DRAFT

SOUTH AFRICA

Diagnostic Report on the Proposed Personal Insolvency System in the New South African Insolvency Bill

January 2015

World Bank

Finance and Markets Global Practice
Africa Vice-Presidency

Table of Contents

I. Introduction

This report is presented in conjunction with the South Africa Financial Sector Development and Reform Program funded by SECO. One of the two main pillars of this program focuses on improving financial inclusion, including an assessment of the legal regime for debt rehabilitation and personal insolvency. An initial analytical assessment of the present South African legal regime for treating personal insolvency was completed by the Legal Department of the World Bank in December 2013.[1] After this initial assessment concluded that the current legal mechanisms are not effective at addressing the growing problem of personal indebtedness in South Africa, the National Treasury engaged the World Bank for further assessment and advice, in particular related to the pending draft Insolvency Bill.[2] Consequently, this report provides further assessment of the current legal framework for treating personal insolvency in South Africa, and of the proposed system envisioned in the Insolvency Bill, along with a set of recommendations for improving the proposed regime. This report was drafted by Jason J. Kilborn, Professor of Law, John Marshall Law School, Chicago, USA (and Van der Grinten Chair in International & Comparative Insolvency Law Radboud University Nijmegen, The Netherlands), with inputs by a World Bank team consisting of Gunhild Berg, Bujana Perolli, and Mahesh Uttamchandani (Finance and Markets Global Practice).

II. Executive Summary

The Insolvency Bill's proposed changes to the South African personal insolvency regime incorporate some elements of modern best practices, but the core of the proposed reform is ambiguous and problematic. The current regime's principal weaknesses include severe restrictions on access and a lack of available discharge relief. The revised insolvency regime would continue to suffer from these weaknesses, among others.

Leaving the current sequestration rules in place (including the unique "benefit to creditors" restriction), the Insolvency Bill expands access to discharge relief by incorporating a new provision in the Insolvency Act on pre-insolvency compositions with creditors. Debtors with relatively limited debts (ZAR200 000 and less) may propose a repayment plan to their creditors, which may be imposed on dissenting individual creditors if it is accepted by a super-majority of creditors and claims voting. If this attempted composition with creditors fails, the Master of the High Court is given the discretion to grant the debtor a discharge of unsecured, non-preferent debts.

While the incorporation of a more widely available discharge is a step forward for South African personal insolvency law, this revised regime deviates from internationally recognized best practices in a number of respects. In particular, the access restriction in the form of a ZAR200 000 debt limit is a recent and unexplained addition to the Bill, as is the new "administrator" in charge of overseeing the creditor composition process. Of greater concern are the creditor voting and discretionary discharge provisions. Both of these processes will impose

[1] World Bank, *Note on the Regulation of the Insolvency of Natural Persons* (Dec. 2013) [*hereinafter*, World Bank *South Africa Note*].

[2] A confidential, non-public copy of the Insolvency Bill and its Explanatory Memorandum, both dated February 2014, were made available to Treasury officials, who in turn made those materials available to the World Bank for the purpose of this evaluation.

significant burdens on South Africa's limited institutional capacity, particularly the offices of the Masters of the High Court. Experience in other countries' pre-insolvency creditor composition processes, as well as South African's own debt review procedure, strongly suggest that very few successful compositions are likely to be achieved, though the process will be time and resource intensive. Similarly, a number of general and specific concerns raise significant doubts that the discretionary discharge will be an effective mechanism for delivering the kind of broad discharge relief required to address South Africa's personal indebtedness problem.

A relatively simple alternative reform would achieve a better balance among South Africa's key concerns: delivering discharge relief to deserving debtors effectively and efficiently, controlling costs and burdens on limited institutional capacity, limiting abuse by debtors and maximizing benefits for creditors, to the extent reasonably possible. These goals might be achieved effectively and efficiently by simply reorienting the personal insolvency relief system around a more carefully defined notion of "overindebtedness," and using that concept as a sorting mechanism to route debtors to full-payment plans, partial-payment plans, and immediate, non-discretionary discharges. The current debt review process provides a tailor-made platform for conducting these analyses and bringing the many parts of the South African personal indebtedness regime into a synergistic whole that balances the interests of creditors, debtors, and most importantly the society in which they must continue to co-exist. Alternatively, it would be preferable to at least revert to the South African Law Reform Commission's original proposed provision on personal insolvency relief rather than implementing the current, revised provision in the Insolvency Bill.

Table 1. Key Recommendations

• Develop objective guidelines for minimum living expenses and payment terms
• Based on these guidelines, develop an objective definition of "overindebtedness"
• Assign debt counsellors as the entry portal to a new universal insolvency system
• Task debt counsellors with applying the overindebtedness guidelines and routing debtors to - an immediate discharge (for debtors with no or minimal payment capacity) - a partial payment plan (for debtors with substantial but not full payment capacity) - a full payment plan (for debtors with capacity to pay off unsecured debts in full) - out of the system (for debtors who are not overindebted)
• Assign responsibility for each route to appropriate authorities (e.g., courts, counsellors, etc.)
• Alternatively, revert to Law Reform Commission's original 2000 proposal, but also - remove the publicity and deposit requirements for applications for rehabilitation - provide for automatic rehabilitation and discharge after 3-4 years

III. Current Landscape of South African Personal Insolvency Law and Policy

The details of the multi-faceted approach to personal indebtedness under current South African law are laid out in the December 2013 *Note*. To briefly summarize, three main components[3] comprise the current regime for mitigating the ill effects of excessive personal debt: administration orders under section 74 of the Magistrates' Courts Act 32 of 1944, debt review under the National Credit Act 34 of 2005, and sequestration under the Insolvency Act 24 of 1936. None of these three legal regimes provides a sufficient form, degree, and breadth of relief to adequately respond to the problems caused by excessive personal debt.

One would expect a discharge of debt under the Insolvency Act to represent the principal source of relief for overburdened debtors, but this relief is available only to a very few, asset-rich debtors. South Africa's insolvency law has long had a unique, singular focus on creditors.[4] A debtor may petition for sequestration (and possible ultimate discharge relief) only "for the benefit of his creditors"; that is, if "it will be to the advantage of creditors of the debtor if his estate is sequestrated."[5] In practice, this means that individual (though not corporate) debtors must convince the court that a liquidation of their assets will produce an "advantage to creditors" in the form of a minimum 20% dividend on submitted claims.[6] Unsurprisingly, a very small percentage of overindebted individuals can establish that the liquidation of their available assets will produce such a dividend, so this requirement is the principle (though not the only) reason why most individual debtors are excluded from discharge relief. Because insolvency cases are lodged in the High Court, substantial expenses for court and administrative fees would prevent lower-income debtors from obtaining relief even if they could produce an advantage to their creditors, and an automatic discharge is available only after a ten-year waiting period.

---

[3] A potential fourth component relates to restrictions on debt collection, in particular emoluments attachment orders. This debt collection procedure has been heralded in the press as subject to "systemic abuse" by "unscrupulous collection attorneys," often reducing to zero the paychecks of desperate debtors. *See, e.g.,* Malcolm Rees, "Treasury threatens to abolish garnishee system," *Moneyweb* (30 Nov. 2012), http://www.moneyweb.co.za/moneyweb-financial/treasury-threatens-to-abolish-garnishee-system. Unrestricted diversion of debtors' wages to creditors was a major contributing cause of the 2012 Marikana miners' strike, which led to the deaths of 34 miners. *See* Deborah James, *Money from Nothing: Indebtedness and Aspiration in South Africa* 63 (Stanford Univ. Press 2014). To date, there has been no legislative action to curtail this problem, though the National Treasury and the Banking Association of South Africa established an agreement in October 2012 restricting the use of garnishee orders against credit defaulters. *See* Joint statement by the Minister of Finance and the chairperson of the Banking Association of South Africa, http://www.treasury.gov.za/comm_media/press/2012/2012110101.pdf.

[4] *See, e.g.,* University of Pretoria, Centre for Advanced Corporate and Insolvency Law, *Final Report Containing Proposals on a Unified Insolvency Act* ¶ 3.8 (2000); Kathleen van der Linde, "National Report for South Africa," *in Commencement of Insolvency Proceedings* 521, 523 (Dennis Faber, Niels Vermunt, Jason Kilborn & Tomas Richter, eds., Oxford Univ. Press 2012).

[5] Insolvency Act 1936 ss. 3(1), 6. Even in cases where one or more creditors seek a "compulsory" sequestration of a debtor, presumably for their advantage, South African jurisprudence urges courts to scrutinize such petitions "to be satisfied that the application was not brought primarily for the relief of a harassed debtor." Explanatory Memorandum ¶ 3.15. Though the drafters of the current Insolvency Bill acknowledge that the benefit-to-creditors requirement is "not common in other legal systems," they explicitly preserved this requirement on the basis that "it is unacceptable to use the expensive procedure of liquidation by the court in cases where the value of the assets is insufficient to ensure a benefit to creditors." *Id.*

[6] *See* World Bank *South Africa Note* at 13-14.

Discharge relief is not available under the other two legal regimes. Administration orders issued by the Magistrates' Courts were designed to be a less costly alternative to the expensive High Court sequestration procedure for low-income debtors. The result of these two procedures differs, however, in the essential respect that an administration order provides no discharge. Rather, it offers the debtor only a means of imposing a full-payment restructuring plan on creditors. An appointed administrator is charged with distributing installment payments to creditors after deducting his or her own remuneration from periodic sums surrendered by the debtor. Because these orders provide no discharge, payments can go on indefinitely, and debtors are often "intimidated into agreeing to unsustainable debt repayments."[7] Also, the lack of professional oversight of administrators has resulted in ineptitude and abuse by administrators seeking to profit from this process, further deepening the debt distress of their debtor-clients.[8] Access to the administration order process is also restricted to debtors with relatively limited debt burdens, not exceeding ZAR50 000.

For debtors who do not qualify for administration orders, similar relief may be obtained through the debt review process under the National Credit Act, though this relief is also very limited. Struggling debtors can seek assistance from "debt counsellors," who unlike "administrators" are registered with and supervised by the National Credit Regulator.[9] These counsellors can recommend that the Magistrate's Court enter an order modifying the debtor's credit arrangements to extend repayment terms and therefore reduce the debtor's periodic payment burden, but here again, no discharge of debt may be ordered.[10] This process encompasses only debts arising from credit agreements (as opposed to involuntary debts, such as delictual obligations), and it does not encompass debts for which the creditor has already initiated enforcement action. Also, a creditor can terminate this process within the first 60 days or pretermit the process at any time by lodging a petition for a compulsory sequestration order.[11]

Though the debt review process was designed to be the first modern South African response to personal overindebtedness, its first decade has produced disappointing results in terms of treating the problem. Between January 2009 and April 2012, by agreement with the National Credit Regulator, the Law Clinic at the University of Pretoria conducted several rounds of desk and field research into the operation of the debt review process.[12] The explicit objective from the NCR was to investigate why the debt review process was not achieving its desired goals of debt restructurings and finalized Magistrates' Courts orders. Simultaneously, the NCR

---

[7] James, *supra* note 3 at 61.
[8] *See id.* at 76, 87 (describing administrators' overcharging debtors and failing to remit payments to creditors).
[9] *See* About the NCR, http://www.ncr.org.za.
[10] Some debt counsellors have attempted to overcome this limitation by submitting "negative" proposals to creditors, proposing that creditors agree to offer a contribution back to the debtor toward payment of the debt. This technique is not supported by the NCA, however, and has apparently enjoyed no success in practice. *See* C van Heerden & H Coetzee, "Perspectives on the Termination of Debt Review in Terms of Section 86(10) of the National Credit Act 34 of 2005," 14 *P.E.R.* 37, 59 (2011).
[11] *See* M. Roestoff, F. Haupt, H Coetzee & M Erasmus, "The Debt Counselling Process—Closing the Loopholes in the National Credit Act 34 of 2005," 12 *P.E.R.* 247, 251-55 (2009).
[12] *See* UP Law Clinic, *The debt counselling process: challenges to consumers and the credit industry in general* (April 2009) [*hereinafter*, UP Law Clinic (2009)]; Univ. of Pretoria Law Clinic & Business Enterprises at the Univ. of Pretoria (Pty) Ltd, *An assessment of debt counselling in South Africa: December 2011-April 2012* (1 May 2012) [*hereinafter*, UP Law Clinic (2012)].

launched its own Task Team in October 2009 to find solutions to "blockages in the debt review process."[13]

One of the main causes of failure in the debt review process was that major credit providers were reneging on work stream agreements that they had accepted months earlier.[14] Creditors refused to report to counsellors with timely and accurate information on the state of debtors' accounts, they reneged on agreed concessions (e.g., interest rate reductions), and they continued to oppose entry of restructuring orders on several technical bases that creditors had agreed not to assert (e.g., court jurisdiction and documentary support for debtors' finances). Indeed, creditors responded to only 350 of the 1493 studied proposals submitted by counsellors, a 23% response rate, and it took creditors between 20 and 36 business days to return these responses.[15]

For cases that made their way to the Magistrates' Courts, researchers observed that "lack of consistency between the courts … [was] still a major issue."[16] Some magistrates confirmed unreasonable repayment arrangements and refused to confirm reasonable proposals advanced by debt counsellors. "Problems experienced in the magistrates' courts were consistently noted by interviewees," including the startling revelation that "some magistrates are opposed to granting orders with no particular reason."[17] Capacity limitations also presented major challenges in many Magistrates' Courts. Debtors and their counsellors faced long waiting periods to obtain hearings on counsellor recommendations, ranging from only a few days in some courts, but extending to as high as 136 days in other courts, with a month-long waiting period being quite common.[18] The NCR's Task Team concluded that "it is not realistic to expect that in the foreseeable future the [Magistrates'] courts will be able to deal with all the debt review cases that enter the system."[19]

One prominent source of these problems among creditors and courts is that "the NCA and Regulations were perceived to be ambiguous, difficult to interpret and leading to contradictory judgments."[20] Particularly problematic for creditors and the composition process was "lack of standardization of format and content of key documentation in the process," especially proposals for debt rearrangement.[21] In an attempt to address the normative void in the debt review process, the NCR Task Team developed objective guidelines for standardizing debt rearrangement proposals.[22] These guidelines emphasize debtors' "reducing their financial lifestyle" to be able

---

[13] National Credit Regulator, *Debt Review Task Team: Covering Report* (May 2010) § 1.1.
[14] UP Law Clinic (2009) §§ 4.2.1, 4.2.2, 4.2.4, 5.2.2, 5.3. While the debt review process does not explicitly call for creditor voting, a 2008 "work stream agreement" agreed to by major credit providers, debt counsellors and the NCR, called for submission of proposals to creditors for approval of uncontested consent orders from the Magistrates' Courts. Roestoff et al., *supra* note 11, at 249 n. 12, 274 nn. 170-71.
[15] UP Law Clinic (2009), *supra* note 12, § 5.2.2.3.
[16] UP Law Clinic (2012), *supra* note 12, § 3.3.5.
[17] *Id.* § 3.4.4.
[18] *Id.* § 3.4.4.
[19] National Credit Regulator, *Debt Review Task Team: Covering Report* (May 2010) § 4.1.1.2 [*hereinafter,* NCR Task Team *Report*].
[20] UP Law Clinic (2012), *supra* note 12, § 3.1.
[21] NCR Task Team *Report, supra* note 19, § 4.1.2.1.
[22] *Id.* Annexure C. The NCR approved these guidelines, effective in the second quarter of 2011 and today referred to as the "DCRS," or Debt Counselling Rules System. UP Law Clinic (2012), *supra* note 12, § 3.4.2.

to offer minimum percentages of their after-tax income toward full payment of creditors.[23] Guidelines for credit providers to agree to term extensions and interest reductions are also set forth (e.g., up to 60 months for unsecured debt, 84 months for car loans, and 240 months for home loans).[24] Detailed suggestions are given for identifying areas where debtors' spending patterns might be curtailed to make more income available to creditors. For example, the guidelines call for debtors with after-tax income up to ZAR2000 to make a minimum of 23%-45% of this income available to creditors each month. The guidelines do not, however, take into account the number of people in such debtors' households or their reasonable subsistence needs.

As these guidelines reveal, the debt review process provides a workable framework for relief for only a fraction of debtors with substantial income. The Task Team guidelines implicitly recognize that, since the goal of debt review under the NCA is to allow debtors to pay their rescheduled debts in full, not all debtors will be able to propose viable proposals.[25] As debt counsellors had long observed, "[m]ost consumers can't afford it."[26] For debtors with significant debts and/or low income, "the proposed repayments offered are very low and proposed term is unrealistically long."[27] Nonetheless, the guidelines also encourage credit providers to accede to a revolutionary policy of consensual discharge: "if the consumer meets the obligations in terms of the repayment plan, [unsecured] capital not repaid … after 60 months … would be set aside (written off and forfeited) by the Credit Provider, in the interest of the consumer rehabilitating into the credit market."[28] Credit providers do not seem to be complying, however, with the NCR Task Team's proposal for consensual debt forgiveness.

Finally, even for the relatively few workout plans accepted (or imposed by Magistrates' Court order), many if not most of these plans are highly likely to fail, as the debtors are unable to manage the demands of maintaining their lives and families while making such a substantial percentage of their income available to creditors. One recent study of a year of files from a major South African debt counselling firm notes "a large percentage of clients fail even to make the first payment" on counsellor-proposed debt review plans.[29] Even for the relatively high-income subjects in the large dataset for this study (averaging over ZAR18 000 per month), over one-third of debtors whose proposals were accepted in 2012 had already defaulted by mid-2014, with the default rate for those with income below ZAR10 000 rising to 45%.[30]

IV. The Proposed Reform

The process of reforming South African insolvency law has been pending for more than 15 years. The South African Law Reform Commission began discussion of the reform, soliciting public comment, in the late 1980s, culminating in draft bills in 1996, 1999, and 2000.[31] After a

[23] NCR Task Team *Report, supra* note 19, Annexure C, § 5.3.
[24] *Id.* Annexure E.
[25] UP Law Clinic (2012), *supra* note 12, § 3.4.2.
[26] *Id.* § 3.4.3.
[27] NCR Task Team *Report, supra* note 19, Annexure C, § 5, p. 17.
[28] *Id.* Annexure E, § 1.4.2.
[29] Phillip de Jager & Neil Tillemans, "The Behavior of South African Consumers Under Debt Counselling," http://ssrn.com/abstract=2474540 (31 July 2014).
[30] *Id.* at 21 (graph 12), 34 (graph 1).
[31] *See* André Boraine & Melanie Roestoff, "The Treatment of Insolvency of Natural Persons in South African Law: An Appeal for a Balanced Approach," 5 *World Bank Legal Review* 91, 107 (2014).

key symposium review and revision by the University of Pretoria's Centre for Advanced Corporate and Insolvency Law in 2000,[32] the revised Bill was accepted in concept by the Cabinet in March 2003, but it then stalled.[33] The most recent (non-public) version of the Bill differs slightly from the public version, in particular with respect to the single provision relating to personal insolvency.

A. The Current Proposal: Clause 118

No material, non-creditor-oriented changes are proposed in the sequestration-and-rehabilitation process, which remains all but unavailable to individual debtors with few assets and little or no income, as discussed above. Rather, the proposal is to implement a new process, prior to and instead of a sequestration proceeding. Clause 118 of the Insolvency Bill adds a new procedure to the Insolvency Act for "pre-liquidation composition with creditors." This new procedure is open to natural individuals and a few types of juridical entities,[34] but only to those with total debts less than ZAR200 000. Rather than lodging a petition with the High Court or Magistrate's Court, the debtor would lodge a proposed composition along with a sworn declaration regarding his or her assets, liabilities, income, and expenses[35] with an "administrator" (see section IV.B.2 below for a discussion of this undefined institution).

The administrator would then be tasked with convening a hearing on at least 14 days' notice to creditors[36] and the relevant Master of the High Court. This hearing would provide an opportunity for the debtor to be questioned regarding the composition proposal (in particular, regarding "the possibility of living more frugally") and for creditors to prove or object to claims and vote on the proposal. As is common worldwide practice, a qualified majority of unsecured, non-preferent[37] creditors would be empowered to bind all creditors who received notice of the composition hearing. The qualified majority here is a majority in number and two-thirds in value of claims held by voting creditors. The *status quo* would be preserved by a prohibition on any existing creditor's institution of any action against the debtor (including a request for compulsory sequestration/liquidation of the debtor's estate) after the determination of the hearing date.

If the composition were accepted, the administrator then would have another series of duties. She or he must circulate a certificate of acceptance to the relevant Master of the High Court and to all creditors. Every six months thereafter, the administrator must send an account

---

[32] *See* University of Pretoria, Centre for Advanced Corporate and Insolvency Law, *Final Report Containing Proposals on a Unified Insolvency Act* ¶ 22.6 (2000) [*hereinafter*, Univ. of Pretoria, *Final Report*].

[33] *Id.*; Explanatory Memorandum ¶ 118.22. The Department of Justice's website on the Insolvency Bill still posts the July 2003 version as the latest. *See* http://www.justice.gov.za/master/insolvency.html. The Department of Justice selectively released a revised Bill in June 2010, however, *see* van der Linde, *supra* note 4, at 522; Boraine & Roestoff, *supra* note 31, at 107, and the current (nonpublic), further revised Insolvency Bill is dated February 2014.

[34] This procedure would be available to juridical entities other than companies and close corporations, both of which already have access to composition proceedings as provided for in Section 155 of the Companies Act of 2008.

[35] Insolvency Bill, Schedule 4. This declaration corresponds to the one used to initiate administration order proceedings in the Magistrates' Courts. Explanatory Memorandum ¶¶ 118.10, 197.

[36] One very positive step here is the rejection of a required notice in the Government Gazette, which the drafters considered "will undermine the objective that the procedure should be as simple as possible." Explanatory Memorandum ¶ 118.14.

[37] Secured and preferent creditors are not affected by the composition unless they consent in writing. Insolvency Bill cl. 118(17).

of receipts, expenses, and payments to all creditors and the Master of the High Court. The administrator may also hail the debtor for further questioning at any time "as the court may consider necessary."[38] If the debtor is eventually unable to comply with the composition, the administrator may revoke it or, if "reasonable grounds" for the debtor's inability are shown, allow the debtor to seek creditor acceptance of a modified composition. In exchange for this work, the administrator is to be remunerated "in terms of the composition."

The key provision here is sub-clause 118(22), which addresses the scenario where the debtor's proposed composition is not accepted by a qualified majority of creditors. In such a case, if the administrator concludes that the debtor is "unable to make available to creditors substantially more," the administrator must declare an end to the composition proceedings and send a copy of this declaration to all creditors and the relevant Master of the High Court. The debtor then may lodge an application with the Master for a discharge of unpaid, unsecured debts. The Master "may" grant such a discharge if two prerequisites are satisfied. First, the debtor must satisfy the Master that the debtor provided standard notice of the application for a discharge to the administrator and all known creditors at least 28 days before lodging the application with the Master. Second, after hearing any comments by the administrator and creditors, the Master must be satisfied that (i) the debtor's proposed composition was "the best offer which the debtor could make to creditors," (ii) the debtor's inability to pay debts in full "was not caused by criminal or inappropriate behavior by the debtor," and (iii) the debtor does not qualify to apply for an administration order.

B. History and Key Revisions to Composition Relief: 1999 to Present

This pre-liquidation composition provision appeared for the first time in the South African Law Reform Commission's *Discussion Paper 86* (1999) and its subsequent *Report on Review of the Law of Insolvency* in April 2000. It has changed in important detail since then, however. Originally proposed as a new section 74X to the Magistrates' Courts Act 32 of 1944, most of these provisions, with the notable exception of sub-clause (22), were drawn to provide parallel treatment to the preceding administration orders provisions. This provision has remained materially unchanged since its introduction in 1999, with three major exceptions.

1. Eligible Debtors

The original provision contained no debt limit. It was designed to be available to all honest debtors who desired a path to relief via an honest, "best efforts" compromise with creditors. Without explanation, a debt limit has appeared recently, limiting access to this process to debtors with debts less than ZAR200 000. The South African Law Reform Commission had explicitly rejected such an arbitrary limitation, and the verbatim language used to explain this rejection curiously remains in the Explanatory Memorandum today.[39] It is unclear why or when this limitation was inserted.[40]

---

[38] Insolvency Bill cl. 118(19)(a). The stray reference to "court" here is likely a remnant of the previous version of this sub-clause, which was administered by the Magistrate's Court, though the intent is not entirely clear.
[39] *Compare* Law Commission *Report* (2000) ¶ 124.4 *with* Explanatory Memorandum ¶ 118.9.
[40] Also, while the original proposal was to be available only to natural persons, *see* Law Commission *Report* (2000) ¶ 124.4, the process was opened to non-natural entities by recommendation of the University of Pretoria's Centre for Advanced Corporate and Insolvency Law in 2000. Univ. of Pretoria, *Final Report, supra* note 32, ¶ 22.6.

2. Magistrate's Court Versus "Administrator"

As originally structured, this new process was designed as a more effective alternative to the administration order process, also under the control of the relevant Magistrate's Court.[41] As very recently modified,[42] sub-clause 118(22) now reassigns and bifurcates responsibility for the two stages of the composition process. This decentralization revision was made "in view of the heavy workload and capacity problems of magistrates,"[43] but no further explanation is offered for the choice of the new responsible parties.

The first stage is now assigned to an "administrator." Though this seems to be a parallel concept to the "administrator" appointed by Magistrates' Courts in administration order proceedings, this is not clear from the Insolvency Bill or its Explanatory Memorandum (and it is unclear how an administrator would be appointed to any given case). An administrator is defined simply as any person who is not disqualified from being a liquidator in terms of new clause 69 of the Insolvency Bill and who has furnished security in a form and amount determined by the Master of the relevant High Court.[44] A new list of prerequisites for qualifying as a liquidator thus represents the only clear control on the identity of these "administrators," the most salient one being that she or he must be a natural person who is "a member of a professional body recognized [in a notice published by the Minister of Justice]."[45] This qualification idea is entirely new, so it is unclear which professional bodies the Minister will endorse or how that decision is to be made.

The second stage—choosing whether to grant the debtor a discharge if a composition is nonetheless rejected by creditors—is assigned to the Master of the High Court.[46] The power to fundamentally alter creditors' rights is withheld from the private "administrator,"[47] though the choice of the relatively few, centralized offices of Master of the High Court (as opposed to the numerous, geographically widespread Magistrates' Courts) and the process of debtors' invoking this new authority are unexplained.

3. A Revised Route to Discharge Relief

The most substantial deviation from the original Law Reform Commission proposal in the latest Insolvency Bill concerns the process of debtors' obtaining a discharge. Under the Law Reform Commission's original proposal, if creditors rejected the debtor's composition offer, the debtor could choose to have his or her assets liquidated and administered and a discharge granted *as if* he or she had qualified for voluntary sequestration under the Insolvency Act.[48] As the

[41] Clause 118 to this day still contains stray references to "the court." *See, e.g.,* clause 118(19)(a) and (23) (providing for questioning of the debtor "as the court may consider necessary") and Explanatory Memorandum ¶ 118.17 (referring to the administrator's permission, though the provision in sub-clause (23) refers to "the court").
[42] Very recent commentary on the Insolvency Bill still reflects a court-driven process, so the abandonment of this approach must have occurred within the past two years. *See, e.g.,* Boraine & Roestoff, *supra* note 31, at 107.
[43] Explanatory Memorandum ¶ 118.7.
[44] Insolvency Bill cl. 118(1)(a).
[45] Insolvency Bill cl. 69(1)(a), (1)(h), (2).
[46] Insolvency Bill cl. 118(22).
[47] Explanatory Memorandum ¶ 118.23.
[48] Law Reform Commission *Report* (2000), Schedule 4, cl. 74X(16); *see also* Explanatory Memorandum ¶¶ 118.21. The Magistrate's Court would simply forward to the Master of the High Court a certificate, which would entitle the debtor to the eventual benefits of rehabilitation, but a liquidation would occur only if a creditor accepted liability for

Commission explained, a consistent theme of the insolvency reform project is that "creditors should be allowed to be the masters of their own faith [sic]."[49] Though creditors would be the masters of their fate in terms of accepting or rejecting a debtor's offer, "[t]he notion that creditors should be left to decide matters affecting them [was] not honoured" if they refused a best-efforts offer and "a debtor who is caught up in debts will remain at the mercy of creditors indefinitely."[50] The Law Reform Commission pointed out that this was "one of the few provisions in the Bill which clearly favour[ed] a fresh start for a debtor in line with modern trends."[51]

This approach was abandoned almost immediately with very little explanation. In its final report on the Law Reform Commission's proposal, the University of Pretoria's Centre for Advanced Corporate and Insolvency Law observed simply that this discharge provision "is going to lead to abuse in practice."[52] With no further elaboration or explanation, the original discharge provision was removed from the Bill in 2000. The University of Pretoria's report contained an important proviso, however. The removal of the Law Reform Commission's proposal "should serve only an interim measure," the final report explained, "until such time as … provisions relating to a fresh start for individuals, have been properly debated and implemented."[53] Fifteen years have elapsed since this statement was made. As discussed below, the time has long since arrived to acknowledge that international consensus has developed in support of the kind of bold proposals made by the Law Reform Commission, effectively balancing a fresh start for debtors and the legitimate demands of rationally oriented creditors.

V. Characteristics of Effective, Modern Personal Insolvency Regimes

In contrast to the Insolvency and Creditors Rights (ICR) Reports of Observance of Standards and Codes (ROSC) process for evaluating business insolvency regimes, there is no internationally accepted standard against which a personal insolvency regime might be measured. Nonetheless, substantial experience has been accumulated among both Anglo-American and Continental European personal insolvency systems. In Europe in particular, new procedures have been adopted and revised multiple times within the past few decades, and several international associations and organizations have identified the key characteristics of effective, modern personal insolvency regimes.[54]

---

the costs of the liquidation process. The disabilities of being an insolvent would not, however, attach to the debtor during the waiting period between liquidation of his or her assets and the grant of a discharge in due course under the Insolvency Act's rehabilitation provisions. Of course, such relief was neither immediate nor necessarily unconditional, as discharge relief under clause 101(1)(c) and (3) of the Insolvency Act requires an application to the High Court after a minimum of four years, with automatic relief becoming available only after 10 years.

[49] Law Reform Commission *Report* (2000) ¶ 124.4. This language remains in the current Explanatory Memorandum ¶ 118.9, though this phrase is entirely out of proper original context in light of the current revision.

[50] Law Reform Commission *Report* (2000) ¶ 124.10; *see also* Explanatory Memorandum ¶ 118.21.

[51] Law Reform Commission *Report* (2000) ¶ 124.10.

[52] Univ. of Pretoria, *Final Report, supra* note 32, ¶ 22.5.

[53] *Id.*

[54] For an in-depth examination of the variety of informal "best practices" reports over the past thirty years, see Jason J. Kilborn, *Expert Recommendations and the Evolution of European Best Practices for the Treatment of Overindebtedness, 1984-2010* (Kluwer 2011), final draft online at http://ssrn.com/abstract=1663108 [*hereinafter,* Kilborn, *Expert Recommendations*].

The World Bank turned its attention to these developments in January 2011, launching a project to utilize the expertise of its Insolvency and Creditor/Debtor Regimes Task Force to study the key regulatory aspects underlying the insolvency of natural persons. Two years later, this project culminated in the release of the *Report on the Treatment of the Insolvency of Natural Persons*.[55] The genesis of the World Bank *Report* was a recognition in the wake of the global financial crisis that "the problem of consumer insolvency [is] a systemic risk" giving rise to "the consequent need for the modernization of domestic laws and institutions" governing this problem.[56] As the World Bank's *Note* of December 2013 on the South African system makes clear, while the *Report* does not represent a standard, its conceptual framework can be used quite fruitfully to identify more effective and less effective characteristics of legal regimes for treating personal indebtedness.[57]

The first, most important characteristic of effective, modern personal insolvency systems is a broad discharge.[58] The scope and depth of the problem confronting individuals in countries like South Africa today requires bold relief that would have been inconceivable in most countries decades ago. Today, a legally imposed discharge of debt is the widely accepted *sine qua non* of effective relief, adopted by dozens of countries in the past few decades, including virtually all EU Member States, and more recently, Colombia and Russia. As numerous observers have discovered of the debt review process, most modern debtors are simply unable to right their deeply distressed financial situations without a wholesale reduction of outstanding obligations.

This approach to debt relief is a distinct departure from a long history of favoring creditors in South Africa and many other countries, but modern personal insolvency laws are built around goals and objectives that expand the perspective well beyond benefits to creditors, emphasizing instead the broad range of benefits for debtors, their families, and broader society. Those benefits are discussed in depth in the World Bank's *Report*[59] and *Note*[60] and so will not be repeated here. A key point made in the *Note* is emphatically true, however, in light of the content and discussion in the Insolvency Bill: "A change of paradigm would be required to overhaul the system."[61] Adopting a new, "debtor friendly" position requires a real shift in perspective, but an increasing number of countries not unlike South Africa have taken this step in the past few decades.

A second characteristic, closely related to the first, is that access to discharge relief is made available openly and broadly, by limiting costs and eligibility requirements and avoiding arbitrary entry and exit restrictions, such as debt limits or a probing examination of debtors' non-fraudulent behavior, good faith, or the reasonableness of granting relief.[62] The type of portfolio relief provided by a personal insolvency system must be made available broadly and in an administratively efficient manner if the macro-economic benefits mentioned above are to be

[55] World Bank, Insolvency and Creditor/Debtor Regimes Task Force, *Report on the Treatment of the Insolvency of Natural Persons* (2013) [*hereinafter*, World Bank *Report*].
[56] World Bank *Report* ¶ 6.
[57] *See* World Bank *South Africa Note* at 17.
[58] *See* Kilborn, *Expert Recommendations, supra* note 54, at 18-23.
[59] *See* World Bank *Report* § I.8, ¶¶ 56-111.
[60] *See* World Bank *South Africa Note* at 17-18.
[61] *Id.* at 17.
[62] *See* Kilborn, *Expert Recommendations, supra* note 54, at 33-45.

obtained. For example, the groundbreaking Danish law (adopted in 1984) was revised for the first time in 2005 in part to ease entry requirements. The first continental regime of its kind, the Danish law hesitantly embraced the novel idea of debt relief, encouraging courts to scrutinize debtors' applications for worthiness. The 2005 reform encouraged broader access by reversing an earlier presumption against relief, so that today, the Danish law calls for debtors to be offered relief unless consideration of a list of factors "suggests decisively against."[63] The longstanding US law contains no entry restrictions at all, and most European laws require only that the debtor demonstrate "overindebtedness" to gain entry to the relief system.

The counter-balance to open access is a common fear of rampant abuse by debtors and a constriction of the supply of credit. As for the latter concern, international experience has demonstrated repeatedly that creditors *always* claim that access to credit will be constrained if *any* consumer protection measure is adopted (South Africa saw this in the adoption of the National Credit Act of 2005), but these threats rarely materialize, or they fade quickly as the market reacts to new profit potential. As for moral hazard, the World Bank *Report* in particular acknowledges the fear of that debtors might seek to take unfair advantage of new opportunities for relief, but in light of years of empirical evidence, it cautions that "the instances of real fraud are vanishingly low"[64] and "any reduction in moral hazard needs to be balanced against the increased screening costs and the social costs of more restricted access."[65] Ultimately, "[c]are should be taken to avoid sacrificing the great good of such a system simply because perfection cannot be assured."[66]

A third common, though not universal, characteristic of modern personal insolvency regimes is a requirement that debtors earn their fresh start. That is, many regimes today require debtors to submit a portion of their future income to paying creditors as a condition for a discharge of the remainder that cannot be paid with this identified portion.[67] Requiring all debtors to submit to a payment plan is a controversial point, however, that has produced significant challenges in practice. The great majority of debtors in existing regimes have been unable to offer more than a nominal amount to their creditors, leading many commentators to question the utility of expending administrative resources to collect and process these meager payments and monitor debtor activity over a term of years.[68]

Nonetheless, requiring compliance with a multi-year plan remains a common characteristic of modern personal insolvency law, which requires a sensitive determination of the level of sacrifice expected of debtors and their families; i.e., what degree of frugality is expected of debtors and over what period of time in order to produce a maximal distribution to creditors? The World Bank *Report* discusses these issues at length, including the particular problems of leaving these sensitive public policy issues to the discretion of a court or any other system actor. Discretion has led inevitably to unrealistic and unworkable expectations of debtors, leaving them

---

[63] *See* Jason J. Kilborn, "Twenty-Five Years of Consumer Bankruptcy in Continental Europe: Internalizing Negative Externalities and Humanizing Justice in Denmark," 18 *International Insolvency Review* 155 (2009), online at http://ssrn.com/abstract=1419488.
[64] World Bank *Report* ¶ 118.
[65] *Id.* ¶ 193.
[66] *Id.* ¶ 115; *see also* ¶ 119.
[67] *See* Kilborn, *Expert Recommendations, supra* note 54, at 45-59; World Bank *Report* ¶¶ 266-67, 284-85, 287-97.
[68] *See, e.g.,* Kilborn, *Expert Recommendations, supra* note 54, at 46; World Bank *Report* ¶¶ 311-14.

unable to obtain needed relief.[69] Discretion has also produced wide disparities in treatment of similarly situated debtors based on nothing more than geography or idiosyncratic personal preference of the particular decision-maker.[70] Decades of trial, error, and reform in many countries have revealed that the best practice is to settle on a norm to be applied countrywide, with variations for different household makeups and needs, preferably developed by a central decision-maker with a sensitivity to the public policy underlying these determinations:[71]

> The appropriate measure of sacrifice to be demanded of debtors in exchange for whatever relief an insolvency system offers is a crucial and inherently political decision. Such a central issue of public policy is likely better made by a legislature or other representative entity, rather than by the administrators of the insolvency system. While the relevant judicial and executive actors indeed do have close contact with debtors and creditors, and thus have insight into the specific needs of the people most closely affected by the system, they are simply not in the best position to make the sensitive social policy decisions that drive an insolvency regime.[72]

In virtually all modern personal insolvency systems, if the debtor complies with the law's objective requirements (usually turning over any disposable income beyond a protected minimum for a term of 3-5 years), a discharge automatically follows. Exceptions can be and often are made for particular debts or for particularly undeserving debtors, but these are exceptions; the rule is non-discretionary relief on objective, predictable terms. Where discretion remains, it is at least guided toward granting relief and limiting expected sacrifices from debtors. For example, the Danish law was reformed in 2005 to address precisely these issues. After years of struggling with overly demanding and widely divergent payment plan expectations, Danish lawmakers standardized and lightened the expected sacrifices of debtors in exchange for relief. No longer do Danish courts have free discretion to define a "modest lifestyle"; rather, Justice Ministry guidelines on basic budgetary allowances constrain that decision, leaving debtors a far more "livable" budget.[73] The standardization of Dutch practice is also described in Annex B.

Ireland presents a particularly impressive example of reigning in discretion and establishing uniform, nationwide guidelines for expected sacrifice. In determining the appropriate level of sacrifice and creditor payment expected of debtors, the new Irish law encourages courts to consider guidelines developed by the new Insolvency Service of Ireland. These guidelines are a model of best practices. The Insolvency Service consulted a wide variety of indicators and experts on the subject of household income and expenses, including a "consensual budgeting" project using focus groups to identify appropriate categories and amounts of expenditures for a minimum standard of living for various household types, adjusted annually for changes in the cost of living. The result is a budget that "is neither a survival standard nor a standard for people in poverty; rather it is a standard of living that should allow for people to engage in activities that are considered the norm for Irish society."[74]

---

[69] *See* World Bank *Report* ¶¶ 266-67, 284-85, 287.
[70] *See id.* ¶¶ 288.
[71] *See* Kilborn, *Expert Recommendations, supra* note 54, at 49-58; World Bank *Report* ¶¶ 290-97.
[72] World Bank *Report* ¶ 290.
[73] *See* Kilborn, Denmark, *supra* note 63.
[74] Insolvency Serv. Ireland, *Guidelines on a reasonable standard of living and reasonable living expenses* 24 (2013).

A fourth and final characteristic of many, though again not all, modern personal insolvency regimes is a mandatory attempt to find an extra-judicial, negotiated solution; i.e., a composition with creditors.[75] Many lawmakers around the world agree with the South African Law Reform Commission's comment that "creditors should be the masters of their own [fate],"[76] and private, negotiated solutions are certainly superior to costly, official proceedings that encumber the formal administrative or judicial system.[77] The provision of low-cost debt counselling is crucial to the success of such negotiations, as is the possibility of overcoming dissent from minority creditors through some means of imposing a majority-supported plan.[78]

Many modern personal insolvency regimes, in contrast, resist relegating the decision as to debt relief to a negotiation. Many lawmakers from the very first personal insolvency laws to the most recent ones have decided that the proper measure of expected sacrifice by debtors and creditors alike is a public policy issue that should be decided as a uniform matter of baseline policy for all cases. "The proper levels of sacrifice by distressed debtors, and the appropriate levels of protection of and compromise by their creditors, are sensitive matters of social policy" that in a substantial number of regimes is assigned to "political representatives whose task is to balance the competing interests of different constituencies, such as debtors and creditors."[79]

The earliest personal insolvency laws extended relief to debtors without requiring negotiation with creditors. Neither the English Insolvency Act 1986 nor any of the related Anglo-American regimes (including that in the US, going back to 1898) imposes such a requirement. Negotiated solutions, or at least payment plans, are possible in these systems, but a compromise workout is a realistic solution only for a subset of debtors who generally self-select into this track. Similarly, the drafters of the first continental European consumer insolvency law explicitly rejected a required overture to creditors. In deliberations over the form of the Danish law of 1984, the commission concluded that a forced compromise system was unsuitable for consumer debtors who could not offer a significant and relatively quick dividend to creditors.[80]

Even where composition proceedings have been adopted, however, "[e]xperience in many existing systems … has revealed that the merits of voluntary settlements are often illusory."[81] At best, the process has been a waste of time and resources; at worst, it has led to serious delays in processing debtor proposals and "onerous payment plans that are not viable."[82] The illustrative challenges of brokering negotiated solutions in France and the Netherlands are described in Annexes A and B. Moreover, encumbering counsellors with universal, mandatory composition negotiation has distracted the efforts of debt counsellors in cases of less distressed debtors who were viable candidates for a workable composition. The conflating insolvency review with debt counselling thus undermined a valuable option for mildly overindebted debtors.

[75] *See* Kilborn, *Expert Recommendations, supra* note 54, at 23-33; World Bank *Report* ¶¶ 127-29.
[76] Explanatory Memorandum ¶ 118.9.
[77] *See* Kilborn, *Expert Recommendations, supra* note 54, at 23-24; World Bank *Report* ¶ 130.
[78] *See* Kilborn, *Expert Recommendations, supra* note 54, at 24-25, 28-33.
[79] World Bank *Report* ¶ 212.
[80] *See* Kilborn, Denmark, *supra* note 63.
[81] World Bank *Report* ¶ 131.
[82] *Id*.

Consequently, "lawmakers from many countries have concluded that the paltry gains to be had from inviting creditors to participate in most natural person insolvency cases are far outweighed by the significant administrative costs and delays occasioned by creditors' meetings."[83] For example, when Sweden adopted its *Skuldsaneringslag* a decade after Denmark in 1994, it required debtors to first seek private solutions in counsellor-supported negotiations with creditors. The formal relief system continued this process, with another payment plan proposal drafted by the system administrator and put to a creditor vote. This process attracted heavy criticism from the beginning. Delays of several months at the first negotiation stage put off needed relief and led to almost certain failure. Lawmakers ultimately scrapped this wasteful formality in both of its iterations. In 2007, Sweden became the first country to abandon its earlier requirement of private negotiation with creditors before seeking formal relief.[84] Similarly, after only two years of struggles with a similar required negotiation stage, Greece has abandoned this requirement, as well,[85] and many newer laws have avoided it from the beginning.[86] Sweden also abandoned the creditor voting aspect of the formal process. After discovering that some creditors (mainly large institutional creditors) were opposing reasonable composition plans pursuant to a general principle of opposition to debt relief, lawmakers scrapped this voting process, as well, empowering the system administrator to simply impose appropriate relief on creditors without asking their opinion.[87]

Among the latest countries to fundamentally reform their personal insolvency regimes, Ireland had high hopes for negotiated solutions, but those hopes have been similarly frustrated. Fully effective as of December 2013, the thoroughgoing reform of Irish personal insolvency now favors negotiated solutions.[88] Just as in Sweden, however, key institutional creditors have already signaled their unwillingness to engage with this new compromise system. Despite pressure from regulators, the Bank of Ireland (a private bank) announced that engaging with distressed debtors to strike debt adjustment deals is "not a policy of the bank."[89] Although the Irish law allows dissent from intransigent creditors to be overridden if a payment plan is

---

[83] *Id.* ¶ 208. The failure of compositions in this context is not at all surprising. Most creditors can be expected to be rationally uninterested in such a process. *See, e.g., id.* ¶ 134. Indeed, some creditors have taken a particularly rigid stance in opposing any compromise, as policymakers have discovered "many creditors [are] simply refusing to participate in good faith in this process, rejecting any modification of their claims," which renders any attempt at a composition "little more than a pure formality." *Id.* ¶ 132. For the vast majority of debtors with little value to offer, creditors have very little non-altruistic incentive to bargain with such debtors. The laborious process of summoning creditors to vote on a composition plan is pointless in the vast majority of cases where debtors have nothing or next to nothing to offer creditors. Even in cases of debtors with something more to offer, the values here are simply not worth the effort and attention for creditors in the vast majority of cases.

[84] *See* Jason J. Kilborn, "Out with the New, In with the Old: As Sweden Aggressively Streamlines Its Consumer Bankruptcy System, Have U.S. Reformers Fallen Off the Learning Curve?," 80 *American Bankruptcy Law Journal* 435 (2007), online at http://ssrn.com/abstract=913096.

[85] Law 3869/2010, reformed by Law 4161/2013.

[86] Greece was the only country to adopt a new personal insolvency law after 2000 and before 2012 with a mandatory plan negotiation stage. Estonia, Portugal, Slovakia, the Czech Republic, Latvia, Slovenia, and Poland adopted laws during this period with no such requirement. *See* Kilborn, *Expert Recommendations*, *supra* note 54, at 25.

[87] *See* Kilborn, *supra* note 84.

[88] *See, e.g.*, Jason Kilborn, "Reflections of the World Bank's *Report on the Treatment of the Insolvency of Natural Persons* in the Newest Consumer Bankruptcy Laws: Colombia, Italy, Ireland," 26 *Pace International Law Review* __ (*forthcoming* 2014), online at http://ssrn.com/abstract=2426622 [*hereinafter*, Kilborn, *Reflections of the World Bank's* Report].

[89] "BoI chief says debt forgiveness 'not bank policy'," *Irish Times* (4 Sept. 2013).

supported by a majority of creditors holding 65% of claims against the debtor, even this has been insufficient to support the conclusion of compromise plans in all but a few cases. The Insolvency Service of Ireland reported a total of just over 1150 new cases seeking negotiated solutions as of the third quarter of 2014, but of these, only 311 had concluded with approved arrangements.[90]

VI. The Insolvency Bill's Proposal Examined In Light of Modern Insolvency Policy

The Insolvency Bill incorporates some of the characteristics of modern personal insolvency law, but its proposed structure includes several key elements that have been commonly criticized and have proven notably problematic in international experience. While the current drafters characterize the Law Reform Commission's original proposal as "rather intricate and drastic,"[91] ironically, it is not the original proposal, but the alternative in the current Insolvency Bill that is unnecessarily intricate and likely to inhibit the effective delivery of relief.

A. Discharge

The Insolvency Bill includes a discharge element not explicitly dependent on conferring a benefit on creditors. This is a positive development that reflects international norms. The Bill and its Explanatory Memorandum do not convey a compelling reason for South African legislators to adopt this drastic departure from longstanding practice, however. On the contrary, a vaguely articulated fear of undefined abuse by debtors pervades the Explanatory Memorandum and has the potential to undermine a constructive discussion of the many reasons why South Africa should join the many other countries that have adopted discharge relief regimes for individuals.

South African policymakers might be understandably hesitant to open up the relief floodgates after decades under an extremely restrictive insolvency regime. Constant invocation of fears of abuse by debtors, without explanation and without counterbalancing discussion of the many benefits of this law, might well dissuade policymakers from taking the appropriate steps to maximize financial and social inclusion. As discussed above, unexplained fear of potential abuse by debtors led to the abandonment of the South African Law Reform Commission's original, non-discretionary proposal in 2000—that it might somehow "lead to abuse in practice."[92] This fear of undefined abuse persists in the current Explanatory Memorandum, which observes without elaboration that it would "[p]robably not" be justified to do as the Law Reform Commission proposed and grant the debtor non-discretionary relief once creditors have rejected a proposed best-efforts composition.[93]

These unexplained fears of abuse are confusing and potentially damaging.[94] It is unclear how a debtor could abuse a system that calls for a best-efforts composition attempt before obtaining formal relief. If the debtor has offered the best he or she can possibly manage, and

[90] Insolvency Service of Ireland, *ISI Statistics Quarter 3 2014*, online at http://www.isi.gov.ie/en/ISI/ISI_Statistics_Quarter3.pdf/Files/ISI_Statistics_Quarter3.pdf.
[91] Explanatory Memorandum ¶ 118.21.
[92] *See* Univ. of Pretoria, *Final Report, supra* note 32, ¶ 22.5.
[93] Explanatory Memorandum ¶ 118.27.
[94] *See* World Bank *Report* ¶¶ 113-119.

creditors reject this, it is unclear how a debtor might abuse the system by seeking relief from the portion of his or her debts that cannot reasonably be paid. The Explanatory Memorandum suggests the need to forestall "abuse to avoid the payment of debts."[95] Once again, if the debtor has offered a best-efforts composition to pay his or her debts, it is unclear how this can properly be called abusive avoidance of paying debts.[96]

Legislating a discharge is one thing; making it practically available to needy debtors is another. More serious problems with the Insolvency Bill relate to its narrowing of access to discharge relief, as well as the method by which that relief is obtained, as discussed below. Incorporating a discharge into South African personal insolvency law is a positive step, but only if that relief is broadly available If a discharge is unavailable to many debtors, this regime will founder on the same problems as its predecessors in the administration order and debt review processes.

B. Low-Cost, Open Access

Restrictions on access to effective debt relief are among the principal stumbling blocks in current South African law,[97] and the Insolvency Bill achieves a mixed success on this factor. On the one hand, it responds sensitively to the issue of cost, in line with modern practices. The Explanatory Memorandum criticizes the notion of requiring a costly application to the High Court,[98] placing administrative responsibility in a presumably less expensive forum (though see below on the particular challenges of institutional capacity). Some questions remain in terms of cost, however, such as the process by which debtors would engage the Master's offices with discharge requests and what costs debtors might be expected to shoulder with such applications.

On the other, less successful hand, the current Bill inexplicably imposes a debt-level entry restriction on the new regime. The recent revision restricting access to only debtors with debts less than ZAR200 000 is surprising and unconstructive. The South African Law Reform Commission explicitly rejected such an arbitrary limitation, and it is unclear on what basis any debt limit restriction was imposed, much less the admittedly arbitrary figure of ZAR200 000. Distress is a relative concept, not absolute. One hundred kilograms is a heavy burden for some, light for others. It is not a useful approach to define "heavy burden" as a maximum or minimum of 100 kilograms. The proper question is what burden can each debtor reasonably bear. A debtor who owes a million Rand is just as much in need of relief as one who owes only 200 000. The current proposed ZAR200 000 debt limit would deny relief to heavily indebted small entrepreneurs, exactly the group who stand to contribute the most to South Africa's economic revitalization.

---

[95] Explanatory Memorandum ¶ 118.27.

[96] The closest thing that might be an "abuse" is invoking the composition process with no intention of making a best-efforts offer, simply to delay a payment obligation. Misuse of the system in this way can be easily identified and sanctioned. But actual best-efforts offers from debtors with the expectation that creditors will accept the best the debtor can offer (or lose their right to harass the debtor further) cannot reasonably be categorized as abusive.

[97] World Bank *South Africa Note* at 19.

[98] The Explanatory Memorandum preserves language from all earlier drafts asserting that "[a]ny proposal which requires an application to the High Court, let alone several applications to the High Court, is also not supported," and then later, it suggests that "[a] court application would be costly" and should be avoided, but then it concludes, surprisingly and without further explanation, that "it is proposed that the decision be made by the Master of the High Court." Explanatory Memorandum ¶¶ 118.9, 118.27; *cf.* Law Reform Commission, *Discussion Paper 86* ¶ 124.4.

C. (Non-discretionary) Requirements for Discharge Relief

The most significant problems with the current Insolvency Bill relate to the vaguely defined gateway to and requirements for discharge relief. The Insolvency Bill does not explicitly incorporate an "earned fresh start" concept by requiring debtors to comply with a multi-year payment plan, but it requires debtors to offer their best efforts to pay their creditors as a condition to an imposed discharge. The way in which the discharge is granted raises serious problems, especially in terms of the multiple levels of discretion inherent in that decision. Unlike the original Law Reform Commission proposal, the current version of clause 118(22) provides that "the Master *may* … grant a discharge" if several other factors are present, including a subjective judgment by the administrator (and Master) that the debtor is "unable to make available to creditors substantially more," and a determination by the Master that "the inability of the debtor to pay debts in full was not caused by criminal or in appropriate behavior by the debtor." The multiple layers of discretion inherent in this provision are inconsistent with international best practices and raise both general and specific concerns.

1. General: Discretionary Discharge Undermines the Delivery of Effective Relief

To enjoy the full benefits of a personal insolvency system, and to control costs and institutional capacity problems, relief should be offered according to clear and predictable rules. If debtors qualify under objective standards for relief, they should receive relief. Making relief available only at the subjective discretion of the Master, a court, or other system actor is practically problematic, unnecessary, and inconsistent with modern norms.[99]

First, subjecting the debtor's discharge to the Master's unfettered discretion dissuades debtors from applying for uncertain relief.[100] The key challenge for a new relief system like that proposed for South Africa is not keeping dishonest debtors *out*, but "enticing honest but unfortunate debtors *into* the system."[101] Debtors will be much less likely to confront the social stigma of declaring themselves to be insolvent if they are unsure that they can obtain relief. Reducing the numbers of debtors accessing the relief procedure defeats the purpose of a regime designed to provide systematic relief to large numbers of overburdened and deactivated individuals. The major benefits of such a regime are broad-based. Narrowing the base of debtors willing to pursue relief (as well as those who actually receive it, see below) is counterproductive in a personal insolvency system.

Second, discretion slows the processing of large numbers of cases. Personal insolvency relief tends to be a large-scale, portfolio process. The National Credit Regulator's most recent

---

[99] The new, discretionary basis for relief in clause 118(22) belies the language in the Explanatory Memorandum responding to suggestions that the discharge be based on a fixed payment plan, as under Chapter 13 of the US Bankruptcy Code and the similar Dutch law. The drafters respond that "[t]here does not appear to be anything provided for in [US and Dutch law] that cannot be dealt with in a composition in terms of clause 118." Explanatory Memorandum ¶¶ 118.5, 118.9. This language, unchanged from the original Law Reform Commission proposal in *Discussion Paper 86* ¶¶ 124.3-124.4, is now out of appropriate context. Under US and Dutch law, if the debtor does what the law objectively requires in terms of a limited-term, fixed payment plan, then the debtor receives non-discretionary relief. This was also true of the original Law Reform Commission proposal, but it is no longer true in the approach of the current, recently revised clause 118(22).

[100] World Bank *Report* ¶ 124.

[101] *Id.* ¶ 120.

Credit Bureau Monitor reports nearly 10 million South African individuals with seriously impaired credit records, and another 1.5 million with accounts one to two months in arrears, many of whom are likely on the brink of overindebtedness.[102] If only one percent of these individuals seek relief in any given year, that will mean more than 100 000 filings flooding the system. This deluge of filings will have to be administered each year in as efficient a way as possible to avoid huge backlogs and deliver as much relief as possible in a reasonable time period. Requiring subjective, discretionary judgments inhibits this process.

Third, discretion introduces unwieldy and costly administrative complexity. Because the maximal effectiveness of this system depends on processing relief for large numbers of debtors, any excess administrative burden will weigh very heavily on the system itself, increasing cost and reducing effectiveness. The costs of a probing evaluation of each case would be overwhelming and/or bring the system to a halt. Perfect justice is simply not attainable in a personal insolvency regime. More importantly, it is not at all worth the cost in a context where debtors have so little to offer creditors, but society has so much to lose by keeping debtors in their constant state of penury.

For example, putting the Master to the task of establishing whether the debtor's inability to pay was "caused" by "inappropriate behavior"—with no definition of the boundaries of that vague concept[103]—assigns an impossible task for which the Master of the High Court is particularly ill-suited. The "causes" of personal insolvency are many and diverse, and the Master of the High Court has no reason to be familiar with the economics or sociology of overindebtedness.[104] Most overindebted debtors have made judgments that are, in hindsight, poor or irresponsible or inappropriate in some sense. But it is an extremely difficult task to tease out all of the myriad factors that contributed to the overindebtedness of any given individual. The Master of the High Court has no experience or training in performing such a complex and delicate analysis. Some degree of "inappropriate" debtor behavior will doubtless be identified in any given case unless the Master takes a *very* liberal view of this term, but the presence of a greater or lesser degree of debtor foolishness or irresponsibility does not detract from the macro-economic, societal need to free such debtors' future productivity and social inclusion from the shackles of past decisions.[105] Refusing to reward criminal behavior by denying a discharge of fines and penalties is common; foreclosing relief for those who have acted "inappropriately" is more difficult to comprehend or justify.

Likewise, the key decision that opens the door to this new relief is problematically relegated to unguided discretion. Clause 118(22) allows the debtor to apply for discharge relief only if the debtor "is unable to make available to creditors substantially more than that which he or she offered in the proposed composition." How to determine whether the debtor's proposed

---

[102] National Credit Regulator, *Credit Bureau Monitor* (2d Quarter, June 2014), tbl. 1 at 2.
[103] Indeed, the Explanatory Memorandum uses the term "unacceptable behavior" instead, already apparently confusing the relevant standard. Explanatory Memorandum ¶ 118.27.
[104] *See, e.g.,* World Bank *Report* ¶ 94.
[105] More fundamentally, the best criterion for access to relief is one that efficiently and effectively measures the problem to be solved rather than the worthiness of the victim of that problem. No good doctor would ask a patient with a broken leg whether the break occurred as a result of "inappropriate behavior" to indicate that the patient was "worthy" of treatment. Leaving the leg broken does not teach the patient a useful lesson on being more careful in the future; it simply inhibits the patient's useful mobility and social inclusion. Lessons on proper conduct can and should be administered later, after the disease is cured.

efforts are "best" or whether the debtor could reasonably offer something more to creditors is a very sensitive issue of public policy. As the Law Reform Commission originally observed, "[t]he requirement that the magistrate [now administrator and/or Master] must decide whether the debtor is able to make substantially more available to creditors than offered in the composition is the most onerous duty" in the proposed provision.[106] International experience has demonstrated that it is extremely problematic to encumber the magistrate, administrator, or Master with this burden without some relatively clear, objective policy guidance on what sacrifices society expects debtors to make to earn their fresh start.

2. Specific: Discretionary Relief Will Likely Be Powerfully Inhibited

South Africa's own history and recent experience strongly suggest that the Master of the High Court is likely to be extremely inhibited in exercising the discretion to grant discharge relief to any significant number of debtors. Several factors suggest that relief will seldom be forthcoming if it depends on the multiple discretionary decisions outlined above.

First, the best laws in the world will be ineffective if they are implemented by people who do not believe in the goals and processes of these laws. South Africa lacks a general culture of insolvency rehabilitation and remains encumbered by a powerful pro-creditor philosophy. This is particularly true in the sequestration system run by the High Court. The Master of the High Court is most likely steeped in the long-standing South African culture of pro-creditor politics. One develops a professional mentality and ethos as one acculturates to a particular system, and the people who have become Masters today have inevitably developed the mentality and ethos of supporting creditors and being very suspicious of debtors and their supposed "abuse." It is all but inevitable that Masters who have worked in such a system for their entire careers are most likely to resist a deviation from traditional pro-creditor culture and toward pro-rehabilitation philosophy.

Second and even more specifically, Masters have no expertise in making the assessments that these discretionary calls require. They are in charge of many issues confronting the High Courts,[107] but dealing with distressed debtors and evaluating the proper balance of debtors' abilities to support families while providing returns to creditors is not among the topics on which Masters have developed any expertise. The Master's offices would enjoy no efficiencies of pre-existing capacity or know-how in dealing with this new relief process. The South African Law Reform Commission placed this new relief process in the Magistrates' Courts precisely for this reason: "The work does not differ much and is not more difficult than other functions entrusted to magistrates' offices," such as administration order hearings, which are by their very nature very similar to the process envisioned in clause 118(22).[108] The current functions of the Masters' offices differ substantially from the tasks assigned to them in the current Insolvency Bill.

Third, the crush of cases requiring complex discretionary appraisal would overwhelm the Masters' offices, leading to administrative backlogs at best, and presumptions of no relief at worst. The resources of the Masters' offices are thinly spread already. In 2000, the Masters resisted a new burden of administering an estimated 66,000 estates of intestate black decedents

---

[106] Law Reform Commission, *Discussion Paper 86* ¶ 124.10.
[107] *See* About the Master of the High Court, http://www.justice.gov.za/master/about.htm.
[108] Law Reform Commission, *Discussion Paper 86* ¶ 124.2.

per year “because of lack of human resources, infrastructure, training and finance.”[109] In recently imposing this raft of new duties on the Master, the drafters of the Insolvency Bill offered no suggestion as to how the Masters’ offices might respond to the flood of tens of thousands of applications from debtors and the resulting strain on already thin resources. Without substantially expanded capacity, Masters will be called upon to make discretionary calls under tremendous pressure due to limited time and resources. In addition to inevitable administrative delays, the most likely result would be a presumption against relief, which runs counter to the goals of a reformed the personal insolvency system.

Finally, the Master’s discretion might well be influenced in an undesirable way by latent racial bias. The United States and South Africa share a continuing struggle, often unknowing, with the remnants of a racially discriminatory past. US researchers have revealed evidence of subtle but potentially significant racial disparity in the treatment of black and white debtors with respect to payment plans under Chapter 13 of the US Bankruptcy Code.[110] The study found that black debtors appeared to have been steered toward payment plans (having to “earn” their fresh start) much more frequently than similarly situated white debtors (who were apparently regarded as better candidates for an immediate, unconditional discharge of their debts). It is easy to overstate the implications of this study, but for the proposed reform in the Insolvency Bill, it has one clear warning: discretionary decisions by insolvency officers, such as the Master, may well be influenced, subtly and inadvertently, by racial animus that leads to greater expectations of black debtors than of similarly situated white debtors. This is yet another reason, among the many others cited here, for avoiding the Insolvency Bill’s many instances of reliance on discretionary judgments in assessing debtors’ applications for discharge relief.

D. Negotiated Solutions

The Insolvency Bill follows the path taken by many European laws, requiring debtors to seek negotiated solutions with a qualified majority of creditors as a prerequisite to formal discharge relief. Like many such laws, the Insolvency Bill clearly favors negotiated solutions, as the clause that introduces this new avenue to a discharge for individual debtors is entitled “Pre-liquidation composition with creditors.” A mechanism for overcoming creditor passivity and minority holdouts is included, in line with common international practice, though the measure of a qualified majority would likely undermine the effectiveness of this provision. The Insolvency Bill attempts to overcome the creditor participation and acceptance hurdles by counting only the votes of creditors who actually vote and by allowing a composition to be imposed on dissenters if the plan is accepted by creditors representing a majority in number and holding two-thirds in claim value. Unfortunately, the super-majority threshold means that any one creditor holding as little as 33% of the debtor’s debts effectively has a veto on any composition. One or two negative vote(s) will very likely spoil what might be a perfectly acceptable and reasonable composition for most debtors and a majority of their creditors holding as much as 65% of voting

[109] *See* Moseneke and Others v Master of the High Court ¶ [14] (CCT51/00) [2000] ZACC 27; 2001 (2) BCLR 103; 2001 (2) SA 18 (6 December 2000), http://www.saflii.org/za/cases/ZACC/2000/27.html.

[110] Jean Braucher, Dov Cohen & Robert M. Lawless, “Race Disparity in Bankruptcy Chapter Choice and the Role of Debtors’ Attorneys,” 20 *American Bankruptcy Institute Law Review* 611 (2012); *see also* Dov Cohen & Robert M. Lawless, “Less Forgiven: Race and Chapter 13 Bankruptcy” *in Broke: How Debt Bankrupts the Middle Class* 175 (Katherine Porter, ed., 2012).

claims. Ireland has faced disappointing results from a similar qualified-majority provision. It is unclear why a simple majority was not considered the appropriate threshold.

Like in other countries that have adopted this approach, the Insolvency Bill's composition procedure is likely to be largely unsuccessful, especially in light of ambiguity with respect to debtor assistance and particularly by the lack of standards for appropriate compositions. The Insolvency Bill does not explicitly rely on the existing debt counselling system or identify any other clear source of support for debtors in drawing up composition proposals, which would inevitably produce complications. If debtors are expected to produce composition plans themselves, without the aid of the administrator or a counsellor, international experience suggests this aspect of the regime will be unsuccessful.

Further, experience in other personal insolvency regimes and the current South African debt review process suggests that even well supported debtors are unlikely to reach successful, workable compositions with creditor. Indeed, the generally unsatisfactory results of the current debt review process would be magnified when applied to all debtors. Extrapolating the high failure rate in the debt review process to all debtors—including the great majority with little or no disposable income—the rate of successful composition negotiation is sure to be small to insignificant. Even for those few debtors who might be pressed by pride or by the administrator or Master into proposing a more aggressive composition that is accepted by creditors, empirical evidence from South Africa and elsewhere casts serious doubt on the likelihood that more than a handful of debtors will be able actually to fulfill these long-term demands. If debtors are pressed into proposing overly aggressive, unworkable plans, as is common in the current debt review process, this would simply set up debtors for more failure in the future. A proper relief system should avoid putting off failure; it should deliver effective relief now for those who qualify.

In a system like that in South Africa, in which most debtors can be expected to have relatively little repayment to offer their creditors on substantial debts, any process of proposing compromise plans for creditor voting is destined to produce little more than waste and expense. The notion of allowing creditors to be masters of their own fate is good in theory, but practically it has produced few benefits and many unwarranted burdens in other countries.

VII. Suggested Revisions: Building on Existing South African Infrastructure

If creditor voting and discretionary extension of relief are undesirable, how might the Insolvency Bill be revised consistent with best practices? As the World Bank's *Report* acknowledges, there is no one "best practice" in this area, and the best choice for any given country must be made in light of that country's context, especially institutional capacity.[111] The top three issues in the South African context, in particular, seem to be (1) delivering needed relief efficiently and effectively to re-energize consumers and small entrepreneurs, while (2) controlling costs and administrative burdens (for the state, debtors, and creditors) and (3) limiting abuse and exploitation of the system by debtors to evade their legitimate obligations. Given the particular emphasis that South African insolvency policy has placed on benefits to creditors, this should also be kept in mind in evaluating various approaches.

[111] World Bank *Report* ¶¶ 25-29, 53-55.

In South Africa's case, lack of institutional capacity presents a particularly pressing challenge. While the Magistrates' Courts are widely accessible and have expertise in dealing with low-income individuals and debt problems, there are serious concerns about their capacity to absorb a new workload in administering tens of thousands of new personal insolvency cases each year. The latest revision to the Insolvency Bill moves administrative responsibility from the already overburdened Magistrates' Courts to an "administrator," but it is unclear who this person is, how he or she is appointed, or to whom he or she reports. The Master of the High Court currently lacks the capacity to expand its role, though assigning greater authority, responsibility, and crucially funding to the Master or other central administrative office might be a constructive development for the entire South African insolvency system.[112] While the best case scenario for South Africa would likely to be to develop and fund a proper regulatory framework for individual and business insolvency cases, such as an insolvency service, this is unlikely given South Africa's history and limited resources.[113] Efficiency will be a particularly important goal for South Africa in light of the limitations on budgets and institutional capacities.

Fortunately, the foundation for a well-functioning personal insolvency system is already in place after a decade of experience with the debt review process. Building on this foundation would solve several problems and create a new personal insolvency structure both consistent with international best practices and well integrated into existing regimes for combatting overindebtedness in South Africa. Significant economy and synergy could be achieved by leveraging the debt review process and the debt counsellors as an entry portal into the new personal insolvency system, and more carefully and objectively defining the entry criterion of "overindebtedness." From this starting point, the process would flow smoothly to one or more forms of relief (described below) that would achieve all four of the objectives noted above.

A. Synergy with Debt Review

In terms of overcoming the most pressing problem of finding an institution with the capacity and expertise to administer a new relief system, fortunately, there is reportedly substantial excess capacity in one important South African institution: debt counsellors. Only 50% of registered debt counsellors are active, perhaps due in part to the huge backlogs of debt review cases awaiting Magistrates' Court approvals.[114] South African debtors seeking relief will naturally turn to debt counsellors for assistance in navigating any debt relief process, so it makes eminently good sense to capitalize on the excess capacity of the already well-known and well-functioning debt review process as a foundation to support a new personal insolvency regime.

Building on this existing capacity makes good sense especially in light of the expertise of the debt counsellors, who have been undertaking the exact kind of analysis that a new personal insolvency procedure would require. Other countries with similar pre-existing counselling

[112] *See* World Bank *South Africa Note* at 20-21.
[113] *See, e.g.* Juanitta Calitz, "Some thoughts on state regulation of South African insolvency law," 2011 *De Jure* 290. Funding for a major shift in insolvency administration seem unlikely in South African fiscal policy today. *See* Rene Vollgraaff & Mike Cohen, "South Africa to Sacrifice Growth to Avoid 'Debt Trap'," *Bloomberg* (22 Oct. 2014).
[114] M Roestoff & H Coetzee, "Consumer Debt Relief in South Africa: Lessons from America and England; and Suggestions for the Way Forward," 24 *SA Merc LJ* 53, 54 (2012).

infrastructures have recently integrated these into their new personal insolvency systems.[115] Debt counsellors are regulated to a small degree now by the National Credit Regulator, and new regulation could be implemented efficiently and effectively if needed for the new personal insolvency process. To the extent that some degree of court involvement is desired, the current interface between debt counsellors and the Magistrates' Courts provides a sensible and sensitive option (more on this below). South Africa has a ready, tailor-made infrastructure in place that would allow for a relatively smooth and effective launch platform for this new form of relief, very much along the lines originally envisioned by the South African Law Reform Commission.

B. A Single Entry Criterion/Restriction: "Overindebtedness"

The lynchpin of making both the existing debt review process and the new personal insolvency procedure more efficient and effective is a more detailed and objective definition of "overindebtedness." In virtually every existing personal insolvency system, some notion of measuring "overindebtedness" functions as an entry criterion to limit abuse by opportunistic debtors.[116] Debtors who are not "overindebted" do not qualify for personal insolvency relief. Defining an entry restriction in this way would make this new regime more palatable politically and impose a much more workable, efficient, and fair control on debtor abuse.

To maximize the fairness and effectiveness of the key concept of overindebtedness, however, it should be defined in clearer, more objective terms. The current definition in the National Credit Act, for example, is quite vague. A consumer is "overindebted" if the preponderance of available information with respect to the consumer's current and prospective financial means indicates that the consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which he or she is a party.[117] This definition begs the question of what "timely" means, and though it implicitly incorporates consideration of the debtor's reasonable living expenses, the notion of "inability" is also problematically vague. As discussed above, leaving these decision to the discretion of any decision-maker is problematic, and in the South African context, it has created anticipated serious problems of opposing viewpoints, long waiting periods and backlogs in the courts.

Well-developed income and expense guidelines would facilitate much quicker and less disputed results. The NCR's Task Team recognized this, though its guidelines are admittedly not suitably detailed or sensitive for a system in which most debtors will be unable to repay any significant portion of their debts. Either the legislature or a regulatory body might make the key public policy decisions with respect to the sacrifices South African society expects debtors to make, in terms of available income, reasonable household expenses, and length of time.

First, one must identify which types of income and asset value should be included and perhaps excluded from the analysis. In a country like South Africa, where a very large proportion of medium- and lower-income debtors are receiving state aid of one sort of another,

---

[115] Ireland and Colombia are two recent, compelling examples. *See* Kilborn, Reflections of the World Bank's *Report, supra* note 88.

[116] Even in the United States, which lacks any explicit restriction on access to the personal bankruptcy system, the crux of the major reform of 2005 was to prevent debtors from evading their obligations through a quick discharge if they had the "means" to pay back at least a substantial portion of their debts.

[117] National Credit Act §§ 79(1), 86(6).

part or all of that state aid might be put beyond the reach of creditors, as Denmark did in its latest reform. Also, while most individuals have few if any assets of significant value, which assets should debtors be expected to liquidate (or surrender for liquidation) in order to produce value for creditors? Providing some degree of protection for debtors' homes and perhaps cars would be an important and politically sensitive policy decision here.

Second, a debtor is "able" to pay creditors only if the debtor has "disposable" income, so one must determine various debtors' reasonable expenses[118] to be subtracted from available income to reveal the debtor's objective repayment ability. This allowance might be determined on a lump-sum basis for different households (with and without spouses, children of various ages, and other dependent family members, such as elderly relatives), as in many European systems, or it might be a more fine-tuned analysis of reasonable line-item expenses, such as those identified in the US "means test"[119] or better yet, the Irish scheme.[120] Determining excluded income or allowable expenses is a delicate and difficult task, but it is the most crucial factor for the welfare of debtors and the proper functioning of the relief procedure.[121]

Finally, one must establish how long debtors should be expected to relinquish all of their available income to creditors to satisfy a demand for their good-faith best efforts. Legislators around the world have struggled with this question, arriving at a variety of results, usually for no clear reason, though generally in the range of 3-5 years. The NCR Task Team's guidelines address this issue squarely and sensibly, settling on 5 years (60 months) as the maximum period for unsecured debts,[122] and defining different terms for secured debts (e.g., home mortgages). Only on the basis of a fixed time period (or periods) can an objective, reliably predictable analysis be made of how much money debtors actually have available to creditors and therefore what volume of debt they are "unable" to pay "timely."

C. Overindebtedness as Objective, Natural Routing Concept, Maximizing Goals

Such expense allowance and payment guidelines could serve as the fulcrum upon which all aspects of a new system would balance.[123] The level of any given debtor's overindebtedness, as determined by applying the expense allowance and payment guidelines, would determine the routing of that debtor's case (much like in the French system, described in Annex A). Debtors who are able to pay all of their outstanding obligations (perhaps excluding long-term debts, such

---

[118] The Insolvency Bill contains a provision to increase the frequency of orders identifying excess income to be turned over to the liquidator in sequestration proceedings. *See* clause 16(6) (former section 23(5)); Explanatory Memorandum ¶ 16.11. The procedure for certifying the portion of the insolvent's earnings that are not "necessary" for household support are entirely uncontrolled, relegated to the subjective judgment of the individual judge. If this procedure is retained, it should also be subjected to objective expense allowance and payment guidelines.

[119] *See* US Department of Justice, *Means Testing Information*, www.justice.gov/ust/eo/bapcpa/meanstesting.htm.

[120] *See supra* note 74 and accompanying text.

[121] For a discussion of alternatives, see World Bank *Report* ¶¶ 291-97.

[122] *See supra* note 24 and accompanying text.

[123] Indeed, South Africa could solve multiple problems at once by applying these new guidelines to the ordinary debt enforcement process. South Africa could join the great majority of countries who protect debtors by limiting the amount of income subject to garnishment by subjecting garnishment/emoluments attachment orders to the same income protection and expense allowance guidelines. This would solve a serious problem outside the insolvency system, and it would set the stage for a smooth functioning, integrated debt review and personal insolvency relief regime.

as home mortgages) within a short period (e.g., less than 2 years) are not overindebted and would be excluded from debt review and insolvency relief. Debtors who are able to pay off all of their outstanding obligations within some intermediate period of time (e.g., more than 2 years but less than 5) could be retained in the ordinary debt review process, culminating in a full-payment plan. At the opposite end of the spectrum, debtors who are unable to pay any substantial portion of their short-term debts under the guidelines could be quickly routed to an immediate discharge. This might be implemented by a Magistrate's Court order confirming a recommendation from the debt counsellor, but as in France and Sweden, for example, burdensome court review of such cases can and should be minimized.

The group that presents the greatest challenges is the likely 10%-15% of debtors who might have the capacity to pay the administrative costs of the relief system as well as a substantial portion, but not all, of their debts. Determining the "substantial portion" that would distinguish these debtors and justify separate administration would be a sensitive matter, as these cases would involve greater complexity, administration, and expense in return for smaller dividends. These debtors might be routed to a payment plan process similar to either the result under the current debt review process (with agreed payments routed through authorized Payment Distribution Agents) or the administration order process (without the limitation on debt levels, and with payments routed through a Magistrate's Court-appointed administrator).

This routing approach would offer effective and appropriate relief to all who need it, and it would satisfy the most pressing objections to current practice and to the notion of debt relief. First, it would control "abuse" by preventing evasion by debtors who are able to pay their debts. Those who are objectively determined by a neutral third party to be overindebted are by definition not abusing the system. Those who continued to object to debtors' "abuse" would have to confine their objections to the clear public policy decisions inherent in the expense allowance and payment guidelines. This would be a much clearer and more productive subject for debate. If creditor constituencies believe policymakers are being too generous to debtors, let the debate focus on more concrete and useful challenges, such as limiting allowable expenses or lengthening the appropriate time period during which debtors should reasonably be expected to labor for their creditors. Continuing debate as to "fairness" or "abuse" or similar vague concepts can and should be sidelined if a public policy of obligation and relief is clearly defined.

Second, the system proposed here would alleviate existing institutional capacity pressures in both the current debt review process and in the new insolvency relief system. Totally solvent debtors would be quickly and efficiently identified and excluded from the system. Debtors unable to make any substantial contribution to creditors would also be quickly processed to an immediate discharge. Judging by comparative experience and South African financial indicators, this would be the result for the great bulk of debtors. If creditors disagreed with this resolution in any given case, they could be given a right of appeal, which would in most cases not be at all cost-effective in light of debtors' limited repayment capacities, providing a built-in disincentive for creditors to oppose the operation of the system "in principle." Debt counsellors would then be free to concentrate their attention on supporting the few debtors able to pay a substantial proportion of their debts within a defined, reasonable time period.

Indeed, this would benefit creditors by offering an encouragement to "can-pay" debtors to apply their best efforts over a reasonable time to produce a dividend for creditors. Rather than engaging in the underground economy or withdrawing from active society altogether, debtors would be reinvigorated by the promise of a discharge in return for a reasonable effort to pay their debts. Creditors also would not be distracted by meaningless and formalistic debt repayment proposals that are mostly predestined for failure. Rather than wasting time and money reviewing and voting on thousands of unproductive offers, creditors could simply rest assured that the system had done their work for them in evaluating debtors' payment capacities and routing available value to creditors without their having to spend time or money to collect these sums.

The precise details of such a routing system, especially the degree and form of court involvement and fees, would have to be developed if the idea were accepted in principle. This general approach, however, centered on expense allowance and payment guidelines applied by debt counsellors leading to objective routing decisions, would be most responsive to South Africa's four primary needs, and it would integrate well with existing structures. South African debtors likely already associate debt distress and relief with the debt review process, so they will naturally gravitate toward the entry portal with the debt counsellors. "Reckless lending" could be identified and sanctioned in every case, consistent with the goals of the National Credit Act. The debt review process would be made vastly more efficient, as counsellors would no longer be forced to press every debtor into an unsustainable compromise plan. "Can't pay" debtors would be routed to discharge under the Insolvency Act, freeing counsellors to formulate payment plans only for the few debtors with at least some capacity to fund sustainable plans.

D. Second-Best Reform

If the reconceptualization of individual relief described above is unacceptable, then at the very least, the South African Law Reform Commission's original proposal should be reinstated. While it suffered from many weaknesses, it was substantially more in line with modern personal insolvency philosophy than the current Insolvency Bill. The Magistrates' Courts would doubtless require far greater funding to absorb the weight of tens of thousands of new filings, however. And those filings will be much more difficult to administer if debtors seek relief without guidance. The debt counsellors could play a crucial role in this process, and they were not foreseen by the Law Reform Commission's pre-NCA proposal. If composition proposals are to have any hope of acceptance, they must be formulated by skilled advisors.

More importantly, if low-income individuals are to be routed through sequestration (now "liquidation"), the philosophy and approach of the rehabilitation provisions should be revisited. In particular, for the reasons discussed above, the four-year discharge period should be mandatory and non-discretionary, with no subjective conditions (though perhaps subject to exceptions for certain types of debt). No debtor should wait ten years for automatic relief.[124] The recent Irish reform process established that such a parsimonious approach to relief is objectionable and outside the mainstream. Also, the formalities associated with applying for that relief (e.g., notices to creditors and in the Government Gazette, a ZAR500 deposit, required report by the Master, and generalized objections to relief) are unconstructive and unnecessarily laborious and expensive. These also are outside the mainstream of modern insolvency policy.

[124] The Explanatory Memorandum's explanation that there were "limited comments" on the 10-year automatic discharge period, and that this period "has become relatively well-known," *see* ¶ 103.1, are no justification for retaining this aberrational approach to automatic rehabilitation. Several countries have reduced their discharge periods in recent years, including England, Ireland, and Germany; none has retained one this long.

VIII. Conclusion

The path of South African insolvency law reform to this point has been long, and the road ahead will likely not be smooth, either. The relentless rise of consumer credit and the inescapable debt bind in which millions of South Africans are trapped provide powerful impetus for reform. The current proposal in the Insolvency Bill's clause 118 adopts some aspects of modern personal insolvency policy, but its approach threatens to thrust South Africa into the kinds of trials and errors that many countries have already encountered and overcome in recent decades. A more constructive way forward requires very little modification, however, and the vital infrastructure is already in place. Oriented around a more carefully defined concept of "overindebtedness," the existing infrastructure of debt counsellors would be a perfect focal point for routing all overindebted individuals to appropriate relief, perfecting the balance between responsible extension of credit and protection from the inevitable casualties of credit, and broadening and deepening the many benefits of these relief systems to honest and responsible debtors, honest and responsible creditors, and South African society in general.

Case Study Annexes

Annex A. France: Four Key Lessons from a Similar Starting Point

The way in which France began its battle against overindebtedness and social exclusion very closely resembles South Africa's current path. The many course-corrections that France has instituted in its 25-year journey offer useful lessons for South Africa. On December 31, 1989, France became the third European country to adopt a legal structure for combating "personal overindebtedness" (*surendettement des particuliers*).[125] This first law closely resembled the South African National Credit Act, in that it envisioned only a structure for supporting individuals in their negotiation of restructuring agreements with creditors. The administrative structure of the French system is similar to the NCA, as well, though more complex (and therefore costly). While the National Credit Regulator oversees a network of private debt counsellors who engage with debtors and creditors, the French system is administered by a nationwide network of official, eight-member commissions, coordinated by the central bank, the Banque de France. These commissions screen debtors for "overindebtedness," and for debtors who qualify, they evaluate debtors' finances for possible restructuring negotiations with creditors, much like the debt review process in South Africa.

The gradual evolution of the French system offers four lessons for South Africa as it considers how to move forward from a similar starting point. The first lesson from French experience is that creditors are unlikely to accept a new system of voluntary workouts without some powerful persuasion. The Banque de France was instrumental in overcoming obstruction by many creditors, especially institutional creditors, toward what they perceived as a radical new process. Lobbying by the Banque de France convinced key creditors to buy into the new workout regime, leading to a sharp rise in the success rate of plan negotiations over its first few years (from an initial acceptance rate of 45% to gradually over 60%). The National Credit Regulator's Task Team appears to have attempted to play a similar role, with limited success. Either the NCR itself, or a more direct financial regulator, might play a similar role in South Africa, and it should take comfort if it is inclined to do so in light of the crucial role of the Banque de France in the success of the French regime. Without this suasion, creditors would most likely have remained reticent to embrace a new workout culture.

The second lesson is that this system requires administrators, but the courts might not be the best choice. Debtors desperately need support in analyzing their past and future finances and proposing workable payment plans to creditors. The entire structure of the new system in France was designed to support debtors in developing feasible plans. Debtors are ill equipped on their own to propose "best efforts" plans to creditors, as the Insolvency Bill seems to expect of debtors. The original French law allowed debtors to initiate cases in court, but those courts were quickly overwhelmed. The average delay for the establishment of a court-developed plan in as many as a quarter of all cases quickly rose to 15.4 months. South Africa has already begun to experience this problem in the NCA debt review process, as well. After five years of this administrative gridlock, the French law was amended to relegate the courts to a supporting role,

---

[125] For a detailed analysis of the history and development of the system in France, see Jason J. Kilborn, "*La Responsabilisation de l'Economie:* What the United States Can Learn From the New French Law on Consumer Overindebtedness," 26 *Michigan Journal of International Law* 619 (2005), online at http://ssrn.com/abstract=703961.

and the courts have been further cast into the background since 2010. Today, in the vast majority of French cases, the courts fulfill only two limited functions: they resolve a small variety of procedural disputes arising in the course of the commissions' work, and they (summarily) confer legal force on the commissions' proposed workout plans involving a discharge of debt. Unless creditors lodge formal opposition, which is rare, the court holds no hearing, does not solicit a vote from creditors, and disposes of most cases with a simple order. France has learned that court formalities are simply not warranted or justified in low-value systems like this. Creditors retain their right to appeal if they regard formal redress as worth the expense. The commissions have played a vital role in France, and the South African network of debt counsellors might play a similar role in the success of any South African regime.

The third, perhaps most important lesson relates to the terms of these payment proposals. Promising creditors a certain sort of payment is one thing, but delivering on that promise while maintaining a dignified life is quite another. Like the debt review process under the NCA, the early French system allowed the commissions to ask a court to impose a plan on recalcitrant creditors, but it did not allow such plans to include an involuntary discharge of debt. Consequently, the commissions had little choice but to propose unworkable plans that stretched over 8-10 years, sometimes as long as 15 years. Moreover, they failed to reserve to debtors the necessary financial support for themselves and their families. Within only a few years, regulators began urging the commissions to leave debtors with at least a standard minimum budget, and after a few more years, the legislature revised the law to impose a standard maximum duration on plans and to ensure that debtors would be left with at least a standard level of minimum income protected by law. Indeed, the law refers to the minimum protected income as a starting point for the amount that should be reserved for debtors, only "*one part* of the resources necessary for ongoing expenses."[126] Leaving decisions as to debtors' "best efforts," that is, plan length and subsistence budgets, to the discretion of system actors is a mistake that country after country has encountered and addressed. France was the first, and its most important lesson is that the South African legislature should set standards for what it expects debtors to sacrifice for their creditors in the interest of revitalizing the national economy. The legislature should identify maximum plan duration and a minimal budget as a matter of national policy, not leaving this to the discretion of any system administrator, however disinterested those administrators may be.

The fourth lesson from France follows from the third: as South African debt counsellors have already learned, compulsory discharge of debt must be one of the available tools, and it should be offered widely. Studies of the new French system revealed what south African debt counselors have reported since 2005, that the great majority of truly overindebted individuals simply cannot afford to pay off their debts over a reasonable period and maintain a dignified life. Commissions for years pressed debtors into subsistence plans that inevitably failed, as debtors simply lacked the capacity to fulfill their obligations in full while supporting even a meager life. Since early 1999, after the first major reform of the French system, the commissions can recommend, and the courts impose, a discharge of debt that cannot be paid over the course of a reasonable payment plan. The commissions and courts were hesitant at first to embrace this new, even more radical form of relief, despite data from the Banque de France suggesting that most overindebted individuals had no hope of returning to solvency within a reasonable period of

[126] *Code de la consommation* art. L.331-2 (emphasis added).

time given their limited resources. The legislature once again responded, reforming the system again in 2004 to allow for the most aggressive relief anywhere outside the US and UK—an immediate and full discharge of debt, without consideration of a payment plan, for the most hopelessly overindebted individuals. The commissions have taken the legislature's signal to grant more effective relief, recommending an immediate discharge in about 30% of all administered cases in the past several years, and a partial discharge in many cases, as well. In light of the more effective relief available today, the rate of cases concluding with a voluntary arrangement has plummeted to its lowest level in history, down to less than 33%.

France's experience presents a challenge to the Insolvency Bill's requirement that all debtors propose a payment plan for creditor voting. Some debtors certainly could propose workable plans that creditors might accept, especially if encouraged more aggressively by a financial regulator such as the NCR. Many (most) debtors, however, are obviously incapable of proposing acceptable plans, and getting them the relief they need quickly and efficiently serves the interests of their families, their creditors, and society much better than delaying necessary relief and incurring administrative delay and expense. The proper identification of "can-pay" and "can't-pay" debtors should be based not on unfettered discretion of an administrator, but on standards developed as a matter of national policy by the legislature or perhaps the NCR. Allowing creditors to appeal to the courts from such administrative determinations adequately protects their rights, and the right to pursue a debtor who is unable to pay is illusory; this is no right at all that deserves protection at the expense of debtors, their families, other creditors, and society.

Annex B. The Netherlands: More Failed Negotiation, Problems with Discretion

With a shared legal heritage, South Africa and the Netherlands have fruitfully exchanged legal know-how in the past. The 1998 Dutch law for the debt rehabilitation of natural persons (*Wet schuldsanering natuurlijke personen*, or more commonly, WSNP)[127] offers useful lessons on both best and not-as-good practices. Like the original French overindebtedness law and the South African National Credit Act, the Dutch WSNP was built on a deep and broad foundation of credit counseling and negotiation with creditors. The municipal credit banks throughout the Netherlands have been in the business of advising debtors and facilitating rehabilitation plans for many decades, coordinated by a national organization, the Dutch Association for Consumer Credit, or NVVK (*Nederlandse Vereniging voor Volkskrediet*). The initiative for the Dutch consumer insolvency system will again be familiar to South African debt counsellors: a sharp spike in the number of counselling requests, and a realization that most debtors lacked the financial capacity to pay off their debts within any reasonable period of time under standard income protections. Debtors needed compulsory discharge relief.

As in France, the Dutch debt counselling process remains the mandatory entry point to the personal insolvency system. Waiting periods have plagued this system, however, as counsellors are overwhelmed with thousands of hopeless cases that require formalistic review as a prerequisite to entry into the formal relief system. As the numbers of debtors seeking relief grew, the percentage of cases for which a voluntary, negotiated settlement could be found diminished. The rate of voluntary workouts fell from over 50% of cases in the early 1990s to less than 10% by 2004. This situation began to see a turnaround only after the counselling agencies implemented an aggressive triage system, routing many more debtors directly to the formal relief system with a certificate attesting that any attempt at a voluntary arrangement would be pointless. This allowed counselors to concentrate their efforts on the few cases where a voluntary workout was a realistic objective. Also, the NVVK launched a concerted effort to convince key creditors to support voluntary workouts. South Africa has seen similar efforts in the NCR Task Team's suggested code of conduct, but Dutch experience shows that only a relatively small fraction of debtors are realistic candidates for an agreed workout no matter how deep the historical negotiation culture, how expert the counselors, or how well coordinated the process. Forcing every debtor to put together a proposed plan and put it to a creditor vote is a real waste of precious administrative resources.

The Dutch experience with the terms for formal relief offers three more crucial warnings for South Africa. Like most modern European debt relief processes, the Dutch WSNP forces every debtor into a standard 3-year payment plan as the mandatory *quid pro quo* for discharge relief. As in France, the terms of these plans were originally left in part to the discretion of the administering courts to craft "fair and reasonable" plans. This discretion was quickly abandoned. First the courts voluntarily abandoned their discretion as unwanted, preferring to ensure uniformity and fairness (as well as motivating debtors) by agreeing to a standard scheme for measuring protected income and evaluating acceptable debtor expenses during a standard three-year repayment period. A national working group of Dutch bankruptcy judges (*Recofa*)

[127] On the early history and development of the Dutch system, see Jason J. Kilborn, "The Hidden Life of Consumer Bankruptcy Reform: Danger Signs for the New U.S. Law From Unexpected Parallels in the Netherlands," 39 *Vanderbilt Journal of Transnational Law* 77 (2006), online at http://ssrn.com/abstract=772705.

developed a standard budgeting guideline in 2000-01,[128] which has since been adopted as the standard by nearly all courts and NVVK member credit counselors. The legislature memorialized this practice in the first and only major reform of the WSNP in 2008. Now the Dutch system makes the same, standard demand of all debtors, consistent with the three-year plan practice developed in the courts. This reduces unnecessary and unhelpful discretion, streamlining generally routine cases.

The first lesson from Dutch experience thus echoes the most important takeaway from French experience: Expectations of debtors should not be left to the discretion of a system administrator. Rather, either a working group or the legislature should craft relatively objective guidelines to be applied evenly, predictably, and efficiently across all cases. Debtors' "best efforts" should be defined in advance in terms of the length of time over which standard sacrifices can be expected of debtors and their families. Debtors' willingness to make these sacrifices shows their seriousness about obtaining relief, their responsibility to do their best to fulfill their debts, and their worthiness for discharge relief.

The second lesson is also consistent with French experience: Very few debtors will have anything meaningful to offer creditors over a reasonable period under reasonable expense allowances. In the best of times, only about 20% of Dutch debtors actually distribute any payment to creditors over the standard three-year repayment term. The payment demand of this system is largely symbolic, and it has significant administrative costs. A "simplified" process is available in cases in which it is clear within one year that the debtor has no reasonable prospect of making any payment to creditors. Such debtors can be granted discharge relief after one year, but this accelerated relief has been offered sparingly, in only about 10% of cases. The current South African proposal does not allow the administrator to press debtors into payment plans, and Dutch experience further suggests that this is the most efficient approach.

A third and final lesson relates again to discretion. Unlike most other personal insolvency systems, the Dutch WSNP charges the court with screening cases for "good faith." Dutch courts have barred the door to relief in a growing percentage of cases in recent years, reaching over 20% in 2013.[129] Given the subjective nature of the inquiry, vast differences in treatment among courts have arisen based on nothing more than the personal predilections and attitudes of individual judges. *Recofa* has acknowledged this as a problem and has begun discussing solutions in earnest. The elements of subjective judgment in the Insolvency Bill will all but certainly lead to vast differences in treatment of similarly situated South African debtors, and thousands of needy and likely deserving debtors would be barred from relief by the subjective exercise of discretion.

---

[128] *See* Werkgroep Rekenmethode vtlb van Recofa, *Vtlb-rapport: Berekening van het vtlb bij toepassing van de Wet schuldsanering natuurlijke personen* (Jan. 2014 version), online at http://www.rvr.org/binaries/wsnp/vtlb-rapport-januari-2014-.pdf.

[129] Raad voor Rechtsbijstand, *Monitor Wsnp: Tiende meting over het jaar 2013* § 3.2.1 (2014).