

CONSTITUTIONALITY OF THE ADVANTAGE TO CREDITORS REQUIREMENT AND A COMPARATIVE INVESTIGATION IN INSOLVENCY LAW

BY

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Through Christ anything is possible. Thank you to the Almighty for all he continues to do for me.

“For I consider that the sufferings of this present time are not worth comparing with the glory that is to be revealed to us.” Romans 8:18

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ABSTRACT

This dissertation is an investigation into the constitutionality of the requirement of advantage to creditors in South African consumer insolvency law as well as a comparative investigation into debt relief procedures available to consumer debtors in Australia and England. The dissertation identifies and discusses debt relief procedures available in South African consumer insolvency law namely sequestration, debt review and administration. The author suggests that these procedures do not provide adequate relief as it does not provide a debt discharge for “poor” debtors, that is debtors who do not have any assets or income (the so-called “No Income No Assets” (NINA) group of debtors) available for distribution amongst creditors.

The author discusses the possible unconstitutionality of the advantage for creditors requirement in light of the creditor oriented approach of the South African insolvency system. In this regard the test that was applied in the famous constitutional court decision in *Harken v Lane* 1998 (1) SA 300 CC, will be analysed in order to determine the possible violation of the right of equality enshrined in the Constitution of the Republic of South Africa 1996.

The comparative study entails an investigation of certain key issues namely the availability of alternative debt relief procedures and in particular how both countries deal with debt discharge for poor debtors.

Ultimately, two sets of conclusions are drawn from the investigation in this dissertation. Firstly, it is concluded that the requirement of advantage to creditors is unconstitutional and should be removed as a provision under the consumer insolvency law. Secondly it is submitted that the South African Reform Commission should learn from developments in English and Australian consumer insolvency law and should reconsider alternative and appropriate debt discharge procedures for debtors, especially “poor” debtors who cannot reasonably repay their creditors.

TABLE OF CONTENTS

CHAPTER 1

INTRODUCTION

1.1 Background.....	8
1.2 Transformation from a distorted legacy.....	10
1.3 Problem Statement and Objectives.....	11
1.4 Methodology.....	13
1.5 Delineation and limitations.....	13
1.6 Structure of dissertation.....	13

CHAPTER 2

SOUTH AFRICAN CONSUMER INSOLVENCY LAW

2.1 Introduction.....	14
2.2 Sequestration.....	14
2.2.1 The purpose of sequestration.....	14
2.3 Voluntary surrender.....	15
2.3.1 Preliminary formalities.....	16
2.3.2 Insolvency burden of proof.....	16
2.3.3 Sufficient residue to cover sequestration costs.....	17
2.3.4 Advantage to creditors.....	17
2.3.5 Application for surrender.....	17
2.3.6 Courts Discretion.....	18
2.4 Compulsory Sequestration.....	18
2.4.1 Requirements of compulsory sequestration.....	18
2.4.2 Preliminary formalities.....	18
2.4.2.1 Security for costs	19
2.4.2.2 Furnishing a copy of application to interested parties.....	19
2.4.2.3 Creditors claim.....	19
2.4.2.4 Debtor committed an act of insolvency or is insolvent	20

2.4.2.5 Advantage to creditors.....	20
2.5 Application for compulsory sequestration.....	21
2.6 Provisional sequestration.....	21
2.7 Final Sequestration.....	22
2.8 Court’s discretion.....	22
2.9 Costs of Proceedings.....	22
2.10 Friendly sequestration.....	22
2.11 Administration.....	23
2.11.1 Application for an Administration Order.....	24
2.11.2 Hearing of Application for Administration.....	25
2.12 Debt Review.....	25
2.12.1 Application for debt review.....	26
2.12.2 Duty of good faith.....	27
2.12.3 Debt counsellor and his or her administrative duties.....	27
2.12.4 Determination of over-indebtedness.....	27
2.12.5 Termination of debt review.....	27
2.12.6 Effect of (pending) debt review or rearrangement order or agreement.....	29
2.12.7 Effects on Credit Provider.....	30
2.13 Proposed pre-liquidation composition.....	31
2.14 Conclusion.....	32

CHAPTER 3

ADVANTAGE TO CREDITORS AND ITS CONSTITUTIONALITY

3.1 Introduction.....	35
3.2 Pro-creditor System.....	35
3.3 Advantage to creditors requirement.....	36
3.3.1 Burden of proof.....	37

3.4 Constitutionality of the advantage to creditors Requirement.....	37
3.4.1 Introduction.....	37
3.4.2 Constitutionality.....	38
3.4.2.1 Does the advantage to creditors requirement differentiate between people or category of people?	38
3.4.2.2 Legitimacy of Advantage to creditors.....	39
3.4.2.3 Unfair discrimination.....	39
3.4.2.4 Justified under limitation clause	40
3.5 Conclusion.....	41
CHAPTER 4	
COMPARATIVE INVESTIGATION	
4.1 Introduction.....	43
4.2 Australia.....	43
4.2.1 Introduction.....	43
4.2.2 Bankruptcy.....	43
4.2.3 Debt Agreements.....	44
4.2.4 Personal insolvency agreements.....	45
4.3 England.....	46
4.3.1 Introduction.....	46
4.3.2 Bankruptcy.....	47
4.3.3 Individual voluntary arrangement.....	48
4.3.4 Debt Relief Order.....	48
4.4 Conclusion.....	50
CHAPTER 5	
CONCLUSION.....	51



BIBLIOGRAPHY.....54

INTRODUCTION

1.1 Background

South African insolvency law is mainly regulated by the Insolvency Act¹ and it is peculiar in its execution of debt discharge in that it is saddled with a stringent requirement of advantage to creditors to be proved before a court can grant a sequestration order. This kind of system is regarded as a pro creditor system, which simply means that, this system stands on a position that discharge of debt for a debtor is not viewed as a primary priority but that there must be a pecuniary benefit on behalf of the creditors.

The Act does not define advantage to creditors and this has therefore been subjected to several judicial interpretations.² However, it is a statutory requirement that must be proved amongst other requirements before a sequestration order can be granted.³ It must be noted that this requirement has been part of our insolvency law system since 1936 and it remains unchanged. The South African insolvency system was influenced by the Civil law and English law and it still reflects both of the systems in its roots. However both of those systems that influenced it in terms of the pro creditor notion have moved away from it. We see the South African insolvency system being faced with a predicament that the requirement of advantage to creditors renders it out of reach for many over-indebted debtors.⁴

This requirement in its own right has far reaching adverse consequences and it has been described as a stumbling-block in the way of debtors wishing to use the sequestration process as a debt relief measure.⁵ The adverse consequences and implications are evident amongst the previously disadvantaged people who are now fast becoming part of the credit industry. Some may therefore view our insolvency system as being discriminatory due to its stringent requirements for sequestration on the one hand, due to the limited alternatives to sequestration available on the other hand and the formal discharge only available to an exclusive few.⁶ Therefore, within

¹ Insolvency Act 24 of 1936. (hereafter referred as Insolvency Act).

² *Ex Parte Van Den Berg* 1950 (1) SA 816 (W) 817.

³ Section 6(1).

⁴ Boraine *et al* "The Pro-Creditor Approach in South African Insolvency Law and the Possible Impact of the Constitution" 2015 *NIBLeJ* 62.

⁵ Roestoff and Renke "Debt Relief for Consumers – Insolvency and Consumer Protection Legislation" (Part 2) 2006 *Obiter* 99.

⁶ Review of administration orders in terms of section 74 of the Magistrates Courts Act 32 of 1994. Interim research report 83. See Boraine *et al* "A comparison between formal debt administration and debt review - the pros and cons of these measures and suggestions for law reform" (part 1) 2012 *De Jure* 254.

the context of some viewing the insolvency system as being discriminatory, the constitutionality of the requirement of advantage to creditors arises.

Roestoff and Coetzee⁷ remark that the need for a no asset procedure is even more pressing in the context of a developing economy and that such exclusion infringes the basic constitutional right of equality under the law. They explain as follows:

...not providing a measure for this relegated group sustains the dualism in the South African economy by systemically contributing to keeping the 'poor' in a state of poverty.

The no asset procedure mentioned above relates to the so called NINA debtors (No Income No Assets). These are a category of debtors who may have sufficient resources to cover their basic needs, but they have no extra resources to pass on to creditors. Significant numbers of debtors in all insolvency systems for natural persons today fall into this category. Because these debtors produce no value for creditors, thus failing to achieve one of the most salient goals of an insolvency system, a minority of insolvency systems has all but excluded them from relief.⁸

Roestoff and Coetzee⁹ point further that it is thus clear that a debtor wishing to utilise the sequestration process as a form of debt relief needs to overcome the obstacle created by the advantage to creditors requirement. In this regard Bertelsmann J remarked in *Ex parte Ogunlaja*:¹⁰

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

It should also be mentioned that the Law Reform Commission has recommended that the advantage to creditors requirement be retained.¹¹ Therefore the

⁷ Roestoff and Coetzee "Consumer Debt Relief in South Africa; Lessons from America and England; and Suggestions for the Way Forward" 2012 SA Merc LJ 24.

⁸ The World Bank Insolvency and Creditor/Debtor Regimes Task Force Working Group meeting on 11 January 2011. See <http://bit.ly/1D1cMoc> (accessed 26 October 2016).

⁹ Roestoff and Coetzee 24.

¹⁰ *Ex parte Ogunlaja* 2001 JOL 27023 (GNP).

¹¹ The South African Law Commission published a report titled the Report on the review of the law of insolvency in 2000. It contained a draft bill as well as an explanatory memorandum – the '2000 Insolvency Bill'

dissertation will consider the extent at which the requirement of advantage to creditors infringes on certain constitutional rights of debtors. The constitutional right that will be investigated is section 9(1) of the Constitution of the Republic of South Africa,¹² which provides that “everyone is equal before the law and has the right to equal protection and benefit of the law”.

1.2 Transformation from a distorted legacy

South Africa during apartheid has left behind a distorted legacy in relation to dualism in the South African economy. The majority of South Africans were not afforded equal opportunity which in turn is reflected in unequal distribution of wealth. The policies and regulations of apartheid were all intended to oppress the majority of South Africans and succeeded in doing so economically. The South African dual economy is characterized by extreme income disparity along racial lines. The constitutional commitment to equality emerges directly from the inequalities and injustices of the past. Policies and segregation led to the deliberate exclusion of black people in all aspects of social, political and economic life.¹³

Many black South Africans are unemployed and poor, while most white South Africans are better off. The uneven distribution of wealth is the direct result of the apartheid system. Inequality is often cited as the biggest challenge facing development and transformation in post-apartheid South Africa. In light of the history of systematic discrimination, the importance of the principle of equality in South Africa is reflected in the very first section of the Constitution.¹⁴

In aligning the insolvency system with the statements made above, Coetzee remarks that, at the outset, it is important to emphasise that on face value, no individual debt relief measure as such seems to be in conflict with the right to equality as debtors who do not find recourse within a specific measure may presumably find a similar solution to their financial woes in another.¹⁵ She goes further and points out that, however, within the constitutional context, the argument is that when the system is viewed holistically, the marginalisation of a group of debtors mainly black South Africans, comprised mostly of NINA debtors, is evident as they are effectively excluded from all debt relief measures. Secondly, even those who are fortunate

and ‘2000 Explanatory memorandum’ respectively. The latest versions of the documents are unofficial working copies on file with the author (‘2015 Insolvency Bill’ and ‘2014 Explanatory memorandum’ respectively).

¹² The Constitution of the Republic of South Africa, 1996. (hereafter referred as the Constitution).

¹³ *Soobramoney v Minister of Health, Kwa-Zulu Natal* 1997 12 BCLR 8-9.

¹⁴ Van Reenen “Equality, Discrimination and Affirmative Action- Section 9 of the Constitution” 1997 *SAPR* 12.

¹⁵ Coetzee “Is the Unequal Treatment of Debtors in Natural Person Insolvency Law Justifiable?: A South African Exposition” 2016 *Int. Insolv. Rev.* 49.

enough to qualify for alternative measures are side-lined as only the sequestration procedure provides actual debt relief in the form of a discharge.¹⁶

The first test of constitutionality and equality in insolvency law post-apartheid South Africa came in the case of *Harksen v Lane*.¹⁷ The Constitutional Court laid down the test for determining whether or not a certain act or legislative provision is unconstitutional. The court explained the stages of enquiry and it would appear that *Harksen* decision came at the right time to have made an alarm that there is a need for absolute reform and transformation of the South African insolvency law.

Indeed the dual economy in South Africa demands a new modern insolvency system which will cater for the needs of all South African consumers. Currently the insolvency legislation is not sufficient and there is a need for transformation from the apartheid legacy that has affected the socio-economic status of South African consumers.

1.3 Problem statement and research objectives

Advantage to creditors is a requirement in an insolvency law procedure, which in order for a court to grant a sequestration order there must be a pecuniary benefit to creditors. In cases where the debtor fails to prove that there will be an advantage to creditors such debtor will not be granted a sequestration order and ultimately will not receive a discharge of his or her debt. Alternatively, there are other procedures that the debtor can utilise. The other two measures are the administration procedure in terms of section 74 of the Magistrates' Courts Act¹⁸ and debt review in terms of section 86 of the National Credit Act.¹⁹ It is important to note that debt review procedure does not offer the consumer an opportunity to obtain a discharge from pre-existing indebtedness.²⁰ All it does is to provide for debt relief through debt re-organisation in cases of over-indebtedness.²¹ The administration procedure on the other hand, involves a relatively simple and inexpensive procedure whereby overcommitted debtors' obligations are rescheduled. The administration orders are intended for smaller estates where sequestration would swallow the assets and the aim is mainly to assist the debtor during a period of financial embarrassment.²²

¹⁶ *Ibid.*

¹⁷ 1998 (1) SA 300 CC.

¹⁸ 32 of 1944.

¹⁹ 34 of 2005.

²⁰ Roestoff and Coetzee 53.

²¹ *Idem* 67.

²² *Idem* 64.

It has been argued that South African insolvency law does not provide sufficient alternative debt relief measures that can assist overburdened debtors. The advantage to creditors principle, in fact cause unequal treatment of debtors that are left without proper relief in the form of statutory discharge. Boraine submits that the exclusion of many overburdened consumer debtors from discharge procedures infringes their basic constitutional right of equality under the South African Constitution.²³ Further Evans, in this regard also points out as follows:²⁴

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

In this dissertation a critical analysis of the South African insolvency law in light of the requirement of advantage to creditors is very essential in the context of the constitutional democracy of the country. The investigation as to the constitutionality of the advantage to creditors is with reference to section 1(a), section 9(1) of the Constitution of the Republic of South Africa.²⁵ Section 1 (a) is advanced as the founding provision which entails that the Republic is founded on the achievement of equality and section 9(1) is a bill of right and states that everyone is equal before the law.

The research objective of this dissertation is thus to investigate the requirement of advantage to creditors in South African insolvency law in respect of the constitutional rights (mentioned above) in relation to debtors who are over-indebted and cannot succeed in proving advantage to creditors.

1.4 Methodology

The proposed research will be conducted by way of a literature review of books, journal articles, thesis, reports, legislation and case law. The research will be a critical analysis of the current South African insolvency law and a comparative study of other

²³ Boraine *et al* 4.

²⁴ Evans R “Friendly Sequestrations, the Abuse of the Process of Court, and Possible Solutions for Overburdened Debtors” 2001 *SA Merc LJ* 508.

²⁵ The Constitution.

jurisdictions. The comparative study will be in regard how other insolvency systems deal with the issue of debt relief and debt discharge procedures in relation to poor debtors as compared to the South African insolvency system.

It will consider the general principles of consumer insolvency law as it stands at the present moment in South African insolvency Law. It will also investigate the notion of a pro creditor system, discuss the principle of advantage to creditors, and investigate the question of its constitutionality.

A comparative study will be undertaken by mainly investigating the Australian and England systems. The Australian system has different debt relief measures, which also involve a system where there is no need for court involvement. The English insolvency law system has undergone several changes in the past and in particular a granting of debt relief orders for the so called NINA debtors. The English and Australian system does not make provision for advantage to creditors in order for a bankruptcy order to be granted.

1.5 Delineation and limitations

The study will focus on consumer insolvency law. This research is not intended to constitute a comprehensive analysis of the constitutional law principles. Therefore, given the limited scope of this study, this dissertation will focus on the Insolvency law and the constitutionality of one of its principle of advantage to creditors. With regard to comparative investigation focus will be on particular systems pertaining to effective procedures of debt relief for debtors.

1.6 Structure of dissertation

This dissertation is divided into five chapters. This chapter being the first chapter dealing with introduction, followed by chapter two which will deal with South African consumer insolvency law procedures (i.e. sequestration, debt review and administration). Chapter three will deal with the advantage to creditors requirement and its constitutionality. Chapter four is the comparative chapter, comparing Australia and England. Chapter five the final chapter contains the conclusions and recommendations made in this study.

CHAPTER 2

SOUTH AFRICAN CONSUMER INSOLVENCY LAW

2.1 Introduction

There are three statutory debt relief measures available in South African consumer insolvency law. Sequestration in terms of the Insolvency Act²⁶ will firstly be discussed as it provides for the primary debt relief measure in South African insolvency law. Thereafter, the administration procedure in terms of section 74 of the Magistrates' Courts Act²⁷ and debt review in terms of section 86 of the National Credit Act²⁸ will be discussed.

It is necessary to give an overview of the South African consumer insolvency procedures as they stand at the present moment in order to analyse their individual deficiencies as regards the plight of poor debtors. It is important to show the lack of alternatives for NINA debtors to get discharge using these available debt relief procedures.

2.2 Sequestration

Sequestration in terms of the Insolvency Act²⁹ makes for provision for two processes in terms of which a debtor's estate may be sequestered. A creditor or creditors may apply to the court for the sequestration of the debtor's estate.³⁰ This is known as compulsory sequestration. The debtor himself or herself may apply to court for acceptance of the surrender of his or her estate.³¹ This is known as voluntary surrender.

2.2.1 The purpose of sequestration

The main objective of the sequestration process is to provide a collective debt collecting process that will ensure an orderly and fair distribution of a debtor's assets in circumstances where his assets are insufficient to meet the claims of all his creditors.³² Once a sequestration order has been made a "*concursum creditorum*" is applied, meaning a coming together of creditors, so that rights of the creditors as a

²⁶ Insolvency Act.

²⁷ 32 of 1944.

²⁸ 34 of 2005.

²⁹ Insolvency Act.

³⁰ Section 9(1).

³¹ Section 3(1).

³² Bertelsmann *et al Mars: The Law of insolvency in South Africa* (2008) 30.

group are preferred to the rights of individual creditors. Describing the concept of “*concursum creditorum*” in *Walker v Syfret*³³ Innes J (as then he was) stated that:

the object of the [Insolvency Act] is to ensure a due distribution of assets among creditors in the order of their preference... 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 by a single creditor to the prejudice of the general body. The claim of each creditor must be dealt with as it existed at the issue of the order.

The sequestration order will only be granted if sequestration is to the advantages to creditors. The South African Insolvency Act lays down ‘advantage to creditors’ as a pre-requisite for sequestration applications. This requirement is fundamental to the South African Insolvency Act. This was illustrated in *Ex Parte Ford*³⁴ where the applicants averred that they had a ‘constitutional right’ to the acceptance of the surrender of their estates. However, the court confirmed that the primary object of the sequestration procedure is not the relief of harassed debtors.

2.3 Voluntary surrender

In terms of section 3(1) of the Insolvency Act, a debtor himself or his agent may apply for acceptance of the surrender of the debtor’s estates. The application can also be brought by a curator bonis of a person who is incapable of managing his own estate, or even the executor of a deceased estate. Section 17(4)(a) of the Matrimonial Property Act³⁵ provides that where the parties are married in community of property, both spouses must apply for the voluntary surrender because they are regarded in law as equal managers of their joint estate.

The statutory requirements for a successful voluntary surrender as stipulated by the insolvency Act³⁶ are:

- a) All the formalities prescribed in the section 4 must be complied with.
- b) The debtor must be factually insolvent.
- c) There must be sufficient assets in the free residue of the insolvent’s estate to defray all the costs of the sequestration.

³³ 1911 AD 141 166.

³⁴ 2009 (3) SA 376 (WCC).

³⁵ 88 of 1984.

³⁶ Section 6.

d) That there must be an advantage of his creditors if his estate is sequestrated.

2.3.1 Preliminary formalities

In terms of section 4 a debtor who wishes to surrender his estate publishes a notice of surrender in the *Government Gazette* and in a newspaper circulating in the magisterial district where he or she resides, or if he or she is a trader, in the district where he has his principal place of business. The notice must correspond substantially with Form A in the First Schedule. The notice must *inter alia* describe the debtor, state the day on which application will be made to court and the period during which the debtor's statement of affairs will lie for inspection. The purpose of the notice is to ensure that creditors know of the intention to apply should they wish to oppose the application. The notice shall be published not more than 30 days and not less than 14 days before the date of the hearing. The tearsheet or cuttings of the newspaper and Gazette are attached on the Affidavit as proof of publication of the surrender. In *Ex Parte Barton*,³⁷ the notice had been published in a Western Cape newspaper, but the applicant had previously lived in Durban and all his creditors were in KwaZulu-Natal. The court postponed the application so that the notice might be published in a KwaZulu-Natal newspaper and the debtors statement affairs might lay for inspection in Durban.³⁸

2.3.2 Insolvency burden of proof

The debtor must be insolvent. The test is whether the debtor's liabilities, fairly estimated, exceed his assets, fairly valued. Proof of inability to pay debts merely constitutes a *prima facie* case which shifts the onus of proof to the debtor to prove that his assets exceed his liabilities'. The extent of the debtor's asset and liabilities is usually determined by reference to the statement of affairs, but the court is not bound by the valuations in the statement and may make a finding of insolvency even where the statement (or other evidence adduced by the debtor) indicates that his assets exceed his liabilities.³⁹

³⁷ 1926 CPD 252.

³⁸ *Sharrock et al Hockly's Insolvency Law* (2007) 18. See Section 7(2). Where the applicant advertise a date which falls upon a Saturday, Sunday or even public holiday, the intended surrender will have to be advertised again. However, if the notice is advertised on the date which is a court day but not for motion court, such application will be called in court and be postponed to another motion court day. The notice of surrender lapses if the court does not accept the surrender within 14 days from the date specified in the notice as the date upon which application will be made for the acceptance of the surrender of the estate. The notice cannot be withdrawn without the consent of the Master unless the Master is satisfied that it was published in good faith and good cause exists for its withdrawal.

³⁹ *Ex Parte Van den Berg* 1962 (4) SA 402 (O) 404.

2.3.3 Sufficient residue to cover sequestration costs

There must be sufficient assets in the residue to cover the sequestration costs. The debtor must prove that he or she owns property that will be realizable to cover the sequestration costs which is payable from the free residue of the estate.⁴⁰ In Gauteng and the Cape,⁴¹ the value of the free residue must be at least R20 000 to pay the costs of sequestration, however this amount is adjusted from time to time. The costs of sequestration include the costs of application, and also the general costs of the administration.⁴²

2.3.4 Advantage to creditors

The court must be satisfied that the sequestration will be to the advantage of creditors should the debtors' estate be sequestrated.⁴³ The onus of proving advantage to creditor in a voluntary surrender application is more strenuous than the requirement to show reason to believe that there will be advantage in a compulsory sequestration. In *Ex Parte Ogunlaja*⁴⁴, it was held that voluntary surrender must provide for a minimum of 20 cents in the rand in order to be advantage to creditors.⁴⁵

2.3.5 Application for surrender

The application for surrender is brought by way of a notice of motion supported by affidavit. The purpose of the founding affidavit(s) is to persuade the court that the four requirements for voluntary surrender have been satisfied. It should contain the following:⁴⁶

- (a) The applicant's personal information (full names, ID number, occupation, name of employer, if he is married details in respect of the marriage regime and spouses name and address);
- b) An allegation that the applicant has by misfortune and without fraud or dishonestly on his part become and is insolvent and that he wishes to surrender his estate for the benefit of his creditors.
- (c) An averment of compliance with all preliminary formalities;

⁴⁰ Section 6(1).

⁴¹ Legal Education and Development (LEAD) *Insolvency Law Practice Manual* 2012 18.

⁴² Section 97. See par 3.3

⁴³ Section 6.

⁴⁴ *Ogunlaja Supra*.

⁴⁵ See chapter 3.

⁴⁶ Sharrock *et al* 24.

- (d) An allegation supported by a statement of the insolvent's affairs that the debtor is in fact insolvent;
- (e) The causes of the applicant's insolvency;
- (f) An allegation that there is sufficient free residue to meet the cost of sequestration;
- (g) An averment that the sequestration will be to the advantage of creditors;
- (h) A statement of the amount of the applicant's salary or other income.

2.3.6 Courts discretion

Even if the court is satisfied that the requirements have been met and that the preliminary formalities have been observed, it still has the discretion to reject the surrender.⁴⁷

2.4 Compulsory sequestration

The second way in which a debtor's estate may be sequestrated is called compulsory sequestration. Compulsory sequestration is instituted by way of notice of motion also known as application proceedings supported by an affidavit. It is regulated by rule 6 of the High Court Rules and the long notice of motion namely Form 2A of the Uniform Rules of Court is used.⁴⁸

2.4.1 Requirements of compulsory sequestration

Before a court will grant a sequestration order, the requirements to be followed are:

- (a) That all the preliminary formalities have been complied with.
- (b) That he has established a claim which entitles him to apply for compulsory sequestration.
- (c) That the respondent debtor is actually insolvent, or the debtor has committed an act of insolvency.
- (d) That there is reason to believe that it will be to the advantage of creditors if the debtor's estate is sequestrated.⁴⁹

2.4.2 Preliminary formalities

⁴⁷ Section 6(1).

⁴⁸ Sharrock *et al* 29.

⁴⁹ Section 12(1).

2.4.2.1 Security for costs

The sequestrating creditor is required before lodging of an application for compulsory sequestration to deposit with the Master security for payment of all fees and charges necessary for the prosecution of all sequestration proceedings until the appointment of trustee, if no trustee is appointed, of all fees and charges necessary for the discharge of the estate from sequestration.⁵⁰ The Master, upon the receipt of the security will issue the certificate confirming that the security has been given. The certificate must be issued not more than 10 days before the application for sequestration and has to be filed with the Registrar of High Court or served with the respondent, but it must be available at the hearing.⁵¹

2.4.2.2 Furnishing a copy of application to interested parties

Section 9(4A)(a)(iv) requires the applicant to furnish a copy of the application to the debtor. Prior to this, the Insolvency Act did not require the debtor to be served with the notice. The court in the case of urgency may dispense with the necessity of furnishing the copy to the respondent debtor, where there is possibility of irreparable loss to the applicant should the debtor be furnished and forewarned of the impending application.⁵² Section 9(4A)(a)(i)-(iii) further provides that when an application is presented to the court, the applicant is required to furnish a copy to every registered trade union that, as far as he can reasonably ascertain, representing any of the debtor's employees themselves and to the South African Revenue Service.⁵³

2.4.2.3 Creditors claim

The sequestrating creditor has to prove that he has a liquidated claim of not less than R100, or where two or more creditors apply they must prove that they have a liquidated claim in the aggregate of not less than R200.⁵⁴ Joint creditors in respect of one claim of not less than R100 can apply for the sequestration of their debtor's estate. The creditors claim must be liquidated. The liquidated claim means a money claim, the amount of which is fixed and determined by agreement, judgment or otherwise. If a creditor relies on claim for R100 or more, he is confined to that claim. However, if the respondent, in opposing the application alleges that the claim is less

⁵⁰ Section 9 (3) (b).

⁵¹ *Standard Bank of South Africa Ltd v Bester NO* 1995 (3) SA 123 (A).

⁵² Rule 6(2) read with Rule 6(5)(a) of the Uniform Rules of court.

⁵³ *Standard Bank of South Africa Ltd v Sewpersadh* 2005 (4) SA 148 (C).

⁵⁴ Section 9(1).

than the required amount and this allegation is uncontroverted by the applicant, he will not be entitled to an order for sequestration.⁵⁵

2.4.2.4 Debtor committed an act of insolvency or is insolvent

The applicant creditor can base his claim on actual insolvency of the debtor or an act of insolvency committed by the debtor in terms of section 8. Although a creditor may have good reason for believing that the debtor is insolvent, he or she will usually not be in a position to prove that the debtor's liabilities exceed his assets. Consequently, the legislature has designated certain behaviour or actions by a debtor as acts of insolvency and if the sequestrating creditor can prove to the satisfaction of the court that the debtor has committed one of these acts of insolvency, then it will not be necessary to prove the actual insolvency.⁵⁶ An act of insolvency need not be committed vis-à-vis the sequestrating creditor.⁵⁷ A practical problem often exists where a creditor has to prove that the debtor is actually insolvent. The creditor will often have to rely on indirect evidence, such as dishonouring of a cheque or the debtor's request for an extension of time to pay. Factual insolvency may be established, directly or indirectly. It will be established directly when evidence of the debtor's liabilities and the market value of his assets are provided or indirectly by evidence of facts and circumstances from which the inference of insolvency is fairly and properly deducible.⁵⁸

2.4.2.5 Advantage to creditors

Before a court can grant a final sequestration order, it must be satisfied that there is reason to believe that it will be to the advantage to creditors if the debtor's estate is sequestrated. Creditors means all, or at least the general body of creditors. The question is whether a substantial portion' of the creditors determined according to the value of the claims, will deprive advantage from sequestration.⁵⁹

The sequestrating creditor bears the onus of proving that the sequestration will be to the advantage of creditors, even where it is clear that the debtor has committed an act of insolvency.⁶⁰ The onus is less stringent than in the case of voluntary surrender applications. Voluntary surrender requires proof of advantage for creditors, whereas

⁵⁵ *Moodley v Cassim* 1953 (4) SA 516 (N) 517.

⁵⁶ *De Villiers NO v Maursen Properties (Pty) Ltd* 1983 (4) SA 670 (T) 676. It follows that the debtor's estate may be sequestrated even though he is technically solvent.

⁵⁷ *Sharrock et al* 31.

⁵⁸ Nagel *Commercial law* (2011) 410.

⁵⁹ *Sharrock et al* 38.

⁶⁰ *Wilkins v Pieterse* 1937 CPD 165. The view was taken that once an act of insolvency is proved, the court will require convincing reasons to persuade it that sequestration will be to the advantage of creditors.

compulsory sequestration requires only a reasonable prospect that it will be to the advantage of creditors if the debtor's estate is sequestrated. The burden will be heavier if there is only one creditor and he has to prove why sequestration will be more advantageous than execution.⁶¹

2.5 Application for compulsory sequestration

The application is brought by way of a notice of motion supported by affidavit. The affidavit must be by the sequestrating creditor or anyone else who can attest positively to the facts. The applicant's affidavit must contain the following information:

- (a) The personal information of the sequestrating creditor (full names, occupation and addresses) and the fact that he has locus standi to apply,
- (b) The personal information of the debtor (full names, Identification Number or date of birth, occupation, name of employer, details of marriage regime and spouses name, address);
- (c) The amount, cause and nature of the applicant claim and statement as to whether the claim is secured or not.
- (d) A statement to the effect that due security has been lodged with the Master of the High court;
- (e) The act of insolvency alleged to have been committed by the debtor
- (f) An allegation that the sequestration of debtors estate will be to the advantage of creditors;
- (g) Evidence of the compliance with the preliminary formalities, for example, such as security has been lodged.

2.6 Provisional sequestration

The sequestrating creditor has to approach the court twice. Once to obtain a provisional order of sequestration,⁶² the second time to have the provisional order confirmed and made final.⁶³ On each occasion, the creditor must establish the same requirements, but the standard of proof differs. At the provisional stage, the court must be of the opinion that *prima facie* the requirements for a sequestration order

⁶¹ See the wording of section 6(1), section 10(c) and section 12(1)(c).

⁶² Section 10.

⁶³ Section 12.

are satisfied. At the final stage, the court must be satisfied that those requirements are proved on a balance of probabilities. A final order cannot be granted without a provisional one first being made. Therefore if the provisional order granted is for any reason a nullity the final order has to suffer the same fate.⁶⁴

2.7 Final sequestration

The sequestrating creditor bears the onus to prove the requirements stated above on the return day. The practice is for the applicants counsel to appear in court and ask for the provisional order of sequestration to be made final. When a provisional order of sequestration has been made final, the date of sequestration is thereafter for all purposes taken to be the date upon which the provisional order was originally granted and not the date upon which it was made final.⁶⁵

2.8 Court's discretion

Even if the court is satisfied that the requirements have been established on a balance of probabilities, it is not bound to grant a final order of sequestration. The court has an overriding discretion, to be exercised upon a consideration of all the circumstances.⁶⁶

2.9 Costs of proceedings

The trustee must from the first available funds of the estate, reimburse the sequestrating creditor his taxed costs in sequestrating the debtor's estate.⁶⁷ No claim need be proved for these costs, as they are part of the costs of sequestration.

2.10 Friendly sequestration

An application for compulsory sequestration brought by a creditor who is not at arm's length is generally referred to as a 'friendly sequestration'.⁶⁸ In *Craggs v Dedekind and others*⁶⁹, Conradie J described a friendly sequestration as follows:

Friendly sequestrations seem to share certain characteristics. Although, like pornography, they may be hard to define, they are easy to recognise. The debt which the sequestrating creditor relies upon is almost always a loan. It is

⁶⁴ *Moch v Nedtravel (Pty) Ltd t/a American Express Travel Service* 1996 (3) SA 1 (A) 9-10.

⁶⁵ *Sharrock et al* 51.

⁶⁶ In *Julie Whyte Dresses (Pty) Ltd v Whitehead* 1970 (3) SA 218 the court exercised its discretion against sequestration, notwithstanding proof of an act of insolvency and other requirements of a sequestration order where the debtor furnished independent evidence that his estate was solvent.

⁶⁷ Section 14(2).

⁶⁸ *Sharrock et al* 40.

⁶⁹ 1996 (1) SA 935 (C) 937.

usually quiet a small loan, very often made in circumstances where it would have been apparent to the whole world that the respondent was in serious financial difficulty. Despite this, the loan is customarily made without security of any sort. It is seldom evidenced by a written agreement, or even subsequently appropriate expression of dismay that the debt cannot be paid, and, sometimes, for good measure, setting out details of the respondents assets and liabilities. Very often debtor and creditor are related: father commonly sequester sons, wives sequester husbands and sweethearts sequester each other, without, I am sure, any damaging effect on their relationship.

Friendly sequestration applications are based on an act of insolvency in terms of section 8(g). A debtor commits an act of insolvency in terms of section 8(g) if he or she gives notice in writing to any of his or her creditors that he or she is unable to pay all or any of his or her debts. Therefore a creditor will rely on this act of insolvency in order to institute compulsory sequestration proceedings against the debtor.

The court must be mindful of the fact it being a matter of common experience, that where debtor and creditor in sequestration proceedings are not at arm's length, there is considerable potential for collusion and malpractice.⁷⁰ Collusion may consist of an agreement between the parties to suppress facts or manufacture evidence in order to make it appear to the court that one of the parties has a cause of action or a defence.⁷¹

2.11 Administration

Administration orders are regulated by section 74 of the Magistrates' Courts Act. The administration order involves a relatively simple and inexpensive procedure whereby overcommitted debtors' obligations are rescheduled by the magistrates' courts. These orders are intended for smaller estates where the sequestration procedure would exhaust the estate and the aim is mainly to protect the debtor during a period of financial embarrassment without the need for sequestration.⁷²

In *Madari v Cassim*⁷³ Caney J accurately described the nature of these orders:

⁷⁰ *Mthimkhulu v Rampersad (BOE Bank Ltd, intervening creditor)* (2000) 3 ALL SA 512 (N).

⁷¹ *Sharrock et al* 41.

⁷² *Roestoff and Coetzee* 64.

⁷³ 1950 (2) SA 35 (D) 38.

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

Administration orders are intended to be utilised where the debtor is unable to satisfy a judgment debt or to meet his financial obligations and where he does not have sufficient assets to attach in satisfaction of such judgment or obligations.⁷⁴ A condition for employing this procedure is that the total amount of all debts due should not exceed the amount determined by the Minister by notice in the Gazette.⁷⁵ The amount is currently set at R50 000.⁷⁶

2.11.1 Application for an Administration Order

The process of obtaining an administration order entails an application to the Magistrate's Court in the prescribed format⁷⁷ coupled with a full statement of affairs⁷⁸ whereby the debtor seeks an order providing for the administration of the estate and payment of debts in instalments or otherwise.⁷⁹ The application is lodged with the Clerk of the Court, and a copy is delivered to each creditor at least three days prior to the hearing.⁸⁰ At the hearing, the Court considers the circumstances and may then grant an administration order⁸¹ whereby the estate is placed under administration, an administrator is appointed⁸² and an amount that the debtor is obliged to pay to the administrator is set.⁸³ Subject to certain exceptions, once the order is in force no creditor can commence enforcement proceedings for outstanding

⁷⁴ Section 74(1)(a).

⁷⁵ Section 74(1)(b).

⁷⁶ GN R217 in GG 37477 of 27 March 2014. See Coetzee A comparative reappraisal of debt relief measures for natural person debtors in South Africa (LLD Thesis University of Pretoria 2016).

⁷⁷ Section 74A(1).

⁷⁸ Section 74A(1) read with section 74A(2).

⁷⁹ Section 74(1).

⁸⁰ Section 74A(5).

⁸¹ In accordance with section 74C.

⁸² Section 74E.

⁸³ Section 74C(1)(a).

debt⁸⁴ and if the proceedings have been instituted, they will be suspended by the administration order.⁸⁵ After his or her appointment the administrator will collect payments in terms of the order and distribute them proportionately amongst creditors at least every three months.⁸⁶ In certain circumstances the Court may authorise the realisation of an asset of the estate.⁸⁷ Once the costs of administration and listed creditors have been paid in full, the administrator lodges a certificate at the Clerk of the Court, whereupon the order lapses.⁸⁸

2.11.2 Hearing of application for Administration

The application is heard before a magistrate in a so-called section 66 court and in the presence of the debtor or an appointed legal representative, as well as creditors and their representatives.⁸⁹ All the debts listed in the statement of affairs are deemed to be proved, subject to any amendments the court may make, except where a creditor objects to a listed debt or the court rejects or requires the debt to be substantiated by evidence.⁹⁰ Similarly, when a debtor objects to a creditor's claim, the court will require the creditor to prove the claim.⁹¹ The court, or any creditor or legal representative may question the debtor with regards to his or her assets and liabilities, present and future income (including the income of a spouse), standard of living and possibilities of economising and any other relevant matter.⁹² It is to be noted that this is a limited enquiry that may take place, but the application is clearly *sui generis* in that it allows oral argument. If it appears to the court that any debt is a matter of contention between the debtor and creditor or between the creditor and any other creditor, the court may, upon inquiry into the objection, allow or reject the debt or a part thereof.⁹³

2.12 Debt review

The National Credit Act⁹⁴ introduces measures in an attempt to prevent over-spending by consumer and, more importantly, to prevent money lenders from lending money to consumers who cannot afford either to pay the loan amount, or to

⁸⁴ Section 74P(1).

⁸⁵ Section 74P(2).

⁸⁶ Section 74J.

⁸⁷ Section 74K.

⁸⁸ Section 74U. See Coetzee (LLD Thesis).

⁸⁹ Section 74B(1).

⁹⁰ Section 74B(1)(b).

⁹¹ Section 74B(1)(c).

⁹² Section 74B(1)(e).

⁹³ Section 74(B)(2). See Borraine *et al* 86.

⁹⁴ National Credit Act 34 of 2005. (hereafter referred as the NCA).

pay the interest on the loan amount. In particular it introduces the concepts of “over-indebtedness” and “reckless credit”. Section 86 of the NCA provides for a specific debt relief measure known as debt review. This process is in practice sometimes loosely referred to as debt counselling. The Supreme Court of Appeal in *Collett v FirstRand Bank Ltd*⁹⁵ stated that ‘the purpose of the debt review is not to relieve the consumer of his obligations but to achieve either a voluntary debt re-arrangement or a debt re-arrangement by the Magistrate’s Court’.

Debt review commences when the consumer applies to the debt counsellor for an evaluation to determine whether the consumer is over-indebted.⁹⁶ The debt review process comprises of, namely the consumer’s application for debt review, the duties of the debt counsellor, the obligation of the consumer and credit provider during the debt review process, the debt counsellor’s determination of over-indebtedness and the steps to be taken after determination and termination of debt review in certain circumstances.⁹⁷

2.12.1 Application for debt review

The consumer may make an application to the debt counsellor to be declared over-indebted. Section 86(2) states that the application may not be made at the time that the credit provider has started proceedings under that credit agreement, and has proceeded to take steps contemplated in section 129 to enforce the agreement. Once the consumer has applied, the debt counsellor must inform the entire consumer’s creditors as well as all registered credit bureaux of the application.⁹⁸ The debt counsellor has 30 business days to determine whether the consumer is over-indebted.⁹⁹ Credit providers and credit bureaux must be notified of the outcome of such determination.¹⁰⁰ If a consumer is found to be over-indebted, the debt counsellor may issue a proposal to the Magistrate’s Court recommending that the consumer’s obligations be re-arranged.¹⁰¹ The debt counsellor has 60 business days from the date of application to refer the matter to the Magistrate’s Court,¹⁰² and may propose that the Court declare one or more of the credit agreements to be

⁹⁵ 2011 (4) SA 508 (SCA) 514.

⁹⁶ Van Heerden and Boraine “The interaction between the debt relief measures in the National Credit Act 34 of 2005 and aspects of insolvency law” 2009 12(3) *PER*.

⁹⁷ Kgarabajang *The Impact of the National Credit Act 34 of 2005 on Insolvency Law* (LLM Dissertation University of Pretoria 2011) 9.

⁹⁸ This should be done within five business days (s 86(4)(b) read with reg 24(2)).

⁹⁹ Section 86(6) and reg 24(6).

¹⁰⁰ Also within five business days (reg 24(10)).

¹⁰¹ Section 86(7)(c)(ii).

¹⁰² Section 86(10).

reckless credit.¹⁰³ Once the Magistrate’s Court has made an order rescheduling the consumer’s debt, the consumer must abide by it. A credit provider may terminate a debt review under certain circumstances and then proceed to enforce the debt.¹⁰⁴

2.12.2 Duty of good faith

Section 86(5) imposes a duty of good faith on the consumer who applies to a debt counsellor for a debt review and a credit provider. This section is couched in peremptory terms. The consumer and the credit provider must co-operate with the debt counsellor. They are obliged to comply with any reasonable request by the debt counsellor to facilitate the evaluation of the consumer’s state of indebtedness and the prospects for responsible debt rearrangement.¹⁰⁵ They should further participate in good faith in the review and in any negotiation designed to result in the responsible debt re-arrangement.¹⁰⁶

2.12.3 Debt counsellor and his or her administrative duties

The NCA creates the office of a debt counsellor to facilitate the investigation of over indebtedness and reckless credit granting. The debt counsellor plays an important role during the debt review process. In particular his function is to assist the over-indebted consumer with the process of debt review. The debt counsellor must evaluate the consumer’s over-indebtedness. A debt counsellor, in terms of regulation 1, “means a natural person who is registered in terms section 44 of the Act offering a service of debt counselling”.¹⁰⁷ The court in *National Credit Regulator v Nedbank Ltd and Others*¹⁰⁸ stated that a debt counsellor who refers a matter to the Magistrate’s Court in terms of section 86(7)(c) and 86(8)(b) of the NCA has a duty to assist the court and should be available and able to render such assistance by way of furnishing evidence or making submissions as to his or her proposal or to answer any queries raised by the court.

2.12.4 Determination of over-indebtedness

The assessment by a debt counsellor may lead to a conclusion that:¹⁰⁹

- a) The consumer is not over indebted, or

¹⁰³ Section 86(7)(c)(i).

¹⁰⁴ Section 86(10). See Roestoff and Coetzee (2012) 67-68.

¹⁰⁵ Section 86(5)(a).

¹⁰⁶ Section 86(5)(b).see Kgarabajang (LLM Dissertation 2011) 11.

¹⁰⁷ Kgarabajang *Ibid*.

¹⁰⁸ 2009 (4) SA 505 (GNP)

¹⁰⁹ Section 86(7).

- b) The consumer is not over indebted, but is nevertheless experiencing, or likely to experience, difficulty satisfying all the consumer's obligations under credit arrangements in a timely manner, or
- c) The consumer is over indebted.

In terms of section 86(7)(a) a debt counsellor may make a determination that a consumer is not over-indebted. In this regard the debt counsellor must reject the application even if he has concluded that a particular credit agreement was reckless at the time it was entered into. Section 86(9) states that if a debt counsellor rejects an application, the consumer, with the leave of the Magistrate's Court, may apply directly to the Magistrate's Court, in the prescribed manner and form, for an order contemplated in subsection (7)(c). Regulation 25 provides that if a debt counsellor finds that a consumer is not over-indebted and makes a finding in terms of section 86(7)(a), the debt counsellor must provide the consumer with a letter of rejection.

In terms of section 86(7)(b) a debt counsellor may make a determination that the consumer is not over-indebted but likely to experience problems in the future. Section 86(7)(b) states that the debt counsellor may recommend that the consumer and the respective credit providers voluntarily consider and agree on a plan of debt re-arrangement. Section 86(8) states that if a debt counsellor makes a recommendation in terms of section 86(7)(b), and the consumer and each credit provider concerned accept that proposal, the debt counsellor must record the proposal in the form of an order, and if it is consented to by the consumer and each credit provider concerned, file it as consent order in terms of section 138 or if the parties do not reach agreement, the debt counsellor must refer the matter to the Magistrate's Court with the recommendation. Regulation 24(9) states that any arrangement made by the debt counsellor with credit providers must be reduced in writing and signed by all credit providers mentioned the debt counsellor and the consumer.

In terms of section 86(7)(c) a debt counsellor may make a determination that the consumer is over-indebted. Section 86(7)(c) states that if as result of the debt review assessment a debt counsellor reasonably concludes that the consumer is over-indebted may issue a proposal recommending that the Magistrate's Court make either or both of the following orders:¹¹⁰

¹¹⁰ Section 86(7) (c).

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

2.12.5 Termination of debt review

No provision is made for the automatic lapsing of debt review proceedings. However, Section 86(10) states that if a consumer is in default under a credit agreement that is being reviewed in terms of this section, the credit provider in respect of that agreement may give notice to terminate the review in the prescribed manner to the consumer, the debt counsellor and the National Credit Regulator, at any time at least 60 business days after the date on which the consumer applied for debt review. It is submitted that a debt counsellor must not terminate a debt review in terms of this subsection once he has referred the matter to the Magistrate's court for consideration. In *Collet v Firstrand Bank Ltd*,¹¹¹ it was held that a referral of a debt review to the magistrate's court does not bar credit provider from terminating the debt review. A creditor provider may therefore terminate the process in respect of a specific agreement as soon as 60 business days have lapsed, irrespective of whether the matter is pending in court.¹¹²

2.12.6 Effect of (pending) debt review or rearrangement order or agreement

Section 88(1) states that a consumer who has filed an application in terms of section 86(1), or who has alleged in court that the consumer is over-indebted, must not incur any further charges under a credit facility or enter into any further credit agreement,

¹¹¹ *Collet v FirstRand Bank Ltd* 2011 (4) SA 508 (SCA). See *Standard Bank of South Africa v Kruger* 2010 (4) SA 635 (GSJ).

¹¹² *Boraine et al* 100.

other than that of a consolidation agreement, with any credit provider until one of the following events has occurred:¹¹³

- a) the debt counsellor rejects the application and the prescribed time period for filing in terms of section 86(9) has expired without the consumer having so applied;
- b) the court has determined that the consumer is not-over-indebted or has rejected a debt counsellor's proposal or the consumer's application; or
- c) a court having, made an order or the consumer and the credit providers having made an agreement re-arranging the consumer's obligations, all the consumer's obligation under the credit agreements as re-arranged are fulfilled, unless the consumer fulfilled the obligations by way of a consolidation agreement.

It is thus possible that a consumer may effectively be removed from the credit market for considerable period of time. If a consumer applies for or enters into a credit agreement contrary to this section, the provisions of Part D of Chapter 4¹¹⁴ of the NCA will never apply to that agreement.¹¹⁵ The implication of this provision appears to be that a consumer who, it is submitted, on own initiative enters into such an agreement will not be able to raise the issues of over indebtedness or reckless credit and will thus not be able to access the debt relief measures afforded in respect thereof.¹¹⁶

2.12.7 Effects on credit provider

Section 88(3) states that:

a credit provider who receives a notice of court proceedings contemplated in section 83 or 85 or notice in terms of section 86(4)(b)(i), may not exercise or enforce by litigation or other judicial process any right or security under that credit agreement until-

- (a) the consumer is in default under the credit agreement; and
- (b) one of the following has occurred:
 - (i) an event contemplated in subsection (1) (a) through (c); or

¹¹³ Section 88(1) NCA.

¹¹⁴ Thus, the provisions relating to over indebtedness and reckless credit.

¹¹⁵ Section 88(5) NCA.

¹¹⁶ Borraine *et al* 101.

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

A credit provider runs the risk of the credit agreement constituting reckless one, if he or she concludes an agreement with the consumer who is under debt review or while debt rearrangement is in place. Section 88(5) states that if a consumer applies for or enters into a credit agreement contrary to this section, the provisions of this part will never apply to that agreement. The consumer cannot invoke the debt relief provisions relating to over indebtedness and reckless credit contained in Part D of Chapter 4 should he or she become even further over-indebted as a result of the prohibited credit agreement he or she should never have entered into.¹¹⁷

2.13 Proposed pre-liquidation composition

The Law Reform Commission has proposed that provision be made for a pre-liquidation composition¹¹⁸ with creditors. The proposed measure is supposed to afford debt relief to natural person debtors¹¹⁹ who cannot pay their debts,¹²⁰ but who are unable to prove advantage to creditors and are consequently excluded from the liquidation process.¹²¹

The Insolvency Bill provides for a binding composition between a debtor and creditors if accepted by the required majority in number and two-thirds in value of the concurrent creditors who vote on the composition.¹²² The debtor initiates the process by lodging a signed copy of the composition and a sworn statement with the magistrate's court of the district where he or she normally resides or carries on business.¹²³ The composition is supervised by the court, and provision is made for an investigation into the affairs of the debtor.¹²⁴

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

¹¹⁷ Kgarabajang (LLM Dissertation) 15.

¹¹⁸ The 2015 Insolvency Bill uses the term 'liquidation' when referring to both the liquidation of juristic persons and the sequestration of natural persons and partnerships. The title of the proposed provision is confusing, as it could mistakenly be interpreted to require a composition as a precondition for liquidation proceedings. The better suited title of 'statutory proposal' is suggested. See Coetzee (LLM Thesis) 250.

¹¹⁹ Companies and close corporations are specifically excluded; cl 118(1).

¹²⁰ Cl 118(1). The test to determine whether a debtor is 'unable to pay debts', as defined in s 2, includes the internationally-favoured liquidity test

¹²¹ See 2014 Explanatory memorandum 201 and 208.

¹²² Cl 118(17).

¹²³ Cl 118(1).

¹²⁴ Clause 118(10)(e). See Coetzee (LLM Thesis) 250.

liquidation of the debtor's estate.¹²⁵ The claims or rights of secured or preferent creditors are only subject to the composition if those creditors consented thereto in writing. After the court has certified that the composition is accepted, it will be binding on all creditors who have been informed of the hearing or appeared at the hearing.¹²⁶ The composition does not constitute a bar to the liquidation of the debtor's estate.¹²⁷

2.14 Conclusion

In this chapter the three debt relief procedures and a proposed relief were discussed. It has been determined that the process of voluntary surrender and compulsory sequestration rely on the requirement of advantage to creditors; although the burden of proof in voluntary surrender is more stringent than in the case of compulsory sequestration. As regards the administration order procedure, the procedure represents a modified form of insolvency and is intended for the protection of debtors with small estates that generally represent the poor who are also either illiterate or ignorant about the law or both. The procedure does not provide for any discharge of debts or costs, and no maximum time limit is set. The order will only lapse once all listed creditors as well as the cost of administration have been paid in full.¹²⁸ An unintended consequence is thus that in theory a debtor may be subject to such an order indefinitely. Debtors under administration therefore suffer a disadvantage compared to those whose estates are under sequestration where, subject to certain conditions, a discharge of debt is guaranteed.¹²⁹ What is more, consumers with no income and no assets will not qualify for this procedure. It is submitted that administration does not provide a sufficient alternative to sequestration. In many instances, consumers will not qualify for either of the procedures and, even if they do qualify for administration, it has serious deficiencies.¹³⁰ The procedure basically provides a statutory rescheduling of debt sanctioned by a court order.

In terms of Debt review, the procedure provides for debt relief through debt-reorganisation in cases of over-indebtedness and makes specific provision for the detection and sanction of credit recklessly extended. The procedure does not provide for a discharge of debt and no maximum period for which the procedure may run has

¹²⁵ Cl 118(23).

¹²⁶ Cl 118 (17).

¹²⁷ Cl 118(21). See Roestoff and Coetzee 66.

¹²⁸ Section 74U.

¹²⁹ Section 129.

¹³⁰ Roestoff and Coetzee 66.

been determined. The procedure may prove to be useful in instances where a significant portion of debt relates to credit agreements as regulated by the NCA and where such debts have not been excluded from the procedure.

The pre-liquidation composition which was proposed by the Commission, still excludes NINA debtors in the purpose of discharge from debt. The proposed composition does not give an alternative process to poor debtors seeking discharge of debt; which goes to the importance of the dissertation. Coetzee remarks in this regard that; in fact the 2014 Explanatory memorandum submits that, in line with international developments in insolvency law, the procedure is intended to afford those who do not qualify for liquidation proceedings ‘an opportunity for a fresh start which entails a discharge of debts.’¹³¹

However, although sub-clause 22 was probably inserted with the NINA category of debtors in mind, it is most certainly not suited to their needs. The major problem with the procedure in relation to NINA estates is that it does not make sense to force such debtors through its negotiation phase as they do not have any negotiating power due to the fact that they do not own anything of value which they can offer. Also, as negotiations are doomed from the outset, the costs involved, for instance that of the administrator and insolvency practitioner as well as travelling expenses (as credit providers’ domiciles need to be followed), in employing the first part of the procedure will all be for naught. Furthermore, NINA debtors are in any event not in a position to finance the procedure and no provision is made for free assistance to these debtors. It is acknowledged that the initiative is commendable and that its implementation would be ground-breaking. However, it will unfortunately not provide an effective debt relief measure for NINA estates.¹³²

The purpose of the chapter was to show that the South African Insolvency system at the present moment is inefficient in offering alternative procedures to poor debtors (NINA debtors). The available debt relief procedures are not sufficient as they do not provide for the needs of all debtors who seek debt relief. Sequestration due to the requirement of advantage to creditors limits the procedure to creditors who can prove that there will be an advantage to creditors. In administration procedure and debt review procedure there is no possibility of discharge.

The proposed pre-liquidation does not solve the predicament facing poor debtors. The main deficiency of this proposed measure as a viable option is that, for a debtor

¹³¹ 2014 Explanatory memorandum 208. See Coetzee (LLD Thesis) 254.

¹³² Coetzee (LLD Thesis) 254.

seeking debt relief it would not, in its current format, provide such a debtor with a discharge if the composition is not accepted by the required majority of creditors.

Having discussed the South African consumer insolvency law and concluded that there is a lack of alternative debt relief and ultimately it excludes poor debtors, the dissertation will discuss the constitutionality of the requirement of advantage to creditors.

CHAPTER 3

ADVANTAGE TO CREDITORS AND ITS CONSTITUTIONALITY

3.1 Introduction

The advantage to creditors requirement is a consideration of great importance in relation to the question whether or not a debtor's estate should be sequestrated.¹³³ The whole tenor of the insolvency Act, as it is directly related to sequestration proceedings, is aimed at obtaining a pecuniary benefit for creditors and it has been debated fiercely by academics on whether the requirement should be removed as many debtors often do not have sufficient assets to prove advantage to creditors.¹³⁴

This chapter will discuss the notion of a pro creditor system, the requirement of advantage to creditors and evaluate the constitutionality of the requirement of advantage to creditors in South African Insolvency law.

3.2 Pro-creditor system

Insolvency systems are often labelled as pro-debtor (debtor friendly) or pro-creditor (creditor friendly). For example, an insolvency regime, favouring the principles of equity or pro rata sharing over a rescue policy and closely connected interference with several creditor rights is commonly seen as pro-creditor. Usually a pro-creditor regime concentrates on the protection of the varying interests of creditors (for example by allowing security and set-off) while a pro-debtor regime is more protective of debtors (for example by increasing the assets available for distribution).¹³⁵ However these systems can be interpreted differently by different authors looking at a particular country and using other examples.

South African insolvency law has traditionally been, and is still regarded as, a pro-creditor system. This notion is reflected in some of the basic characteristics of the system. For example, a court may not grant a sequestration order if it has not been shown that sequestration will be to the advantage for creditors. It is only upon rehabilitation, which follows sequestration, under the Insolvency Act,¹³⁶ which regulates treatment of creditors' claims against, and the assets of, insolvent persons,

¹³³ *Amod v Khan* 1947 (2) SA 432 (N) 438. See Chapter 2.

¹³⁴ Kanamugire "The Requirement of Advantage to Creditors in South African Insolvency Law – a Critical Appraisal" 2013 *MJSS* 1.

¹³⁵ Falke *Insolvency Law Reform in Transition Economies* (LLD Thesis Goethe University Frankfurt 2003).

¹³⁶ Insolvency Act.

that a debtor may obtain a statutory discharge from liability for pre-sequestration debt.¹³⁷

This system was captured correctly by Boraine and Roestoff and they observed that the South African insolvency law is still regulated by the Insolvency Act, which unfortunately has not moved with the times. In many instances it is still steeped in a pro-creditor approach that gives rise to a situation where only a privileged few debtors can successfully apply for a sequestration order that will ultimately lead to their rehabilitation and that would in turn provide them with a discharge of pre-sequestration debt.¹³⁸

The pro-creditor approach by the South African court is largely due to the requirement of advantage to creditors, which clearly plays a central role in the exercise of the court's discretion and our courts' emphasis on the creditors' position when considering this requirement should obviously be attributed to the fact that the Act currently sets such a requirement for sequestration applications.¹³⁹

3.3 Advantage to creditors requirement

The court may not grant a sequestration order unless it is established that there is reason to believe that it will be to the advantage of creditors.¹⁴⁰ Creditors means all or at least the general body of creditors.¹⁴¹ The question to be asked in court is whether a substantial portion of the creditors, determined according to the value of the claims, will derive advantage from sequestration.¹⁴²

With regard to the meaning of advantage to creditors, our courts have repeatedly cited the dictum in *Meskin & Co v Friedman*¹⁴³ that there must be a reasonable prospect – not necessarily likelihood, but a prospect which is not too remote – that some pecuniary benefit will result to creditors.¹⁴⁴

Van Heerden and Boraine are of the view that, it has been held that an advantage to creditors is proved generally in applications for compulsory sequestration when the petitioning creditor establishes that the debtor has a substantial estate to

¹³⁷ Boraine *et al* 2015 *NIBLeJ* 61.

¹³⁸ Boraine and Roestoff "Revisiting the State of Consumer Insolvency in South Africa after Twenty Years: The Courts' Approach, International Guidelines and an Appeal for Urgent Law Reform" Part 1 2014 *THRHR* 352.

¹³⁹ Roestoff and Boraine "*Body Corporate Palm Lane v Masinge* 2013 JDR 2332 (GNP): Discretion and powers of the court in applications for sequestration" 2015 *De Jure* 214.

¹⁴⁰ Section 12(1)(c), section 6, section 10.

¹⁴¹ *Lotzof v Raubenheimer* 1959 (1) SA 90 (O) 94.

¹⁴² *Sharrock et al* 38.

¹⁴³ 1948 (2) SA 555 (W) 559.

¹⁴⁴ *Lynn and Main Inc v Naidoo* 2006 (1) SA 59 (N) 68. *Ex parte Bouwer* 2009 (6) SA 382 (GNP) 386.

sequesterate and that the creditors cannot obtain payment except through sequestration.¹⁴⁵ As sequestration is viewed as a drastic measure, courts will also consider alternative measures such as administration or debt review when considering the advantage to creditors requirement.¹⁴⁶

3.3.1 Burden of proof

The process of voluntary surrender and compulsory sequestration rely on the requirement that advantage to creditors must be proved although the burden of proof in voluntary surrender is more stringent than in case of compulsory sequestration. This due to the wording of section 6(1) of the Insolvency Act as compared to the peculiar wording of sections 10(c) and section 12(c) of the Act. In compulsory sequestration it is not necessary for the applicant to prove that it will be to the advantage of creditors, but only that there is reason to believe that it will be so. The reason for the difference in the burden of proof is that a debtor knows his own business and can adduce facts to show advantage to creditors. On the other hand, a creditor is not in the position of being in possession of sufficient facts relating to the debtor's assets as to be able to furnish details to the court.¹⁴⁷

Furthermore, it is not necessary to prove that the insolvent has any assets. Even if there are no assets, but there is reason to believe that as a result of investigation in terms of the Insolvency Act some assets may be found to the advantage of creditors, it will be sufficient.¹⁴⁸ Creditors must therefore at least receive a not negligible dividend, and the amount of this dividend depends on the fact of each particular case.¹⁴⁹

3.4 Constitutionality of the advantage to creditors requirement

3.4.1 Introduction

The question that this chapter intends to answer is whether the requirement of advantage to creditors is unconstitutional or not? The constitutional test will be investigated and the alleged violation of equality due to the advantage to creditors requirement will be discussed. The constitutional provision which is alleged violated by the requirement is section 9(1) which reads as follows:

Equality

¹⁴⁵ Boraine and Roestoff 2015 214.

¹⁴⁶ Van Heerden and Boraine 56. *Ex parte Ford Supra*. See chapter 2.

¹⁴⁷ *Botha v Botha* 1990 (4) SA 580 (W) 584. See chapter 2.

¹⁴⁸ *Meskin & Co v Friedman* 1948 (2) SA 555 (W).

¹⁴⁹ *Fesi and Another v Absa Bank Ltd* 2001 (1) SA 499 (C) 501.

Everyone is equal before the law and has the right to equal protection and benefit of the law.

3.4.2 Constitutionality

Coetzee¹⁵⁰ correctly explains that in *Harksen v Lane*¹⁵¹ the Constitutional Court set out three distinct steps of an investigation into an alleged violation of the right to equality. The stages of enquiry are as follows:

(a) Does the provision differentiate between people or categories of people? If so, does the differentiation bear a rational connection to a legitimate government purpose? If it does not, then there is a violation of section 8(1). Even if it does bear a rational connection, it might nevertheless amount to discrimination.

(b) Does the differentiation amount to unfair discrimination? This requires a two-stage analysis:

(i) Firstly, does the differentiation amount to 'discrimination'? If it is on a specified ground, then discrimination will have been established. If it is not on a specified ground, then whether or not there is discrimination will depend upon whether, objectively, the ground is based on attributes and characteristics that have the potential to impair the fundamental human dignity of persons as human beings or to affect them adversely in a comparably serious manner.

(ii) If the differentiation amounts to 'discrimination', does it amount to 'unfair discrimination'? If it has been found to have been on a specified ground, then unfairness will be presumed. If on an unspecified ground, unfairness will have to be established by the complainant. The test of unfairness focuses primarily on the impact of the discrimination on the complainant and others in his or her situation.

If, at the end of this stage of the enquiry, the differentiation is found not to be unfair, then there will be no violation of section 8(2).

(c) If the discrimination is found to be unfair, then a determination will have to be made as to whether the provision can be justified under the limitations clause.

3.4.2.1 Does the advantage to creditors requirement differentiate between people or category of people?

¹⁵⁰ Coetzee (LLD Thesis) 15.

¹⁵¹ 1998 (1) SA 300 CC.

The requirement (provision) of advantage to creditors distinguishes from debtors that can offer some pecuniary benefit to creditors as opposed to those who cannot. The differentiation arises where the poor debtors are excluded from accessing debt relief due to the fact that they cannot prove advantage to creditors. Individuals with sufficient assets qualify for sequestration and the resultant discharge from debt as opposed to those with disposable income but insufficient assets to show that the liquidation of their estates would result in a benefit to creditors.¹⁵² Coetzee¹⁵³ explains that, when applying this constitutional test as set out in *Harksen v Lane*¹⁵⁴ to the advantage to creditors requirement, it is safe to say that the requirement at the very least differentiates between categories of people as it distinguishes between those who can prove an advantage for creditors and those who cannot. This is so as most of those who do not have the option of ridding themselves of excessive debt, as opposed to their more well-to-do fellow citizens who can prove advantage for creditors, generally find themselves in a lower socio-economic position.¹⁵⁵

3.4.2.2 Legitimacy of advantage to creditors

Even though the requirement may amount to discrimination, there is a debatable argument that the differentiation is based on a legitimate government purpose. I disagree with this debate mainly because the legislation that governs the insolvency system at the present is out-dated. It is questionable that the provisions envisaged in the Constitution, mainly section 9(1) of the Constitution could support and legitimise such a differentiation and further it is in direct contrast with the worldwide trend to focus natural person insolvency law on the rehabilitation of the debtor.¹⁵⁶ Coetzee explains that, because of the current lack of proper alternative measures, the purpose of the sequestration procedure is not legitimate. In order for it to gain legitimacy, proper alternatives should be devised in order to assist those who are excluded from the sequestration procedure on a separate but equal basis. In other words, if all insolvent debtors had a form of recourse that leads to an eventual discharge, the purpose of the sequestration procedure, as it currently stands, would probably be legitimate.¹⁵⁷

3.4.2.3 Unfair discrimination

¹⁵² Coetzee 2016 *Int. Insolv. Rev.* 43.

¹⁵³ Coetzee (LLD Thesis) 156.

¹⁵⁴ 1998 (1) SA 300 CC.

¹⁵⁵ The term “differentiation” is used when a distinction is made on an unlisted ground. See *Pretoria City Council v Walker* 1998 (2) SA 363 (CC) 380 and *Harksen v Lane* 321. See Coetzee (LLD Thesis) 16.

¹⁵⁶ The World Bank, Report on the Treatment of the Insolvency of Natural Persons (2012) 25 and 117. See Coetzee (LLD Thesis).

¹⁵⁷ Coetzee 2016 *Int. Insolv. Rev.* 44.

The next factor as stated in the test is whether such discrimination constitutes unfair discrimination. Discrimination was defined in *Prinsloo v Van der Linde*¹⁵⁸ as meaning ‘treating persons differently in a way which impairs their fundamental dignity as human beings, who are inherently equal in dignity. The question of whether such discrimination constitutes unfair discrimination boils down to the impact thereof on the complainant and others in the situation.’¹⁵⁹ In this regard, various factors must be considered. These include:

- a) the position of the complainants in society and whether they have suffered in the past from patterns of disadvantage, whether the discrimination in the case under consideration is on a specified ground or not;
- b) the nature of the provision or power and the purpose sought to be achieved by it; and
- c) with due regard to (a) and (b) in the preceding text, and any other relevant factors, the extent to which the discrimination has affected the rights or interests of complainants and whether it has led to an impairment of their fundamental human dignity or constitutes an impairment of a comparably serious nature.¹⁶⁰

Coetzee states that if it is accepted that socio-economic status resorts under ‘social origin’, discrimination is established and unfairness is presumed. Otherwise, if the differentiation does not resort under ‘social origin’, discrimination and unfairness must be determined. As far as discrimination is concerned, the evident socio-economic difficulties already riddling the lower section of the South African economy serve as associated attributes and characteristics having the potential to impair the human dignity of especially NINA debtors and to affect these debtors adversely and seriously as opposed to those who have more and are thus allowed access to statutory debt relief measures.¹⁶¹

3.4.2.4 Justified under limitation clause

The last factor relates to the nature of the provision and its purpose. This is an enquiry to ascertain whether the established unfair discrimination is justifiable in terms of the limitations clause. The limitation clause allows for limitation of the rights in the bill of rights provided that the limitation is reasonable and justifiable in

¹⁵⁸ 1997 (3) SA 1024 (CC).

¹⁵⁹ *Harksen Supra*.

¹⁶⁰ See Coetzee 2016 *Int. Insolv. Rev.* 43.

¹⁶¹ *Idem* 52.

an open and democratic society based on human dignity, equality and freedom.¹⁶² These are the guiding pointers in determining whether the limitation is justifiable. From the examination above, it is very clear that the right being infringed by the requirement of advantage to creditors is not essential to ensuring betterment to society. There is no compelling need for the limitation; therefore the requirement is discriminatorily unfair. Coetzee explains that, it is unclear how discrimination that has been categorised as being ‘unfair’, as it has attributes and characteristics that can potentially impair the human dignity of people as human beings, could ever be found to have been reasonable in an open and democratic society based on human dignity, freedom and equality. When the insolvency system is viewed holistically, it is difficult to contemplate how the irrational and unfair systemic differentiation that the broader natural person insolvency law creates can be justified in terms of the limitations clause.¹⁶³

3.5 Conclusion

In *Kerbel v Chames*,¹⁶⁴ Curlewis JP remarked that the words ‘advantage to creditors’ have in many cases come to be entirely meaningless. In the majority of cases it is simply speculation as to whether or not there is reason to believe that sequestration will be advantageous to creditors. A survey conducted in the office of the Master of the High Court, Pretoria, revealed that concurrent creditors received dividends in only 28.6 per cent of the cases included in the survey, while creditors were liable to pay contribution in 40.6 per cent of the cases. These statistics signify that sequestration would in many instances probably not be to the advantage of creditors, even though the Act requires this to be proved.¹⁶⁵

The South African insolvency law has been under review for decades. The South African Law Reform Commission commenced an investigation on the insolvency law and a project committee was appointed to conduct and direct the review as project 63. From this committee a several number of working papers were produced that culminated into draft bills. At present the South African insolvency system is still under review and a formal Reform Bill has not been published yet.

In relation to the advantage to creditors requirement, the Law Reform Commission has always been in favour of its retention. From the 2015 Insolvency Bill draft it would appear that the Commission has recommended that the advantage to

¹⁶² Section 36 of the Constitution. *The Republic of South Africa v Grootboom* 2001 (1) SA 46 (CC).

¹⁶³ Coetzee 2016 *Int. Insolv. Rev.* 47.

¹⁶⁴ 1925 WLD 72 77.

¹⁶⁵ Roestoff and Coetzee 59.

creditors requirement be retained in the highly anticipated Act.¹⁶⁶ The Law Reform Commission has proposed that provision be made for the granting of a provisional order in the case of voluntary surrender applications as is the case with compulsory sequestration applications and the reason for this being so that the first meeting of creditors can be held before the return date so that the creditors can in terms of clause 38(6) consider whether the sequestration would be to the advantage of the creditors.¹⁶⁷

The factors stated above that were mentioned in the *Harksen v Lane*¹⁶⁸ matter, confirm and conclude that the requirement of advantage to creditors pass the test set out in that matter. Simply meaning, the advantage to creditors requirement directly and indirectly withholds benefits, opportunities and advantages from individuals as they will not be able to receive the eventual discharge that the sequestration procedure brings about. Debtors are also adversely and seriously affected in a manner at least comparable to discrimination on a listed ground above. It further perpetuates systemic disadvantage as members of the excluded group are mostly from the lower tiers of the economy and are consequently already in a disadvantaged socio-economic position.¹⁶⁹

It is clear that the interests of creditors have been a consideration of utmost importance when our courts exercised their discretion in sequestration applications and at the heart of the discretion is the requirement of advantage to creditors. The creditor-orientated approach of the South African insolvency system to sequestration applications is to be understood in light of the advantage to creditors requirement and the often-stated objective of the Insolvency Act, namely, to be for the benefit of creditors and not to bring relief to harassed debtors.¹⁷⁰ The exclusion of debtors who are unable to prove this requirement mainly due to the fact that they have no income or no assets is argued to be unconstitutional. It violates section 9(1) of the constitution.

¹⁶⁶ See cls 3(8)(a)(ii), 10(1)(c)(i) and 11(1)(c) of the 2015 Insolvency Bill.

¹⁶⁷ Roestoff and Coetzee 59.

¹⁶⁸ 1998 (1) SA 300 CC.

¹⁶⁹ Coetzee 2016 *Int. Insolv. Rev.* 52.

¹⁷⁰ Borraine and Roestoff 219.

CHAPTER 4

COMPARATIVE INVESTIGATION

4.1 Introduction

The purpose of the comparative investigation is to make an analysis of how other jurisdictions address challenges that confront the South African insolvency law. In particular how they have dealt with issues such as, access to debt relief for poor debtors, sufficient alternative debt discharge procedures and so forth. The jurisdictions considered in the comparative investigation are Australia and England. I chose the English system because the South African insolvency system takes its origins from this system and adopted principles and precedents from the English system but unfortunately has failed to develop with time as compared to that of England. I also chose the Australian system mainly because the Australians have made headway in developing their insolvency procedures since 1996.

It must be noted that the comparative investigation does not discuss in detail insolvency procedures of the two jurisdictions, however to give an overview of the systems and the debt relief procedures they provide. Further, the idea is to show key elements of the whole discussion, in particular the advantage to creditors principle, ultimate debt discharge for debtors, no exclusion for poor debtors, alternative debt relief as compared to Australia and England.

4.2 Australia

4.2.1 Introduction

Australia's bankruptcy regime provides for three alternative bankruptcy procedures, two of which are for low-income and low costs. First, under section 55 of the Bankruptcy Act 1966¹⁷¹, second Part IX (debt agreements) and third Part X (personal insolvency agreements).¹⁷² The Australian system has a separate institution, known as the Australian Financial Security Authority (AFSA), responsible for the administration and regulation of the personal insolvency system.¹⁷³

4.2.2 Bankruptcy

There are two ways of becoming bankrupt. The first is where the debtor presents a petition (referred to as voluntary bankruptcy), while the second is a creditor petition

¹⁷¹ The Bankruptcy Act 1966 (Cth). (hereafter referred to as Bankruptcy Act).

¹⁷² Ben-Ishai and Scharz "Bankruptcy for the poor?" 2007 *CLPE* 24.

¹⁷³ See <http://www.afsa.gov.au/> (accessed 29 November 2016).

(referred to as involuntary bankruptcy). If it is a voluntary bankruptcy, then debtor will need to complete and lodge a debtor's petition and a statement of affairs with AFSA within 28 days of signing the form that declares voluntary bankruptcy. When the forms are accepted by AFSA, generally within 24-48 hour period, the debtor becomes bankrupt.¹⁷⁴ The debtor becomes due for discharge three years and one day after the debtor filed that petition and statement of affairs with AFSA.¹⁷⁵

A creditor to whom the debtor owes \$5,000 or more can file for involuntary bankruptcy. The creditor applies for a bankruptcy notice, and serves it on the debtor demanding that the debtor pay the money owed to the creditor within 21 days. If the debtor does not pay the creditor by the time given in the notice, the debtor commits an "act of bankruptcy". A creditor can then apply to the court (called a creditors petition) to have the debtor made bankrupt. If after hearing the creditor's case and any submissions the debtor makes, the court is satisfied that the debtor has not paid the creditor, the court makes an order (called a sequestration order) making the debtor bankrupt. A trustee is appointed and the debtor is then required to file a statement of affairs with AFSA within 14 days of being notified of the order. The debtor becomes due for discharge three years and one day after AFSA accepted the completed statement of affairs.¹⁷⁶

After discharge, the name of the debtor appears on the NPII (National Personal Insolvency Index) forever as a discharged bankrupt. Credit reporting organisations also keep records of bankruptcies for seven years.¹⁷⁷ In my observation this procedure is similar to that of sequestration under South African insolvency law even though there are a number of differences such the period of appointing the trustee, and the number of years regarding discharge etc.

4.2.3 Debt agreements

One alternative to bankruptcy available for some debtors is to enter into a debt agreement under Part IX of the Act. It is essentially a binding agreement between debtors and creditors where creditors agree to accept a sum of money that the debtor can afford. An insolvent debtor¹⁷⁸ may propose a debt agreement to the Official Receiver,¹⁷⁹ in which the debtor makes a 'best offer' to their creditors, who in

¹⁷⁴ Sections 40-44, 52 of the Bankruptcy Act.

¹⁷⁵ Ramann *et al* "Reforming personal insolvency law in India" 2015 *IGIDR* 15.

¹⁷⁶ *Ibid.*

¹⁷⁷ *Ibid.*

¹⁷⁸ In the past ten years the debtor must not have been a bankrupt, had a debt agreement, or had a Part X arrangement: Section 185C(4)(a)(i)-(iii).

¹⁷⁹ Section 185C (1).

turn vote on that offer.¹⁸⁰ During the voting period, creditors cannot take debt recovery action or enforce action against the debtor or his property. Unsecured creditors are bound by the debt agreement and paid in proportion to their debts. Secured creditors may seize and sell any assets mortgaged to them.¹⁸¹ If majority of creditors accept, then it is registered on the NPII as a debt agreement and the debtor begins to comply. If a majority of creditors do not accept, then this voting outcome is recorded on the NPII. Creditors can commence or continue with action to recover the debts.

When debt agreements were introduced in 1996 they were intended as a viable low-cost alternative to bankruptcy for low-income debtors with little or no property, with few creditors, and with low levels of liability, for whom entry into Part X administration is not possible because of inability to meet set up costs.¹⁸² Debt agreements in my observation cater for poorer debtors whom otherwise would have been faced with the costly procedure of bankruptcy. It assists low-income debtors in that, it releases the debtor from debts in a manner that they propose an agreement and in which they assessed their own plight and in turn they believe will effectively settle the debt and ultimately discharge them from debt.

4.2.4 Personal insolvency agreements

A personal insolvency agreement (PIA) is a deed agreement that is expressed to be entered into by a debtor and his or her creditor(s). The PIA is more formal than a debt agreement, but allows debtors to arrange for the discharge of their debts without having to resort to bankruptcy. The debtor however has to be insolvent to propose a PIA.¹⁸³

An insolvent debtor must firstly authorise the Official Trustee, a registered trustee in bankruptcy, or a solicitor, to call a meeting of creditors¹⁸⁴ and to take control of the debtor's property.¹⁸⁵ The majority of authorisations are given to registered trustees. The signing of this authorisation is an act of bankruptcy, which might then be used by a creditor to apply to court for a sequestration order. However this does not denote that the debtor is a bankrupt. At this time, the insolvent debtor provides a draft

¹⁸⁰ The proposal may provide for any matter relating to the debtor's financial affairs: section 185C(3). However, the proposal must meet several requirements: section 185C(2). One such requirement is that all provable debts in relation to the debt agreement must rank equally. section 185C(2)(d)(i).

¹⁸¹ Ramann *et al* 13.

¹⁸² Bankruptcy Legislation Amendment Bill 1996: Explanatory Memorandum.

¹⁸³ Ramann *et al* 13.

¹⁸⁴ Section 188(1).

¹⁸⁵ Section 189.

PIA,¹⁸⁶ which must specify how the debtor's property and income is to be dealt with.¹⁸⁷ The debtor must also complete the statement of affairs, which is then available for inspection by the debtor's creditors.¹⁸⁸ The statement of affairs will advise creditors of the amount they can expect from the proposal compared to the amount they could expect if the debtor became bankrupt, and make a recommendation whether it is in creditors' interests to accept the proposal. Once the authority becomes effective, it is irrevocable, and the debtor's property becomes subject to the trustee's control. The debtor can then only deal with their own property with the consent of the trustee.¹⁸⁹ The PIA caters for insolvent debtors. These are debtors that are not necessarily bankrupt but wish to arrange with his or her creditors to discharge debt without resorting to bankruptcy. This procedure shows that the Australian system has no exclusion for insolvent debtors; in that an insolvent debtor is afforded a leg to stand on with assistance from an authority and PIA with creditors instead of facing only one costly procedure of bankruptcy without an alternative.

Ramsay and Sim point out that, the Australian experience of increasing numbers of PIA is not uncommon amongst other comparable jurisdictions which have legal systems inherited from English law. Over the last two decades in Australia, growth in personal insolvency activity has averaged almost 6.5% per annum.¹⁹⁰ Between 1990 and 2008 there was a 26% increase in the total number of PIA. The rise in numbers of Australian PIA is not a phenomenon occurring in isolation. Rises have occurred in a number of other common law jurisdictions, such as in England and Wales, New Zealand, and the United States of America. However, the personal insolvency systems of those jurisdictions do vary, and comparisons between them are inherently difficult to make however there is a trend observed.¹⁹¹

4.3 England

4.3.1 Introduction

The England legal framework for individual insolvency is governed by the Insolvency Act, 1986 which repealed the Insolvency Act, 1985 and the Bankruptcy Act, 1914. The

¹⁸⁶ Section 188(2E).

¹⁸⁷ Section 188A(2).

¹⁸⁸ Sections 188B(2), 188B(3)

¹⁸⁹ Section 189(2)(a).

¹⁹⁰ Insolvency and Trustee Service Australia, *Annual Report by the Inspector-General in Bankruptcy on the operation of the Bankruptcy Act 2007-2008*, 7.

¹⁹¹ Ramsay and Sim, "Personal Insolvency Trends in Australia 1990– 2008" 2009 *Insolvency Law Journal* 39.

1986 Act was further amended by the Enterprise Act, 2002 and then 2007. There are three kinds of relief possible:

1. Court initiated bankruptcy
2. Individual Voluntary Agreement (IVA)
3. Debt Relief Order (DRO)

In the first two cases debtors in bankruptcy can be subject to Income Payment Orders, requiring payment of all future income beyond “reasonable domestic needs”, generally for a term of three years. An important feature of the England process is that the house or dwelling of bankrupt is excluded from estate available for distribution only after 3 years of adjudication of debtor as insolvent by the Court. Discharge in the England has also become faster. Debtors are now discharged automatically after one year. As a result they can return to professional and financial life (at least legally) in a year.¹⁹²

4.3.2 Bankruptcy

Bankruptcy may be applied for by a hostile creditor (or creditors) of the debtor or the debtor himself and entails an application to court.¹⁹³ Although both creditors’ and debtors’ petitions currently involve the courts, the Enterprise and Regulatory Reform Act, the provisions of which have already been rendered effective to some extent, will in future reduce debtors’ petitions to administrative procedures.¹⁹⁴ Under the new bankruptcy regime the Enterprise and Regulatory reform Act 2013, states that, section 71 inserts a new section 398A and the main changes are as follows:

- Individuals can still apply for bankruptcy orders to be made against them, however, rather than presenting a debtor’s petition, individuals will instead make a bankruptcy application
- Bankruptcy application must be made through an online portal, unless there are technical issues with the portal
- The court will not (save in certain circumstances) be involved in determining bankruptcy applications- instead applications must be made to, and determined by, an adjudicator...

¹⁹² Ramann *et al* 9.

¹⁹³ Section 264(1) Insolvency Act 1986.

¹⁹⁴ Section 71 Enterprise and Regulatory Act.

According to the insolvency services latest insolvency statistics, on the face of it the introduction of the new bankruptcy applications regime will remove a significant amount of the courts workload and the applications will be less costly.¹⁹⁵

As stated above in the England bankruptcy regime as compared to the South African system of sequestration, the debtor when applying for bankruptcy, there is no requirement for advantage to creditors. The development that the England insolvency regime has enacted makes bankruptcy more accessible and less costly as opposed to sequestration in the South African insolvency system.

4.3.3 Individual voluntary arrangement

This is an alternative debt relief procedure to bankruptcy that is regulated in part 8 of the Insolvency Act of 1986 which allows private negotiation between debtors and creditors so that debtors avoid the stigma of bankruptcy. While negotiations are outside of the court, they are supported by legal provisions embedded in the law. Coetzee observes that the procedure is reliant on the courts, but (save for a cram down) cannot generally be imposed upon parties as it is contractual in nature.¹⁹⁶ It offers an “earned fresh start” in which debtors receive a partial discharge of past indebtedness accompanied by the prospect of wider financial rehabilitation in return for repaying what they can reasonably afford from present and future income over a predictable time period.¹⁹⁷

Individual voluntary arrangements invariably provide for debt composition and discharge on successful completion and therefore function as a tool of debt relief. Debtors also avoid the greater publicity and perceived stigma associated with bankruptcy. For creditors, individual voluntary arrangements offer better returns than bankruptcy¹⁹⁸, however it is important that payment terms are set at realistic and affordable levels because, should the debtor default, she is exposed to a bankruptcy order on the basis of her inability to meet the liabilities contracted under the agreement. There are generally no court fees or deposits to pay affront.¹⁹⁹

4.3.4 Debt relief order

The debt relief order (DRO) procedure was introduced by the Tribunals, Courts and Enforcement Act 2007²⁰⁰ and became effective on 6 April 2009. This procedure was

¹⁹⁵ See <http://Lexisnexis.co.uk> (accessed 29 November 2016)

¹⁹⁶ Coetzee (LLD Thesis) 378.

¹⁹⁷ *Ibid.*

¹⁹⁸ McKenzie *et al* “Consumer Bankruptcy Law Reform in Great Britain” 2006 *Am Bankr LJ* 485.

¹⁹⁹ *Ibid.*

²⁰⁰ Section 108(1).

intended for people referred to as (NINA) debtors, no income no assets debtors. It was realised that while the IVA works for larger debts, insolvency and difficulty of debt repayment continued to be problem for NINA debtors. The costs of doing an IVA often exceeded the debts of these households. This motivated the setting up of the DRO mechanism. The DRO is only applicable to those with maximum debts of pound 15,000, and maximum assets of pounds 300.²⁰¹

Fletcher describes the purpose of the procedure as follows:²⁰²

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

The procedure essentially allows an individual who is unable to pay his or her debts to apply to the official receiver,²⁰³ through an approved intermediary,²⁰⁴ for a debt relief order.²⁰⁵ The order will be granted if the following criteria are met:²⁰⁶

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

The order is intended to operate with no court involvement,²⁰⁷ and only qualifying debts may be included in the order. Once the official receiver has made the order, a moratorium is placed on the commencement of enforcement procedures in relation to each qualified debt specified in the order. A creditor may not commence bankruptcy procedures during this period.²⁰⁸ Generally, the moratorium will be in force for one year, after which qualifying debts will be discharged.²⁰⁹

²⁰¹ Ramann *et al* 10.

²⁰² Fletcher *The law of insolvency* (2009) 386. See Coetzee (LLD Thesis) 388.

²⁰³ The official receiver is an official of the Insolvency Service of the Department of Trade and Industry as well as the court to which he is attached.

²⁰⁴ Section 251B(1).

²⁰⁵ Sections 251A(1) and 251B(1).

²⁰⁶ See Schedule 4ZA(6) – (8); http://www.bis.gov.uk/insolvency/personal-insolvency/dro-debtors_1. (accessed 7 November 2016) See Roestoff and Coetzee (2012) 74.

²⁰⁷ Unless an interested party decides to intervene on one of the grounds mentioned in section 251G.

²⁰⁸ Section 251G.

²⁰⁹ Sections 251H, 251I and 251M.

In March 2005, the Insolvency Service published a paper for discussion focusing solely on the NINA procedure, recognizing that there is a category of person who has fallen into debt and has no way out of it.²¹⁰ U.K. research has shown that the great majority of people who fall into arrears with their household bills or credit commitments do so because they are in financial difficulty resulting from a change in circumstance or living long term on a low income.²¹¹ These debtors simply lack the money to make payments on time, and include people on low incomes who face unexpected expenditure, people who have had a sudden substantial fall in income leaving them unable to meet all their commitments, and people with mental health problems which impair their ability to manage their finances.²¹²

4.4 Conclusion

The comparative investigation shows that Australia has three regulated debt relief measures. Out of the three, two were shown to be intended for low income debtors. Even though the bankruptcy option is costly, it does not have the strict requirement of advantage to creditors as compared to South Africa. The requirements that Australia demands under bankruptcy are there to protect the interests of both creditor and debtor and the courts have discretion in granting the order. The Australian system caters for proper alternative debt discharge depending on the individual debtor. If a debtor wishes to avoid the stigma of bankruptcy one can propose to his or her creditors an agreement intended to duly pay their debts. These alternative procedures for low in-come debtors assist in that they do not exclude debtors based on the income and offers ultimate debt relief which is important in any insolvency system.

The England system by the introduction of the DRO system has seen a major development in addressing debt relief for poor debtors. The English system does not make provision for the advantage to creditors requirement when a debtor applies for bankruptcy. Furthermore with the latest reforms on bankruptcy applications assists debtors with reducing administrative costs and unburdening courts with caseload.

I conclude that the South African insolvency system must take lessons from the two jurisdictions. The requirement of advantage to creditors is an obstacle in addressing debt relief for poor debtors, the South African system must make provision for proper alternative debt discharge, cater for NINA debtors without exclusion.

²¹⁰ The Insolvency Service (United Kingdom), "Relief for the Indebted – An Alternative to Bankruptcy" (March 2005), online: http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/consultationpaperwithnewannex1.pdf 5 (accessed 2 December 2016).

²¹¹ *Ibid.*

²¹² Ben-Ishai and Scharztz 33.

CHAPTER 5

CONCLUSION

The dissertation sought to answer whether the requirement of advantage to creditors in South African consumer insolvency law is unconstitutional. To answer this question, the dissertation premised by discussing the background of the topic; then a thorough discussion of the current consumer insolvency was conducted. Further, the author analysed the constitutionality of the requirement to advantage to creditors and finally conducted a comparative investigation considering two jurisdictions that of England and Australia respectively.

From the research conducted it is evident that in order for a court to grant a sequestration order, a debtor must prove that there will be advantage to creditors.²¹³ The requirement of advantage to creditors shows a problem in relation to access to debt relief where poor debtors are unable to do so. It therefore discriminates against debtors who cannot prove advantage to creditors to get access to debt relief.²¹⁴ The discussion went further to ascertain that due to the nature of the South African insolvency system, the insolvency system is a pro-creditor friendly system.

The South African insolvency procedures do not provide for adequate debt relief and this heightens the effect of discrimination for poor debtors who are unable to resort to sequestration due to the stringent requirement of advantage to creditors. The South African natural person debt relief system was compared with England and Australia systems in order to draw inferences on whether any of these systems' attributes could be considered for law reform in South Africa. Both jurisdictions have alternative procedures that allow for poor debtors to get debt discharge. In both systems there is no requirement of advantage to creditors and both systems have in place procedures that assist the so called NINA debtors, which is very essential.²¹⁵

From the discussions in the previous chapters, it is apparent that the requirement of advantage to creditors stands in the way of debtors accessing the fresh start that the sequestration procedure offers.²¹⁶ This requirement stems from the fact that the procedure is only indirectly regarded as a debt relief measure, due to its object of regulating the sequestration process to ensure an orderly and fair distribution of

²¹³ Chapter 2 and 3.

²¹⁴ Chapter 3.

²¹⁵ Chapter 4.

²¹⁶ Chapter 3.

assets to the advantage of creditors.²¹⁷ Furthermore, this procedure is costly and many debtors, mostly poor debtors who fall under the NINA category are excluded from the sequestration procedure.

With the lack of alternative debt relief procedures, debtors have no other choice but to gain entry to secondary measures, namely, the administration and debt review procedures, which are only truly assist mildly over-indebted individuals as neither procedure leads to a discharge of debt.²¹⁸ While the secondary procedures are useful in instances where debtors are in need of temporary relief, they do not offer real relief to heavily over-indebted individuals, firstly as such debtors do not necessarily meet the access criteria, and secondly as the twin features of repayment plans, namely, a discharge and maximum payment period, are not provided for.²¹⁹ On another level, it has been found that the sequestration procedure's advantage to creditors requirement, which serves an important government purpose, can only be saved from unconstitutionality if proper alternative measures leading to a discharge are available to debtors who are excluded from its ambit – which is evidently not the case at present.²²⁰

The constitutionality of the requirement of advantage to creditors was evident in the discussion of the matter *Harksen v Lane*²²¹ in which Coetzee correctly points out that steps into an investigation into an alleged violation of the right to equality that the requirement of advantage to creditors amounts to unfair discrimination and violates the right to equality.²²² This discrimination is based on the fact that poor debtors who wish to get access to debt relief are faced with the insurmountable insolvency system that excludes poor debtors due to its creditor friendly nature.

I am of the view that the South African insolvency system needs a complete overhaul. The system should be developed to a system that targets NINA debtors, a system that will serve as a non-court-based alternative that will afford a debtor a reasonable opportunity to pay off some or all of his or her debt through a repayment plan spread over a period of time. This alternative debt relief procedure as part of the reform, must aim at providing poor debtors means of reaching some form of compromise or agreement with creditors and most importantly ultimately achieve discharge of debt.

²¹⁷ Coetzee (LLD Thesis) 409.

²¹⁸ Chapter 2. See Coetzee (LLD Thesis) 409.

²¹⁹ *Ibid.*

²²⁰ *Ibid.*

²²¹ 1998 (1) SA 300 CC.

²²² Chapter 3.

Australian and England systems have developed systems that allow access for low-income debtors to be granted debt relief. There is no requirement of advantage to be creditors that debtors have to prove in order to be granted a bankruptcy order. Evans correctly points out that the English policy driven reform ‘can be of considerable value in an attempt to reform South African law’.²²³ This is in relation to the Debt Relief Order which provides for NINA debtors and clearly shows no exclusion based on pecuniary grounds for debt relief.

AI submit that the requirement of advantage to creditors amounts to discrimination and is unconstitutional in all aspects. I conclude that the South African Law Reform Commission should remove this requirement completely and I recommend that a parallel model to that of the England system be introduced as this will best suit the needs of the South African insolvency climate whilst aligning with the international insolvency trends and standards.

²²³ Evans “A critical analysis of problem areas in respect of assets of insolvent estates of individuals” (LLD Thesis University of Pretoria 2008) 13. See Coetzee (LLD Thesis) 32.

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