Credit Act* par 11-1 and Otto and Otto *The National Credit Act explained* 54. See also Kelly-Louw 2008 *South African Mercantile Law Journal* 200.

²⁶⁹ S 86(7) of the *NCA*. Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 23.

reducing or postponing the payments due under such agreement, or even both.²⁷⁰ Under the NCA, credit providers who provide credit irresponsibly may also be reprimanded with severe sanctions.²⁷¹

4.5.2.1 *Application of the NCA and who may apply for debt review*

The NCA applies to every credit agreement²⁷² that has legal consequences in South Africa and entered into between parties that are at a sufficient distance to be deemed unrelated under the NCA, subject to a number of exceptions.²⁷³ In addition, while the NCA does in many instances apply to credit agreements entered into by juristic persons²⁷⁴ Part D of Chapter 4 that deals with debt counselling does not protect these legal entities.²⁷⁵ Consequently, only natural persons who enter into credit agreements that are subject to regulation under the NCA are entitled to apply for debt counselling.²⁷⁶

The NCA excludes a closed list of credit agreements from the application of the provisions protecting individuals from reckless credit. The following credit agreements are therefore excluded:²⁷⁷

- (a) an emergency loan;
- (b) a public interest credit agreement;
- (c) a student loan;
- (d) a pawn shop transaction;
- (e) an incidental credit agreement; and

²⁷⁰ *Ibid.*

²⁷¹ See S 80 of the *Insolvency Act* with regard to reckless credit.

²⁷² S 1 of the NCA defines a credit agreement as any agreement where goods or services are purchased and are repayable in instalments and not on delivery. This definition includes any money extension repayable in instalments under the NCA.

²⁷³ S 4 of the NCA.

²⁷⁴ Under s 1 of the NCA the term “juristic person” includes companies and close corporations but also includes partnerships, any association of persons except a *stokvel*, and certain types of trusts where one of the trustees is a juristic person. See Lombard and Renke 2009 *South African Mercantile Law Journal* 486.

²⁷⁵ Otto and Otto *The National Credit Act explained* 30. Juristic persons also do not enjoy protection under the parts of the NCA that deal with reckless credit, negative option agreements, and regulations relating to fees, maximum interest rates and credit insurance and marketing practices. See Scholtz *et al Guide to the National Credit Act* par 11-2 in this regard.

²⁷⁶ *Ibid.*

²⁷⁷ S 78(2) of the NCA.

(f) a temporary increase in the credit limit under a credit facility.

These exclusions are subject to the condition that any credit that is extended in terms of any of these credit agreements is reported to the National Credit Register in the prescribed manner and form.²⁷⁸

Therefore it appears that debt counselling has limited application as a debt relief procedure. It is specifically limited to natural persons who enter into credit agreements that are subject to the NCA. Furthermore, only obligations that arise from credit agreements subject to the NCA can be subject to debt counselling. This excludes all other obligations or debts from this procedure that the debtor would also benefit from if they were also restructured.²⁷⁹

4.5.2.2 *Debt counsellors and their function in the debt counselling process*

Debt counsellors perform a vital role in the debt counselling process prescribed in section 86 of the Act.²⁸⁰ In short, they are entrusted under the NCA with the task of evaluating a debtor's debt review application and deciding whether that debtor is indeed over-indebted or whether a particular credit grantor issued credit irresponsibly to the debtor.²⁸¹ In addition debt counsellors also make recommendations to the debtor or to the Magistrates' Courts regarding debt restructuring possibilities during the debt review process.²⁸² The role of debt counsellors is limited to the few duties listed under the NCA. They are for example not allowed to give financial advice to debtors who consult with them during the debt review process.²⁸³ It is also important to note that it is the Court that declares a debtor over-indebted and not the debt counsellor.²⁸⁴ Debt counsellors are only empowered by the NCA

²⁷⁸ *Ibid.*

²⁷⁹ The implications of this limitation will be further discussed below.

²⁸⁰ Boraïne *et al* 2012 *De Jure* 93.

²⁸¹ Otto and Otto *The national Credit Act Explained* 38.

²⁸² *Ibid* and S 86(7) of the NCA.

²⁸³ Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 252. This is of course unless the debt counsellor is registered with the Financial Services Board as a financial advisor in terms of the *Financial Advisory and Intermediary Services Act* 37 of 2002.

²⁸⁴ Scholtz *et al Guide to the National Credit Act* par 11-7.

to conduct an evaluation of whether the debtor is over-indebted and advise the Court on the deductions they have drawn from their evaluation.²⁸⁵

Only natural persons are allowed to register with the National Credit Regulator (NCR) to provide debt counselling services.²⁸⁶ This entity is the regulatory body of all debt counsellors in South Africa.²⁸⁷ Before registration as a debt counsellor potential applicants must satisfy the NCR that they met certain requirements relating to education, competence and experience.²⁸⁸ Regulation 10(a)²⁸⁹ requires that every debt counsellor has a Grade 12 high school certificate or equivalent and has completed a debt counselling course approved by the NCR. Regulation 10(b) further requires a debt counsellor to have a minimum of two years working experience in specific related fields such as debtor advisory services or debtor protection. The prospective debt counsellors must also demonstrate a knack for managing their own finances.²⁹⁰

4.5.2.3 *The Debt Counselling Process*

Under the NCA the main duty of the debt counsellor in the debt review process is to determine whether the debtor is over-indebted. A debtor is over-indebted when he or she cannot meet all his or her obligations under all his or her credit agreements in a timely fashion.²⁹¹ Before this determination can take place the debt review process must be initiated. The process of debt review can be set in motion in the following three ways:

²⁸⁵ *Ibid.*

²⁸⁶ S 44(1) of the NCA. The NCR is also charged with the registration of credit providers, credit bureaux and debt counsellors and enforcement of compliance with the NCA.

²⁸⁷ www.ncr.org.za (last accessed 2012-06-10). The National Credit Regulator is also charged with the registration of credit providers, credit bureaux and debt counsellors and enforcement of the NCA.

²⁸⁸ Scholtz *et al Guide to the National Credit Act* par 11-8 and Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 255.

²⁸⁹ Regulations refer to regulations made in terms of the NCA published in GN no. 8477 of 2006.

²⁹⁰ Regulation 10(b).

²⁹¹ S 79 of the NCA. See Scholtz *et al Guide to the National Credit Act* pars 11-4 to 11-6 for a detailed discussion of the term over-indebtedness and its determination.

- (a) Under section 86(1) of the NCA a debtor who is of the opinion that he or she is over-indebted may, on their own accord, apply to a debt counsellor in the appropriate manner to have himself or herself declared over-indebted.²⁹²
- (b) In any Court proceeding in which a credit agreement is being considered, if it is alleged that the debtor holding the agreement is over-indebted the Court may, under section 85 of the NCA refer the matter to a debt counsellor or declare the debtor over-indebted.²⁹³ When deciding on such a matter the Court is led by the information before it. The Court has a wide discretion in this regard and is not obliged to refer the matter to a debt counsellor or declare the debtor over-indebted.²⁹⁴
- (c) The NCR may also refer a complaint of a contravention of the NCA to a debt counsellor where the matter appears to concern an over-indebted debtor or granting of reckless credit.²⁹⁵

Therefore debtors, who are over-indebted, may apply for debt counselling on their own or instead may wait for a credit provider to enforce a credit agreement-in respect of which the debtor is in default and then raise the issue of over-indebtedness in Court.²⁹⁶ With regard to the latter method, a credit provider who wishes to enforce a debt under a credit agreement must first issue a section 129(1)(a) letter to the debtor.²⁹⁷ This letter is a default notice issued to the debtor instructing him or her to refer the credit agreement to a debt counsellor or an alternative dispute resolution agent with the aim of resolving any dispute under the agreement.²⁹⁸

²⁹²S 86(1) of the NCA. See Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 257–265 for details on the proper manner in which to make such an application.

²⁹³S 85 of the NCA. The debtor can however only be declared over-indebted if that is proved in Court as intended in section 79(1). In this regard see *Standard Bank of SA Limited v Panayiotts* Case 2009(3) SA 363 (WLD).

²⁹⁴Otto and Otto *The national credit act explained* 59.

²⁹⁵S 139(1) of the NCA.

²⁹⁶S 85 of the NCA. See also Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 312.

²⁹⁷Maghembe 2011 *Potchefstroom Electronic Law Journal* 171 and Van Heerden and Coetzee 2009 *Potchefstroom Electronic Law Journal* 333. See also Scholtz *et al Guide to the national credit act* par 12.4.5.

²⁹⁸S 129(1)(a) of the NCA.

Before detailing the debt review process, it is important to note some of the consequences of a debt review application. Otto explains that there is a certain level of interaction in the NCA between the provisions that deal with the application for debt review and the provisions that regulate the enforcement of the debtor's contractual obligations.²⁹⁹ The following procedures affect one another in the following way under the NCA:³⁰⁰

- (a) Where a debtor applies of his or her own accord to have himself or herself declared over-indebted, and a credit provider has already taken steps contemplated under section 129 of the NCA to enforce a particular credit agreement, the obligations under that credit agreement are restricted from forming part of the debt review process.³⁰¹ The NCA unfortunately does not define what constitutes a step to enforce an obligation under a credit agreement, which has led to some uncertainty on this issue in practice.³⁰² This position has been recently clarified by the Supreme Court of Appeal in *Nedbank Ltd v The National Credit Regulator*.³⁰³ It was held that after the section 129 letter has been sent by the credit provider with regard to a specific credit agreement, that agreement may not be part of a subsequent debt review.
- (b) Once a credit provider receives notice from a debt counsellor that the debtor has lodged an application for debt review,³⁰⁴ the credit provider is restricted from litigating to enforce that agreement until such time as the debtor has defaulted on the credit agreement and one of the following circumstances occurs:³⁰⁵

²⁹⁹Otto and Otto *The National Credit Act explained* 99; Roestoff 2009 *Obiter* 430 and *BMW Financial Services South Africa (Pty) Ltd v Donkin* 2009 6 SA 63 KZD.

³⁰⁰Otto and Otto *The National Credit Act explained* 99.

³⁰¹S 86(2) read with s 129 of the NCA; Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 262 and Otto 2007 *JSAL* 667. See also Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 31.

³⁰²*Ibid.*

³⁰³2011 3 SA 581 SCA.

³⁰⁴S 86(4) of the NCA.

³⁰⁵S 88(3)(a) and (b)(i) and (ii) of the NCA.

- the Court which is hearing the proceedings on the credit agreement declares that the debtor is not over-indebted;
 - upon debt review the debt counsellor determines that the debtor is not over-indebted and rejects the debtor's application;
 - a debt rearrangement is ordered by the Court or voluntarily agreed to by the disputing parties and all the obligations under this rearrangement have been fulfilled, or the debtor defaults in terms of the rearrangement plan itself.
- (c) Under section 88(1) of the NCA a debtor who has filed an application for debt review or who has alleged in Court that he or she is over-indebted may not incur any further charges under a credit facility or enter into more credit agreements until one of the events described directly above in Part (b) occurs.³⁰⁶

The credit provider may terminate the debt review procedure where the debtor defaults under an agreement that is subject to the debt review provided the credit provider gives notice to the debtor, the debt counsellor and the National Credit Regulator.³⁰⁷ This notice must be given not less than 60 days after the debtor has applied for debt review.³⁰⁸ The intended consequence of this section is that the debt counsellor is given 60 business days to complete the debt review process.³⁰⁹ After this period if the credit provider has served the required notices, he or she may begin to enforce the debtor's obligations under the agreement.³¹⁰ The Court to which the dispute would be referred by the credit provider does however have the discretion to order that the debt review continues.³¹¹ In the case of *FirstRand Bank Ltd v Evans*³¹² the High Court held that the credit provider could terminate the credit agreement up

³⁰⁶Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 31.

³⁰⁷S 86(10) of the NCA and Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 283.

³⁰⁸*Ibid.*

³⁰⁹Boraine and Renke 2008 *De Jure* 15.

³¹⁰Otto and Otto *The National Credit Act explained* 101.

³¹¹*Ibid.* S 86(11) of the NCA.

³¹²2011 4 SA 597 KZD pars 18 and 19.

until an order was made under section 87 of the NCA.³¹³ In the same year the Supreme Court of Appeal upheld this decision in *Collett v FirstRand Bank Ltd*³¹⁴ and stated that the credit provider may terminate a credit agreement even though debt review has already been referred to the Magistrates' Court.³¹⁵ The fact that the highest Court in South Africa on non-constitutional matters is still willing to allow a credit provider to terminate a debt review, a statutory procedure, once it has already been lodged with a Magistrate for ruling shows the creditor-orientated nature of the South African debt relief system.

The exact procedure to be followed during the debt review process is not fully regulated in the NCA or its subsidiary regulations.³¹⁶ As a result, the major credit providers in South Africa in consultation with debt counsellors and the NCR at numerous work stream sessions, decided on specific guidelines that would be followed in order to provide some clarity and consistency in the debt counselling process.³¹⁷

At the first consultation between the debtor and the debt counsellor, the latter informs his or her client of what debt review entails and how the process works.³¹⁸ Once the debtor is well informed on the debt review procedure and should he or she still wish to continue with the process, the debt counsellor assists him or her to properly fill out the prescribed form and attach the

³¹³Van Heerden and Coetzee 2011 *Potchefstroom Electronic Law Journal* 43.

³¹⁴2011 4 SA 508 (SCA). Before this Court of Appeal decision there were a number of High Court cases that were heard on whether a debt review could be terminated once a debt counsellor refers the matter to Court but before it was heard, under s 87 of the NCA. A number of conflicting views emerged from the High Court, which were recently settled by the Court of Appeal in *Collett v FirstRand Bank*. Since then the *FirstRand Bank v Raheman* 2012 3 SA 412 KZD case was passed by the KwaZulu-Natal High Court which contradicts the decision in the *Collett* case that credit providers may terminate debt review before a determination by the court, under s 87. See also Roestoff 2012 www.linnet.co.za 266.

³¹⁵For a detailed discussion of this case see Bristol 2012 *Without Prejudice* 27.

³¹⁶Scholtz *et al Guide to the national credit act* par 14-2.

³¹⁷*Ibid.*

³¹⁸*Ibid.* The debt counsellor is obliged to communicate the consequences of debt review to his or her client. For a comprehensive list of the information a debt counsellor should provide to his or her client see Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 258 and 259.

necessary supporting documents.³¹⁹ Upon receiving the application the debt counsellor receives a R50 application fee from the debtor and must in turn provide the debtor with a copy of the form and a receipt.³²⁰ Once the application has been submitted the debt counsellor must inform all the debtor's credit providers and all the registered credit bureaus of the application within five working days.³²¹ Apart from informing the credit providers of the debt review application, the latter notification also prohibits the debtor from entering into more credit agreements while under debt review.³²²

After the debt counsellor notifies the debtor's credit providers and the credit bureaus the debt counsellor must verify the information provided to him or her by the debtor.³²³ This is done by asking the debtor for documentary proof.³²⁴ In addition, the debt counsellor must also formally contact all the debtor's credit providers or make use of any other method to verify the debtor's information.³²⁵

The next step in the process is that the debt counsellor must perform an assessment of whether the debtor is over-indebted. Under regulation 24(6) the debt counsellor has 30 business days from the date of the application for debt review to make such an evaluation.³²⁶

Under section 79(1) of the NCA a debtor is considered to be over-indebted:

³¹⁹Scholtz *et al Guide to the National Credit Act* par 14-3. This so-called form 16 forms the basis of the client's instruction.

³²⁰S 86(4)(a) of the NCA. ZAR 50 was equivalent to approximately 7.40 United States dollars on 2011.06.18.

³²¹S 86(4)(b) of the NCA read with reg 24(2). See Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 266.

³²²S 88 of the NCA.

³²³Reg. 24(3) and 24(1).

³²⁴*Ibid.*

³²⁵*Ibid.* If the credit provider does not provide the requested information within five business days of receiving the verification request from the debt counsellor, the debt counsellor may accept that the information provided by the debtor is correct. Under the work stream agreement the debt counsellor should send a reminder to the credit provider upon receiving no response after the five-day period. The reminder will grant the credit provider a further five business days to respond. See Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 266 for more information on this process.

³²⁶Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 268.

If the preponderance of available information at the time a determination is made indicates that the particular debtor is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the debtor is a party.³²⁷

A determination in terms of section 79(1) is made by having regard to the debtor's:

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

The debt counsellor must conclude the evaluation by placing the debtor's case in one of three categories. The way in which the debt counselling process will proceed after the assessment will depend on which assessment category the debtor falls. The categories and the way the debt counsellor may continue in each category are as follows:

- (a) The debt counsellor may determine that the debtor is not over-indebted.³²⁸ In this case he or she is obliged under the Act to reject the debtor's application for debt counselling.³²⁹ In terms of regulation 25 the debt counsellor must subsequently provide the debtor with a standard form letter of rejection. This is so even if the debt counsellor has concluded that a certain credit agreement was reckless.³³⁰ Where this occurs the debtor still has a right of recourse under the NCA. The debtor may, upon being granted leave to do so by the Court, within 20 business days of receiving a letter of rejection from the debt counsellor, apply directly to the Court for an order rearranging his or her debts or declaring one or more credit agreements reckless.³³¹

³²⁷When determining whether the debtor is over-indebted the criteria set out in s 79(1) of the NCA must be applied as they exist at the time the determination is being made. See also Scholtz *Guide to the National Credit Act et al* pars 11-4 and 11-5.

³²⁸S 86(7)(a) of the NCA. See also Otto and Otto *The National Credit Act explained* 61.

³²⁹*Ibid.* Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 272.

³³⁰*Ibid.*

³³¹S 86(9) of the NCA and reg 26.

- (b) The debt counsellor may determine that the debtor is not over-indebted but is experiencing or is likely to experience some difficulties in paying his or her debts on time.³³² The debt counsellor may make one of two recommendations. First, he or she may recommend that the debtor and his or her credit providers voluntarily agree to a debt rearrangement plan.³³³ Where the two parties reach an agreement, this rearrangement plan may be filed as a consent order with the Magistrates' Court or the National Consumer Tribunal.³³⁴ Where the parties cannot reach agreement the debt counsellor may make a recommendation to the Magistrates' Court to make a rearrangement order for the debtor's credit agreement debt, or declare any agreement the debtor entered into as reckless, if indeed it is.³³⁵
- (c) Where the assessment concludes that the debtor is actually over-indebted the debt counsellor may issue a proposal recommending that the Magistrates' Court order declare the debtor over-indebted and that the debtor's obligations be re-arranged,³³⁶ or one or more of the credit agreements be declared to be reckless credit,³³⁷ or both.

Before making any recommendations to the Court or the relevant parties the debt counsellor must, upon completion of the evaluation, inform all the affected credit providers and all registered credit bureaus within five business days of his or her assessment and recommendations.³³⁸

Where the debt counsellor must make recommendations to the Court or a consumer whose application was denied approaches the Court, section 87(1)

³³²S 86(7)(b) of the NCA.

³³³*Ibid.* Incidentally, Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 272 note that section 86(5) of the NCA obliges the credit providers of the debtor to "participate in good faith in the review and in any negotiations designed to result in responsible debt rearrangement".

³³⁴Ss 86(8)(a) and 138 of the NCA.

³³⁵S 87 of the NCA.

³³⁶S 86(7)(c) of the NCA.

³³⁷*Ibid.*

³³⁸Reg 24(10).

of the NCA states that the Magistrate's Court must hold a hearing. At the hearing the Court makes a decision based on the debt counsellor's proposal and/or any other information at its disposal. The Court may reject the application or proposal as the case may be, declare any of the relevant debt agreements to be reckless³³⁹ and make an order under section 86(7)(c) of the NCA restructuring the debtor's obligations. The debtor's obligations under his or her credit agreement may be rearranged by the Court either by extending the duration of the agreement and reducing respectively the amount of each payment due, or by postponing the dates on which payments are due under the agreement for a specified period, or both.³⁴⁰ It is noted that under this procedure, similar to the administration order, the debtor's pre-sequestration debts may not be discharged. He or she must satisfy all his or her obligations before he or she is released from the procedure.

Where consensus has been reached voluntarily on rearranging the debtor's obligations or an order has been made to that effect by the Court, the debt counsellor is charged with assisting the parties with setting up a repayment structure for the debtor.³⁴¹ Once the repayment plan is in place the collection and distribution of monies owed by the debtor is handled by another separate person/entity known as a payment distribution agent.³⁴² Once a plan is in place, the debt counsellor's only duty is to provide a so-called "after care service".³⁴³ He or she must perform a review of that particular debtor's case a minimum of at least once a year.³⁴⁴ The object of these reviews is to identify any possible financial problems that require further debt counselling and to identify if the repayment plan should be adjusted.³⁴⁵ Any changes to the plan must be accepted by all the credit providers.³⁴⁶

³³⁹S 82(2) and (3) of the NCA. See par 4.5.2.5 below.

³⁴⁰S 86(7)(c)(ii) of the NCA

³⁴¹Da Silva *et al* 2008 www.ncr.org.za 16.

³⁴²Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 282.

³⁴³Da Silva *et al et al* 2008 www.ncr.org.za 20.

³⁴⁴*Ibid.*

³⁴⁵*Ibid.*

³⁴⁶*Ibid.*

Where a debtor has fully satisfied all the obligations under each credit agreement that was under the debt rearrangement plan, he or she can apply to a debt counsellor for a clearance certificate.³⁴⁷ Where the debt counsellor receives an application for a clearance certificate, he or she must investigate whether all the obligations under the rearrangement plan agreed to, voluntarily or by Court order, have actually been fulfilled.³⁴⁸ If he or she is convinced that the debts have been cleared, he or she is obliged to issue the certificate.³⁴⁹ Copies of the clearance certificate must be sent to all the registered credit bureaus. When a credit bureau receives a clearance certificate under section 71(5) of the NCA it is required to expunge the debtor's record of the fact that the debtor was subject to debt review or a debt rearrangement order/plan.³⁵⁰ Where the debt counsellor wrongly refuses to give a clearance certificate the debtor can apply to the Tribunal to compel the debt counsellor accordingly.³⁵¹ The debt counsellor must ensure that the credit bureau clears the debtor within five days of receiving the clearance certificate.³⁵²

4.5.2.4 *Reckless credit granting*

A discussion on debt counselling as an alternative debt relief procedure would be incomplete without a discussion of the power of the Court to alter or terminate credit that was granted irresponsibly. Credit which is granted under these agreements is known under the NCA as reckless credit.³⁵³ A credit agreement is considered reckless when the credit provider providing the credit:

- (a) failed to perform a proper assessment of the debtor; or

³⁴⁷Reg 27.

³⁴⁸Scholtz *et al* *Guide to the National Credit Act* par 11-27.

³⁴⁹*Ibid.*

³⁵⁰*Ibid.* See also s 71 of the NCA which provides for the removal of a record of debt adjustment or judgment. In this regard also see Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 285.

³⁵¹Da Silva *et al* 2008 www.ncr.org.za 20.

³⁵²*Ibid.*

³⁵³S 80(1) of the NCA.

- (b) performed an assessment but agreed to provide the debtor with credit despite the fact that the evaluation indicated that the debtor either did not generally understand the risks or costs involved or became over-indebted by entering into that agreement.³⁵⁴

A Court, while considering a credit agreement, may at any time declare that particular agreement reckless.³⁵⁵ Otto points out that section 83(1) of the NCA is worded to allow the Court to act *ex mero motu* in this regard.³⁵⁶ This means that a Court may make an order of reckless credit under the above section of its own accord without the debtor specifically asking for such an order.

Where a Court declares a credit agreement reckless, it may make an order setting aside the credit agreement completely, or just part of the debtor's obligations under the agreement.³⁵⁷ The Court may also, in the alternative, make an order suspending the reckless credit agreement.³⁵⁸ During the period that the credit agreement is suspended in terms of the NCA, section 84 states that the debtor is not required to make any payment under the agreement. The obligations under that agreement are not enforceable and no interest or charge may be placed on those obligations during the suspension period. After the suspension of the of credit agreement all the obligations of the credit provider and the debtor under that agreement are revived. No amount may be charged to the debtor by the credit provider as interest, fee, or other charge that could not be charged during the suspension.

Where the Court declares a credit agreement reckless under the NCA, it must further consider whether or not the debtor is over-indebted at the time of the proceedings.³⁵⁹ If the Court finds that the debtor's over-indebtedness was caused by the reckless credit agreement and the debtor is now indeed over-

³⁵⁴S 80(1)(a) and (b) of the NCA.

³⁵⁵S 83(1) of the NCA.

³⁵⁶Otto and Otto *The National Credit Act explained* 78.

³⁵⁷S 83(2)(a) of the NCA.

³⁵⁸S 83(3)(b) of the NCA.

³⁵⁹S 83(3)(a) of the NCA. See also Van Heerden and Boraine 2011 *De Jure* 35 and Otto and Otto *The National Credit Act explained* 78.

indebted, it may order that the credit agreement be suspended until a date determined by the Court when making the order of suspension.³⁶⁰ On top of that it may also then order that the debtor's obligations be restructured in accordance with section 87.³⁶¹

Boraine and Van Heerden note that it is not definite that a declaration of reckless credit will offer a permanent solution to a debtor who is over-indebted,³⁶² because although the obligations under the agreement are set aside, the NCA does not declare the credit agreement null and void. Therefore it is still possible for the credit providers to claim restoration of the monies already given to the debtor. When the obligations of the debtor are suspended however, the debtor does get some temporary relief from payments and charges. This may offer the debtor some time to get back on his or her feet. When the suspension period is over however, the debtor must still make good on his or her payments.³⁶³

4.5.2.5 *The effectiveness of debt counselling as a debt relief procedure*

Statistics provided by the NCR show that since the inception of the debt counselling procedure in 2006,³⁶⁴ approximately only four per cent of individuals who applied for the procedure have had their cases ruled on by the Court.³⁶⁵ Considering that in order for debt repayments to begin the debtor must first be declared over-indebted by the Court and a debt restructuring order must be made, this poor statistic is a solid indicator that the debt counselling process is not working efficiently.³⁶⁶

In 2009 the Law Clinic of the University of Pretoria, working together with the University's Bureau for Statistical and Survey Methodology at the behest of

³⁶⁰ *Ibid.*

³⁶¹ *Ibid.*

³⁶² Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 36.

³⁶³ Otto and Otto *The national credit act explained* 78.

³⁶⁴ www.amfisa.org.za (last accessed 2012-06-10).

³⁶⁵ Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 249. The amount of individuals who applied for debt review totaled 160,000 at the end of 2011. See www.ncr.org.za (last accessed 2013-01-29).

³⁶⁶ *Ibid.*

the NCR, conducted an inquiry to establish the reasons for the inefficiency of the debt counselling procedure.³⁶⁷ This report highlighted two main problems: firstly, although compelled to do so under section 86(5) of the NCA, the parties to the debt counselling process were not participating in good faith;³⁶⁸ secondly, the fact that the NCA is vague on a number of procedural issues and is frankly rather inadequate to regulate the debt counselling process.³⁶⁹

Roestoff *et al* points out that it is obvious that the success of the debt counselling procedure depends largely on how well the over-indebted debtor, credit providers, and debt counsellor work together to balance the interests of these role players who are naturally at odds.³⁷⁰ The legislature, understanding that a problem may arise where the parties do not act in accordance with the debt counselling process, inserted section 86(5) into the NCA which states the following:

A debtor who applies to a debt counsellor and each credit provider must ...participate in good faith in the review and in any negotiations designed to result in responsible debt re-arrangement.

Research undertaken by the University of Pretoria shows that despite the intention of the legislator, credit providers and debt counsellors are not acting in good faith during the debt counselling procedure.³⁷¹ Further, the study shows that non-compliance with the provisions of the NCA and its regulations as well as a breach of the work stream agreement are some of the other reasons for the inefficiency of the debt counselling procedure.³⁷²

The second reason presented by the University of Pretoria's report is that some of the provisions on debt counselling in the NCA are vague and

³⁶⁷ *Ibid.* The research culminated in a report titled *The debt counselling process: challenges to consumers and the credit industry in general*. Hereinafter cited as Haupt *et al Debt counselling process* 307.

³⁶⁸ *Ibid.*

³⁶⁹ *Ibid.*

³⁷⁰ Roestoff *et al* 2009 Potchefstroom Electronic Law Journal 250. See also Kelly-Louw *et al The future of debtor credit regulation: Creative approaches to emerging problems* 201.

³⁷¹ *Ibid.*

³⁷² *Ibid.*

inadequate, leading to uncertainty and in turn the inefficiency of the procedure.³⁷³ In an effort to cover the gaps left by legislation the NCR in the case of *National Credit Regulator v Nedbank Limited*³⁷⁴ applied to the High Court for a number of declaratory orders on the debt counselling process. However, despite these efforts calls have been made for the legislature to address these gaps in the debt counselling process to establish a more effective procedure.³⁷⁵ Roestoff *et al* propose numerous areas that require the legislature's attention.³⁷⁶ A few have been selected to illustrate the ambiguity and insufficiency of the current provisions regulating the debt counselling procedure:

- (a) It is proposed that the legislature makes amendments to sections 86 and 87 of the NCA to allow the Court to force a discharge of part of the debtor's obligations on his or her credit providers.
- (b) The legislature is required to shed some light on the exact procedure to be followed when a matter is referred to the Magistrates' Court because the debtor and his or her credit providers could not reach consensus on a debt restructuring proposal.
- (c) The requirements for the aptitude required to be a debt counsellor with specific focus on education and experience need to be made steeper.

These defective areas of the NCA identified by Roestoff *et al* correctly illustrate that despite the work stream agreement and the declaratory order by the High Court in the *Nedbank* decision, there are still gaps in the regulation of crucial areas of the debt counselling process.

³⁷³ *Idem* 260. See also Otto and Otto *The National Credit Act explained* 62.

³⁷⁴ 2009 6 SA 295 (GNP).

³⁷⁵ Scholtz *et al Guide to the National Credit Act* par 14–19 and Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 361.

³⁷⁶ Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 288–297. Solutions for all the legislative gaps are also provided for in this well researched article.

Another area which has been quite problematic as a result of the insufficiency of the NCA is where this Act, as a result of dealing with over-indebted consumers, naturally overlaps in practice with the *Insolvency Act*.³⁷⁷ The NCA does not mention the *Insolvency Act* in any of its provisions, regrettably not even in Schedule I to the Act which deals with any conflict between the NCA and different legislation. In this regard it is, however, hypothesised that the legislature did not intend to exclude the application of the *Insolvency Act* to the NCA.³⁷⁸ Therefore the situation where a credit provider applies for the compulsory sequestration of a debtor who is already under debt review is not covered by any statute in South Africa. All the same, this inevitable situation has already occurred. The High Court of Appeal confirmed in *Naidoo v ABSA Bank*³⁷⁹ that the fact that the debtor is under debt review does not bar sequestration. This is because insolvency proceedings do not qualify as proceedings to enforce a debt by judicial process. Although the decision of the Supreme Court of Appeal was substantively correct, it may hamper one of the aims of the NCA, namely the principle of satisfaction by the debtor of all of his or her financial obligations.³⁸⁰ It cannot be right that an over-indebted debtor, who has the financial potential to overcome his or her debt if assisted by the procedures available under the NCA, should still be subject to the harsh realities of sequestration at the whim of his or her credit providers.³⁸¹

The opposite is observed by Boraine and Van Heerden on this point: they state that a debt situation is not static and even after the debt review process is in place the financial position of the debtor may get worse.³⁸² They also note that neither administration orders nor debt review will cover all debts in

³⁷⁷Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 59.

³⁷⁸*Idem* 44.

³⁷⁹2010 4 SA 597 (SCA) 7. The Supreme Court of appeal confirmed the decision of the High Court in *Investec Bank v Mutemeri* 2010 1 SA 265 (GSJ). See also Maghembe 2011 *Potchefstroom Electronic Law Journal* 7.

³⁸⁰Maghembe 2011 *Potchefstroom Electronic Law Journal* 8 and 9.

³⁸¹*Ibid.*

³⁸²Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 32.

every circumstance.³⁸³ These authors therefore submit that debt-restructuring orders should not bar applications for sequestration.³⁸⁴

In addition, in the case of *Ex parte Ford*,³⁸⁵ in the absence of any guidance by the legislature on the Court's power under section 85 of the NCA to refer matters to a debt counsellor, the High Court held it may dismiss an application for voluntary surrender on the basis that the debtor should have resorted to debt review first. The Court's reasoning was that debt review was the appropriate remedy since the major portion of the debtor's debt arose out of credit agreements under the NCA, and there was a suspicion of reckless credit granting.³⁸⁶ It is submitted in this regard that the Court with this decision in effect created a new hurdle for debtors wishing to use the sequestration process to acquire a discharge.³⁸⁷ Considering that sequestration is the only way for debtors to force a discharge on their creditors in South Africa, this decision it is concurred, may have grave consequences.

Several other reasons for the ineffectiveness of the debt counselling process, apart from the provisions of the NCA being ambiguous, have also been suggested.³⁸⁸ These include accusations that credit providers have not been co-operating in the debt review process and are failing to comply with the NCA.³⁸⁹ Furthermore, credit providers do not accept the fact that they may have to take some losses as part and parcel of the consequences of being a credit provider.³⁹⁰ Debtors in turn do not want to accept that they cannot continue to maintain the high standard of living they were used to, which may well have gotten them in to the financial mess they are in.³⁹¹ *Boraine et al* also blame the poor cooperation between government departments with regard to

³⁸³ *Ibid.*

³⁸⁴ *Ibid.*

³⁸⁵ 2009 3 SA. See also Van Heerden and Boraine 2009 *Potchefstroom Electronic Law Journal* 44 10.

³⁸⁶ *Ibid.*

³⁸⁷ Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 308.

³⁸⁸ Roestoff *et al* 2009 *Potchefstroom Electronic Law Journal* 249–246.

³⁸⁹ Roestoff 2010 *Obiter* 789.

³⁹⁰ *Jackson Mail and Guardian* 39.

³⁹¹ Gillingham *Sunday Times* 21.

the efforts to reform the consumer debt relief system.³⁹² They point out that it has been over ten years since the initiation of the review of the administration order procedure, and that the government has failed to use the NCA to make reforms to this procedure and resolve any negative interactions between all the available debt relief legislation in South Africa.³⁹³

4.6 Conclusion

The study of the South African debt relief procedures is aimed at identifying any process, practice or rule that would steer the current Tanzanian debt relief system towards achieving the features of a modern system.³⁹⁴ In short, these features include the debt relief system being able to come to the aid of the unfortunate debtor by providing him or her with an opportunity to be swiftly rehabilitated. Second, the system must attempt to balance the interests of the creditor(s) and debtor as best as possible.³⁹⁵ Finally, the system must also provide for a cost-effective alternative to sequestration/bankruptcy. A brief comparative rundown of the two main consumer insolvency procedures in South Africa and Tanzania will be undertaken with these features as a comparative standard. The aim of this comparison is to see where the Tanzanian regime can learn from its South African counterpart.

With regard to the South African debtor's insolvency remedy of voluntary surrender, the Court has absolute discretion as to whether the debtor should be granted a sequestration order or not. Before any such decision may be made the debtor has to offset a number of preliminary formalities and endure a judicial examination of whether his or her sequestration will truly be to the advantage of creditors.³⁹⁶ The Tanzanian section 8 petition on the other hand, allows the debtor to surrender his or her estate with fewer formalities before the submission of the main petition than its South African counterpart.³⁹⁷ In addition, the Court in Tanzania has no discretion on the granting of a

³⁹²Boraine *et al* 2012 *De Jure* 269.

³⁹³*Ibid.*

³⁹⁴Pars 2.6 and 3.1 above.

³⁹⁵Par 3.5 above.

³⁹⁶Par 4.4.1 above.

³⁹⁷Par 3.3.3 above.

receiving order based on the petition which is issued simply by correctly complying with the formalities and submitting the petition.³⁹⁸ There is no advantage for creditors' requirement at this stage of the bankruptcy process in Tanzania.

The South African creditor application for sequestration, known as compulsory sequestration, has fewer preliminary formalities than the debtor application for voluntary surrender discussed above. Compulsory sequestration also has a less strict burden of proof with respect to the advantage of creditors' requirement attached to both applications. This remedy only requires that there be a reasonable likelihood of advantage to creditors should the debtor's estate be sequestrated, whereas voluntary surrender requires factual proof that the debtor's estate will yield a certain dividend for all the debtor's concurrent creditors.

When an application for compulsory sequestration and the equivalent creditor's petition for bankruptcy in Tanzania are compared, there are a number of similarities. Respectively, before a sequestration or receiving order can be issued both systems require proof of specified liquidated claims from the creditors, proof of insolvency by the debtor, or an act of bankruptcy and proper service of the petition on the debtor.³⁹⁹ In both systems the Court has total discretion on whether or not to grant an order.⁴⁰⁰ There are some important differences. Firstly, the Tanzanian remedy again does not require proof of a reasonable prospect of advantage to creditors for the granting of a receiving order.⁴⁰¹ The Tanzanian creditors' remedy, unlike its South African equivalent, requires a Court hearing.⁴⁰² This obviously has cost implications for the Tanzanian creditor(s). Thus the Tanzanian system may consider using written submissions as in South Africa, instead of a Court hearing for creditor petitions, to save costs.

³⁹⁸ Par 3.3.2 above.

³⁹⁹ See par 4.4.2.

⁴⁰⁰ *Ibid* and 3.3.1 above.

⁴⁰¹ *Ibid*.

⁴⁰² *Ibid*.

The difficulty in obtaining an order for voluntary surrender in South Africa is evidenced by the widespread phenomenon known as friendly sequestrations.⁴⁰³ The reasons behind such applications are of course that the formalities in a compulsory sequestration are fewer and the burden of proof for the advantage for creditors' requirement is substantially watered down.⁴⁰⁴ It would appear that these types of applications are a desperate attempt by debtors to acquire a discharge in a system that is deficient of any other practical alternatives. In light of these facts, it is submitted that the protection offered by a debtor's petition in Tanzanian is more accessible than any similar protection under voluntary surrender in South Africa.

Rehabilitation in South Africa comes in two forms, by application to the High Court or automatically through the passage of time.⁴⁰⁵ The Tanzanian *Bankruptcy Act* allows the discharge of a debtor only through an application to the Court. There is no provision for an automatic discharge through the passage of time.⁴⁰⁶ One of the main differences between these two systems is that the Tanzanian process requires that the debtor prove that his or her assets are equal to ten shillings in the pound on the amount of his or her unsecured liabilities, before he or she is discharged.⁴⁰⁷ This requirement notwithstanding, in order to prefer the honest debtor the Court may dispense with this requirement if the debtor can prove that his or her financial troubles were caused through no fault of his or her own.⁴⁰⁸ Furthermore, the Tanzanian Courts are urged to refuse a discharge order where the debtor's bankruptcy was brought about by the debtor's culpable neglect of his or her affairs.⁴⁰⁹ In South Africa during the application for rehabilitation, the judge is obliged to take into consideration whether the insolvent has learned "the lessons of insolvency" or whether he or she appreciates the hardship he or

⁴⁰³Par 4.4.3 above

⁴⁰⁴*Ibid.*

⁴⁰⁵Par 4.4.4 above.

⁴⁰⁶Par 3.3.7 above.

⁴⁰⁷See pars 3.4 and 3.6 above.

⁴⁰⁸Par 3.3.6 above.

⁴⁰⁹*Ibid.*

she may have caused his or her creditors.⁴¹⁰ This latter consideration in South Africa is some indication that this system recognises the importance of the debtor's culpability as a factor in earning a fresh start.

The composition procedures in South Africa and Tanzania, although having certain similar characteristics, are fairly different from each other. Both the common law composition and the Tanzanian composition under the *Deeds of Arrangement Act* 10 of 1930 are procedures intended to be used before the application of sequestration or bankruptcy respectively.⁴¹¹ Both procedures are not supervised by any judicial authority. The main difference between them is that the South African common law composition is only binding after all the creditors agree to the planned composition.⁴¹² The Tanzanian composition, on the other hand, requires agreement from a majority in number and value of the creditors and a formal filing at the documents registry. It is suggested that this is a positive feature since this allows the composition to bind even dissenting creditors to the composition. Both procedures, it is suggested, serve the purpose of avoiding the complicated sequestration process.

Tanzanian bankruptcy legislation also provides for a composition and scheme of arrangement procedure after the issuing of a receiving order which is similar to the South Africa composition under section 119 of the *Insolvency Act*, that may be sought after a sequestration order has been issued.⁴¹³ The South African composition is thus only available after the advantage for creditors' requirement has been proved. This is similar to the Tanzanian composition under the *Bankruptcy Act*, as the Tanzanian composition will not be confirmed by the Court unless it will benefit the creditors.⁴¹⁴ The main distinctions between these two compositions are that the Tanzanian procedure is subject to Court approval after a majority of the creditors agree

⁴¹⁰ Par 4.4.4 above.

⁴¹¹ See par 3.3.6 and 4.4.5 above.

⁴¹² *Ibid.*

⁴¹³ *Ibid.*

⁴¹⁴ *Ibid.*

to it. Additionally the Tanzanian Act, unlike its South African counterpart, provides for the composition process to take place after the public examination of the debtor has been concluded, thereby allowing the debtor to avoid bankruptcy adjudication. By holding the public examination first, the true position of the estate can be discovered at an early stage and assist the creditors in whether to agree to the composition process or not.⁴¹⁵ The proposed pre-liquidation composition in the South African unified insolvency bill has caught on to what is already in the Tanzanian *Bankruptcy Act*. This proposed pre-liquidation composition will be supervised by a magistrate and be available only after a full examination of the debtor's affairs.⁴¹⁶

When comparing the consumer insolvency procedures of Tanzania and South Africa against the features mentioned above, the Tanzanian bankruptcy procedure ever so slightly better embodies the first two features namely: giving preference to the faultless insolvent during rehabilitation and balancing the interests of the creditors and debtor. With regard to the first feature the South African *Insolvency Act* does not entrench the principle of expeditiously rehabilitating the honest debtor. The South African Courts do, however, have a wide discretion when granting rehabilitation orders and there is case law indicating that the Court will not grant an order where the insolvent was reckless and did not take into account the hardship he caused his or her creditors. The Tanzanian *Bankruptcy Act* clearly entrenches the principle of giving preference to the honest debtor by allowing them to circumvent the advantage to creditors' requirement as set out for rehabilitation in Tanzania, and other provisions set out in paragraph 3.5 above. With regards the second feature, the sequestration process in South Africa clearly leans towards the interests of the creditors while comparatively the Tanzanian sequestration procedure has made a better attempt to balance the interests of both parties.⁴¹⁷

⁴¹⁵ *Ibid.*

⁴¹⁶ Par 4.4.5 above.

⁴¹⁷ See the discussion in paragraph 3.5 above.

The third feature that requires each system to have formal alternatives to bankruptcy places the South African debt relief system strides ahead of the Tanzanian regime, as the former has formal alternatives to sequestration and Tanzania does not. South Africa has two formal alternatives to insolvency: administration and debt counselling. The main criticism levied against both these procedures is that they are limited in their application.⁴¹⁸ Administration is limited by the fact that only debtors whose debt does not exceed R50 000 can apply for administration.⁴¹⁹ Debt counselling is available only to debtors whose debts arose from credit agreements regulated under the NCA.⁴²⁰ Furthermore, neither of these procedures offers the debtor a complete discharge.⁴²¹ Also, both the debt review and administration procedures are not protected from applications for compulsory sequestration by the debtor's creditors, and can be terminated in this manner at any time. This thwarts the purpose of having alternative procedures and is an example of the troublesome legislative overlaps in this jurisdiction between the *Insolvency Act* and the Acts that regulate the alternative procedures.⁴²² The aim of both administration and debt counselling it would appear is not to grant the debtor a discharge but rather to reschedule the debtor's payment installments and give him or her more time to make all the payments. This is in keeping with South Africa's creditor-orientated approach to debt relief. The debtor is obliged to pay off all his or her debts plus the management fees levied against him or her by the supervising third party. This may, and often does, lead to the debtor being caught in a debt trap.⁴²³ When combined, the limited applicability of these procedures and the fact that voluntary surrender is an expensive and difficult remedy to procure, many South African debtors do not have a procedure that will secure them a permanent discharge of debt.⁴²⁴ It must also be added that both formal alternatives to sequestration have serious procedural deficiencies, ranging from the poor regulation of administrators to

⁴¹⁸Kelly-Louw *et al* *The future of consumer credit regulation: Creative approaches to emerging problems* 216.

⁴¹⁹Par 4.5.1 above.

⁴²⁰Par 4.5.2 above.

⁴²¹Par 4.5 above.

⁴²²Par 4.5.2 above.

⁴²³Par 4.5.1 above.

⁴²⁴*Ibid.*

inadequate debt counsellor education and training.⁴²⁵ Therefore it is submitted that none of these alternative procedures can be replicated in Tanzania in their current form without causing some of the same problems experienced in the South African jurisdiction.

In summary, the South African debt relief system is clearly a creditor-orientated system. As a result even though alternative measures to sequestration exist, sequestration is still the only way for a South African debtor to force a discharge on his or her creditors.⁴²⁶ This of course depends on whether he or she can even afford to apply for sequestration and prove that the process will be to the advantage of the creditors.⁴²⁷ The debt relief regime must move away from these creditor-orientated policies and find a balance between creditor and debtor based ideas. The system also requires a method to deliberately ensure that honest, unfortunate debtors are swiftly rehabilitated, and at low cost. Thirdly, the alternatives to sequestration in this system are limited in their application and are poorly regulated. It is also noted that with the proposed pre-liquidation composition, South Africa is on its way to a proliferation of debt relief procedures that will make it difficult to provide effective consumer education and ensure that consumers make the right choice of procedure for themselves and their creditors.

Tanzania must learn from the mistakes of South Africa in their own review of the debt relief system. It is imperative that the Tanzanian Law Reform Commission makes one consolidated effort to reform the Tanzanian debt relief system. This will avoid the problems associated with different government departments pursuing their own legislative agendas with regard to debt relief and causing troublesome overlaps in debt relief legislation, as is seen in South Africa.⁴²⁸ A consolidated reform project will also culminate in a single well-oiled debt relief system, unlike the current South Africa situation where the NCA appears to be an innovative piece of legislation out of place in

⁴²⁵ *Ibid.*

⁴²⁶ Par 4.4 and 4.5 above.

⁴²⁷ *Ibid.*

⁴²⁸ Par 4.5.2 above.

the debt relief system. It is also submitted that further study is required to find a discharge dispensation for Tanzania that includes formal alternatives to bankruptcy that grant a complete discharge for the debtor, that are well regulated and cost-effective. These alternatives must however take into consideration the right of the debtor's creditors to fulfilment of their claims. Therefore a discharge dispensation must be sought that balances both the interest of creditors and debtors. In this discharge dispensation, the alternative debt relief procedures must not be limited to specific debts, as in South Africa. The ideal debt relief system would be a streamlined process that does not include several different procedures.

The next two chapters of this thesis will therefore investigate developed jurisdictions with the aim of identifying aspects that could improve the current Tanzanian system. Chapter 5 will investigate selected common law jurisdictions for a suitable debt relief model and Chapter 6, selected civil and Scandinavian systems.

CHAPTER 5

APPROACHES TO DEBT RELIEF IN DEVELOPED COMMON LAW JURISDICTIONS

SUMMARY

- 5.1 Introduction
 - 5.2 United States of America
 - 5.3 Australia
 - 5.4 Canada
 - 5.5 England and Wales
 - 5.6 Conclusion
-

5.1 Introduction

One of the challenges faced by most developed nations with highly complex credit economies is the need to deal with the related increase of overburdened debtors.¹ As a result, many western countries are in the process of, or have already reviewed their bankruptcy procedures and alternative debt relief measures.² While these first world jurisdictions amend and develop their debt relief regimes,³ good opportunities arise for third world countries like Tanzania to participate in cross-systematic learning to solve their own debt relief problems.⁴ As previously established, these faults are that the bankruptcy procedure for individuals in Tanzania does not have a

¹Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 3.

²Niemi-Kiesilainen 1999 *Osgoode Hall Law Journal* 474; Borraine 2003 *De Jure* 236; Calitz 2007 *Obiter* 398 and Kilborn 2006 *American Bankruptcy Law Journal* 435.

³Kilborn 2006 *American Bankruptcy Institute Law Review* 70.

⁴*Ibid.*

provision for the automatic discharge of a debtor.⁵ Second, the system lacks an informal debt relief procedure that provides for the debtor's discharge as an alternative to bankruptcy.⁶ Tanzanian debt relief is also too heavily reliant on Court supervision slowing the process down and making it more expensive.

This chapter will survey the debt relief regimes of the United States of America,⁷ Australia, England and Wales, and Canada, with a view to identifying solutions to the problems of the Tanzanian regime. The specific grouping of these countries into one chapter is, noticeably, related in part to their English common law background.⁸ It is a known fact that underlying similarities between jurisdictions make comparative studies between them easier and more meaningful.⁹ Like Tanzania, the legal heritage of Australia, Canada and the United States can be traced back to England, as a result of these countries all being former colonies of the British Empire.¹⁰

The United States of America, apart from being from the same group of legal systems as Tanzania, has been chosen because it is regarded by a number of commentators as one of the most influential legal systems in the field of debt relief and as such merits some inspection.¹¹ The debt relief system of England and Wales was selected because of the recent reforms undertaken in this jurisdiction on debt relief.¹² These include the promulgation of the *Enterprise Act* of 2002 which has had a wide-range of implications for consumers, and in 2009, the introduction of a new alternative to bankruptcy

⁵Par 3.5 above see also Maghembe and Roestoff 2010 *Comparative and International Law Journal of Southern Africa* 314.

⁶*Ibid.*

⁷Hereinafter referred to as "the United States."

⁸For a full discussion of the reception of the English Common law to these former colonies see Reinsch *English common law in the early American colonies* 12-15; Dupont *The common law abroad: constitutional and legal legacy of the British empire* xvii and Matson *International and Comparative Law Quarterly* 753-755.

⁹Tabb 2005 *Law and Social Inquiry* 770 and Oderkerk 2001 *Netherlands International Insolvency Law Review* 305.

¹⁰*Ibid.*

¹¹Langer 2004 *Harvard International Law Journal* 1-3; Wiegrand 1991 *American Journal of Comparative Law* 229; Kilborn 2006 *Vanderbilt Journal of Transnational Law* 79; Calitz 2009 LLD Thesis 57.

¹²Sealy and Milman *Volume 1: Annotated guide to the insolvency legislation 2011* 2.

for indigent debtors.¹³ The Australian system's minimal use of the judiciary to supervise the bankruptcy process, and the relatively new alternative procedure known as a debt agreement merit its inclusion in this discussion.¹⁴ The Canadian system was included in this study because of its stance on mandatory debt counselling, having numerous alternatives to the main bankruptcy system, and its differentiation of the debtor's obligations under bankruptcy depending on the number of times they have been bankrupt.

5.2 The United States of America

During the current modernisation boom of debt relief regimes worldwide,¹⁵ the United States debt relief system has stood out as the premier model for study.¹⁶ Many developing and developed nations have used this model to inform the improvements of their own debt relief regimes.¹⁷ For this reason the United States system will be discussed first. The American debt relief system, despite its iconic status, has seen its fair share of problems and also been forced to succumb to the reform bug. In the United States currently, a staggering 1.5 million natural persons file for bankruptcy every year.¹⁸ The number of filings was even higher prior to 2005, which indicated that there was a crisis in the country as far as the number of bankruptcy filings was concerned. Zywicki¹⁹ hypothesises the following reasons for this abnormal level of personal insolvency filings:

The cause of the consumer bankruptcy crisis is not an increase in consumer financial vulnerability but rather an increase in consumers' propensity to respond to financial problems by filing for bankruptcy and discharging their debts instead of reining in spending or tapping accumulated wealth. The novelty, therefore, is not in the underlying problems but rather the increasing willingness

¹³ *Ibid.*

¹⁴ See par 5.3 below.

¹⁵ See par 2.1 above.

¹⁶ Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 3; Langer 2004 *Harvard International Law Journal* 1–3 and Wiegand 1991 *American Journal of Comparative Law* 229-234.

¹⁷ Calitz 2009 LLD Thesis 57.

¹⁸ Baird *Elements of Bankruptcy* 34. In the year finishing February 2011 there were recorded 1,536,799 natural persons who filed for bankruptcy in America for non-business reasons. For further statistics see www.bankruptcyaction.com/USbankstats.htm (last accessed 2012-06-10).

¹⁹ Zywicki 2005 *Northwestern University Law Review* 1526.

of individuals to use bankruptcy as a response to those underlying problems.

The majority of these bankruptcies prior to 2005 were short no asset bankruptcies where the creditors did not object to the debtor's bankruptcy and normally the whole case was overseen by the Clerk of the Court over a matter of months.²⁰ As is evident from past discussion,²¹ the debt relief process in America, prior to 2005, had developed around the so-called "honest but unfortunate debtor", allowing him or her to acquire a fresh start.²² Although this liberal approach towards the debtor's discharge had greatly benefited the American consumer over the last century,²³ creditors had suffered at its mercy.²⁴ In order to redress the interests of creditors and force debtors who were abusing the discharge dispensation at the cost of their creditors to make larger repayments, the American legislature introduced the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*.²⁵ These reforms were enacted into law after large-scale lobbying efforts by mainstream commercial creditors such as banks and credit card companies.²⁶

Article 1 section 8 clause 4 of the Constitution of the United States empowers the country's federal legislature to enact bankruptcy laws that will regulate all bankruptcy issues throughout the whole of the United States.²⁷ The United States federal legislature has used this authority on a number of occasions in combating different financial crises since the inception of the constitution, and

²⁰ *Ibid.*

²¹ See par 2.1 above.

²² *Local Loan Co. v Hunt* 1934 292 US 234; Hardaway *The great American housing bubble: The road to collapse* 235 and Frumkin *Tracking America's economy* 135. See also par 2.4 below.

²³ Baird *Elements of bankruptcy* 34 and 35.

²⁴ Kilborn 2003 *Ohio State Law Journal* 860.

²⁵ Hereinafter known as the BAPCPA. Chemerinsky 2005 *American Bankruptcy Law Journal* 571; Hildebrand 2005 *American Bankruptcy Law Journal* 373; Kilpatrick 2005 *American Bankruptcy Law Journal* 820 and Singer 2006 *North Dakota Law Review* 297 and 305. The legislature noted that the purpose of the Act was to restore some financial responsibility to American consumers and integrity to the bankruptcy process.

²⁶ Mann 2007 *Illinois Law Review* 375 and Barley 2007 *Journal of Management Inquiry* 205-207.

²⁷ Klee 1978–1979 *De Paul Law Review* and Tab 1995 *American Bankruptcy Institute Law Review* 5.

more recently, it passed the *Bankruptcy Reform Act* of 1978.²⁸ This Act completely revised and reorganised Title 11, which is currently known as the “Bankruptcy Code” and is the main source of bankruptcy and insolvency law in the United States.²⁹

The Code provides for numerous types of bankruptcy procedures all catering for different types of debtors including natural persons, corporations and state organs.³⁰ Similar to all the countries studied in this thesis, the American regime has both a creditor and debtor initiated bankruptcy process.³¹ A creditor can petition a debtor into bankruptcy under section 303 of the Code.³² However, of over 1.3 million bankruptcy filings each year, less than one per cent of these cases are initiated by creditors.³³ When the debtor wishes to seek bankruptcy protection under the Code he or she has three options:³⁴

- (a) A straight bankruptcy procedure known as a Chapter 7 bankruptcy;
- (b) a Chapter 13 wage repayment plan; or
- (c) a reorganisation procedure known as a Chapter 11 procedure. It is noted however, that this procedure is used more by partnerships and corporations. Its use by natural persons is considered rare.³⁵

5.2.1 Overview of the Procedures Available to Consumer Debtors

On the whole, debtors seeking bankruptcy protection in the United States have two choices, namely the Chapter 7 straight bankruptcy provisions and the Chapter 13 wage earner plan.³⁶ Before the BAPCPA was passed in 2005, the debtor’s freedom to choose either procedure was absolute.³⁷ Post 2005 the BAPCPA introduced numerous creditor oriented provisions that reformed

²⁸Lawrence 1984 *Journal of Law and Economics* 422 and 423.

²⁹Trost 1979 *Business Lawyer* 1310 and Levy 1979–1980 *Connecticut Law Review* 3. Title 11 is hereinafter referred to as the “Code.”

³⁰Evans 2003 *Juta’s Business Law* 176 and Lam 1990 *Arizona State Law Journal* 625.

³¹Epstein and Nickles *Principles of bankruptcy law* 40.

³²*Ibid.*

³³*Ibid.*

³⁴Landry and Mardis 2006 *Golden Gate University Law Review* 95.

³⁵Anil *et al* 1994 *University of Illinois Law Review* 847.

³⁶*Ibid.* See also Wang and White 2002 *Journal of Legal Studies* 256.

³⁷Culhane and White 2005 *American Bankruptcy Institute Law Review* 665.

the eligibility requirements for debtors applying for Chapter 7 bankruptcies.³⁸ In effect, this Act sufficiently diminishes the debtor's freedom to choose between the bankruptcy procedure in terms of Chapter 7, or the repayment plan under Chapter 13. The specific provision that caused this change is known as "the means test."³⁹ The effect of the means test is to force debtors with a reasonable quantum of income to file for bankruptcy directly through Chapter 13, or consent to a conversion to the Chapter 13 repayment plan, even though they initially applied through Chapter 7.⁴⁰

Chapter 7 of the Code allows a natural person who lives, owns property or trades in the United States to file for bankruptcy in a federal Court.⁴¹ The application of any natural person under Chapter 7 will be subject to the means test noted above in order to determine if he or she is eligible for a Chapter 7 application, or whether he or she should convert his or her application to a Chapter 13 wage earner plan.⁴² Relief is available under Chapter 7 irrespective of the size of the debts or whether the debtor is in fact actually insolvent.⁴³ Natural persons applying for bankruptcy protection under Chapter 7, or any chapter of the Code, must receive credit counselling within 180 days before filing for such protection.⁴⁴ Once the Court has accepted the application, a Chapter 7 bankruptcy commences. This involves the ordinary trustee-administered process of liquidating the debtor's assets and the subsequent distribution of monies to the creditors.⁴⁵ Where a debtor completes the Chapter 7 process he or she receives an immediate discharge of the majority of his or her unsecured debt, and is protected from any claims

³⁸ *Ibid.*

³⁹ Carlson 2007 *American Bankruptcy Institute Law Review* 250 and 251 and Braucher 2005 *American Bankruptcy Institute Law Review* 457.

⁴⁰ *Ibid.*

⁴¹ Ss 101(41) and 109(b) of the Code. The Chapter 7 process is also available to partnerships, corporations and any other business entities. Although the Act requires application fees to be paid that amount to approximately USD \$316, if the debtor's income is less than a certain official threshold and the debtor is unable to pay the Chapter 7 fees even in instalments, the Court may waive the requirement that the fees be paid. See also www.usCourts.gov (last accessed 2012-06-10).

⁴² Culhane and White 2005 *American Bankruptcy Institute law Review* 665.

⁴³ Newton *Bankruptcy and insolvency accounting, practice and procedure* 264.

⁴⁴ Ss 109 and 111 of the Code. Newman 2007 *Utah Law Review* 490 and Eisler 2006 *American University Law Review* 1339.

⁴⁵ Calitz 2007 *Obiter* 402.

by the creditors against his or her income or newly acquired assets after the bankruptcy petition.⁴⁶ On average, the bankrupt is discharged approximately four months after the date the debtor filed his or her petition with the Clerk of the bankruptcy Court.⁴⁷ Despite the seemingly rapid discharge, it must be noted that a Chapter 7 bankruptcy is characterised by a large number of debts that are non-dischargeable including student loans, maintenance payments and government taxes.⁴⁸ These debts aside, the debtor emerges on the other side of the Chapter 7 procedure with a fresh start.⁴⁹

Only natural persons are entitled to apply for relief under Chapter 13, provided that their unsecured debts are less than \$360,475 and their secured debts are less than \$1,081,400.⁵⁰ A debtor will not be able to file for a Chapter 13 reorganisation plan if he or she has not undertaken credit counselling.⁵¹ Chapter 13 provides for the adjustment of debt of individuals who have a regular income, allowing them to keep their assets and pay their debts over a fixed time span.⁵² The debtor must file a plan with the Clerk of the Court, proposing to repay a portion of his or her debt over a period of three to five years out of his or her future income.⁵³ The plan must provide that the unsecured creditors will receive as much as they would receive if the bankrupt filed for straight bankruptcy under Chapter 7.⁵⁴ Once the plan is accepted by the Court, the debtor uses all his or her income that is surplus to his or her living expenses to carry out the plan.⁵⁵ Once the debtor has completed all his

⁴⁶ *Ibid.*

⁴⁷ www.usCourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics (last accessed 2012-06-10).

⁴⁸ See s 523(a) of the Code for a complete list of non-dischargeable debts.

⁴⁹ Landry and Mardis 2006 *Golden Gate University Law Review* 96.

⁵⁰ S 109(e) of the Code. These threshold amounts are adjusted regularly to reflect changes in the consumer price index. Rodriguez *Consumer bankruptcy* 101 109 and Cross and Miller *The legal environment of business: Text and cases: ethical, regulatory and corporate issues* 350. Where the debtors debts exceed this threshold he or she must consider filing either under Chapter 7 or Chapter 11.

⁵¹ Ss 109 and 111 of the Code.

⁵² White 1998 *University of Chicago Law Review* 691.

⁵³ S 1323 of the Code. See also Landry and Mardis 2006 *Golden Gate University Law Review* 96.

⁵⁴ S 1325(a)(4) of the Code. See Cross and Miller *The legal environment of business: Text and cases: ethical, regulatory and corporate issues* 351.

⁵⁵ S 1325(b)(1) of the Code. See also Silver 1987 *Bankruptcy Development Journal* 221 and 222.

or her obligations under the plan the Court may grant a discharge of all his or her debts on the payment plan.⁵⁶ There are some debts that are not discharged and are excluded by statute, but in comparison with a Chapter 7 discharge there are far less excluded debts under Chapter 13.⁵⁷

During a Chapter 7 bankruptcy, the debtor is obliged to surrender all his or her secured and non-secured assets that are then liquidated for the benefit of the creditors.⁵⁸ Under a Chapter 13 plan the debtor is allowed to retain his or her secured and non-secured property.⁵⁹ The debtor may then restructure most of his or her secured loans with lower periodic payments, usually over a period of three to five years.⁶⁰ Under a Chapter 13 procedure a mortgage on the debtor's primary residence cannot be rescheduled. However, the debtor can pay off his or her arrears on this type of mortgage, and the regular mortgage payments, on time to avoid foreclosure.⁶¹

Chapter 13 plans can be difficult to complete. They can often be derailed by unforeseen factors such as sudden unemployment, illness or other difficulties.⁶² Bearing this in mind the legislature added a hardship discharge as part of the Chapter 13 provisions.⁶³ In order to apply to the Court for a hardship discharge the debtor's inability to complete the plan must be caused by circumstances that the debtor cannot be reasonably held accountable for.⁶⁴ The hardship discharge will not be granted if the debtor's inability to meet his or her obligations can be resolved by a modification to his or her repayment plan.⁶⁵ Before the discharge may be granted the debtor's unsecured creditors must also have received at least as much as they would have received under a Chapter 7 bankruptcy procedure.⁶⁶

⁵⁶S 1328(a) of the Code.

⁵⁷Landry and Mardis 2006 *Golden Gate University Law Review* 96.

⁵⁸*Ibid.*

⁵⁹*Ibid.*

⁶⁰Hurst and White 2002 *American Economic Review* 707.

⁶¹1322(c) of the Code.

⁶²Ginsberg and Martin *Ginsberg and Martin on Bankruptcy* 11–137.

⁶³Driscoll 2000 *University of Illinois Law Review* 1312.

⁶⁴S 1328(b) of the Code.

⁶⁵*Ibid.*

⁶⁶*Ibid.*

Chapter 13 also contains what is known as a “cram down” provision under section 1325(a)(5)(B) of the Code.⁶⁷ This provision allows a bankruptcy judge to accept certain reorganisation plans without the unanimous approval of the creditors.⁶⁸ Under this provision a bankruptcy judge can approve a plan at the request of the proponent of the plan, even if the plan has not received unanimous approval from the creditors.⁶⁹ Before issuing a “cram down” order the Court is, however, required to determine the value of the debtor’s assets⁷⁰ and verify the debtor’s ability to meet the obligations in the reorganisation plan.⁷¹

With regard to debtors who are unable to pay Court fees or provide security for their debt relief applications, the Code under section 1915(a)(1) provides for an *in forma pauperis* filing. Once a petition is made to the Court for an *in forma pauperis* designation the Court may grant this status to the debtor, based on the pleadings before it.⁷² Once granted by order of the Court the debtor is entitled to waive all the normal costs of litigation, except for attorney fees and the costs associated with bringing witnesses before the Court.⁷³ A bankruptcy Court will only grant such a designation where the debtor’s income is 150 per cent less than the poverty guidelines published by the United States Department of Health, and he or she cannot pay back the costs in installments.⁷⁴

5.2.2 Overview of the Reforms to the American Bankruptcy System

Prior to 2005 there was a general concern that too many debtors that were able to repay at least some portion of their debts were taking advantage of a bankruptcy system that forgives debtors and gives them a fresh start.⁷⁵ The concern was that consumers were intentionally borrowing beyond their

⁶⁷Zywicki 1994 *Thurgood Marshall Law Review* 243.

⁶⁸S 1325(a)(5)(B) of the Code.

⁶⁹*Ibid.* See also Brown 1989 *Review of Financial Studies* 113.

⁷⁰S 506(a) of the Code.

⁷¹S 1325(a)(5)(B) of the Code.

⁷²Ginsberg and Martin *Ginsberg and Martin on bankruptcy* 2-10.

⁷³*Ibid.*

⁷⁴www.usCourts.gov/bankruptcyCourts/povertyguidelines.pdf (last accessed 2013.2.12).

⁷⁵Tab and McClelland 2006-2007 *Southern Illinois University Law Journal* 463 and Ivy 2000 *Bankruptcy Development Journal* 222.

means, knowing that bankruptcy was a financial tool they could fall back on to purge themselves of their debt.⁷⁶ In reply to strong lobbying by major commercial lenders and criticism against an apparent softness of American bankruptcy laws,⁷⁷ the legislature enacted the BAPCPA on 20 April 2005.⁷⁸ This statute made several material changes to the Code that have arguably shifted the country's fresh start policy from one that favoured debtors outright to one that places relatively more emphasis on protecting creditors.⁷⁹ This shift in the policy on how to balance the interests of the debtor and his or her creditors in bankruptcy is regarded by some commentators as a shift towards the centre left balancing style of other common law jurisdictions, specifically those discussed above.⁸⁰ The BAPCPA made the following amendments to the Bankruptcy Code:⁸¹

- (a) Section 707 of the Code introduced a means test as part of the requirement for eligibility into a Chapter 7 bankruptcy;
- (b) mandatory credit counselling was introduced before filing a bankruptcy petition and during the post-petition bankruptcy process;⁸²
- (c) it reduced the number and type of debts that can be discharged after a Chapter 7 or 13 bankruptcy;⁸³
- (d) in an effort to stop debtors from "forum shopping", section 505 of the Code now states that a debtor who has moved from one state to another within two years of filing for the bankruptcy must use the exemptions from the place of his or her previous domicile for a specified period of time;⁸⁴

⁷⁶*Ibid.*

⁷⁷Sommer 2005 *American Bankruptcy Law Journal* 192

⁷⁸www.justice.gov/ust/eo/bapcpa/index.htm (last accessed 2012-06-10).

⁷⁹Landry and Mardis 2006 *Golden Gate University Law Review* 104.

⁸⁰See pars 5.2 and 5.3 above and Ziegel 2006 *Theoretical Inquiries in Law* 302.

⁸¹Landry and Mardis 2006 *Golden Gate University Law Review* 105 and 106 and Wedoff 2007 *University of Illinois Law Review* 31.

⁸²S 109(h)(1) of the Code.

⁸³S 727(a)(8) of the Code. See also Brown 2005 *American Bankruptcy Journal* 420.

⁸⁴Ahern 2005 *American Bankruptcy Institute Law Review* 586.

- (e) previously, certain liens on property were avoidable under Chapter 7. The BAPCPA now limits the avoidance of liens through bankruptcy;⁸⁵
- (f) whereas previously a repeat bankrupt could not receive a discharge unless his or her previous discharge was in a case that commenced more than six years before the date of the filing of the current petition, this time period has now been increased to eight years;⁸⁶
- (g) the exceptions to a discharge under section 523 of the Code have been expanded to include expansions on fraud and student loans;⁸⁷
- (h) more demanding disclosure requirements are set for a debtor applying for a Chapter 7 discharge, coupled with the dismissal of his or her application as a consequence if he or she does not meet these requirements;⁸⁸ and
- (i) the bankrupt's alimony and child support obligations are now first in repayment priority.⁸⁹

The most significant change to the bankruptcy Code by the BAPCPA was the introduction of the “means test.” The effect of BAPCPA is to subject Chapter 7 debtors who have a regular income that is more than the State’s census median income to a 60 month disposable income-based test.⁹⁰ Where the debtor's surplus monthly income is higher than the specific floor amount in each State, the debtor is found to be abusing the Chapter 7 process.⁹¹ A debtor whose income is below the state's median income is, however, not subject to the means test.⁹² Prado summarises section 707 which regulates the means test as follows:⁹³

⁸⁵S 522(f)(1)(B) of the Code.

⁸⁶S 727(a)(8) of the Code.

⁸⁷Wedoff 2007 *University of Illinois Law Review* 38.

⁸⁸S 521(i) of the Code.

⁸⁹S 507(a)(1) of the Code.

⁹⁰Drobish 2007–2008 *University of Washington Law Review* 190.

⁹¹*Ibid.*

⁹²Elias and Leonard *Chapter 13 Bankruptcy: Keep your property & repay debts over time* 46.

⁹³Prado 2007 *American Bankruptcy Journal* 482.

Much like the rest of BAPCPA, it is not a piece of artful drafting... That said, if one carefully parses through that language, one concludes that Congress has sought to preordain the presumption of abuse in one of three scenarios:

- first, in the case of a debtor whose non-priority unsecured debt is less than \$26,300.02, if the debtor's disposable monthly income is greater than or equal to \$109.59;
- second, in the case of a debtor whose non-priority unsecured debt is greater than or equal to \$26,300.02 and less than or equal to \$43,799.97, if the debtor's disposable monthly income is greater than or equal to the debtor's non-priority unsecured debt divided by 240; and
- third, in the case of a debtor whose non-priority unsecured debt is greater than \$43,799.97, if the debtor's disposable monthly income is greater than or equal to \$182.50.

Where the debtor is found to have abused the Chapter 7 procedure he or she will not be allowed to use the process and the application will have to be dismissed, or the debtor may consent to a conversion to a Chapter 13 payment plan.⁹⁴

Another important provision added by the BAPCPA is mandatory counselling. Under the Code, in order for a debtor to petition for a Chapter 7 or Chapter 13 bankruptcy, an individual must first, within 180 days of the petition, have received credit counselling from a recognised non-profit counselling agent.⁹⁵ The reformed Code also requires the debtor's completion of an instructional course in personal financial management prior to obtaining a discharge.⁹⁶ Gross and Block-Lieb note that although there is room in the American bankruptcy regime for the mandatory counselling of debtors, the main problem with the current procedure is the Code's vagueness on numerous issues regarding the process.⁹⁷ The Code for example does not specify the goals of the counselling process, what should occur in the counselling sessions, or even the qualifications of the providers of the debtor education.⁹⁸

⁹⁴ *Ibid.*

⁹⁵ S 109(h)(l) of the Code. See also Linfield 2005 *American Bankruptcy Institute Journal* 1.

⁹⁶ S 111 of the Code.

⁹⁷ Gross and Block-Lieb 2005 *American Bankruptcy Institute Law Review* 561.

⁹⁸ *Ibid.*

5.3 Australia

In recent times over-indebtedness is affecting a growing number of consumers in Australia.⁹⁹ This is evidenced by the approximately 300 per cent increase in personal insolvency applications registered between the years 1990 and 2010.¹⁰⁰ In the financial year 2010-2011 there were 31,530 recorded personal bankruptcy applications.¹⁰¹ This increase comes during a period of relatively low interest rates and economic development.¹⁰² While this has not prompted much academic research in personal bankruptcy in Australia,¹⁰³ the country's legislature has certainly been busy making frequent amendments to its bankruptcy dispensation.¹⁰⁴

The Australian law pertaining to over-indebtedness of individuals is set out in the *Bankruptcy Act* of 1966.¹⁰⁵ Like Tanzania, the laws governing corporate insolvency are codified in separate legislation. The *Bankruptcy Act* regulates all the procedures dealing with financially stressed debtors and their creditors.¹⁰⁶ The insolvent individual in Australia can either have his or her estate administered in bankruptcy or enter into a binding arrangement with

⁹⁹Ramsay and Sim 2010 *Federal Law Review* 283. The exact figures can be found on the Annual report by the Inspector-General in bankruptcy on the operation of the bankruptcy act 2010–2011. See also www.itsa.gov.au/dir228/itsaweb.nsf/docindex/about+us-per-cent3Epublications-per-cent3Eannual+reports (accessed 2011-08-26). Hereinafter referred to as Inspector-General *Report on the operation of bankruptcy*.

¹⁰⁰*Ibid.* The term “personal insolvency” includes both actual bankruptcy applications and applications for formal alternatives to bankruptcy available in Australia.

¹⁰¹*Ibid.*

¹⁰²Ramsay and Sim 2010 *Federal Law Review* 284. These authors note that this indicates the rise in debt levels in Australia are not purely due to the existing economic conditions but also that filing for bankruptcy and alternative relief in Australia has become some sort of middle class phenomenon. Ryan 1993 *Australian Journal of Social Issues* 34 notes that the bankruptcy of debtors is caused more by the dishonest lending practices of lenders and low incomes of the debtors. For an in depth discussion on the causes of Australian consumer insolvency, see Ryan *The last resort: A study of consumer bankrupts* 44.

¹⁰³Morrison 2011 *Insolvency Law Journal* 209 and 210. This author observes that Australian insolvency scholars tend to focus their energies on corporate financial difficulty rather than personal insolvency. See also Niemi-Kiesilainen *et al Consumer bankruptcy in global perspective* 227 and 228.

¹⁰⁴Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 93–108. The number of amendments discussed in this short survey alone is evidence of this fact.

¹⁰⁵Also in the *Bankruptcy Rules* (statutory rule no. 2 of 1968, as amended) and *Bankruptcy Regulations* of 1966. In par 5.3 the *Bankruptcy Act* of 1966 will be known as the “*Bankruptcy Act*”.

¹⁰⁶Duns and Mason 2001 *International Insolvency Law Review* 199.

creditors in satisfaction of his or her debts.¹⁰⁷ These two options for the debtor are covered under the following three personal insolvency procedures under the Act:¹⁰⁸

- (a) the traditional bankruptcy procedure including compositions and schemes of arrangement;
- (b) debt agreements; and
- (c) Part X arrangements.

5.3.1 Bankruptcy Proceedings¹⁰⁹

In 1989 the legislature, troubled by the number of debtors who filed bankruptcy petitions without understanding the consequences of bankruptcy or that there were viable alternatives, introduced what is known casually as a “cooling off period” for debtors.¹¹⁰ The strategy behind this amendment was to try and stop debtors from making hurried decisions about filing for bankruptcy without weighing all the alternative options available to them.¹¹¹

The cooling off period is achieved in the following manner. Before the Australian debtor files a petition for bankruptcy, he or she may file a “Declaration of Intention to File a Petition” with the Official Receiver.¹¹² There is no filing fee for this submission. The Official Receiver is obliged to refuse to accept the declaration until he or she is satisfied that the debtor is aware of all the procedures under the *Bankruptcy Act*, 1966, that are available to him or her.¹¹³ In practice the debtor is issued with a catalogue of all the relevant

¹⁰⁷ *Ibid.*

¹⁰⁸ See Ss 55, 185 and 187 of the *Bankruptcy Act*. See also Niemi-Kiesilainen *et al Consumer bankruptcy in global perspective* 230.

¹⁰⁹ See in general Rose *Lewis’ Australian bankruptcy law* 60–232 and Mason 1999 *Osgoode Hall Law Journal* 463.

¹¹⁰ Murray and Harris *Keay’s Insolvency: Personal and corporate law practice* 29 and Duns and Mason 2001 *International Insolvency Law Review* 207.

¹¹¹ Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 97 and Mason 1999 *Osgoode Hall Law Journal* 463.

¹¹² S 54A of the *Bankruptcy Act*. See also Rose *Lewis’ Australian bankruptcy law* 83. This declaration may also be submitted by fax. After filing the declaration with the Official Receiver the debtor is not obliged to file a discontinuance notice if he or she decides not to proceed with the actual filing of the petition.

¹¹³ S 54D of the *Bankruptcy Act*.

information.¹¹⁴ Bankruptcy regulation 4.11 sets out in some detail the information that the Official Receiver must give to the debtor. This includes information on alternatives to bankruptcy, sources of financial advice and the choice between the Official Trustee and a private registered trustee to administer the debtor's estate.¹¹⁵ Under regulation 4.11 the Official Receiver must also receive a signed letter from the debtor acknowledging receipt and understanding of all the reading material provided before accepting the declaration.

Barring this one requirement the Official Receiver is obliged to accept the debtor's declaration if it appears it was submitted in the correct form and that the debtor is legally entitled to present it.¹¹⁶ The effect of this declaration is to create a stay of enforcement proceedings against the debtor for any debts against the debtor individually or his or her property.¹¹⁷ This stay ends upon the occurrence of one of the following events:¹¹⁸

- (a) a period of 21 days elapses;¹¹⁹
- (b) a bankruptcy petition is filed either by the debtor or the creditor; or
- (c) a sequestration order is made against the debtor.¹²⁰

During this 21-day period creditors are prohibited from proceeding with any enforcement processes in relation to a judgement debt or enforce an action

¹¹⁴*Ibid.*

¹¹⁵Ben-Ishai and Schwartz 2007 *Osgoode Hall Law Journal* 490. Personal insolvency procedures in Australia are administered by private sector trustees, as in South Africa and Tanzania, or by the public sector through the Official Receiver on behalf of the Official Trustee s 18(8) of the *Bankruptcy Act*). The choice is the debtor's. 95 per cent of applications are currently administered by the public sector. This is of course due to the minimal cost of the latter administrator. See also Tomasic *Insolvency law in East Asia* 474 and Mason *Osgoode Hall Law Journal* 453.

¹¹⁶S 54C of the *Bankruptcy Act*. Certain debtors named under s 54B of the *Bankruptcy Act* may not submit a declaration of intent to present a debtor's petition. These include debtors who are not themselves entitled to lodge a petition for bankruptcy under the *Bankruptcy Act*. See Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 29.

¹¹⁷S 54E of the *Bankruptcy Act*. This stay against enforcement proceedings of creditors does not apply to secured creditors.

¹¹⁸*Ibid.*

¹¹⁹Ss 5 and 54(C) of the *Bankruptcy Act*.

¹²⁰The term sequestration order has the same meaning as in the South African insolvency law in par 4.3 above. It denotes the Court order that declares the debtor bankrupt. See S 43 of the *Bankruptcy Act* in this regard.

against the debtor's property or person.¹²¹ The sheriff is prohibited from taking any action to enforce a judgement during this period and similarly, the Registrar of the High Court is forbidden to pay out any proceedings from a sale in execution to judgement creditors.¹²² Any person who owes the debtor money is prohibited from paying any monies owed to the debtor to his or her creditors.¹²³

A debtor who is in financial distress may petition himself or herself into bankruptcy.¹²⁴ A debtor need only submit with the Official Receiver a petition in the prescribed form accompanied by a statement of affairs and a list of creditors.¹²⁵ According to regulation 24 the petition may even be submitted by fax.¹²⁶ Once the petition is accepted and endorsed by the Official Receiver, the debtor automatically becomes bankrupt unless the debtor is party to a Part X personal insolvency arrangement or a stay/moratorium under a proclaimed law in Australia.¹²⁷ The Official Receiver is obliged to accept the petition unless the procedural exceptions under section 55(3) of the *Bankruptcy Act* exist.¹²⁸

¹²¹S 54E(2) of the *Bankruptcy Act* and Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 31.

¹²²S 54G of the *Bankruptcy Act*.

¹²³S 54H of the *Bankruptcy Act*.

¹²⁴Rose *Lewis' Australian bankruptcy law* 82; Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 97, *Keay Bankruptcy proceedings handbook* 7 and *Mason Osgoode Hall Law Journal* 453. According to s 7(2) of the *Bankruptcy Act* the definition of a debtor is a resident of Australia except a corporation. This definition includes a person who has leave from the Court to present a bankruptcy petition where he or she is under a Part X arrangement.

¹²⁵S 55(1) and (2) of the *Bankruptcy Act*. Where the petition is presented without any of these documents it has no effect. In *Re Shead* 1954 16 ABC 188 the Court held that all the relevant documents must be submitted together and may not even be submitted at separate times.

¹²⁶Rose *Lewis' Australian bankruptcy law* 84 and Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 34.

¹²⁷S 55(4A) of the *Bankruptcy Act*. *The Official Receiver v Walia* 1997 79 FCR 299.

¹²⁸Rose *Lewis' Australian bankruptcy law* 84 and Murray and Harris *Keay's insolvency: Personal and corporate law practice* 33. Two exceptions exist to this obligation to accept the petition by the Official Receiver. First, where at the time the debtor's petition is being submitted a creditor's petition is pending in a Court, the Receiver is obliged to refer the debtor's petition to the Court for direction on whether to accept or reject the petition. Second, where it appears that the debtor's petition and the relevant annexures are not correctly presented, the Receiver must either reject the petition or refer it to a Court for a ruling on whether it should be accepted or not. Unlike the Tanzanian petitioning-debtor the Australian equivalent does not need to be adjudged bankrupt, the acceptance of the debtor's petition is all that is required. See par 3.3 above.

After the Official Receiver has accepted the petition and the debtor is bankrupt,¹²⁹ the Official Receiver must cause a notice to appear in the commonwealth *Gazette* to this effect.¹³⁰ In addition, the Official Receiver, or if there is already a registered trustee, must give each of the bankrupt's creditors official notice informing them of the debtor's bankruptcy.¹³¹

Again, like the debtor's petition, the Australian procedure of submitting a creditor's petition for the debtor's bankruptcy is quite similar to that of Tanzania. Like the Tanzanian process a Court hearing is necessary before such an order is given, and the Court has an unencumbered discretion in deciding whether to place the debtor in bankruptcy.¹³² There are, however, a few differences.

One or more creditors acting together may submit a petition for a debtor's bankruptcy.¹³³ The amount owing to the creditor or creditors acting jointly must amount to AUD 5000.¹³⁴ The debtor must have committed an act of bankruptcy under the *Bankruptcy Act* 1966, within six months of the presentation of the bankruptcy petition.¹³⁵ Sections 3(2) and 43(1)(b) require the debtor, against whom the petition is being made, to be connected with Australia either by residing in the country personally or conducting some form of business in the jurisdiction. The petition is presented at the Federal Court Registry.¹³⁶ The "presentation" of the petition occurs by lodging the petition itself in the prescribed form and with the verifying affidavits, with the Registrar of the Court.¹³⁷ The petition must be served on the debtor not less than eight

¹²⁹Ss 55-57 of the *Bankruptcy Act*.

¹³⁰S 310(1) of the *Bankruptcy Act* and *Rose Lewis' Australian bankruptcy law* 89.

¹³¹S 19(1) of the *Bankruptcy Act* 1966.

¹³²See 3.3.1 above on the Tanzanian process.

¹³³S 44(1)(a) of the *Bankruptcy Act*.

¹³⁴*Ibid.* AUD 5000 was approximately USD 5082 on 2011-08-27. It must be noted that this is an extremely high threshold compared to South Africa and Tanzania.

¹³⁵The Acts of bankruptcy under s 40 of the *Bankruptcy Act* are similar to the Tanzania acts of bankruptcy detailed below and in par 3.3 above and therefore will not be detailed here.

¹³⁶*Ibid.* See *Purden Pty Ltd v Registrar in Bankruptcy* 1982 64 ALR 512 for a discussion on when the presentation process will be complete.

¹³⁷S 47(1) of the *Bankruptcy Act*, reg. 15 and *Rose Lewis' Australian bankruptcy law* 41. The hearing cannot take place until proper service has been effected on the debtor. In the cases of *Re Florance* 1979 36 FLR 256 and *Re Dittfort* 1998 19 FCR 347 the Court held that these provisions on service must be adhered to strictly.

business days before the Court hears the petition.¹³⁸ Where a debtor wishes to resist the petition, he or she must file a notice to that effect within three days of the Court hearing.¹³⁹

On the day of the hearing, all bankruptcy petitions are first heard by the Registrar of the Federal Court who exercises judge-delegated powers under the *Federal Court Rules*.¹⁴⁰ During a hearing where the creditor is seeking an order for the debtor's bankruptcy, he or she is required to prove:¹⁴¹

- (a) the proper service of the petition;
- (b) all the matters stated in the petition; and
- (c) that the debt upon which the petition is based is still owing to him or her.

Also during the hearing the debtor may be required by the Court to give oral evidence on the state of his or her financial affairs.¹⁴² Once both sides have been heard the Court will deliver one of the following rulings on the petition:¹⁴³

- (a) that it be dismissed if the petition is defective and cannot be fixed;¹⁴⁴
- (b) that the matter be adjourned;
- (c) that the petition be withdrawn if the debtor has paid his or her debts in full;¹⁴⁵ or

¹³⁸S 47 (1) of the *Bankruptcy Act*.

¹³⁹Order 77 Rule 11 under the *Federal Court Rules* that are subsidiary to the *Federal Court of Australia Act* of 1976.

¹⁴⁰Order 77 Rule 7 of the *Federal Court Rules*.

¹⁴¹S 52(1) of the *Bankruptcy Act*.

¹⁴²Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 52. This occurs specifically where the debtor has paid his or her debts and the Court requires proof of his or her solvency.

¹⁴³S 52 of the *Bankruptcy Act*.

¹⁴⁴*Ibid.*

¹⁴⁵S 47 of the *Bankruptcy Act*. In practice a petitioning creditor who has now been paid will seek permission to withdraw from the matter. In the case of *Re Hood; Ex parte E.S and A. Bank Limited* 1971 ALR 151 the Court held that a withdrawal order will not be given unless the debtor can prove his or her solvency. The reason given was that the Federal Court does not view bankruptcy as alternative means of debt collection. See also *Re Stubbersfield* 1995 134 ALR 169.

- (d) order sequestration proceedings.

As stated above, the Courts have an unrestricted discretion to grant a sequestration order. However, the Australian Courts will not give sequestration orders lightly as they have long understood the awful consequences of bankruptcy and the effect it has on a person's status.¹⁴⁶ The Court will therefore be extremely cautious before they hand over control of a person's estate to a trustee.¹⁴⁷ In the creditors' favour however, a precedent set in *Rozenbes v Kronhill*¹⁴⁸ holds that once a creditor proves the elements in the petition, a debtor resisting a petition must show something extra that will override the public interest which demands that all trading debts be paid.¹⁴⁹ This approach by the Australian Courts towards creditor petitions is somewhat similar to that of the creditor-friendly South African Courts whose scrutiny is softer on creditor sequestration applications as a result of the same sentiment,¹⁵⁰ namely that the maximum benefit should be obtained for creditors.

The Court may dismiss the creditor's petition in the following instances:¹⁵¹

- (a) where it is not satisfied with the creditor's proof of the matters referred to in the petition; or
- (b) where the Court is satisfied that the debtor can pay off the debt; or
- (c) for some other sufficient cause the order should not be given.

The burden of proof rests on the debtor to prove that there is sufficient cause why he or she should not be placed into bankruptcy.¹⁵² It must be noted that section 52(2), with regard to the Courts' powers on dismissals, is almost

¹⁴⁶ *Russel v ANZ Bank* 1987 14 FCR 75.

¹⁴⁷ *Ibid.*

¹⁴⁸ 1959 95 CLR 409. See also Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 52.

¹⁴⁹ *Ibid.*

¹⁵⁰ See par 4.3.1.2 above.

¹⁵¹ S 52(1) of the *Bankruptcy Act*.

¹⁵² *Ling v the Commonwealth* 1996 139 ALR 159.

identical to the Tanzanian *Bankruptcy Act* section 7(3) that deals with the Courts' powers to dismiss creditors' petitions.

5.3.1.1 *Compositions and schemes of arrangements*

When the debtor is bankrupt he or she is still entitled to present a proposal to his or her creditors for a composition in satisfaction of his or her debts, or a scheme of arrangement of his or her affairs.¹⁵³ In order to start the process, the debtor must submit to the trustee a proposal in writing detailing all the particulars of the proposal including the details of any security or proposed sureties.¹⁵⁴ The trustee is then obliged to call a meeting of all the known creditors of the debtor.¹⁵⁵ Before calling the debtors the trustee must cause a copy of the proposal to be sent to the creditors.¹⁵⁶ Along with a copy of the proposal the trustee must send a copy of the debtor's statement of affairs or a summary and a proxy form.¹⁵⁷ This pack of documents must be delivered to the creditors at least seven days before the creditors' meeting.¹⁵⁸

A creditor who has proved his or her debt may consent or dissent to the proposal by delivering a written notice to the trustee before the meeting.¹⁵⁹ Once the letter has been delivered, that creditor is deemed to have voted as if he or she was at the meeting in person.¹⁶⁰ At the meeting the creditors can accept the proposal by passing a special resolution.¹⁶¹ Where the resolution is passed by the required three quarters majority, the composition or scheme is binding on all the creditors, even the dissenting ones.¹⁶² The bankruptcy is annulled on the same day as the special resolution.¹⁶³ Once the resolution is passed, the trustee must as soon as possible lodge with the Registrar of the

¹⁵³ Rose Lewis' *Australian bankruptcy law* 129. Before calling a meeting under s 73, the trustee may require the bankrupt to lodge with the trustee an amount that is sufficient to cover the costs of the meeting. In this regard see s 73A of the *Bankruptcy Act*.

¹⁵⁴ *Ibid.*

¹⁵⁵ S 76A of the *Bankruptcy Act*.

¹⁵⁶ *Ibid.*

¹⁵⁷ S 73(2) of the *Bankruptcy Act* and Schedule 2 of the *Bankruptcy Regulations*.

¹⁵⁸ Regulation 4.18

¹⁵⁹ S 73(5) of the *Bankruptcy Act*.

¹⁶⁰ *Ibid.*

¹⁶¹ S 73(4) of the *Bankruptcy Act*.

¹⁶² *Ibid.*

¹⁶³ S 74(5) of the *Bankruptcy Act*.

Federal Court a certificate informing the Court of the annulment.¹⁶⁴ A copy of this certificate must also be delivered to the Official Receiver.¹⁶⁵ Once the Court has received the certificate, any deal agreed to under the agreement can be enforced by an order of the Court. Failure to comply is contempt of Court, an offense which is punishable under the Act.¹⁶⁶

5.3.1.2 *Compulsory payments from surplus income*

In 1991 the *Bankruptcy Amendment Act 1991* added Division 4B to the *Bankruptcy Act 1966*, which introduced compulsory contributions to the bankrupt estate for debtors that earned over a certain amount.¹⁶⁷ With the large majority of cases in Australia being no asset bankruptcies, this division was introduced to combat former business moguls who were seen by the legislature to be living in comfort and wealth during bankruptcy while their creditors were offered scraps.¹⁶⁸

The *Bankruptcy Act* sets out a broad definition for what is regarded as the bankrupt's income. This includes all sorts of benefits ranging from gifts to those under trusts and insurance policies.¹⁶⁹ Under the income contribution provisions the trustee assesses the bankrupt's income for a full year, this period is known as the "contribution assessment period".¹⁷⁰ Where the debtor's income during this period exceeds "the actual income threshold amount" for that particular bankrupt,¹⁷¹ he or she must pay into the bankrupt

¹⁶⁴S 74(5A) of the *Bankruptcy Act* and *bankruptcy rule 36*.

¹⁶⁵*Ibid.*

¹⁶⁶S 75(3) of the *Bankruptcy Act*.

¹⁶⁷Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 125. See also Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 100.

¹⁶⁸*Ibid.* For a further discussion of this issue see Murray 1994 *Australia Insolvency Bulletin* 6; Costello 2001 *New Directions in Bankruptcy* 14–16 and Duns and Mason 2001 *International Insolvency Law Review* 197.

¹⁶⁹S 139L of the *Bankruptcy Act*.

¹⁷⁰S 139P of the *Bankruptcy Act*. Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 124. For an exact definition of the assessment period see s 139K of the *Bankruptcy Act*, 139. In *re Sharpe* 1998 80 FCR 536 the Court held that if the trustee suspects that the debtor is withholding information he or she is entitled to request that information in writing.

¹⁷¹*Ibid.* This amount is calculated in terms of s 139K on the basis of an amount known as the "basic income threshold." This amount is specified in the *Social Security Act*, 1991. The actual income threshold amount varies according to how many dependents the bankrupt has.

estate a calculated contribution.¹⁷² The contribution is determined by calculating 50 per cent of the difference of his or her assessed income and the actual threshold amount.¹⁷³ Where the bankrupt is unsatisfied with the assessment he or she may apply in writing to the trustee to have the assessment reviewed on grounds of hardship.¹⁷⁴ Where the trustee refuses the request, the bankrupt may apply to the Inspector-General on appeal.¹⁷⁵

5.3.1.3 *Termination of the Bankruptcy Process*

The Australian fresh start policy is often described as “reasonably generous to bankrupts.”¹⁷⁶ This description is used with specific reference to how the system discharges bankrupt debtors.¹⁷⁷ The bankruptcy of a debtor ends in one of two ways in Australia, either by annulment of the bankruptcy or automatic discharge of the debtor through the passing of time.¹⁷⁸

Annulment

There are two types of annulments under section 153 of the *Bankruptcy Act*.¹⁷⁹ The first under section 153A is known as an annulment on payment of debts, or an annulment by operation of law.¹⁸⁰ This type occurs where the trustee administering the estate is satisfied that all the bankrupt's debts have been paid in full. The bankruptcy is automatically annulled on the date which the last payment was made to the creditors.¹⁸¹ Once the trustee is satisfied that the bankrupt has paid all his or her debts, the trustee must as soon as possible submit a certificate in the prescribed form to the Official Receiver.¹⁸²

¹⁷²S 139P(1) of the *Bankruptcy Act*.

¹⁷³S 139W of the *Bankruptcy Act*.

¹⁷⁴S 139T(2) of the *Bankruptcy Act*. The list of grounds for review with respect to hardship is a closed list, and includes supporting other members of the family and medical and illness grounds. The trustee has the discretion to amend the income contribution assessment.

¹⁷⁵S 139ZG of the *Bankruptcy Act*

¹⁷⁶Telfer *et al International perspectives on consumers' access to justice* 231.

¹⁷⁷*Ibid.*

¹⁷⁸Ss 153 and 149 of the *Bankruptcy Act*.

¹⁷⁹Rose *Lewis' Australian bankruptcy law* 239.

¹⁸⁰*Ibid.*

¹⁸¹S 153A(1) of the *Bankruptcy Act*.

¹⁸²S 153A(2) of the *Bankruptcy Act*.

Before the *Bankruptcy Amendment Act* of 1991, a bankrupt debtor who had satisfied all his or her obligations only acquired a discharge through a Court order to that effect.¹⁸³ It was explained in the *Explanatory Memorandum to the Bankruptcy Amendment Bill 1991*¹⁸⁴ that the new approach was meant to save time and costs by avoiding having to apply to the Court for a discharge.¹⁸⁵

The second type of annulment is regulated under section 153B of the *Bankruptcy Act*, 1966. This type is known as an annulment by Court order.¹⁸⁶ This section gives the Court the power to annul a bankruptcy if the Court is satisfied that:

- (a) the debtor's petition should not have been presented;¹⁸⁷
- (b) the debtor's petition should not have been accepted;¹⁸⁸
- (c) the sequestration order should not have been given against the debtor.¹⁸⁹

The practice in Australia is that the bankrupt himself usually applies for this type of annulment.¹⁹⁰ However, the trustee and creditors have been known to apply for an annulment by the Court.¹⁹¹

When a bankruptcy order is annulled, the bankrupt debtor is restored to the

¹⁸³This is the current position in Tanzania, see par 3.4 above. Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 143.

¹⁸⁴See www.aph.gov.au/hansard/hanssen.htm (last accessed 2012-06-10) for a copy of the *Explanatory Memorandum to the Bankruptcy Amendment Bill 1991*.

¹⁸⁵*Ibid.*

¹⁸⁶Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 144.

¹⁸⁷S 153B of the *Bankruptcy Act* and Rule 57 of the *Bankruptcy Rules*. For an example of the objective test required under s 153B in this regard see *Re Mundy* 1963 19 ABC 165 where the Court annulled the bankruptcy of an infant.

¹⁸⁸See *Re Betts* 1901 2 KB 39. In this case the debtor filed a petition to evade liability when he could afford to pay the debt.

¹⁸⁹In *Re Raymond* 1992 36 FCR 425 it was decided that judges have a wide discretion regarding ordering the annulment of bankruptcy orders. In this particular case the bankruptcy of the debtor was annulled because the judgment debt which the creditor relied upon to file a bankruptcy petition was set aside.

¹⁹⁰Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 235.

¹⁹¹*Clyne v Deputy Commissioner of Taxation* 1984 55 ALR 138.

status he or she enjoyed before the bankruptcy.¹⁹² According to the Court in *Re Coyle*¹⁹³ an annulment of bankruptcy has the effect that the bankrupt debtor is treated as if he or she was never in bankruptcy.¹⁹⁴

Automatic discharge

A bankrupt debtor in Australia may be discharged automatically three years from the date on which he or she filed his or her statement of affairs.¹⁹⁵ In the instance where the debtor filed his or her own bankruptcy petition, the date upon which he or she becomes bankrupt will naturally be the same as the date when the statement of affairs was filed, due to the operation of section 55.¹⁹⁶ On the other hand, where the creditor brought about the bankruptcy order, the statement of affairs must be handed in within 14 days of the bankrupt being notified of the sequestration order.¹⁹⁷

Although the debtor is entitled to an automatic discharge the trustee or the Official Receiver may object to his or her impending discharge.¹⁹⁸ Where such an objection is made, depending on the ground(s) of objection, the debtor's discharge may be postponed for five to eight years.¹⁹⁹ This will only occur where the trustee is of the opinion that the bankrupt has not done something which he or she is required to do under the law, and filing for an objection is the only way to induce the debtor into doing it.²⁰⁰ The trustee may then file an objection with the Official Receiver.²⁰¹ The office of the Official Receiver may also file an objection to the debtor's discharge on its own behalf.²⁰² The objection notice must be in the prescribed form and set out the grounds of

¹⁹² Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 143.

¹⁹³ 1993 42 FCR 72. See also *Re Fitzgerald* 1991 99 ALR 189.

¹⁹⁴ *Ibid.*

¹⁹⁵ S 149(4) of the *Bankruptcy Act*. Unlike in Tanzania, Australia does not have Court ordered suspended or conditional discharges, only automatic discharges.

¹⁹⁶ Rose *Lewis' Australian bankruptcy law* 149.

¹⁹⁷ S 54(2) of the *Bankruptcy Act*.

¹⁹⁸ S 149B of the *Bankruptcy Act*.

¹⁹⁹ *Ibid.*

²⁰⁰ *Ibid.* See also Rose *Lewis' Australian bankruptcy law* 149.

²⁰¹ *Ibid.*

²⁰² *Ibid.*

objection and evidence substantiating them.²⁰³ The Act contains a closed list of 14 grounds for objection under section 149D of the Act:²⁰⁴

- (a) the bankrupt has failed to return from overseas;
- (b) the bankrupt has been managing a company without the permission of the Court;
- (c) after becoming bankrupt the debtor engaged in misleading conduct in relation to a person in respect of AUD 3000;²⁰⁵
- (d) the bankrupt failed to provide information on property or income upon request by the trustee;
- (e) the bankrupt failed to provide details on his or her income;
- (f) the bankrupt failed to pay the trustee the section 139ZG contributions from his or her income;²⁰⁶
- (g) the bankrupt failed to give information of how money, income or property was spent or disposed of within five years of prior to the commencement of the bankruptcy;
- (h) where the bankrupt failed to return from overseas during the period given to him or her by the trustee;
- (i) where the bankrupt failed to disclose a liability that existed on the date he or she went bankrupt;
- (j) the bankrupt failed to notify the trustee of any change to his or her name, address or day-time telephone number.
- (k) where the bankrupt fails to sign a document after being requested to do so by the trustee;
- (l) the bankrupt fails to attend a meeting of the creditors without the approval of the trustee or reasonable explanation;
- (m) the bankrupt fails to attend an examination sanctioned under the Act without a proper explanation; and
- (n) where the bankrupt fails to inform the trustee of a beneficial interest in a property.

²⁰³S 149C of the *Bankruptcy Act*

²⁰⁴S 149(D) (a)–(n) of the *Bankruptcy Act*.

²⁰⁵AUD 3000 was approximately USD 3049 on 2011-08-27

²⁰⁶See par 5.2.1.5 below.

Where the notice of objection is filed with respect to grounds (a) to (h) above, the bankrupt can only be automatically rehabilitated after eight years.²⁰⁷ If the notice is filed with respect to grounds (i) to (n) above, the bankrupt will be entitled to a discharge after five years.²⁰⁸

Once the written notice of objection has been filed it takes effect from the day of filing.²⁰⁹ After the filing, the Official Receiver must as soon as possible notify the bankrupt of the filing and his or her right to have the objection reviewed by the Inspector-General or the Administrative Appeals Tribunal.²¹⁰ A review may be initiated by the bankrupt or by the Inspector-General on his or her own initiative.²¹¹ Where the bankrupt insists on a review he or she must apply for the review in writing to the Official Receiver within 60 days.²¹² In the case of *McGoldrick v Official Trustee*²¹³ it was held that the filing of an objection is a serious matter and must be regulated and controlled.²¹⁴ Therefore, notices of objection must not merely be recitations of the grounds under section 149D; sufficient proof must be provided to substantiate whatever grounds are alleged in the objection.²¹⁵ More importantly, in the case of *Inspector-General in Bankruptcy v Nelson*²¹⁶ it was held that a sufficient reason for filing an objection is that doing so will advance the trustee's administration of the bankrupt estate. Punishment of the bankrupt, however, for failing to cooperate, was found not a suitable reason for an objection.²¹⁷

In *Re Giuca*²¹⁸ the Court explained that an automatic discharge under section 149 and 153 of the Act bestows an unconditional release of all pre-sequestration debts on the debtor. An annulment on the other hand, has the effect that any pre-sequestration debts that have not been paid off or proved

²⁰⁷ S 149D(a)–(h) of the *Bankruptcy Act*.

²⁰⁸ S 149D(i)–(n) of the *Bankruptcy Act*.

²⁰⁹ S 149G of the *Bankruptcy Act*.

²¹⁰ S 149F of the *Bankruptcy Act*.

²¹¹ *Ibid.* S 149K of the *Bankruptcy Act*.

²¹² S 149K(3) of the *Bankruptcy Act*.

²¹³ 1993 47 FCR 547.

²¹⁴ See also Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 150.

²¹⁵ *Ibid.*

²¹⁶ 1998 168 ALR 340. See also www.austlii.edu.au (last accessed 2012-06-10).

²¹⁷ *Ibid.*

²¹⁸ 1986 70 ALR 219.

during the bankruptcy can be raised again after the debtor's annulment. Rose points out that an automatic discharge is better for debtors as it results in the permanent release of pre-sequestration debts whether they were proved or not.²¹⁹

5.3.1.4 *The cost of bankruptcy*

The Australian legislature has made two noteworthy strides to limit the costs of bankruptcy for the parties involved. It should first be noted that the Australian bankruptcy procedures are not overseen by the Court and it is sufficient that the majority of the process is supervised by the Official Receiver or the trustee.²²⁰ This of course cuts down the costs of hiring lawyers and time spent waiting to be heard by the judiciary. The following processes do not require judicial supervision in Australia:²²¹

- (a) where the bankrupt has paid all his or her debts proved in bankruptcy and now wishes to terminate bankruptcy;
- (b) with respect to the statutory composition or scheme of arrangement; once the creditors have passed a special resolution accepting the proposal in Australia no judicial confirmation is necessary;²²²
- (c) once the debtor has filed a petition for bankruptcy with the Official Receiver he or she is automatically bankrupt;²²³ and
- (d) the assessment of the bankrupt's salary and income with respect to contribution to the bankrupt estate is not done by the Court.

Secondly, in 2004 the Insolvency and Trustee Services Australia initiated a cost recovery management policy which resulted in a review of the charges

²¹⁹*Ibid.*

²²⁰Rose *Lewis' Australian bankruptcy law* 237 and Ben-Ishai and Schwartz 2007 *Osgoode Hall Law Journal* 489 and 490.

²²¹In Tanzania all these processes require Court approval see pars 3.2 to 3.4 above.

²²²See par 5.3.1.3 above.

²²³In Tanzania although a receiving order is granted immediately on the occurrence of this event a Court must still adjudge the debtor bankrupt. See par 3.3 above.

and fees concerned with personal insolvencies.²²⁴ This review culminated in the *Bankruptcy Legislation Amendment (Fees and Charges) Act, 2006* where the legislature, among other initiatives, declared there would be no fees levied for the processing of debtor petitions.²²⁵ It was also decided that the expenses and remuneration costs due to the Official Trustee would not be claimed by him or her if the bankrupt estate after administration had no funds.²²⁶ These provisions came into effect on 1 July 2006. Consequently, due to the fact that 95 per cent of personal insolvency cases in Australia are administered by the Official Trustee and most of them are no asset bankruptcies, a large majority of Australian consumers are having their personal insolvencies subsidised by the State, and are not paying for this service.²²⁷

5.3.1.5 *The discarded early discharge procedure*

Before the *Bankruptcy Legislation Amendment Act, 2002* the *Bankruptcy Act, 1966* made available to the bankrupt another form of discharge known as an early discharge.²²⁸ This type of discharge was available on application to the trustee after six months from the time of filing of the statement of affairs.²²⁹ A bankrupt was allowed to apply for discharge under the repealed Act only if:

- (a) at the time the application was made there was sufficient monies in the bankrupt estate to satisfy the trustee's remuneration and expenses;²³⁰
- (b) the bankrupt had not entered into any voidable transactions prior to the bankruptcy;²³¹

²²⁴ *Ben-Ishai and Schwartz 2007 Osgoode Hall Law Journal* 489.

²²⁵ This exemption used to include debt agreement proposals, but as of 2011-01-01 lodging a debt agreement proposal with the Official Receiver requires a fee. See in this regard www.itsa.gov.au (last accessed 2012-06-10).

²²⁶ *Ibid.* See also Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 100.

²²⁷ *Ibid.*

²²⁸ *Keay Insolvency: Personal and corporate law and practice* 153 and *Rose Lewis' Australian bankruptcy law* 229.

²²⁹ *Ibid.*

²³⁰ S 149T(3) of the *Bankruptcy Act* (repealed).

²³¹ *Ibid.*

- (c) the bankrupt's income did not exceed the actual income threshold amount for the period one year before he or she became bankrupt;²³² and
- (d) the bankrupt also could not have previously been a bankrupt or party to any debt agreement or composition-like procedure.²³³

This discharge method was repealed by the 2002 amendments for a number of reasons.²³⁴ The Explanatory Memorandum for the 2002 amendments noted this form of discharge was often blamed for bankruptcy being labeled as too easy.²³⁵ Also, the short period of bankruptcy was thought to discourage debtors from pursuing formal or informal arrangements with their creditors to clear their debts.²³⁶ Furthermore, when the early discharge was introduced the legislature intended it to target honest and unfortunate consumer debtors with very few assets who had over-extended themselves financially.²³⁷ This goal was not achieved by the early discharge provisions. The explanatory memorandum also explained that there was no justifiable reason why debtors with assets or income sufficient to make a contribution to the estate are less deserving of an early discharge than those who do not.²³⁸ Also, allowing only those whose debts exceed 150 per cent of their income to apply, discriminated against women who have joint debts with, and generally a lower income than, their spouse.²³⁹

²³² *Ibid.*

²³³ See the repealed s 149X and Y of the *Bankruptcy Act*.

²³⁴ Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 100.

²³⁵ Bankruptcy Amendment Legislation Bill 2002, Explanatory memorandum 2002 par 41. See www.austlii.edu.au/au/legis/cth/bill_em/blab2002344/memo1.html (last accessed 2012-06-10) for the 2002 explanatory memorandum hereinafter referred to as the "Explanatory memorandum 2002."

²³⁶ Explanatory memorandum 2002 par 43. See Duns and Mason 2001 *International Insolvency Law Review* 197 who explain that perceived abuses by debtors caused law makers to make changes to the bankruptcy regime in Australia similar to those in Canada and the United States.

²³⁷ *Ibid.*

²³⁸ Explanatory memorandum 2002 par 44.

²³⁹ *Ibid.*

5.3.2 Alternatives to Bankruptcy

There are two formal alternatives to bankruptcy in Australia. These are known as debt agreements and Part X arrangements.²⁴⁰ The Part X arrangement is aimed more towards commercial debtors as it is fairly complex and costly for ordinary consumers.²⁴¹ Debt agreements were introduced into Australia after the 1996 amendments although it had already been suggested by the law reform commission in 1977.²⁴² This procedure is purportedly a straightforward procedure for low income consumer debtors with few liabilities and creditors.²⁴³

5.3.2.1 Debt agreements

A debt agreement is a negotiated arrangement between the debtor and his or her creditors governed by the *Bankruptcy Act*.²⁴⁴ This alternative to bankruptcy combines all the debtor's existing debts into one consolidated debt for repayment.²⁴⁵ Just as in bankruptcy, debtors who enter into debt agreements must be legally insolvent.²⁴⁶ In order to initiate a debt agreement once the debtor is insolvent, he or she may present a written proposal to the Official Trustee with a detailed statement of affairs offering a debt agreement.²⁴⁷ The details required for the statement of affairs are quite specific and the document itself must conform to a particular structure.²⁴⁸ The

²⁴⁰Keay and Kennedy 1993 *Insolvency Law Journal* 187.

²⁴¹*Ibid.* Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 100. See also the *Report on the Bankruptcy legislation Amendment Bill 1995* on www.trove.nla.gov.au/work/6982665 (last accessed 2012-06-10) where it was explained that the cost of a Part X arrangement for the debtor is not less than AUD 3000. AUD 3000 was approximately USD 3049 on 2011-08-29.

²⁴²Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 191. Before the introduction of the debt agreement the bankrupt debtor had two alternative options namely a Part X arrangement or an informal agreement with his or her debtors, which both had disadvantages. These included large costs for non-commercial debtors with respect to Part X arrangements and informal agreements did not bind dissenting creditors. As a result the legislature enacted the debt agreement procedure as an extra option aimed specifically at low income debtors.

²⁴³Murray and Harris *Insolvency: Personal and corporate law practice* 191.

²⁴⁴*Idem* 193.

²⁴⁵Murray and Harris *Insolvency: Personal and corporate law practice* 193

²⁴⁶S 185(1) of the *Bankruptcy Act*. See Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 193 and 194 for a discussion on the definition of "insolvent" under the *Bankruptcy Act*.

²⁴⁷S 185C of the *Bankruptcy Act* Murray and Harris *Keay's Insolvency: Personal and corporate law practice* 194.

²⁴⁸S 6B of the *Bankruptcy Act*.

debtor is required to make the best offer possible to his or her creditors in the debt agreement proposal.²⁴⁹ The proposal may provide for the following solutions to the debtor's creditors in full and final settlement:²⁵⁰

- (a) weekly or monthly payments from the debtor's income;
- (b) a deferral of payments for an agreed period;
- (c) the sale or assignment of an asset to pay creditors; and/or
- (d) a lump sum payment to be divided among creditors.

The debtor may not, however, present the proposal if:²⁵¹

- (a) during the ten years before the debtor's current bankruptcy he or she was legally bankrupt or party to a debt agreement or a Part X arrangement;
- (b) his or her unsecured debts or divisible property are equal or larger than the current threshold amount; or
- (c) his or her taxable income in the year of the proposal is likely to exceed three-quarters of the threshold amount.

The debtor must have a future expected income after tax, unsecured debts, and divisible property within the prescribed amounts.²⁵² The threshold amount for future expected income is AUD 73,259.55 per annum.²⁵³ Unsecured debts and divisible property must be valued at less than AUD 97,679.40.²⁵⁴

Before accepting presentation of the proposal the Official Trustee is obliged to give the debtor information in a similar fashion to the "debtor's declaration of

²⁴⁹Ramsay and Sim 2010 *Federal Law Review* 285.

²⁵⁰S 185C(3) of the *Bankruptcy Act*, 1966. Insolvency and Trustee Service Australia *Personal insolvency information for debtors 7* found at the following site [www.itsa.gov.au/dir228/itsaweb.nsf/docindex/Aboutper_cent20Usper_cent3EPublicationsper_cent3EFormspers_cent20Documents/\\$FILE/ITSA Info to Debtors.pdf?OpenElement](http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/Aboutper_cent20Usper_cent3EPublicationsper_cent3EFormspers_cent20Documents/$FILE/ITSA%20Info%20to%20Debtors.pdf?OpenElement) (last accessed 2012-06-10).

²⁵¹S 185C(4) of the *Bankruptcy Act*.

²⁵²Ramsay and Sim 2010 *Federal Law Review* 286.

²⁵³*Ibid.* S 185C(4)(d) of the *Bankruptcy Act*.

²⁵⁴*Ibid.* Ss 185C(4) and 139K of the *Bankruptcy Act*.

intent to file”, detailed above.²⁵⁵ In addition, the Official Trustee will not accept the proposal until it contains all the information on the plan and the debtor’s finances as set out in sections 185C (3) and 6B of the Act. The debtor must also be legally entitled to present such a proposal.²⁵⁶ Furthermore, where the Official Trustee is of the opinion that refusing the proposal would better serve the interests of the creditors, the proposal will not be accepted.²⁵⁷ It is submitted that this discretion of the Official Trustee to scrutinise the application for a debt agreement in favour of the creditors, is similar to the South African advantage for creditors’ requirement for sequestration.²⁵⁸ In both instances the debtor will not be permitted into a debt relief process unless it will benefit the group of creditors. If the debtor feels aggrieved by the Official Trustee’s refusal he or she may appeal the decision to the Administrative Appeals Tribunal.²⁵⁹

When the proposal is accepted the Official Trustee may either call a meeting of the creditors or correspond with them in writing concerning the proposal.²⁶⁰ The voting process by the creditors on the proposal may be done either in writing or by way of a meeting.²⁶¹ The communication to the creditors must explain the proposal in detail and contain a summary of the statement of affairs.²⁶² Where the communication is in writing the Official Trustee must also request advice from the creditors on whether to accept the proposal or not.²⁶³ The creditors must decide whether to accept the proposal or not within 35 working days after the day the Official Receiver accepted the proposal, or the offer from the debtor lapses.²⁶⁴ In order for a debt agreement to be accepted a majority of the creditors in value must agree to the proposal.²⁶⁵ When this occurs all the creditors are now bound by the debt agreement, including those

²⁵⁵ See par 5.2.1.1 above; Regulation 4.11 and s185E(1) of the *Bankruptcy Act*

²⁵⁶ S 185C of the *Bankruptcy Act*.

²⁵⁷ S 185E(3) of the *Bankruptcy Act*.

²⁵⁸ See par 4.4.1 above.

²⁵⁹ S 185E(4) of the *Bankruptcy Act*.

²⁶⁰ S 185A(1) of the *Bankruptcy Act*.

²⁶¹ *Ibid.*

²⁶² S 185E(3) and (6) of the *Bankruptcy Act*.

²⁶³ *Ibid.*

²⁶⁴ See S 185 and 185G of the *Bankruptcy Act* for the definition of the so-called “applicable deadline” and lapsing of the proposal.

²⁶⁵ S 185H of the *Bankruptcy Act*.

that dissented.²⁶⁶ Next the details of the debt agreement are entered onto the National Personal Insolvency Index.²⁶⁷

There are a number of consequences of the acceptance of a debt agreement proposal. First, the acceptance of the proposal by either the Official Receiver or the creditors constitutes an act of bankruptcy.²⁶⁸ While the debt agreement is in force the debtor's creditors cannot present a petition against the debtor, continue to prosecute a petition that was presented prior to the debt agreement, or enforce a remedy against the debtor.²⁶⁹ There is in effect a *moratorium* on proceedings against the debtor. The secured creditors may, however, enforce their securities on assets offered for credit if the debtor defaults on the debt agreement.²⁷⁰ After the acceptance, the administrator appointed by the debtor or the Official Receiver begins to offset the obligations set by the parties in the debt agreement.²⁷¹ The debtor is released from the debt agreement only once all the obligations under the agreement have been fulfilled.²⁷² Where the debtor is in arrears on payments on the debt agreement for six months the Official Receiver will terminate the debt agreement.²⁷³

Keay notes the following deficiencies with this procedure:²⁷⁴

- (a) there are no specific rules that deal with the setting aside of voidable transactions prior to the debt agreement under this procedure;
- (b) a creditor who wishes to terminate the procedure may apply to have his or her request heard by the other creditors under section

²⁶⁶S 185EC of the *Bankruptcy Act*.

²⁶⁷S 185H of the *Bankruptcy Act*.

²⁶⁸S 40(1)(ha) and (hb) of the *Bankruptcy Act*.

²⁶⁹S 185K of the *Bankruptcy Act*.

²⁷⁰*Ibid.*

²⁷¹*Ibid*

²⁷²S 185N(1) of the *Bankruptcy Act*.

²⁷³S 185QA of the *Bankruptcy Act*.

²⁷⁴Keay *Insolvency: Personal and corporate law and practice* 201.

185P. This may occur any time after the debt agreement is in force and for any reason;

- (c) there are no provisions stopping the debtor from lodging further proposals once one has been rejected. Keay believes this may give rise to abuse of the procedure; and
- (d) since the Official Trustee is not party to the debt agreement the creditors may be saddled with the cost of enforcing the agreement when the debtor defaults.

In a study on the completion rates of debt agreements for a five year period between 1997 and 2001, it appeared that debt agreements are subject to a high rate of non-completion.²⁷⁵ On average just about 25 per cent of debt agreements ended with a complete discharge of all the debtor's obligations during that period.²⁷⁶ It is submitted that these statistics call the efficiency of this process into question.

5.3.2.2 *Part X arrangements*

In short a Part X arrangement involves the debtor presenting the creditors with a proposal as to how his or her financial affairs should be managed.²⁷⁷ Similar to the debt agreement, the debtor's creditors decide whether to reject or accept the proposal. The main advantages of this procedure for the creditors are:²⁷⁸

- (a) the assets of the debtor are controlled by a third party from the moment the Part X arrangement is initiated, reducing the possibility of voidable transactions by the debtor;
- (b) that they can avoid Court proceedings to declare the debtor bankrupt;

²⁷⁵Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 106.

²⁷⁶*Ibid.* However, Ziegel cautions that since the majority of the debt agreements in this study were ongoing and had not reached the end of their projected lifespan, this statistic may not paint a realistic picture of the effectiveness of the procedure.

²⁷⁷Keay *Insolvency: Personal and corporate law and practice* 164

²⁷⁸*Idem* 165.

- (c) that more often than not creditors in these arrangements receive payments well before any such payments would be available in a bankruptcy; and
- (d) debtors are more likely to assign non-divisible property to creditors.

The advantages for the debtor are of course that he or she avoids the stigma of bankruptcy, any limitations placed on his or her status as well as having to contribute part of his or her income to the creditors unless agreed.²⁷⁹

Just like a bankruptcy petition presented by a creditor, the debtor must be legally insolvent and either reside or carry on some form of trade in Australia to present a proposal for a Part X arrangement.²⁸⁰ The debtor also must not have proposed another similar proposal in the previous six months. The debtor may present one of three types of arrangements to his or her creditors:²⁸¹

- (a) The debtor may propose a composition in which he or she agrees to pay his or her debts in instalments.
- (b) The debtor may present a proposal for an assignment of all his or her divisible property in full and final settlement of his or her debt.
- (c) The debtor may present a deed of arrangement which provides for the arrangement of the debtors affairs but is not a composition or an assignment of property.²⁸²

Before a debtor presents a proposal he or she must appoint a third party, known as the controlling trustee, to take control of his or her property and forward the proposal to the creditors.²⁸³ For this appointment the debtor has a choice between a registered trustee, a qualified solicitor, or the Official

²⁷⁹ *Ibid.*

²⁸⁰ S 187(1A) and S 188(1) of the *Bankruptcy Act*.

²⁸¹ Keay *Insolvency: Personal and corporate law and practice* 164.

²⁸² Mason 1999 *Osgoode Hall Law Journal* 455.

²⁸³ Ss 188(1) and 189 of the *Bankruptcy Act*. Insolvency and Trustee Service Australia *Personal insolvency information for debtors* 9.

Trustee.²⁸⁴ Once appointed the controlling trustee must study the proposal and investigate the debtor's affairs. The trustee's examination of the debtor concludes in a detailed report to the creditors.²⁸⁵ The report summarises the controlling trustee's investigation of the debtor's financial affairs, and gives the creditors an indication of the dividend they should expect from the proposal compared to the amount where the debtor is made bankrupt.²⁸⁶ In addition, the controlling trustee recommends whether it is in the creditors' interests to accept the proposal or to make the debtor bankrupt.²⁸⁷

Once the creditors have all been sent the trustee's report, the meeting of creditors must be held within 25 days of the controlling trustee's appointment.²⁸⁸ The debtor is obliged to attend the meeting but may, however, be excused by the trustee.²⁸⁹ The creditors may interview the debtor before taking a vote.²⁹⁰ During the meeting the creditors may resolve by special resolution:²⁹¹

- (a) that they should accept the debtors proposal;
- (b) to release the debtor's property from the charge of the controlling trustee; or
- (c) that the debtor should present his or her own bankruptcy petition within seven days of the resolution.

Where the proposal is accepted, all the creditors are bound by the terms of the arrangement.²⁹² Similar to the debt agreement above, secured creditors'

²⁸⁴It is very rare for the Official Trustee to be appointed for this task and in most case a registered trustee is appointed. See Keay *Insolvency: Personal and corporate law and practice* 172.

²⁸⁵S 189(A) of the *Bankruptcy Act*. The report of the controlling trustee is an integral part of the arrangement process and is the main tool used by the creditors in making their decision to consent. See also *Re Burlock* 1994 49 FCR 522.

²⁸⁶S 189(A) of the *Bankruptcy Act*.

²⁸⁷*Ibid.*

²⁸⁸S 194 of the *Bankruptcy Act* and Regulation 10.04. *Insolvency and Trustee Service Australia Personal insolvency information for debtors* 9.

²⁸⁹*Ibid.*

²⁹⁰S 64S of the *Bankruptcy Act*.

²⁹¹S 204(1) of the *Bankruptcy Act* and Keay *Insolvency: Personal and corporate law and practice* 179.

²⁹²S 229 of the *Bankruptcy Act*.

rights to deal with their security cannot be altered without their express consent.²⁹³ A trustee is appointed to administer the arrangement by the creditors. This trustee may be a registered trustee other than the controlling trustee.²⁹⁴ The new trustee's tasks are similar to those of the bankruptcy trustee and will depend largely on the nature of the arrangement.²⁹⁵ During the existence of the arrangement a *moratorium* on debt enforcement proceedings against the debtor is in effect.²⁹⁶ The arrangement terminates only when the debtor has fulfilled his or her obligations.²⁹⁷

It is important to understand that while it may appear that the Australian debt agreements and Part X arrangements are similar, there are some important differences that make them two separate remedies aimed at different consumers. Debt agreements are subject to income, debt and asset thresholds that make it a remedy specifically for low income and no asset debtors. Part X arrangements are available for all consumers, however the cost of appointing the controlling trustee may not be affordable to low income debtors.²⁹⁸

5.4 Canada

In Canada, similar to the United States and Australia, the federal government is constitutionally authorised to legislate on bankruptcy and insolvency legislation.²⁹⁹ Notwithstanding this fact there is a large amount of overlap between federal and provincial legislation as regards bankruptcy.³⁰⁰ Where

²⁹³ S 229(3) of the *Bankruptcy Act*.

²⁹⁴ S 215A of the *Bankruptcy Act*.

²⁹⁵ Keay *Insolvency: Personal and corporate law and practice* 182.

²⁹⁶ S 228(2) and 238(2) of the *Bankruptcy Act*.

²⁹⁷ S 230 of the *Bankruptcy Act*.

²⁹⁸ See Keay *Insolvency: Personal and corporate law and practice* 172 where he explains that the controlling trustee in practice hardly ever comes from the office of the Official Trustee, meaning that the debtor must bear the cost of appointing a privately registered trustee or solicitor.

²⁹⁹ Ziegel 1999 *Osgoode Hall Law Journal* 205 and 211.

³⁰⁰ Provincial legislation exerts a lot of influence specifically on matters relating to property of the bankrupt exempt from bankruptcy and certain other pre-bankruptcy rules. Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 13.

provincial legislation does not conflict with federal legislation the Canadian Courts are relatively tolerant of the overlap.³⁰¹

Canada and Australia, as well as being the two largest Commonwealth countries, also have similar debt relief systems.³⁰² Canada, however, has three times more individual bankruptcy filings than Australia per annum.³⁰³ In the year 2010 there were 135,008 natural persons who filed for personal insolvency.³⁰⁴ It must be noted that these numbers dropped from a high in 2009 where 151,712 individuals filed for the same procedures.³⁰⁵

In contrast to Tanzania, South Africa and Australia, the majority of matters on corporate insolvency and individual bankruptcy in Canada are regulated in one statute. The *Bankruptcy and Insolvency Act* (R.S 1985 C B-3 The consolidated statutes of Canada)³⁰⁶ provides for the liquidation of an insolvent natural person, a corporation or a partnership.³⁰⁷ This Act also provides for certain rights for the debtor and his or her creditors where receiverships are invoked.³⁰⁸ The law on the insolvency of corporations is further supplemented by the *Companies' Creditors Arrangement Act*, 1985 and the *Winding-up and Restructuring Act*, 1985.³⁰⁹ The following remedies are available under the BIA, where a natural person is in financial distress:

- (a) bankruptcy;
- (b) a consumer proposal under division II of the Act;

³⁰¹ The Courts tolerance of the overlap between federal and provincial statutes has not however always been consistent. See Ryder 1991 *Revue de Droit de McGill* 321.

³⁰² Niemi *et al* *Consumer credit, debt and bankruptcy: Comparative and international perspectives* 226; Sarra *et al* *Annual Review of Insolvency law* 857 and 858 and Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 97.

³⁰³ *Ibid.*

³⁰⁴ www.bankruptcy-canada.ca/trustees-talk/bankruptcy-canada/20110328/bankruptcy-rate-drops-in-canada.html (last accessed 2012-06-10).

³⁰⁵ *Ibid.* The decrease in numbers may be caused by amendments in the bankruptcy rules that increased the cost of filing for bankruptcy procedures. Therefore although a fall in bankruptcy filings is welcome, the numbers may not give an accurate picture of the level of indebtedness in the country. See Sarra 2011 www.papers.ssrn.com/sol3/papers.cfm?abstract_id=1934457 12 for the causes of bankruptcy for Canadian residents.

³⁰⁶ Hereinafter referred to as the "BIA."

³⁰⁷ See in general Bennett *Bennett on bankruptcy* 32.

³⁰⁸ *Ibid.*

³⁰⁹ *Ibid.*

- (c) a consolidation order regulated by Part X of the Act; and
- (d) a commercial proposal under division I of the Act.

5.4.1 Bankruptcy Proceedings

In Canada the bankruptcy of the individual debtor can be brought about in one of two ways: the debtor may make an assignment into bankruptcy, or his or her creditors may file an application for a bankruptcy order to that effect.³¹⁰ These remedies are available only if the debtor is insolvent. Under section 2(1) of the BIA an insolvent person is defined as:

- 2(1).... a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
- (a) who is for any reason unable to meet his obligations as they generally become due,
 - (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
 - (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.

5.4.1.1 Assignment into bankruptcy by the debtor

An insolvent corporation, natural person or partnership may file an assignment into bankruptcy for the benefit of his or its creditors.³¹¹ The assignment document must be attached with a sworn statement of affairs detailing the insolvent's property and known creditors.³¹² Both these documents must be filed with the Official Receiver in the district where the insolvent resides or carries on some form of trade.³¹³ The insolvent performs this assignment as a voluntary act to place him or herself into bankruptcy.³¹⁴ Although under the BIA the Official Receiver is the person authorised to

³¹⁰Sarra 2009 *Banking and Financial Law Review* 7; Bennett *Bennett on bankruptcy* 114 and Houlden *et al the 2008 Annotated Bankruptcy and Insolvency Act* 130 and 132. See also www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02320.html (last accessed 2012-06-10).

³¹¹S 49(1) of the BIA.

³¹²S 49(2) of the BIA.

³¹³S 49(3) of the BIA. Similar to the Australian system the Official Receiver is obliged to refuse the assignment document if they are defective or the statement of affairs is not in the prescribed form.

³¹⁴Bennett *Bennett on bankruptcy* 148.

appoint the trustee for the insolvent's bankruptcy,³¹⁵ in practice the insolvent individual or corporation names which trustee they prefer, which is then approved by the Official Receiver.³¹⁶ When the Official Receiver accepts the assignment documents and allocates the debtor's estate an estate number and a certificate appointing the trustee, the insolvent is officially bankrupt under the BIA.³¹⁷

Where the debtor is filing for summary administration³¹⁸ the filing fee is CAD \$75 if the debtor is a first-time bankrupt under the laws of Canada.³¹⁹ For any other type of bankruptcy the filing fee is CAD \$150.³²⁰ Canada does not make provision for an *in forma pauperis* filing for the indigent insolvent.³²¹

In practice the procedure followed by a debtor to assign themselves into bankruptcy can be summarised in the following steps:³²²

- (a) Under *Directive 1R2* from the Office of the Superintendent of Bankruptcy of 1998, an insolvent individual who wishes to undergo bankruptcy must first contact and submit him or herself to a mandatory assessment by a licensed trustee, solicitor or qualified counsellor.³²³ The trustee's task at this point is to review the insolvent's state of affairs for warning signs of financial difficulties,

³¹⁵S 49(4) of the BIA.

³¹⁶Bennett *Bennett on bankruptcy* 148.

³¹⁷*Ibid.* This interpretation of s 49(4) of the BIA was held in *Re Copeland* 2001 CBR 201 (Ontario Dept. Reg.)

³¹⁸The summary administration procedure in Canada is similar to the administration of small estates procedure in Tanzania, a process explained above in par 3.3. Summary administration is a streamlined version of the main bankruptcy procedure that has less statutory formalities to reduce the cost of filing a bankruptcy where the debtor's estate is small.

³¹⁹Rule 138(1)(a) of the *Bankruptcy and Insolvency General Rules, 2011*. See also Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 20. 75 Canadian dollars was the equivalent of approximately 73.35 United States dollars on 2011.06.18.

³²⁰150 Canadian dollars was the equivalent of approximately 147 United States dollars on 2011.06.18.

³²¹Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 20 and 21.

³²²Bennett *Bennett on bankruptcy* 149 and 150.

³²³*Ibid.* This assessment is mandatory for both normal consumers and persons involved in commerce, and is part of the debt counselling programme introduced by the Canadian legislature to educate bankrupts. For a detailed discussion see par 5.3.1.4 below. See also www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01091.html (last accessed 2012-06-10).

spending patterns and the individual's money management. The purpose of this review is to assist the insolvent to explore all the alternatives to bankruptcy and allow him or her to make an informed decision;³²⁴

- (b) where the insolvent decides to enter into bankruptcy, the trustee assists the debtor to prepare the assignment document and the statement of affairs in the required form;³²⁵
- (c) once these documents are complete they are filed with the Official Receiver who will in turn assign the insolvent's estate with a number and issue the trustee with an appointment certificate. The Official Receiver also determines how much security must be given by the trustee before he or she can take up his or her appointment;³²⁶ and
- (d) after the issuing of the trustee appointment certificate, the debtor is officially bankrupt. To complete the process the trustee must then submit to the Official Receiver an Estate Information Summary Form.

Once the trustee has been appointed he or she administers the insolvent's estate either by ordinary bankruptcy administration or by summary administration.³²⁷

Sections 155 to 157 of the BIA that regulate summary administrations apply to an insolvent's estate where the bankrupt is a natural person and where all his or her realisable assets do not exceed CAD \$15,000.³²⁸ The BIA allows the trustee to save costs throughout the summary administration procedure.³²⁹ Firstly, where the debtor's realisable assets do not exceed the threshold amount, the trustee is not required to post security for his or her

³²⁴ *Ibid.*

³²⁵ Sarra 2009 *Banking and Financial Law Review* 7.

³²⁶ *Ibid.* See also *Re Mitchell* 1985 CBR NS 67 (NB QB) with regard to the discretion of the Official Receiver with respect to the amount of security.

³²⁷ Bennett *Bennett on bankruptcy* 115.

³²⁸ *Insolvency Circular* 2R2 of 6 November 2009. 15,000 Canadian dollars is the equivalent of approximately 14,357 United States dollars on 2011.06.18.

³²⁹ Bennett *Bennett on bankruptcy* 385.

appointment.³³⁰ Secondly, the trustee does not need to post a bankruptcy notice in any local newspapers and the notices sent to the creditors may be sent by ordinary mail as opposed to the more expensive registered mail, in the normal administration process.³³¹ There is also no requirement of a first meeting of creditors unless it is requested by 25 per cent of the creditors with proven claims.³³² In addition, the fees of the trustee are fixed by tariff to keep them reasonable.³³³ If the conditions are met by the bankrupt's estate, summary administration is compulsory.

5.4.1.2 *The creditor's application for a bankruptcy notice*

The insolvent individual's creditor(s) may file an application for a bankruptcy order against a debtor.³³⁴ In so doing the following requirements must be met:

- (a) the creditor must be owed CAD \$1000 by the debtor;³³⁵ and
- (b) the debtor must have committed an act of bankruptcy within six months of the filing of the application for bankruptcy of the debtor.³³⁶

Under section 48 of the BIA a creditor cannot apply for a bankruptcy order against any person whose income is derived solely from fishing and farming. These individuals however can assign themselves into bankruptcy.³³⁷ The creditor does not need to prove the exact amount of the debt, rather he or she must prove that on the date of the application the debtor owes him or her at

³³⁰S 155(b) of the BIA. However, it may be required by the Official Receiver, in which case the trustee will have to give security.

³³¹S 155(c) and (d) of the BIA.

³³²S 155(d.1) of the BIA.

³³³R 128 of the *Bankruptcy Rules*, 2009. The fee tariffs are adhered to quite strictly. Not even the Courts are allowed to increase the trustee's fees, even where he or she did a lot of additional work. In this regard see *Wasserman, Arsenault Limited v Sone* 2002 33 CBR (4th) 145 (Ont. CA) and *Re Frustuglio* 1985 56 CBR (NS) 158 (Ont. SC).

³³⁴S 43(1) of the BIA.

³³⁵S 43(1) of the BIA. 1,000 Canadian dollars was the equivalent of approximately 957.13 United States dollars on 2011.06.18.

³³⁶S 49(1) of the BIA.

³³⁷Houlden *et al the 2008 Annotated Bankruptcy and Insolvency Act* par 2–15. It is noted that the word used in the BIA is "individual", so this defence may obviously not be raised by a company.

least CAD \$1000.³³⁸ The creditor may not use the bankruptcy process to merely collect a debt.³³⁹ This will be viewed by the Court as an abuse of the Court process and the application will be dismissed.³⁴⁰ For this reason if in the creditor's application he or she fails to demonstrate that there are other creditors who are also owed money by the debtor, the creditor must also prove that "special circumstances" exist for him or her to receive a bankruptcy order.³⁴¹ There are three distinct types of special circumstances set out by the case of *re Holmes*:³⁴²

- (a) Where the creditor has made numerous demands to the debtor for him or her to pay his or her debts and the latter has failed to meet those demands.
- (b) Where the application creditor is a "significant" creditor and special circumstances such as fraud exist that require the bankruptcy process to protect the interests of the creditor.
- (c) The debtor confirms that he or she cannot pay his or her creditors in general although these other creditors are not identified.

The creditor's bid to bankrupt a debtor must be adjudicated by the Court at a hearing.³⁴³ At the hearing of the application, the Court will require proof of the facts alleged in the application and of the service of the application.³⁴⁴ Where the Court is satisfied with the proof, it may make a bankruptcy order.³⁴⁵

³³⁸ *Re Electra* 1979 39 CBR (NS) 141 (Ont. SC).

³³⁹ *Re Aarvi Construction Co* 1978 29 CBR (NS) 265 (Ont. SC). See also Bennett *Bennett on bankruptcy* 123. This position is similar to the Australian system see par. 5.2.2 above.

³⁴⁰ *Ibid. Re Mastronardi* 2000 21 CBR 107 (Ont. CA).

³⁴¹ *Re Holmes* 1975 20 CBR (NS) 111 (Ont. SC).

³⁴² *Ibid.* These 3 categories of special circumstances were confirmed by the Canadian Court of Appeal in the case *Valente v Fancy Estate* 2004 70 OR 47 CBR 317 (Ont. CA). This intolerance of the single creditor is questioned in the case of *Datamatics Limited v Parax Development International Inc.* 2003 40 CBR 43 (Sask. QB). See also Bennett *Bennett on bankruptcy* 119.

³⁴³ S 48(6) of the BIA.

³⁴⁴ *Ibid.*

³⁴⁵ *Ibid.*

5.4.1.3 *Mandatory counselling for bankrupts*

Since its introduction in 1992, counselling is compulsory for all bankrupts in Canada.³⁴⁶ In this respect the Canadian system is similar to the United States where bankruptcy is compulsory for all bankrupts.³⁴⁷ In theory, bankruptcy counselling is intended to provide financially stressed debtors with financial education.³⁴⁸ This type of counselling also applies to one of the alternatives to bankruptcy known as consumer proposals.³⁴⁹ Bankrupts who refuse or neglect the counselling process are not eligible for an automatic discharge.³⁵⁰ With regard to the debtor's assignment into bankruptcy, as already detailed above,³⁵¹ the counselling process begins with the debtor's assessment by the licensed trustee prior to his or her filing the assignment documents.³⁵² Once in bankruptcy the bankrupt is obliged to attend two approximately one hour counselling sessions during the nine-month period before the automatic discharge is available to him or her.³⁵³

These counselling sessions have different objectives. The first counselling session takes place between ten and 60 days after the debtor enters bankruptcy or files a consumer proposal.³⁵⁴ This session is used by the trustee/counsellor to provide the debtor with information on money management and efficient spending habits.³⁵⁵ The second session has to take place more than one month after the first session and within 210 days after entering bankruptcy or filing a consumer proposal.³⁵⁶ In this session, known

³⁴⁶ Berry and McGregor 1999 *Osgoode Hall Law Journal* 370 and Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 50.

³⁴⁷ See par 5.2.1 below.

³⁴⁸ *Ibid.* See also *Directive 1R2* from the Office of the Superintendent of Bankruptcy, 1998 where an explanation of mandatory counselling is given. "Counselling" means "to assist and educate bankrupts and/or relatives of bankrupts, or consumer debtors, on good financial management, including prudent use of consumer credit and budgeting principles; in developing successful strategies for achieving financial goals and overcoming financial setbacks; and at any time, where appropriate, making referrals to deal with non-budgetary causes of insolvency (these include any addictions and marital problems)."

³⁴⁹ S 66.13(2) of the BIA. See par 5.3.2 below in respect of consumer proposals.

³⁵⁰ S 157.1(3) of the BIA.

³⁵¹ See par 5.3.1.2 above.

³⁵² *Ibid.*

³⁵³ Schwartz 2005 www.ic.gc.ca 2.

³⁵⁴ *Directive 1R2* from the Office of the Superintendent of Bankruptcy, 1998.

³⁵⁵ Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 50.

³⁵⁶ *Ibid.*

as the “Identification of Road Blocks to Solvency and Rehabilitation”, the trustee sets out to determine if there are any non-financial reasons for the debtor’s money problems.³⁵⁷

There appears to be consensus among commentators on bankruptcy counselling that the value of the counselling process is not substantial.³⁵⁸ A statistical study undertaken by Schwartz that was aimed at measuring the creditworthiness of counselled bankrupts against those that were uncounselled over a ten year period showed hardly any substantive differences between these two groups.³⁵⁹ It was therefore concluded in this study that there is little evidence to show that bankruptcy counselling improves a former bankrupt’s credit worthiness.³⁶⁰

5.4.1.4 *Surplus income payments*

Under section 68 of the BIA the licensed trustee administering the bankrupt estate is obliged to review the bankrupt’s income and expenses and determine if he or she should make payments to the bankrupt estate.³⁶¹ The trustee uses information published by the Superintendent of Bankruptcy to calculate any surplus income the bankrupt must pay into the bankrupt estate for the benefit of his or her creditors.³⁶² The process to be followed in practice is set out in the Court of Appeal case of *Re Landry*.³⁶³

³⁵⁷Curnock 1999 *Osgoode Hall Law Journal* 387.

³⁵⁸Ziegel Comparative consumer insolvency regimes: A Canadian perspective 50; Ziegel 1996 *Canadian Business Law Journal* 108; Ramsay 2001 *Fordham Journal of Corporate and Financial Law* 541 and Schwartz 2005 www.ic.gc.ca 3.

³⁵⁹Schwartz 2003 *American Bankruptcy Law Journal* 227. See Block-Lieb 2001 *et al Fordham Journal of Corporate and Financial Law* 505 for a discussion on the rationale behind post-bankruptcy debtor education.

³⁶⁰*Ibid.* By comparison it is noticeably easier for an Australian debtor to enter into bankruptcy, as there are no mandatory counselling requirements by a trustee before the filing of the debtor’s petition in Australia.

³⁶¹Bennett *Bennett on bankruptcy* 256.

³⁶²*Ibid.* S 68(1) and (3) of the BIA. See *Directive 11R* by the Superintendent of Bankruptcy October 2000. The Superintendent of Bankruptcy, similar to the Master of the High Court in South Africa, is an administrative office that ensures that bankruptcies in Canada are conducted in an orderly manner and adhere to statutory direction.

³⁶³2000 50 OR 1 (CA). Due to the similarity with the Australian position it is unnecessary to further discuss the process.

5.4.1.5 Discharge³⁶⁴

Similar to the South African regime³⁶⁵ the Canadian bankruptcy process makes provision for both an automatic discharge and an application to a force discharge on the creditors. Under section 168.1 of the BIA a first-time bankrupt may be automatically discharged after nine months if he or she is not required by law to make surplus income payments.³⁶⁶ Where the bankrupt is obliged to make surplus income payments he or she will be eligible for an automatic discharge only after 21 months.³⁶⁷ The automatic discharge may be opposed by the creditors, the trustee or the Superintendent of Bankruptcy at any time before the nine month period has lapsed.³⁶⁸ Where the debtor receives an opposition notice to his or her automatic discharge, section 168.1 does not apply.³⁶⁹ The trustee must then apply to the Court for a hearing on the opposition notice immediately.

The nine-month automatic discharge is not granted to everyone, there are conditions. Where the insolvent debtor is involved in his or her second or more bankruptcy, he or she is eligible for an automatic discharge only after 24 months from the date of bankruptcy if he or she is not liable for surplus income payments.³⁷⁰ Where this type of debtor does have to make surplus income payments, he or she will be eligible for an automatic discharge only after 36 months from the date of bankruptcy.³⁷¹ In addition the debtor is not eligible for an automatic discharge where he or she owes the Canadian

³⁶⁴See in general Rickett and Telfer *Consumer bankruptcy in a global perspective* 231.

³⁶⁵See par 4.3 above.

³⁶⁶*Re Teles* 1999 1 CBR 43 (Ont. Gen. Div), Bennett *Bennett on bankruptcy* 405. See also www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01861.html#toc8 (last accessed 2012-06-10).

³⁶⁷S 172.1(1)(a)(ii) of the BIA.

³⁶⁸S 168.2(1) of the BIA.

³⁶⁹S 168.2(2) of the BIA. Under s 170.1 of the BIA where the opposition notice is based on the fact that the bankrupt did not pay the required amount of surplus income, or the bankrupt chose bankruptcy rather than a formal alternative to bankruptcy as a solution to his or her debt, the trustee must request the Official Receiver to chair mediation proceedings between the parties. A trustee may not apply to the Court for a hearing to oppose a first-time bankrupt's automatic discharge if he or she does not have enough trust money to cover his or her fees, as the Court may choose to censor the trustee for conduct unbecoming a licensed trustee. See also Bennett *Bennett on bankruptcy* 407.

³⁷⁰S 172.1(1)(b)(i) of the BIA.

³⁷¹S 172.1(1)(b)(ii) of the BIA.

Revenue Authority CAD \$200,000 or more in income tax, representing 75 per cent or more of his or her total unsecured claims.³⁷²

The Canadian model for the application for discharge of a bankrupt is based on the British *Bankruptcy Act* of 1914.³⁷³ Under section 169(1) of the BIA the act of an insolvent person, who is not entitled to an automatic discharge to become bankrupt, operates as an application for discharge *ex lege*. The trustee must, in not less than three months and not more than one year after the date of the insolvent's bankruptcy, obtain an appointment with the Court for a hearing of the discharge application.³⁷⁴ The trustee must prepare a report for the Court to consider during the application for the debtor's discharge.³⁷⁵ This report is given considerable weight by the Court, but in the end the Court has the final decision on whether or not to grant a discharge order.³⁷⁶

The Court proceedings during a discharge hearing are summary proceedings. The Court therefore dispenses with most formalities and is charged simply with determining whether the bankrupt should be discharged or not.³⁷⁷ The exact process and how the facts should be considered during discharge hearings are not set out in the BIA. Hence these issues are regulated by provincial legislation and differ from province to province.³⁷⁸ In general

³⁷²S 172.1 of BIA. This provision was inserted by the 2009 amendments to the BIA to combat individuals that were seeking personal insolvency strictly to wipe out their income tax debt. See also www.lbblaw.ca/res/LawNow36-1_Shaw.pdf (last accessed 2012-06-10).

CAD \$200,000 was the equivalent of USD \$196,618.29 on 8-11-2011.

³⁷³Telfer 1994 *Canadian Business Law Journal* 357 and Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 14 and 38. The Tanzanian *Bankruptcy Act* is also heavily based on this British Act. As a result the provisions for a bankrupt's discharge in Tanzania and Canada are quite similar. Due to this likeness a detailed discussion on Canadian applications for discharge will not be necessary.

³⁷⁴S 169(1) of the BIA

³⁷⁵S 170(1) of the BIA.

³⁷⁶*Re Heinonien* 1990 3 CBR (3d) 1 (BC CA). See par 3.3.6.1 above where the Tanzanian report is prepared by the Official Receiver.

³⁷⁷Bennett *Bennett on bankruptcy* 408.

³⁷⁸For a discussion on the different provincial procedures see Bennett *Bennett on bankruptcy* 409 to 410.

however, the Canadian Courts consider the interests of the creditors, the rehabilitation of the bankrupt and the integrity of the bankruptcy system.³⁷⁹

Under section 173(10)(a) of the BIA the Canadian Court cannot grant an absolute discharge to a bankrupt who does not have enough assets to settle 50 per cent of his or her unsecured debts.³⁸⁰ The Court, however, has the discretion to grant an absolute discharge where the debtor can prove that his or her inability to pay off 50 per cent of the debts is no fault of his or her own.³⁸¹ Further to this discretion under section 170, the Canadian Court also has an unconditional discretion that has developed through case law, to grant an absolute discharge in cases of hardship.³⁸²

5.4.2 Alternatives to Bankruptcy

An insolvent debtor in Canada, seeking relief from his or her creditors but not through bankruptcy, has a number of options.³⁸³ He or she may opt for formal alternatives to bankruptcy such as a statutory consolidation order, a consumer proposal or a commercial proposal. There are also informal alternatives such as credit counselling services that operate similarly to debt counselling in South Africa. These are however not regulated by statute and are only active in some provinces, such as Ontario.³⁸⁴ It has been pointed out however, that the impact of this service on relieving over-indebtedness is minimal.³⁸⁵ This discussion of alternatives to bankruptcy will therefore focus on the formal alternative processes identified in the BIA. In Canada the debtor may offer his or her creditors a proposal in full and final settlement of his or her debts.³⁸⁶ Similar to the Australian system there are also two types of these proposals, one general proposal procedure designed for commercial debtors, and one

³⁷⁹ *Re Crowley* 1984 54 CBR (NS) 303 (NS TD) and *Re Cote* 1991 42 CBR 209 (Ont. Gen. Div).

³⁸⁰ It is noted that the provision under section 170(10) of the BIA that includes an advantage to creditors requirement is similar to section 29(3) of the Tanzanian *Bankruptcy Act*.

³⁸¹ S 173(10)(a) of the BIA.

³⁸² See the case of *Re Smith* 1989 74 (NS) 183 (Nfld TD) for a discussion on what constitutes hardship. See also *re Henderson* 1992 24 CBR (Ont. Gen Div) and *re Chaytor* 2006 26 CBR 274 (BS Reg).

³⁸³ Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 45.

³⁸⁴ *Ibid.* www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02049.html (last accessed 2012-06-10).

³⁸⁵ Ziegel 1997 *Journal of Consumer Policy* 209.

³⁸⁶ Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 104 and 105.

strictly for ordinary consumers. In addition, debtors in specific provinces have the option of a consolidated debt order.

5.4.2.1 *Consumer proposals under division II*

The BIA, under Part III Division II, allows the insolvent to offer his or her creditors a compromise in the form of a consumer proposal.³⁸⁷ This alternative to bankruptcy is similar to the Chapter 13 repayment plan in the United States, discussed above.³⁸⁸ Consumer proposals are available only to natural persons.³⁸⁹ Before the amendments of the BIA in 1992 this procedure did not exist. The BIA did not differentiate between commercial and ordinary consumers' proposals as it does now.³⁹⁰ All insolvents could suggest a proposal to their creditors to avoid the hassles of bankruptcy. The introduction of the division II proposal was intended to streamline the procedure by reducing costs and expediting the procedure for ordinary consumers.³⁹¹

Division II consumer proposals are available only to natural persons whose debts are less than CAD \$250,000 and where the debtor's mortgage on his or her principal residence is excluded.³⁹² In order to initiate proceedings that lead to a consumer proposal, the debtor must enlist the aid of an administrator in preparing the consumer proposal.³⁹³ The debtor must provide the administrator with all his or her financial information so that the administrator is able to complete an assessment of the debtor's current financial position.³⁹⁴ The administrator must also provide compulsory counselling to the insolvent, educating him or her on good financial management and how to remain

³⁸⁷ Bennett *Bennett on bankruptcy* 163.

³⁸⁸ See par 5.2.1 above.

³⁸⁹ Sarra 2009 *Banking and Financial Law Review* 9.

³⁹⁰ *Ibid.*

³⁹¹ *Ibid.* See Bennett *Bennett on bankruptcy* 163 and Office of the Superintendent of Bankruptcy (OSB), *Annual Report, 2007* 37. This report can be found at [www.strategis.ic.gc.ca/epic/site/bsf-osb.nsf/vwapj/annual-report2007.pdf/\\$FILE/annual-report2007.pdf](http://www.strategis.ic.gc.ca/epic/site/bsf-osb.nsf/vwapj/annual-report2007.pdf/$FILE/annual-report2007.pdf) (last accessed 2012-06-10).

³⁹² *Ibid.* S 66.11(b) of the BIA. CAD \$250,000 was the equivalent of USD \$245,678.11 on 8-11-2011.

³⁹³ S 16.13(1)(a) An administrator may be any licensed trustee. Their duties with regard to consumer proposals are set out in s 16.13(2) of the BIA.

³⁹⁴ S 66.13(1) and (2) of the BIA.

solvent.³⁹⁵ The administrator must then prepare a consumer proposal and a statement of affairs which are to be filed with the Official Receiver.³⁹⁶ Within ten days following the filing of the proposal, the administrator must prepare and file a report on the results of his or her investigation with the Official Receiver.³⁹⁷ The report must include his or her opinion, based on the investigation, as to whether the consumer proposal is fair to the parties involved and if it is realistic.³⁹⁸ With the report a shortened statement of the debtor's affairs and a list of the creditors whose claims exceed CAD \$250 dollars are attached.³⁹⁹ Once the proposal has been filed with the Official Receiver an automatic stay on enforcement proceedings against the insolvent comes into force.⁴⁰⁰

The administrator must send to the creditors a copy of the report, proposal, claim forms and a note explaining that a meeting of creditors will be called only if the creditors request it or the Official Receiver directs the administrator to call a meeting within 45 days of the proposal being filed.⁴⁰¹ The creditors must consider the proposal and reply to the administrator within 45 days indicating whether they accept or reject the proposal.⁴⁰² The creditors may accept or refuse the consumer proposal by passing an ordinary resolution.⁴⁰³ Once the proposal has been accepted by the creditors and 15 days have elapsed with no interested party filing an opposition to the proposal in Court, the proposal is deemed to be approved by the Court.⁴⁰⁴ The Court itself

³⁹⁵S 66.13(1)(b) of the BIA.

³⁹⁶S 66.13(1)(b) of the BIA. The trustee must ensure that the consumer proposal provides for the payment of preferred claims; for the payment of all prescribed fees and expenses of the administrator related to the proposal proceedings, and of any person providing counselling. The proposal must also set out the manner of distributing dividends. See also Sarra 2009 *Banking and Financial Law Review* 9 and 10.

³⁹⁷S 66.14(1)(a)(i) of the BIA. Sarra 2009 *Banking and Financial Law Review* 9.

³⁹⁸S 66.14(1)(a)(ii) of the BIA. Bennett *Bennett on bankruptcy* 164.

³⁹⁹*Ibid.* Read with s 66.14(1)(a)(iv) of the BIA. \$250 Canadian dollars was the equivalent of approximately \$245 United States dollars on 2011.06.18.

⁴⁰⁰S 69(2) of the BIA.

⁴⁰¹S 66.15 of the BIA. See also Sarra 2009 *Banking and Financial Law Review* 10.

⁴⁰²S 66.17 of the BIA.

⁴⁰³S 66.19 of the BIA. Bennett *Bennett on bankruptcy* 165.

⁴⁰⁴S 66.22 of the BIA.

however, is not involved in this process unless such an engagement is required by the Official Receiver.⁴⁰⁵

Once the proposal is accepted it is binding on all unsecured creditors and the secured creditors where they were part of the voting process in the required manner.⁴⁰⁶ In order for the consumer proposal to be binding on secured creditors a majority in number and a two thirds majority in value of the secured creditors must accept the proposal.⁴⁰⁷ Unlike in commercial proposals, secured creditors and unsecured creditors vote in one class.⁴⁰⁸ Where the obligations of the proposal have been fully performed, the administrator lodges a certificate of full performance with the Official Receiver and provides an original copy to the debtor.⁴⁰⁹ A proposal typically takes three to five years to complete the payment schedule.⁴¹⁰ The administration of a consumer proposal may not, however, take more than five years.⁴¹¹

The Office of the Superintendent of Bankruptcy reports that the failure rate of consumer proposals is approximately 30 per cent.⁴¹² Regardless of this failure rate, they remain quite popular with Canadian consumers.⁴¹³

5.4.2.2 *Commercial proposals under division I*

Commercial proposals under the BIA are available for natural persons and corporations and are commonly initiated where the debts are more than CAD \$250,000.⁴¹⁴ The BIA does not contain a specific formula as to the form of compromise that may be presented in the proposal⁴¹⁵ and consequently,

⁴⁰⁵ *Ibid.*

⁴⁰⁶ S 62(2) of the BIA.

⁴⁰⁷ *Ibid.*

⁴⁰⁸ S 66.19(1) of the BIA.

⁴⁰⁹ S 66.38(1) of the BIA. Bennett *Bennett on bankruptcy* 1347.

⁴¹⁰ Bennett *Bennett on bankruptcy* 205 and Sarra 2009 *Banking and Financial Law Review* 9.

⁴¹¹ *Ibid.*

⁴¹² www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br01667.html (last accessed 2012-06-10). See Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 46 and Sarra 2009 *Banking and Financial Law Review* 10.

⁴¹³ Ramsay 2000 *American Bankruptcy Law Journal* 339 and Ziegel 2007 *Illinois Law Review* 200.

⁴¹⁴ Sarra 2009 *Banking and Financial Law Review* 11.

⁴¹⁵ Bennett *Bennett on bankruptcy* 158.

similar to the Australian arrangement and debt agreement, they are quite flexible. As with consumer proposals, the insolvent works with the trustee to negotiate an offer to be presented to the creditors. The most popular solutions are payments to the creditors in partial fulfilment of their debts over a specific period of time or an extension on the payment period for the debts, or both.⁴¹⁶ These payments are then made to the creditors through the trustee.⁴¹⁷

The process for the application of a commercial proposal is similar to the Division II consumer proposal in many respects. The insolvent individual engages a licensed trustee to assist him or her in filing the proposal with the Official Receiver.⁴¹⁸ To this end the trustee must file the following documents with the Official Receiver:⁴¹⁹

- (a) the proposal must be filed on the day of filing for the commercial proposal;⁴²⁰
- (b) the insolvent's cash flow statement;⁴²¹
- (c) the trustee's report on the reasonableness of the cash flow statement;⁴²² and
- (d) the debtor's report on his or her representations while preparing the statement above.⁴²³

It often occurs that the insolvent and the trustee need some time to prepare the proposal and the annexing documents.⁴²⁴ In these cases the BIA allows the insolvent to file a notice of intention to make a proposal.⁴²⁵ Filing this

⁴¹⁶ *Ibid.*

⁴¹⁷ *Ibid.*

⁴¹⁸ S 62(1) of the BIA.

⁴¹⁹ Bennett *Bennett on bankruptcy* 153.

⁴²⁰ S 50(2) of the BIA.

⁴²¹ S 50(6)(a) of the BIA. Cash flow statements projecting the insolvent's income must be filed continually at least once a month.

⁴²² S 50(6)(b) of the BIA.

⁴²³ S 50(6)(c) of the BIA.

⁴²⁴ Sarra 2009 *Banking and Financial Law Review* 11.

⁴²⁵ S 50.4 of the BIA.

notice gives the insolvent an automatic stay for 30 days, and time to prepare his or her proposal for submission.⁴²⁶

A creditor's meeting must take place within 21 days of the filing of the proposal with the Official Receiver.⁴²⁷ At this meeting a majority of the creditors with proven claims in number and two thirds in value of the claims are required before the proposal is deemed accepted under the BIA.⁴²⁸ Before the terms of the proposal are accepted they must be approved by the Court.⁴²⁹ Where the proposal is rejected by the creditors or the Court, both actions amount to the automatic assignment of the debtor into bankruptcy.⁴³⁰

5.4.2.3 *Statutory consolidation of debt*

Debt consolidation orders under section 219 of the BIA are only available in provinces that have officially requested the section's application.⁴³¹ Currently they include Manitoba, Nova Scotia, British Columbia, Prince Edward Island, Alberta and Saskatchewan.⁴³² A consolidation order is issued by a provincial Court and has the effect that all the insolvent's debts are combined into a single debt.⁴³³ The Court then determines the amount which the debtor will pay in instalments and the length of the payment period.⁴³⁴ The Court also takes it upon itself to ensure that the creditors are all paid on time by making the necessary distributions to the creditors itself.⁴³⁵ This process is administered by the Clerk of the Court.⁴³⁶ Consolidation orders do not apply to any debts that are owed to the State, nor to any debt in respect of a charge or agreement of sale over land, and any amount owed by a trader that arose out of the course of his or her business.⁴³⁷ Although at first this procedure was

⁴²⁶ *Ibid.*

⁴²⁷ S 51(1) of the BIA.

⁴²⁸ S 54(2)(b) and 62(2)(b) of the BIA. Sarra 2009 *Banking and Financial Law Review* 11.

⁴²⁹ S 59 and 58 of the BIA.

⁴³⁰ S 57(a) and 61(2) of the BIA. Bennett *Bennett on bankruptcy* 160.

⁴³¹ Bennett *Bennett on bankruptcy* 497. See also www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02049.html (last accessed 2012-06-10).

⁴³² S 27 of the *Orderly Payment of Debts Regulations* (C.R.C. c. 369) 1998.

⁴³³ *Ibid.* See also Goode *Consumer Credit* 208.

⁴³⁴ *Ibid.*

⁴³⁵ *Ibid.*

⁴³⁶ S 217 of the BIA.

⁴³⁷ S 218(2) of the BIA.

meant to be used only for debts that did not exceed CAD \$1000, section 28(a) of the *Orderly Payment of Debts Regulations* (C.R.C c. 369) of 1998 allows this procedure to be used for all amounts of debts that are not specifically excluded.⁴³⁸

A debtor who lives in one of the provinces identified above may apply to the Clerk of the Court for a consolidation order.⁴³⁹ Upon receiving and filing the application the Clerk of the Court must cause a notice to be sent to all creditors informing them of the application for a consolidation order, their right to object to such an order, and the time and place of the Clerk's hearing of the application.⁴⁴⁰ After reading the affidavit and hearing the debtor and creditors, the Clerk of the Court will make a decision on the facts and decide whether or not to issue the order.⁴⁴¹ Where he or she decides to issue the order, he or she must decide on the amounts that are to be paid by the creditors to the Court and at what time intervals.⁴⁴² These details are presented in the order to the debtor and creditors.⁴⁴³ The effect of the order is a Court judgment in favour of all the creditors listed in the order for the amount that appears in the order.⁴⁴⁴ Secondly, the debtor is under Court order to pay the creditors, through the Court, the amounts stated in the order at the specified time intervals.⁴⁴⁵ Lastly, the amounts owing under the consolidation order bear interest at an amount of five per cent per annum.⁴⁴⁶

5.5 England and Wales

After the recession of the 1990s consumers in the United Kingdom, aided by the availability of credit and a boom in the real estate market, went on a

⁴³⁸ See also Bennett *Bennett on bankruptcy* 495.

⁴³⁹ S 219 of the BIA. The application must be accompanied by an affidavit setting out the debtor's information, the debts he or she has owing, the relationship he or she has with the creditors and all income available to him or her and its expenditure.

⁴⁴⁰ S 220(1) and (2) of the BIA.

⁴⁴¹ S 223(2) of the BIA.

⁴⁴² *Ibid.*

⁴⁴³ S 225(1) of the BIA.

⁴⁴⁴ S 225(2)(a) of the BIA.

⁴⁴⁵ S 225(2)(b) of the BIA.

⁴⁴⁶ S 225(2)(c) of the BIA and S 31 of the *Orderly Payment of Debts Regulations* (C.R.C. c. 369) 1998.

shopping spree.⁴⁴⁷ As a result there has been a large rise in the numbers of debt-ridden consumers seeking relief through formal debt relief procedures. In 1997 there were 24,441 consumers who sought debt relief through formal means; this number almost tripled by 2010, when 135,045 consumers did the same.⁴⁴⁸ Along with this increase there has also been a shift in the demographic profile of insolvency with consumer debtors now making up 70 per cent of total debtors who seek formal debt relief in England and Wales.⁴⁴⁹

The government response to the rising consumer debt levels was first to develop preventative strategies aimed at limiting consumer over-indebtedness.⁴⁵⁰ These strategies focused on financial education and responsible lending.⁴⁵¹ Secondly, the legislature began to prepare a series of reform proposals that sought to modernise the insolvency laws of England and Wales in an attempt to meet the needs of consumers with financial trouble.⁴⁵² A considerable number of these reforms to the laws concerning consumer debt relief as a whole, such as the duration of bankruptcy and individual voluntary agreements, were brought about by the *Enterprise Act* of 2002.⁴⁵³ Currently the following formal debt relief procedures are available for insolvent debtors in England and Wales:⁴⁵⁴

- (a) bankruptcy;
- (b) debt relief orders; and
- (c) individual voluntary arrangements.

There are also informal options for debt relief available to the consumer in England and Wales. The debtor can, with the help of a private institution or a

⁴⁴⁷McKenzie-Skene and Walters 2006 *American Bankruptcy Law Journal* 477.

⁴⁴⁸www.insolvencydirect.bis.gov.uk (last accessed 2012-06-10).

⁴⁴⁹McKenzie-Skene and Walters 2006 *American Bankruptcy Law Journal* 480.

⁴⁵⁰Milman *Personal insolvency law, regulation and policy* 157.

⁴⁵¹Tackling over-indebtedness action plan 2004, available at www.dti.gov.uk/ccp/topics1/pdf1/overdebt0704.pdf (last accessed 2012-06-10).

⁴⁵²McKenzie-Skene and Walters 2006 *American Bankruptcy Law Journal* 480.

⁴⁵³Milman *Personal insolvency law, regulation and policy* 52.

⁴⁵⁴www.bis.gov.uk/insolvency/personal-insolvency (last accessed 2012-06-10).

not-for-profit organisation, set up what is called a “debt management plan”.⁴⁵⁵ This measure involves the organisation negotiating a repayment plan on behalf of the consumer who in turn takes on the responsibility of making monthly payments to his or her creditors.⁴⁵⁶ Interest on the consumer’s debt is normally suspended during the execution of the plan, which normally means the plan will not provide a full discharge.⁴⁵⁷ The debt management plan may be administered by Consumer Credit Counselling Services where it is administered free of charge, or by a Debt Management Company for a price. Debt management companies are not well regulated and have been accused of charging high fees and misleading consumers.⁴⁵⁸ This situation appears to be similar to the administration orders in South Africa, discussed above.⁴⁵⁹

5.5.1 Bankruptcy

The main debt relief procedure available to insolvent individuals in England and Wales is bankruptcy under the *Insolvency Act* of 1986.⁴⁶⁰ Bankruptcy orders are granted by the High Court on the lodging of a petition by a debtor or creditor(s) in the prescribed form and circumstances.⁴⁶¹ Debtors filing for bankruptcy must lodge a statement of affairs with the Court, demonstrating an inability to pay their debts.⁴⁶² Once a bankruptcy order has been granted the majority of bankruptcies are administered by the Official Receiver.⁴⁶³ A private trustee may be appointed by the creditors to succeed the Official Receiver,⁴⁶⁴ but this is normally done when there are enough assets to make the

⁴⁵⁵ Niemi Kiesiläinen *The consumer bankruptcy in global perspective* 216.

⁴⁵⁶ Parliament of Great Britain House of Commons: Business, Innovation and Skills Committee *Debt management: Fourteenth report of session 2010-12* 62.

⁴⁵⁷ Huls 2012 *Journal of Consumer Policy* 504.

⁴⁵⁸ Parliament of Great Britain House of Commons: Business, Innovation and Skills Committee *Debt management: fourteenth report of session 2010-12* 62.

⁴⁵⁹ See par 4.5.1 above.

⁴⁶⁰ *Ibid.*

⁴⁶¹ Ss 264–268, 272 and 373–374 of the *Insolvency Act*, 1986. The application procedure is mostly administrative, petitions are rarely heard in Court. There is a facility (commonly used) for the Court to make the bankruptcy order on the same day that the debtor files the applications.

⁴⁶² S 272 of the *Insolvency Act*, 1986.

⁴⁶³ S 287 of the *Insolvency Act*, 1986. The Official Receiver is an official of the Insolvency Service, an executive agency of the Department of Trade and Industry that is charged, among its other duties, with the proper administration of certain debt relief procedures. See www.insolvency.gov.uk in respect of the role of the Official Receiver.

⁴⁶⁴ Ss 292-296 of the *Insolvency Act*, 1986.

appointment worthwhile, or if there are matters within the bankrupt estate that require an extraordinary investigation.⁴⁶⁵ The debtor must submit him or herself to an initial investigation by the Official Receiver and any private trustee who may subsequently be appointed.⁴⁶⁶ During the course of the bankruptcy the debtor surrenders all his or her non-exempt assets towards the payment of his or her debts.⁴⁶⁷ The surrender of assets may include contributions from his or her surplus income. These contributions are, however, limited to a maximum of three years.⁴⁶⁸

The current discharge dispensation in England and Wales resembles that of Australia in that it relies on the automatic discharge provision.⁴⁶⁹ As a result of amendments promulgated by the *Enterprise Act* of 2002, the *Insolvency Act* of 1986 provides for the automatic discharge of the debtor no later than one year after the commencement of the bankruptcy case.⁴⁷⁰ A debtor may even receive a discharge earlier than one year where the Official Receiver considers that an investigation of the debtor's conduct and affairs is unnecessary or has been completed. Under these circumstances the Official Receiver may file a notice for the debtor's discharge with the Court.⁴⁷¹ Where no objections are made by interested parties to this notice the debtor is discharged from the date the notice was filed with the Court.⁴⁷² This type of discharge is known as an "early discharge."⁴⁷³ The debtor will receive an automatic or early discharge irrespective of the fact that he or she is still making contributions under an income payments order, or that some of his or her assets have yet to be sold.⁴⁷⁴ The discharge does not release the debtor

⁴⁶⁵ McKenzie-Skene and Walters 2006 *American Bankruptcy Law Journal* 480.

⁴⁶⁶ S 291 and 333 of the *Insolvency Act*, 1986.

⁴⁶⁷ Ss 283 and 307–308A of the *Insolvency Act*, 1986.

⁴⁶⁸ Ss 310–310A of the *Insolvency Act*, 1986. An income payment order will only be made where the debtor earns more than he or she needs to support him or herself and his or her family. The final decision is made by a judge on application from the Official Receiver. See www.bankruptcyadvisoryservice.co.uk (last accessed 2012-06-10).

⁴⁶⁹ www.bis.gov.uk/insolvency/personal-insolvency/discharge (last accessed 2012-06-10).

⁴⁷⁰ S 279 of the *Insolvency Act*, 1986.

⁴⁷¹ S 279(2) of the *Insolvency Act*, 1986.

⁴⁷² S 333 of the *Insolvency Act*, 1986.

⁴⁷³ Frieze *Personal insolvency law: In practice* 126.

⁴⁷⁴ S 280(1)(a) of the *Insolvency Act*, 1986.

from the obligations under an income payments order made before the debtor's discharge.⁴⁷⁵

The Official Receiver may apply to the Court to suspend the discharge of a bankrupt who is not complying with his or her duties during the bankruptcy for a specified period of time and the bankrupt must then apply to the Court to have the suspension lifted.⁴⁷⁶ In addition, the discharge provision does not apply to individuals who have been made bankrupt as a result of a criminal bankruptcy order.⁴⁷⁷

5.5.2 Individual Voluntary Arrangements

An individual voluntary arrangement is an alternative to bankruptcy available to debtors under the *Insolvency Act* of 1986. This procedure is a binding consensual agreement between the debtor and his or her creditors on terms set out in a proposal drawn up by the debtor with the assistance of an Insolvency Practitioner.⁴⁷⁸ In order to bind the debtor and his or her creditors to the agreement, a creditors' meeting must be called to consider the proposal and more than 75 per cent of the creditors in value must vote to approve the proposal.⁴⁷⁹ Under section 253(1) of the *Insolvency Act* of 1986 the proposal is required to be "for a composition in satisfaction of the debtor's debts or a scheme of arrangement of his affairs." The interpretation of this provision allows the debtor a wide range of solutions that he or she may offer the creditors, which include surplus income payments and an assignment of property.⁴⁸⁰

⁴⁷⁵S 281(1) of the *Insolvency Act*, 1986.

⁴⁷⁶Ss 279(3)–(5) of the *Insolvency Act*, 1986.

⁴⁷⁷S 264(1)(d) of the *Insolvency Act*, 1986.

⁴⁷⁸McKenzie-Skene and Walters 2006 *American Bankruptcy Law Journal* 492. An insolvent debtor who has not been bankrupted or a debtor subject to a bankruptcy order may propose an individual voluntary arrangement. However, a debtor who has been discharged under the automatic discharge provisions is not a debtor under the definition of the *Insolvency Act* of 1986 and may not make a proposal under this provision. See further Frieze *Personal insolvency law: In practice* 205.

⁴⁷⁹Ss 257–258 of the *Insolvency Act*, 1986.

⁴⁸⁰McKenzie-Skene and Walters 2006 *American Bankruptcy Law Journal* 493.

Once the proposal has been approved by the necessary majority, an individual voluntary arrangement comes into force and binds all the creditors who were entitled to vote, whether they were present at the vote or not.⁴⁸¹ The insolvency practitioner who assisted the debtor during the proposal process becomes the supervisor of the approved individual voluntary arrangement.⁴⁸² The supervisor is responsible for overseeing the implementation of the voluntary arrangement and ensuring that the debtor complies with its terms. Control of the debtor's estate is also given to him or her.⁴⁸³ Where the debtor complies with the terms of the arrangement for its duration, he or she will receive a discharge from all unsecured debts that were outstanding at the commencement of the individual voluntary arrangement while avoiding the publicity and perceived stigma associated with bankruptcy.

The *Enterprise Act* of 2002 introduced a fast-track individual voluntary arrangement procedure that is administered by the Official Receiver.⁴⁸⁴ Fast-track voluntary arrangements can only be proposed by undischarged bankrupts.⁴⁸⁵ This procedure provides a way in which the Official Receiver can channel debtors who have surplus income, out of bankruptcy.⁴⁸⁶ The procedure for fast-tracked voluntary arrangements is significantly more streamlined than that outlined above for the individual voluntary arrangement.⁴⁸⁷ A creditors' meeting is not required for the approval of the fast-track procedure.⁴⁸⁸ The proposal is sent to the creditors by registered mail and they vote for or against the proposal on the form provided and return it to the Official Receiver within the prescribed period.⁴⁸⁹ It is put to the vote on a "take it or leave it" basis. Once the arrangement has been approved the

⁴⁸¹ S 260 of the *Insolvency Act*, 1986.

⁴⁸² S 263 of the *Insolvency Act*, 1986.

⁴⁸³ Ss 260 and 263 of the *Insolvency Act*, 1986. See also Frieze *Personal insolvency law: In Practice* 221.

⁴⁸⁴ S 263A–G and 263 of the *Insolvency Act*, 1986.

⁴⁸⁵ S 263A of the *Insolvency Act*, 1986. See also Davies *Bankruptcy* 47.

⁴⁸⁶ McKenzie-Skene and Walters 2006 *American Bankruptcy Law Journal* 493.

⁴⁸⁷ *Ibid.*

⁴⁸⁸ S 263C of the *Insolvency Act*, 1986

⁴⁸⁹ *Ibid.*

Official Receiver becomes the supervisor of the process and the Court, on application, annuls the bankruptcy order.⁴⁹⁰

5.5.3 Debt Relief Orders

The *Tribunals, Courts and Enforcement Act* of 2007 introduced the debt relief order in 2009.⁴⁹¹ This procedure was intended to be a bankruptcy alternative for debtors with no or close to no assets or income, the so-called NINA cases of “no income no asset” debtors.⁴⁹² This debt relief measure, unlike bankruptcy, is not advertised to the public, making it advantageous to the debtors seeking such an order.⁴⁹³ The procedure normally lasts just about a year during which time the debtor has the advantage of a moratorium against his or her creditors for the claims included in the debt relief order.⁴⁹⁴ Only qualifying debts can be included in a debt relief order. These are debts that arose from liquidated claims that are not excluded from forming part of the order by legislation.⁴⁹⁵

In order to be eligible to apply for a debt relief order the total sum of the consumer’s debts must not exceed £15,000.⁴⁹⁶ Furthermore, among other restrictions, the debtor must not have any assets or savings that exceed £300 or a motor vehicle worth more than £1000.⁴⁹⁷ The debtor must also have a very low income; his or her disposable income per month after living expenses must not exceed £50.⁴⁹⁸

A debtor who meets these requirements may apply to the Official Receiver for a debt relief order through an intermediary, normally a skilled debt advisor.⁴⁹⁹ The procurement of the debt relief order by the debtor does not require judicial approval unless an interested party wishes to file an objection under

⁴⁹⁰S 263D of the *Insolvency Act*, 1986.

⁴⁹¹Sealy and Milman *Volume 1: Annotated guide to the insolvency legislation* 268.

⁴⁹²Clarke *Dealing with debt* 25.

⁴⁹³*Ibid.* See also par 2.5 above.

⁴⁹⁴S 251G, 251H and 251M of the *Insolvency Act*, 1986.

⁴⁹⁵S 251A of the *Insolvency Act*, 1986.

⁴⁹⁶Schedule 4ZA(6) of the *Insolvency Act*, 1986.

⁴⁹⁷Schedule 4ZA(7)–(8) of the *Insolvency Act*, 1986.

⁴⁹⁸*Ibid.*

⁴⁹⁹S 251B of the *Insolvency Act*, 1986.

section 251G of the *Insolvency Act* of 1986. The debt relief order is granted by the Official Receiver and its main effect is to place a moratorium on the qualifying debts listed in the order.⁵⁰⁰ The debtor is not allowed during this period to make any payments to the creditors.⁵⁰¹ Once the moratorium period lapses, after 12 months from the date of the order, although there may be an exception, the listed debts are all discharged.⁵⁰²

5.6 Conclusion

The common law bankruptcy regimes surveyed in this chapter, and Tanzania (true to its British heritage), all carry with them the familiar features of early British bankruptcy legislation.⁵⁰³ This is particularly evident in the uniform ease across these jurisdictions for a debtor to procure a bankruptcy order without any adjudication from the Court. Another trait shared by these jurisdictions is the increased number of preliminary formalities and the need for a Court hearing for creditor petitions before an order of bankruptcy may be granted.⁵⁰⁴ Unlike Tanzania, however, these regimes have a wealth of debt relief knowledge and strategies garnered from evolving separately and catering for the needs of their own unique consumer populations, which will prove useful to Tanzania. A discussion will ensue detailing the findings of the survey and identifying lessons which the Tanzanian system may learn from.

The United States has two main procedures available for consumer debtors, these are the Chapter 7 straight bankruptcy procedure and a court-supervised bankruptcy repayment plan under Chapter 13.⁵⁰⁵ Before 2005 the debtor was entitled to choose between these procedures; this has now been limited by the addition of a means testing provision.⁵⁰⁶ A debtor with regular income that wishes to enter the Chapter 7 bankruptcy procedure may be forced to convert his or her bankruptcy application into a Chapter 13

⁵⁰⁰Clarke *Dealing with debt* 30.

⁵⁰¹S 251H of the *Insolvency Act*, 1986

⁵⁰²S 251I of the *Insolvency Act*, 1986

⁵⁰³Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 14 and 38.

⁵⁰⁴See pars 3.3, 5.2.1 and 5.3.1 above.

⁵⁰⁵Par 5.5.1 above.

⁵⁰⁶Par 5.5.2 above.

repayment plan.⁵⁰⁷ This move was made to address the fact that American debtors before 2005 used the Chapter 7 procedure to acquire a speedy discharge to the detriment of their creditors.⁵⁰⁸ The means test has therefore been used to restore the all-important balance between creditor and debtor interests discussed above.⁵⁰⁹

Both procedures under the American debt relief system require the debtor to undergo credit counselling in the form of consumer education before being admitted into the respective procedures.⁵¹⁰ The Chapter 7 bankruptcy provisions regulate a straightforward liquidation process similar to the one under the Tanzanian *Bankruptcy Act* that is mostly unremarkable apart from the compulsory means test administered to each debtor at the beginning of the procedure.⁵¹¹ It is submitted in this regard that the debt relief system in the United States does not function with two completely separate debt relief procedures, but rather as a close meld of both a bankruptcy procedure and a wage-earner repayment plan.

The wage-earner repayment plan under Chapter 13 consists of a rescheduling of the obligations of the debtor over a three to five year period.⁵¹² The main distinction between this procedure and the Chapter 7 bankruptcy is that under the repayment plan, the debtor is entitled to keep the majority of his or her secured and unencumbered assets.⁵¹³ The debtor may also reschedule his or her secured debts over the requisite time period. This unfortunately does not include the mortgage on the debtor's principle domicile.⁵¹⁴ In order to avoid foreclosure on his or her residence, the debtor may however pay all his or her scheduled payments and those that are in arrears.⁵¹⁵ When applying for the repayment plan, debtors may apply to the

⁵⁰⁷ *Ibid.*

⁵⁰⁸ Par 2.4 above.

⁵⁰⁹ Par 2.6 above.

⁵¹⁰ Par 5.5.2 above.

⁵¹¹ *Ibid.*

⁵¹² Par 5.5.2 above.

⁵¹³ *Ibid.*

⁵¹⁴ *Ibid.*

⁵¹⁵ S 1322(c) of the Code.

Court to make the plan binding on all the creditors where a small minority of the latter group is unreasonably blocking the proposed repayment plan.⁵¹⁶ This is known as a Chapter 13 “cram down” procedure. Once the repayment plan is in force, the debtor can only be discharged from the plan after he or she fulfils all his or her obligations under the plan. The procedure does however contain a provision for the debtor to petition the Court for a “hardship discharge.”⁵¹⁷ The hardship discharge under the plan is a provision used by *bona fide* debtors that are unable to meet their obligations as a result of circumstances beyond their control.⁵¹⁸

In comparison to the United States the Tanzanian debt relief system has a bankruptcy procedure similar to that under the US Chapter 7, although it does not currently have any alternatives to bankruptcy.⁵¹⁹ Lessons can be learned by Tanzania from the structure of the United States system. When introducing an alternative procedure to bankruptcy, Tanzania must introduce a procedure with both the intention to provide the debtor with an efficient alternative, and some ample returns to the creditors. Secondly, it is essential that the alternative procedure afford the debtor an opportunity to hold on to his or her assets. Thirdly, consumer education for all debtors who are financially insolvent and in need of formal debt relief may benefit Tanzanian debtors after bankruptcy. The Tanzanian scheme of arrangements and composition procedure as well as any possible debt repayment plan may benefit from a provision similar to the Chapter 13 “cram down” provision. This provision will reduce the occurrence of creditors unreasonably refusing any formal settlement proposals. The hardship discharge on the repayment plan may also be a viable option for *bona fide* consumers in Tanzania for both a discharge on the main bankruptcy procedure and any proposed formal debt repayment plan. The United States also allows *in forma pauperis* filings by debtors for the Chapter 7 bankruptcy procedure to reduce the costs of the procedure. This may be a useful model for indigent debtors in Tanzania.

⁵¹⁶ *Ibid.*

⁵¹⁷ *Ibid.*

⁵¹⁸ *Ibid.*

⁵¹⁹ Par 3.5 above.

Finally, the United States model of two procedures, where access is controlled by a means test does not leave the system open to an over proliferation of debt relief procedures that are improperly controlled. That being said the United States debt relief system is still quite reliant on the Court for supervision, although not as much as is Tanzania.

The Australian debt relief system has three main procedures: the normal straight bankruptcy mechanism and two formal alternatives to bankruptcy.⁵²⁰ The bankruptcy procedure consists of both a petition for creditors and debtors. Under the debtor's petition the debtor need only lodge a correct application with the Official Receiver and he or she will be bankrupt by operation of law.⁵²¹ This is similar to the Tanzanian system where a debtor under section 8 of the *Bankruptcy Act* will be granted a receiving order by just submitting a petition with the correct annexures.⁵²² Creditors in Australia may also file a petition to the Federal Court to obtain a sequestration order which if granted, bankrupts the debtor. Similar to the Tanzanian system, the Australian creditor's petition must be heard by the Court. In practice, however, creditor petitions are heard by the Registrar of the Federal Court who exercises judge delegated powers.⁵²³

Before a debtor files for bankruptcy in Australia, he or she may file with the Official Receiver a "declaration of intention to present a debtor's petition".⁵²⁴ Once properly filed, this declaration provides the debtor with a three-week stay of execution against his or her creditors. The Official Receiver is obliged to educate the debtor on all the debt relief options available to him or her before accepting the declaration.⁵²⁵ The rationale behind the declaration is to allow the debtor time to consider his or her options and stop debtors in general from making hurried decisions because of pressure from creditors.

⁵²⁰ Par 5.3 above.

⁵²¹ *Ibid.*

⁵²² Par 3.3.1 above.

⁵²³ *Ibid.*

⁵²⁴ Par 5.3.1 above.

⁵²⁵ *Ibid.*

Once the debtor in Australia has been declared bankrupt he or she must undergo a compulsory income assessment.⁵²⁶ Where the debtor's income during the contribution assessment period exceeds a certain statutory threshold, the debtor is obliged to make calculated payments to his or her bankrupt estate. Failure to make or keep up with these payments may result in the debtor's discharge being postponed.⁵²⁷ Similar to the United States discussed above, the Australian system it would appear is reluctant to allow debtors with regular income who can afford to make payments on their claims, to receive a discharge without doing so.

For the most part in Australia a debtor's bankruptcy ends without any adjudication from the Court. Debtors are normally automatically discharged after the three year statutory period has expired or the bankruptcy is annulled by operation of law when all their obligations have been discharged.⁵²⁸ A debtor's bankruptcy will also be annulled once a composition under section 73 of the *Bankruptcy Act* is accepted by the requisite majority of the creditors and a certificate to that effect is filed with the Court.⁵²⁹ The debtor may also petition the Court to annul the bankruptcy on grounds that a sequestration order should not have been presented against the debtor.⁵³⁰ While the Court may be involved in a few annulments of bankruptcy, it plays no part in discharging a bankrupt debtor from his or her pre-sequestration debts; this occurs as a result of an automatic discharge. The automatic discharge of the debtor may be postponed for five to eight years, depending largely on the debtor's cooperation with the trustee and the office of the Official Receiver.

Australia has two formal alternatives to bankruptcy: these are debt agreements and Part X arrangements. It is important to note that in both procedures secured debtors cannot be bound to any compromise agreement without their consent.⁵³¹ Hence these alternatives are aimed primarily at

⁵²⁶ Par 5.3.1.2 above

⁵²⁷ *Ibid.*

⁵²⁸ Par 5.3.1.3 above.

⁵²⁹ Par 5.3.1.2 above.

⁵³⁰ Par 5.3.1.1 above.

⁵³¹ Par 5.3.1

unsecured debts. The Part X arrangement caters to commercial debtors while the debt agreement was introduced fairly recently and was meant to be a consumer remedy.⁵³² Both procedures are similar to compositions. Part X agreements are geared more towards commercial debtors as the procedure is fairly complicated and pricey for ordinary consumers.⁵³³ The debt agreement is meant to be a simple procedure for low income debtors with few liabilities and creditors similar to the South African administration order above.⁵³⁴ The debt agreement therefore is subject to a monetary threshold. The completion rates for this procedure are low – approximately one in four – and raise questions as to its efficiency.⁵³⁵

The alternative procedures in the Australian system have a number of disadvantages. These include that they are only available to debtors who are already insolvent, and not available to debtors simply experiencing financial difficulties. Another disadvantage of these alternative procedures is that secured creditors may not be party to these formal compositions unless they consent.⁵³⁶ This may hinder the debt relief purpose of the alternative to bankruptcy since even if the debtor pays off his or her unsecured debts under the procedure, he or she will still be liable for the secured debt.

The Australian system has been very innovative in cutting the costs of the debt relief process. Firstly, they have reduced the role of the judiciary to a bare minimum.⁵³⁷ In practice the judiciary hears consumer insolvency issues that are still unresolved after being heard by the Official Receiver and the Appeals Tribunal.⁵³⁸ This reduces the costs and delays associated with legal action. Second, all debtors have the choice of a government appointed Official Trustee to administer the bankruptcy, which is virtually cost free, where the

⁵³² *Ibid.*

⁵³³ Par 5.3.2.1 above.

⁵³⁴ Par 4.5.1 above and Par 5.3.2.2 above.

⁵³⁵ *Ibid.*

⁵³⁶ Par 5.3.2 above.

⁵³⁷ Par 5.3.1.4 above.

⁵³⁸ Par 5.3.1 above.

bankrupt estate has little or no free residue.⁵³⁹ Lastly, as of 2006 there are no fees levied on debtor petitions in Australia.

When comparing the Tanzanian and Australian bankruptcy systems, immediately evident is the difference in the amount of judicial supervision. In the Australian system the only aspect of the bankruptcy process, including the composition procedure that requires direct judicial supervision, is the creditors' petition into bankruptcy and even here the *Federal Court Rules* delegate these powers to the registrar of the Federal Court.⁵⁴⁰ The majority of the process is overseen by the Official Receiver. This type of structure may be able to reduce the cost of legal proceedings for the Tanzanian bankruptcy system and avoid the delays caused by an overburdened judiciary. When considering reform the Tanzania system must also look into the possibility of the Official Receiver in Tanzania playing a more active role in debt relief procedures, hence reducing the costs and increasing the efficiency of the procedures. The Tanzanian system does not have provision for a "declaration of intention to file a petition." This procedure may give the debtor some respite from his or her creditors, and the time required to make a choice between bankruptcy and an alternative procedure. The Australian system has done away with the receiving order and the process of the debtor having to be adjudged bankrupt. This again may save time and costs if followed in the Tanzanian system.

While the assessment of the debtor's income is under the trustee's discretion in Tanzania, in Australia as in the United States, the debtor's income assessment is compulsory. A compulsory means test for Tanzania could result in more debtors who are financially capable being compelled to make contributions from their income to the bankrupt estate. The structure of the Australian discharge is such that the majority of debtors who fulfil their obligations under bankruptcy are automatically rehabilitated without having to apply to the Court for a discharge. As previously stated, this saves costs. With

⁵³⁹ *Ibid.*

⁵⁴⁰ Par 5.3.1 above.

regard to the alternative procedures in Australia, Tanzania must learn that any alternative procedure must also be available to consumers that are in a financial bind as well as to those that are factually insolvent. Further, any alternative measures that may come into being in Tanzania must include both unsecured and secured debt, like the system in the United States.

The Canadian debt relief system consists of bankruptcy and three possible alternative procedures. The bankruptcy process is further divided into an ordinary bankruptcy administration procedure and summary administration.⁵⁴¹ The ordinary bankruptcy administration procedure is the main bankruptcy procedure in Canada. Where the debtor subject to a bankruptcy application has disposable assets of less than CAD \$15,000, the bankruptcy will proceed as a summary administration.⁵⁴² The summary administration procedure is similar to the administration of small estates in the Tanzanian system.⁵⁴³ The Canadian summary administration procedure is, however, compulsory for debtors who do not exceed the asset threshold, unlike in Tanzania where it is optional. This summary procedure in Canada is streamlined for efficiency. No notifications are placed in newspapers to alert the public of the debtor's bankruptcy and normally, unless requested by the creditors themselves, creditor meetings are not required.⁵⁴⁴ Court costs are also decreased by the fact that only trustees may administer a summary administration and the process rarely requires judicial supervision.

The initiation of bankruptcy proceedings in Canada takes place in characteristic Common Law fashion. The creditor's application for bankruptcy must be heard by the Court before a bankruptcy order can be granted and the debtor's assignment into bankruptcy occurs simply by following procedure and filing the application with the Official Receiver.⁵⁴⁵ The Canadian jurisdiction does however require mandatory credit counselling for debtors with a

⁵⁴¹ Par 5.4 above.

⁵⁴² Par 5.4.1 above.

⁵⁴³ Par 3.3.8 above.

⁵⁴⁴ Par 5.4.1 above.

⁵⁴⁵ *Ibid.*

registered trustee before he or she is assigned into bankruptcy.⁵⁴⁶ After the debtor is bankrupt, be it by creditor's petition or a debtor's, the debtor is required to attend two credit counselling sessions within a nine-month period. Failure to do so will result in his or her automatic discharge being postponed.⁵⁴⁷ This type of counseling, similar to that in the United States, is focused on consumer education rather than debt counselling in the South African sense.⁵⁴⁸ Statistics in Canada have shown though, that bankrupts who have received credit counselling do not fare any better after bankruptcy than those that do not.

Like Australia, Canada also has a means testing provision that results in the debtor making compulsory payments from his or her monthly income to his or her bankrupt estate.⁵⁴⁹ The Canadian bankruptcy process makes provision for both an automatic discharge and a Court application to force a discharge on the creditors.⁵⁵⁰ The Canadian debtor is eligible for an automatic discharge nine months after becoming bankrupt. Where a debtor is obliged to make surplus income payments, the term is increased by 21 months. Any failure to make these compulsory payments to the bankrupt estate results in the debtor's automatic discharge being further postponed.⁵⁵¹ This regime adds another feature, presumably to guard against the dishonest debtor who may abuse the bankruptcy process to obtain a discharge. Where the debtor has been bankrupt more than once, he or she is only eligible for an automatic discharge after 24 months. Where such an individual is required to make surplus income payments, he or she can then only be automatically discharged after 36 months.⁵⁵²

Like the Australian system, Canada makes provision for two alternatives to bankruptcy that are both modified composition procedures, namely consumer

⁵⁴⁶Par 5.4.1.2 above.

⁵⁴⁷*Ibid.*

⁵⁴⁸See par 4.5.2 above for a discussion on debt counselling as a debt relief measure that restructures credit agreement debt in South Africa.

⁵⁴⁹Par 5.4.1.4 above.

⁵⁵⁰Par 5.4.1.5 above.

⁵⁵¹*Ibid.*

⁵⁵²*Ibid.*

proposals and commercial proposals.⁵⁵³ Again, like Australia, these alternative procedures are aimed at unsecured debts, and secured creditors can only be party to these proceedings through their own consent.⁵⁵⁴ A consumer proposal is similar to the Australian debt agreement and is also subject to a monetary debt ceiling. Only debtors whose debt does not exceed CAD \$250,000 may apply for a consumer proposal.⁵⁵⁵ The difference between the Australian and Canadian procedure is that with the latter, the debtor is required to undertake mandatory credit counselling in the same exact manner as a debtor who assigned himself or herself into bankruptcy in that jurisdiction.⁵⁵⁶ Seven out of every ten consumer proposals succeed.

The commercial proposal is similar to the Australian Part X arrangement and is available for all Canadian debtors but it is usually used by debtors whose debts exceed CAD \$250,000. The focus of this alternative procedure is also unsecured debt. This procedure however, requires direct Court Approval.⁵⁵⁷ Canada also makes provision for a debt consolidation order in specific states. This procedure is a Court order for the debtor's debts to be consolidated into one debt that the Court restructures and supervises to make sure all the creditors are paid timeously.⁵⁵⁸

Tanzania can learn some lessons from the Canadian debt relief system. Canada, like the United States and Australia, has removed the receiving order and the adjudication stage from their main bankruptcy procedure.⁵⁵⁹ In all three jurisdictions, once the debtor completes his or her filing or the Court rules in favour of a creditor's petition, the debtor is immediately declared bankrupt. The Tanzanian system should also consider removing these stages from its bankruptcy procedure to save time and costs. The Tanzanian administration of small estates procedure may benefit from making the

⁵⁵³Par 5.4.2 above.

⁵⁵⁴*Ibid.*

⁵⁵⁵*Ibid.*

⁵⁵⁶Par 5.4.1 above.

⁵⁵⁷Par 5.4.2 above.

⁵⁵⁸Par 5.4.2.3 above.

⁵⁵⁹See par 3.3.5 above where the adjudication of bankruptcy of the Tanzanian debtor is discussed.

procedure compulsory for debtors with a small number of assets, ensuring that these debtors are rehabilitated quickly and at less cost, as in Canada. The asset threshold in Tanzania must also be increased so that more debtors partake in this proceeding.

Another lesson which can be learnt by Tanzania is placing as little Court supervision on the summary administration process as possible. The Tanzanian system also does not set out exactly what processes the trustee may bypass in summary administration that will hasten the procedure.⁵⁶⁰ The Tanzanian procedure can take a page out of the Canadian book in this regard and create some certainty around summary administration. With respect to the alternative procedures to bankruptcy in Canada, they are limited in their application as they do not include secured debt. It is imperative that any alternative procedure introduced into Tanzania must, like the United States and South African procedures discussed above, include secured debt in its debt relief process. Alternative procedures that do not include secured debt may leave the debtor with a sizeable amount of debt still unpaid and if his or her main domicile is subject to a mortgage, without a home.

With regard to any possible inclusion into the Tanzanian system of an automatic discharge, this system ought to include a longer bankruptcy period for debtors that have been bankrupt before, as in Canada.⁵⁶¹ This provision may serve as a deterrent for any individual seeking to use bankruptcy as a method to quickly discharge his or her debt.

The current English bankruptcy procedure is similar to the Australian system in a number of ways. Firstly, under both systems the debtors have a choice between a state official who may administer the debtor's bankruptcy at a largely reduced cost, or a private trustee.⁵⁶² The option of a state sponsored bankruptcy procedure is a good way to cut the costs of administration. Both systems have also amended their laws so that an automatic discharge is the

⁵⁶⁰ Par 3.3.8 above.

⁵⁶¹ Par 5.4.1 above.

⁵⁶² Par 5.5.1 above.

main method that a bankrupt debtor may be discharged from his or her pre-sequestration debt.⁵⁶³ The bankrupt debtor in England and Wales may be automatically discharged after one year.⁵⁶⁴ The English system also has a discharge provision known as the early discharge. A debtor may receive an early discharge where the Official Receiver has completed an investigation into the debtor's affairs and the debtor's creditors don't object to the Official Receiver filing a notice with the Court of the debtor's early discharge.⁵⁶⁵ Once the notice has been filed without any objection, the debtor is discharged immediately without any adjudication from the Court.

Similar to all common law jurisdictions discussed in this chapter, England and Wales have alternatives to the main bankruptcy procedure. The individual voluntary arrangement is a private affair between the debtor and his or her creditors.⁵⁶⁶ This alternative procedure is a legally binding arrangement between the debtor and his or her creditors supervised by a licensed Insolvency Practitioner.⁵⁶⁷ The main advantage of this alternative is that it is flexible and allows the debtor a wide range of solutions to offer the creditors, unlike the American Chapter 13 procedure which is in essence an installment repayment plan. The main drawback is that the procedure is a private affair between the debtor and his or her creditors and no neutral third party is able to evaluate the proposal to determine whether or not it is feasible. The *Enterprise Act* of 2002 introduced a fast-track version of the individual voluntary arrangement administered solely by the Official Receiver.⁵⁶⁸ This procedure is streamlined for efficiency. England and Wales also have an informal alternative known as a debt management plan.⁵⁶⁹ This procedure is a negotiated settlement procedure that does not provide a discharge. It is poorly

⁵⁶³ *Ibid.*

⁵⁶⁴ *Ibid.*

⁵⁶⁵ *Ibid.*

⁵⁶⁶ Par 5.5.2 above.

⁵⁶⁷ *Ibid.*

⁵⁶⁸ *Ibid.*

⁵⁶⁹ Par 5.5 above.

regulated and is rife with abuse, similar to the South African administration order procedure.⁵⁷⁰

The debt relief order is a unique procedure in that it only deals with indigent debtors by essentially letting them off the hook for certain liquidated debts. The legislature of Wales and England have taken a bold step in realising that dragging poverty-stricken debtors with no income and no assets through bankruptcy is a waste of resource and time. It seems however, that these debtors are having their debts written off too easily as a result of their circumstances. It may be more prudent to have these debtors attend a certain amount of hours of financial management lessons, or insist that they try and find jobs during the period of their moratorium.⁵⁷¹

The Tanzanian system can pick up on the English system's debtor-orientated policies. These include having the Official Receiver that administers the majority of the debt relief procedures to cut the costs associated with the Court supervision of these procedures. The time periods of debtors spent under debt relief procedures in England and Wales are quite short, allowing for fast rehabilitation and recovery by creditors of their monies. The discharge of the debtor from bankruptcy occurs mostly through an automatic discharge which also may save any costs associated with a Court application for a discharge. The organisation of the fast-track individual voluntary arrangement that is only administered by the Official Receiver will definitely also cut any costs associated with insolvency practitioners or Court supervision. The Debt Relief Order is a notable innovation for no income no asset debtors, and may be a viable solution in Tanzania. The informal debt management plan however would appear to be a procedure that may lead debtors into debt traps if administered by private companies, and is not recommended for use in Tanzania.

⁵⁷⁰Par 4.5 above.

⁵⁷¹See par 6.5 below for an example of where the discharge of low-income debtors income is dependent on their continuous efforts to find jobs and means to pay off their creditors.

In summation, the common law regimes discussed in this chapter are fairly debtor-friendly in that they allow the debtor a choice of more than two debt relief procedures each, and subscribe to the notion of an automatic discharge provision. The United States is the exception to the rule having intentionally moved away from debtor-friendly policies in 2005 with the BAPCPA. The United States has only one alternative to bankruptcy and the debtor's choice in procedure is limited by the amount of his or her surplus income. The majority of the common law jurisdictions have also enacted measures to cut procedural costs. Australia and England stand out the most here, with government subsidised debt relief procedures and the introduction of debt relief orders respectively, measures that insure low income debtors can also afford bankruptcy. All four jurisdictions also have limited judicial supervision of debt relief procedures, allowing agencies in the executive branch of government to fulfil most of the supervisory duties.

CHAPTER 6

APPROACHES TO DEBT RELIEF IN SELECTED CIVILIAN AND SCANDINAVIAN LEGAL SYSTEMS IN CONTINENTAL EUROPE

SUMMARY

- 6.1 Introduction
 - 6.2 The Netherlands
 - 6.3 Germany
 - 6.4 Sweden
 - 6.5 Conclusion
-

“If you murder your wife you get six years, but if you fail to pay the milkman you get a life sentence.”¹

6.1 Introduction

Niemi-Kiesiläinen hypothesises that there are three main distinctions between the common law systems approach to debt relief and that of the civilian and Scandinavian systems.² Firstly, she concludes that the civilian and Scandinavian systems all restrict access to debt relief procedures only to *bona fide* debtors who deserve it. Secondly, that in the civilian and Scandinavian systems, there are no provisions for automatic discharge unlike in most of the common law systems, and all debtors are required to engage in

¹Huls 1992 *Journal of Consumer Policy* 126.

² Niemi-Kiesiläinen *et al Consumer bankruptcy in global perspective* 504 and Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 135. See also Niemi-Kiesiläinen 1999 *Osgoode Hall Law Journal* 475.

a mandatory repayment plan before a discharge.³ Lastly, she notes that a great deal of importance is placed on debt counselling debtors through state sponsored institutions. In short, the management of over-indebted consumers in the civilian legal systems is traditionally more conservative than in the common law jurisdictions discussed in the previous chapter. This is often evidenced in the debt relief regimes of continental Europe by their requirement for debtors to make sizable payments on their debts to creditors before they are released.⁴

While this may be the current position, any release of debtors from their debt was for a long time before the 1990s and late 80s often regarded as too liberal by the Europeans, save the United Kingdom.⁵ In recent times however, strides have been made towards a relatively more liberal dispensation towards debtors in Europe.⁶ During the 1980s, although non-commercial persons were not expressly excluded from using bankruptcy as a debt relief measure, they did not use it as one of their primary debt relief solutions. A few reasons are put forward in this regard, for example the costs of the process, the inconvenience caused by the process and the lack of a complete discharge at the end of the cumbersome procedure.⁷ Consequently, although not expressly excluded, consumers in continental Europe found little benefit in the bankruptcy process and did not use it. Besides, there was hardly any need for it; the credit market was heavily controlled in these countries before the 1980s and debtors were carefully screened. Few were given credit if they were clearly unable to repay it.⁸ As a result, demand for credit always exceeded supply and debtors rarely defaulted.⁹

³Niemi-Kiesiläinen *et al Consumer bankruptcy in global perspective* 504.

⁴*Ibid.*

⁵Huls 1992 *Journal of Consumer Policy* 124 and Niemi-Kiesiläinen 1997 *Journal of Consumer Policy* 133.

⁶McBryde *et al Principles of European insolvency law* 1.

⁷Niemi-Kiesiläinen 1997 *Journal of Consumer Policy* 134.

⁸Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 136 and Niemi-Kiesiläinen 1997 *Journal of Consumer Policy* 134.

⁹*Ibid.*

The need for a new debt relief dispensation in Western Europe arose in the early 1980s when the so-called “household debt crisis” in these countries required their legislatures to jump into action to curb the rising debt levels.¹⁰

The occurrence of the need for reform is eloquently explained by Huls as follows:¹¹

A new urge for debt relief measures was felt in the 1980s, when the economic decline of the West European economies led to mass unemployment, budget cuts in the public sphere, etc. As a result of this economic downturn, over-indebtedness became a social and political problem and the national governments started looking for solutions.

A further explanation for rising debt levels can be found in the deregulation of consumer credit laws by these Western European states in the 1980s and early 90s, which was intended to increase access to credit for consumers.¹²

Though successful, it also gave rise to an unintended consequence of increased credit which these states were not ready for; the over-indebtedness of consumers.¹³ This deregulation of the credit market was one of the causes of the household debt crisis in Western Europe that eventually lead to a recession in the region.¹⁴ Although the citizens of these continental jurisdictions, especially the Nordic states, were covered by innovative welfare programmes that addressed daily cash flow problems, it soon became clear to these Nordic states that social benefits could not cure over- indebtedness.¹⁵

Consequently, the increasing number of debt-strained consumers in these jurisdictions eventually obliged their legislatures to reform their debt relief regimes to aid their consumers in dealing with their financial burden.¹⁶

¹⁰ *Ibid.*

¹¹ Huls 1992 *Journal of Consumer Policy* 126.

¹² Niemi-Kiesiläinen 1997 *Journal of Consumer Policy* 134 and Kilborn 2009 *Spring Consumer Finance Law Quarterly Report* 84.

¹³ *Ibid.* As a result of deregulation of consumer credit laws, projections show that in a number of European countries, the total outstanding volume of consumer credit doubled during this period. See also Kilborn 2009 *Spring Consumer Finance Law Quarterly Report* 84.

¹⁴ Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 136 and Niemi-Kiesiläinen 1997 *Journal of Consumer Policy* 134.

¹⁵ Kilborn 2009 *Spring Consumer Finance Law Quarterly Report* 84.

¹⁶ Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 137; Niemi-Kiesiläinen 1997 *Journal of Consumer Policy* 482; Kilborn 2004 *Northwestern Journal of International Law and Business* 257; Kilborn 2005 *Michigan Journal of International Law* 619; Footnote continues on next page.

Denmark led the way in 1984 by enacting the *Debt Agreement Act* which was a pioneering piece of legislation as far as debt relief for consumers was concerned. This statute formed the basis of many reforms in continental Europe.¹⁷ France followed Denmark in 1989, Norway and Finland in 1993, the Germans passed their law in 1994 which eventually came into force in 1999 and finally, the Netherlands and Belgium in 1998.¹⁸

A survey of all the debt relief regimes in continental Europe is not practical. However, due to the noticeable similarities of the law on debt relief in the region, study of a few jurisdictions should suffice to establish the broad structure of the processes in these systems.¹⁹ A survey of the Netherlands, Germany and Sweden will be undertaken in this chapter. The German system was chosen because of its unique unitary debt relief system that has one entry point for both juristic and natural persons for bankruptcy and any alternative debt relief.²⁰ The Netherlands was selected because of the availability of English sources in this jurisdiction and its similarity to other European jurisdictions, namely Denmark and Austria.²¹ The Dutch private law also resembles the South African private law, of which the author has some understanding.²² The Swedish system was selected as representative of the Scandinavian systems in this study because of the availability of sources in this jurisdiction and the fact that it recently made some wholesale changes to its debt restructuring plan, which is of vital importance to this study.²³

The focus of this chapter will be on the structure of the debt relief procedures in these jurisdictions, paying specific attention to the alternative procedures and how they are administered, the aim being to learn lessons that may be

Tabb 2005 *Law & Soc. Inquiry* 763, Kilborn 2006 *American Bankruptcy Institute Law Review* 69 and Ramsay 2007 *University of Illinois Law Review* 241.

¹⁷ *Ibid.*

¹⁸ *Ibid.*

¹⁹ Couwenberg 2001 *European Journal of Law and Economics* 257 and Kilborn 2011 www.papers.ssrn.com 1.

²⁰ *Idem* 16.

²¹ Niemi-Kiesiläinen 1997 *Journal of Consumer Policy* 482 and Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 136.

²² See par 4.1 above.

²³ See discussion in par 6.4 below.

used to modernise the Tanzanian debt relief regime that sorely misses an alternative to bankruptcy procedure.

6.2 The Netherlands

6.2.1 Introduction

While the Netherlands may be a small country in continental Europe, it is still an important jurisdiction for investors in the troubled European investment market.²⁴ Despite its popularity with investors and a strong economy, statistics show that out of seven million households, approximately a quarter of a million are over-indebted.²⁵ This is due in part, as previously explained, to the deregulation of credit laws undertaken by the state in the 1980s. The debt relief procedures available to these over-indebted consumers can be found in the Dutch *Bankruptcy Act* of 1893, known as the *Faillissementswet*.²⁶ The following debt relief processes are regulated by the Act:²⁷

- (a) bankruptcy (*Faillissement*);
- (b) suspension of payments (*Surseance van betaling*); and
- (c) debt reorganisation for natural persons (*Schuldsanering natuurlijke personen*).

The bankruptcy and suspension of payments procedures are available to both natural and juristic persons, while the debt reorganisation procedure is only available to natural persons.²⁸ These procedures are separate legal measures, each intended to deal differently with the insolvency of the debtor.²⁹ The Dutch bankruptcy procedure is a typical liquidation procedure that is aimed at dividing the debtor's assets among his or her proven

²⁴This is often attributed to its beneficial tax system. See Declercq 2003 *American Bankruptcy Law Journal* 378 for a further explanation in this regard.

²⁵Niemi-Kiesiläinen *et al Consumer bankruptcy in global perspective* 304 and Kilborn 2006 *Vanderbilt Journal of Transitional law* 92.

²⁶Hereinafter the *Faillissementswet* will be referred to as the "Fw." Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 1.

²⁷*Ibid.*

²⁸McBryde *et al Principles of European insolvency law* 488.

²⁹*Ibid.*

creditors.³⁰ In contrast the suspension of payments procedure is intended to act as a restructuring procedure, where the debtor is allowed a period of time to reorganise his or her business and restructure his or her debts.³¹ The debt restructuring procedure is in essence a combination of both a bankruptcy procedure and a repayment plan that offers a discharge after compliance with all the formal requirements of the procedure.³²

6.2.2 Bankruptcy

Similar to the regimes previously discussed in this study, in the Netherlands the debtor or his or her creditors may petition for a bankruptcy order.³³ In rare cases where the public interest is concerned, the public prosecutor may present a petition for the debtor's bankruptcy.³⁴ Bankruptcy proceedings may also be initiated after a suspension of payments or a debt rescheduling procedure.³⁵ Any debtor may be the subject of a bankruptcy order in the Netherlands provided he or she resided or conducted business within the country's jurisdiction.³⁶ Since no special bankruptcy Court exists in the Netherlands, bankruptcy petitions are presented before the District Courts which have bankruptcy chambers that are presided over by judges with experience in bankruptcy matters.³⁷

A petition for a bankruptcy order is lodged with the Clerk of the District Court and is heard by the Court in chambers as soon as possible.³⁸ The Public Prosecution Service is also heard upon such a request.³⁹ Where a petition for a bankruptcy order is made by the debtor and he or she is a natural person, the Clerk of the District Court is obliged to inform him or her that he or she may lodge an application for a debt repayment scheme under article 284 of

³⁰ Harmsen and Jitta *The insolvency laws of the Netherlands* 7 and Van Wijmen 2002 www.ec.europa.eu/enterprise/policies/sme/files/sme2chance/doc/report_ned_en.pdf 4.

³¹ www.chasecambria.com/site/journal/S.php?id=350 (last accessed 2012-05-02).

³² *Ibid.*

³³ S 2 Fw and Harmsen and Jitta *The insolvency laws of the Netherlands* 7, 8 and 9.

³⁴ S 1(2) Fw.

³⁵ *Ibid.*

³⁶ S 2(1) Fw and Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 62.

³⁷ Declercq *the Netherlands Bankruptcy Act and the most important legal concepts* 63.

³⁸ S 4(1) Fw.

³⁹ *Ibid.*

the Fw.⁴⁰ Once the petition for bankruptcy has been presented to the Court in the required manner, the Court examines the petition to see if there is *prima facie* proof that the debtor has stopped paying his or her debts.⁴¹ The Court has an unrestricted discretion with regard to determining if the debtor has stopped paying his or her debts.⁴² Where a creditor initiates the bankruptcy he or she has to also provide *prima facie* evidence that he or she has a legitimate claim against the debtor and similar to the Canadian system, that there is at least one other creditor of the debtor.⁴³ In addition to these requirements the petitioning creditor's claim against the debtor must be due and payable at the time of the presentation of the petition.⁴⁴ Where these requirements are met the debtor may be declared bankrupt by the Court in its own discretion.⁴⁵

Where a bankruptcy order is granted, the District Court is obliged to appoint a trustee and a member of the bench as a supervisory judge.⁴⁶ The supervisory judge is tasked with the supervision of the trustee through the administration of the estate.⁴⁷ The Court order declaring the debtor bankrupt must as soon as possible be published by the trustee in the *Official Gazette*, known as the *Nederlandse Staatscourant*.⁴⁸ As with all the other jurisdictions discussed, the trustee is charged with the administration and liquidation of the bankrupt's estate. Directly after his or her appointment the trustee must take all the necessary steps required to preserve the value of the estate.⁴⁹ Every three months during the course of the bankruptcy the trustee is obliged to file with

⁴⁰ *Ibid.*

⁴¹ S 6(3) Fw. A bankruptcy proceeding can also be opened on the basis that the debtor is unwilling to pay his or her debts. McBryde *et al Principles of European insolvency law* 490.

⁴² *Ibid.*

⁴³ The reason for the applicant creditor proving that there is another creditor, in practice, is to make it difficult for a creditor to apply for sequestration when the debtor has only failed to satisfy this one creditor's claim(s). In this case the creditor is obliged to rather try and acquire an enforceable judgment against the debtor for specific performance rather than place the debtor's estate into bankruptcy. Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 63.

⁴⁴ *Ibid.*

⁴⁵ Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 64.

⁴⁶ S 14(1) Fw.

⁴⁷ S 68(1) Fw.

⁴⁸ S 14(3) Fw and Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 63. There is a legal assumption that after publication all interested parties are made aware of the debtor's bankruptcy.

⁴⁹ McBryde *et al Principles of European insolvency law* 491.

the competent Court a public report on the state of affairs of the bankruptcy for the benefit of all interested parties.⁵⁰ These reports are open for inspection by the public.⁵¹

Once the debtor is declared bankrupt by a Court order the bankruptcy can be terminated only in one of the following ways:

- (a) **Where as a result of an objection or an appeal the bankruptcy order is nullified.**⁵² The bankruptcy process may be annulled by a decision of the Court of Appeal following a successful appeal being lodged by the debtor.⁵³ A bankruptcy order may also be withdrawn by the Court through the successful opposition of the order by the debtor through an objection where the debtor asserts that he or she was not heard by the Court during the bankruptcy proceedings.⁵⁴ Creditors and other interested parties may also lodge an objection against the order.⁵⁵

- (b) **Where the liquidation process is discontinued as a result of the insufficiency of the assets of the estate.**⁵⁶ Bankruptcies in the Netherlands may be brought to a close when there are only enough assets to settle the so-called “costs of the bankruptcy”.⁵⁷ These costs are wide by definition and do not only consist of the fees incurred by the trustee, but also include estate debts.⁵⁸ Where the trustee is of the opinion that the bankruptcy should be

⁵⁰Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 66.

⁵¹*Ibid.*

⁵²S 18(1) Fw. See also www.insol-europe.org/download/file/827 (last accessed 2012-05-02).

⁵³*Ibid.* This provision may be compared to the advantage for creditors' requirement in the South African system.

⁵⁴S 18(2) Fw.

⁵⁵S 10 Fw.

⁵⁶S 16 (1) and (2), Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 84 and www.insol-europe.org/download/file/827 (last accessed 2012-06-10).

⁵⁷*Ibid.*

⁵⁸S 15d(1) and S 16(1) Fw. Estate debts are debts which are made with the consent of the trustee for the benefit of the insolvent estate. The creditor involved has a preferential claim that must be satisfied first from the assets insolvent estate. See also Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 119 on the topic of bankruptcy costs.

terminated on the ground that there are not enough assets, he or she informs the supervisory judge accordingly.⁵⁹ The supervisory judge may then advise the District Court to terminate the bankruptcy.⁶⁰

- (c) **The simplified winding-up of a bankruptcy.**⁶¹ Where the debtor's assets are only enough to settle all the costs of bankruptcy and the statutory preferent claims of the tax authorities, and the social security board wholly or partially, the Court may also terminate the bankruptcy.⁶² In this case the trustee is obliged to prepare a plan of distribution which shows the assets and liabilities of the estate as well as indicating what portion of the monies will be paid to the state as taxes and to the social security board.⁶³ The distribution plan must be submitted to the Court for approval and once it has been approved the plan will lie open for inspection for ten days.⁶⁴ Where none of the creditors who have proved their claims object to the proposed plan, the bankruptcy terminates within ten days of the plan being left open for public inspection.⁶⁵
- (d) **By liquidation of the debtor's assets.** After the granting of a bankruptcy order where no composition with the creditors is offered by the trustee, or where the Court refuses to sanction such a composition, the estate of the debtor will by operation of law enter into a state of insolvency.⁶⁶ This, however, is dependent on whether there are enough assets to defray the costs of bankruptcy and to ensure that the unsecured creditors will at least receive a

⁵⁹S 16(2) Fw.

⁶⁰*Ibid.*

⁶¹S 137a Fw.

⁶²Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 84.

⁶³S 137c(2) Fw.

⁶⁴S 137d(2) Fw.

⁶⁵S 137f(2) Fw.

⁶⁶S 173 (1) Fw.

dividend.⁶⁷ While bankruptcy is not a debt relief measure in the Netherlands, it will only be implemented if there is an advantage to the creditors. Through liquidation of the debtor's estate, the bankruptcy comes to an end.

Liquidation proceedings require a special meeting of creditors. This type of meeting is referred to by Declercq as a "verification meeting for creditors".⁶⁸ The purpose of this meeting is to verify and to classify all the claims made by the debtor's creditors.⁶⁹ The date of the meeting is determined by the supervisory judge within 14 days of the bankruptcy order being issued.⁷⁰ During this meeting the claim of each creditor is scrutinised and may be challenged.⁷¹ Where a valid dispute that cannot be settled amicably exists between the trustee and a creditor over a claim, the supervisory judge will preside over proceedings known as "reference proceedings" to determine whether the claim should be accepted or not.⁷²

Once the list of admitted claims is finalised the trustee is obliged to prepare a plan of distribution known as an *uitdelingslijst*.⁷³ This document shows the net worth of the estate and shows what portion of monies from the insolvent estate will be paid to each admitted creditor.⁷⁴ The distribution plan for liquidation must be approved by the supervisory judge.⁷⁵ When the plan has been approved it is filed with the District Court and lies open for

⁶⁷Under section 179 of the Fw the debtor's estate will only be liquidated if a dividend is available for the creditors.

⁶⁸Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 86.

⁶⁹*Idem* 87.

⁷⁰S 108(1) Fw.

⁷¹S 122(1) Fw.

⁷²*Ibid.* See also Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 89.

⁷³S 180(1) and (2) Fw. This distribution plan is similar in nature to the one used in a simplified bankruptcy proceeding discussed above. See also De Moor and Schoorlemmer *Vereenvoudigde afwikkeling van faillissementen* 53.

⁷⁴*Ibid.*

⁷⁵Ss 180 and 183 Fw.

inspection by creditors at the office of the Clerk of the Court for ten days.⁷⁶ Creditors who feel aggrieved by the plan may object formally to the plan by petition.⁷⁷ Where such an objection is raised the magistrate after the end of the inspection period hears the objection in open Court and makes a decision on the matter.⁷⁸ Where no creditor opposes the distribution plan, the bankruptcy terminates ten days after the plan was filed.⁷⁹ If there is an objection raised by a creditor the bankruptcy terminates directly after the Court's decision.⁸⁰ After the final distribution plan has become binding on all the creditors, the creditors regain their rights of execution on the assets of the debtor to the extent that their claims have remained unpaid.⁸¹

- (e) **By final arrangement with the creditors.**⁸² This procedure is better known as a composition (*akkoord*). The Act allows the bankrupt debtor to offer a final arrangement for full and final payment to his or her creditors.⁸³ As in the other jurisdictions where a composition is discussed, the debtor and all of his or her creditors may agree on whatever terms of payment they see fit.⁸⁴ Where the debtor wishes to make a composition he or she must make a composition proposal before the verification meeting of creditors and file it with the District Court eight days before the said meeting.⁸⁵ Once the proposal has been deposited with the Court, the bankrupt debtor must at the same time send a copy of the draft

⁷⁶ *Ibid.*

⁷⁷ S 184 Fw.

⁷⁸ S 185(1) Fw.

⁷⁹ S 187(4) Fw.

⁸⁰ *Ibid.*

⁸¹ S 195 Fw.

⁸² S 138 Fw and de Moor and Schoorlemmer *Vereenvoudigde afwikkeling van faillissementen* 21.

⁸³ *Ibid.* Declercq *the Netherlands Bankruptcy Act and the most important legal concepts* 90 notes that while a composition in a suspension of payments proceeding is meant to cure the debtor of his or her financial woes, this composition is meant to prevent him or her from entering liquidation proceedings.

⁸⁴ www.insol-europe.org/download/file/827 (last accessed 2012-06-10).

⁸⁵ S 139(1) Fw.

to the trustee and to each of the members of the provisional creditors committee.⁸⁶ At the verification meeting the creditors will consult with the debtor on the proposed plan and may require further information before a vote is taken.⁸⁷ The creditors consent for a proposal is obtained by a two thirds majority of creditors that represent three quarters of the unsecured creditors admitted and provisionally admitted claims.⁸⁸ Where the composition is accepted by the creditors it does not become final until it is ratified by the District Court.⁸⁹ Before the closing of the verification meeting the supervisory judge sets a date for the ratification proceedings of the newly consented composition proposal.⁹⁰ The creditors of the debtor may present arguments to the Court in writing before the ratification hearing as to why the composition should not be ratified.⁹¹ Once the Court ratifies the composition it becomes binding on all the unsecured creditors, irrespective of whether the creditor's claim was admitted or not.⁹² As soon as the judicial decision in which the final arrangement with the creditors' composition is approved and becomes final and binding without the creditors' right to appeal, the bankruptcy comes to an end.⁹³

With regard to the consequences of these five methods of termination of bankruptcy proceedings in the Netherlands, only composition proceedings may result in a complete discharge of the debtor's liabilities.⁹⁴ This of course depends on the terms of the composition itself; where the debtor can clear all his or her obligations under the agreement this may result in him or her being

⁸⁶S 139 (2) Fw.

⁸⁷S 144 Fw.

⁸⁸S 145 Fw. Where the first vote does not meet the required threshold the Act makes provision for a second vote with a slightly less stringent threshold 8 days after the first vote. - see S 146 Fw.

⁸⁹S 150 Fw.

⁹⁰S 150 (1) Fw.

⁹¹S 151 Fw.

⁹²S 151 Fw and Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 93.

⁹³S 161 Fw.

⁹⁴Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 93.

free of debt.⁹⁵ With regard to the first four methods of termination identified above, the unpaid claims of the debtor's creditors continue to exist and may be the cause of the debtor's bankruptcy in future.⁹⁶ If his or her debts are not paid in full, the debtor may be in debt for the rest of his or her natural life. This is the meaning behind the quotation that opens this chapter, that a debtor may be a prisoner to lifelong debt.⁹⁷

6.2.3 Suspension of Payments

The aim of the suspension of payments procedure as intended by the legislature is to give a business debtor who is in a financial dilemma that is not beyond saving from bankruptcy, some breathing room.⁹⁸ This moratorium given on payment of debts is aimed at allowing this type of debtor the opportunity to reorganise his or her business.⁹⁹ Whether such reorganisation takes the form of refinancing his or her debts or entering into a composition to secure a discharge, the ultimate goal is to avoid bankruptcy.¹⁰⁰ Declercq however notes that this rarely occurs and usually the procedure operates as a gateway to the debtor's ensuing bankruptcy.¹⁰¹

An order in favour of a suspension of payments procedure will not be granted to a natural person who does not operate some form of commercial enterprise, because this procedure is a tool that is intended to assist the burdened debtor to continue his or her business.¹⁰² Additionally, with regard to the scope of this remedy, a suspension of payments order only affects the creditors that do not have statutory preferent claims, or claims that are secured by real security such as mortgages or a pledge.¹⁰³

⁹⁵ *Ibid.*

⁹⁶ *Ibid.*

⁹⁷ Huls 1992 *Journal of Consumer Policy* 126 and par 6.1 above.

⁹⁸ Van Wijmen 2002 www.edz.bib.uni-mannheim.de/daten/edz-h/gdb/02/report_ned.pdf 19.

⁹⁹ www.insol-europe.org/download/file/827 (last accessed 2012-06-10).

¹⁰⁰ Dulack *Surseance van betaling* 11.

¹⁰¹ *Ibid.*

¹⁰² S 214(4) Fw and Declercq 2003 *American Bankruptcy Law Journal* 384.

¹⁰³ S 232 Fw and Dulack *Surseance van betaling* 11. See Ss 232 and 257 Fw for specific instances where a suspension of payments order may affect secured and preferential creditors.

Only the debtor may apply for a suspension of payments order. This debt relief mechanism may not be initiated by creditors or any other interested third parties.¹⁰⁴ The debtor resorts to seeking this order only when he or she can foresee and expects that he or she will not be able to pay his or her debts as they fall due.¹⁰⁵ Where the petition for the order is correctly submitted to the competent Court,¹⁰⁶ the Court will, without delay, grant a provisional suspension of payments order without considering the facts or merits of the case.¹⁰⁷ When granting the provisional order the Court will also:

- (a) appoint one or more administrators;
- (b) set a date for the meeting of creditors; and
- (c) appoint a supervisory judge.¹⁰⁸

In practice the meeting of creditors is normally set on a date two to three months after the granting of the provisional suspension order.¹⁰⁹ This meeting is necessary to assist the Court in deciding whether or not to grant the final suspension of the payment order.¹¹⁰

After his or her investigation the administrator may, if he or she is of the opinion that a suspension order will bear fruit for the creditors, call a meeting of the creditors.¹¹¹ At this meeting the creditors cast their votes for or against the suspension order and the Court, based on the creditor's preference,

¹⁰⁴S 214 Fw. See also Dulack *Surseance van betaling* 12 and Declercq *The Netherlands bankruptcy act and the most important legal concepts* 37.

¹⁰⁵S 214 (1) Fw and Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 39. The debtor need not prove that he or she expected to be unable to pay his or her debts before the Court.

¹⁰⁶S 214(2) Fw.

¹⁰⁷S 215(2) Fw.

¹⁰⁸*Ibid.* During the suspension period the debtor's business affairs are jointly managed by the debtor and a court-appointed administrator. Declercq refers to the relationship between these two parties as Siamese twins after the suspension order is given since each party can only operate with the consent of the other. See s 228 par 1 Fw and Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 32.

¹⁰⁹Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 46 and www.insol-europe.org/download/file/827 (last accessed 2012-06-10). The 90 or so days after the granting of the provisional order gives the administrator time to investigate whether or not it is useful to convene a creditors' meeting. Where it appears that a bankruptcy cannot be avoided, holding a creditors' meeting and proceeding with the suspension may not be useful.

¹¹⁰*Ibid.*

¹¹¹Van Wijmen 2002 www.edz.bib.uni-mannheim.de/daten/edz-h/qdb/02/report_ned.pdf 22.

decides on whether to grant the final order.¹¹² Where the suspension order is denied, the Court may declare the debtor bankrupt.¹¹³ The Court may only grant a final suspension order under the following circumstances:¹¹⁴

- (a) where there is reason to believe that the suspension will assist the debtor to pay off all his or her debts;
- (b) where the creditors of the debtor holding a quarter of the claims are present at the meeting or a third in number of the creditors holding such claims do not oppose the final order; and
- (c) where there is no reason to suspect that the debtor will attempt to prejudice the creditors during the suspension.¹¹⁵

Where the final suspension order is granted, the Court determines the time span of the order which can be up to a maximum of one year and six months.¹¹⁶

A suspension of payments order has a number of consequences. Firstly, from the moment the provisional suspension order is handed down the creditors who are subject to the order may no longer pursue the debtor using legal avenues.¹¹⁷ All legal remedies that have already been put into effect by creditors against the debtor are also suspended.¹¹⁸ In addition, certain limitation periods and terms of forfeiture mentioned in articles 36 and 230 of the Fw that will prescribe during the suspension period are automatically extended to a date six months after the termination of the suspension of payments procedure. The limited nature of the role of the administrator in a

¹¹² *Ibid.*

¹¹³ S 218(5) Fw. The decision of the Court where the suspension is refused and the debtor is declared bankrupt is subject to appeal see s 219 Fw in this respect.

¹¹⁴ S 218(2) Fw. See also Dulack *Surseance van betaling* 17.

¹¹⁵ S 218(4) Fw.

¹¹⁶ S 232(1) Fw. This period may however be subject to an extension through the Court see S 231(2) Fw in this regard.

¹¹⁷ S 230(1) Fw. This prohibition against legal proceedings does not bind new creditors that have not been part of the suspension order from instituting new actions for specific performance.

¹¹⁸ S 230(2) Fw. Once the Court order is granted and has become final and binding, all previous attachments come to an end. If the debtor was arrested and had been held in custody he or she is released.

suspension procedure as opposed to a bankruptcy trustee also means he or she no longer has the power to invalidate any fraudulent transactions by the debtor with an *actio pauliana*. The creditors, however, may in a suspension procedure themselves invalidate impeachable transactions using the paulianian action.¹¹⁹

Once the suspension order is final, the administrator and debtor may decide between a number of methods on how to make the debtor financially stable. For example, the parties could use the moratorium to put the debtor's financial affairs in order, with the goal of enabling the debtor to resume his or her commercial activities after the suspension order lapses.¹²⁰ During this revival period the creditors are kept at arm's length, allowing the debtor to accumulate the required profit.¹²¹ These creditors are then paid in full at the end of the suspension. Any debts accumulated during the suspension period itself must be paid in full as well as any statutory preferent claims.¹²² Another option allowed by the Fw is allowing the debtor to propose a composition to his or her creditors. Once the required majority of creditors assent to the composition it is binding on all the creditors.¹²³ The suspension order may also be used to effect a transaction of the debtor's assets to a new company or merchant. The proceeds of the assets may subsequently be used to pay the creditors or propose a scheme of arrangement.¹²⁴

A suspension of payments in the Netherlands may come to an end in a number of ways.¹²⁵ Where a request is made by the Court under its own motion, a creditor or the administrator or the supervisory judge may end a suspension procedure.¹²⁶ A reasonable basis for such an application would be if the possibility of the creditors' claims being satisfied by the procedure

¹¹⁹Ss 42 and 43 Fw and Buchem-Spapens and Pouw *Faillissement, surseance van betaling en schuldsanering* 45.

¹²⁰www.insol-europe.org/download/file/827 (last accessed 2012-06-10).

¹²¹*Ibid.*

¹²²Van Wijmen 2002 www.edz.bib.uni-mannheim.de 21.

¹²³*Ibid.*

¹²⁴Van Wijmen 2002 www.edz.bib.uni-mannheim.de 20.

¹²⁵Buchem-Spapens and Pouw *Faillissement, surseance van betaling en schuldsanering* 119 and McBryde *et al Principles of European insolvency law* 523.

¹²⁶S 242(1) Fw.

has diminished significantly.¹²⁷ In the same Court order withdrawing the suspension of payments order it is essential that simultaneously the debtor also be declared bankrupt.¹²⁸ The Fw also points out the following grounds that may be used to request a revocation order:¹²⁹

- (a) where the debtor acts in bad faith in managing his or her estate during the suspension;
- (b) if the debtor attempts to prejudice his or her creditors;
- (c) where the debtor during the suspension enters into any transactions without the consent of the administrator;¹³⁰ and
- (d) where the debtor fails to comply with directions from the District Court or directions given to him or her by the administrator in the interest of the bankrupt estate.

The debtor, as previously discussed, may also offer the creditors a composition after submitting the application for a suspension of payments order to the Court.¹³¹ Once the composition is accepted in the required manner, the suspension of payments procedure will terminate. The procedure of the composition is the same as that previously discussed above under Bankruptcy in the Netherlands.¹³² Where the Court refuses to condone the composition proposal, even if it has been agreed to by the creditors, the Court will proceed to bankrupt the debtor.¹³³ Where the debtor settles in full all claims against him or her, the suspension of payments procedure will also terminate.¹³⁴

Studies on suspension of payments procedures as an alternative to bankruptcy have shown that it seldom occurs that merchants in financial

¹²⁷ *Ibid* and s 283(1) Fw.

¹²⁸ S 242(4) Fw.

¹²⁹ S 242(1)(1) to (4) Fw.

¹³⁰ See also S 228(1) Fw.

¹³¹ S 252 Fw and Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 46.

¹³² See par 6.2.1 above.

¹³³ S 272(4) Fw.

¹³⁴ Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 47.

trouble successfully use the suspension procedure to cure their problems.¹³⁵ This conclusion is attributable to a number of reasons. These include that the procedure itself is limited only to unsecured and non-preferential debt and as a result does not take into account the possibly large number of statutory preferred debt.¹³⁶ Another reason is that debtors often apply too late to be saved by the suspension of payments procedure; by the time he or she has applied, the size of the ever increasing statutory preferent debts makes it impossible to avoid bankruptcy.¹³⁷ Additionally, because the debtor works together with the administrator to restructure the debtor's business affairs, poor cooperation between the two parties at times becomes a hurdle to a successful suspension procedure.¹³⁸ This is especially the case where the debtor is a poor manager.

6.2.4 Debt Restructuring for Natural Persons

The Netherlands has a second alternative to bankruptcy that came into force in 1999 in the form of a debt repayment scheme strictly for natural persons.¹³⁹ In the early 1990s the legislature of the Netherlands, concerned over the dwindling numbers of voluntary debt agreements at municipal level, enacted the *Wet Schuldsanering Natuurlijke Personen*, meaning the *Debt Restructuring of Private Individuals Act*.¹⁴⁰ This Act was incorporated as an autonomous procedure for debt relief under Title III of the Fw. Unlike the two previous procedures discussed under the Fw that do not as their primary goal grant the debtor a complete discharge, the debt repayment scheme, if correctly adhered to, will free the debtor of the majority of his or her debt burden.¹⁴¹ The intention of the Dutch legislature when enacting this procedure

¹³⁵Business and Law Research Centre 2000 April *De efficiëntie van de faillissementswet* 5

¹³⁶*Ibid.*

¹³⁷*Ibid.*

¹³⁸*Ibid.*

¹³⁹Van Apeldoorn 2008 *International Insolvency Law Review* 29

59. This statute was not easily guided through the legislature and took long to be promulgated. While the Lower House of the Dutch Parliament passed the bill in its original form, the legislative process had to be suspended as a result of numerous objections from those in practice. The main complaints were that the law was too complicated and the process itself would be time consuming. See Wijmen 2002 www.edz.bib.uni-mannheim.de/daten/edz-h/qdb/02/report_ned.pdf 32

¹⁴⁰Hereinafter this Act will be referred to as the WSNP.

¹⁴¹Van Apeldoorn 2008 *International Insolvency Law Review* 59.

was to ensure that the debtor is not hounded indefinitely by his or her creditors.¹⁴²

The debt restructuring procedure is available only to natural persons and may only be initiated by the debtor.¹⁴³ Before the debtor may apply for the debt repayment scheme he or she must make a *bona fide* effort to settle his or her debts through an extra-judicial debt rescheduling process also known as a voluntary plan.¹⁴⁴ This process must be distinguished from the credit counselling procedure seen in the United States of America and Canada, as it attempts to provide a negotiated settlement between the parties, while not offering consumer education. To ensure that the debtor attempts the voluntary plan the Fw requires the debtor to include in his or her petition:

a reasoned statement issued by the [...] Alderman of the municipality of the residence or place of abode of the debtor, confirming that there is no realistic possibility of an extra-judicial debt rescheduling, and the extent to which the applicant is able to settle his debts.¹⁴⁵

The reasoned statement is often obtained from the municipality where the debtor resides or from his or her local credit counselling agency to which the municipality has delegated these duties.¹⁴⁶ In the Dutch system the principle with regard to debt restructuring is that a court-supervised process with a Receiver is not to be preferred over an out-of-court settlement; the former should take place only if an amicable arrangement is impossible.¹⁴⁷ While creditors do have the right to refuse a debtor's offer for an arrangement during this preliminary negotiation phase, the refusal must be reasonable and where

¹⁴²Wijmen 2002 www.edz.bib.uni-mannheim.de/daten/edz-h/gdb/02/report_ned.pdf 32.

¹⁴³ S 284(1) Fw and www.insol-europe.org/download/file/827 (last accessed 2012-06-10). Natural persons who are involved in business such as one person businesses may also apply for the debt repayment scheme.

¹⁴⁴ S 285(1) Fw and Kilborn 2006 *Vanderbilt Journal of Transitional law* 94. One of the objectives of the WSNP is to have debt restructuring effected as much as possible out-of-court.

¹⁴⁵ Buchem-Spapens and Pouw *Faillissement, surseance van betaling en schuldsanering* 122 and 125.

¹⁴⁶ *Ibid.*

¹⁴⁷ Van Apeldoorn 2008 *International Insolvency Law Review* 59.

it is not, a cost order may be awarded against the creditor.¹⁴⁸ In the subsequent petition the debtor may request the Court to instruct any creditor that refused to cooperate in the voluntary rescheduling scheme that was offered to the creditors prior to the petition being lodged, to accept that particular rescheduling scheme.¹⁴⁹ The Court has the discretion to grant the request if the creditor reasonably should not have refused the rescheduling scheme that was offered, taking into account his or her interests, those of the debtor and of the other creditors who were harmed by his or her refusal.¹⁵⁰ This procedure, which forces a creditor to accept an arrangement, is also known as a “compulsory debt repayment scheme” and came into use after the 2008 amendments to the WSNP.¹⁵¹

Other amendments have also been made to the WSNP. In 2008 an amendment was made that allows the debtor or Alderman simultaneously with the petition for a debt repayment scheme, to initiate a preliminary injunction in the event of a so-called “threatening situation”.¹⁵² Both the applications for an injunction and the compulsory debt repayment scheme mentioned above are heard before the application for the judicial debt repayment scheme is considered.¹⁵³ A preliminary injunction offers the debtor protection against any impending threat of the disconnection of water, electricity, gas, eviction from a leased property or termination of health insurance.¹⁵⁴ The Court using its own discretion may impose a preliminary injunction for a maximum period of six months.¹⁵⁵ Furthermore, in 2011, unhappy with the low success rates of out-of-court voluntary plans, the Netherlands legislature introduced certain compulsory obligations that a municipality must fulfil to its over-indebted consumers.¹⁵⁶ The introduction of this legal duty of care is intended to provide

¹⁴⁸S 287a(6) Fw.

¹⁴⁹S 287a(1) and (5) Fw.

¹⁵⁰*Ibid.*

¹⁵¹S 287b Fw. A threatening situation under this section of the FW is where the debtor's essential utilities such as electricity and gas are about to be disconnected as a result of non-payment. See Moser and Horal 2007 www.ecdn.eu 5.

¹⁵²S 287b Fw.

¹⁵³*Ibid.*

¹⁵⁴S 287b and 304 Fw and Moser and Horal www.ecdn.eu 5.

¹⁵⁵S 287b(5) Fw.

¹⁵⁶Huls 2012 *Journal of Consumer Policy* 500.

better access to voluntary debt assistance and increase the procedure's efficiency.¹⁵⁷

When seeking a debt restructuring order the debtor must file a petition with the District Court that has jurisdiction where he or she resides.¹⁵⁸ In order to file for the petition the debtor must fulfil one of two criteria: he or she either must have stopped paying his or her debts completely, or can reasonably be expected to be unable to pay those debts.¹⁵⁹ The petition must be accompanied by a number of documents, including an income and expenditure statement.¹⁶⁰ Among the other annexures, the petitioner must submit a draft debt restructuring scheme; the reasoned statement issued by the municipal executive discussed above; and a document setting out the debtor's repayment options.¹⁶¹ Once the petition has been lodged with the Registrar of the District Court, the petition must lie open for inspection to the public.¹⁶²

The Court will grant a debt repayment scheme only if it is sufficiently probable that:

- (a) the debtor is not able to continue to pay his or her debts;¹⁶³
- (b) the debtor acquired the debt that is causing his or her financial problems in good faith;¹⁶⁴ and
- (c) the debtor will perform the obligations arising from the debt repayment scheme with required care and will strive to the best of his or her ability to increase the value of the bankrupt estate.¹⁶⁵

¹⁵⁷ *Ibid.*

¹⁵⁸ S 284(1) Fw.

¹⁵⁹ *Ibid.*

¹⁶⁰ S 285(1) Fw and Wijmen 2002 www.edz.bib.uni-mannheim.def 33.

¹⁶¹ *Ibid.* The comprehensive nature of the documents is to assist the Court to reach a decision on the debt restructuring order as soon as possible.

¹⁶² S 286(1) Fw.

¹⁶³ S 288(1)(a) Fw.

¹⁶⁴ S 288(1)(b) Fw.

¹⁶⁵ S 288(1)(c) Fw.

The Fw makes provisions for grounds, some mandatory and some optional, under which the petition of the debtor may be denied.¹⁶⁶ Where there is reason to suspect that the debtor may attempt to prejudice his or her creditors during the restructuring period, or he or she may fail to fulfil his or her commitments under the restructuring arrangement, the petition will be rejected.¹⁶⁷ The Court will also reject the petition if it is possible that the debtor did not act in good faith when he or she acquired the debts or left them unpaid.¹⁶⁸ Before making a decision the Court will take the direction in the Act into account and all relevant circumstances.¹⁶⁹ Other considerations that are taken into account are the nature and the amount of the debt and the degree of culpability of the debtor in incurring the debt.¹⁷⁰ The Court may also look into how much effort the debtor made to try and repay his or her creditors.¹⁷¹ It is quite evident from this discussion that the good faith criterion is of material importance when the Court is considering an application for a debt repayment scheme. Wijmen explains that the purpose of the “good faith” requirement is to prevent abuse of the procedure by *mala fide* debtors and to ensure that only honest debtors get a chance to acquire a discharge from their debt and a fresh start.¹⁷²

When the Court grants a debt rescheduling scheme, it also appoints a supervisory judge.¹⁷³ The debt rescheduling order affects all the creditors’ claims against the debtor that are due and payable at the time the order was

¹⁶⁶S 288(2)(a) to (d) Fw. See also Wijmen 2002 www.edz.bib.uni-mannheim.def 34.

¹⁶⁷*Ibid.*

¹⁶⁸Van Apeldoorn 2008 *International Insolvency Law Review* 59.

¹⁶⁹Buchem-Spapens and Pouw *Faillissement, surseance van betaling en schuldsanering* 131.

¹⁷⁰*Ibid.*

¹⁷¹Wijmen 2002 www.edz.bib.uni-mannheim.def 34.

¹⁷²*Ibid.*

¹⁷³S 287(3) Fw. As directed in s 287(1) Fw petitions in the Dutch system are often dispensed with expeditiously, therefore the debt rescheduling scheme comes into effect quite quickly after the petition has been lodged with the Registrar of the Court. See www.insol-europe.org/download/file/827 (last accessed 2012-06-10) for a discussion in this regard. The supervisory judge’s duty is to ensure that the administrator complies with all his or her statutory duties. The administrator on the other hand supervises the debtor and primarily ensures that he or she meets all of his or her obligations under the debt rescheduling order. The administrator is also obliged to inspect the debtor’s premises and all his or her mail. In short, the administrator manages and liquidates the debtor’s assets during the implementing phase of the repayment plan. For more detail on the duties of these actors in the debt rescheduling process see Moser and Horal 2007 www.ecdn.eu 4.

granted.¹⁷⁴ In order for the debt rescheduling procedure to bestow a complete discharge on the debtor at the end of the procedure, the debtor must fulfil his or her obligations under the plan.¹⁷⁵ Debt rescheduling as a procedure primarily involves the raising of funds over a specified period. These funds are eventually used to pay off as much of the debtor's debt as possible at the end of that period.¹⁷⁶ A debt rescheduling scheme may last three years and may be extended to five years.¹⁷⁷ The raising of these funds involves first the liquidation of the debtor's non-exempt assets.¹⁷⁸ Second, the Court calculates the amount of excess income that the debtor must pay into a special account for the three-year period.¹⁷⁹ Thus the reorganisation procedure involves both a repayment plan and liquidation of the debtor's assets. If the debtor adheres to the repayment plan and fulfils all his or her obligations over the specified period, any creditors' claims against the debtor become natural obligations and may not be claimed against the debtor.¹⁸⁰ The debtor has in effect been granted a fresh start.¹⁸¹ In order to receive a discharge under this procedure, the debtor may also offer a composition to his or her creditors in full and final settlement of his or her debts.¹⁸²

A debt rescheduling order may also be brought to an end by shortening the three-year time period.¹⁸³ The Court may grant such an order where there is no reasonable prospect of the debtor being able to meet his or her obligations.¹⁸⁴ The Fw also provides the Court with a number of grounds for terminating the debt rescheduling order before the end of the three-year period; these include the following:¹⁸⁵

¹⁷⁴Van Apeldoorn 2008 *International Insolvency Law Review* 59.

¹⁷⁵S 350(3) Fw and Van Apeldoorn 2008 *International Insolvency Law Review* 59.

¹⁷⁶*Ibid.*

¹⁷⁷S 349a(1) Fw.

¹⁷⁸S 295(1) Fw and Van Apeldoorn 2008 *International Insolvency Law Review* 59.

¹⁷⁹S 295(2) Fw. the Court usually sets aside any income received by the debtor that is over 90 per cent of the income support level applicable to the debtor under S 475d of the Dutch Code of Civil Procedure.

¹⁸⁰S 358(1) Fw.

¹⁸¹Ss 329 to 332 Fw.

¹⁸²Moser and Horal www.ecdn.eu 5.

¹⁸³S 350(3) Fw.

¹⁸⁴*Ibid* and Moser and Horal www.ecdn.eu 5.

¹⁸⁵*Ibid.*

- (a) the debtor being in a position to resume his or her payments to the creditors;
- (b) the debtor failing to perform his or her obligations under the repayment scheme;
- (c) the debtor allowing himself or herself to incur excessive debt;
- (d) the debtor attempting to prejudice the creditors; and
- (e) facts coming to light that were present at the moment the Court granted the order and if known at that time the procedure would not have been granted.

Where the debtor is able to restart paying his or her debts as explained in Part (a) above, without the assistance of the debt repayment scheme, the procedure ends when the judgment to terminate is ordered.¹⁸⁶ With respect to grounds (b) through (e) above, the debtor is declared bankrupt by operation of law and the Court immediately appoints a bankruptcy judge and a trustee.¹⁸⁷

6.3 Germany

6.3.1 Introduction

For more than twenty years German state bodies, starting in the late 1970s, considered the reform of the *Bankruptcy Act* of 1877.¹⁸⁸ This reform process concluded with the promulgation of the *Insolvency Act* of 1994.¹⁸⁹ The Act however, only came into force in 1999. Along with increased bankruptcy filings due to credit deregulation,¹⁹⁰ another reason for the massive reform process undertaken in Germany during the 1980s and 90s was the large number of bankruptcy proceedings that were rejected by the Courts during the 1970s.¹⁹¹ The reason for the rejection of the bankruptcy applications was that

¹⁸⁶S 350(4) Fw.

¹⁸⁷S 350(5) Fw.

¹⁸⁸McBryde *et al Principles of European insolvency law* 313 and Ziechmann *Business bankruptcy in Germany: An introduction analysis* 6 and 7.

¹⁸⁹*Ibid.* The new Act is known as the *Insolvenzordnung* and will be referred to as “the InsO” hereafter.

¹⁹⁰As a result of the deregulation of credit in Germany in the 1980s, the total consumer debt more than doubled in the ten years between 1984 and 1994. See Kilborn 2004 *Northwestern Journal of International Law and Business* 261

¹⁹¹www.edz.bib.uni-mannheim.de/daten/edz-h/gdb/02/report_germ.pdf (last accessed 2012-05-02).

the repealed *Bankruptcy Act* of 1877 did not allow the Court to issue a bankruptcy order if the debtor's estate did not have any assets.¹⁹² One of the objects of the new Act was therefore to allow more debtors access to the bankruptcy procedure. Further, under the old bankruptcy regime a debtor who completed the bankruptcy process remained liable for any unpaid debts for up to 30 years.¹⁹³

The objectives of the current insolvency statute are named in section 1 of the InsO. These are specifically, to satisfy the debtor's creditors by liquidation of the debtor's assets or to continue the debtor's business ventures by reaching an arrangement in an insolvency plan and/or including other procedures such as self-administration.¹⁹⁴ The objectives are clearly creditor-oriented. The InsO also provides for a step-by-step debt relief measure for consumers who are not by definition engaged in economic activity.¹⁹⁵ The current regime makes provision for one gateway into debt relief in Germany and is therefore described as a "unitary proceeding."¹⁹⁶ The gateway is applying for a liquidation proceeding. All formal debt relief measures in Germany begin as an application for liquidation. There are however slightly separate processes to be followed by consumers who do not engage in economic activity as opposed to so-called business debtors. These will be discussed separately.¹⁹⁷ In general however, once the application for insolvency has been accepted and the debtor is inside the gate the procedure may,

¹⁹²This provision is an advantage for creditors' requirement similar to the South African system discussed in par 4.3 above. Under the previous Bankruptcy Act more than 70 per cent of the applications for bankruptcy were dismissed because of lack of sufficient assets. No application was granted if the assets present were not enough to cover sequestration and administration costs of the bankruptcy procedure. Under the new legislation the (InsO) the definition of costs of sequestration under s 26 InsO has been amended only to include the costs of the Court application and the costs of the administrator in order to allow for more applications to see the opened insolvency proceeding stage. See Kilborn 2004 *Northwestern Journal of International Law and Business* 263.

¹⁹³Houghton and Atkinson *Guide to insolvency in Europe* 81 and Ziechmann *Business bankruptcy in Germany: An introduction analysis* 9.

¹⁹⁴See par 6.3.1.2 below for a discussion on self-administration and DePonte *The definitive guide to distressed debt and turnaround investing* 142, Halladay and Jark 2010 www.blog.dlapiper.com/DEstructuring/resource/German_Insolvency_Booklet.PDF 9 and Broude *et al* 2010 www.lw.com/upload/pubContent/pdf/pub1844_1.pdf 47.

¹⁹⁵Declercq *The Netherlands Bankruptcy Act and the most important legal concepts* 63

¹⁹⁶*Ibid* and Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 141.

¹⁹⁷See par 6.3.2 and 6.3.3 below.

depending on the debtor, his or her creditors and the Court, proceed into either liquidation or debt reorganisation.¹⁹⁸ Where the debtor goes down the liquidation pathway and he or she fulfils all that is required of him or her over seven or more years, he or she may receive a complete discharge of debt.¹⁹⁹ Where the debtor chooses the debt reorganisation route he or she is required to negotiate with his or her debtors over a debt adjustment plan. Once the requisite majority of creditors agree to it, Court approval is required to complete the debt reorganisation process.²⁰⁰ When the plan has been approved and the debt is properly reorganised as per the plan, the estate of the debtor is returned to him or her.²⁰¹ It is important to note that a request for the debtor's liquidation in Germany may be filed by either the debtor or the creditor. Where the creditor files a liquidation application against a debtor who is not a business person, the Court will give the debtor an opportunity to request permission to proceed with the debt reorganisation plan for non-business debtors.²⁰² Where the Court grants the debtor permission, the Court will suspend the liquidation proceedings and continue with the formal debt reorganisation plan.

Under the InsO a natural person is a business debtor where he or she has or is currently pursuing some form of commercial enterprise and has more than twenty creditors at the time of the insolvency application, or has a claim against him or her from an employee.²⁰³ These individuals may not use the special insolvency proceeding for consumers provided for by the InsO but must use the debt relief measure available to "business debtors." This term includes legal entities such as companies and certain types of trusts and partnerships.²⁰⁴ Due to the large number of Tanzanian debtors who are over-

¹⁹⁸McBryde *et al Principles of European insolvency law* 314.

¹⁹⁹*Idem* 315. During the six year period the debtor has to make a constant effort to pay off his or her debts to his or her creditors by making contributions from his or her income to the payment of the debts. Thus the liquidation is not purely a liquidation as debtors also have to make surplus income repayments. See par 6.3.3 below.

²⁰⁰Davydenko and Franks 2008 *The Journal of Finance* 569.

²⁰¹Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 141.

²⁰²S 305 InsO.

²⁰³S 304 InsO.

²⁰⁴Davydenko and Franks 2008 *the Journal of Finance* 569.

indebted as a result of credit received for their business,²⁰⁵ it is necessary to survey both procedures in Germany in detail to learn if separate procedures for consumers and business individuals may be more efficient.

6.3.2 Natural Persons Involved In Business

6.3.2.1 The opening of the debt relief proceeding for a business debtor

Before a decision is made regarding whether to proceed with a straight liquidation or a debt reorganisation plan, a business debtor or even a normal consumer must have a liquidation proceeding opened against him or her.²⁰⁶ This is the one gate into any type of formal debt relief in Germany. Liquidation in Germany may only be requested by filing an application to that effect in the Court of first instance, known as the *Amtsgericht* or the Regional Court.²⁰⁷ The jurisdiction of this Court with respect to liquidation matters is determined, as in all the other countries discussed in this thesis, by the locality of where the debtor resides or if he or she is a business person, by the location of his or her place of business.²⁰⁸ Similar to the other developed jurisdictions discussed in this thesis, liquidation procedures for both natural persons and legal entities are combined into one statute and treated as one process.²⁰⁹ Therefore, under the InsO, a natural person and certain legal entities and partnerships may apply for formal debt relief.²¹⁰

The application for liquidation may be filed either by the debtor or a creditor. Unlike in the Netherlands, the public prosecutor may not apply for the debtor's bankruptcy.²¹¹ A creditor's application for liquidation will only be accepted by the Court if he or she proves a legal interest in the liquidation proceedings by

²⁰⁵See par 1.1 below.

²⁰⁶McBryde *et al Principles of European insolvency law* 315.

²⁰⁷S 2 InsO.

²⁰⁸*Ibid.*

²⁰⁹Ziechmann *Business bankruptcy in Germany: An introduction analysis* 11; Evans *et al* 1999 *South African Mercantile Law Journal* 21 and Havenga 2001 *South African Mercantile Law Journal* 419.

²¹⁰S 11 InsO.

²¹¹S 13 InsO and see also par 6.2 above.

proving his or her claim to the satisfaction of the Court.²¹² The application by both the debtor and the creditor must be brought before the Court for one of three reasons in order to be considered.²¹³ The first of these reasons is the “illiquidity” of the debtor, meaning that the debtor will be unable to meet his or her debts as they become due.²¹⁴ The second condition that may lead to an order of insolvency is described as the “imminent and lasting inability to pay” meaning the debtor may likely be unable to meet his or her debts.²¹⁵ The third condition is known as *überschuldung* or over-indebtedness, meaning that the debtor’s liabilities on a balance sheet exceed his or her assets.²¹⁶ This third criterion is for corporate entities only and is not available to natural persons.²¹⁷

The German insolvency proceedings consist of two stages, the provisional administration or preliminary phase of the process and the opened proceedings stage.²¹⁸ The provisional administration phase begins when the application for an insolvency proceeding is filed, and normally lasts approximately three months until the Court makes a ruling on the application.²¹⁹ Once the application to open the procedure has been filed, the Court is obliged to protect the value of the debtor’s assets.²²⁰ To this end the

²¹²S 14(1) of the InsO. Secured creditors do not have to prove a legitimate interest against the debtor as they are deemed to have one already. For a further discussion see McBryde *et al Principles of European insolvency law* 318.

²¹³Ss 16–19 InsO.

²¹⁴S 17 InsO and Ziechmann *Business bankruptcy in Germany: An introduction analysis* 14. The illiquidity requirement is often presumed to be satisfied when the debtor stops making his or her payments. That notwithstanding, the German Federal High Court has held in a number of cases where a debtor can reasonably be expected to be able to pay those of his or her debts that are due and those that fall due within the preceding three weeks, he or she must be considered liquid. See DePonte *The definitive guide to distressed debt and turnaround investing* 138.

²¹⁵*Ibid* and s 18 InsO. The focus of the Court’s investigation into this condition will be on whether the debtor’s inability to pay will be long-term. As a result debtors with short-term cash flow problems will not be able to use this criterion to apply for protection under the InsO. In addition, under s 22 InsO creditors are prohibited from using this condition as a basis for an insolvency request for fear they may misuse the provision.

²¹⁶S 19(1) InsO.

²¹⁷S 19(3) InsO and see also North Rhine-Westphalia Justice Portal 2011 www.justiz.nrw.de 2.

²¹⁸McBryde *et al Principles of European insolvency law* 318.

²¹⁹*Ibid*.

²²⁰Halladay and Jark 2010 www.blog.dlapiper.com 6 and DePonte *The definitive guide to distressed debt and turnaround investing* 138.

InsO does not provide for an automatic stay; it does however allow the Court to make any appropriate order to protect the debtor's assets.²²¹ The Court also normally appoints what is known as a temporary insolvency administrator during the period immediately after the application is filed and before it makes a ruling on the application. Where the debtor is a merchant, trader or sole proprietor of a business the temporary administrator continues the debtor's business on his or her behalf.²²² The temporary administrator is also obliged during this preliminary administration phase to compile an official report on the debtor's finances and form an opinion as to whether any of the insolvency criteria discussed above have been met and whether the debtor has enough assets to cover the sequestration costs.²²³

After taking the report of the temporary administrator into account the Court has the discretion to refuse the application or open an insolvency proceeding.²²⁴ Where the Court is of the opinion that the debtor's estate cannot cover the costs of the insolvency it will refuse the application.²²⁵ The Court will then consider a debt restructuring order. Where the Court decides insolvency proceedings should be opened, the Court will appoint the permanent insolvency administrator.²²⁶ This is what is known as the opened proceedings phase. The Court also sets the date for the first creditors' meeting known as the *Berichtstermin* or the report meeting.²²⁷ At this meeting the creditors decide on whether to proceed with liquidation or a debt reorganisation plan, or to replace the Court-appointed administrator and issues regarding the course of the procedure.²²⁸ In the usual manner of sequestration the claims of the creditors have to be filed with the

²²¹ S 21 and 22(1) InsO. The usual measures offered in this regard are that the Court may issue a general prohibition against any transfers of the debtor's property and all execution proceedings against the debtor. See McBryde *et al Principles of European insolvency law* 318 for further discussion on the Court's role in protecting the debtor's assets during the preliminary administration phase.

²²² S 22(1) par 1 InsO.

²²³ S 22(1) par 3 InsO and Halladay and Jark 2010 www.blog.dlapiper.com 9.

²²⁴ S 26 and 27(1) InsO read together.

²²⁵ *Ibid.* Under the current regime the debtor may apply for a deferral of costs payment – see par 6.3.2.4 below.

²²⁶ S 27(2) InsO.

²²⁷ *Ibid.*

²²⁸ Hess *Insolvenzrecht: großkommentar in drei bänden volume 1* 764.

administrator. These claims are then verified in a so-called “verification meeting” similar to the one previously described for the Netherlands.²²⁹

6.3.2.2 *Insolvency plan and self-administration*

The operation of an insolvency plan under the German regime is somewhat similar to the Tanzanian composition after the filing of a bankruptcy petition.²³⁰ The Insolvency plan concept was introduced in the InsO in 1999 and is heavily based upon the US Chapter 11 procedure.²³¹ Although not commonly used in practice, it provides the parties involved with the flexibility to provide an amiable solution for the debtor to repay his or her debts.²³² One of the advantages of an insolvency plan is that certain compulsory statutory provisions that deal with the sale and distribution of the debtor’s assets may be waived.²³³ An insolvency plan is only available within the insolvency procedure and may not be initiated before an insolvency proceeding is open.²³⁴

Only the debtor or the insolvency administrator can propose an insolvency plan.²³⁵ Although creditors cannot themselves propose a plan, they may, however, through the creditors’ assembly, instruct the insolvency administrator to make a proposal.²³⁶ The law does not determine the course or purpose of engaging in an insolvency plan to the debtor or creditors.²³⁷ The parties to the plan are allowed to negotiate and be creative in finding an amicable solution.²³⁸

²²⁹ S 176 InsO and see also par 6.2.1 above.

²³⁰ See par 3.3.6 above.

²³¹ Hess *Insolvenzrecht: großkommentar in drei bänden volume 1* 3326. The Chapter 11 procedure however caters for business debtors and corporations. See Newton *Bankruptcy and insolvency accounting, practice and procedure* 9.

²³² *Ibid* and Halladay and Jark 2010 www.blog.dlapiper.com 16. As a result of a few high profile companies such as electronics traders ProMarkt using the insolvency plan, the use of insolvency plans has been rising as the measure’s popularity increases.

²³³ *Ibid*.

²³⁴ Reischl *Insolvenzrecht* 232.

²³⁵ S 218(1) InsO.

²³⁶ S 218(2) InsO.

²³⁷ *Ibid*.

²³⁸ North Rhine-Westphalia Justice Portal 2011 www.justiz.nrw.de 7.

The InsO does however determine that the insolvency plan has to consist of both a declaratory and a constructive part.²³⁹ The declaratory section of the plan describes the measures that will be taken and sets out the terms which the debtor must complete before he or she is rehabilitated.²⁴⁰ The constructive part of the plan determines the legal position of the parties involved in the plan after the plan has been carried out.²⁴¹ One of the key principles of this debt relief measure is that the creditors may, under the direction of section 222, be divided into separate groups and be treated differently under the plan if a good reason exists for such separation.²⁴²

Once the plan has been negotiated and tabled to the creditors at a meeting of the creditors, the creditors must consent to the plan via a vote.²⁴³ The creditors' vote takes place within the groups that have been described in the proposed plan.²⁴⁴ The plan is consented to where a majority of the voting creditors in number and in value in each group accept the proposal.²⁴⁵ In order to stop a viable insolvency plan from failing the InsO has incorporated a safeguard against one group of creditors torpedoing a practical plan.²⁴⁶ Once a majority of the creditor groups have accepted the plan, but in one group the required majority was not achieved, that group is deemed to have consented if the creditors of that group will not be worse off under the proposed plan.²⁴⁷ The debtor must also consent to the proposed plan.²⁴⁸ However, he or she is also deemed to consent where he or she, under certain circumstances, will not be worse off under the insolvency plan than without it.²⁴⁹

²³⁹S 219 InsO.

²⁴⁰S 220 InsO.

²⁴¹S 221 InsO.

²⁴²Lachmann 2008 www.ec.europa.eu 14 and 15. Creditors may for example be divided into unsecured and secured creditors or those that incurred their debts before a particular action by the debtor. There is complete freedom in making these divisions as long as a valid reason exists for the division. See also Halladay and Jark 2010 www.blog.dlapiper.com 17 in this regard.

²⁴³S 235 InsO.

²⁴⁴S 243 InsO.

²⁴⁵S 244(1) InsO.

²⁴⁶Reischl *Insolvenzrecht* 233.

²⁴⁷S 245(1) InsO.

²⁴⁸S 247(2) InsO.

²⁴⁹S 247(2) par 1 InsO.

When the creditors have agreed to the plan it must be confirmed by the District Court.²⁵⁰ Once the Court confirms the plan, the insolvency plan is binding on all the creditors.²⁵¹ The insolvency proceedings are immediately terminated and the debtor regains control of his or her estate.²⁵² The insolvency plan may provide for the debtor's supervision during the duration of the insolvency plan.²⁵³

During the insolvency liquidation proceedings or an insolvency plan, the debtor may apply for *eigenverwaltung* or self-administration.²⁵⁴ Self-administration is similar to the debtor in possession concept of the United States, under Chapter 11.²⁵⁵ Under this innovation the debtor remains in control of his or her assets and administers the procedure agreed among the parties whether it is an insolvency plan or liquidation under the supervision of a Court-appointed custodian.²⁵⁶ The introduction of this procedure is meant to encourage debtors to file for insolvency sooner, when more options are available for the restructuring of their businesses and obligations.²⁵⁷

The InsO outlines the following conditions before an order for self-administration may be awarded:²⁵⁸

- (a) the debtor must apply for the order at the District Court where the insolvency application was made;
- (b) an order for self-administration must not delay the formal insolvency proceeding or prejudice the creditors; and

²⁵⁰S 248 InsO.

²⁵¹Reischl *Insolvenzrecht* 234.

²⁵²*Ibid.* As a result of the ruling the creditors' bodies such as the committee and creditors' meetings are released from their obligations.

²⁵³S 260 and 261 InsO. This supervision process may only continue for three years after the insolvency proceedings have been terminated.

²⁵⁴S 270(1) InsO.

²⁵⁵Halladay and Jark 2010 www.blog.dlapiper.com 19.

²⁵⁶North Rhine-Westphalia Justice Portal 2011 www.justiz.nrw.de 2.

²⁵⁷*Ibid.*

²⁵⁸S 270(2) par 1-3 InsO.

- (c) where the application for insolvency was filed by a creditor, that creditor must consent to the debtor application for self-administration.

Self-administration of insolvency proceedings is not commonly used in practice and the Courts appear to be hesitant to make such orders.²⁵⁹ The main concern of course of any Court in a conservative jurisdiction, no matter how open-minded the times are, is allowing a manager who has already led his or her enterprise into a financial collapse to remain in control over liquidation proceedings.²⁶⁰

6.3.2.3 *Closure of the process*

Where the insolvency proceeding has run its course and produced a confirmed insolvency plan or the debtor is the subject of an insolvency order and monies have been distributed, the Court may declare the proceeding terminated.²⁶¹ The Court does this by issuing a decree which is published in the relevant Federal Bulletin.²⁶² Where an insolvency plan is involved this may occur only after the plan has been confirmed. Only then can the Court make a decision on the termination of the insolvency proceedings.²⁶³ Where there is a straight insolvency and no insolvency plan, the debtor's estate must first be liquidated in the normal manner.

While the termination of proceedings may remove most of the restraints imposed by the insolvency on the debtor, it does not provide him or her automatically with a complete discharge.²⁶⁴ Discharge of any outstanding debt from the insolvency proceeding must be formally requested to the Court under sections 286 to 303 of the InsO. A full discharge of residual debt is available to any natural person, whether a business person or a normal consumer.²⁶⁵

²⁵⁹Halladay and Jark 2010 www.blog.dlapiper.com 17.

²⁶⁰*Ibid.*

²⁶¹S 200 InsO and McBryde *et al Principles of European insolvency law* 364.

²⁶²*Ibid* see also s 9 InsO.

²⁶³S 258 InsO.

²⁶⁴McBryde *et al Principles of European insolvency law* 365.

²⁶⁵*Idem* 368.

Failure to apply for a discharge means that after termination of the insolvency proceeding a debtor is still liable for the pre-insolvency debt.²⁶⁶

6.3.3 Ordinary Consumers and Discharge of Debt

With regard to normal consumers that are not involved in independent economic activity,²⁶⁷ the InsO provides for a separate procedure aimed at providing them with debt relief.²⁶⁸ Although the entry gate into the unitary debt relief measure remains the same as that of the business debtors, the normal consumer's procedure involves three main steps:²⁶⁹

- (a) the debtor must first attempt an out-of-court settlement of the debt with his or her creditors;
- (b) where this fails, he or she may attempt a judicial settlement plan which involves the debt restructuring procedure; and
- (c) where the judicial settlement plan fails the debtor will be subject to a simplified insolvency proceeding.

6.3.3.1 Attempt of extra-judicial settlement

Before the debtor may apply for formal insolvency proceedings using the same route as a business debtor, he or she must attempt to resolve his or her disputes with the creditors through debt counselling.²⁷⁰ This step was included in the InsO to ensure that fewer insolvency cases are overseen by an already strained judiciary in Germany.²⁷¹ In Germany this process is facilitated by debt counselling which is provided by consumer organisations, social agencies, charitable organisations, trade unions, and other not-for-profit institutions.²⁷² The InsO enforces this step in the consumer debt relief process by requiring that the debtor submit a certificate to the effect that he or she has made such

²⁶⁶S 201 InsO.

²⁶⁷See par 6.1 above.

²⁶⁸Kilborn *Comparative consumer bankruptcy* 77. Consumer insolvency proceedings or so-called "minor proceedings" are more flexible, faster, and cheaper than regular insolvency proceedings for individuals involved in business.

²⁶⁹Braun 2005 *German Law Journal* 62.

²⁷⁰Reischl *Insolvenzrecht* 239.

²⁷¹*Ibid.*

²⁷²Niemi-Kiesilainen 1999 *Osgoode Hall Law Journal* 410.

an attempt before his or her application for insolvency may be accepted.²⁷³ The certificate has to state that within the last six months the debtor made an attempt to reach an out-of-court settlement with his or her creditors on the basis of a settlement plan that failed.²⁷⁴ Although current statistics are hard to come by, a study in 2001 showed that in Berlin, 44 per cent of credit counselling applications resulted in settlements being reached between the parties.²⁷⁵

6.3.3.2 *The judicial settlement plan proceedings*

Where debt counselling fails to yield an amicable solution to the dispute between the debtor and his or her creditors, the debtor may file an application to open insolvency proceedings.²⁷⁶ The filing of the insolvency proceedings takes the same form as that of business debtors, except for certain annexures which are added to inform the Court on its decision whether or not to award the settlement plan.²⁷⁷ While the debtor must of course submit the certificate declaring that he or she attempted an out-of-court settlement plan, he or she must also submit, among other documents:²⁷⁸

- (a) a draft settlement plan;
- (b) a record of his or her income, assets, and liabilities;
- (c) a record of his or her creditors and debts; and
- (d) a request for a discharge of his or her residual debt.²⁷⁹

Where a creditor has filed an insolvency application against the debtor and the debtor makes a successful request to the Court for a debt reorganisation proceeding, the debtor will also have to deliver these documents to the

²⁷³S 305(1) par 1 InsO. The proposed plan that failed must also be enclosed in the insolvency application and the primary reasons for its failure must be explained.

²⁷⁴*Ibid* and Reischl *Insolvenzrecht* 239. Under section 305a InsO the out-of-Court settlement will be deemed to have failed where, after debt counselling has begun, one of the creditors seeks an order of specific performance or coercive execution from the Court.

²⁷⁵Kilborn 2004 *Northwestern Journal of International Law and Business* 275.

²⁷⁶Bork *Einführung in das insolvenzrecht* 213.

²⁷⁷*Ibid*.

²⁷⁸S 305(1) par 1 to 4 InsO.

²⁷⁹*Ibid* and see also s 287 InsO.

Court.²⁸⁰ When the Court has heard the debtor, it will issue the order only if it is of the opinion that a Court-supervised settlement plan will succeed where an out-of-court plan failed.²⁸¹ German Courts also accept settlement plans where the debtor has no income and no assets that in all probability will provide no benefit to the creditors.²⁸² These are known as “zero plans”.²⁸³ The effect of such acceptance is best explained in the booklet of the *German North Rhine-Westphalia Justice Portal on Insolvency*.²⁸⁴

The effect of the acceptance of the zero-plans by the Courts is that debtors, either in the settlement plan proceedings, or at the latest after the six years of the discharge proceedings can be freed of their debts even if they cannot pay anything to their creditors.

However, it must be noted that the debtor in Germany is required by law to make a principled effort to find a job and keep it, in an endeavour to pay off his or her creditors.²⁸⁵ Where the debtor does not make such an effort the creditors may apply to have the debt restructuring proceeding cancelled.²⁸⁶ However, despite the debtor’s best efforts, if he or she cannot find or maintain a job, he or she does not lose his or her opportunity of a fresh start.²⁸⁷

Where the Court decides in favour of the judicial settlement plan, the plan and all its annexures are served on all creditors who are named by the debtor.²⁸⁸ Where all the creditors consent to the proposed plan or do not object to it within one month of receiving the relevant documents, they are deemed to have consented to the plan.²⁸⁹ Where more than half of the creditors in number and in value of their claims have consented to the plan, the Court

²⁸⁰ S 305 InsO.

²⁸¹ S 306(1) InsO.

²⁸² Reischl *Insolvenzrecht* 245.

²⁸³ *Ibid.*

²⁸⁴ North Rhine-Westphalia Justice Portal 2011 www.justiz.nrw.de 8.

²⁸⁵ S 295 InsO and Kilborn 2004 *Northwestern Journal of International Law and Business* 280.

²⁸⁶ *Ibid.*

²⁸⁷ *Ibid.* The same procedure is followed in Sweden, France, Finland and the Netherlands where the debtor under a repayment plan is unable to make any payments. See Van Apeldoorn 2008 *International Insolvency Law Review* 65 for further discussion on this issue.

²⁸⁸ S 307(1) InsO. The requests to open insolvency proceedings and to grant discharge of residual debt shall be regarded as retracted. See S 307(2) InsO.

²⁸⁹ S 308(1) InsO and Kilborn *Comparative consumer bankruptcy* 77.

may dispense with the objections of the minority creditors under certain circumstances.²⁹⁰ On the other hand, where a majority of the creditors reject the plan, the debt settlement proceeding is terminated and the debtor is liquidated.²⁹¹

6.3.3.3 *Insolvency and discharge proceedings*

In practice, once the out-of-court debt counselling process fails, more often than not the Court-guided debt settlement plan will also fail.²⁹² As soon as the Court-led process fails, the simplified consumer insolvency proceedings begin. These are known as the *vereinfachtes verbraucherinsolvenzverfahren*.²⁹³ These proceedings in theory take place in two stages.²⁹⁴ In the first phase of the proceedings the Court appoints a trustee who liquidates the debtor's estate and distributes the proceeds among the creditors.²⁹⁵ The second phase of the simplified insolvency is referred to as the "good behavior period"²⁹⁶ and lasts for approximately six years. During this period the debtor assigns all of his or her excess income to the trustee.²⁹⁷ Once every year during this period the trustee distributes this income to the creditors.²⁹⁸ After six years the Court will decide on the discharge of the debt.²⁹⁹ The discharge issued by the Court is intended only for honest debtors. Therefore, creditors may request the Court not to issue a discharge where the debtor for example:³⁰⁰

- (a) has been convicted of a bankruptcy crime;
- (b) within the last three years before the opening of the proceedings made false statements to obtain a loan from a public fund or to avoid making payments to such funds;

²⁹⁰ S 309(1) InsO and Reischl *Insolvenzrecht* 244.

²⁹¹ S 311 InsO.

²⁹² Kilborn *Comparative consumer bankruptcy* 77.

²⁹³ *Ibid.*

²⁹⁴ Reischl *Insolvenzrecht* 287.

²⁹⁵ Ss 312–314 InsO.

²⁹⁶ Kilborn *Comparative consumer bankruptcy* 77 and 78. This stage of the simplified insolvency is the main part of the proceeding.

²⁹⁷ S 287 InsO.

²⁹⁸ *Ibid.*

²⁹⁹ *Ibid.*

³⁰⁰ *Ibid* and s 290(1) pars 1–6 InsO.

- (c) has previously obtained a debt discharge under the InsO within the last ten years; and
- (d) intentionally or through gross negligence infringes the obligations of disclosure or cooperation under the InsO during the insolvency proceedings.

During this second phase of the simplified insolvency the German legislature also provides incentives for the debtor to continue on the plan; these are known as “motivational rebates.”³⁰¹ At the end of the fourth year of the plan the trustee refunds the debtor with ten per cent of the income gathered by the trustee that year, in the fifth year of the plan the debtor receives 15 per cent of the monies gathered back.³⁰² These rebates are meant to encourage the debtor towards the end of the plan where he or she may have started to lose motivation to make payments and continue to work hard to earn income.

6.3.3.4 *Efficiency of the procedure and deferment costs*

During the first year that the InsO was in force it encountered a few operational issues.³⁰³ According to unconfirmed reports, only 13 per cent of the applications for consumer insolvency proceedings have led to a discharge for the debtor under the Act.³⁰⁴ A few examples of the problems faced were:³⁰⁵

- (a) major creditors such as banks did not wish to cooperate in the negotiations;
- (b) debt counselling agencies were strained and long waiting lists existed at the time for the service; and
- (c) some of the district judges in exercising their discretion to order a debt settlement proceeding were of the opinion that the debtor needed to be able to make a certain minimum dividend payment.

³⁰¹Kilborn *Comparative consumer bankruptcy* 78.

³⁰²*Ibid.*

³⁰³Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 140.

³⁰⁴*Ibid.*

³⁰⁵Braun 2005 *German Law Journal* 70.

The judicial settlement plan proceedings were also criticised for being too complex and being able to come to an end without the debtor's participation. The procedure was also frowned upon for not holding creditors accountable for their part in the debtor's over-indebtedness.³⁰⁶

Another problem which initially arose was that the debtor had to bear his or her own costs to apply for debt relief under the InsO.³⁰⁷ In 1999 Germany had 2.8 million over-indebted households, but only 1,634 debtors succeeded in their applications for consumer insolvency proceedings.³⁰⁸ Busch singles out section 26(1) of the InsO as the cause for such low figures.³⁰⁹ This provision states that the debtor's assets must cover the administration costs of the proceeding, or the application is dismissed. In response to this the legislature in 2001 introduced a deferment of costs of the insolvency proceedings as a unique form of legal aid.³¹⁰ Under section 4a of the InsO a natural person subject to insolvency proceedings who has filed for a discharge may on application be granted deferment of insolvency proceedings costs, provided that his or her assets will seemingly not cover these costs.³¹¹ Consequently, in 2002 the number of debtors who requested insolvency proceedings and the discharge of residual debt rose by 61.5 per cent.³¹²

6.4 Sweden

Sweden's economy was severely affected by the credit deregulation in the 1980s.³¹³ During this period the economic crisis included a real estate market crash and an increase in unemployment in the early 1990s.³¹⁴ The real estate crash led consumers to take on large amounts of credit in order to purchase property and to stay abreast of their installments, which was possible to do at

³⁰⁶ *Ibid.*

³⁰⁷ Busch 2006 *German Law Journal* 592.

³⁰⁸ *Ibid.*

³⁰⁹ *Ibid.*

³¹⁰ *Ibid.*

³¹¹ Moser and Horal 2007 www.ecdn.eu 6. These costs are transferred to the Federal Cash Office and payment is postponed till the debtor is able to pay these costs. They may even be paid in instalments at a later date.

³¹² Busch 2006 *German Law Journal* 592.

³¹³ Kilborn 2006 *American Bankruptcy Law Journal* 437.

³¹⁴ Freeman *et al* *Reforming the welfare state: Recovery and beyond in Sweden* 8.

the time due to the deregulation.³¹⁵ This type of debt became a serious burden to the normal consumer, especially when unemployment became an issue as a result of the meltdown. This gave rise to a large amount of consumers struggling with debt.³¹⁶ The consumers' plight soon caught the attention of the Swedish law makers who enacted the *Debt Relief Act* of 1994 as a supplement to the bankruptcy procedure already available.³¹⁷ Thus at present in Sweden, consumers in financial distress have two formal options for debt relief: bankruptcy under the *Bankruptcy Act* of 1987³¹⁸ and debt adjustment under the *Debt Relief Act* of 1994.³¹⁹

Due to teething problems in the implementation of the *Debt Relief Act* of 1994, Sweden made some wholesale changes to their debt relief system in 2007 that are important to this study.³²⁰ These changes included the elimination of informal debt counselling, the centralisation of the administration, and consolidating oversight of the formal debt relief procedures into one government agency.³²¹

6.4.1 Bankruptcy

A debtor can be subject to a bankruptcy proceeding in Sweden only when he or she is insolvent. A debtor is insolvent in this jurisdiction where he or she cannot meet his or her obligations when they fall due, and this inability to pay must not be temporary.³²² The debtor must be so over-indebted that he or she must not be able to meet his or her debts indefinitely.³²³ The bankruptcy of the debtor, whether he or she is a natural person or a juristic person, may be

³¹⁵ *Ibid.*

³¹⁶ Niemi-Kiesilainen 1999 *Osgoode Hall Law Journal*

³¹⁷ Bogdan *Swedish law in the new millennium* 234.

³¹⁸ The Swedish *Bankruptcy Act* will be referred to as the SBA hereinafter.

³¹⁹ *Ibid.*

³²⁰ Kilborn 2006 *American Bankruptcy Law Journal* 154. Among the changes that were made to the original procedure was the removal of mandatory debt counselling before the application for debt restructuring made by the consumer, for the reason that it wasted time. See par 6.4.2 below.

³²¹ *Ibid.*

³²² Chapter 1 s 1 of the SWB.

³²³ Vandone *Consumer credit in Europe: Risks and opportunities of a dynamic industry* 96.

initiated by petition either by the debtor or a creditor.³²⁴ The primary requirement in a petition for bankruptcy in Sweden is that the applicant must show that the debtor is insolvent. Where the debtor is the applicant he or she must also provide proof of balance sheet insolvency.³²⁵ Any information presented by the debtor that he or she is factually insolvent shall be accepted by the District Court unless there is special reason not to do so.³²⁶ Curiously, secured creditors may not present a bankruptcy petition against a debtor.³²⁷

Once the order is granted a permanent administrator is appointed by the Court to take control of the debtor's assets including any business that the debtor may be operating.³²⁸ In Sweden the debtor prepares an estate inventory of assets and after the granting of the bankruptcy order swears to the contents of the inventory before a commissioner of oaths.³²⁹ The bankruptcy order contains the date for the meeting at which the debtor shall take the estate inventory oath.³³⁰ The normal sale of assets and distribution of monies to the creditors follows. During the bankruptcy the Royal Debt Collector's Office that is responsible for debt enforcement supervises the bankruptcy to ensure that it is conducted in line with the country's law.³³¹

The debtor and his or her creditors may agree to a composition in full and final settlement of the debt, allowing the debtor to apply for an annulment order.³³² A composition can only be proposed under the *Bankruptcy Act* during bankruptcy and after the creditors have proved their claims.³³³ This composition must be approved by the Court. Where a composition is not made or is rejected, the bankruptcy is considered complete only after the

³²⁴Chapter 2 s 2 of the SWB. The petition must be in writing and must justify the competence of the District Court to hear the matter. Failure to do so results in the petition being moved *ex lege* to the appropriate Court.

³²⁵Chapter 2 s 7 of the SWB.

³²⁶*Ibid.*

³²⁷Chapter 2 s 10 and Chapter 3 s 1 of the SWB.

³²⁸Chapter 2 s 24 and Chapter 7 s 2 of the SWB.

³²⁹Chapter 6 s 3 of the SWB.

³³⁰Chapter 2 s 24(1) of the SWB.

³³¹Chapter 5 s 27 of the SWB. See par 6.4.2 below for a discussion on the Royal Debt Collector's Office.

³³²Chapter 12 of the SWB.

³³³Chapter 12 s 3 of the SWB.

District Court has confirmed the administrator's distribution account.³³⁴ There is no provision in the Swedish *Bankruptcy Act* that states that the debtor receives a discharge after completion of the bankruptcy process.³³⁵ Therefore bankruptcy does not provide the Swedish consumer with a discharge from pre-bankruptcy debt. This may be one of the reasons why natural persons hardly ever use the bankruptcy procedure in Sweden.³³⁶

6.4.2 Debt Restructuring

The Swedish debt restructuring procedure will not be dealt with extensively due to its resemblance to the German system's procedure. The focus of this discussion will therefore be on the advances in the process as a result of the amendments to the original procedure in 2007. One such amendment is the removal of mandatory debt counselling before the application for debt restructuring. It was decided during the buildup to these amendments that counselling was a waste of time and had no real benefits for debtors.³³⁷ Although debtors may still seek an out-of-court settlement with the aid of debt counsellors, it is no longer a requirement for acceptance into the debt restructuring procedure in Sweden.

A consumer may apply for debt restructuring only where he or she is heavily burdened by so much debt that he or she will not be able to pay off his or her debts in the foreseeable future.³³⁸ The petitions for debt restructuring in this jurisdiction are not submitted to the Courts, but rather to a government administrative body.³³⁹ The government body in Sweden is known as the *Kronofogdemyndigheten*, which translates to the Debt Enforcement Agency and is also known as the Royal Debt Collector's Office.³⁴⁰ The main activity of the Royal Debt Collector's Office is to act as an official debt collector for public

³³⁴ Chapter 11 s 18 of the SWB.

³³⁵ Ginsburg *et al Civil procedure in Sweden* 341.

³³⁶ www.kronofogden.se (last accessed 2012-05-02).

³³⁷ Kilborn 2006 *American Bankruptcy Law Journal* 437.

³³⁸ Moser and Horak www.ecdn.eu 8 and McGregor *et al* 2001 *International Journal of Consumer Studies* 210.

³³⁹ Both in France and Luxemburg similar bodies are in charge of debt collection. Kilborn 2006 *American Bankruptcy Law Journal* 440.

³⁴⁰ *Ibid.*

departments, private individuals and companies.³⁴¹ The Authority is accountable to central government but operates as an independent public authority. The reasoning behind this is to stop the Swedish government from having any influence over the affairs of individuals or businesses through the Authority.³⁴² The recent reforms also gave the Debt Collector's Office the powers previously held by the Court to force creditors who did not accept the debt adjustment plan to be bound by it. Indeed, it is safe to say that apart from hearing appeals from the parties to the debt relief process, after 2007 the Court has played no role in the debt restructuring process.

With respect to this regime's administrative structure, Huls notes that because the government is a major creditor in a majority of debt relief procedures, having a government department responsible for debt relief procedures creates a conflict of interest.³⁴³ While it is correct that allowing a creditor to be an arbiter in a debt relief procedure will create a conflict, it is suggested that because the Swedish Debt Collector's Office is independent from the executive branch of government, this conflict may be sufficiently reduced for the Authority to operate on some acceptable impartial level.

All applications for debt restructuring are lodged with the Debt Collector's Office. On application by the debtor, the Debt Collector's Office has the discretion to open a case for debt restructuring.³⁴⁴ The Authority will only open a case where it is of the opinion that the debtor's personal and economic circumstances indicate that it is reasonable that a debt adjustment should be granted to the debtor.³⁴⁵ Kilborn notes that the following factors have been shown to be considered by the Authority when deciding on debt adjustment applications:³⁴⁶

³⁴¹ www.kronofogden.se (last accessed 2012-05-02). This Enforcement Authority has the power to decide on debt relief applications, the length of the repayment plan and the termination of the plan. See also Huls 2012 *Journal of Consumer Policy* 504.

³⁴² *Ibid.*

³⁴³ Huls 2012 *Journal of Consumer Policy* 504.

³⁴⁴ Moser and Horak www.ecdn.eu 8.

³⁴⁵ *Ibid* and Kilborn 2006 *American Bankruptcy Law Journal* 440.

³⁴⁶ Kilborn *Comparative consumer bankruptcy* 91.

- (a) The debts must be old enough to demonstrate that the debtor has struggled with them for a while.
- (b) The main causes of the debtor's financial dilemma. This factor looks at the good faith aspect of the debtor's predicament. In other words where the debt was caused by criminal activity, gambling or reckless over-expenditure the application will not be granted.
- (c) The authority will also look at the efforts made by the debtor to pay off his or her debts Swedish law requires that the debtor make an effort to find a job and maintain it in order to pay off his or her debts. This requirement is similar to that of the German system; in Sweden however, the debtor must make an effort even before being granted formal debt relief rather than during the procedure.³⁴⁷

In Sweden the opportunity for a complete discharge of debt through debt restructuring is seen as a very high privilege and a once in a lifetime chance to walk away from debt.³⁴⁸ Unlike in Germany where a debtor can seek another discharge after ten years, in Sweden a discharge is a onetime deal for the most part. A second discharge is possible in theory for what is referred to as "extreme reasons", but is not easily be granted.³⁴⁹ Therefore the screening process is extremely detailed and thorough.³⁵⁰

Once a petition for debt restructuring has been lodged with the Authority, each petition undergoes diligent screening to ascertain whether the debtor meets the requirements to enter the debt relief procedure.³⁵¹ If he or she meets the requirements discussed above, a debt restructuring case is opened. The Authority will calculate what portion of the debtor's income will be paid to the creditors, using budgetary guidelines set by the Swedish Tax Service.³⁵² Unlike any of the systems previously discussed in this study with regard to the

³⁴⁷ See par 6.3.2.2 above.

³⁴⁸ Kilborn *Comparative consumer bankruptcy* 91.

³⁴⁹ *Ibid.*

³⁵⁰ *Ibid.*

³⁵¹ *Ibid.*

³⁵² Kilborn 2006 *American Bankruptcy Law Journal* 440.

execution of debt restructuring plans, there are no intermediaries in the Swedish system, thereby saving costs.³⁵³ Debtors are charged under the plan to deliver the monies they owe to creditors themselves and the creditors remain as the only checks that the debtor is actually making his or her payments.³⁵⁴

Once the debtor has completed the five-year plan he or she receives a full discharge from all the debts that were included in the plan, regardless of whether or not they were paid in full.³⁵⁵ During the duration of the plan there is a moratorium on any actions against the debtor for specific performance.³⁵⁶ The costs of the debt restructuring process and the related activities of the Authority are covered by the Swedish government. Therefore the process is free.³⁵⁷ Where the debtor has no income above the minimum amount he or she needs to survive, he or she is not required to make any payments to creditors.³⁵⁸ This occurs in approximately half of the cases accepted for the procedure in Sweden, and is similar to the situation under the German debt restructuring plan.³⁵⁹ Where the debtor has made a substantial effort to get a job and maintain it, he or she will not lose out on his or her fresh start.³⁶⁰

6.5 Conclusion

Before the 1980s and 90s the only debt relief measures available to over-indebted consumers in continental Europe were bankruptcy and, depending on the jurisdiction, a statutory composition. None of these procedures could at the time force a discharge of the debtor's debt on his or her creditors.³⁶¹ The debt relief procedures that allow debtors to force a discharge on their creditors were enacted in the 1980s due to necessity during the economic depression

³⁵³Kilborn *Comparative consumer bankruptcy* 90.

³⁵⁴*Ibid.* Where the debtor is not honouring his obligations under the plan, creditors can apply to the Enforcement Authority for enforcement of the plan.

³⁵⁵Bogdan *Swedish law in the new millennium* 165.

³⁵⁶Moser and Horak www.ecdn.eu 8.

³⁵⁷*Ibid.*

³⁵⁸Bogdan *Swedish law in the new millennium* 165.

³⁵⁹*Ibid.* See also par 6.3.2.2 above.

³⁶⁰Kilborn *Comparative consumer bankruptcy* 91.

³⁶¹Par 6.1 above.

in the region.³⁶² During these reforms, despite the large numbers of over-indebted consumers, these conservative jurisdictions still resolved not to release any debtors from their debts without them first earning the discharge.³⁶³ Furthermore, they decided that only *bona fide* debtors could earn a fresh start.³⁶⁴ Today, therefore, a fresh start is earned by completing a rigorous repayment plan, the duration of which may vary from three to seven years, depending on the jurisdiction. True to their conservative roots on the subject of discharging debtors, none of the jurisdictions in this region present with an automatic discharge provision, and some still do not have a discharge provision in their main bankruptcy procedure.

The Netherlands debt relief system consists of bankruptcy and two alternatives. The bankruptcy procedure is quite similar to the bankruptcy procedures in the common law jurisdictions and the South Africa system discussed above.³⁶⁵ With respect to the straight liquidation procedure in the Netherlands one point does, however, stand out: the fact that a completed bankruptcy procedure does not provide a discharge for the debtor.³⁶⁶ This failure to grant a discharge is a remnant of the conservative approach of the European jurisdictions prior to the debt relief renaissance in continental Europe towards the end of the millennium.

The first alternative to bankruptcy in the Netherlands is a suspension of payments. This procedure is intended for companies and natural persons involved in business.³⁶⁷ Here the debtor is provided with a moratorium to reorganise his or her affairs under formal supervision. It is noted that the procedure is hardly ever used by natural persons engaged in business for a variety of reasons, including the fact that the moratorium does not include statutory preferent and secured claims.³⁶⁸ Such a procedure, it is submitted, is

³⁶² *Ibid.*

³⁶³ *Ibid.*

³⁶⁴ Van Apeldoorn 2008 *International Insolvency Law Review* 65.

³⁶⁵ Par 6.2.1 above.

³⁶⁶ Par 6.2.2 above.

³⁶⁷ Par 6.2.3 above.

³⁶⁸ *Ibid.*

of very little use in Tanzania where the majority of credit is given only with real security collateral.³⁶⁹

The second alternative to bankruptcy in the Netherlands is a debt reorganisation scheme.³⁷⁰ A debtor may not gain access to this procedure if he or she does not make an attempt to settle his or her debts through extra-judicial debt counselling.³⁷¹ The Netherlands legislature has recently created a legal duty of care in the municipalities involving this type of informal debt counselling.³⁷² The purpose of this minimum standard is to increase the use and success rate of informal debt counselling in the Netherlands. Where this process fails however, the debtor may apply for a Court-driven debt reorganisation order. Before granting the order, the Court must be satisfied that the debtor incurred his or her debt in good faith.³⁷³ During the initial hearing for the debt reorganisation order, the debtor may apply to the Court to force a creditor who was unreasonably refusing a negotiated settlement during the informal counselling process, to accept the plan and bring the proceedings to a close.³⁷⁴ An application for a preliminary injunction may also be brought with the initial application by the debtor for protection against imminent loss of his or her utilities or imminent eviction from a leased premise.³⁷⁵

The plan normally involves a combination of liquidation and a repayment plan involving the debtor's extra income for three years. The debt restructuring procedure, if properly executed amounts to a complete discharge. Furthermore, similar to Germany and Sweden, an individual under a debt reorganisation plan who is unable to pay anything over his or her subsistence budget can still receive a full discharge as long as good faith is shown through

³⁶⁹Par 1.1 above.

³⁷⁰Par 6.2.4 above.

³⁷¹*Ibid.*

³⁷²*Ibid.*

³⁷³*Ibid.*

³⁷⁴*Ibid.*

³⁷⁵*Ibid.*

his or her actions in trying to pay his or her creditors.³⁷⁶ This normally takes the form of a sustained effort to find a job and monies to repay his or her creditors.

Tanzania can take some lessons from the organisation of the Netherlands debt relief system. The Netherlands system prescribes a compulsory attempt at an out-of-court negotiated settlement for the debt reorganisation plan. This may be an ideal procedure to incorporate into the Tanzanian system as it would save both parties any costs that may be incurred with seeking a formal solution to the debtor's predicament. Allowing a provision similar to the Chapter 13 "cram down" for the extra-judicial debt counselling process is also a good idea as forcing the creditors to be bound to a reasonable plan at this initial stage will save time and Court costs. It is submitted that the absence of a discharge of the debtor's pre-sequestration debt in bankruptcy in the Netherlands may be too creditor-orientated for Tanzania, and provides little incentive for Tanzanian debtors to file for bankruptcy.

The combination of both liquidation and a repayment plan as an alternative to bankruptcy may be more beneficial to Tanzanian creditors than the straight repayment plans seen in Sweden and the United States. This type of alternative also increases the importance of creditors' interests in the all-important scale of creditor versus debtor interests discussed above.³⁷⁷ The Netherlands also requires that all debtors who are granted a debt restructuring order must have incurred their debt in good faith. This provision would be of some benefit to Tanzania and again is in line with the notion discussed earlier in this thesis that debt relief regimes should strive to favour honest debtors in debt relief proceedings. Moreover, on the issue of supporting the *bona fide* debtor, the provision that an honest poverty-stricken debtor may acquire a discharge through a repayment plan by showing sustained effort in finding employment, is appealing to any future reform in Tanzania.

³⁷⁶ *Ibid.*

³⁷⁷ See par 2.6 below.

The German debt relief procedure has two separate proceedings, one for business debtors as defined by the InsO and one for normal consumer debtors.³⁷⁸ Business debtors may be subject to the regular liquidation procedure only, while ordinary consumers are eligible for both a debt reorganisation plan and the liquidation procedure. Both these procedures are formally initiated by an application for insolvency hence, the analogy that Germany has one gateway for debt relief.³⁷⁹ Where the ordinary consumer opts for debt reorganisation he or she must first attempt an out-of-court negotiated settlement with his or her creditors through a credit agency.³⁸⁰ This out-of-court process takes the same form as the extra-judicial debt counselling exercise in the Netherlands. Where a creditor applies for the debtor's insolvency, the debtor may request to be admitted to the formal debt reorganisation procedure and bypass the debt counselling phase.³⁸¹ The business debtor does not need to attempt an out-of-court settlement before applying for insolvency, but may do so if he or she pleases. The German debt relief procedure provides for a deferment of the costs of the insolvency proceedings where the debtor cannot offset these costs immediately. These costs may be paid by instalment at a later date to the Federal Cash Office.³⁸²

Once a business debtor has been issued an insolvency order he or she may wish to initiate an insolvency plan that is more or less a composition.³⁸³ There is also the possibility of continuing with the liquidation. The liquidation or the insolvency plan may be conducted under self-administration.³⁸⁴ This procedure is hardly ever awarded to natural debtors in Germany and is rather reserved for legal persons.³⁸⁵ Natural business debtors may apply for a complete discharge of their residual debt after the insolvency plan or straight liquidation procedure is complete.³⁸⁶

³⁷⁸ Par 6.3.1 above.

³⁷⁹ *Ibid.*

³⁸⁰ Par 6.3.3 above

³⁸¹ *Ibid.*

³⁸² Par 6.3.3.4 above.

³⁸³ Par 6.3.2.2 above.

³⁸⁴ *Ibid.*

³⁸⁵ *Ibid.*

³⁸⁶ *Ibid.*

Out of every ten attempts at extra-judicial debt counselling, just under half of these attempts succeed.³⁸⁷ It is submitted that this innovation is successful, as it prevents a large number of formal debt reorganisation procedures. Where the consumer's out-of-court debt settlement does fail, he or she may apply for a formal debt reorganisation order.³⁸⁸ He or she does so by applying for insolvency and attaching a proposed debt repayment plan plus other compulsory annexures to his or her pleadings. The Court also accepts petitions for so-called "zero plans" where the debtors have no income and no assets.³⁸⁹ Where the Court is in favour of the debt repayment plan, the creditors have to vote on the plan. Where a majority of the creditors in number and in value accept the plan, it is binding on all the creditors. Similar to the Netherlands and the United States, where a few creditors are unreasonably blocking the repayment plan at this stage, the Court may "cram down" the repayment plan on the creditors.³⁹⁰

Where the debt repayment plan has been accepted, the debtor must for six years make contributions from his or her surplus income to his or her creditors.³⁹¹ Where the debtor follows the plan he or she may receive a complete discharge of his or her residual debt. If the plan fails or it is ruled that it will not work by the Court, the consumer is liquidated in a simplified insolvency proceeding. A simplified insolvency proceeding is similar to the Netherlands debt repayment plan in that once the debtor's assets are summarily liquidated for the benefit of the creditors, the debtor is still subject to pay a portion of his or her surplus income to the creditors for six years.³⁹² At the end of the six years the Court must decide on whether or not to grant the debtor a discharge. When granting a discharge the main factor the Court will take into account is whether the debtor completed the simplified insolvency in good faith.³⁹³

³⁸⁷ Par 6.3.3.2 above.

³⁸⁸ *Ibid.*

³⁸⁹ *Ibid.*

³⁹⁰ *Ibid.*

³⁹¹ *Ibid.*

³⁹² *Ibid.*

³⁹³ *Ibid.*

Tanzania can learn a lot from the German debt relief system. The German system separates business debtors and consumer debtors. It appears that this division was made to provide a unitary summary procedure for consumer debt relief that would save costs and time. Since business debtors may be involved in complex transactions involving their assets and personal finances, they are subject to the normal liquidation procedure that has the provisions to cater for such transactions. Normal consumers have limited choices in Germany with regard to debt relief. There is only one unitary procedure and they must follow a fixed path through the process to obtain a discharge, or be subject to a liquidation proceeding. This restriction provides the debt relief system with a high level of control over consumers through the debt relief process and ensures that they do not pick the wrong procedure leading to debt traps as seen in the South African jurisdiction with respect to alternatives such as administration orders and debt counselling.³⁹⁴ This condensed structure bears some similarity to that in the United States, as the American system leaves little room for choice or any ambiguity among debtors with regard to the debt relief regime. The same cannot be said of systems with a proliferation of debt relief procedures, and this controlled structure may be ideal for the Tanzanian system. Furthermore, in the German system, the deferment of costs provision for insolvency may assist more Tanzanian debtors to afford debt relief.

The extra-judicial counselling procedure in Germany appears to be successful as it leads to a settlement in just under half the cases. This may be of some use in Tanzania. Similar to the Netherlands, the German repayment plan procedure accepts only applications from honest debtors; those who do not comply are subject to the rigors of the simplified bankruptcy provision. Zero plans are also accepted in Germany. As previously noted, this type of preferment of the honest debtor may be beneficial to Tanzania.

The Swedish debt relief system is very similar to the Australian system in terms of administration. Both systems have a quasi-government

³⁹⁴Par 4.5 above.

administrative body that is concerned with debt collection and the management of its debt relief procedures. In Sweden, while the Royal Debt Collector's Office is accountable to government, it operates as an independent authority. In both Australia and Sweden appeals against decisions by these bodies are heard by the judiciary. It is submitted that this system is preferable to the Tanzanian process where every decision must be made by or ratified by the Courts which are already overburdened and whose procedure is costly.³⁹⁵ It is, however, important to bear in mind Huls'³⁹⁶ concern of the Swedish model. He notes that because governments are often creditors in the majority of debt relief procedures, this may cause a conflict of interest.

Sweden, like the United States of America,³⁹⁷ has two main procedures available for consumers: the first is a straight bankruptcy procedure similar to that regulated under the Tanzanian *Bankruptcy Act*.³⁹⁸ The straight bankruptcy provision is, however, hardly ever used by natural persons. This may be because bankruptcy in Sweden, like the Netherlands, does not provide a discharge of pre-sequestration debts at the end of the procedure.³⁹⁹ The second procedure is the debt reorganisation plan.⁴⁰⁰ In 2007 Sweden scrapped the mandatory debt counselling provision under the guise that it wasted too much time. In the Swedish system the Royal Debt Collector's Office also has the power to "cram down" a proposed plan that was unreasonably refused by debtors during the voting process.⁴⁰¹ The Authority may only grant a debt reorganisation order where the debtor's debts are old debts, meaning that he or she has struggled with them for some time and also that he or she incurred them in good faith.⁴⁰² In Sweden a discharge of debt is looked upon as a privilege.

³⁹⁵ Par 1.1 above.

³⁹⁶ Par 6.4.2 above.

³⁹⁷ See par 5.6 above.

³⁹⁸ Par 6.4.1 above.

³⁹⁹ *Ibid.*

⁴⁰⁰ Par 6.4.2 above.

⁴⁰¹ *Ibid.*

⁴⁰² *Ibid.*

The Swedish system does not provide for a supervisory third party to administer the repayment plan.⁴⁰³ This structure cuts the costs of paying a third party to supervise the debtor. The idea behind the Swedish system is that the majority of debtors truly wants a fresh start and will not fail to make their repayments. Where they do fail to make their repayments, the creditors can report them to the Royal Debt Collector's Office.⁴⁰⁴ Lastly, perhaps the best innovation of the Swedish repayment plan is that the process is sponsored and administered by government. The debtor need not make available any monies that should be paid to the creditors for administration of the process, and it is therefore affordable for all debtors.⁴⁰⁵

Tanzania can learn a lot from the methods of supervision and administration of debt relief procedures in Sweden. An administrative Authority, whose only focus is debt relief, may be a good way of reducing costs and increasing efficiency in debt relief procedures in Tanzania. The Swedish bankruptcy procedure is quite similar to Tanzania's. However, as noted in the Netherlands jurisdiction, the absence of a discharge provision in the Swedish bankruptcy procedure is too creditor-orientated and may not be feasible in Tanzania. The Swedish system saw fit to get rid of the extra-judicial debt counselling provision for their debt reorganisation plan. It is suggested that this may be premature considering the moderate success encountered by this provision in the German system observed above. Another way of reducing costs followed by the Swedish system is not having a third party supervising the debtor during the repayment plan. However, Tanzania may not yet be ready to jump from Court supervision to no supervision whatsoever.

In support of a compulsory repayment plan before a debtor may be granted a discharge, Niemi-Kiesiläinen states the following:⁴⁰⁶

⁴⁰³ *Ibid.*

⁴⁰⁴ *Ibid.*

⁴⁰⁵ *Ibid.*

⁴⁰⁶ Niemi-Kiesiläinen *et al Consumer bankruptcy in global perspective* 503.

In the European assessment, the mandatory payment plans work well. However, making a plan work is neither easy nor free. The design of, and compliance with, mandatory payment plans usually requires support from professional counsellors. Most plans do not survive for five years and have to be revised. Often this requires a whole new procedure, including counselling, consultation with creditors, and the drafting of a new plan. In Europe, adjustment plans are considered a good investment, and on completion of the plan the debtor obtains a fresh start, even if it is delayed.

Bearing in mind the experience of continental Europe with repayment plans that lead to a discharge, it is suggested that the Tanzanian system take a real look at the compulsory repayment plan. It would appear that this formulation, when combined with a simplified liquidation procedure, benefits both parties by giving the debtor a discharge and by giving better returns to the creditors.

While cautious of oversimplification, it can be said in summary that the new laws in these jurisdictions allow a financially stressed consumer to petition for a formal adjustment of their debt, and a partial discharge. In following their conservative roots however, a discharge in continental Europe must still be earned by the debtor and usually involves a rigorous payment plan. In addition, in many of these countries the debtor must also make an attempt to reach an out-of-court settlement with his or her creditors before being allowed to apply for formal debt adjustment. The requirements with regard to such pre-judicial debt counselling do however vary from jurisdiction to jurisdiction.

CHAPTER 7

CONCLUSION

SUMMARY

- 7.1 Introduction
 - 7.2 Which Debt Relief Solutions Will Work Best For Tanzania?
 - 7.3 Proposed Structure for the Tanzanian Debt Relief Regime
 - 7.4 Conclusion and Summary of the Recommendations
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7.1 Introduction

As previously observed, the Tanzanian private sector is expanding through the deliberate efforts of the state, in order to conform to the modern global economy.¹ As the economy expands and the national microfinance policy is implemented, more credit is given to consumers and consequently the number of over-indebted consumers increases.² Regrettably, the current debt relief regime that is regulated by the Tanzanian *Bankruptcy Act* of 1930 is inefficient, costly and unable to cope with the increase of consumer over-indebtedness.³ This inept system also has the effect that foreign investors seeking to invest in Tanzania are discouraged by the country's expensive and lengthy debt relief system.⁴ The purpose of this thesis therefore, is to make recommendations for the reform of the current debt relief regime and propose

¹Par 1.1 above.

²Par 2.1 above.

³Par 1.1 above.

⁴*Ibid.*

a debt relief dispensation that will be efficient and to the benefit of both debtor and creditor.⁵

At the beginning of this study, a review was undertaken of the well-known philosophies and best practices that influence the reform of debt relief systems around the globe.⁶ The purpose of this review was twofold, firstly to create a theoretical basis for the entire study and secondly to provide a list of best practice against which the Tanzanian system could be evaluated. With regard to philosophy, this study considered the two main bankruptcy paradigms, namely the proceduralist and traditionalist schools.⁷ The proceduralist school holds that bankruptcy laws should concern themselves only with maximising creditor returns and that bankruptcy itself is just a collective debt collection procedure.⁸ Traditionalists on the other hand advocate that bankruptcy laws have a wider role to play than mere debt collecting and that there are values that require protection outside the accrued rights of creditors.⁹ These, for example, include the rights of the debtor's employees and those of the debtor's and creditors' local community.¹⁰ It would appear that the traditionalist school is correct. The consequences of bankruptcy often have a ripple effect and can be experienced far beyond the direct effect they have on the bankrupt. That being said, it is suggested that these peripheral values should not diminish the creditors' rights against the bankrupt. It is therefore submitted that a debt relief regime must balance and incorporate both traditionalist and proceduralist concepts into its debt relief procedures in order to operate proficiently.

This thesis also evaluated the American "fresh start" theory in practice in the United States before 2005. This theory's inclusion in the study was warranted being that it is the single most influential theory in the modern age and has

⁵ *Ibid.*

⁶ See pars 2.2–2.4 below.

⁷ Par 2.3 above.

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ *Ibid.*

been the basis for a number of national debt relief reforms.¹¹ This bankruptcy philosophy was developed in the United States as a way of cushioning debtors from the consequences of the numerous financial disasters in their history, and as a result they were provided with a liberal debtor discharge dispensation.¹² This theory is based on traditionalist values and advocates that a fresh opportunity in the economy and life can be earned by the debtor through a bankruptcy discharge.¹³ In practice, while this dispensation did manage to discharge a large number of debtors, the returns to creditors under this dispensation were dismal.¹⁴ This outcome reinforces the earlier submission that while it is important to incorporate traditionalist values in a debt relief regime, proceduralist concepts must also be incorporated in the same regime to ensure that creditors' rights are properly protected.¹⁵

After a review of the main bankruptcy philosophies a survey was undertaken of a number of prominent studies, recommendations and guidelines on present-day consumer debt relief reform, derived from the theories previously discussed.¹⁶ This review identified a list of ideas and features that should, under ideal circumstances, be incorporated into all debt relief systems.¹⁷ These are that each system should endeavor to follow a balanced approach with regard to the interests of the debtor and his or her creditors; to have a cheap and efficient alternative to bankruptcy; and to promote the swift rehabilitation of the honest but unfortunate debtor.¹⁸ As previously stated, these features serve a dual purpose in this thesis. Firstly, they serve as an underlying theoretical base for the study, indicating the direction that Tanzanian debt relief reform should follow.¹⁹ Secondly, they were used as a comparative standard under which the Tanzanian debt relief system was

¹¹Par 2.4 above.

¹²*Ibid.*

¹³*Ibid.*

¹⁴*Ibid.*

¹⁵*Ibid.*

¹⁶Par 2.5 above.

¹⁷Par 2.6 above.

¹⁸*Ibid.*

¹⁹Par 2.1 above.

investigated and its deficiencies identified.²⁰ These shortcomings included numerous outdated provisions in the Tanzanian *Bankruptcy Act*, the lack of a swift cost-effective alternative to bankruptcy, and the regime's complete reliance on an already overburdened judiciary.²¹ Once these deficiencies of the Tanzanian system were identified, a comparative investigation of a number of different legal systems was undertaken with the aim of providing solutions to these problems.

All the debt relief regimes reviewed in this study to obtain solutions for Tanzania all strive to assist over indebted consumers who cannot meet their obligations within a reasonable time frame. They also endeavor to help the creditors of these debtors to recover as much value on the Shilling of their claims as possible. However, the different jurisdictions prioritise these objectives differently. This study has shown that the different jurisdictions use different approaches and underlying philosophies to reach these goals. Their philosophies on debt relief vary from the liberal common law jurisdictions that endorse a debtor's right to a discharge, to the conservative continental European systems that set no store by the right to a discharge unless the debtor has been subjected to a rigorous repayment plan. South Africa, while considered a conservative, creditor-orientated jurisdiction, is in some aspects quite moderate as it subscribes to the concept of a debtor's right to a discharge.

Despite the differences between these debt relief systems that are caused by historical, economic and political factors, there are currently some signs that the philosophies of consumer insolvency in these jurisdictions are all converging towards a moderate or centrist approach to resolving consumer debt.²² For example, the South African Law Reform Commission has added a pre-liquidation composition procedure to the Unified Insolvency Bill.²³ When this bill becomes law, South Africa will have an alternative to bankruptcy in the

²⁰Par 3.5 above.

²¹*Ibid.*

²²Ziegel *Comparative consumer insolvency regimes: A Canadian perspective* 147.

²³Par 4.4.5 above.

pre-liquidation composition that is quite similar to the Australian debt agreement procedure and also to both Canadian consumer proposals.²⁴ These improvements amount to a move away from the conservative creditor-orientated system currently in place, towards a more moderate insolvency system.²⁵

Also on the convergence of debt relief systems, over the last two decades the continental European jurisdictions have moved away from being very conservative over discharging the debtor of his or her pre-bankruptcy debts, to allowing such a discharge to be subject to a repayment plan.²⁶ These changes were brought about by a large increase in over-indebted consumers and a corresponding need for functionality and efficiency of the debt relief system.²⁷ Common law jurisdictions, specifically the United States, Australia and Canada, have put into place means testing provisions to ensure that debtors who can make surplus income payments are forced to undertake a repayment schedule rather than receive a “free” discharge under bankruptcy.²⁸ In the United States this move away from the liberal discharge dispensation was lobbied for heavily by groups of credit providers that insisted they were making losses as a result of the previous dispensation.²⁹ The American system’s debt relief structure for consumers currently resembles the continental European systems, which only have two procedures, either straight bankruptcy or a repayment plan.³⁰

It is submitted that in order for Tanzanians to thrive in the free market economy with access to credit being at an all-time high, it must show the same willingness as the other jurisdictions discussed in this study to adapt its debt relief system and follow a centrist approach. This being because consumer credit will always be linked to bankruptcy. The different jurisdictions

²⁴Par 5.6.3 above.

²⁵*Ibid* and 5.6.4 above.

²⁶Par 6.1 above.

²⁷Par 6.2 above.

²⁸Par 5.6.1 above.

²⁹Par 5.2.2 above.

³⁰Par 6.5.3 above.

discussed in this thesis offer a number of solutions to the shortcomings in the Tanzanian system. A final assessment of the possible solutions for Tanzania's problems will now be made, with final recommendations for change.

7.2 Which Debt Relief Solutions Will Work Best For Tanzania?

7.2.1 South Africa

The South African jurisdiction was chosen as the main comparative model in this study because of the many similarities between the two jurisdictions.³¹ These range from their similar legal systems to being fellow developing countries.³² The South African debt relief regime has been in the process of reform for many years and was able to provide a great deal of meaningful insight into consumer debt relief.³³ This system also provided insightful lessons for Tanzania on the *modus operandi* it should follow when embarking on the reform of its debt relief system.³⁴

As previously noted, the South African insolvency system is extremely creditor-orientated.³⁵ While alternative procedures to sequestration are available, none of these alternatives grant the debtor a discharge from debt.³⁶ Filing for sequestration is the only way for a South African debtor to achieve a discharge of his or her pre-sequestration debt.³⁷ As pointed out above though, there are a string of technical formalities that must be fulfilled before the application may be made by a debtor, increasing the degree of difficulty of this application.³⁸ Furthermore, the availability of this sequestration application depends on whether the debtor can afford to apply for sequestration and prove that the process will be to the advantage of the creditors.³⁹ Proving advantage for creditors is such an issue for debtors in South Africa that, a large number of debtors choose rather to collude with their creditors to have

³¹Par 1.1 above.

³²*Ibid* and Par 4.1 above.

³³*Ibid* and par 4.3 above.

³⁴*Ibid.*

³⁵Par 4.3 above.

³⁶Par 4.6 above.

³⁷*Ibid.*

³⁸Par 4.4.1 above.

³⁹*Ibid.*

themselves sequestrated, because the burden of proving advantage in creditor applications is less onerous.⁴⁰ The Tanzanian debtor application for bankruptcy only requires that the debtor correctly completes the necessary formalities and files the petition with the Court Registrar, whereupon bankruptcy is granted *ex lege*. It is therefore submitted that the Tanzanian bankruptcy system has a better procedure for initiating bankruptcy proceedings and requires no input from the South African system in this regard.

Both the South African and Tanzanian systems require the debtor to apply to a judge for a discharge from the bankruptcy proceedings. With regard to discharge, the South African procedure does however have an extra provision that needs incorporation into the Tanzanian regime: an automatic discharge provision.⁴¹ This provision ensures that the debtor does not remain trapped in bankruptcy as a consequence of the poor administration of the process. Currently under the Tanzanian *Bankruptcy Act* a debtor may remain bankrupt indefinitely if not discharged by the High Court.⁴² The ten years for a debtor to be automatically discharged in South Africa, it is submitted, is too long and would be pointless in the Tanzanian system where the average bankruptcy lasts three years.⁴³ Since a bankruptcy runs for three years on average in Tanzania, it is suggested that the automatic discharge period be the same. This will force the parties, especially the creditors and the trustees, to cooperate and complete the process before the automatic discharge period lapses.

South Africa provides for two formal alternatives to sequestration, namely debt counselling and administration.⁴⁴ Both procedures are faulted for applying only to a limited number of consumers. Debt counselling to those consumers that have debt arising out of credit agreements that fall under the

⁴⁰Par 4.4.3 above.

⁴¹Par 4.6 above.

⁴²Par 3.3.7 above.

⁴³Par 1.1 above.

⁴⁴Par 4.3 above.

scope of the *National Credit Act, 2005*⁴⁵ and administration to consumers with simple debt not worth more than ZAR50,000.⁴⁶ Also, both procedures at their conclusion do not provide a discharge for the debtor and are not subject to a limited time frame.⁴⁷ Hence the debtor may be caught in a debt trap and spend all his or her life making repayments. Administration orders have the added disadvantage of not being properly regulated which gives rise to the possibility of a number of abuses. One of the positive features that Tanzania can take away from the South African alternative procedures is that debt review under the *NCA* does include mortgages and other secured debts incurred under the this Act.⁴⁸

In addition to the issues mentioned above, both these alternative procedures can be terminated by an application for sequestration made by any of the debtor's creditors.⁴⁹ It is submitted that allowing the creditors to terminate an ongoing alternative procedure somewhat defeats the purpose of having an alternative to insolvency. This is one of a number of examples of troublesome interactions between the debt relief statutes in South Africa that have been caused by poor cooperation between government departments while pursuing their individual legislative agendas.⁵⁰ As a result of all these shortcomings, the current debt relief regime in South Africa is not able to deal with the South African consumer debt crisis.⁵¹ Bearing these problems in mind, it is submitted that the South African dispensation in respect of alternatives procedures may not be a practical option for Tanzania.

The main lessons that Tanzania can take away from the South African debt relief experience involve learning from the mistakes made by this regime when it ventures into reform of its own debt relief system. Firstly, the Tanzanian Law Reform Commission must review and reform the Tanzanian

⁴⁵ Hereinafter referred to as the *NCA*.

⁴⁶ Par 4.6 above.

⁴⁷ *Ibid.*

⁴⁸ Par 4.5 above.

⁴⁹ *Ibid.*

⁵⁰ Par 4.5 above.

⁵¹ Par 4.6 above.

debt relief system in one consolidated effort to avoid harmful interaction between any new legislation and the *Bankruptcy Act* of 1930. To this end, it may be advisable to repeal the current *Bankruptcy Act* and have a brand new statute for debt relief for Tanzanian consumers regulating all the procedures under one umbrella. The Tanzanian system, when considering reform, must not find itself in a situation where there are an expanding number of debt relief procedures.⁵² This type of proliferation of procedures reduces the efficiency of the system as it necessitates allowing laymen debtors some degree of choice of the available legal procedures that may have dire consequences when improperly selected or improperly managed. With regard to any future alternative procedures in Tanzania these must be well regulated by a government agency or professional body to avoid the current situation occurring in South Africa with respect to administration orders.⁵³ The Tanzanian system must also note the fact that the alternatives to bankruptcy in South Africa do not provide for a discharge, thus causing debt traps for its consumers and consequently reducing the efficiency of the system.⁵⁴ The alternatives selected by Tanzania must not limit debtors based on the type or size of the debt, as seen in administration orders and debt review in South Africa. Last but not least it is important to note the lesson learned from the *NCA* that a debt rescheduling procedure can and should include secured debts.

7.2.2 The Common Law Jurisdictions

7.2.2.1 The United States of America

America has two procedures available for consumer debtors: the Chapter 7 straight bankruptcy procedure and a Court-supervised bankruptcy repayment plan under Chapter 13.⁵⁵ The 2005 reforms to the American system did away with the liberal Chapter 7 bankruptcy procedures for debtors who have a surplus of income.⁵⁶ A means test for all debtors entering the Chapter 7

⁵² *Ibid.*

⁵³ Par 4.5 above.

⁵⁴ *Ibid* and 4.6 above.

⁵⁵ Par 5.2.1 above

⁵⁶ Par 5.2.2 above.

procedure, similar to that used in Canada, was used to give effect to this goal. The Americans also incorporated a mandatory credit counselling structure for debtors requiring two consumer education sessions before a discharge is made available to the bankrupt.⁵⁷ It is submitted that the structure of the United States debt relief regime which has only two procedures, both with access limited by statute, is a good way to stop the problems that accompany the proliferation of debt relief measures in a jurisdiction.⁵⁸ The system however, still entails a lot of Court supervision for these two debt relief processes and may have cost implications and delay the process.

Chapter 13 wage earner plans involve the debtor's obligations being rescheduled for a maximum period of five years.⁵⁹ Under the Chapter 13 plan the debtor may keep the majority of his or her unsecured and secured property.⁶⁰ He or she may also reschedule the majority of his or her secured debt. This unfortunately does not apply to a mortgage on his or her principal residence, which may not be rescheduled.⁶¹ The debtor may still cure the mortgage on his or her home where he or she settles all the installments in arrears and all his or her current installments as they fall due.⁶² It is submitted that not only does allowing the rescheduling of the debtor's secured and unsecured debts provide the debtor with a realistic opportunity to be free of any obligations after the repayment plan is completed, but it also allows him or her to keep any property subject to such security.

The Chapter 13 repayment plan includes a few innovations that may be useful for the Tanzanian system. Chapter 13 allows the Court, on application from the debtor, to force the repayment plan on creditors who are unreasonably blocking the plan.⁶³ This is known as a Chapter 13 "cram down." The jurisdictions of continental Europe have similar provisions with respect to their

⁵⁷ *Ibid.*

⁵⁸ Pars 4.6 and 7.2.1 above.

⁵⁹ Par 5.2.2 above.

⁶⁰ *Ibid.*

⁶¹ Par 5.2.1 above.

⁶² *Ibid.*

⁶³ Par 5.6 above.

debt restructuring procedures.⁶⁴ The hardship discharge under Chapter 13 discussed above,⁶⁵ is the American answer to the English debt relief order. It is submitted that Tanzania can learn from this procedure and that it is unnecessary to hold debtors under bankruptcy or any alternative procedures where there is little chance that the creditors will benefit from the procedure. The American system also allows indigent debtors to file for bankruptcy *in forma pauperis*, which entails a waiver of certain Court costs.

7.2.2.2 *Australia*

The Australian debt relief system, like its South African counterpart, consists of three formal procedures; bankruptcy and two formal alternatives.⁶⁶ These procedures are overseen by the Insolvency and Trustee Service of Australia. Debtors and creditors have to apply to this government agency to initiate the formal proceedings available for debt relief in this jurisdiction.⁶⁷ This agency also supervises the procedure in the same manner as the Master of the High Court in South Africa.⁶⁸ The judiciary has very little involvement in debt relief in this jurisdiction. Orders are sought from the Court only on appeal where decisions by the Insolvency and Trustee Service of Australia and the subsequent Appeals Tribunal do not satisfy the interested parties.⁶⁹ In Australia, before a debtor files for bankruptcy he or she may file with the Official Receiver a “declaration of intention to present a debtor’s petition”.⁷⁰ Once the declaration has been properly filed and the debtor has been counselled by the agency on his or her options, it grants the debtor a three-week moratorium against his or her creditors. The reasoning behind this declaration is to allow the debtor time to consider his or her options and stop debtors in general from making hurried decisions under pressure from their creditors.⁷¹ This moratorium may be useful should the Tanzanian system opt for a system of more than one alternative. The stay in proceedings will allow

⁶⁴Par 6.5 above.

⁶⁵*Ibid.*

⁶⁶Par. 5.3 above.

⁶⁷Par 5.3.1 above

⁶⁸*Ibid.*

⁶⁹*Ibid.*

⁷⁰Par 5.3.1 above.

⁷¹*Ibid.*

the debtor time to make a reasoned choice as to which procedure will work best for him or her.

An Australian bankrupt does not need to apply to the Court for a discharge; this occurs either by automatic discharge or when the debtor's bankruptcy is annulled by operation of law on payment of his or her last debt.⁷² It is submitted that this type of administrative structure may cut the costs associated with applications through the Tanzanian Courts. The current Tanzanian bankruptcy system relies on the High Court for a decision on a number of processes from the creditor's petition, all the way to his or her discharge. The bankruptcy process is slowed down because of the backlog in the Tanzanian High Court.⁷³ It is suggested that the Australian construction may assist in reducing the time a debtor remains bankrupt. Another feature in Australia that may save time is that the debtor does not need to be adjudged bankrupt after submitting a bankruptcy petition, as is the case in Tanzania.⁷⁴ This occurs either immediately after the debtor files his or her petition or after the creditor is granted a Court order.⁷⁵

The Australian system has two alternatives to bankruptcy, namely debt agreements and Part X arrangements.⁷⁶ Both procedures are modified composition procedures and have no Court involvement in their respective procedures.⁷⁷ Part X arrangements cater to commercial debtors, while debt agreements are intended to be used by normal consumers. Under both procedures secured creditors can only be party to the proceedings if they consent. These alternatives are therefore aimed primarily at unsecured debt.⁷⁸ The completion rate of these procedures is approximately 25 per cent, which it is submitted is quite low.

⁷² *Ibid.*

⁷³ Par 1.1 above.

⁷⁴ Par 3.3 above.

⁷⁵ Par 5.6 above.

⁷⁶ Par 5.3.2 above.

⁷⁷ *Ibid.*

⁷⁸ *Ibid.*

A universal theme through all the common law countries in this survey is that the bankrupt's discharge depends on the bankrupt's commitment to his or her compulsory surplus income payments. In the Australian system failure by the bankrupt to make his or her payments to the bankrupt estate may result in five more years being added to his or her bankruptcy before an automatic discharge is available to him or her.⁷⁹ This may be a good incentive to keep the debtor honest. However, it is suggested that the current Tanzanian system where the trustee applies to the Court to attach a justifiable amount of the debtor's surplus income, serves the same purpose. The trustee can also object to the debtor's discharge on the grounds of improper payment of this surplus income.⁸⁰

The Australian system made some important advances in initiatives to provide for the so-called indigent debtor.⁸¹ Along with removing most of the supervision by the judiciary to cut costs, the Australian regime allows the debtor the choice between an Official Trustee, who is a state official, and a private registered trustee.⁸² Consequently, in government led bankruptcies, no fees are levied for the processing of debtor petitions. In Australia the end result of these innovations to cut the cost of debt relief is that the majority of consumers receive state subsidised debt relief procedures.

7.2.2.3 *Canada*

The Canadian over-indebted consumer has an option between four procedures. These are the straight bankruptcy procedure, the consumer proposal, a commercial proposal and a consolidation order if he or she is in the right province.⁸³ The bankruptcy procedure in this jurisdiction is quite similar to that in Tanzania except for the requirement of mandatory credit counselling.⁸⁴ The debtor must submit for mandatory credit counselling before

⁷⁹Par 5.3.1.4 above.

⁸⁰See par 3.3 above.

⁸¹Par 5.3.1.6 above.

⁸²*Ibid.*

⁸³Par 5.4 above.

⁸⁴Par 5.4.1 above.

he or she may file for a bankruptcy order.⁸⁵ Credit counselling in Canada and the United States takes the form of consumer education sessions. Statistical studies in Canada performed on the financial performance of post-bankruptcy consumers who were counselled and those who were not, showed very little difference between these groups financially after the bankruptcy order.⁸⁶ Since this type of consumer education seems not to bear any fruit post-bankruptcy, it is suggested that it should not be included in any proposed reforms as it would be an unnecessary cost burden to the state. The Canadian bankruptcy procedure also makes use of a summary administration procedure. Unlike the Tanzanian system, the Canadian summary administration procedure is compulsory for debtors who qualify, and cannot be prevented by the creditors.⁸⁷ It is recommended that this formulation of the summary administration procedure will allow more debtors the benefits of this streamlined procedure.

With regard to alternatives to bankruptcy, Canada has quite a few. The commercial and consumer proposals are both composition styled plans that focus on unsecured debt, similar to their Australian counterparts.⁸⁸ The only difference is that the Canadian commercial proposal requires confirmation by the Court. The consumer proposal's confirmation is optional and dependent on an application by the Official Receiver or an unsatisfied creditor.⁸⁹ None of these procedures may go on for more than five years. This provision avoids the debt traps that may engulf debtors who partake in procedures that have no time limit. It is suggested that any recommendation of an alternative to bankruptcy for Tanzania must have a time limit.

The main lesson to be learnt by Tanzania from the Canadian system is the structure of its automatic discharge. Bearing in mind that one of the features of the ideal system is taking the culpability of the debtor into account during

⁸⁵ Counselling in Canada means financial education and not an out-of-Court settlement as seen in the continental European jurisdictions.

⁸⁶ Par 5.4.1 above.

⁸⁷ *Ibid.*

⁸⁸ *Ibid.*

⁸⁹ *Ibid.*

rehabilitation, the Canadian automatic discharge is not dependent on the passage of a fixed number of years,⁹⁰ but rather on the circumstances and obligations of the debtor.⁹¹ Where the debtor is a first-time bankrupt with no surplus income payments, he or she may be eligible for an automatic discharge in nine months. Where surplus income payments are compulsory, the debtor is eligible in 21 months.⁹² Where the debtor is insolvent for a second time or more, both time periods are extended to 24 months and 36 months respectively.⁹³ It is submitted that this type of automatic discharge is preferred as it distinguishes between debtors. Firstly, those who repeatedly wish to use bankruptcy as a method to discard their debt are discouraged from doing so and secondly, first-time bankrupts with a small number of obligations are not kept under bankruptcy without cause.

7.2.2.4 *England and Wales*

The English and Welsh bankruptcy procedure is similar in many respects to the Australian system.⁹⁴ In both systems the debtors have a choice between a state official who supervises the procedure, or a private trustee. Both systems have also amended their laws so that an automatic discharge is the main method that a debtor who is subject to a bankruptcy order, may be discharged from pre-sequestration debt.⁹⁵ These measures have both already been accepted as good methods to reduce costs.⁹⁶ England also has an “early discharge” procedure that takes effect after an investigation into the debtor’s affairs by the Official Receiver, with a filing to that effect to the Court.⁹⁷ It is suggested that this early discharge procedure may be too debtor-orientated and may affect the value of returns on the creditors’ claims.

⁹⁰ See par 4.6 above for South Africa as an example of a jurisdiction with a fixed time period for the automatic discharge of the debtor.

⁹¹ Par 5.4.1.5 above.

⁹² *Ibid.*

⁹³ *Ibid.*

⁹⁴ Par 5.6.4 above.

⁹⁵ Par 5.5.1 above.

⁹⁶ Par 7.2.2 above.

⁹⁷ Par 5.5.2 above.

England and Wales have a number of alternatives to the main bankruptcy procedure.⁹⁸ These include formal alternatives such as individual voluntary arrangements and debt relief orders, as well as informal alternatives such as debt management plans.⁹⁹ Individual voluntary arrangements are based on a negotiated agreement between the debtor and his or her creditors.¹⁰⁰ The process has no High Court involvement and is supervised by the Official Receiver and administered by an insolvency practitioner.¹⁰¹ The “fast-track” individual voluntary arrangement is available only to undischarged bankrupts, and is administered by the Official Receiver to reduce the costs of the procedure.¹⁰² Debt management plans are informal negotiated settlements administered by a private third party, usually a not-for-profit organisation or a private company.¹⁰³ Debt management plans are unfortunately poorly regulated, leaving debtors vulnerable to abuse.

It is submitted that a large selection of procedures for the debtors may result in some of them making bad choices for their specific financial situations. This may occur as a result of touting by private insolvency administrators or inadequate information available to the debtors.¹⁰⁴ It is suggested that the Tanzanian debt relief dispensation should include bankruptcy and one formal alternative. Despite these criticisms on the alternatives to bankruptcy in England and Wales, the promulgation of the debt relief order is very commendable. This procedure, which deals only with “no income no asset debtors”, is a most important innovation¹⁰⁵ that must be distinguished from the other income restructuring alternatives discussed in this thesis. The debtors under this procedure have next to no income and are restricted from making payments to the creditors.¹⁰⁶ This procedure is in essence one that serves the purpose of just discharging indigent debtors. An argument can however be

⁹⁸Pars 5.5.2 and 5.5.3 above.

⁹⁹Par 5.5.2 above.

¹⁰⁰*Ibid.*

¹⁰¹Par 5.6 above.

¹⁰²*Ibid.*

¹⁰³*Ibid.*

¹⁰⁴See pars 4.3.2 and 5.5 above.

¹⁰⁵Par 5.6.4 above.

¹⁰⁶Par 5.5.3 above.

made that these debtors are having their debts written off too easily as a result of their circumstances. It may be prudent to have these debtors attend a certain amount of financial management lessons before they are discharged.¹⁰⁷

7.2.3 The Selected Civilian and Scandinavian Jurisdictions

7.2.3.1 Netherlands

The bankruptcy procedure in the Netherlands is quite similar to the corresponding procedures in Tanzania and South Africa.¹⁰⁸ It does however have one important difference in that it does not grant a discharge to the debtor of his or her pre-bankruptcy debt.¹⁰⁹ This provision, it is submitted, is too creditor-orientated and would upset the required creditor/debtor interest balance required in a modern jurisdiction. The Netherlands also has two formal alternatives to bankruptcy, one being the suspension of payments for business debtors and the other, a debt reorganisation plan.¹¹⁰

The suspension of payments procedure is a Court-supervised moratorium procedure for business debtors.¹¹¹ The stay in execution against the debtor's creditors is intended to allow the debtor some time to reorganise his or her business affairs.¹¹² This procedure does not attract a lot of natural persons because it does not include secured and statutory preferent debtors.¹¹³ Tanzanian credit providers in most cases require some form of real security before issuing credit.¹¹⁴ The suspension of payments procedure, as in the Netherlands, is therefore not practical in Tanzania as a result of its limited application to unsecured debt.¹¹⁵ The question arises however, whether a modified suspension order that includes secured debt would be a viable debt relief procedure in Tanzania. It is submitted that this type of remedy need not

¹⁰⁷ *Ibid.*

¹⁰⁸ Par 6.5.1 above.

¹⁰⁹ Par 6.2.2 above.

¹¹⁰ Par 6.2.1 above.

¹¹¹ Par 6.2.3 above.

¹¹² *Ibid.*

¹¹³ *Ibid.*

¹¹⁴ Par 1.1 above.

¹¹⁵ Par 6.5.1 above.

be a separate remedy and can be incorporated into a debt restructuring provision of the reformed debt relief statute.¹¹⁶

The debt reorganisation procedure in the Netherlands starts with a compulsory extra-judicial debt settlement procedure.¹¹⁷ This out-of-court procedure is meant to be a genuine effort at reaching a negotiated settlement between the debtor and his or her creditors, and is mediated by counsellors at the local municipality. This procedure must be distinguished from the credit counselling procedures in the United States and Canada which are at the core of consumer education sessions.¹¹⁸ It is submitted that where an agreement or compromise can be reached informally between the disputing parties without Court involvement, money and time is saved. Thus, Tanzania should incorporate a similar procedure into their debt relief system.

Where a negotiated settlement cannot be reached, the debtor may apply for a court-supervised debt reorganisation.¹¹⁹ At this initial stage the debtor may, along with his or her application for debt reorganisation, apply to the Court to force a creditor to accept a reasonable proposal offered to the creditors during the informal negotiations.¹²⁰ This provision is recommended in any proposed reform in Tanzania that includes an informal counselling process, as it brings some legitimacy to the informal process and forces creditors to be objective during the procedure.

The reorganisation plan in the Netherlands must be distinguished from other reorganisations discussed in this thesis, because it consists of both a repayment plan and liquidation of the debtor's assets. The repayment plan runs for a period of three years.¹²¹ Where a "no income no asset" debtor is subject to debt reorganisation, he or she must satisfy the Court that although

¹¹⁶See for example the powers of the Court to restructure a credit agreement in the South African system for a similar inclusion of the power to suspend payments in a debt review procedure. See section 86(7)(c) of the *National Credit Act*, 2005 and par 4.5.2 above.

¹¹⁷Par 6.2.4 above.

¹¹⁸Pars 5.2.1 and 5.3.1 above.

¹¹⁹*Ibid.*

¹²⁰Par 6.3.3 above.

¹²¹*Ibid.*

no payments were made for a period of three years, he or she gave his or her best efforts to find a job and fulfil his or her obligations.¹²² Where the debtor succeeds in demonstrating this, he or she may still receive his or her full discharge at the end of the three-year period.

Requiring debtors to make available both surplus income and their assets will provide much better returns for the creditors than each option on its own. The main disadvantage here is, of course, that during this repayment plan the debtor loses his or her assets. It is also suggested that allowing a “no income no asset” debtor to receive a discharge after three years where he or she has given his best efforts to make repayments, and regardless of whether any payments were made, is a much better concept than the English debt relief order that merely discharges these debtors.¹²³ Here, the debtor is simply not released; he or she still has to make an effort to make repayments. It is submitted this construction keeps the morale of creditors high and sits better with those who advocate against discharges in bankruptcy using the *pacta sunt servanda* maxim.

7.2.3.2 Germany

The German debt relief system has two procedures for natural persons, one for debtors who are involved in business and one for ordinary consumers.¹²⁴ Both procedures are initiated by an insolvency application.¹²⁵ The German system thus has only one gateway into debt relief proceedings. It is submitted that the Tanzanian *Bankruptcy Act*, has the required provisions to deal with the complex bankruptcies of individuals involved in business. These include provisions for the investigation of the debtor’s estate, interrogation of the debtor and parties relevant to the bankruptcy, provisions for the reversal of voidable dispositions and provisions for the Court to hear expert witnesses.¹²⁶ Furthermore in Tanzania, where the bankruptcy is not complex and is below

¹²² *Ibid.*

¹²³ Par 5.5 above

¹²⁴ Par 6.3.1 above.

¹²⁵ *Ibid.* The debtor may apply for a deferment of the costs of the insolvency application where he or she cannot afford to pay these costs even in instalments.

¹²⁶ Ss 17, 28 and 45–52 of the Tanzanian *Bankruptcy Act*.

the set threshold, a sole proprietor's bankruptcy may even be subject to the summary administration procedure.¹²⁷ Therefore, the specific procedures for business debtors in Germany will not be considered for the Tanzanian system. It is however recommended that Tanzania should consider separating the bankruptcy of business debtors who sometimes require extensive specialised procedures within a bankruptcy, from normal consumers whose debt relief procedure may be summarily administered to save time and costs.

For the normal consumer the German debt relief regime has a single procedure made up of three steps,¹²⁸ beginning with informal debt counselling with the aim of reaching a negotiated settlement.¹²⁹ The debt counselling process in Germany is similar to the extra-judicial counselling process in the Netherlands. Statistics show that almost half of these out-of-court settlements end in an agreement between the parties.¹³⁰ Where the out-of-court settlement fails however, the consumer may apply for a formal debt reorganisation order. When the Court is in favour of the plan presented by the debtor it orders creditors to vote on the plan; if the requisite majority is achieved the plan is binding on the creditors.¹³¹ At this stage in the process the Court can force a few dissenting creditors to accept the plan if they are unreasonably blocking it.¹³² It is submitted again that this type of "cram down" of a plan is necessary to ensure that creditors do not unreasonably block a settlement plan.

During the six-year duration of the order the debtor has to contribute his or her surplus income to the creditors. Where the debtor follows the plan he or she may receive a complete discharge of his or her residual debt. Where the plan fails or is adjudged not to work by the Court, the consumer is liquidated in a simplified summary insolvency procedure that reduces costs.¹³³ The simplified

¹²⁷ See par 3.6 above.

¹²⁸ Par 6.3.3 above.

¹²⁹ *Ibid.*

¹³⁰ *Ibid.*

¹³¹ *Ibid.*

¹³² *Ibid.*

¹³³ *Ibid.*

insolvency procedure consists of both a liquidation procedure and a repayment plan. During the debt reorganisation procedure, indigent debtors who are unable to meet their obligations are treated the same as in the Netherlands.¹³⁴ They are obliged during the duration of the debt repayment plan to use their best efforts to find a job and make repayments. These debtors will still receive a discharge, even where they have not made any payments, as long as they have been *bona fide* in their efforts to find employment.

This construction of the debt relief procedure for consumers in Germany is ideal. The procedure for consumers has one gateway and thus can be considered to be a single procedure with one entrance and three possible steps leading to the debtor's discharge. It consists of both a debt repayment plan and a simplified insolvency procedure. Also, while the debtor has some say in the procedure, the Court has the final say. This restriction of the debtor's choice and a single procedure alleviates problems such as touting, and the problem of poor regulation experienced in jurisdictions with multiple alternative procedures. In addition, the extra-judicial debt counselling prior to the application reduces formal debt relief applications and where a settlement is not reached, the debtor is at any rate well informed about the choices available to him or her. Criticism has however been levelled against this debt relief procedure, mainly that it is too complex and expensive.¹³⁵ It is submitted that with the deferment of cost available to reduce the costs of the insolvency application and the debtor not having to make any payments under a debt repayment plan or simplified insolvency where he has no income or assets, these assertions on costs are unfounded. With regard to the system's complexity, it is submitted that any procedure that seeks to balance the interests of creditors with claims against the debtor's assets that are, by the very definition of bankruptcy not sufficient to compensate every creditor, will be complex.

¹³⁴ *Ibid.*

¹³⁵ *Ibid.*

7.2.3.3 Sweden

Sweden has two debt relief procedures for consumers, a straight bankruptcy procedure and a debt reorganisation procedure. The straight bankruptcy provision is hardly ever used by natural persons because it does not offer a discharge of pre-sequestration debt.¹³⁶ The debt reorganisation procedure is similar to the debt reorganisation in the Netherlands and Germany except for the fact that Sweden has abolished the initial extra-judicial debt counselling procedure, citing that it wasted too much time.¹³⁷ It is submitted that the statistics encountered in the German system on this procedure warrant that this process be included in the recommendations for the Tanzanian debt relief procedure. Furthermore, because the Tanzanian civil procedure already has an informal mediation process with the judge acting as the mediator between two disputing parties,¹³⁸ this informal debt counseling process will not be an entirely new concept.

The standout feature in Sweden is the administrative structure of the debt relief regime. Sweden has an independent administrative agency that is concerned with debt collection in general and the management of debt relief procedures.¹³⁹ In this jurisdiction all applications for debt relief orders are heard, issued and supervised by the administrative agency known as the Royal Debt Collector's Office.¹⁴⁰ Only appeals from the decisions taken from this body are heard by the Courts. Also, in order to cut costs for consumers Swedish debt reorganisation is sponsored and administered by government. It is noted that Australia, Canada and England and Wales, at varying levels of independence from their judiciary, use the same model of administration.¹⁴¹

The Swedish system presents the ideal administrative structure that reduces costs for consumers. These costs are reduced by removing the Court's involvement in the majority of the debt relief procedure and removing private

¹³⁶ Par 6.4.1 above.

¹³⁷ *Ibid.*

¹³⁸ Par 3.4 above.

¹³⁹ *Ibid.*

¹⁴⁰ *Ibid.*

¹⁴¹ Par 6.5 above.

trustees from administering debt relief procedures. It is recommended that this structure be used in any reform of the debt relief regime in Tanzania.

7.3 Proposed Structure and Amendments for the Tanzanian Debt Relief Regime

It is submitted that in order to create a well-organised and cost-effective debt relief system in Tanzania, a comprehensive restructuring of the current system is required. These proposed reforms would benefit Tanzania by bringing its debt relief philosophies into line with those of the developed jurisdictions where the majority of Tanzania's large investors and credit providers for consumers are from.¹⁴² These new measures would increase the confidence of investors and credit providers in Tanzania, by allowing creditors where necessary to use the debt relief system to claim repayment of debts at less cost in a predictable manner and time frame. In summary, these proposals will go a long way to address the issues that prompted this study, namely the high cost and inefficiency of debt relief in Tanzania. These reforms will also benefit over-indebted consumers who are currently confronted with an expensive and long bankruptcy procedure in order to discharge their debt.

It is suggested that the proposed restructuring of the Tanzanian debt relief system may be separated into three parts that all require reform. Firstly, the administration and supervision of debt relief procedures under the consumer insolvency system requires a complete overhaul in order to reduce Court supervision of these procedures and enhance efficiency. Secondly, with regard to the debt relief measures, it is submitted that the Tanzanian system requires to be separated into two procedures: a regular bankruptcy procedure primarily for business debtors and a three-part combined alternative procedure only for ordinary consumers. While ordinary consumers may be subject to both the regular bankruptcy procedure and the alternative procedure, business debtors only have bankruptcy as a debt relief option. Lastly, some proposals for amendments to the Tanzanian bankruptcy

¹⁴²Par 1.1. See also Basu and Srinivasan *Foreign direct investment in Africa: Some case studies* 34.

procedure are also necessary to update the procedure and make it more proficient. These proposals can be summarised as follows:

- (a) A provision for the automatic discharge of the debtor must be inserted into section 29 of the Tanzanian *Bankruptcy Act*. It is suggested that for a debtor's first bankruptcy the length of the time period spent in bankruptcy should be no more than three years before he or she may be released automatically. Where the debtor is bankrupt more than once and is subject to bankruptcy, again the period for automatic discharge should be increased to five years as a deterrent. The three-year period is ideal since on average the Tanzanian court-driven system currently takes about three years,¹⁴³ the idea being that under the new regime a bankruptcy procedure should not take longer than the current court-supervised process.
- (b) Section 20 of the Tanzanian *Bankruptcy Act* that deals with the adjudication of bankruptcy should be abolished and sections 6 to 9 of the Tanzanian *Bankruptcy Act* need to be amended to do away with the receiving order and the adjudication of bankruptcy. The amendments should be in favour of a straight bankruptcy order.¹⁴⁴
- (c) The legislature needs to revisit the thresholds set for the current *Bankruptcy Act*. For example, the current minimum threshold for an application of summary administration in Tanzania is still eight US dollars. As a result, this procedure of summary administration is currently unavailable to the majority of consumers because of the low threshold. These thresholds are out of date and make the *Bankruptcy Act* difficult and impractical to use.
- (d) Section 119(c) of the Tanzanian *Bankruptcy Act* that allows creditors to veto a summary administration procedure in Tanzania

¹⁴³The setup of this automatic discharge provision was borrowed from the Canadian system – par 5.4.1 above.

¹⁴⁴The bankruptcy order provision was borrowed from all the jurisdictions in this comparative study. South Africa, the United States, Australia, Canada, England, the Netherlands, Germany and Sweden do not have an adjudication of bankruptcy or sequestration provision, as the case may be.

must be abolished and summary administration must be made compulsory for all debtors who qualify for the procedure.¹⁴⁵

The proposed structure for debt relief measures and their administration will now be described.

7.3.1 The Tanzanian Debt Enforcement Authority

It is suggested that the current roles of the Official Receiver and the High Court of Tanzania with regard to bankruptcy should be combined into one independent government body similar to the Australian and Swedish jurisdictions. The purpose of this proposal is to eliminate the supervisory role of the overburdened Courts and increase the efficiency of the debt relief system by appointing one specialised government agency to assume that role. This government office will be known for present purposes as the Debt Enforcement Authority. It would operate as an independent unit in the Ministry of Justice and Constitutional Affairs.¹⁴⁶ The Authority would have the mandate to:

- (a) mediate any pre-bankruptcy settlement efforts where the reformed laws contain such a procedure;
- (b) decide on bankruptcy applications;¹⁴⁷
- (c) confirm statutory composition proposals;
- (d) rule on applications for the discharge of a bankrupt debtor;
- (e) supervise bankruptcy, statutory compositions and any other alternative procedures;
- (f) provide government officials who would act as trustees on behalf of consumers who need them; and

¹⁴⁵The setup of this compulsory summary administration provision was borrowed from the Canadian system – par 5.4.1 above.

¹⁴⁶The independence of this proposed agency will take on the same form as that of the Royal Swedish Debt Collector's Office which receives its funding from the government but is independent to avoid government influence. See par 6.5 above in this regard.

¹⁴⁷The provisions under the Tanzanian *Bankruptcy Act* that only creditors' petitions need to be heard by a legal authority would continue to apply in any proposed reforms. In this case the legal authority would be the Debt Enforcement Authority.

- (g) reprimand any creditor, private trustee or debtor who commits an offence in terms of specified debt relief legislation.

The main function of this Authority would be the efficient administration and supervision of the Tanzanian debt relief regime. Any consumer who uses the official Authority personnel to administer their procedure be it a composition, bankruptcy or any other procedure, would be subject to a nominal administration and stamp duty fee. The majority of the expense for the running of this Authority would be borne by the government or through fees for the same services offered to juristic persons. These measures would ensure that debt relief is not too costly for ordinary Tanzanians and that the process of bankruptcy and other debt relief procedures is administered quickly and at low cost. This Authority would also be responsible for regulating, training and keeping a register of qualified insolvency practitioners.¹⁴⁸

7.3.2 A Unitary Combined Debt Relief Procedure for Normal Consumers

It is submitted that the Tanzanian debt relief regime would benefit from having two procedures: bankruptcy, and a combined alternative to bankruptcy. Both procedures would however only be accessible through an application for bankruptcy to the Debt Enforcement Agency, making debt relief for natural persons available in Tanzania through one gateway. This model for debt relief has been borrowed from the German system.¹⁴⁹ It avoids having a number of debt relief procedures which become difficult to regulate and to advise consumers on. Furthermore, under this model bankruptcy is normally the last option for consumers. The combined procedure¹⁵⁰ is therefore intended to keep normal consumers away from the effects of a full-length bankruptcy procedure where possible.¹⁵¹

¹⁴⁸This is necessary in order to avoid any of the problems experienced by the South African legal system with respect to its administrators and legal practitioners who are responsible for a number of abuses – par 4.4.1 above.

¹⁴⁹See par 6.3.1 above.

¹⁵⁰For present purposes the proposed alternative procedure will be called the “combined debt relief procedure”.

¹⁵¹Under the German unitary procedure liquidation is also the last option after an out-of-Court settlement attempt followed by formal debt reorganisation. Where these procedures fail the debtor is then subject to “simplified insolvency proceedings” which is a summary procedure.

This proposed debt relief model requires debtors to be differentiated into business debtors and ordinary consumers. It is suggested that any debtor who is or was pursuing some form of commercial enterprise that caused his or her insolvency and who has more than 15 creditors at the time of his or her bankruptcy application or has a claim against him or her from an employee associated with that enterprise, should be regarded as a “business debtor.”¹⁵² Business debtors it is suggested should not be eligible for the combined debt relief procedure. These debtors should only have the Tanzanian bankruptcy procedure available to them. This is because the bankruptcy procedure has the interrogation processes and committees of inspection provisions that are sometimes necessary in the complex bankruptcies of business debtors.¹⁵³ The combined debt relief procedure is intended to be a summary procedure for ordinary consumers. Thus under this proposed debt relief model an ordinary consumer may choose to enter the combined debt relief procedure or be subject to bankruptcy of his or her own volition, or by a creditor’s application.¹⁵⁴ Where a creditor applies for the consumer’s bankruptcy however, the ordinary consumer will be given 14 days by the Debt Enforcement Authority to submit a request for the combined debt relief procedure. Similar to the German system,¹⁵⁵ where this request is granted the bankruptcy proceeding will be suspended in favour of the combined debt relief procedure.¹⁵⁶ The idea behind this provision is to always give an ordinary consumer an opportunity to avoid bankruptcy where possible. That being said, in this proposed dispensation bankruptcy is still a viable option for final debt enforcement for creditors, and debt relief for ordinary consumers. In par 7.3 above it is recommended that summary administration be made compulsory for all debtors whose assets are below a certain statutory threshold. It is suggested that this should apply to an ordinary consumer only where he or she applies for bankruptcy of his or her own volition, or who does not opt for

¹⁵²This definition of a business debtor is borrowed directly from the German InsO – par 6.3.1 above.

¹⁵³Par 7.2.3.2 above.

¹⁵⁴Par 6.3.1 above in the German system.

¹⁵⁵*Ibid.*

¹⁵⁶*Ibid.*

the combined debt relief procedure when a creditor applies for his or her bankruptcy.

The combined debt relief procedure may only be initiated by ordinary consumers and once the consumer lodges an application to that effect with the Debt Enforcement Authority, bankruptcy ceases to be an option for the creditors.¹⁵⁷ Only debtors who accrued their debts in a *bona fide* manner may be eligible for the combined debt relief procedure.¹⁵⁸ Once an application for the combined procedure has been made the Debt Enforcement Authority will first mediate an informal debt settlement procedure with the aim of reaching an amicable settlement between the debtor and all his or her creditors.¹⁵⁹ Where the debtor and his or her creditors agree on a plan the combined procedure is abandoned in favour of the negotiated plan. It is noted that at this stage, secured creditors must give their consent before an informal debt settlement can be binding upon them.

Where an agreement cannot be reached amicably in the mediation phase, the Debt Enforcement Authority will proceed with the second formal phase, which is to decide formally on the merits of the case and whether debt reorganisation is possible.¹⁶⁰ The Authority will then present a plan to the creditors and the debtor. This plan must include all the secured and unsecured creditors. It is submitted that Tanzania should follow the example of the United States under Chapter 13 of the Code and South Africa in the *National Credit Act, 2005* and allow the rescheduling of secured debts.¹⁶¹ In

¹⁵⁷This provision stops the creditors from terminating the combined debt relief procedure by applying for sequestration.

¹⁵⁸The requirement for a debtor to be *bona fide* before entering into a debt repayment plan has been borrowed from all three continental European jurisdictions – pars 6.2, 6.3 and 6.4 above. Furthermore it is one of the underlying values that modern debt relief regimes should take cognisance of in-debt relief reform – par 2.6 above.

¹⁵⁹The informal debt counselling procedure to achieve an informal settlement was borrowed from both the Netherlands and Germany – pars 6.3.2.1 and 6.3.1 above.

¹⁶⁰*Ibid.*

¹⁶¹This lesson was learnt from the United States Code; Chapter 13 repayment plans are allowed to reschedule the majority of a debtor's secured debt see par 5.2.2 above. Similarly, this provision was also borrowed from the South African debt review procedure that allows the rescheduling of secured debt, such as mortgages, under the *National Credit Act, 2005* see par 4.3 above.

order to allow the debtor an opportunity to keep his or her secured and unsecured assets it is suggested that the debt restructuring plan consist only of a surplus income repayment plan.¹⁶²

Where more than half of all the creditors in value and number accept the proposed debt reorganisation plan, it becomes binding on all the creditors, secured or otherwise. If a few creditors are unreasonably causing the formal reorganisation to fail, the debtor or one of the creditors may apply to the Debt Enforcement Authority for a “cram down” of the reorganisation plan on the creditors.¹⁶³ Once accepted the plan is then entered into the records of the Debt Enforcement Authority and an officer is assigned to supervise the debtor’s compliance. When the debtor has fulfilled his or her obligations under the plan he or she is discharged of all his or her pre-debt reorganisation debt.¹⁶⁴ The proposed plan may not exceed more than three years. This time period appears reasonable and fitting considering that currently a bankruptcy procedure in Tanzania takes about three years and thus any new procedure should not take longer. The Debt Authority cannot cancel a plan on the grounds that the debtor has, through personal circumstances, become unable to meet his or her repayments. In that situation the Authority can only cancel the plan if the debtor is not using his or her best efforts to find a job or to make repayments in general.¹⁶⁵

Where the debtor is unable to complete the formal debt reorganisation plan or the Debt Enforcement Authority refuses to “cram down” the plan, or after the mediation stage the Debt Enforcement Authority decides that formal debt reorganisation will not work, or a plan presented by the Debt Enforcement Authority is rejected by the creditors, the debtor will then be subject to a

¹⁶²This provision was borrowed from the Chapter 13 repayment plans – par 5.2.2 above.

¹⁶³The “cram down” procedure in this proposed structure is borrowed from the United States Code with respect to Chapter 13 plans, the Netherlands with respect to the debtors application to force a voluntary plan on his or her creditors. and the German system where the Court can force creditors to be bound to a reasonable debt restructuring plan – respectively pars 5.2.2, 6.2.4 and 6.3.3 above.

¹⁶⁴As seen in the German system – par 6.3.3 above.

¹⁶⁵This model that caters for debtors that have no assets or income either before the debt relief procedure or during the repayment plan is borrowed from all three continental European jurisdictions – pars 6.2, 6.3 and 6.4 above.

“simplified bankruptcy.”¹⁶⁶ In the first phase of this procedure the Debt Enforcement Authority appoints an official trustee who liquidates the debtor’s estate and distributes the proceeds among the creditors. The first phase cannot exceed more than one year. For a period not exceeding two years the debtor must assign all his or her excess income to the official trustee who then disburses it to the creditors. After three years have elapsed the debtor is automatically released.

The Debt Enforcement Authority may not refuse a debtor’s application for this combined debt relief procedure on the grounds that he or she has no assets and no income. The Debt Enforcement Authority must attempt an amicable settlement in these cases. Where this fails the debtor must be referred to a simplified bankruptcy procedure. The debtor’s discharge under this procedure is based on the debtor’s *bona fide* efforts to find a job and make repayments, and not the amount reimbursed to his or her creditors. Therefore the “no income no assets” debtor may be party to a simplified bankruptcy proceeding and be discharged without making a single payment.

7.4 Conclusion and Summary of the Recommendations

The objective of this study was to evaluate the Tanzanian consumer insolvency system with the aim of proposing a model and making recommendations for a debt relief dispensation that would handle the current increase in consumer debt. The model proposed consisted of two procedures: bankruptcy, and a combined debt relief procedure. The main recommendations for an efficient and functional debt relief system for consumers in Tanzania are as follows:

- (a) A complete overhaul of the supervision and administration of debt relief procedures in Tanzania is required in order to put in place a cost-effective and proficient debt relief system. It is proposed that the roles of the Official Receiver and the High Court in the supervision and administration of debt relief procedures be

¹⁶⁶This procedure is borrowed from the German system – par 6.3.3 above.

transferred to a new independent government unit known for these purposes as the “Debt Enforcement Agency.” This unit should then be charged with the efficient supervision and administration of debt relief procedures.

- (b) The Tanzanian legislature needs to approve an alternative to bankruptcy that combines mediation, formal debt reorganisation and a summary bankruptcy proceeding.
- (c) The current bankruptcy procedure, it is proposed, requires an automatic discharge provision. Under this provision first-time bankrupts will be discharged of their pre-sequestration debt in three years. Second-time bankrupts and more, only after five years.
- (d) The minimum threshold values under the *Bankruptcy Act*, 1930 need to be revised by the legislature.
- (e) The summary administration procedure for small estates in Tanzania must be made compulsory for all debtors who qualify for the procedure.

Finally, it is concluded that these recommendations and the model proposed for debt relief in this study will contribute to reducing the costs of doing business in Tanzania. The proposed model provides predictable, well-organised debt enforcement for creditors, and debt relief for debtors.

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List of abbreviations

<i>AUD</i>	<i>Australian Dollar</i>
<i>CAD</i>	<i>Canadian Dollar</i>
<i>MCA</i>	<i>Magistrates' Courts Act</i>
<i>NCA</i>	<i>National Credit Act</i>
<i>NCR</i>	<i>National Credit Regulator</i>
<i>SADC</i>	<i>Southern African Development Community</i>
<i>SWB</i>	<i>Swedish Bankruptcy Act</i>
<i>ZAR</i>	<i>South African Rand</i>