UNIVERSITY OF CAPE TOWN, FACULTY OF LAW

Recent Developments in South African Consumer Insolvency Law

An analysis of the National Credit Amendment Act 7 of 2019 and its possible impact on the economy, taking into account the experiences of the British, New Zealand and German legal systems.

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Abstract

A key challenge of the present is the growing number of consumer debtors, often caused by easy access to credit. Especially for people on low incomes, even an unforeseen event can lead to a situation in which credit rates can no longer be serviced. The result is insolvency. However, in the past many jurisdictions were not prepared for the challenges of low income insolvency. It was not until more recent times that legislators began to develop special insolvency procedures tailored to people with low incomes.

This comparative research presents the insolvency proceedings of South Africa, in particular the recently introduced low income insolvency proceedings, and compares them with those of New Zealand, Great Britain and Germany, whereby Germany is the only one of these countries without a low-income insolvency procedure. It is established that each of these proceedings has advantages and disadvantages. It is also noted that despite the existence of insolvency proceedings, the number of consumer debtors continues to rise. Therefore, in addition to a proposal for insolvency proceedings combining the feasible aspects of each of the legal systems presented, it is also proposed to teach financial literacy at school in order to prevent over-indebtedness.

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Chapter One Introduction

I. Problem Outline

Although consumer credit law is highly influenced by economic, social and political considerations, there is a certain similarity between the legislations of different countries in this area. Therefore, consumer credit law offers a broad and interesting basis for comparison.[1] Historically, consumer protection did not feature prominently in legislation. In fact, in most jurisdictions there were either no provisions on consumer insolvencies in force or existing provisions focused mainly on the creditors' best interests.[2] However, the situation gradually changed and a noticeable increase in consumer credit occurred.[3] The reason for this was that the first credit card providers emerged, making credit available to consumers worldwide.[4] The availability of (unsecured) credit soon extended to groups of society that previously had no access to loans due to a lack of securities.[5] Some reasons for this change are the deregulation of consumer lending, originating from the U.S. Supreme Court's decision to lift state interest rate restrictions on credit cards to increase their profitability, technologies for assessing credit worthiness, and the advertising of credit cards by banks.[6] Access to credit has opened up new opportunities for consumers, more specifically access to consumer goods that they previously could not afford.[7] The downside, however, is that even a small unforeseen event can lead to the consumer no longer being able to service her credit and becoming indebted.[8] The result is the growing over-indebtedness of consumers, characterised by the fact that the debt burden exceeds the ability to meet repayment obligations.[9]

A common cause for changes in the law is that current legislation no longer meets the needs of society. The influence of social change on legislation was noticeable, for example, in Germany, where the number of indebted consumers increased significantly in the 1980s and 1990s.[10] More precisely, total consumer debt in Germany more than doubled between 1984 and 1994 from around

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[1] Jannie Otto, *The History of the Consumer Credit Legislation in South Africa*, Unisa Press (2010) 257 at 259.
[2] Assaf Lichtash, *Realigning the American Consumer Bankruptcy System with the Goals of the Fresh-Start Doctrine: A Global Comparative Analysis*, 34 Loy. L.A. Int'l & Comp. L. Rev 169 (2011); Keeper op cit note x at 83-84; Johanna Niemi-Kiesiläinen, Ian Ramsey, William Whitford (eds.), *Consumer Bankruptcy in Global Perspective* (2003) Hart Publishing, Oregon at 1 (hereafter Niemi-Kiesiläinen et al *Bankruptcy*).
[3] Niemi-Kiesiläinen et al op cit note 2 at 2.
[4] Ibid.
[5] Adrian Walters*, Individual Voluntary Arrangements: 'Fresh Start' for Salaried Consumer Debtors in England and Wales?* Int. Insolv. Rev. Vol.18: 5-36 (2009) at 4.
[6] *Marquette National Bank of Minneapolis v First of Omaha Service Corporation* 439 US 299 (1978); Niemi-Kiesiläinen et al *Bankruptcy* op cit note 2 at 3.
[7] Ibid.
[8] Ibid at 4.
[9] Johanna Niemi-Kiesiläinen, Ann-Sofie Henrikson, '*Legal Solutions to Debt Problems in Credit Societies – A Report to the Council of Europe*' (Umea University, 2005) 7.
[10] Jason J. Kilborn, *The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States*, 24 Nw. J. Int'l L. & Bus. 257 (2004) 260.

160 billion Deutsche Mark[11] in 1984 to almost DM 364 billion in 1994.[12] However, German insolvency law did not contain specific rules for consumer insolvencies. As a result, German insolvency law was unable to meet the challenges of rising consumer debt. The increasing number of consumer debtors led to the need for consumer protection provisions.[13] It followed that the German insolvency law had to be adapted and the result was the new Insolvency Act of 1999. Current figures also show that the number of loans continues to rise: around 8 million new credit agreements were concluded in 2017.[14] This represents an increase of around 4.45 percent compared to the previous year. The number of private insolvencies in 2017 amounted to 94,079.[15]

Yet, Germany is by no means the only country with an increasing number of consumer debtors. Rather, a global transformation can be observed. A similar development can be noted in South Africa. The Usury Act was passed before microcredits, credit cards and access bonds on home loans were introduced. Moreover, this law was complicated and incomprehensible. These factors contributed to the Usury Act becoming outdated.[16] In addition, in 1992 the first Exemption Notice was issued, which exempted loans below R6 000 from the interest rate restrictions of Section 15A of the Usury Act. This exemption opened up the possibility for credit providers to charge an unlimited interest rate on small loans and thereby led to the establishment of a largely unregulated microcredit industry.[17] Thus a credit market was created for people on low incomes who could not provide any other assets as security and thus had no access to the official credit market.[18] Consumer debt became increasingly out of control given the fact that creditors were demanding interest rates of up to 30 percent, but also had no access to the National Payment System and therefore used other methods to obtain their money.[19] The usual method to secure the repayment of these loans was to take possession of the bank card with the corresponding private identification number and then

[11] German currency between 1948 and 1999, abbreviated as DM or D-Mark; in 1999 the Euro was introduced in Germany.
[12] Ibid at 261.
[13] Kilborn op cit note 9 at 262.
[14] For the statistics see https://de.statista.com/statistik/daten/studie/70156/umfrage/abgeschlossene--kreditvertraege-in-deutschland/ (last accessed on 27 November 2019).
[15] For the statistics see https://de.statista.com/statistik/daten/studie/37122/umfrage/anzahl-der-insolvenzen-in-deutschland-insgesamt/ (last accessed on 27 November 2019).
[16] Michelle Kelly-Louw, The Prevention and Alleviation of Consumer Over-Indebtedness SA Mercantile Law Journal, Volume 20, Issue 2, Jan (2008) at 201 (hereafter Kelly-Louw Prevention).
[17] Ibid at 202.
[18] Michelle Kelly-Louw, *Consumer Credit Regulation in South Africa*, (2012) Juta, Cape Town at 290 (hereafter Kelly-Louw *Regulation*); Kelly-Louw *Prevention* op cit note 16 at 202.
[19] Ibid.

withdraw money monthly. The consumer sometimes received a small amount to cover her living expenses, but often received no money at all.[20]

There are many conflicting interests in consumer credit law. On the one hand, credit providers have an interest in profit, but on the other hand it is necessary to protect the consumer as the weaker party.[21] Moreover, credit is an essential factor for the functioning of society as they play an important role especially in business but also for households.[22] The importance of credits can be seen in the example of South Africa, where in 2017 the total value of newly granted loans increased from R123.64 billion to R135.71 billion, and thus by 9.76 percent, between September and December. In addition, outstanding consumer credit at the end of December 2017 was R1.76 trillion, an increase of 1.53 percent quarter-on-quarter and 3.77 percent year-on-year.[23]

South Africa's economy is divided into two sectors: the formal sector with a skilled labour force and the informal sector, where the unemployed and those who are not employable in the formal sector work. In order to obtain credit, those in the informal sector are largely dependent on the so-called unregulated credit industry. The beginnings of unregulated micro-lending can be traced back to the enactment of the Usury Act, which aimed to protect debtors from excessive interest rates.[24] In fact, however, it led to people on low incomes being excluded from access to credit as they became too high a risk for credit providers due to a lack of securities and were not profitable due to capped interest rates introduced by the Usury Act.[25] To counter this problem the legislator issued the first Exemption Notice which introduced an exception to the capped interest rates for loans under R6 000 (later changed to R10 000 in the second Exemption Notice).[26] This exemption was designed to enable people on low incomes to obtain loans by reducing the risk of credit providers with uncapped interest rates.[27] As a result, the basis was laid for the growth of an unregulated micro lending industry.[28] However, the Exemption Notice failed to establish rules for credit providers' behaviour, which allowed them to exploit debtors.[29] For example, debtors' credit cards were confiscated and they were forced to disclose their PIN so that the credit providers were

[20] Kelly-Louw *Prevention* op cit note 16 at 202.
[21] Otto op cit note 1 at 259.
[22] Kelly-Louw *Regulation* op cit note 18 at 290.
[23] Consumer Credit Market Report, National Credit Regulator (Available at https://nca.co.za/consumer-credit-health-improves/#more-1160 (last accessed on 02 December 2019).
[24] Kelly-Louw *Regulation* op cit note 18 at 7-8.
[25] Ibid at 8.
[26] Kelly-Louw *Regulation* op cit note 18 at 8.
[27] Ibid.
[28] Ibid.
[29] Ibid.

able to withdraw the monthly payments with interest directly from the debtors' accounts.[30] Furthermore, the Exemption Notices did not provide for a limit on the number of loans a credit provider could issue to the same debtor. As a result, it was possible for credit providers to give a debtor multiple loans for R10 000 or less and thus avoid the capped interest rates.[31] This practice allowed micro-lenders to take advantage of the desperate situation of low-income debtors and force them into serious debt through excessive interest rates.[32]

A crucial problem in South Africa was that a distinction was made between debtors with assets and those without income and own assets. While wealthy debtors were eligible for sequestration under the Insolvency Act, non-wealthy debtors had no access to statutory debt relief measures.[33] Instead, these debtors only had access to measures under the National Credit Act[34] or the Magistrate's Courts Act[35]. However, these procedures are rather to be classified as repayment plans as there is no possibility for debt relief and the debt must be repaid in full.[36] The last option for such debtors was instead to enter into voluntary negotiations with the creditors to agree a debt rescheduling.[37] However, these negotiations were often doomed to failure as the creditors rarely co-operated due to the lack of assets.[38] To put an end to the unequal treatment of wealthy and low-income debtors in South Africa, the legislator published the National Credit Amendment Bill in 2017, which has been in force since August 2019. This National Credit Amendment Act 7 of 2019 aims at reducing reckless lending and enabling people on low income to obtain debt relief.[39] However, this law does not receive universal approval. Rather, it is argued that it is an unconstitutional confiscation of property and that it will have an unpredictable impact on the South African economy.[40]

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[30] Kelly-Louw *Prevention* op cit note 16 at 201-202.
[31] Kelly-Louw *Regulation* op cit note 18 at 10.
[32] Pamhidzai Bamu, Joachim Schukmann, Shane Godfrey, The National Credit Act: will it increase access to credit for small and micro enterprises? Law, Democracy & Development Vol 11, 33 (January 2007) 38.
[33] Melanie Roestoff, Hermie Coetzee, Consumer Debt Relief in South Africa; Lessons from America and England; and Suggestions for the Way Forward, 24 S. Afr. Mercantile L.J. 53 (2012) at 59.
[34] Debt review in terms of Section 86.
[35] Administration order in terms of Section 74.
[36] Hermie Coetzee, *An Opportunity for No Income No Asset (NINA) Debtors to Get out of Check - An Evaluation of the Proposed Debt Intervention Measure*, 81 THRHR 593(2018) 596.
[37] Hermie Coetzee and Melanie Roestoff, *Consumer Debt Relief in South Africa— Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand,* Int. Insolv. Rev., Vol. 22: 188 (2013) at 189.
[38] Ibid.
[39] Preamble National Credit Amendment Act 7 of 2019.
[40] Association of Debt Recovery Agents, *Written Submissions Pursuant to Publication of the National Credit Amendment Bill of 2018 in Parliamentary Notice 922 Published on 24 November 2017 in Government Gazette 529, No 41274* at 15; https://businesstech.co.za/news/finance/267443/new-debt-relief-bill-will-make-it-harder-to-get-a-loan-in-south-africa-expert/ (last accessed 12 November 2019).

In January 2017, consumer credit in New Zealand had reached 248,163 million New Zealand Dollars (hereafter NZD), an increase of 0.52 percent from NZD 246.877 million in December 2016.[41] In a period beginning in 1990 with a record low of NZD 21.498 million in December 1990 to January 2017 with a historic peak of NZD 248.163 million, consumer credit increased by 1154 percent.[42] Following the Ministry of Economic Developments findings that consumer credit agreements had become the main reason for insolvency, the New Zealand Government introduced the No Asset Procedure (hereafter NAP) into New Zealand law, thereby reacting to the rising number of consumer insolvencies.[43]

Great Britain is also facing growing consumer indebtedness. In September 2019, the average debt per household in the United Kingdom amounted to £59,823, thus stagnating since December 2008 when it stood at around £59,630 per household, although a new insolvency procedure was introduced in 2009.[44] However, according to the Office for Budget Responsibility's forecast, this figure is expected to rise in the following years to a total debt of £2.425 trillion and thus to £86,388 on average per household.

These figures indicate that the growing indebtedness of consumers is a critical problem and that legislation needs to address these social changes. At the same time, however, it raises the question of the extent to which legislation can actually remedy the situation.

II. Research Question

In the light of the above-mentioned problem-outline the research question is what alterations the National Credit Amendment Act brings, how it might influence the South African economy and how the insolvency proceedings are regulated in Great Britain, New Zealand and Germany.

III. Aim of the Research

This research focuses on the consumer insolvency law in South Africa within the context of its history and recent changes. Furthermore, the research describes and makes comparison between the consumer credit legislations in Germany, Great Britain and New Zealand. The aim of this research is to point out how the legislation of these countries developed, what economic influences it was

[41] https://tradingeconomics.com/new-zealand/consumer-credit (last accessed 12 November 2019).
[42] Ibid.
[43] New Zealand, Ministry of Economic Development, *Insolvency Law Review: Tier One Discussion Documents* (Wellington, 2001) 30.
[44] https://themoneycharity.org.uk/money-statistics/; https://themoneycharity.org.uk/media/december-2008.pdf (last accessed 4 December 2019).

subject to, and to what extent these legal systems are similar. The aim is also to determine if and to what extent these legal systems serve as examples for each other and what conclusions can be drawn for economic development of one country for another. However, this influence is not one-sided rather, this research aims to show that legislation and social, economic and political influences affect each other. This is reflected in the fact that legislation needs to be adapted to social, political and economic change, in other words to the continuously changing needs of society. On the other hand, the enactment of a law can also influence the economy as can be seen in the rise of the unregulated micro credit industry in South Africa which was a consequence of the enactment of the Usury Act and which will be explained in detail below.

IV. The Structure of this Research

This study is structured into seven chapters. Chapter one outlines the background to the latest legislative amendment in South African insolvency law. It also gives an overview of the relationship between social changes in the area of over-indebtedness and changes in insolvency law in Great Britain, New Zealand and Germany. In Chapter two and three the different procedures of British law and New Zealand insolvency law will be appraised. Chapter four then examines the German Insolvency procedure. Chapter five deals with the previous legislation regarding insolvency law in South Africa and then outlines the changes the new National Credit Amendment Act 7 of 2019 brought. In Chapter six compares the different legal systems, highlighting their differences and similarities. Chapter seven concludes the research suggesting how the different approaches might learn and benefit from each other.

In the following chapter, British Consumer Insolvency Law will be described.

Chapter Two British Consumer Insolvency Law

I. Introduction

Consumer credit law is often perceived as a modern phenomenon, but on the contrary has historical roots that can be traced back to ancient peoples such as the Romans.[45] At that time there were already regulations for consumer protection and some of these regulations have survived into modern times, like for example the *ultra duplum* rule, which is still in force today in South Africa.[46] Another source for South African law apart from Roman and Roman-Dutch law is English law.[47] However, South Africa is not the only legal system inspired by English law. Rather, English law also had a significant impact on consumer protection within the European Union. More precisely, the Consumer Credit Act 39 of 1974 which is based on the Report of the *Crowther* Commission in 1971[48] served, as a model for the European Economic Community Directive on Consumer Credit[49] from 1986 (hereafter Directive).[50] This Directive lays down the minimum standards of consumer protection to be implemented by the Member States in their national law in its Article 14. These minimum requirements form the basis of a uniform level of consumer protection in the European Union, yet the Directive does not prevent Member States from adopting stricter provisions to protect consumers,[51] which is the case for example in Germany, where *inter alia* the founder of a new business enjoys consumer protection.[52]

This chapter gives a brief overview of British consumer insolvency law, with the term 'British' for this purpose covering only the legal systems in England and Wales, as Scotland has retained its own legal system albeit being part of the United Kingdom.[53] This overview consists of a breakdown of the various insolvency mechanisms such as Bankruptcy, Individual Voluntary Agreement, County Court Administration Order and Debt Management Arrangement.

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[45] Otto op cit note 1 at 257.
[46] Ibid.
[47] Ibid.
[48] Great Britain. Committee on Consumer Credit & Sir Geoffrey Crowther, *Consumer credit: report of the Committee on Consumer Credit*, H.M.S.O, Lond 1907- 1971 (Cmnd 4596).
[49] Council Directive 87/102/EEC of 22 December 1986 or the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, amended by Council Directive 90/88/EEC of 22 February 1990.
[50] Otto op cit note 1 at 265.
[51] Directive, Art. 15.
[52] German Civil Code, Section 513; see also Philipp Wösthoff, *Die Verbraucherkreditrichtlinie 2008/48/EG und deren Umsetzung ins deutsche Recht*, (2010) Peter Lang, Berlin at 138.
[53] Donna McKenzie Skene, Adrian Walters, *Consumer Bankruptcy Law Reform in Great Britain*, 80 Am. Bankr. L.J. 477 (2006).at 480.

II. History of British Consumer Insolvency Law

In the United Kingdom, as elsewhere in the world, economic, political and social developments led to a reform of insolvency law that focused on consumer insolvency. Stable economic conditions, increasing credit availability and rising house prices led to a rising number of indebted households and made consumer insolvency a central political concern in the United Kingdom.[54] This concern was usually addressed at two levels: on the one hand, it was sought to develop strategies to prevent consumer over-indebtedness.[55] These included measures to promote responsible lending, debt advice and financial education.[56] On the other hand, a legislative reform restructured bankruptcy law in such a way as to support and relieve over-indebted consumers.[57] The Insolvency Act 1986 experienced two important changes. The first was the amendment of the Enterprise Act 2002 to the Insolvency Act in that the period for discharge was reduced from three years to 12 months, several restrictions, disqualifications and prohibitions have been revoked and also a sharper distinction between culpable and non-culpable bankruptcies was enforced.[58] The second amendment was brought about by the Tribunals, Courts and Enforcement Act 2007 and included the introduction of the Debt Relief Order (hereafter DRO) designed to provide relief to debtors with little or no income.[59]

III. The Different Procedures in British Consumer Insolvency Law

(a) The Bankruptcy Procedure

The term bankruptcy in English insolvency law is understood as a final remedy with strict consequences for the debtor.[60] On the other hand, English insolvency law is also strongly influenced by the idea of a fresh start for the debtor.[61] In other words, in the event of bankruptcy, the debtor is granted debt relief. In England and Wales bankruptcy is governed by Part IX of the Insolvency Act 1986 (hereafter Insolvency Act). The procedure begins with an application by the debtor or a creditor to the court.[62] The debtor must submit a statement of affairs to the court, stating that she is not able to pay off her debts.[63] According to Section 286 of the Insolvency Act 'the debtor appears to be unable to pay a debt if, but only if, the debt is payable immediately and either (a) the

[54] Ibid at 477.
[55] Ibid at 478.
[56] Ibid.
[57] Ibid.
[58] Walters op cit note 4 at 15.
[59] Roestoff/Coetzee op cit note 33 at 73.
[60] Ian F. Fletcher, *The Law of Insolvency*, 3rd ed (2002) Sweet and Maxwell, London, 37 para 3-002.
[61] Ibid.
[62] Insolvency Act, Sections 264(1) and 373.
[63] Ibid Section 272.

petitioning creditor to whom the debt is owed has served on the debtor a demand (known as "the statutory demand") in the prescribed form requiring him to pay the debtor to secure or compound for it to the satisfaction of the creditor, at least three weeks have elapsed since the demand was served and the demand has been neither complied with nor set aside in accordance with the rules, or (b) execution or other process issued in respect of the debt on a judgment or order of any court in favour of the petitioning creditor, or one or more of the petitioning creditors to whom the debt is owed, has been returned unsatisfied in whole or in part'. Furthermore, the administrative costs of £250 and the court costs of £370 must be paid.[64] Where the court sees a possibility for the debtor to enter into an Individual Voluntary Agreement with her creditors, the court shall appoint an insolvency practitioner to assist the debtor with its implementation.[65] This applies mainly in cases where the debtors' debts don't exceed the amount of £20,000[66], the value of her assets amounts to at least £2,000, and the debtor has not been adjudged bankrupt or entered into a composition or scheme of affairs with creditors during the past five years. The bankruptcy is managed at least temporarily by the so-called Official Receiver (hereafter OR).[67] This is a state official employed by the Insolvency Service, which itself is an executive agency of the Ministry of Trade and Industry.[68] From the time of her appointment, the assets of the bankrupt vest in the trustee.[69] The trustee is endowed with extensive powers allowing her to perform her role of distributing the assets among the creditors effectively.[70] She can, for example, reverse transactions that the bankrupt has made before her adjudication.[71] The money obtained by the trustee through the realisation of the debtor's assets is distributed proportionally among those creditors who hold a provable claim against the debtor.[72] The debtor must surrender her non-exempt estate but may keep books, vehicles and tools needed to carry out her profession, as well as clothing, furniture and equipment necessary to meet the basic needs of the debtor and her family.[73] Furthermore the debtor has to make payments to the creditors from her income in cases where the income exceeds the exempted amount.[74] As long as the debtor is subject to summary administration and the discharge has not yet taken place, she is

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[64] Iain Ramsay, *Bankruptcy in Transition: The Case of England and Wales - the Neo-Liberal Cuckoo in the European Bankruptcy Nest? 205* in Johanna Niemi-Kisläinen, Iain Ramsay, William Whitford (eds), CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE (2003) Hart Publishing, Oregon at 208-209.
[65] Insolvency Act, Section 273(2)(b).
[66] See Insolvency Proceedings (Monetary Limits) Order 1986 No 1996.
[67] Insolvency Act, Section 287(1).
[68] Donna McKenzie Skene, Adrian Walters, Consumer Bankruptcy Law Reform in Scotland England and Wales, (the article is based on a paper given at the INSOL Academics' Group Meeting held at Scottsdale, Arizona, May 2006) at 7.
[69] Fletcher op cit note 60 at 41 para 3-009.
[70] Ibid.
[71] Ibid.
[72] Ibid.
[73] Insolvency Act, Section 283(2).
[74] Walters op cit note 4 at 20.

subject to some restrictions.[75] She may not borrow more than £250 without disclosing her insolvency and may not hold office as a Member of Parliament or a local authority.[76] Discharge typically takes place two years after the commencement of the bankruptcy if a summary administration certificate was issued or three years in all other cases.[77] As an effect of the discharge, the insolvent is released from her debts. In other words, the debtor is granted a discharge.[78] Effectively, the creditors cannot obtain any outstanding balance from the debtor through individual enforcement.[79] A debtor who filed for bankruptcy for the first time is automatically discharged two to three years after the beginning of the bankruptcy proceedings.[80]

However, there are also debts that cannot be subject to discharge. Those include criminal penalties, student loans, debts obtained through fraud or fraudulent breach of trust, certain categories of damages and debts resulting from a court order in family proceedings.[81] Furthermore, the rights of secured creditors will not be affected by the discharge.[82]

In cases where the debts owed to the creditors don't exceed the small bankruptcy level of £20,000[83] and the debtor has not been adjudged bankrupt in the past five years the bankruptcy is processed in the so-called summary administration.[84] In principle, summary administration is a simplified procedure as it is carried out without a creditors' meeting, the OR acts as trustee of the assets, and contrary to Section 289(1) of the Insolvency Act she has no obligation to investigate the circumstances that led to the insolvency. Discharge thereafter takes place following two instead of three years.[85]

(b) The Individual Voluntary Agreement

An Individual Voluntary Agreement (hereafter IVA) is a binding composition between a debtor and her creditors, which is based on a proposal by the debtor to the creditors.[86] Within the framework of an IVA, the sale of property or income repayments may be agreed upon.[87] In addition, the debtor is assigned an insolvency practitioner (hereafter IP) as nominee and supervisor for the agreement.[88]

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[75] Ramsay op cit note 64 at 209.
[76] Ibid.
[77] Insolvency Act, Section 279(2).
[78] Ibid at para 3-010.
[79] Ibid.
[80] Insolvency Act, Section 279.
[81] Ibid Section 281(3)-(5).
[82] Ibid Section 281(2).
[83] See The Insolvency Proceedings (Monetary Limits) Order 1986 No 1996.
[84] Insolvency Act, Section 275(2).
[85] Ramsay op cit note 64 at 209.
[86] Ibid at 211.
[87] Ibid.
[88] Ibid.

The nominee submits a report to the court informing the court whether a creditors' meeting should be held to consider the proposal.[89] To approve the proposal, a majority of more than 75 percent of the value of the unsecured creditors present is required.[90] A creditor in the vote may also be represented by a proxy.[91] Furthermore the proposal is binding for both the concurring and the dissenting creditors.[92] However, the rights of secured or preferential creditors cannot be compromised without their consent.[93] Although the vast majority of IVAs are concluded prior to bankruptcy, a debtor who is subject to bankruptcy may agree on an IVA with her creditors prior to discharge in order to cancel the bankruptcy.[94] Once the proposal is put in place through the creditors' vote, the nominee is to supervise the debtor's compliance with its terms.[95] The terms of the IVA depend on the debtor's proposal and whether it is accepted unconditionally by the creditors since the latter have the right to request adjustments to the proposal.[96] Upon fulfilment of the conditions of the IVA, a discharge follows. Thus, the IVA offers debt relief to the debtor.[97] If the conditions of the IVA are to be changed due to changes in the debtor's living conditions, for example, the unanimous consent of the creditors is generally required.[98] However, there is usually a provision in the proposal that changes require approval by the majority of creditors.[99] Expenses of the IP for the work as nominee and supervisor will be covered from the arrangement proceeds.[100] Usually, court fees or deposits do not have to be paid in advance.[101]

IVAs account for about 20-25 percent of all insolvency proceedings, although this procedure was not originally developed for consumer insolvency and is not affordable for all consumers given the average cost of £1500 for the nominee and £2500 for the supervisor.[102]

(c) County Court Administration Order

A County Court Administration Order (hereafter CCAO) is an, albeit limited, way of dealing with over-indebtedness outside the bankruptcy system and is known throughout its existence as the ‘poor

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[89] Ibid.
[90] Ibid.
[91] Ibid.
[92] Insolvency Act, Section 260.
[93] Ramsay op cit note 64 at 211.
[94] Ibid.
[95] McKenzie Skene/Walters op cit note 53 at 484-485.
[96] Insolvency Act, Section 258(2)-(5).
[97] McKenzie Skene/Walters op cit note 53 at 486.
[98] Ibid; *In re Alpha Lighting Ltd.*, [1997] B.P.I.R. 341.
[99] McKenzie Skene/Walters op cit note 53 at footnote 54.
[100] Ibid at 487.
[101] Ibid.
[102] See *Regulatory Impact Assessment for Insolvency Provisions in Enterprise Bill as introduced to House of Lords*, 19 June 2002 at 10.

persons bankruptcy'.[103] The CCAO is dealt with in the County Courts Act 1984 (hereafter CCA). Its original purpose was to facilitate the collection of small loans where bankruptcy proceedings would be too expensive and, at the same time, to protect the debtor against being harassed by her creditors.[104] The CCAO is initiated by an application to the county court.[105] The conditions for a CCAO are that the applicant's debt is below the £5,000 threshold and part of it is from a judgment.[106] The order issued by the court may include full or partial repayment of the debt.[107] In addition, the court has no limitation on the granting of a period for the repayment.[108] Each of the creditors mentioned in the order is prevented from taking legal action against the debtor for the entire duration of the order.[109] Furthermore, the CCAO is not subject to an entry fee, the costs of enforcing the order will be deducted from the repayments and may not exceed 10 percent of the total amount of the debt.[110]

(d) Debt Relief Order

On 6 April 2009 the Debt Relief Order (hereafter DRO) was introduced into the Insolvency Act 1986. The procedure is regulated in Sections 251A-251X of the Insolvency Act and enables people who cannot afford the costs of bankruptcy proceedings due to low or no income or assets to obtain debt relief.[111] In order to apply for a DRO, the debtor must be unable to pay her debts.[112] It is important to note that an application for a DRO can only be made in respect of qualifying debts.[113] This is any unsecured debt which is 'a liquidated sum payable either immediately or at some certain future time; and is not an excluded debt'.[114] The DRO is a procedure that is carried out by the OR without any court proceedings. To start the DRO an application for debt relief must be submitted to the OR. Furthermore, the applicant must meet certain requirements.[115] Firstly, the applicant's liabilities may not exceed the amount of £15,000.[116] Secondly, the amount that the debtor has left after paying normal household expenses may not exceed £50 per month.[117] Finally, the debtor's

[103] McKenzie Skene/Walters op cit note 53 at 487; Ramsay op cit note 64 at 212.
[104] Ibid.
[105] Ramsay op cit note 64 at 213.
[106] Ibid.
[107] CCA, Section 112(6).
[108] Ramsay op cit note 64 at 213.
[109] CCA, Sections 112(4) and 114.
[110] Ramsay op cit note 64 at 213.
[111] Roestoff/Coetzee op cit note 33 at 73.
[112] Insolvency Act, Section 251A(1).
[113] Ibid.
[114] Ibid Section 251A(2) and (3).
[115] Roestoff/Coetzee op cit note 33 at 74.
[116] Ibid.
[117] Ibid.

assets may not exceed £300 and a vehicle owned by the debtor must not exceed a value of £1000.[118] Once the order has been issued, a moratorium is imposed prohibiting creditors from enforcing the debts covered by the order.[119] According to Section 251K of the Insolvency Act, the creditors have the possibility to object to 'the making of the order, the inclusion of the debt in the list of the debtor's qualifying debts; or the details of the debt specified in the order'.[120] The debtor has various obligations set out in Section 251J of the Insolvency Act while the moratorium is in force. One of them is to inform the OR of any change in her circumstances that concerns an increase in her income or the acquisition of property.[121] The debtor is also faced with restrictions similar to those applicable in bankruptcy.[122] This includes for example that the debtor must give a credit provider the relevant information about her status before obtaining credit.[123] The moratorium is generally valid for one year.[124] Upon termination of the moratorium, the debtor is granted a discharge.[125] An application for a DRO is possible every six years.[126]

(e) Debt Management Arrangement

Another alternative, but independent of the bankruptcy system, is the Debt Management Arrangement (hereafter DMA). Generally, the DMA is negotiated by the debtor herself after visiting a debt counselling service.[127] However, the condition for a DMA is that the debtor has a regular surplus in her income.[128] The aim of the DMA is a full repayment over a certain period or a repayment on DMA terms, bridging the gap until the debtor has sufficient capacity again for the originally agreed repayments.[129] To achieve this, the debt is rescheduled and the monthly payment is distributed to the creditors.[130] The advantage of the DMA is that no assets have to be surrendered, which is why this procedure is a frequently used alternative, especially for homeowners.[131] However, there are also several disadvantages: DMAs are neither binding nor individual enforcement efforts.[132] Furthermore, the interest continues to add up to the amount of the

[118] Ibid.
[119] Insolvency Act, Section 251G.
[120] Ibid Section 251K(1).
[121] Ibid Section 251J(5).
[122] Roestoff/Coetzee op cit note 33 at 74.
[123] Insolvency Act, Section 251S(1)(a).
[124] Ibid Section 251H(1).
[125] Ibid Section 251I (1).
[126] Roestoff/Coetzee op cit note 33 at 74.
[127] McKenzie Skene/Walters op cit note 53 at 488.
[128] Ibid.
[129] Ibid at 489.
[130] Ibid at 488-489.
[131] Ibid at 489.
[132] Ibid.

outstanding principal debt, unless the creditors waive it.[133] A further disadvantage is the duration of such a procedure which can drag on over a long period.[134]

IV. Summary of the British Insolvency Law system

In the event of insolvency, England and Wales have a total of five different procedures, four of which are formal procedures. These five procedures are Bankruptcy, IVA, County Court Administration Order, Debt Relief Order and Debt Management Arrangement. The Bankruptcy procedure is based on the idea of giving an honest but unfortunate debtor a fresh start. It seeks to relieve the debtor of her debts by discharging her debts after a certain period. However, bankruptcy is not suitable for every debtor, since the costs of the procedure must be paid out of the insolvent estate. This means the debtor needs enough assets to cover the costs for the insolvency proceedings. It is worth mentioning that there is a possibility of a less cost-intensive summary administration within the bankruptcy procedure for small bankruptcies, which at least broadens the scope of debtors who can enjoy the advantages inherent to the bankruptcy procedure. Instead of entering into bankruptcy proceedings, the debtor has the possibility to negotiate an IVA with her creditors. The advantage of this procedure is, that bankruptcy itself and the restrictions, which the debtor has to face during bankruptcy proceedings can be avoided. Furthermore, it is binding even on dissenting creditors if the required quorum is met. Admittedly, this procedure can only be considered for debtors with assets, since the consent of a creditor majority is required in order for the IVA to come into force and they would not agree to a disadvantageous arrangement. Before the DRO was introduced in 2009 low income debtors could only apply for a CCAO or a DMA but neither of these procedures provides for debt discharge, therefore creating an unequal situation for no income debtors. This changed with the introduction of the DRO, which is designed for debtors with no income or low income and which provides for debt relief after a period of one year and which the debtor can apply for every six years. One can say, that the British insolvency system with its five different procedures provides a solution for a vast majority of insolvency situations, but at the same time the fact that it is regulated in many different laws (Insolvency Act, County Courts Act, Insolvency Proceedings (Monetary Limits) Order) therefore making it difficult for a non-lawyer to weigh her options.

Chapter three will give an overview of New Zealand insolvency Law.

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[133] Ibid.
[134] Ibid.

Chapter Three New Zealand Consumer Insolvency Law

I. Introduction

New Zealand legislation was the first country to explicitly address the no income no asset debtor.[135] In 2007, the Insolvency Act 2006 No 55 (hereafter Insolvency Act) came into force which established a new procedure for insolvent persons, the so-called 'No Asset Procedure' (hereafter NAP).[136] This was introduced against the background that the Ministry of Economic Development had established that since the last debt review, debts arising out of consumer credit agreements had become the main cause of bankruptcy.[137] Especially for consumers, there are few possibilities to avoid future debts.[138] Therefore, in these cases the criminal law provisions concerning bankruptcy were often inappropriate and resulted in debtors not being able to improve their financial situation.[139] For this reason, the NAP[140] has been introduced into New Zealand law.[141] In addition to bankruptcy and the NAP, the 2006 New Zealand Insolvency Act also provides for alternative measures such as proposals[142] and summary instalment orders[143].

II. History

When it entered into force, the Insolvency Act replaced the Insolvency Act 1967. Under the old Act, private compromises with creditors were a possible option and still are today under the new law.[144] According to the old legislation, there were two alternatives before bankruptcy: on the one hand, the debtor could present a proposal for financial restructuring for which he needed the consent of the creditors.[145] Possible contents of this proposal were an offer to assign all or part of their assets to a trustee, an offer to pay by instalments, an offer to reduce debt or an offer to repay debt in the future.[146] This procedure was retained in the new Insolvency Act and is described below.

On the other hand, the debtor could also apply to the court for a summary instalment order, which was binding on the creditors for three years, but the requirement was that the total debt of the

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[135] Coetzee/Roestoff op cit note 37 at 201.
[136] Trish Keeper, *New Zealand's No Asset Procedure: A Fresh Start at No Costs?,* QUT Law Review Volume 14, Number 3, 2014 at 79.
[137] New Zealand, Ministry of Economic Development, *Insolvency Law Review: Tier One Discussion Documents* (Wellington, 2001) 30.
[138] Ibid at 21.
[139] Ibid.
[140] Insolvency Act, Section 36-377B.
[141] New Zealand, Ministry of Economic Development, *Insolvency Law Review: Tier One Discussion Documents* (Wellington, 2001) 21.
[142] Insolvency Act, Sections 325-339.
[143] Ibid Section 340-360.
[144] Keeper op cit note 2 at 80.
[145] Ibid.
[146] Ibid.

insolvent must be less than NZD 12,000.[147] This procedure enabled the debtor to pay his debts in regular instalments.[148] At the same time, they were protected from further legal proceedings as long as the order remained in force.[149] This procedure was also adopted in the new Insolvency Act, but the total debt limit was raised to NZD 40,000.[150]

III. Description of the Different Procedures

(a) Bankruptcy

Bankruptcy is the main procedure for those who cannot pay their debts in New Zealand insolvency law.[151] The term 'bankruptcy' in New Zealand law means the status of a natural person who is declared bankrupt by the High Court at the request of the debtor herself or one of her creditors.[152] Legal persons are not covered by this term.[153] As an entry requirement the debtor must have debts of NZD 1000 or more.[154]

When speaking of bankruptcy the procedure can be described as follows: both the debtor and her creditors can apply for bankruptcy. However, they must apply to different authorities. A creditor applies for bankruptcy at the court,[155] while the debtor does so at the Assignee.[156] According to Section 3 of the Insolvency Act, 'Assignee or Official Assignee means the Official Assignee for New Zealand, the Deputy Official Assignee for New Zealand, and any other Official Assignee or Deputy Assignee appointed under this Act'. In the bankruptcy procedure, all provable debts are included[157] and are usually discharged after three years.[158] According to Section 232(1) of the Insolvency Act 'a provable debt is a debt or liability that the bankrupt owes at the time of adjudication; or after adjudication but before discharge, by reason of an obligation incurred by the bankrupt before adjudication'. However, secured debts are treated differently: The creditors of these debts may realise the property, value it and, in the bankruptcy proceedings prove a claim as an unsecured creditor for any remaining amount due after deduction of the valuation amount.[159] Alternatively the creditors may transfer the property to an Assignee and go bankrupt as an

[147] Ibid.
[148] Keeper op cit note 2 at 81.
[149] Ibid.
[150] Ibid.
[151] Ibid.
[152] Ibid.
[153] Ibid.
[154] Insolvency Act, Section 13.
[155] Ibid Sections 13-15 and 36.
[156] Ibid Sections 45-49.
[157] Ibid Sections 231 and 23.
[158] Coetzee/Roestoff op cit note 37 at 201.
[159] Insolvency Act, Section 234(1).

unsecured creditor for the entire outstanding amount.[160] By the bankruptcy adjudication the entire property of the bankrupt debtor is transferred to the Assignee.[161] In addition, restrictions are imposed on the debtor. These include, for example, a restriction on entering into a business without the Assignee's consent or, under certain circumstances, from travelling abroad.[162] The distribution of the insolvency assets is as follows: according to Section 243 of the Insolvency Act, secured creditors can choose between three different options. First, Section 243(1) (a) of the Insolvency Act states, that 'a creditor may sell property subject to a charge'.[163] According to Section 3 of the Insolvency Act a 'charge includes a right or interest in relation to property owned by a debtor, by virtue of which a creditor of the debtor is entitled to claim payment in priority to other creditors; but does not include a charge under a charging order issued by a court in favour of a judgment creditor'. In other words, the creditor may realise property in which they have a right on the basis of which he may claim preferential satisfaction from other creditors. Second, they can value the property and join the bankruptcy for the outstanding amount after deduction of the valuated amount as an unsecured creditor.[164] The third option is that the creditor assigns the right or interest to the Assignee for the general benefit of the creditors and joins the bankruptcy as an unsecured creditor for the entire debt.[165] In addition, Section 273 of the Insolvency Act regulates the distribution of assets. After that, the Assignee first settles the preferred claims in the order of priority.[166] Then the remaining money is distributed to the general creditors.[167] The claims of the general creditors are equally ranking and to be paid in full.[168] However, if the assets are not sufficient for this, the claims shall be reduced in equal parts.[169] In the event that there is any remaining money, it is paid out to the debtor.[170]

(b) Proposals

Another alternative is the Proposal to pay or satisfy the debts of the insolvent person to the creditors.[171] According to Section 325(1) of the Insolvency Act, 'insolvent means a person who is not bankrupt, but who is unable to pay his or her debts as they become due'. The Proposal may

[160] Ibid.
[161] Coetzee/Roestoff op cit note37 at 201.
[162] Ibid.
[163] Insolvency Act, Section 243(1)(a) of the Insolvency Act.
[164] Ibid Section 243(1)(b).
[165] Ibid Section 243(1)(c).
[166] Ibid Section 273(1).
[167] Ibid Section 273(2).
[168] Ibid Section 280(2).
[169] Ibid.
[170] Ibid Section 273(3).
[171] Ibid Section 326(1).

include one or all of the measures referred to in Section 326(2) of the Insolvency Act. It must also be submitted to the court in the form specified in Section 327 together with a statement of affairs.[172] In addition, the Proposal must appoint a temporary trustee who must convene a creditors' meeting to vote on the Proposal.[173] The majority of creditors and at the same time three quarters in value must accept the Proposal.[174] The Proposal must be filed in court together with a statement of affairs and where possible the statement must contain a security or guarantee.[175] Finally, a court must accept the Proposal, but not before hearing the creditors' objections.[176] By approving the Proposal, the court binds all creditors whose debts are provable and affected.[177] It should also be noted that creditors may not take any enforcement action without the consent of the court.[178] Unlike the insolvent who can cancel a Proposal by filing an application, creditors cannot apply for the debtor's adjudication without the court's consent.[179] Once the application has been approved, the debtor must put the Proposal into effect.[180] Furthermore, the property is administered by a trustee in accordance with the Proposal and the proposal then is given effect to.[181] Under certain circumstances, the Proposal may be amended or cancelled by the court.[182] However, this procedure suffers from some disadvantages: Firstly, the approval of a clear majority of creditors is necessary.[183] Secondly, an application must be filed with the court and no moratorium is required before the court's approval.[184] Finally, the procedure is unsuitable for most debtors with little or no assets, as the threshold of Proposals acceptable to creditors is high.[185]

(c) Summary Instalment Order

The Summary Instalment Order is regulated in Part 5(3) of the Insolvency Act. If a debtor has unsecured debt they have the option to file for a Summary Instalment Order.[186] Since this procedure only involves an application to the Assignee, it is relatively simple and therefore not very cost-

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[172] Coetzee/Roestoff op cit note 37 at 202.
[173] Mike Josling, *Alternatives to Bankruptcy* in Paul Heath and Michael Whale (eds), INSOLVENCY LAW IN NEW ZEALAND, 253-285, 2ed (2014) LexisNexis New Zealand 266.
[174] Insolvency Act, Sections 331-333.
[175] Keeper op cit note 2 at 80.
[176] Insolvency Act, Section 333(2).
[177] Ibid Sections 334–335.
[178] Ibid Sections 335(2) (d), 335(3).
[179] Ibid Sections 335(2), 339.
[180] Ibid Section 336.
[181] Ibid Section 337.
[182] Cotzee/Roestoff op cit note 37 at 202.
[183] David Brown, *The Financial Health Benefits of a Quick "NAP"—New Zealand's Solution to Consumer Insolvency?* (INSOLConference Academic Programme, Vancouver, June 2009) 8.
[184] Ibid.
[185] Ibid.
[186] Insolvency Act, Section 343(1).

intensive.[187] However, a fee of NZD 100 must be paid by the applicant.[188] The debtor then must inform her creditors about the submitted application as soon as possible in order for them to be able to assert their claims.[189] The Assignee then issues a summary instalment order, whereby the repayment period may be up to three years and, under special circumstances up to five years.[190] This order creates the effect that all instalments must be repaid in the prescribed manner.[191] At the same time it is not possible to continue or start proceedings against the debtor without the permission of the Assignee.[192] In this respect Section 352(1) of the Insolvency Act defines the term 'proceedings'. It refers to 'any proceeding against the person or property of the debtor in respect of a debt that has been shown in the debtor's application for the summary instalment order or included in the summary instalment order or notified to the supervisor'.[193] Section 358 of the Insolvency Act then regulates the distribution of instalment payments. This is done in the following order: the administrative costs are paid first. Next on the list are the costs and fees of the Assignee. In third place, the debts are settled and finally any surplus is paid out to the debtor. Furthermore, Section 358(2) of the Insolvency Act provides that the debtor shall be released from her debts if the Assignee has paid in full the amounts referred to in Subsection (1).

(d) The No Asset Procedure

The No Asset Procedure (hereafter NAP) was introduced into New Zealand law by the Insolvency Act 2006. Pursuant to Section 361 of the Insolvency Act, the NAP was developed as a procedure for debtors without realisable assets. The criteria on the basis of which a debtor may file an application for the NAP are outlined in Section 363 of the Insolvency Act. Accordingly, the debtor must not have any realisable assets with the exception of assets which the debtor may retain under Section 158 of the Insolvency Act. In addition, the debtor must not have been previously admitted to the NAP.[194] It is thus an opportunity that is granted only once in a lifetime. Furthermore, the debtor must not already have been declared bankrupt.[195] Also, the applicant's debt must be in the range of NZD 1,000 to 47,000, with student loans being excluded. Finally, the prescribed means test must reveal that the applicant does not have the means to repay the amount of those debts. For this purpose, it is determined whether the debtor has a surplus after the usual and reasonable costs of

[187] Josling op cit note 172 at 275.
[188] Ibid at 276.
[189] Ibid.
[190] Insolvency Act, Section 349.
[191] Ibid Section 351.
[192] Ibid Section 352(2).
[193] Ibid Section 352(1).
[194] Ibid Section 363(1) (b).
[195] Ibid Section 363(1) (c).

living of her household have been paid.[196] This process takes into account the income of the debtor as well as that of any relative living with the debtor.[197] The admission of the debtor to the NAP means that it is not possible for creditors to enforce claims against the debtor which were present at the time of the application and which would have been proven bankrupt.[198]

However, there are also some reasons that imply the debtor's exclusion from the NAP. These can be found in Section 364 of the Insolvency Act. These reasons include the possible concealment of assets with the intention of defrauding creditors, a fraud that would constitute a criminal offence in the event of bankruptcy. It also includes entering into a debt even though the debtor knows that he cannot repay it. Finally, the debtor cannot be admitted to the NAP if a creditor intends to apply for the debtor's bankruptcy and it is more beneficial for the creditor if the debtor goes bankrupt.

The termination of the proceedings is then governed by Section 372 of the Insolvency Act. Thereafter, the proceedings shall end if the Assignee terminates the participation of the debtor for the reasons stated in Section 373 of the Insolvency Act. These reasons include the debtor's wrongful admission to the NAP as well as the Assignee's conviction that the debtor's financial circumstances have changed so as to be able to settle the debt in full. Further reasons for the termination of the proceedings are the debtor's discharge, the debtor's application for her own adjudication or if a creditor who is entitled to do so applies for the debtor's adjudication and the debtor is adjudicated bankrupt.[199] In principle, the debtor is automatically released from her debts after twelve months[200]. However, the Assignee can postpone the discharge by written notice if she needs time to consider whether the debtor's participation in the NAP should be terminated.[201] This written notice must include an alternative date for the discharge, which must not be longer than 25 days later.[202]

Debts that have become unenforceable with the debtor's entry into the NAP are remitted to the debtor upon discharge.[203] Thus they are not obliged to pay any part of these debts nor penalties and interests that may have accrued.[204] However, this does not include liability for fraud or fraudulent conduct or debts and liabilities for which the debtor has obtained forbearance through fraudulent conduct.[205]

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[196] Regulation 66 of the Insolvency (Personal Insolvency) Regulations 2007 of New Zealand.
[197] Ibid.
[198] Insolvency Act, Section 369(1).
[199] Ibid Section 372(b)-(c).
[200] Ibid Section 377(1).
[201] Ibid Section 377(2).
[202] Ibid Section 377(2)(b).
[203] Ibid Section 377A(1).
[204] Ibid.
[205] Ibid Section 377A(2).

IV. Evaluation of New Zealand Insolvency Law

With bankruptcy, proposal, summary instalment order and the NAP, the consumer has four different mechanisms at her disposal in the event of insolvency.

The NAP was developed with the underlying idea of giving people without income a way out of their debts. As the 2011 Ministry of Economic Development Final Report states, the NAP has already provided relief to over 7,000 debtors.[206] In fact, the NAP achieves this goal and enables a fresh start for debtors.[207] Especially for people who have slipped into over-indebtedness through circumstances beyond their control, this mechanism is a major relief that helps them get back on their feet. However, this study also revealed that the NAP is unsuitable for teaching debtors to handle money responsibly in the long term.[208] Intrinsic to this procedure is that it carries the risk of the debtor not learning her lesson. In fact, there are some debtors who accumulate debts of the same amount shortly after a discharge under the NAP.[209] Therefore, consideration should be given to the introduction of a mechanism requiring participants in the NAP to learn how to manage money responsibly, for example through training.

From the creditors' perspective, the NAP offers few advantages. According to the final report of the Ministry of Economic Development, according to initial estimates, the sum of debt relief amounts to NZD 149 million and thus indicates a loss for creditors, which can, however, be compensated by other measures.[210] On the other hand, it is the credit providers' job to screen the insolvency register before a loan is provided and thus ensure that a debtor does not incur substantial debts. The behaviour of some credit providers has also helped to create asset-less debtors by exacerbating the debt problem through reckless lending. For this reason, the report also proposes to provide creditors with guidelines created by the legislator in order to influence the lending practices of the financial sector.[211] Another effect of introducing the NAP is that banks and other credit providers have become more reluctant to grant loans to NAP debtors in the future.[212] However, the long-term effects of this development cannot be foreseen yet.[213]

In summary, it can be said that the NAP can be a relief for debtors. However, this is only applicable if they have learned their lesson.

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[206] New Zealand Ministry of Economic Development, *Evaluation of the No Asset Procedure, Final Report*, July 2011 page 2 (hereafter: report).
[207] Ibid at 2.
[208] Ibid.
[209] https://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11937297 last accessed on 4 December 2019.
[210] Report op cit note 205 at 3.
[211] Ibid at 4.
[212] Ibid.
[213] Ibid.

In Chapter four German insolvency law will be described.

Chapter Four German Consumer Insolvency Law

I. Introduction

As German law is primarily governed by written laws rather than case law, the German insolvency law is mainly regulated in the German Insolvency Act[214]. Nonetheless, there are also some provisions in the Code of Civil Procedure[215]. This chapter is focusing on German consumer insolvency law. It first outlines a few historical key points of German insolvency law and presents the scope of the German entrepreneur and consumer concept (Part II) before it then provides an overview of German consumer insolvency law (Part III). Then the individual steps of the insolvency procedure are explained in more detail in Part IV. Subsequently, the different types of insolvency creditors are described in Part V and the residual debt discharge procedure is explained in more detail (Part VI. Finally, after the outline of the restrictions on enforcement (Part VII) a summary of the most important points of German insolvency law is given (Part VIII).

II. Historical Background

The Insolvency Act came into force on 1 January 1999. With the passing of this law, the coexistence of the Bankruptcy and Settlement Acts[216] was eliminated and a uniform insolvency proceeding was introduced.[217] Prior to this reform, there was no distinction in German law between consumers and entrepreneurs.[218] Under German law, the terms 'consumer' and 'entrepreneur' are defined in Sections 13 and 14 of the Civil Code. According to Section 14(1) of the German Civil Code[219] 'an entrepreneur means a natural or legal person or a partnership with legal personality who or which, when entering into a legal transaction, acts in exercise of his or its trade, business or profession'. In contrast to this 'a consumer means every natural person who enters into a legal transaction for purposes that predominantly are outside his trade, business or profession'.[220] This means that the classification as consumer basically depends on the purpose of the concrete legal transaction. If the contract has a mixed purpose (so called 'dual-use' cases), a consumer transaction

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[214] Insolvenzordnung; English version: www.gesetze-im-internet.de/englisch_inso/ (last accessed 8 November 2018).
[215] Zivilprozessordnung; English version: http://www.gesetze-im-internet.de/englisch_zpo/index.html (last accessed 8 November 2018).
[216] Konkurs- und Vergleichsordnung.
[217] Markus Scheffer, *German Insolvency Law - Nothing More than a Perfect Legal Framework*, 30 Int'l Bus. Law. 461, (2002); Susanne Braun, *German Insolvency Act: Special Provisions of Consumer Insolvency Proceedings and the Discharge of Residual Debts*, 7 German L.J. 59 (2006).
[218] Kilborn op cit note 9 at 262.
[219] Bürgerliches Gesetzbuch, English version: http://www.gesetze-im-internet.de/englisch_bgb/index.html, (last accessed 4 December 2019).
[220] German Civil Code, Section 13.

exists if the component attributable to the self-employed professional or commercial activity does not predominate.[221]

There are also some debatable cases for example a partnership or joint heirship. What these cases have in common, however, is that a consumer can only be a natural person and never a legal person.[222] However, majorities of persons who do not pursue a commercial purpose when concluding the legal transaction are covered by the consumer concept of Section 13 of the German Civil Code.[223] The consumer status is then determined separately for each person.[224] For example, a civil-law partnership[225] may also be a consumer within the meaning of the provision.[226] According to the ruling of the European Court of Justice[227], legal entities cannot in principle be consumers, but the partnership under civil law is not classified as a legal entity in German law.[228] Therefore, the assessment of consumer status depends on the purpose of the partnership. As far as this is not commercial, the partnership acts as a consumer.[229] However, this does not apply if the shareholder of the partnership is a legal entity.[230]

Although the Bankruptcy and Composition Acts also applied to consumers, they did not contain any specific provisions concerning consumers.[231] The Bankruptcy Act contained rules for the liquidation of the debtor's assets and the subsequent distribution of the proceeds among the creditors, whereas, the Settlement Act wanted to give the debtor the opportunity to seek a solution apart from her bankruptcy through negotiations with the creditors and thus save her economic existence.[232] In practice however, these laws were unsuitable for consumer insolvency for several reasons: First of all, although both laws contained rules allowing the consumer to reach an agreement with the creditors, this settlement required the consent of the majority of the creditors who had to own at least 75 percent of the claims.[233] In addition, in most cases the debtor had to

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[221] Peter Bülow, Markus Artz, *Verbraucherprivatrecht*, 6ed (2018) C.F. Müller, Heidelberg, 27 para 58.
[222] Ibid at 37 para 74; *Cape and Idealservice MN RE* C-541/99 (22 November 2012); Claudia Schubert, Christian Armbrüster, Frank Bayreuther, Jan Busche, Dorothee Einsele,. Helmut Grothe, Robert Heine, Lars Leuschner, Hans-W. Micklitz, Roland Rixecker, Franz Jürgen Säcker, Claudia Schubert,. Andreas Spickhoff, Christina Stresemann, Gregor Thüsing,. Birgit Weitemeyer, Harm Peter Westermann, *Münchner Kommentar zum BGB*,. Hans-W. Micklitz (ed), 8ed (2018) C.H. Beck, Munich, § 13 para. 8; BGH NJW 2009, 3780.
[223] Bülow/Arzt op cit note 220 at 37 para 74.
[224] Christian Alexander, *Verbraucherschutzrecht*, (2015) C.H. Beck, Munich, 136 para 37.
[225] Gesellschaft bürgerlichen Rechts (GbR), German Civil Code, Sections 705-740.
[226] Bülow/Artz op cit note 220 at 37 para 75; Alexander op cit note 223 at 36 para 40.
[227] Cape and Idealservice MN RE C-541/99 (22 November 2012).
[228] Bülow/Artz op cit note 220 at 37 para 75.
[229] Ibid at 38 para 76.
[230] Ibid.
[231] Kilborn, op cit note 9 at 262.
[232] Ibid.
[233] Bankruptcy Act, Section 90 (see https://de.wikisource.org/wiki/Konkursordnung (1898) (accessed on 3 December 2019); Settlement Act, Section 74(1)

make a minimum payment of at least 35 percent of all claims.[234] Furthermore, in order to open the proceedings, the debtor's existing assets had to be sufficient to pay the costs of the proceedings, including the court costs and those of the administrator.[235] This, however, meant that more than 75 percent of the cases had to be rejected due to insufficient assets.[236] The crucial problem with the old legislation was that the Bankruptcy Act focused on facilitating enforcement for creditors rather than debtor relief.[237] In other words, there was no remission of unpaid debt at the end of the proceedings. This situation was exacerbated by the fact that every creditor who participated in the proceedings was given a writ of execution against the debtor allowing her to enforce into the debtor's future assets and income at any time during the next thirty years.[238] This led to many consumers remaining indebted for their whole lives and often going into illegal employment.[239]

According to Section 1 of the German Insolvency Act, an important goal is the debt release of the debtor.[240] When the new law had been drafted, the legislator also had in mind to create a unified process that focused on avoiding insolvency through restructuring.[241] Before the Insolvency Act came into force, only small insolvency estates were available.[242] This meant that the creditors received only three to five percent of their claims. Furthermore, three quarters of all insolvency proceedings had to be rejected due to lack of assets.[243] In contrast, the Insolvency Act was to create a legal framework for the confiscation and distribution of debtors' assets.[244] This is done by preventing individual creditors from accessing the insolvency assets ahead of the proceedings.[245] The aim is to increase the size of the insolvency estate so that a larger number of creditors can be satisfied.[246] This new regulation is intended to meet the special needs of consumers.[247] Smaller proceedings, including consumer insolvency proceedings, are more flexible, cheaper and faster than regular insolvency proceedings.[248]

(https://www.rechtsportal.de/Rechtsprechung/Gesetze/Gesetze/Verfahrensrecht/Vergleichsordnung last accessed on 4 December 2019).
[234] Kilborn op cit note 9 at 262.
[235] See Killborn op cit note 9 at 263 with further references.
[236] Ibid at 263.
[237] Ibid at 264 with further references.
[238] Ibid at 264.
[239] Ibid.
[240] See also Scheffer op cit note 216 at 462.
[241] Rolf Stürner, Alexander Bruns, Vuia Mihai, Hans-Gerhard Ganter, *Münchner Kommentar zur Insolvenzordnung* 4ed (2019) C.H. Beck, Munich, § 1, para 51.
[242] Braun op cit note 216 at 59.
[243] Ibid.
[244] Ibid at 60.
[245] Ibid.
[246] Ibid.
[247] Ibid.
[248] Ibid at 62.

III. Overview of the German Insolvency Law

The consumer insolvency proceedings are regulated in Sections 304-314 of the Insolvency Act. In principle, the insolvency proceedings in Germany are as follows: If someone is unable or unwilling to fulfil an existing obligation, her creditors have the opportunity to seek government assistance.[249] This is basically done in two steps. First, the creditors have the opportunity to obtain a title in the main proceedings[250]. Thereafter, this title can be used to enforce foreclosure against the debtor.[251] The corresponding enforcement proceedings are regulated in the Code of Civil Procedure. According to Section 804(2) of the Code of Civil Procedure, the distribution is usually done by the principle of priority, which at its heart means "first come, first served". However, this might lead to a 'race' of creditors, in cases where the assets of the debtor are not enough to meet all liabilities.[252] As a result, few creditors would obtain full satisfaction while the majority would go out empty-handed.[253] In order to prevent this, the principle of joint creditor satisfaction (*par conditio creditorum*) applies in insolvency proceedings according to Section 1 of the Insolvency Act.[254] This means that under state supervision, the existing assets are basically divided evenly among the creditors. It protects, in particular, smaller creditors who do not have the ability to compete within a "creditors' contest".[255]

In German law, there is a special consumer insolvency procedure, which has the purpose to promote the mutual debt settlement in order to relieve the courts and debtors.[256] The main aim is to settle debts by means of a waiver on the part of creditors.[257] The consumer insolvency procedure is divided into three phases: First, the debtor should seek out-of-court debt settlement without filing for bankruptcy.[258] If successful, insolvency proceedings are not necessary.[259] Second, if the debtor's efforts are unsuccessful, he must file for bankruptcy and submit a debt settlement plan.[260] This plan is the basis on which the court itself seeks a consensual debt settlement.[261] The insolvency creditors

[249] Konold, *Prüfungsrelevante Grundlagen der InsO*, JuS 2015, 1067, 1068.
[250] Erkenntnisverfahren.
[251] Konold op cit note 248.
[252] Ibid.
[253] Ibid.
[254] Ibid.
[255] Ibid.
[256] Ulrich Foerste, *Insolvenzrecht*, 7ed (2018) C.H. Beck, Munich, 318 para 633.
[257] Ibid.
[258] Ibid at 319 para 634.
[259] Ibid at 319 para 634; Kilborn op cit note 9 at 272.
[260] Foerste op cit note 255 at 319 para634.
[261] Ibid.

must review their claims indicated in the plan and agree to the plan.[262] If the plan has been approved by all the creditors, it becomes the enforcement order.[263] In this case, the application for insolvency is considered as withdrawn.[264] Finally, if the plan is not approved, the process will result in the formal insolvency proceedings.[265]

IV. The Individual Steps of the Formal Insolvency Proceedings

(a) Written Request

The formal insolvency proceedings begin with a written request. Such can either be provided by the debtor herself (own application) or by a creditor (third party request).[266] Another mandatory requirement for the opening of insolvency proceedings is an opening reason.[267] Such grounds may include insolvency[268] and impending insolvency[269] if the debtor herself applies for the opening of insolvency proceedings.

Next, an insolvency expert checks whether there is an opening reason and whether the assets of the debtor are at least sufficient to cover the costs of the proceedings.[270] Despite the existence of an insolvency reason, the insolvency proceedings can only be opened if their financing is secured.[271] If the debtor's assets are insufficient to cover the costs of the proceedings, the application for opening the insolvency proceedings will be rejected due to a lack of assets, under Section 26(1) Insolvency Act.[272] The consequence of the failure to open insolvency proceedings is that the debtor retains her freedom of disposal.[273] However, the creditors still have the option of individual enforcement.[274] Another consequence is that there is no debt relief.[275]

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[262] Ibid.
[263] Ibid.
[264] Ibid.
[265] Braun, op cit note 216 at 63; Foerste op cit note 255 at 319 para 634.
[266] Insolvency Act, Section 13(1) (2).
[267] Ibid Section 16.
[268] Ibid Section 17(2): Inability to pay exists if the debtor is unable to meet the due payment obligations.
[269] Ibid Section 18(2): Impending insolvency occurs when the debtor is unlikely to be able to meet the existing payment obligations at maturity.
[270] Konold op cit note 248.
[271] Foerste op cit note 255 at 71 para 120.
[272] Ibid at 72 para 123; Braun op cit note 216 at 61.
[273] Foerste op cit note 255 at 72 para 124.
[274] Ibid.
[275] Kilborn op cit note 9 at 279.

(b) Transition of Administrative and Disposition Rights

The opening of insolvency proceedings results in the debtor losing the right to manage and sell her pledged assets.[276] Instead, this right is transferred to a court appointed trustee.[277] In addition, the debtor is obliged to cooperate with the trustee and to provide her with the necessary information.[278] From the opening of bankruptcy proceedings to their termination, the trustee has full control over all assets of the debtor and also has all decision rights.[279] The trustee's powers include the right to reverse transactions, which took place before bankruptcy or during provisional insolvency proceedings and could therefore disadvantage creditors.[280] This is intended to prevent the insolvency assets from being harmed by the debtor's actions and to prevent the creditor from favouring certain creditors.[281] The rules contained in the Insolvency Code are rather unspecified and broad in the way that they give the trustee the right to challenge such transactions for a period of up to ten years before the start of the proceedings.[282]

(c) Prohibition of individual enforcement

From this date at the latest, the insolvency creditors are prohibited from accessing the debtor's assets by way of individual enforcement.[283] The thereby intended protection of the insolvency assets is additionally extended by the so-called non-return barrier of Section 88 of the Insolvency Act which states:

> 'If in the last month before the application for the opening of the insolvency proceedings or following this application, a bankruptcy creditor has secured by way of foreclosure a security on the assets belonging to the debtor, belonging to the insolvency estate, this security becomes ineffective with the opening of the proceedings'.

According to this provision, the idea of *par conditio creditorum*[284] is brought forward to the crisis period prior to insolvency.[285] This is done by automatically declaring securities which are obtained

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[276] Insolvency Act, Section 80(1).
[277] Ibid Section 80(1).
[278] Ibid Section 97.
[279] Andreas Dimmling, Sandra Krepler, *German Insolvency Law Has Become More Creditor Friendly but the Federal Tax Court Puts Restructurings at Risk,* 11 Insolvency & Restructuring Int'l 30 (2017).
[280] Ibid.
[281] Ibid.
[282] Ibid.
[283] Insolvency Act, Section 89.
[284] Ibid Section 1.
[285] Diederich Eckardt in *Insolvenzrechtshandbuch,* Jens Adolphsen (ed), Peter Gottwald (publisher), 5ed (2015) 5ed (2015) C.H. Beck, Munich, § 33 para 51.

by compulsory execution in the last month prior to the filing of the insolvency application or thereafter invalid upon the opening of the proceedings.[286]

V. Types of insolvency creditors

There is a total of six different types of creditors. The insolvency risk they have to bear depends on their position and consequently on their prospects of satisfaction.[287]

(a) Creditors with a Prospect of Complete Satisfaction

In principle, there are two types of creditors with a prospect of complete satisfaction, the mass-creditors and the secured creditors who are entitled to exemption and segregation.

(i) Mass Creditors

The claims of the former are called mass liabilities and are primarily satisfied from the mass according to Section 53 of the Insolvency Act. The mass creditors are excluded from the principle of equal treatment of creditors.[288] They rank before the insolvency creditors and are therefore satisfied in advance.[289] However, only the costs of the insolvency proceedings and other mass liabilities[290] are included in the mass claims.[291] The reason for this privileged treatment is that an orderly settlement of the insolvency proceedings should be rendered possible.[292]

(ii) Secured Creditors

According to Section 47 of the Insolvency Act, secured creditors are entitled to separation and therefore may demand the surrender of certain objects in which they have a right in *rem* or a personal right, for example in accordance with Section 985 of the German Civil Code outside the insolvency proceedings.

The right to separation corresponds to the enforcement action of third parties (Section 771 of the Code of Civil Procedure).[293] In this way, non-debtor assets are protected.

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[286] Ibid.
[287] Konold op cit note 248 at 1070.
[288] Foerste op cit note 255 at 41 para 75.
[289] Ibid.
[290] Debts arising on the occasion of or during insolvency proceedings.
[291] Foerste op cit note 255 at 41 para 75.
[292] Ibid.
[293] Ibid.

(iii) Creditor entitled to separate satisfaction

In contrast, a person entitled to separate satisfaction[294] has a right to preferential satisfaction from certain assets.[295] The trustee is entitled to the valuation of these rights, which are asserted outside the insolvency proceedings.[296] Consequently, the right of separation corresponds to the action for preferential satisfaction in individual enforcement.[297]

(b) Insolvency Creditors within the Meaning of Section 38 of the Insolvency Act

Insolvency creditors within the meaning of Section 38 of the Insolvency Act are all creditors who have a justified but unsecured claim without statutory preference (so-called concurrent creditors) against the debtor at the time of the insolvency proceedings' opening.[298] These insolvency creditors may only assert their claims with the trustee.[299] The trustee reviews the claims which are asserted.[300] Undisputed claims are established and participate in the distribution.[301] The distribution is made proportionately according to the so-called insolvency dividend, which is usually around 2-5 percent.[302]

(c) Lower-Ranking Insolvency Creditors

In addition, there are the sub-ordinate insolvency creditors[303] who can only assert their claims in exceptional cases and are therefore generally left empty-handed.[304] This constitutes a restriction of the principle of equal treatment of creditors, in that this group of creditors will not be satisfied until the claims of the creditors of the insolvency proceedings have been satisfied.[305]

(d) New Creditors

Despite the pending insolvency proceedings it is still possible for the debtor to contract with an unknowing contract party, since the opening of the insolvency proceedings only prevents the debtor to exercise dispositions.[306] These new creditors can neither participate in insolvency proceedings

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[294] Insolvency Act, Sections 49–52.
[295] Konold op cit note 248 at 1070.
[296] Ibid.
[297] Code of Civil Procedure Section 805.
[298] Konold op cit not 248 at 1070.
[299] Ibid.
[300] Ibid.
[301] Ibid.
[302] Ibid.
[303] Insolvency Act, Section 39.
[304] Konold op cit note248 at 1070.
[305] Foerste op cit note 255 at 37 para 65.
[306] Ibid at 35 para 60.

nor access the debtor's assets outside of insolvency proceedings.[307] Instead they have to wait until the insolvency proceedings have been finished respectively until the residual debt exemption proceedings have been finished.[308]

VI. The Residual-Debt Exemption Proceedings

(a) The Process of the Residual Debt Exemption Procedure

The residual debt exemption procedure, which was originally unknown to German law, was established with the 1999 law reform. At the beginning debtors, however, were reluctant to submit a file for consumer insolvency proceedings.[309] The reason for this was that such proceedings are only initiated if the debtor's assets cover the costs of the proceedings.[310] If this is not the case, Section 26(1) of the Insolvency Act stipulates that the court must reject the application. In principle, poor parties can apply for legal aid.[311] Yet, this does not apply to insolvency proceedings.[312] Section 4a of the Insolvency Act was only introduced in 2001. According to this provision, the costs of the residual debt discharge procedure can be deferred if the debtor's assets are not sufficient at the time of the application's filing. As a result of this possibility, the number of applications for a residual debt exemption procedure increased by 61.5 percent.[313] The residual debt exemption procedure takes both social and economic aspects into account: First of all, the general personal right, i.e. its right to privacy and dignity, is protected.[314] In addition, the debtor is to be reintegrated into economic life, thus preventing illegal employment.[315]

It should be noted that the claims of the creditors in the insolvency proceedings only expire to the extent that they are being distributed, for example in the amount of the insolvency rate.[316] For the remaining debts, the debtor will continue to be liable even after the termination of the insolvency proceedings. However, there is the possibility for the debtor to undergo the residual debt exemption proceedings following the insolvency proceedings.[317] The residual debt exemption proceeding terminates the debtor's subsequent liability under Section 201(1) of the Insolvency Act

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[307] Ibid.
[308] Ibid 36 para 60.
[309] Dörte Busch, *Current Reform Effects of German Consumer Insolvency Law and the Discharge of Residual Debts*, 7 German L.J. 591 (2006), 592.
[310] Ibid.
[311] Ibid.
[312] Ibid.
[313] Ibid.
[314] Busch op cit note 308 at 591.
[315] Ibid.
[316] Foerste op cit note 255 at 11 para 15.
[317] Ibid.

with its future assets.[318] This procedure is, in principle, a compromise between the debt-relief of insolvent persons and the legitimate expectations of creditors in the fulfilment of their claims.[319] Its aim is to enable the debtor to regain her economic freedom instead of having to live permanently on her non-remunerated income.[320] As a result of the granting of the proceeding, the debtor is exempted from the liabilities to the insolvency creditors that are not fulfilled in the insolvency proceedings and in the residual debt relief proceedings.[321] Furthermore, these proceedings should reduce the number of over-indebted households from a social and financial perspective.[322]

The debtor must apply separately for the residual debt exemption procedure.[323] In addition, the application must be accompanied by a declaration in which the debtor conveys all seizable claims for remuneration from an employment relationship or comparable remuneration for a period of six years after the opening of the proceedings to a trustee.[324] The obligations of the debtor during the term of so-called 'good behaviour' period[325] are regulated in Section 295 of the Insolvency Act. For instance, the debtor must do her best to satisfy her creditors as much as possible with her seizable income. To do so, the trustee distributes the received amounts to the insolvency creditors on a pro rata basis each year after the deduction of the costs of the proceedings.[326] Furthermore, according to Section 295(1) No. 1 of the Insolvency Act, the debtor must perform appropriate gainful employment. In addition, in the event of unemployment, the debtor must seek a new job and must not refuse any reasonable employment.[327] 'Reasonable' in this sense also means that the debtor may have to take up an activity outside her job.[328] After the expiry of the good behaviour period, the court grants the remaining debt exemption on the condition that there are no grounds for refusal.[329] As a result, all claims of the insolvency creditors that have not been met by then will expire.[330] According to Section 300(1) of the Insolvency Act, it is also possible for the court to decide prematurely on the exemption from residual debt upon application. This is the case if the experience costs are covered and no claims have been filed or all claims have been satisfied.[331] It can either

[318] Heinz Vallender, *Restschuldbefreiung*, JuS 2004, 665.
[319] Ibid.
[320] Ibid at 666 and 667 with further references.
[321] Ibid.
[322] Foerste op cit note 255.
[323] Konold op cit note 248 at 1071.
[324] Ibid.
[325] Wohlverhaltensperiode.
[326] Insolvency Act, Section 292(1).
[327] Insolvency Act, Section 295 (1).
[328] *Gesetzesentwurf der Bundesregierung: Entwurf einer Insolvenzordnung* Bundesrats-Drucksache 1/92 at 192.
[329] Insolvency Act Section 300.
[330] Ibid Section 301(1)(1).
[331] Konold op cit note 247 at 1071.

happen at any time or three years after the transfer of all seizable claims to the trustee, if at least 35 percent of the claims have been satisfied by then (in addition to the costs).[332]

(b) Refusal of Debt Exemption

In addition to the provisions governing the process of the residual debt exemption procedure, the Insolvency Act also contains reasons for the refusal of residual debt exemption. What all these provisions have in common is that they have their origin in the regulation that only an honest debtor should get the opportunity of debt relief.[333] These are circumstances relating to criminal offences and dishonest conduct.[334] As a rule, these grounds for refusal are only taken into account at the request of a creditor of the insolvency proceedings.[335]

VII. Debtor Protection – Restrictions on Enforcement

However, German law does not allow unrestricted enforcement in the assets of the debtor. Especially the protection of debtors in the seizure of claims, such as earned income, is important.[336] In principle, the debtor's income from work is one of the most important objects of enforcement.[337] On the other hand, the debtor needs her earned income to pay her living expenses. For this reason, creditors are not permitted to seize the debtor's entire income.[338] Further reasons are that the debtor would lose the interest to work and would become a burden to the general public.[339] Therefore, the amount that the debtor needs for living is generally excluded from the right of execution.[340] The relevant provisions can be found in the Code of Civil Procedure.[341] Income from employment within the meaning of Section 850 of the Code of Civil Procedure is defined as 'recurrently payable remuneration for employment'.[342] According to a decision of the Federal Labour Court, social compensation also forms a part of earned income.[343] The earned income can only be seized under consideration of the so-called seizure exemption limit.[344] In order to determine an appropriate amount that cannot be seized, the circumstances of the individual case must be taken into

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[332] Ibid.
[333] Vallender op cit note 317 at 667.
[334] Insolvency Act, Section 297(1).
[335] Ibid Section 297(1).
[336] Wolfgang Lüke, *Zivilprozessrecht*, 10ed (2011) C.H. Beck, Munich, 558 para 636.
[337] Ibid.
[338] Code of Civil Procedure, Section 850(1).
[339] Lüke op cit note 335.
[340] Code of Civil Procedure Section 850c.
[341] Ibid Sections 850-850i.
[342] Lüke op cit note 335 at 559 para 638.
[343] BAG NZA 1992, 384.
[344] Lüke op cit note 335 at 559. para 638.

account.[345] These include the amount of the debtor's income, the number of her dependents and the legal nature of the claim to be enforced.[346] According to Section 811(1) of the Code of Civil Procedure 'objects for personal use or household use in so far as the debtor requires them for modest living and housekeeping commensurate with her professional activity and her indebtedness' are excluded from enforcement. Furthermore, objects which the debtor needs for her employment, as well as pets may not be seized.[347] However, this is not fully guaranteed. Rather, Sections 811a and 811b regulate the so-called 'exchange garnishment', according to which one item can be exchanged for a less valuable similar item. For example, a colour television can be replaced by a black and white television.[348]

VIII. Conclusion

In summary, it can be stated that the key aspects of German consumer insolvency law are the principle of joint creditor satisfaction and the residual debt discharge procedure. In addition, German insolvency law also provides a mechanism to prevent insolvency proceedings by giving priority to out-of-court settlement. It is indeed a crucial aim to enable the debtor to be released from debt and to reintegrate her into society. However, the debtor must earn this privilege during the period of good conduct. This period is relatively long with a duration of six years and therefore poses a certain challenge to the debtor. Yet this is precisely how the different interests of debtors and creditors are balanced. Furthermore, the debtor also retains the amount of her salary that falls under the attachment exemption limit. She thus receives an amount that is necessary to finance her living expenses. In conclusion, it can be said that German law seeks to balance the various interests as fairly as possible, through the protective mechanisms for the debtor described above and the relatively long repayment of debts during the period of good conduct, while at the same time enabling the debtor to return to a normal, debt-free life.

In the following chapter South African insolvency law will be described.

[345] Ibid at 558, para 636.
[346] Ibid.
[347] Code of Civil Procedure Sections 811 (10) (5) and 811c.
[348] Example taken from Kilborn op cit note 9 at 265.

Chapter Five South African Consumer Insolvency Law

I. Introduction

This chapter deals with consumer insolvency law in South Africa. A notable feature of South African law as a whole is that it comprises various sources of law. These range from codified laws through case law and common law to customs and indigenous law.[349] This variety of legal sources can also be found in South African insolvency law. The main statute of South African insolvency law is the Insolvency Act 24 of 1936 (hereafter Insolvency Act), though not the only one.[350] Other important laws are the Magistrates Court Act 32 of 1944 (hereafter MCA) and the National Credit Act 34 of 2005 (hereafter NCA). In addition, there are some laws concerning the insolvency of companies.[351] Furthermore, decisions of the high courts, for example the Constitutional Court of South Africa and common law principles must be taken into account.[352] The South African Constitution also plays an important role, as it is the highest law of the South African legal system and thus sets the norm to be met by all other laws.[353] In the area of insolvency law, various fundamental rights are affected,[354] which results in the fact that several insolvency regulations are subject to the scrutiny of the Constitutional Court but also lower ranking courts.[355]

Unlike most legal systems, South African insolvency law does not primarily aim at releasing the debtor from her liabilities.[356] Instead, the main objective of the South African Insolvency Act is the orderly and fair distribution of the debtor's assets.[357] This objective comes to the fore especially when the debtor's assets are not sufficient to satisfy all her liabilities towards creditors.[358] A decisive element of South African insolvency law is its creditor friendliness.[359] While the global trend tends to support insolvent consumer debtors through debt relief, the requirements for South

[349] http://www.justice.gov.za/policy/african%20charter/afr-charter02.html (last accessed on 28 November 2019).
[350] Herbert Walter Mars, Eberhard Berteslmann, Chris Nagel, Roger G. Evans, Adam Harris, Michelle Kelly-Louw, Anneli Loubser, Melanie Roestoff, Alastair Smith, Leonie Stander, Lee Steyn, *The Law of Insolvency in South Africa,* 9ed (2008) Juta, Cape Town at 16.
[351] The Companies Act 61 of 1973 and the Close Corporations Act 69 of 1984.
[352] Mars et al op cit note 349 at 16.
[353] Robert Sharrock, Kathleen Van der Linde, Alastair Smith, Harold Edward Hockly, Hockly´s Insolvency Law, 9ed (2012) Juta, Cape Town at 13.
[354] Such as the right to equality (Section 9); the right to freedom and security of the person (Section 12); the right to privacy (Section 14); the right to property (Section 25).
[355] Sharrock et al op cit note 352 at 13.
[356] Coetzee/Roestoff op cit note 37.
[357] Ibid at 193.
[358] Insolvency Act, Section 3(1); Coetzee/Roestoff op cit note 37 at 193; Mars et al op cit note 349 at 48.
[359] Coetzee/Roestoff op cit note 37.

African debt relief although they exist, can hardly be met. [360]The majority of the debtors concerned belong to the 'No Income No Assets' group, the so-called NINA debtors.[361]

Part II of this chapter discusses the history of South African insolvency law, its roots in Roman law and the elements which are still part of today's insolvency law. Special attention is drawn to the latest developments in South African insolvency law. After an overview of South African insolvency law (Part III), the individual requirements of the insolvency proceedings are explained in more detail (Part IV). Finally, the last part summarises the most important aspects of South African insolvency law.

II. History of South African Insolvency Law

(a) Early History and Overview over the Laws currently in Force

Although consumer insolvency law is often seen as a new achievement, the history of South African law can be traced back to Roman law.[362] One of the first forms of consumer protection was probably the *ultra duplum* rule, according to which arrears and interest could not exceed the original loan amount.[363] This rule is still valid today in South Africa in that it was initially not only an integral part of South African jurisprudence but was also finally incorporated in the NCA.[364]

The Insolvency Act 24 of 1936, still in force today, replaced Insolvency Act 32 of 1916 in 1936, which in turn had replaced statutory law in 1916.[365] It is important to point out that the Insolvency Act of 1936 is not a codification of the common law of insolvency, although the latter with some modifications, forms the basis of the Insolvency Act.[366] This means that the common law of insolvency applies in addition to the Insolvency Act to the extent that it has not been amended or invalidated by the Act.[367] In other words common law is always used as a complementary measure if the Insolvency Act does not contain any regulations.[368]

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[360] Ibid.
[361] Ibid..
[362] Otto op cit note 1 at 257-258.
[363] Jannie Otto, Renee-Louise Otto *The National Credit Act Explained* (2007) LexisNexis South Africa para 373; Otto op cit note 1 at 258.
[364] Otto op cit note 1at 258.
[365] Ibid.
[366] *Du Plessis & another NNO v Rolfes Ltd* 1997 (2) SA 354 (A) 363; *Fey NO and Whiteford NO v Serfotein and* Another 1993 (2) SA 605 (A) at 613B--I; *Millman NO v Twiggs and Another* 1995 (3) SA 674 (A) at 679H--680B; *Janse van Rensburg v Muller* 1996 (2) SA 557 (A) at 562G--H ([1996] 1 B All SA 353 at 356h—i.
[367] Ibid.
[368] Mars et al op cit note 349 at 13 with further references.

(b) The National Credit Act 34 of 2005

With the passing of the NCA, the Credit Agreements Act 75 of 1980 and Usury Act 73 of 1968 were revoked.[369] The Usury Act aimed at protecting credit receivers from excessive interest rates by regulating the financial aspects of money lending agreements, lease agreements on movable assets, rendering of services and the sale of movable goods.[370] Whereas the Credit Agreements Act regulated the contractual aspects of credit agreements that is for example the written format and the deposit it required.[371] Although these laws should have complemented each other, their areas of application overlapped, thus causing various problems in the area of consumer credit law.[372] These problems mainly existed due to the fact that these laws regulated credit agreements in a complicated and ineffective way.[373]

The aim of the NCA is to solve problems of the consumer credit market, such as prohibition of reckless lending by credit providers, the prevention and alleviation of the over-indebtedness of consumers, and the prevention of the high costs of credit.[374] This will be achieved, inter alia, through the establishment of the National Credit Regulator (hereafter NCR) and the National Consumer Tribunal (hereafter Tribunal).[375] The law requires credit providers, credit bureaus and debt counsellors to register with the NCR.[376] In addition, the law also sets limits for interest rates and other (non-interest) credit costs.[377] Another objective of the NCA is to provide debt relief for consumers.[378] Yet, similarly to the Insolvency Act, the NCA does not intend to achieve this goal by discharging consumer debt.[379] Rather, this goal is to be achieved by restructuring debt.[380]

(c) The National Credit Amendment Act

According to the Memorandum on the Objects of the National Credit Amendment Bill (hereafter Memorandum) which was published in the *Government Gazette* by the Portfolio Committee on Trade and Industry (hereafter Committee) on 24 November 2017 together with the National Credit Amendment Bill, there were 24.68 million credit-active consumers in South Africa in March 2017.

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[369] Kelly-Louw *Prevention* op cit note 16 at 201.
[370] Bamu et al op cit note 32 ar 36.
[371] Otto op cit note 1 at 266; Kelly-Louw *Prevention* op cit note 16 at 201 and 203.
[372] Kelly-Louw *Prevention* op cit note 16 at 203; Otto op cit note 1 at 266.
[373] Kelly-Louw *Regulation* op cit note 18 at 12.
[374] Kelly-Louw *Prevention* op cit note 16 at 201.
[375] Ibid.
[376] Ibid.
[377] Ibid.
[378] NCA, Section 3(g).
[379] *Collette v Firstrand Bank Ltd* (2011) 4 SA (SCA) 508, 514; Coetzee/Roestoff op cit note 37 at 197.
[380] Ibid.

Roughly 40 percent (9.69 million) of these consumers were in a state in which they could be described as over-indebted.[381] In the Memorandum, the Committee furthermore acknowledges that existing insolvency mechanisms do not adequately address the group of debtors with little or no income and assets and thus there is a need for a specific insolvency procedure tailored to that group.[382] These considerations were the reason for establishing the debt intervention regulated in the National Credit Amendment Act (hereafter Act). Furthermore, the Act introduces mechanisms to protect consumers, such as mandatory registration for credit providers.[383] Failure to register is considered to be a criminal offence.[384] Also, a debt counsellor will be required to always scrutinise a credit agreement for being reckless and not only do so at the request of the consumer. [385]

III. The Insolvency Procedures of South African Insolvency Law

Over-indebted consumers in South Africa currently have three alternatives for debt relief. Initially, there is sequestration under the Insolvency Act. This method is the only one under which debts are discharged.[386] However, the sequestration does not aim at the discharge.[387] Instead, the latter is merely an accompanying effect.[388] Furthermore, there is the administrative procedure under Section 74 of the Magistrate's Courts Act 32 of 1944 and the debt review under Section 86 of the NCA.

(a) Sequestration under the Insolvency Act

In South African Law there are two ways of sequestrating a debtor's estate: the voluntary surrender where the debtor herself applies to the court and the compulsory surrender where a creditor or creditors apply to the court.[389] Both procedures differ in their processing and the necessary prerequisites.[390] The granting of sequestration order by the court means that the debtor loses the right of disposal over his assets.[391]

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[381] Memorandum page 1.
[382] Memorandum page 1.
[383] Act, Section 157C.
[384] Ibid.
[385] Ibid Section 86.
[386] Insolvency Act, Section 129(1)(b).
[387] See also *Ex parte Ford and Two Similar cases* (2009) 3 SA (WCC) 376; Coetzee/Roestoff op cit note 37.
[388] Ibid.
[389] Sharrock et al op cit note 352 at 17.
[390] Ibid.
[391] Mars et al op cit note 349 at 16.

(i) Voluntary Surrender

a) Requirements

The conditions for the court to accept the voluntary surrender are the following: first, the debtor's estate must be insolvent.[392] Furthermore, she must have sufficient assets to cover the costs of enforcement.[393] Finally, enforcement must also be to the creditors' advantage.[394]

i) Insolvency of Debtors Estate

The term 'insolvent' is defined in Section 2 of the Insolvency Act as 'a debtor whose estate is under sequestration and includes such a debtor before the sequestration of his estate, according to the context'. An 'insolvent estate' means 'an estate under sequestration'[395] However, there is no definition of the term 'insolvency'. Although 'insolvency' is commonly understood as being unable to pay ones debts, this definition is not accurate from a legal point of view.[396] Instead, the question must be asked 'whether the debtor's liabilities, fairly estimated, exceed his assets, fairly valued' (insolvency test).[397] However, it should be noted that the inability to pay debts does not necessarily indicate insolvency.[398] Rather, proof of insolvency is only an appearance by which the burden of proof that the assets are higher than the liabilities passes to the debtor.[399] Even if a person with insufficient assets passes the insolvency test, he will not be treated as insolvent from the legal point of view unless there is a court order for sequestration.[400] This order is defined as 'any order of Court whereby an estate is sequestrated and includes a provisional order, when it has not been set aside'[401] and it constitutes the formal declaration that the debtor is insolvent.[402] The term 'insolvent' can be used to describe both: the debtor herself and also her estate.[403] It has two different meanings when used to describe the debtor. On the one hand, it may mean that the debtor's assets have been sequestrated.[404] On the other hand, it also includes debtors whose liabilities exceed her assets but whose estate is not yet sequestrated.[405]

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[392] Sharrock et al op cit note 352 at 18.
[393] Ibid.
[394] Ibid.
[395] Insolvency Act, Section 2.
[396] Sharrock et al op cit note 352 at 3.
[397] *Venter v Volkskas Ltd* 1973 (3) SA 175 (T) 179; *Ex parte Harmse* 2005 (1) SA 323 (N) 325.
[398] Mars et al op cit note 349 at 2; Cf *Corner Shop (Pty) Ltd v Moodley* 1950 (4) SA 55 (T) at 60.
[399] *Mackay v Cahi* 1962(4) SA 193 (O) 194, 195 and 204; *ABSA v Rhebokskloof (Pty) Ltd* and others 1993 (4) SA 436 (C) 443.
[400] Sharrock et al op cit note 352 at 3.
[401] Insolvency Act, Section 2.
[402] Sharrock et al op cit note 352 at 3.
[403] Ibid.
[404] Insolvency Act, Section 2.
[405] Ibid.

The debtor must prepare and submit a statement of affairs to determine her assets and liabilities.[406] However, the court is not bound by this statement.[407] Consequently, it may also conclude that the debtor is insolvent even though her liabilities do not exceed her assets.[408] According to the test applied by the court, the question is whether it is established that the debtor does not have enough money to pay his debts in full and whether it is impossible for the assets to yield enough for this purpose.[409]

ii) Costs of Sequestration are covered by estate

Another condition of voluntary surrender is that the debtor has sufficient realisable assets to cover all the costs of the sequestration.[410] These are, according to the law, to be paid out of the free residue of her assets.[411] In this context, 'free residue' means 'means that portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothec, pledge or right of retention'.[412] According to Article 97 of the Insolvency Act, the costs of sequestration include both the costs of surrender and the costs of administration. Furthermore, Section 2 of the Insolvency Act states that free residue 'in relation to an insolvent estate, means that portion of the estate which is not subject to any right of preference by reason of any special mortgage, legal hypothec, pledge or right of retention'.

Conversely, it can be concluded from the requirement of sufficient assets that no voluntary surrender is possible in the case of insufficient assets.[413] However, this does not mean that no seizure will take place in this case. Rather, assets which consist only of liabilities can be subject to compulsory sequestration.[414] If the costs of sequestration are obviously not covered by the free residue, the court must reject the application for sequestration.[415] The lack of assets cannot be compensated by a guarantee, as it does not create real assets for the debtor.[416] The situation is quite different, however, if it is not clear whether the debtor's assets are sufficient to pay the costs of sequestration. In this case, the application may be accepted by the court as a guarantee removes the uncertainty about the existence of assets.[417]

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[406] *Ex parte Van den Berg* 1962 (4) SA 402 (O) 404.
[407] Ibid.
[408] Ibid.
[409] *Ex parte Harmse* 2005 (1) SA 323 (N) 326.
[410] Sharrock et al op cit note 352 at 18.
[411] Ibid.
[412] Insolvency Act, Section 2.
[413] Sharrock et al op cit note 352 at 19.
[414] *Miller v Janks* 1944 TPD 127.
[415] *Ex parte Swanepoel* 1975 (2) SA 367 (O).
[416] *Ex Parte Theron* 1923 OPD 46.
[417] *Mindel v Share* 1937 TPD 378; Sharrock et al op cit note 352 at 19.

iii) The Sequestration must be to the Advantage of the Creditors

A further criterion for sequestration is that the sequestration must be to the advantage of the creditors. This is one of the main criteria of the Insolvency Act and has been enshrined in insolvency law since 1916.[418] Before the court can confirm a sequestration order, it must be ensured that the debtor's creditors benefit from the sequestration of her estate.[419] In this context 'to the advantage of the creditors' means 'the advantage of all creditors or at least the general body of creditors'.[420] In determining whether there is an advantage for the creditors, the court often takes the creditors' view as a basis, in particular whether they want the sequestration, since it assumes that they know what is to their advantage.[421] Furthermore, it must be to the advantage of a significant number of creditors in relation to the value of their claims.[422]

b) Application of Surrender

In order to submit an application of surrender to court, the debtor must submit a notice of motion and an affidavit.[423] The content of the affidavit must be facts which give reason to the court to issue a sequestration order.[424]

(ii) Compulsory Surrender

Another method of sequestration is that of compulsory surrender, which is carried out by the creditors. In order for the court to issue an order for sequestration, the following preconditions must be met: Firstly, the applicant creditor must be entitled to a claim giving her a right of sequestration under Section 9 of the Insolvency Act.[425] Secondly, the debtor must be insolvent or have committed an Act of Insolvency within the meaning of Section 8 of the Insolvency Act.[426] Finally, there must also be a reason to believe that the sequestration is for the creditor's advantage.[427] In the case of compulsory sequestration, the burden of proof for the existence of these three conditions remains

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[418] Coetzee/Roestoff op cit note 37 at 193.
[419] Insolvency Act, Section 12(1)(c); *Ex parte Vane* 1956 (4) SA 616 (O); *Ex parte Swanepoel* 1975 (2) SA 367 (O); *Ex parte Henning* 1981 (3) SA 843 (O) 847.
[420] *Lotzof v Raubenheimer* 1959 (1) SA 90 (O) 94; *Stainer v Estate Bukes,* 1933 OPD 86; *Amod v Khan* 1947 (1) SA 150 N.
[421] *In re Deare* 17 NLR 94; *Ex parte Gardner* 1927 CPD 452; *Whittle v Whittle* 1933 EDL 331; Mars et al op cit note 349 at 75.
[422] *Trust Wholesalers and Woollens (Pty) Ltd v Mackan* 1954 (2) SA 109 (N) 111.
[423] Sharrock et al op cit note 352 at 27.
[424] Ibid at 48.
[425] Ibid at 33.
[426] Ibid.
[427] Ibid.

with the creditor.[428] It is precisely the proof of the second condition that will typically cause the creditor difficulties.[429] To address this problem, Section 8 of the Insolvency Act provides for acts and omissions which enable the creditor, if the debtor commits them, not to having to prove her actual insolvency.[430]

(iii) The Effects of the Sequestration Order

The sequestration order results in a *concursus creditorum*.[431] Also, the individual creditors lose their rights in favour of the creditors as a group.[432] In other words, an individual creditor can no longer take any further measures affecting the other creditors' rights.[433] Furthermore, the sequestration order also concerns other matters, such as incomplete contracts, liens and set-off.[434] The bankrupt has no express right to apply for the release of his assets, but if he provides sufficient security, the sheriff must release the assets.[435]

The effects of sequestration order are set out in Section 20 of the Insolvency Act. For example, the debtor is divested of her assets and these are temporarily transferred to the master before being transferred to the trustee.[436]

(iv) Realisation and Distribution of the Assets

The trustee's responsibility is to liquidate the insolvency assets for the creditors' benefit.[437] This also includes the realisation of any of the spouse's assets to which the trustee is entitled.[438] The realisation of the property is carried out according to the manner and conditions which the creditors instruct the trustee.[439] If the creditors have not given instructions to the trustee after the second meeting, the realisation of the property takes place by public auction.[440] There are three different types of creditors: preferent, secured and concurrent creditors. According to Section 2 of the Insolvency Act, 'preference' is defined as means 'the right to payment of that claim out of the assets

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[428] *Braithwaite v Gilbert (Volkskas Bpk intervening)* 1984 (4) SA 717 (W) 718.
[429] *De Villiers NO v Maursen Properties (Pty) Ltd* 1983 (4) SA 670 (T) 676.
[430] Ibid.
[431] Coetzee/Roestoff op cit note 37 at 193; *Walker v Syfret* [1911] AD 141 at 166; Mars et al op cit note 349 at 2.
[432] Ibid.
[433] *Walker v Syfret* NO 1911 AD 141 at 160; Mars et al op cit note 349 at 171.
[434] Mars et al op cit note 349 at 171.
[435] Ibid at 172.
[436] Insolvency Act, Section 20(1)(a).
[437] Sharrock et al op cit note 352 at 173.
[438] Ibid.
[439] Insolvency Act, Section 82(1).
[440] Ibid.

of the estate in preference to other claims'. In other words, it means that a preferent creditor is paid before the other creditors. Although a secured creditor in the general sense is also a preferent creditor, the term preferent creditor is commonly used for creditors with unsecured claims but who yet have priority over concurrent creditors.[441] Claims which enjoy preferential treatment are those listed in Section 96 to 102 of the Insolvency Act. These include funeral and death-bed expenses[442], costs of sequestration[443], costs of execution[444], salary or renumeration of former employees of the insolvent[445], statutory obligations[446], income tax[447] and claims arising out of general bonds[448]. Yet some of these categories are subject to statutory limitations.[449] For any amount that exceeds the threshold, the creditors may join the concurrent creditors.[450] Secured creditors on the other hand are those who have a right to a property belonging to the insolvency assets on the basis of a special mortgage, a landlord's legal hypothec, a pledge or a right to retention.[451] Additionally, secured creditors have a claim as a concurrent creditor on the outstanding amount to the extent their claim has not been satisfied with the proceeds of the property.[452] The third category, the concurrent creditors, on the other hand, does not benefit from any advantage. Rather, these creditors are satisfied by the remaining assets, the free residue.[453] Given that concurrent creditors are of equal rank, they receive a proportionate share to their claim if the insolvency assets are not sufficient to fully satisfy all creditors.[454]

(v) Composition and Rehabilitation

There are two different ways for the debtor, to prevent the liquidation of her assets through a compromise with her creditors. One of these options is known as common-law compromise.[455] This is a compromise based on a contract with the creditors and therefore requires the consent of all of them to come into effect.[456] This form of compromise is a means of preventing insolvency if the

[441] Sharrock et al op cit note 352 at 183-184.
[442] Insolvency Act, Section 9.
[443] Ibid Section 97.
[444] Ibid Section 98.
[445] Ibid Section 98A.
[446] Ibid Section 99.
[447] Ibid Section 101.
[448] Ibid Section 102.
[449] See Sharrock et al op cit note 352 at 184 et seqq for more information.
[450] Insolvency Act, Section 103(1)(a).
[451] Cf Insolvency Act, Section 2.
[452] *Singer* NO *v The Master & another* 1996 (2) SA 133(A).
[453] Sharrock op cit note 352 at 182.
[454] Insolvency Act, Section 103(1)(a).
[455] Sharrock et al op cit note 352 at 203.
[456] Ibid.

debtor is on the verge of insolvency or her assets are subject to temporary sequestration.[457] However, if the debtors assets have already been sequestered she can circumvent liquidation by seeking compromise as stated in Section 119 of the Insolvency Act.[458] In contrast to the common-law compromise, this so-called statuary law composition is advantageous in that it does not require all creditors' cooperation but rather only the approval of a certain majority.[459]

By the debtor's rehabilitation her insolvency is terminated and she is given a fresh start, unencumbered by any debts and restrictions.[460] The rehabilitation generally takes place automatically with expiry of a certain deadline, usually 10 years after sequestration, but the debtor has the possibility of applying to the court for preliminary rehabilitation.[461] The effect of rehabilitation is the termination of the sequestration process and thus the debtor's release from all debts that arose before sequestration and from any impairment caused by sequestration.[462]

(b) Administration Order in Terms of the Magistrate's Courts Act

A debtor whose debt amounts to R50 000 or less may apply for an administration order.[463] This procedure is intended for bankruptcies where the assets are too small for sequestration as its costs would consume all the assets.[464] The administration order aims to 'assist a debtor over a period of financial embarrassment without the need for sequestration'.[465] However, this procedure also has some disadvantages: there is no discharge for debts or costs in this procedure.[466] In addition, the procedure does not have a time limit for repayment.[467] Moreover, the administration order only expires when all creditors have been fully paid.[468] Since debts that are due as a result of future instalments due under an existing and enforceable contract (so-called *in futuro* debts) are excluded from the administration order, the procedure is in principle nothing more than a debt rescheduling.[469] It should be noted that Section 74 of the MCA doesn't contain any period for the repayment of the debts under an administration order. Rather, the period and the amount of debt

[457] *Mahomed v Lockhat Brothers & Co Ltd* 1944 AD 230 at 241.
[458] Sharrock et al op cit note 352 at 203.
[459] Ibid at 203-204.
[460] Ibid at 208.
[461] Ibid.
[462] Ibid at 217.
[463] Andre Boraine, *Some Thoughts on the Reform of Administration Orders and Related Issues*, 36 De Jure 217 (2003) 217; Coetzee/Roestoff op cit note 37 at 195-196; *Fortuin and Others v Various Creditors*, 2004 2 SA (c) 570, 573.
[464] Ibid.
[465] *Cape Town Municipality v Dunne* 1964(1) SA 741, 744.
[466] Coetzee/Roestoff op cit note 37 at 196.
[467] Ibid.
[468] Ibid.
[469] *Cape Town Municipality v Dunne* 1964(1) SA 741, 744; Boraine, op cit note 463 at 218; M. A. Greig, *Administration orders as shark nets* 117 S. African L.J. 622 (2000) 624.

repayment only play a subordinate role in the courts decision on whether to grant an administration order.[470] This is supported by the fact that unlike the sequestration, the administration order doesn't have the 'advantage to the creditors' as a requirement.[471]

In order to apply for an administration order, the debtor must submit an application and a statement of affairs in which she confirms under oath that the creditors' names, the sum of the debts and all other details correspond to the truth.[472] The fact that the debtor cannot pay her debts on their due date is the basis for an application.[473] After a hearing, the court issues an administration order. This serves to assist the debtor by appointing an administrator who takes control of the debtor's financial affairs and manages the payment of the debts.[474] In particular, the administration or declaration comprises the declaration that the debtor's assets have been placed under the control of an administrator, that this administrator has been appointed and the amount to be paid by the debtor.[475]

On the basis of this administration order, the debtor is obliged to make regular payments to the administrator, which the latter then distributes to the creditors after deduction of her expenses and a specified tariff remuneration.[476] The administrator's costs may amount up to 12.5 percent of the money received.[477] A limited *concursus creditorum* is activated by the administration order.[478] This means that individual creditors are prevented under Section 74P of the MCA from continuing their individual remedies against the debtor or the debtor's assets after the administration order has been issued.[479] Nevertheless, all debts including interest and costs must be repaid since, in contrast to sequestration which is followed by rehabilitation, there is no limited repayment period for administration or repayment.[480] For this reason, the administration order often leads to exploding costs. As a result, the debtor remains trapped in her hopeless situation instead of relieving herself of her debts.[481] Although debtors are often in arrears for these reasons and the administration order can therefore strictly speaking not be regarded as a debt relief measure, the administration order has

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[470] Andre Boraine; Corlia van Heerden; Melanie Roestoff, *A Comparison between Formal Debt Administration and Debt Review - the Pros and Cons of These Measures and Suggestions for Law Reform* (Part 1), 45 De Jure 80 (2012) at 85; Ex Parte August 2004 3 SA 268 (W) 273.
[471] Ex Parte August 2004 3 SA 268 (W) 273: Boraine et al op cit note 470 at 85.
[472] MCA, Section 74A(3).
[473] Boraine et al op cit note 470.
[474] Ibid at 84.
[475] MCA, Section 74C.
[476] MCA, Sections 74L and 74J; Boraine et al op cit note 470 at 84.
[477] MCA, Section 74L(2).
[478] *Madari v Cassim* 1950 2 SA 35 (D) 38; *Ex Parte Fortuin v Various Creditors* 2004 2 SA 570 (C) 574; *Ex Parte August* 2004 3 SA 268 (W) 272.
[479] Boraine et al op cit note 470 at 92.
[480] Ibid; Boraine op cit note 463 at 218.
[481] Ibid.

surprisingly become very popular over the years, which could also be attributed to the strong growth of the microcredit sector.[482] In fact, there is even reference to a whole 'industry', which is also accused of being under-regulated and therefore subject to abuse.[483] One of the reasons given for this is that unscrupulous administrators were blackmailing debtors.[484] As a result, these consumers are stuck in their current situation instead of deleveraging.[485] Although this is not proven, it is considered certain that especially people who rely on microcredit providers ultimately end up in the system of administration order and thus worsen their situation instead of freeing themselves from their debts.[486] Furthermore, this remedy is only available up to a debt limit of R50,000.[487] This excludes those whose debts exceed this amount, but who are also excluded from rehabilitation after sequestration because they cannot provide an advantage to the creditors as required by Section 12(1)(c) of the Insolvency Act. Thus, there is a regulatory gap for these debtors, which means that they do not have access to debt relief measures.[488] On the other hand, the administration order, despite its shortcomings and problems, can also represent a relief for the debtor.[489]

(c) Debt Review under the National Credit Act

The National Credit Act deals with debt relief measures in connection with over-indebtedness and reckless lending in Chapter 4 Part D. In the context of the NCA, the term over-indebtedness has a very specific meaning since it applies only to credit agreement debts to which the Act is applicable.[490] A definition of the term ‘over-indebtedness’ can be found in Section 79(1) of the NCA. The determination of whether a consumer is over-indebted is made on the basis of the criteria set out in Section 79(1) of the NCA. The existence of these criteria depends on the time at which the determination is made.[491] This is different however, if the debtor's over-indebtedness is caused by the conclusion of a certain credit agreement.[492] In this case, a credit agreement may constitute reckless lending.[493] According to the definition of ‘reckless’ in Section 80(1) of the NCA over-

[482] Boraine op cit note 463 at 218.
[483] Ibid.
[484] Ibid.
[485] Ibid.
[486] Ibid.
[487] Boraine et al op cit note 470 at 92.
[488] Ibid.
[489] Ibid.
[490] Corlia van Heerden, Andre Boraine, *The Interaction between the Debt Relief Measures in the National Credit Act 34 of 2005 and Aspects of Insolvency Law*, 12 Potchefstroom Elec. L.J. 21 (2009) 24-25.
[491] NCA, Section 79(2).
[492] Kelly-Louw *Regulation* op cit note 18 at 323.
[493] Ibid.

indebtedness at the time the credit agreement is concluded only has an impact if reckless lending is identified as the reason for over-indebtedness.[494] It may be useful to have some credit agreements declared reckless, as this can have an impact on the insolvency proceedings.[495] The reckless declaration of a credit agreement can lead to sanctions being taken against the credit provider, which can be to the creditor's advantage.[496] Under the NCA, the over-indebtedness is to be overcome by debt review and restructuring of the credit agreement.[497]

The scope of the NCA covers natural persons irrespective of the amount of the credit and therefore is much broader than the Usury Act which only applied to credit agreements with a principal debt of R500 000 or less and which merely set a maximum interest limit.[498] Legal persons, however, are not fully protected as consumers.[499] The debt review process is governed by Section 86 of the NCA. It usually begins with the consumer's application to a debt counsellor with the aim of being declared over-indebted and placed under debt review.[500] Alternatively, the application can be made to a court, which then forwards the matter to a debt counsellor.[501] The debt counsellor's responsibility is to review the credit agreements to determine whether the debtor is over-indebted and whether reckless credit has been granted.[502] In determining over-indebtedness, the debt counsellor should take into account the consumer's 'financial means, prospects and obligations'.[503] 'Financial means' refers to both assets and liabilities whereas 'prospects' means prospects for an improvement in the consumer's financial situation, such as increases and liquidations of assets.[504] Consequently, for credit agreements involving goods, the financial resources and prospects must include the prospect of selling the goods in order to reduce the consumer's indebtedness.[505] The debt review is followed in the second stage by the completion of the over-indebtedness and the restructuring carried out by the court within the meaning of Section 138 of the NCA.[506] The methods available to the court for debt restructuring are various. They include: extending the period of the agreement and reducing the amount of each payment due accordingly, the postponement of

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[494] Ibid; JW Scholtz, Jannie Otto, E Van Zyl, Corlia Van Heerden, Nicky Campell, *Guide to the National Credit Act* (2008) LexisNexis South Africa, para 11.3.2.
[495] Van Heerden/Boraine op cit note 490 at 23.
[496] Ibid.
[497] Ibid at 22.
[498] Michelle Kelly-Louw, *Consumer Credit*, LAWSA vol 5(1) 2 ed (replacement volume) (2010) (eds Joubert and Fairs) para 1 at 6; Kelly-Louw *Regulation* op cit note 18 at 7.
[499] Otto op cit not 1 at 271.
[500] Coetzee/Roestoff op cit note 37 at 197.
[501] See Sections 86(9), 87(1) and 85; Kelly-Louw *Regulation* op cit note 18 at 324-325.
[502] NCA, Section 86(6)(b).
[503] Ibid Section 79(1)(a).
[504] *Standard Bank of South Africa Ltd v Panayiott* (2009) 3 SA 363 (W) para 47.
[505] Ibid at par a 77.
[506] Van Heerden/Boraine op cit note 490 at 26.

the dates on which payments are due under the agreement during a specified period, extending the period of the agreement and postponing during a specified period the dates on which payments are due under the agreement; or recalculation of the consumer's obligations because of contraventions of Part A (unlawful agreements and provisions) or B (disclosure, form and effect) of Chapter 5 or Part A (collection and repayment practices) of Chapter 6.[507]

(d) The Debt Intervention Procedure

In addition to the three existing insolvency procedures, debt intervention is to be incorporated into the NCA as a new mechanism especially for impecunious debtors who are not granted access to debt relief.[508] The Amendment Act's intention is, hence, to bridge the gap between the conflicting statements of the NCA. On the one hand the purpose of the NCA is 'to promote and advance the social and economic well-being of South Africans, to promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market economy, and to protect consumers'.[509] On the other hand, however, existing provisions of insolvency law are inadequate, either because they require income or assets in favour of creditors or because they entail excessive costs.[510] Especially the sequestration procedure, which is the only one to provide for debt relief, requires a high asset threshold in that the sequestration must be to the creditors' advantage. This compares to a rather high unemployment rate of 27.6 percent (in the first quarter of 2019).[511] In this context, it is recognised that this unequal treatment on the basis of the level of income constitutes unjustified discrimination which makes it impossible for many consumers to escape their desolate financial situation.[512] Therefore, the Bill in its preamble strives to protect all consumers irrespective of their income through a 'fair, transparent, sustainable and responsible process'. With this aim, the foundation is laid for the incorporation of debt intervention into the NCA. First of all, clause 1(b) will introduce a legal definition of debt intervention into the NCA. It reads as follows: 'debt intervention means a measure as contemplated in Section 86A, which aims to assist identified consumers for whom existing natural person insolvency measures are not accessible in practice'.

[507] NCA, Section 86(7)(c)(ii)(aa)-(dd).
[508] See title of the National Credit Amendment Act 7 of 2019 (hereafter Act).
[509] Preamble of the Act.
[510] Ibid.
[511] http://www.statssa.gov.za/?p=12121 last accessed 28 November 2019.
[512] Preamble of the Act.

(i) The Requirements for the Debt Intervention Procedure

Section 86A of the Act, then describes the requirements for debt intervention in further detail. Before the individual requirements of the debt intervention will be illustrated, it is first necessary to clarify who is covered by the term debt intervention applicant. Pursuant to Section 1(b)(b), a debt intervention applicant must meet the following criteria: First, it must be a natural person. Secondly, this person must be a consumer under an unsecured credit agreement. Thirdly, the applicant must not have any income respectively an income not exceeding R7 500 per month. Fourthly, the applicant must be over indebted and finally must not be sequestrated or subject to an administration order. If these criteria are met, an individual qualifies as a debt intervention applicant.

By virtue of Section 86A(1) of the Act, the debt intervention applicant's total unsecured debt may not exceed R50 000. Total unsecured debts are defined as 'the total of all principal debts due by a debt intervention applicant under the unsecured credit agreements, unsecured short term credit transactions or unsecured credit facilities to which the debt intervention applicant is a party'.[513] However, total unsecured debt resulting from a developmental credit agreement pursuant to Section 10(1) of the NCA and, subject to Section 85(c), credit agreements in respect of which the lender has already taken measures as provided for in Section 130 of the NCA, namely an application for a court order to enforce the credit agreement, are excluded from debt intervention.[514] The debt intervention procedure also provides for the applicant to receive both counselling and training in financial literacy.[515]

(ii) The Application Process

The debt review process is initiated by an application of an individual for a declaration of over indebtedness. This application is submitted to the NCR.[516] The NCR must issue the applicant with a receipt of the application and inform all creditors listed in the application as well as all registered credit bureaus.[517] Pursuant to the reference in Section 86A(3) of the Act to Section 86(6) of the NCA, the NCR must establish whether the consumer is over indebted and whether credit agreements can be subsumed under the category of reckless lending. If so, Section 86A(6)(c) of the

[513] Clause 1(f) of the Act.
[514] Act, Section 86A(2).
[515] Act, Section 86A(5).
[516] Act, Section 86A(1).
[517] Act, Section 86A(3) in conjunction with NCA, Section 86(4).

Act provides that the NCR shall refer the credit agreement to the Tribunal. The Tribunal then has the power to declare it void.[518]

The creditor providers and the debtor also have certain obligations. These are laid down in Section 86A(4) of the Act in conjunction with Section 86(5) of the NCA. According to this, both the credit providers and the debtor must support the NCR in its task of debt intervention by complying with every reasonable demand.[519] Furthermore, they must participate in good faith in the debt intervention process.[520] The NCR then assesses the application and determines the further progress of the procedure, the possibilities of which are set out in Section 86A(6) of the Act. These possibilities differ according to whether the applicant qualifies for debt intervention or not. Accordingly, if the applicant does not qualify, there are the following options: if the applicant is clearly not eligible for debt intervention, the application must be rejected by the NCR.[521] However, if the applicant does not meet the requirements for debt intervention and still has or is likely to have difficulties to pay her debts, the NCR must propose that the debtor and the concerned credit providers consider debt re-arrangement.[522] Nonetheless, this opportunity should be viewed critically, as a debtor who is unable to pay her debts, or who is very likely on the verge of being unable to paying her debts, has a weak negotiating position vis-à-vis an experienced businessperson, the credit provider, and thus has difficulties adequately protecting and enforcing her interests. For this reason, this option does not represent a significant improvement on the existing debt measures.

If the applicant meets the conditions for debt intervention, there are two different scenarios: First, there is the possibility that the debt will be re-arranged with a repayment period of five years or longer. In this case, the NCR must refer the matter to the Tribunal for and provide a recommendation. The court then has the task of issuing an order as described in Section 87(1A) of the Act.[523] Second, the NCR must refer the matter to the Tribunal, which will issue an order under Section 87A of the Act, if the income from the application is not sufficient to restructure her debts over a period of 5 years.[524] The order under Section 87A(2) of the Act includes either that the

[518] Cf changes to NCA, Section 89(5) by clause 19 of the Act.
[519] Act, Section 86A(4) in conjunction with NCA, Section 86(5)(a).
[520] Act, Section 86A(4) in conjunction with NCA, Section 86(5)(b).
[521] Act, Section 86A(6)(a).
[522] Act, Section 86A(6)(b).
[523] Act, Section 86A(6)(d).
[524] Act, Section 86A(6)(e).

applicant does not qualify for the debt intervention[525] or that all her qualifying credit contracts are suspended for a period of 12 months[526]. This period may be extended by a further 12 months.[527]

Section 87A(3) of the Act then contains some aspects to be taken into account by the Tribunal in its decision. These aspects include whether the applicant has ever applied for debt intervention, sequestration or an administration order before.[528] They also include whether the applicant has ever had debt written off by a court order.[529] As a further factor, the Tribunal must consider whether the applicant concerned is a disabled person, a minor running a household, a woman running a household or an old person.[530] This provision is rather questionable as it raises some concerns: Firstly, it is not quite clear, why these groups of individuals are mentioned separately, since except minors these groups of individuals have full legal capacity. Secondly, the provision might either be made under the assumption that households are only run by women not men or it is to be wondered whether households run by men fall within the scope of this provision.[531] On the other hand it may be interpreted as an effort by the legislator to support particularly underprivileged groups. In addition, the Tribunal must also consider actions and omissions of the debt intervention applicant and creditors.[532] As per Section 87A(5)(a), eight months after the debt intervention order, under subsection (2)(b), the NCR must evaluate whether the applicant has sufficient income or assets to allow for restructuring her debts within a period of five years as described in Section 86A(6)(d). If not, the NCR may extend the period for another year, with a review after eight months.[533] Should the applicant not be able to meet her obligations and repay her debts despite all possible remedies taken, there is the possibility to have the tribunal declare these debts extinguished.[534] The Tribunal may also order participation in a financial literacy program.[535] The Bill furthermore provides for mandatory credit life insurance.[536] This means the consumer is required to arrange for credit life insurance for the duration of the credit agreement, if the principal debts amount to R50 000 or less and the duration of the credit agreement exceeds six months.[537]

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[525] Act, Section 87A(2)(a).
[526] Act, Section 87A(2)(b)(i).
[527] Ibid.
[528] Act, Section 87A(3)(a)(ii).
[529] Act, Section 87A(3)(a)(iii).
[530] Act, Section 87A(3)(a)(i).
[531] Cf Coetzee op cit note 36 for similar considerations.
[532] Act, Section 87A(3)(b) and (c).
[533] Act, Section 87A(5)(b)(ii).
[534] Act, Section 87A(5)(c)(ii) and (6).
[535] Act, Section 87A(2)(b)(ii).
[536] Act, Section 106.
[537] Ibid.

Finally, the debt intervention procedure will be terminated by the debtor's rehabilitation. After the Tribunal has declared the debtor's debts extinguished by virtue of Section 87A(6), the debtor may submit an application for a rehabilitation order to the NCR.[538] The Tribunal will then issue the requested order, if all the requirements set out in Section 88B are met. As an effect of the rehabilitation order, any limitations on the rights of the debtor end 60 days from the date of the order.[539] Furthermore, all credit providers listed in the application and every registered credit bureau will be informed of the rehabilitation order.[540]

IV. Evaluation of the Debt Intervention Procedure in South Africa

The introduction of the Act in South Africa is seen very ambivalently. While the Chairperson of the Portfolio Committee on Trade and Industry *Joanmarie Fubbs* described the Act as an achievement as it 'will strengthen the National Credit Amendment Act which enabled South Africa to withstand the worst effects of the global financial meltdown in 2008' and 'for the first time in SA, [..] the plight of the poor and low-income worker who is over-indebted' will be addressed,[541] there is also a number of opposition to the Bill. An argument against the introduction of the debt relief procedure is that it will lead to an 'economic upheaval' in that banks have to mitigate their increased risk of losing money through higher interest rates for people on low incomes.[542] According to the critics of the Bill it would also mean that consumers would have to pay higher interest rates overall.[543] On the other hand, however, the Bill can be a step towards eliminating the informal financial sector, as it requires credit providers to register and, if they fail to do so, they commit a criminal offence and can be arrested.

Another aspect *Fubbs* highlights is the possibility for the court to lower interest rates down to zero, so as to assist the debtor in paying back her debts.[544] That is however precisely what concerns the critics. One crucial aspect of their criticism is that the debt relief procedure is nothing more than an unconstitutional deprivation of property. Yet, it can be argued that the credit provider possibly already lost her investment and thus her property by the time the debtor files for a Debt Relief Order if the debtor can no longer service the loan and can therefore no longer be expropriated. It must furthermore be borne in mind that debt relief is just an *ultima ratio* and that

[538] Act, Section 88B(1).
[539] Act, Section 88B(8).
[540] Act, Section 88B(9).
[541] https://www.iol.co.za/business-report/economy/new-debt-relief-bill-to-help-over-indebted-consumers-17049114 last accessed 27 November 2019.
[542] Ibid.
[543] Ibid.
[544] Ibid.

the debtor must first make an effort to repay the debt over a certain period of time. Only if no other remedies show promise, then the debtor may apply for debt relief. With this regulation the legislator has created a sufficient barrier to protect the creditors' property. Ultimately, it is the credit provider's responsibility to ensure that the debtor is creditworthy before granting her a loan.

It could also be argued that debt relief harms the debtor more than it helps, since the debtor does not have to take responsibility for her over-indebtedness and therefore learns nothing from it, as is often the case under the New Zealand NAP. Unlike in New Zealand, however, the South African debt relief procedure contains an obligation to participate in financial literacy training. It remains to be seen whether this measure will contribute to reducing the growing number of debtors. The Act must, furthermore, withstand the allegation that it shifts the balance between the rights of credit providers and debtors too much towards debtor protection and thus fails to take sufficient account of the credit providers' rights. It must be noted, however, that South African insolvency law, unlike many legal systems worldwide, is still strongly creditor-oriented and the satisfaction of creditors is a vital element. Consequently, it is the Act that represents a step towards balancing the conflicting rights of debtors and creditors, by providing a fresh start to all honest but unfortunate debtors, not only debtors with assets. A widespread assumption, which is also often used as an argument by supporters of the Act, is that a fresh start for debtors will boost the country's economy, as a debt-free individual is able to participate in the economy by spending money. However, opponents argue that the long-term consequences of the debt relief have not been thoroughly reasoned. As *Cas Coovadia*, Managing Director of the Banking Association South Africa stated: 'The consequences of the proposed broadened scope of the Act for consumers, the economy and sectors such as banking, retail, and micro-lending, have not been subjected to an in-depth social and economic impact assessment and engagement with relevant stakeholders'.[545] Yet, the effects of introducing the debt relief procedure are not entirely unpredictable, as their critics say. On the contrary, New Zealand adopted the NAP in 2005 which is quite similar to the debt relief procedure. The procedure was evaluated in 2011 and the results were published in the New Zealand Ministry of Economic Development's *Evaluation of the No Asset Procedure, Final Report*. Consequently, there is some experience available which can be used as a guideline for assessing the impact the debt relief procedure might have on the economy. The survey revealed that the NAP enabled debtors who had become insolvent as a result of an unexpected life event a fresh start.[546] A vast majority of NAP participants were able to manage their finances in such a way that they could

[545] https://businesstech.co.za/news/finance/267443/new-debt-relief-bill-will-make-it-harder-to-get-a-loan-in-south-africa-expert/ last accessed 12 November 2019.
[546] Report op cit note 205 at 16.

either save money or at least cover their expenses with their income.[547] Although NAP participants didn't necessarily manage to get employment, the predominant part of them did not incur any new debts. There were two reasons for this: some of the NAP participants, about 42 percent, did not apply for a new loan, which suggests there was a learning process. On the other hand, it was likely due to the fact that banks and credit providers were reluctant or unwilling to grant loans to registered NAP participants or open a bank account for them due to their increased risk of loss.[548] Further negative effects for the NAP participants were the loss of the job and difficulties in finding accommodation as landlords refuse to rent to NAP debtors.[549] It remains to be seen how these aspects will develop in South Africa.

V. Conclusion

In summary, it can be said that South African insolvency law has been shaped by various cultural influences throughout its history. Just as diverse as the South African culture are the existing insolvency remedies. There are currently three existing procedures, sequestration, administration order and debt review, which suffer from significant weaknesses, as only the first one provides for debt relief. This is a critical issue to the extent that sequestration, and thus debt relief, brings with it a certain financial hurdle and is therefore inaccessible to the vast majority of debtors, especially to the most vulnerable group, the no income no asset debtors. Administration order and debt relief are in principle only a rearrangement of the existing debts and usually lead to an increase in the debt of the insolvent due to the legal costs, whereby her situation is aggravated. A significant number of these debtors thus had no chance of escaping the debt trap. However, the current situation will evolve as the amendments of the National Credit Amendment Act came into force thereby establishing the Debt Intervention Procedure. While this new procedure initially attempts to restructure debts, it also provides debt relief in cases of severe over-indebtedness with no prospect of recovery. Furthermore, measurements such as mandatory financial literacy programs will be introduced to prevent a recurring insolvency of the debtor. It can be concluded that these amendments also represent a step away from the creditor friendliness of South African Insolvency Law towards enhanced consumer protection.

The last chapter provides a summary and a comparison of the different legal systems. Furthermore it contains a conclusion with the key points of this research as well as a recommendation for an

[547] Ibid at 16 and 20.
[548] Ibid.
[549] Ibid at 18.

improved insolvency procedure taking into account the advantageous aspects of each of the mentioned jurisdictions.

Chapter Six Comparison of the Different Legal Systems

Legislation can have a significant impact on changes in social structures. This can also lead to unforeseeable changes. For example, the intention of the South African legislator was to prevent excessive interests by introducing the Usury Act. At the same time, however, this law led to the emergence of an informal financial sector.

Conversely, legislation often has to address changes in social structures. The introduction of consumer protection, for example, can be attributed to the increasing number of consumer debtors worldwide, which forced legislators to react. Meanwhile, many countries have realised the need to introduce a special insolvency procedure for people with low incomes. Despite these developments, however, the number of over-indebted consumers continues to rise. This chapter will first give a summary of the legislation regarding consumer insolvency in Great Britain, New Zealand, Germany and South Africa. Second, a comparison of the different systems is provided. The last part presents a recommendation for insolvency proceedings combining the most favourable aspects of the legal systems described in this research is presented.

I. Summary of the Different Legal Systems

In the United Kingdom there are five different procedures, namely Bankruptcy, Individual Voluntary Agreement, County Court Administration Order, DRO and Debt Management Arrangement. With its five different procedures, Great Britain has the most possibilities within the legal systems mentioned and is quite liberal with the possibility of a DRO every six years as compared to New Zealand and South Africa where debt relief is a once in a lifetime opportunity. Nevertheless, the average debt per household continues to rise and peeked to £15,400 per household in early 2019, whereas it 'only' amounted to around £10.00 per household, when the DRO was introduced in 2006.[550]

Similar to British insolvency law, New Zealand insolvency law has four different procedures: Bankruptcy, Proposal, Summary Instalment Order and NAP. While Bankruptcy establishes a minimum debt of NZD 1000, the other three procedures do not. The proposal requires the consent of creditors and is therefore unsuitable for low-income debtors. The Summary Instalment Order, on the other hand is a simplified, and therefore a cost-effective alternative to the Bankruptcy. It is a debt restructuring measure, which protects the debtor against the debtors' attempts to enforce their claims outside the procedure, but doesn't provide for debt relief.[551] Finally,

[550] See graphic at https://www.theguardian.com/business/2019/jan/07/average-uk-household-debt-now-stands-at-record-15400 (last accessed on 13 November 2019).
[551] Section 352(2) New Zealand Insolvency Act.

the NAP offers an alternative to Bankruptcy and provides access to debt relief for debtors without assets whose debts are between NZD 1000 and 47000 and who pass the prescribed means test.

Germany, on the other hand, only has one insolvency procedure which is only available to debtors who have sufficient assets to bear the costs of the proceedings. If this is not the case, the application for insolvency is dismissed due to lack of assets. This has the advantage that the debtor is not subject to the restrictions which the insolvency proceedings entail. However, the debtor does not enjoy the advantages of successful insolvency proceedings, such as debt relief and prohibition of individual enforcement.

South African insolvency law is predominantly creditor friendly and does not principally aim to relieve the debtor of her debts. There are four different procedures in force: Firstly, there is sequestration, which requires enforceable assets and an advantage for creditors and is therefore only suitable for wealthy debtors. After ten years, the debtor is discharged of all her debts and thus enabled to have a fresh start. Second, there is the Administration Order for debtors whose debts are R50 000 or less. The aim of this procedure is to restructure the debt in order to achieve debt reduction. The disadvantage of this procedure is that it does not provide for debt relief and due to its high costs only causes more debts to the debtor. The third procedure is the debt review, another debt restructuring measure which, similar to the administration order, is not very helpful for the debtor. Finally, the Debt Intervention Procedure was recently introduced, which provides for debt relief for debtors with little or no income. Fourthly, the Debt Intervention Procedure has been in force since August 2019, which is now also providing debt relief for low-income debtors.

In summary, the insolvency systems in South Africa, New Zealand and Great Britain are similar in that they have several procedures with different requirements, whereas in Germany there is only one insolvency procedure. The advantage of different procedures is that they cover a wider range of insolvency scenarios, whereas a single procedure offers less flexibility. For instance, there is no special procedure in Germany for people on low incomes. Thus, there is no possibility of debt relief for those debtors who do not meet the criteria for insolvency. The disadvantage of many different procedures, however, is that the insolvency system can easily become incomprehensible for a non-lawyer. Furthermore, South Africa is faced with the problem that the Administration Order and the Debt Review are practically ineffective and exacerbate the debtor’s precarious situation due to their high costs. The introduction of debt relief for people with low incomes through the National Credit Amendment Act in South Africa was an important step towards equality since it provides debt relief for people on low income. However, it remains to be seen whether it fulfils its purpose.

II. Comparison

As can be seen in the preceding chapters, the legislations in the different countries deal differently with the issue of low income insolvency. What they have in common is that the rights of creditors and debtors need to be restricted in order to reach a compromise. However, the extent of the restrictions varies depending on whether the protection of creditors or debtors is the primary concern in the country in question.

A striking difference between the different legal systems is that South Africa, New Zealand and Great Britain have many different insolvency procedures, while there is only one in Germany. However, this means that in Germany there is no alternative remedy available to those debtors who do not meet the requirements of this procedure. Sequestration in South Africa, Bankruptcy in New Zealand and Great Britain and insolvency proceedings in Germany are comparable procedures. What they have in common is that the debtor's assets are enforced and the proceeds of the auction of the property are paid out to the creditors. After a certain period of time in which the debtor tries to pay off the remaining debts, the debtor is granted debt relief and thus a fresh start. However, repayment periods vary considerably from country to country. In Great Britain, for example, a new start is granted after two to three years and in New Zealand after three years. By contrast, debtors in Germany have to wait six years for debt relief and in South Africa 10 years.

To a certain extent, the IVA in Great Britain and the proposal in New Zealand are comparable. Both procedures involve negotiations with the creditors to enable the debtor to repay her debts, for example by reducing credit rates or interests. Both procedures, however, have the decisive disadvantage that the creditors' consent is required for an effective conclusion to be reached.

Furthermore, Debt Review and Administration Order in South Africa are comparable to the Summary Instalment Order in New Zealand and the DMA in Great Britain. These procedures are similar in that they are essentially debt restructuring measures. Differences exist primarily in costs and effectiveness. Both administration order and the debt review are not suitable for reducing the debtor's liabilities due to their high costs. On the contrary, in many cases they even cause an increase in the debtor's financial distress. The Summary Instalment Order, on the other hand, is comparatively inexpensive, as only a one-time fee of NZD 100 has to be paid. Therefore, this procedure is likely to help the debtor to achieve the desired debt relief. The DMA has the explicit requirement of a regular income of the debtor and in return enables her to retain her property. This measure is also not very cost-intensive. Therefore, this measure is a viable alternative to Bankruptcy.

Finally, in South Africa, New Zealand and Great Britain there is an insolvency procedure for low income debtors. These procedures have in common that they should give low-income debtors access to debt relief. In addition, the debt may not exceed a certain amount, which varies from country to country. Despite the common purpose, there are some differences: The DRO in Great Britain is open to the debtor if her liabilities do not exceed £15,000, her assets do not exceed £300 and the value of her car does not exceed £1000. The debtor receives a debt discharge after one year. British DROs are unique in that an application for DRO is possible every six years. In contrast, the NAP in New Zealand and the Debt Intervention in South Africa are unique opportunities. In order to be admitted to the NAP, the debtor must not have any realisable assets. In addition, the debtor must not be adjudicated bankrupt or declared bankrupt. Unlike Great Britain and South Africa, there is no strict income or asset limit in New Zealand. Instead the debtor must pass the prescribed means test. This test takes into account not only the debtor's own income but also that of relatives living in the same household. Debt relief in New Zealand also takes place after one year. The debtor's debt must be in the range of NZD 1000 to 47,000. The South African debt intervention is for debtors whose debt does not exceed R50 000 and who either have no income or whose income does not exceed R7 500. Unlike NAPs and DROs, debt relief is not automatically granted to every debtor after one year. Rather, there are two options, depending on the possibilities of the debtor. Under the first option, the debtor's debts are restructured and she must seek to repay her debt over a period of five years or more. If her income is not sufficient for a restructuring, the second option allows the debt to be suspended for 12 months with the possibility of extending this period. An evaluation takes place after eight months. If the evaluation reveals that repaying the debts is not possible for the debtor, there is a possibility to have the debts written off. A special feature of the newly introduced debt intervention procedure is that it requires its participants to attend a financial literacy program. The legislator has thus clearly recognised that many debtors lack the knowledge about the responsible management of money. The South African legislator has thus taken up the criticism of the participants of the New Zealand NAP.

III. Recommendation

Looking at the different approaches of the legal systems outlined above, it becomes apparent that they each have certain advantages and disadvantages. The knowledge gained can be used to design a new insolvency procedure that combines the advantages of these systems. An insolvency procedure containing advantageous features of the different insolvency systems might look as follows: After the debtor has filed for insolvency, her financial situation is evaluated. If her assets are sufficient to cover the costs of sequestration, they are liquidated and distributed to the creditors

on a pro rata basis. After a good conduct period of 5 years, in which the debtor makes monthly payments to the creditors to pay off her debts, the debtor is granted debt relief and thus a fresh start. If the debtor's assets are not sufficient, debt restructuring and a reduction in interest rates must first be attempted, and the debtor must try to repay the debt. After 3 years the debtor's progress will be evaluated. If it is found to be impossible for the debtor to repay her debt, a debt discharge takes place. This procedure is supported by compulsory participation in a financial literacy program. Furthermore, there should be an alternative procedure comparable to the British Debt Management Arrangement, which doesn't require the surrender of the debtor's asset and allows the debtor to retain her property, for example a house, on the condition of regular payment. Furthermore, each debtor should attend compulsory financial literacy training. The increasing number of consumer debtors worldwide is also an indicator that many people lack knowledge about the responsible use of money. Thus, it is advisable to already teach financial literacy at school so as to possibly prevent indebtedness.

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