SOME OBSERVATIONS REGARDING RECKLESS CREDIT IN TERMS OF THE NATIONAL CREDIT ACT 34 OF 2005

1 Introduction

In general, and depending on the reason for invalidity, where parties have performed in terms of an invalid or void contract or where a voidable contract has been voided, the general rule is that they are in principle entitled to claim a return of their respective performances or claim in terms of unjustified enrichment, except where they are in law barred from doing so. (Cf *Laco Parts (Pty) Ltd t/a ACA Clutch v Turners Shipping (Pty) Ltd* 2008 (1) SA 279 (W). For the purposes of this note restoration will be used in a wide sense as to include the return of performance or an enrichment claim.) However, it is trite law that legality is one of the basic elements of a valid contract. In essence this element requires the parties to a contract not to enter into an illegal contract in that the purported contract must not be prohibited by a rule of law. Contracts of a particular kind may for instance be prohibited by a specific legislative provision, or it may be prohibited at common law if it militates against the good morals or the public interest or policy. (See in general Van der Merwe *et al Contract general principles* (2007) para 7.1 and Otto "Die *par delictum*-reël en die National Credit Act" 2009 *TSAR* 417.)

Textbooks on the law of contract usually explain that illegal contracts are void and that the private-law consequences are twofold in that the parties will be prevented from claiming performance from each other, and secondly, that where a party has performed in terms of an illegal contract, the *par delictum* rule may prevent him or her from claiming return of the performance based on unjustified enrichment where the parties are equally blameworthy (see Van der Merwe *et al* para 7.3.2.). In the latter instance the person in possession of goods or money delivered will have the stronger position unless a court is prepared to relax the strict operation of the rule by doing simple justice between man and man (see Van der Merwe *et al* para 7.3.2; Otto 2009 *TSAR* 417ff).

In the case of voidable agreements the contract remains valid until it is set aside – usually by means of a court order. In principle patrimonial transfers rendered in terms of a voidable contract should be returned after the contract has been set aside but the party who claims will have to establish a proper cause of action, for instance unjustified enrichment or the *rei vindicatio*. (See in general Sonnekus *Unjustified enrichment* (2008); Visser *Unjustified enrichment* (2008); *Laco Parts (Pty) Ltd t/a ACA Clutch v Turners Shipping (Pty) Ltd* above.)

Against this backdrop, it must be noted that section 81(3) of the National Credit Act 34 of 2005 (the NCA; unless otherwise indicated all references are to this Act) clearly provides that a credit provider must not enter into a reckless credit agreement with a prospective consumer. Section 3(c)(ii) of the NCA also states that it is one of the purposes of this Act to discourage reckless credit. The NCA, however, does not state that credit agreements that give rise to reckless credit are *ab initio* null and void as is the case with unlawful credit agreements in terms of section 89 of the NCA. (S 89 deals with unlawful credit agreements but the section does not indicate reckless credit agreements as being unlawful – see

para 3 1 below.) Courts may, however, declare credit agreements in terms of the NCA to be reckless and may then, depending on the type of reckless credit, *inter alia* set aside all or part of the consumer's rights and duties in terms thereof or suspend its operation.

The NCA is not clear in all respects as to how the courts should exercise their discretion in this regard but it was recently reported in the media that a magistrate's court in Port Elizabeth had caused a stir by setting aside a residential mortgage bond that amounted to a reckless credit agreement (see the *Business Report* at http://www.busrep.co.za/index.php accessed on 3 May 2010). From this it is unclear whether the court exercised its discretion in terms of section 83(2)(a) of the NCA or another NCA provision.

This note analyses some consequences of reckless credit agreements as provided for by the NCA.

2 Powers of the court regarding reckless credit agreements

2 1 General

Courts have wide powers to consider whether a particular credit agreement constitutes reckless credit and, if so, to deal with it in terms of the provisions of the NCA. A court may *mero motu* declare a credit agreement to be reckless in any court proceeding in which a credit agreement is being considered. (See s 83(1) and cf Otto *The National Credit Act explained* (2006) 66; Vessio "Beware the provider of reckless credit" 2009 *TSAR* 272; Stoop "South African consumer credit policy: Measures indirectly aimed at preventing consumer overindebtedness" 2009 *SA Merc LJ* 365; Scholtz *et al Guide to the National Credit Act* (2009 update) para 11.4.)

The NCA makes it clear in section 83 that it will be for the courts to set aside rights and obligations of the consumer flowing from such an agreement or to suspend its force and effect. Credit granting may thus have serious consequences for the credit provider. Since the NCA does not state in particular that reckless credit causes a credit agreement to be illegal or unlawful and that it is therefore null and void as such, and in view of the sections dealing with the consequences of reckless credit (ss 83 and 84), it is submitted that such credit agreements remain valid and that it is left to the courts to decide their fate regarding the consequences as provided for in the NCA.

2 2 Types of reckless credit

Section 80(1) of the NCA defines three distinct types of reckless credit and the Act also prescribes the consequences in each case. In terms of the NCA, a credit agreement may be reckless in the following circumstances:

(a) If, at the time that the credit agreement was made, or at the time when the amount approved in terms of a credit agreement is increased other than an increase in terms of section 119(4) of the NCA, the credit provider failed to conduct an assessment as required by section 81(2), irrespective of what the outcome of such an assessment might have been at the time. (See s 80(1)(a). Such an agreement is thus *per se* reckless.)

(b) If, at the time that the credit agreement was made, or at the time when the amount approved in terms of the agreement is increased, the credit provider (despite) having conducted an assessment as required by section 81(2),

entered into a credit agreement with the consumer, despite the fact that the preponderance of information available to the credit provider indicated that the consumer did not generally understand or appreciate his or her risks, costs or obligations under the proposed credit agreement (s 80(1)(b)(i)).

(c) If, at the time that the credit agreement was made, or at the time when the amount approved in terms of the agreement is increased, the credit provider (despite) having conducted an assessment as required by section 81(2), entered into the credit agreement with the consumer despite the fact that the preponderance of information available to the credit provider indicated that entering into that credit agreement would make the consumer over-indebted (s 80(1)(b)(ii)).

As discussed below, the powers of the court with regard to the first two types of reckless credit are similar but these powers differ markedly from those relating to the third type. Only the third type of reckless credit is directly linked to over-indebtedness whilst the first two types are deemed to be reckless although it did not cause over-indebtedness of the consumer as such. Strictly on the wording of section 80(1) the first two types may also apply where the consumer was already over-indebted when entering into any of those types of reckless credit or became over-indebted afterwards but not as a direct result of entering into such agreements like in the case of the third type. Notably section 88(4) mentions a further less-defined type of reckless credit but oddly no consequences are ascribed to it.

2 3 Court-induced remedies in case of a finding of reckless credit

2 3 1 Section 80(1)(a) and 80(1)(b)(i) reckless credit

The statutory powers of the court in respect of the first two types of reckless credit referred to in paragraph 2 2 (a) and (b), are that it has a discretion to make an order setting aside all or part of the consumer's rights and obligations under that agreement, as it deems just and reasonable in the circumstances (s 83(2)(a)). Alternatively, it may suspend the force and effect of that specific credit agreement (s 83(2)(b)) in which instance the provisions of section 83(3(b)(i) will apply (see para 2 3 1 below).

There are, however, no guidelines as to how the court should exercise its discretion in these matters. To rephrase the question: how must a court decide between setting the rights and obligations of the consumer aside and suspension? If the court opts for the first remedy, how must it exercise its discretion between setting such rights and obligations aside in part or in full? Usually a court must have facts before it that will direct it as to the course it should take.

It strikes one that section 83(2)(a) does not state that the court may set the credit agreement aside as being voidable, but rather that it may set all or part of the rights and obligations of the *consumer* aside. It is further notable that these consequences may follow even where the consumer is not over-indebted due to the fact that this relief is linked to the sections 80(1)(a) and 80(1)(b)(i) reckless credit (cf s 80(1)(b)(ii) where the debtor is over-indebted as a result of entering into that particular credit agreement and see para 2 2).

The section also does not differentiate between the situation where a credit provider and a consumer have (a) merely entered into the credit agreement, and (b) the case where either one or both have already performed in terms of such an agreement.

Where performance in terms of the contract has not yet occurred it makes sense that the court may rule that the consumer has no further rights and obligations. In effect this will for all practical purposes amount to the cancellation of the contract which means the end of that contractual relationship.

In the case where one or both of the parties have performed,, and in the absence of precedents or clear guidelines, one may ask how the provisions should be applied by a court. As stated above, where all the rights and obligations of the consumer are set aside it amounts to a cancellation for all practical purposes, although the provision does not state this explicitly and remains silent about the rights and obligations of the credit provider. The reason is that a credit agreement usually constitutes a reciprocal contract and that every right has an obligation as its counterpart. If the rights and obligations of one party to the credit agreement, that is, the consumer, are thus cancelled, it simply means that the counter rights and obligations of the credit provider will necessarily also fall away without the Act stating this in as many words.

Clearly, whenever the court sets all or part of the rights and obligations of the consumer aside, the next question to be asked relates to restoration; thus whether the credit provider will still be able to reclaim any amount of the credit granted or goods delivered to the consumer and whether the consumer will be entitled to reclaim any payments made by him or her to the credit provider. Section 83(2)(a) states explicitly that the court may set aside all or any of the rights and obligations of the consumer *under that agreement*, but the section does not prohibit or limit the credit provider from claiming money or goods delivered in terms of another cause of action such as unjustified enrichment as is the case with unlawful credit agreements as discussed in paragraph 3. (The boundaries of common law remedies have not been tested in this respect – posing some risk for the claimant.)

After a court sets all or part of the rights and obligations of the consumer aside, consequences regarding restoration will still have to be determined. This must be determined in terms of any available cause of action – be that any remaining provisions of the credit agreement, or in terms of the common law in the absence of a statutory provision in this instance. The other practical problem is that the party who so claims will probably have to do so by means of a subsequent legal suit that may be costly and time consuming.

The common law provisions (briefly referred to in paragraph 1 above) regarding illegal contracts will not apply since a reckless agreement is evidently not treated as an illegal credit agreement by the NCA as such. The fact that the NCA does not make the agreement voidable in so many words may also pose difficulties.

With regard to the magistrate's court matter referred to in paragraph 1, the court may have set aside all the rights and obligations of the consumer in terms of a residential mortgage bond in terms of its section 83(2)(a) powers. It is submitted that in such an instance the credit provider will also lose its security over the security object, ie the consumer's house, due to the setting aside of all rights and obligations relating to the mortgage bond that amounts to a credit agreement. Where the principal debt falls away as a result of such setting aside, the security will in any event lapse due to the operation of the principle of accessoriness. (See Scott and Scott *Wille: The law of mortgage and pledge in South Africa* (1987)

166 re accessoriness.) But it has already been submitted above that where the credit provider is left without any contractual remedy, such grounds will have to be found in relevant principles of the common law.

In view of the many unanswered questions relating to the application of the above provisions, the question may be asked whether a better solution could not have been achieved by rather providing that the court may either void, or suspend the operation of these types of reckless credit, depending on the circumstances. At the same time a restoration provision in the first instance would also have resolved many issues and could have prevented subsequent litigation.

2 3 2 Section 80(1)(b)(ii) reckless credit

Regarding the third type of reckless credit mentioned in paragraph 2 2(c) where the entering into the credit agreement would make the consumer over-indebted, the court is obliged, since the word "must" is used, to consider whether the consumer is over-indebted at the time of the court proceedings and, if so, it may also make an order suspending the force and effect of that specific credit agreement until a date as determined by it, and restructuring the consumer's obligations under any other credit agreements in accordance with section 87 of the NCA (s 80(3)(a) and (b)(i) and (ii)).

The effect of the suspension of a credit agreement is basically that it creates a moratorium period during which the consumer is not required to make any payment required under the agreement and no interest, fee or other charge under the agreement may be charged to the consumer (s 84(1)(a) and (b)). During this time the credit provider's rights under the agreement, or under any law in respect of that agreement, are unenforceable, despite any law to the contrary (s 84(1)(c)).

Once the suspension ends, all the respective rights and obligations of the credit provider and the consumer under that agreement are revived and are fully enforceable – except to the extent that a court may order otherwise. (See s 84(2)(a)(i) and (ii).) The exception seems to relate to a further suspension. However, no amount may be charged to the consumer by the credit provider with respect to any interest, fee or charge that were unable to be charged during the period of suspension (s 84(2)(b)).

What is salient is that this type of reckless credit, which essentially causes the consumer to become over-indebted, seems at face value to have less of a sanction than the first two types of reckless credit as discussed above in paragraph 2 3 1. In any event, it is clear that the consumer, when his or her credit agreement is suspended, will still remain indebted towards the credit provider although he or she may benefit in the sense of enjoying a payment moratorium and that at least finance charges will not be levied during the period of suspension (see ss 84(1)(b) and 84(2(c)).

As indicated in paragraph 2 3 1 above, reckless credit agreements of the first two types mentioned in that paragraph may also be suspended in which case section 83(3)(b)(i) will apply.

In case of suspension it is not clear whether a court may more than once suspend a credit agreement that was found to be reckless, even though this may be possible in view of the exception in section 84(2)(a)(ii). The suspension is clearly intended to assist the consumer to eventually repay the debt.

3 Reckless credit and unlawful contracts

3 1 Unlawful contracts

Section 89 of the NCA deals with unlawful credit agreements. Section 89(2) states specifically that credit agreements entered into under circumstances stated in that section are unlawful and section 89(5)(a) then states unequivocally that such an agreement is void *ab initio*.

Where a credit agreement is unlawful under this provision, the court has no discretion but to order the credit provider to return to the consumer any money paid by him or her, together with interest prescribed by this section. The court must also order that all the purported rights of the credit provider under that agreement to recover any money paid or goods delivered to, or on behalf of the consumer in terms of such an agreement are cancelled, unless where the court concludes that doing so in the circumstances would unjustly enrich the consumer. If this is the case, the rights to recover such moneys or goods will be forfeited to the state in order to prevent the consumer as such from being unjustly enriched (ss 89(5)(a) to (c)).

Section 90 deals with unlawful provisions in a credit agreement that are also void *ab initio* in terms of section 90(3). In this instance a court may sever such a provision from the rest of the agreement or it may declare the entire contract unlawful in which case section 89(5) will apply (see discussion above).

It seems that the legislature has replaced the general common-law consequences flowing from an illegal contract as mentioned in paragraph 1 above with its own and more severe statutory dispensation in section 89(5). (See Otto 2009 *TSAR* 428ff for criticism of this approach.)

3 2 Reckless credit agreements and section 89(5)

It is clear from the types of unlawful agreements provided for in section 89 that reckless credit does not constitute an unlawful credit agreement. In view of some uncertainty as to the application of section 83(2)(a) it may, however, be asked whether the legislature intended to grant a court the power to prevent the credit provider from reclaiming any money or goods delivered to the consumer under the described circumstances and where it sets the rights and obligations of the consumer aside. It is submitted that this is not the case and that the parties should in principle still be entitled to claim at least some return of performance. When compared it is evident from the consequences and concomitant penalties that the legislature deemed the listed unlawful credit agreements and terms as being of a more serious nature than reckless credit. Unfortunately the Act is silent on the issue of restoration where a court sets the rights and obligations of the consumer in terms of a reckless credit agreement aside.

4 Conclusion

The NCA provides for three defined types of reckless credit agreements without stipulating that these are unlawful or void. Depending on the type of reckless credit involved in a particular case, a court may *inter alia* either suspend the operation of such an agreement, or may set aside all or any of the rights and obligations of the consumer in terms thereof. Section 88(4) refers to a rather undefined instance to which no consequences are ascribed. (See paras 2 2 and 2 3 above.)

Although the common law provides for the effect of illegal contracts by declaring such contracts null and void and by prescribing the consequences regarding restitution and bars against restitution, it seems that the NCA has

prescribed its own dispensation with regard to unlawful contracts in terms of the NCA (see paras 1 and 3 1 above). Since a reckless credit agreement is not unlawful and therefore not null and void as such, and since the Act contains its own remedies, it is submitted that these common-law provisions relating to illegal contracts will not apply in this instance.

It is submitted that section 83(2)(a) that applies to the first two types of reckless credit is not clear in all respects as to the rights and obligations of the credit provider when the court exercises the right to set aside all or any of the rights and obligations of the consumer. In this respect the question may arise whether it may result in the consumer not having to restore any of the moneys or goods received by him or her. Although such a possibility cannot be ruled out, it seems to be highly unlikely and not the intention of the legislature. Section 89(5), for instance, contains a pertinent forfeiture penalty clause where a credit agreement is deemed to be unlawful in terms of that provision. Reckless credit, however, does not cause the contract to be unlawful and void and the NCA does not contain a similar penalty provision. Section 83(2)(a) also allows the court to set aside any or all rights in terms of the credit agreement but it does not oust other possible causes of action for the credit provider such as unjustified enrichment, although the application thereof might pose its own difficulties. (See paras 2 3 1 and 3 above.)

The court may suspend a reckless credit agreement in the case of the first two types of reckless credit, or the third type where the consumer becomes over-indebted by entering into a reckless credit agreement. In both instances the court is empowered in terms of section 83(3)(b)(ii) to suspend the force and effect of the credit agreement until a date determined by the court.

Regarding the third type, the court may, apart from suspending the reckless credit agreement, also restructure the obligations of the consumer under any other credit agreement as provided for in section 87. Section 83(4) lists aspects to be considered by the court when it has to apply section 83 with respect to the third type of reckless credit. These aspects are clearly intended to allow the consumer a moratorium during a period when he or she may not be able to meet the payment obligations in terms of the reckless credit agreement. Section 84 further regulates the effects of suspension, as well as the effects when the suspension ends. The NCA is, however, silent on the question whether the consumer may more than once approach the court on the same basis if his or her financial situation has not improved at the time that the suspension of the operation of the reckless credit agreement expires. (See para 2 3 2 above.)

The legislature clearly frowns on reckless credit but it has refrained from listing it as an unlawful contract in terms of section 89. Courts should therefore do justice between (wo)man and (wo)man when hearing claims for restoration. It is in general submitted that the treatment of reckless credit would have been clearer and more satisfactory if the legislature had rather allowed a court the discretion in case of any type of reckless credit to either suspend the operation of such an agreement, or to void such an agreement. The last-mentioned option could be linked to a statutory restoration and/or a forfeiture clause depending on the type of reckless credit involved. This at least would have saved the parties from entering into subsequent litigation to deal with restoration.

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