DEVELOPMENTS IN THE UNITED STATES' CONSUMER BANKRUPTCY LAW: A SOUTH AFRICAN PERSPECTIVE

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SUMMARY

The United States Congress's enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 has produced the most significant revision of consumer bankruptcy law in over a century. The tale of the South African attempt to adopt new legislation started in the late '80s and has not yet managed to culminate in the promulgation of modern and effective insolvency legislation. This article examines the developments in the United States consumer bankruptcy law from a South African perspective. The question arises whether in order to develop legislation which would be a more accurate reflection of current South African economic and social environmental circumstances, we should not reassess some of the deep-rooted principles in the South African insolvency law.

> "The love of rationalistic simplification ... leads people to think that in the mere technicalities of law they possess the means and the power to effect unlimited changes ... [Such an illusion is] cherished by lawyers who imagine that, by drafting new constitutions and laws, they can begin the work of history all over again, and know nothing of the force of traditions, habits, associations and institutions."
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> Guido de Ruggiero *The History of European Liberalism* (1927)

1 INTRODUCTION

In many European countries the last three decades have witnessed a continuing cycle of procedural reforms with the aim of addressing consumer over-indebtedness.[1] The relaxation of credit controls[2] and the vast increase in the number of insolvent debtors have forced many jurisdictions to reconsider their traditional consumer insolvency[3] philosophies.[4] Until the

[1] Ramsay "Comparative Consumer Bankruptcy" 2007 *Univ of Illinois LR* 241; Ziegel "The Challenges of Comparative Consumer Insolvencies" 2005 *Pennsylvania State International LR* 639; and Ziegel "Facts on the Ground and Reconciliation of Divergent Consumer Insolvency Philosophies" 2006 *Theoretical Inquiries in Law* 299.

[2] Ramsay 2007 *Univ of Illinois LR* 244.

[3] Worldwide the word "insolvency" is the more common term for such proceedings where a business debtor is involved, while "bankruptcy" would refer to the procedures to be applied

mid-eighties most countries did not perceive consumer insolvency law as a significant social, legal or economic problem, and even fewer gave it any legislative attention.[5] However, during the past decade the heightened interest and focus on insolvency law in the United States (US) has been mirrored in jurisdictions worldwide and this interest sequentially has led to consumer insolvency law increasingly being the subject of scholarly articles, reflection and debate.[6]

Traditionally, civil law jurisdictions in continental Europe had a very conservative attitude towards debtor relief to consumer debtors,[7] which has as foundation the deep moral commitment to the sanctity of contracts in the civil law.[8] They either did not recognise the availability of consumer insolvency or, if they did, a discharge as an element of such proceedings was not part of the solution.[9] At the opposite end the near century-old "fresh-start"[10] philosophy of the US accepted a more sympathetic attitude towards the debtor.[11] It is interesting to note that historically, insolvency law in South Africa has been structured around the individual debtor. Certain scholars attribute this occurrence to the fact that the concept of a separate legal entity, as provided for in company law legislation, only developed a considerable time after insolvency law had already become established.[12]

Now, at the beginning of the 21st century, the profile of international consumer insolvency law has changed significantly. Many of the conservative "creditor-friendly" jurisdictions[13] have since adopted debt adjustment policies providing for various forms of debt relief to over-indebted

to individuals. In South Africa in common parlance, the word "insolvency" refers to both individuals and corporate entities, while in the US the term "bankruptcy" is used to refer to all procedures. In this article the words "insolvency" and "bankruptcy" are used interchangeably.

4 Ziegel 2006 *Theoretical Inquiries in Law* 300.

5 *Ibid*.

6 The following are recent publications on comparative consumer insolvency law: Niemi-Kiesiläinen, Ramsay and Whitford *Consumer Bankruptcy in Global Perspective* (2003); and Ziegel *Comparative Consumer Insolvency Regimes – A Canadian Perspective* (2003).

7 The term "consumer debtor" in this publication has the same meaning as the term mentioned in the report issued by INSOL International: *Consumer Debt Report* (May 2001) http://www. insol.org/pdf/consdebt.pdf (accessed 2007-08-26). "Consumer debtor" refers to a debtor whose liabilities are incurred primarily for private or household purposes and not, in the first place, as a result of carrying on a business.

8 Embodied the principle of *pacta sunt servanda*. *Cf* Niemi-Kiesiläinen "Consumer Bankruptcy in Comparison: Do We Cure a Market Failure or a Social Problem?"1999 *Osgoode Hall LJ* 473.

9 Ziegel 2006 *Theoretical Inquiries in Law* 300.

10 For an in-depth discussion of the "fresh start" principle see Roestoff *'n Kritiese Evaluasie van Skuldverligtingsmaatreëls vir die Individu in die Suid-Afrikaanse Insolvensiereg* (LLD thesis UP 2002) 172.

11 Kilborn "The Hidden Life of Consumer Bankruptcy Reform: Danger Signs for the US Law from Unexpected Parallels in the Netherlands" 2006 *Vanderbilt J of Transnational Law* 77.

12 Burdette *Framework for Corporate Insolvency Law Reform in South Africa* (LLD thesis UP 2002) Chapter 3.

13 In Wood *Principles of International Insolvency* (1995) 3, a pro-creditor jurisdiction is described as a jurisdiction which allows a creditor to protect itself against insolvency *eg* by security or set-off. Jurisdictions classified as being pro-creditor are *eg* Germany, France, Austria and Netherlands.

debtors and have progressed towards a more liberal consumer bankruptcy system.[14] Ironically, with the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[15] the US has reversed its liberal "fresh-start" attitude and adopted a stance considerably more conservative in its philosophy as was the case previously.[16]

It is submitted that during the almost twenty year-old attempt to adopt new insolvency legislation, South Africa has become isolated and has ignored global trends with regard to developments in international consumer insolvency law. In making this submission, the consumer bankruptcy legislation and recent law reform initiatives within the legal system of the US and the South African insolvency law will briefly be discussed, in the light of which suggestions for future research in South Africa will be made. Finally, I will endeavour to illustrate that, while it has become an international trend to characterise the US as the model for consumer insolvency reform, it would be wise for South Africa to integrate the US knowledge and experience into our unique economic and cultural environment, rather than to adopt any foreign process entirely.

2 CONSUMER BANKRUPTCY LEGISLATION IN THE UNITED STATES

2 1 Introduction

The Constitution of the US gives Congress the right to establish "Uniform Laws on the subject of Bankruptcies throughout the United States"[17] and it is therefore not surprising that the earlier bankruptcy procedures were mere extensions of older English practices such as debt slavery and imprisonment.[18] Access to bankruptcy was only restricted to merchants as incorporated in the 1570 Elizabethan statute[19] and the theory was carried across the Atlantic into the US Bankruptcy Act of 1800.[20] During the 19th century Congress exercised its bankruptcy powers only sporadically to meet

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14 For a more detailed illustration of the global differentiation between insolvency laws that are pro-debtor or pro-creditor see Wood 2-3. See also Ziegel 2006 *Theoretical Inquiries in Law* 301.

15 On 20 April 2005, President Bush signed into law s 256 entitled the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005". The great majority of provisions became effective on 17 October 2005. For a detailed discussion of the legislative path and history of BAPCPA see Neustadter "2005: A Consumer Bankruptcy Odyssey" 2005-2006 *Creighton LR* 225-226.

16 Ramsay 2007 *Univ of Illinois LR* 250.

17 US Const. Art 1, § 8, cl. 4.

18 White *Cases and Materials on Bankruptcy* (1996) 53. *Cf* Tabb "The History of the Bankruptcy Laws in the United States" 1995 *American Bankruptcy Institute LR* 5. For an example of the treatment of debtors in early England see Dickens *The Little Dorrit* (1857), a story concerning a father and his family living in the Swansea Debtor's Prison.

19 13 Eliz.,ch 7 (1570). See also Tabb "Top Twenty Consumer Bankruptcy Issues" 2007 *Univ of Illinois LR* 12; and Landry "Consumer Bankruptcy Reform: Debtor's Prison without Bars or 'Just Desserts' for Deadbeats?" 2006 *Golden Gate Univ LR* 95.

20 Tabb 2007 *Univ of Illinois LR* 12.

periodic crises in a growing market economy.[21] The passage of the Bankruptcy Act of 1898 significantly changed the US bankruptcy law and marked the beginning of the era of permanent federal bankruptcy legislation in the US.[22] The 1898 Act was not only significant because it allowed for the voluntary and involuntary filing of bankruptcy by debtors, but also represented a shift from bankruptcy laws that protected only creditors to a law which protected the interests of both creditors and debtors.[23]

During the 1960s it became evident that a complete review of the system was necessary and in 1970 the Commission on Bankruptcy laws of the United States, charged with the mission to recommend changes to the 1898 Act, was established.[24] The report[25] released by the Commission made substantial recommendations regarding regulation and administrative organization, consumer bankruptcy, business bankruptcy and business rehabilitation and many of these recommend changes were subsequently incorporated into the Bankruptcy Reform Act of 1978 (The Bankruptcy Code).[26]

A fundamental goal of the federal bankruptcy laws enacted in the US has always been to give debtors a financial "fresh-start" from burdensome debts.[27] The Supreme Court made this statement with regard to the purpose of the bankruptcy law in *Local Loan Co v Hunt*: "[I]t gives to the honest but unfortunate debtor … a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt."[28] The underlying philosophy of this approach is that the debtor is a victim to unforeseen circumstances and should promptly be allowed back into society without the millstone of perpetual indebtedness.[29]

In many countries the US "fresh start" policy has influenced a general tendency to relax earlier stringent preconditions to the granting of a discharge and has become the pinnacle of several international law reform initiatives.[30] After celebrating its 25-year anniversary the Bankruptcy Code recently received an extensive overhaul by means of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005.[31] At the heart of BAPCPA is an array of provisions aimed at reaching the Act's public

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21 Herbert *Understanding Bankruptcy* (1997) 49.

22 Tabb 1995 *American Bankruptcy Institute LR* 23.

23 Landry 2006 *Golden Gate Univ LR* 95.

24 The Commission acted under the guidance of Prof Frank Kennedy and filed a two-part report in July 1973. See Tabb 1995 *American Bankruptcy Institute LR* 33.

25 *Report of the Commission on the Bankruptcy Laws of the United States*, H.R.Doc.No.93-137, 93rd Cong.,1st Sess. (1973).

26 Codified in Title 11 of the United States Code. 11 U.S.C.§ 101 *et seq*. Signed into law by President Carter on 6 November 1978.

27 Broude "The Judge's Role in Insolvency Proceedings: Views from the Bench: Views from the Bar" 2002 *American Bankruptcy Institute LR* 511 522.

28 292 US 234, 244 (1934).

29 Ziegel 2005 *Pennsylvania State International LR* 639. For a discussion of the process of bankruptcy in the US see http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/process.html (accessed 2007-08-25).

30 Ziegel 2005 *Pennsylvania State International LR* 640.

31 *Ibid.*

policy goal of preventing abuse, disallowing debts obtained through fraud or crime and disallowing loopholes that previously existed.[32]

BAPCPA has fundamentally changed the mood of the US consumer bankruptcy law and the sweeping and controversial changes to the Bankruptcy Code have been widely criticized by *inter alia* the Bench, academic scholars and other role-players.[33] These dramatic changes did not occur in an economic and social vacuum but were rather inspired by the dismantling of usury barriers and other credit restrictions, the rapid growth of consumer credit, and the equally rapid and disturbing increase in the number of over-indebted consumers.[34]

2 2 Formal bankruptcy legislation in the US

The Bankruptcy Code[35] was a significant amendment to the US bankruptcy legislation and represents the most important source of bankruptcy law in the US. Even thought the Code significantly changed substantive bankruptcy law it did not alter the fundamental policy in favour of debtors.[36] Although the Code remains the main source of bankruptcy Law, federal and state consumer credit legislation, state common law and statutory law, as well as the Bankruptcy Rules on procedural matters, combine to outline the US bankruptcy law.[37]

Six basic types of bankruptcy cases are provided for under the Bankruptcy Code, and are traditionally given the names of the chapters that describe them.[38] Only the chapters related to consumer bankruptcy will be discussed in this publication. The Code provides for a dual portal system where consumer debtors usually have two primary options under which to file for bankruptcy.[39] Each of these options follows a different procedure and is designed to suit a different kind of debtor.[40]

Chapter 7 entitled "Liquidations" governs what used to be known as "straight bankruptcy" and contemplates an orderly, court-supervised procedure.[41] The process consists of the trustee's collection and realization

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32 Schlecter "Before and after the Bankruptcy Abuse Preventions and Consumer Protection Act of 2005 Examined Under Recent Case Law: A Curse in Disguise for Consumers?" 2005-2006 *Whittier LR* 787.

33 Schlecter 2005-2006 *Whittier LR* 788. For a summary of papers presented at a recent symposium at the University of Illinois where leading scholars were brought together to assess the new legislation see Brubaker "Consumer Credit and Bankruptcy: Assessing a New Paradigm" 2007 *Univ of Illinois LR* 1.

34 Ziegel 2006 *Theoretical Inquiries in Law* 302.

35 See fn 26 above.

36 Landry 2006 *Golden Gate Univ LR* 95-105.

37 White 57.

38 Evans "Bankruptcy the American Way" 2003 *Juta's Business Law* 173-177.

39 Although an individual may also file a Chapter 11 application its procedures and costs are significantly greater and more complex.

40 Landry 2006 *Golden Gate Univ LR* 96.

41 11 U.S.C. §§ 101(41), 109(b). Refer to par 2 4 2 below for a discussion of the new "means-testing" procedure as prerequisite to filling a Chapter 7 application.

of the debtor's assets, and the consequent distribution to creditors.[42] The distribution is made subject to the debtor's right to retain certain exempt property and the rights of secured creditors.[43] Consumers who successfully file for Chapter 7 debt relief and who meet certain requirements, receive an immediate discharge of most of their unsecured debts which also shields any post-petition income and new assets acquired.[44] The discharge also serves as a permanent injunction against an attempt by a creditor to collect discharged debt.[45]

A typical arrangement under Chapter 13 is designed for an "individual with a regular income" to enter into a plan of mostly partial repayment to creditors by using disposable income to fund the plan.[46] For this reason the Chapter 13 procedure is often referred to as the "wage earner's plan". At a confirmation hearing, the court either approves or disapproves the debtor's repayment plan, depending on whether it meets the Bankruptcy Code's requirements for confirmation. Unlike Chapter 7, the Chapter 13 debtor does not receive an immediate discharge of debts and is forced to complete the payments required under the plan before a discharge is received.[47] Chapter 13 is often preferable to a Chapter 7 application as it enables the debtor to retain valuable assets such as the family dwelling, and pay creditors out of post-petition income, as opposed to the Chapter 7 procedure which represents the liquidation of the debtor's assets.[48]

2 3 Institutional framework

2 3 1 Bankruptcy courts

The US bankruptcy system is supported by an institutional framework consisting of specialized Bankruptcy Courts and the United States Trustee (US Trustee) which is a component of the Department of Justice. One of the major weaknesses of the 1898 Act was the splintered jurisdictional scheme in which bankruptcy referees (renamed judges in 1973) could only hear certain core matters in bankruptcy.[49] The 1978 Code established a bankruptcy court system with a substantially enlarged Bankruptcy Court jurisdiction, enabling bankruptcy judges to hear virtually any matter arising

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42 11 U.S.C. §§ 701, 704. When a Chapter 7 petition is filed, the US Trustee (or the Bankruptcy Court in Alabama and North Carolina) appoints an impartial case trustee to administer the case and liquidate the debtor's non- exempt assets.

43 See http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/process.html (accessed 2007-08-20).

44 Certain categories of debts such as child support, student loans, alimony and certain taxes may not be dischargeable.

45 Hynes "Why (Consumer) Bankruptcy?" 2004-2005 *Alabama LR* 128.

46 White 61.

47 See http://www.uscourts.gov/bankruptcycourts/bankruptcybasics.html (accessed 2007-08-28).

48 See 11 U.S.C. §§ 307, 308, 322.

49 Tabb 1995 *American Bankruptcy Institute LR* 34.

in, or related to bankruptcy cases. The Code was, however, not clear on the status of the bankruptcy judges who exercised this enlarged jurisdiction.[50]

Although the Code gave bankruptcy judges substantial jurisdiction over bankruptcy matters as adjuncts of the district court, the protection of Article III constitutional status was not bestowed on them.[51] In response, the Supreme Court swiftly ruled in the *Northern Pipeline Construction Co v Marathon Pipeline Co*[52] decision *vis-à-vis* the power of bankruptcy judges, and held that the broad jurisdiction given to the untenured bankruptcy judiciary was unconstitutional. The Supreme Court's decision subsequently forced Congress to restructure the bankruptcy court system, and the bankruptcy courts were established on a more certain footing with the enactment of the Bankruptcy Amendments and Federal Judgeship Act (BAFJA).[53]

The jurisdictional and court scheme established by Title 1 of BAFJA established the bankruptcy courts as units of the district courts, and as a result Bankruptcy Courts are able to hear cases and proceedings relating to bankruptcy by reference from the district courts. At present the Bankruptcy Courts serve as Article 1 courts,[54] or in other words, are attached to the US Federal Courts who in return delegate their bankruptcy powers to the bankruptcy courts.[55] The current state of affairs implies that US Federal Courts (District courts) can "withdraw the reference" to the bankruptcy court when requested and signifies that they may take back control of a particular case if necessary.[56]

With the enactment of the Code it was the stated intention of Congress that bankruptcy judges were to be relieved of administrative, clerical and supervisory duties so as to focus primarily on the judicial function.[57] The essence of the judicial function therefore is the resolution of disputes, and legislation instructs judges only to provide a hearing when it is specifically required or where there is a contested matter.[58]

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50 *Ibid*.

51 Which includes a life-time appointment to the Bench.

52 458 US 50 (1982).

53 Pub. L. No. 98-353, 98 Stat. 3 33. Signed into law on 19 July 1984. See Herbert *Understanding Bankruptcy* (1997) 49.

54 Providing for the establishment of a federal judiciary, Article III, s 1 of the Constitution appears to require Congress to grant federal judges life tenure and undiminishable salaries. As Bankruptcy Court judges are serving in Article 1 courts they are only given limited status and are appointed for 14-year terms as opposed to Federal Court judges who are given life tenure.

55 There is a right of appeal from the Bankruptcy Court to the District Court, and from the District Court to the Circuit Court of Appeals for the district. Finally, from there it can be referred to the US Supreme Court. (State courts have no jurisdiction over bankruptcy matters that are based on the Bankruptcy Code since they are part of Federal legislation.)

56 Usually they are requested to do so because of special circumstances or if a bankruptcy judge is acting unsatisfactorily.

57 Stripp "An Analysis of the Role of the Bankruptcy Judge and the Use of Judicial time" 1993 *Seton Hall LR* 1330.

58 11 U.S.C. § 102(1).

2 3 2 United States Trustee (US Trustee)

One of the final recommendations of the 1973 Reform Report[59] was that the administration of the bankruptcy system should be turned over to a new government agency, the "United States Bankruptcy Administration", which was recommended to be an independent establishment in the executive of the government.[60] These recommendations were further developed and in 1986, as part of an extensive bankruptcy reform statute, Congress passed the Bankruptcy Judges, U.S. Trustees, & Family Farmer Bankruptcy Act of 1986,[61] which implemented the US Trustee Program nationwide.[62] A US Trustee has now been appointed in virtually every jurisdiction in the US to supervise all bankruptcy cases filed in the particular districts.[63]

The primary role of the US Trustee program is to serve as "watchdog over the bankruptcy process"[64] and to supervise the administration of cases filed under the Bankruptcy Code. With the implementation of the US Trustee program an attempt was made to relieve bankruptcy judges of administrative duties, thereby permitting them to focus on the judicial role. In the past decade the US Trustee program has broadened its scope of authority to include issues such as detecting criminal activity within the bankruptcy system, ensuring debtor compliance with the Bankruptcy Code and Bankruptcy Rules as well as managing and supervising private trustees.[65] In this sense the US Trustee functions as a substitute for the bankruptcy judge regarding supervisory and administrative matters pertaining to the administration of the bankruptcy estate. The US Trustee may also serve as a trustee in those instances where there is no creditor participation and private trustees are unwilling to serve as such.[66]

BAPCPA imposes significant new responsibilities on the US Trustee. According to the new law the US Trustee is involved in *inter alia* the implementation of the new "means-test" provisions in order to determine whether a debtor is eligible for Chapter 7 (liquidation).[67] The introduction of financial education is another significant feature of the reform provisions and

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59 See fn 25 above.

60 See *Document 42 of the 95th 1st session of the Congress, HR,* Report No. 95-595.

61 Pub. L. 99-554, 100 Stat. 3088, reprinted in part at 28 U.S.C. § 581.

62 See the official site of the US Trustee http://www.usdoj.gov/ust/eo/ust_org/about_ustp.htm (accessed 2007-08-25).

63 The Attorney General is charged with the appointment of US Trustees and the Executive Office for US Trustees (EOUST) in Washington, DC, and provides general policy and legal guidance, oversees the Program's substantive operations, and see to the administrative functions. The US Trustee does not function in Alabama and North Carolina where instead the Bankruptcy Administrator Program acts as supervisory institution.

64 See House Report No. 989, 95th Cong., 2d Sess. 88 (reprinted in 1978 US Code Congressional & Admin. News 5787, 5963, 6049).

65 See Alexander "A Proposal to Abolish the Office of the United States Trustee" 1996-1997 *Univ of Michigan Journal of Law Reform* 3. See also 18 U.S.C. §§ 151-158, 3057(a).

66 The applicable federal law is found at 28 U.S.C. § 586 and 11 U.S.C. § 101 *et seq.*

67 11 U.S.C. § 707(b). See par 2 4 2 below for a discussion of the "means-test" provision.

it is the responsibility of the Executive Office of the US Trustee[68] to provide a list of legitimate services and courses and must also develop procedures to ensure compliance by debtors.[69]

Owing to a variety of reasons, the US Trustee was introduced to perform a regulatory duty, and to alleviate the bankruptcy judges of the administrative burden regarding the administration of bankrupt estates. In this sense a clear demarcation regarding judicial and administrative functions concerning the administration of a bankrupt estate was brought about.[70] As stated in the US Trustee's mission statement: "The USTP mission is to promote integrity and efficiency in the nation's bankruptcy system by enforcing bankruptcy laws, providing oversight of private trustees, and maintaining operational excellence."[71]

2 4 Consumer bankruptcy reform

2 4 1 Introduction

The adoption of the BAPCPA has introduced extensive amendments to US bankruptcy law by rewriting the conceptual framework of the 1978 Bankruptcy Code and arguably shifting away form the century-old "fresh-start" policy of favouring debtors.[72] The reform provisions are mostly creditor-oriented within an attempt to tighten abuse and fraud regulation within the bankruptcy system.[73] From a consumer bankruptcy perspective the most significant amendments introduced by the new legislation are the "means-testing" provision and the introduction of a mandatory financial education programme. BAPCPA retained both the Chapter 7 and Chapter 13 personal bankruptcy procedures, but abolished the debtor's right to choose between them and replaced them with a "means test" for Chapter 7. The new legislation also changed a debtor's obligation to repay in Chapter 13. Instead of proposing their own repayment plans, the new "means test" determines the debtor's "disposable income" and requires that they use all of it for five years to repay the creditor.[74]

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[68] Specific responsibilities of the US Trustees include: Appointing and supervising private trustees who administer Chapter 7, 12, and 13 bankruptcy estates (and serving as trustees in such cases where private trustees are unable or unwilling to serve); taking legal action to enforce the requirements of the Bankruptcy Code and to prevent fraud and abuse; referring matters for investigation and criminal prosecution when appropriate; ensuring that bankruptcy estates are administered promptly and efficiently, and that professional fees are reasonable; appointing and convening creditors' committees in Chapter 11 business reorganization cases; reviewing disclosure statements and applications for the retention of professionals; and advocating matters relating to the Bankruptcy Code and rules of procedure in court.

[69] 11 U.S.C. §§ 111(b)(c) (2005).

[70] Calitz and Boraine "The Role of the Master of the High Court as Regulator in a Changing Liquidation Environment: a South African Perspective" 2005 *TSAR* 728 734.

[71] See http://www.usdoj.gov/ust/eo/ust_org/mission.htm (accessed 2007-08-25).

[72] Landry 2006 *Golden Gate Univ LR* 95 105.

[73] 11 U.S.C. § 101 *et seq* 2005.

[74] See White *Abuse or Protection? Consumer Bankruptcy Reform under BAPCPA* 8 paper presented at the Forum for Economic Policy, Marseille, 12 June 2006.

2 4 2 Means testing

BAPCPA introduces a means-testing provision to the US bankruptcy process and requires that every debtor seeking relief under Chapter 7 of the Bankruptcy Code has to comply with this formality.[75] A preliminary inquiry, before reaching the means-test calculation, represents an investigation into whether the debtor's current monthly income multiplied by twelve is below the median family income within the state in which the debtor resides.[76] If the answer is affirmative, the debtor will be protected by a safe-harbour provision and will not be subjected to the means test.[77] Assuming the debtor's income is, however, exceeding the median income a means-test analysis is required which would be largely based on the debtor's current income less any allowed deductions.[78]

The means test is primarily a tool to determine if a debtor has sufficient disposable income to preclude a Chapter 7 proceeding, and entails that the trustee is compelled to review every Chapter 7 application and file a statement confirming whether the debtor "passes" the means test. A presumption of abuse arises if the review is negative.[79] The means-testing procedure is the cornerstone of the Act's solution to combat previous abuse of the bankruptcy system and consists of a formula applied to the imputed income, expenses and actual debt of a debtor who files for a Chapter 7 relief. A debtor will be denied such relief if presumed able to pay a defined portion of his/her unsecured debt.[80] If the debtor proves to have sufficient income it will result in either the dismissal or a conversion into Chapter 11 or 13 applications.

2 4 3 Credit counselling and debtor education

Another significant amendment introduced by BAPCPA is the introduction of mandatory credit counselling and post-petition financial management education.[81] As prerequisite to enter the bankruptcy process under the new

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[75] To determine whether a presumption of abuse arises, all individual debtors with primarily consumer debts who file a chapter 7 case must complete Official Bankruptcy Form B22A, entitled "Statement of Current Monthly Income and Means Test Calculation – For Use in Chapter 7" (The Official Forms may be purchased at legal stationery stores or downloaded from the internet at www.uscourts.gov/bkforms/index.html (accessed 2007-08-25).

[76] 11 U.S.C. § 707(b)(6) (2005). See also White *Abuse or Protection?* 10.

[77] Landry 2006 *Golden Gate Univ LR* 109. When the court is considering whether or not the person is eligible for bankruptcy, the person's monthly income, when reduced according to the law, and multiplied by 60, has to be greater than 25 percent of the person's unsecured debt or $6 000 if the 25 percent is less than $6 000, or it must be greater than $10 000.

[78] Landry 2006 *Golden Gate Univ LR* 109. The allowed deductions are set forth in 11 U.S.C. § 707(b)(2)(A)(ii)-(iv) (2005).

[79] 11 U.S.C. § 704(b)(1) (2005).

[80] See Neustadter 2005-2006 *Creighton LR* 225 233.

[81] 11 U.S.C. §§ 727(a)(11), 1328(g) (2005). The Government Accountability Office (GAO) issued a report on its study of the implementation of the credit counselling and debtor education requirements under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, including the approval process for providers. Report http://www.gao.gov/new.items/d07203.pdf (accessed 2007-08-25).

requirements a debtor will have to receive "an individual or group briefing (including a briefing conducted by telephone or on the Internet) from an approved non-profit budget and credit counseling agency that outlines the opportunities for available credit counseling and assists such individual in performing a related budget analysis" within 180 days prior to filing for bankruptcy.[82]

The rationale for this is that if more consumers were channelled into pre-bankruptcy debt-management plans, creditors and especially credit card companies would receive more substantive payments as opposed to debtors pursuing a formal Chapter 7 or 13 procedure.[83] As a matter of legislative intent the new required "credit counselling" may represent a *sub silentio* alternative to formal bankruptcy proceedings in the form of out-of-court repayment plan negotiations.[84]

In addition to the requirement that a debtor has to receive credit counselling prior to filing for relief, the new law requires a debtor to complete "an instructional course concerning personal financial management".[85] This requirement exists as a pre-condition to receiving a discharge under either Chapter 7 or 13 applications. The Bankruptcy Code provides limited exceptions to the "financial management" requirement if the US Trustee or bankruptcy administrator determines there are inadequate educational programme available, or if the debtor is disabled or incapacitated or on active military duty in a combat zone.[86]

2 5 Conclusion

A golden thread runs through many of the amendments introduced by BAPCPA, namely a movement away from an open-access pro-debtor bankruptcy regime with the liberal "fresh-start" approach as one of its pillars.[87] Although BAPCPA has only been in operation since 2005, there has been fierce criticism against the new procedures.[88] Some critiques have raised the opinion that in the Act's crusade to prevent abuse and fraud, genuine debtors are punished and face uncertainty as to solutions to their financial distress.[89] Another limitation mentioned is that as a result of the poor drafting of particular provisions of BAPCPA consumers will undoubtedly become the victims of judicial discretion and the lack of uniformity among

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82 Kilborn 2006 *Vanderbilt J of Transnational Law* 114.

83 Gross "Legislative Messaging and Bankruptcy Law" 2005-2006 *Univ of Pittsburgh LR* 504 514.

84 Kilborn 2006 *Vanderbilt J of Transnational Law* 115.

85 11 U.S.C. § 727(a)(11) (2005).

86 For a discussion of the discharge procedure see http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/discharge.html (accessed 2007-08-25).

87 See fn 10 above.

88 See Gross 2005-2006 *Univ of Pittsburgh LR* 504; Schlecter 2005-2006 *Whittier LR* 787; Kilborn 2006 *Vanderbilt J of Transnational Law* 77; and Landry 2006 *Golden Gate Univ LR* 95.

89 Schlecter 2005-2006 *Whittier LR* 787.

bankruptcy courts.[90] The process of credit counselling and debtor education has also been criticised to be an added expense and a challenging assignment for debtors as well as the institutional role-players.[91] Concern has been raised as to the homogeneous nature of the programme and education's lack of clear legislative goals.[92]

BAPCPA has fundamentally changed the direction of US consumer bankruptcy philosophy and has taken it much closer, in concept, though surely not in execution and detail, to the qualified discharge model practised by other common law jurisdictions.[93] It is still unknown if the law will have its intended effect. As with all new legislation the exact impact of BAPCPA will only be determined after it has been tested in court and a meaningful empirical analysis can be carried out. In remains to be seen how BAPCPA will translate into practice and whether it will represent an authentic change in US public opinion or will ultimately only reflect the successful lobbying of a very powerful credit industry.[94]

3 CONSUMER INSOLVENCY LAW IN SOUTH AFRICA

3 1 Introduction

To a certain extent it can be said that South African insolvency laws have their origin in both Roman-Dutch and English law with their true foundation evolving from the Ordinance of Amsterdam 1777.[95] Modern insolvency legislation clearly bears the imprint of both Dutch practices and earlier English bankruptcy laws, most notably on aspects such as rehabilitation and discharge of debts.[96] The primary source of South African insolvency law is the Insolvency Act 24 of 1936 (Insolvency Act), supplemented by common law[97] judgments of the courts[98] and the Constitution of the Republic of South Africa.[99] The Insolvency Act represents the foundation of South African

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90 *Ibid*.

91 Landry 2006 *Golden Gate Univ LR* 95.

92 Bross and Block-Lieb "Empty mandate or opportunity for innovation? Pre-petition Credit Counseling and Post-petition financial management Education" 2005 *American Bankruptcy Institute LR* 549.

93 Ziegel 2006 *Theoretical Inquiries in Law* 302.

94 Ziegel 2006 *Theoretical Inquiries in Law* 321.

95 Several common law principles and procedures are still applicable *eg Actio Pauliana*. See Smith *Insolvency Law* (1988) 5; and Boraine *Die Leerstuk van Vernietigbare Regshandelinge in die Insolvensiereg* (LLD thesis UP 1994) 115. See also *Fairlee v Raubenheimer* 1935 AD 135 136.

96 Palmer *Mixed Jurisdictions Worldwide: The Third Legal Family* (2001) 168; and Wessels *History of the Roman-Dutch Law* (1908) 661.

97 Wessels 660.

98 See *Fairlee v Raubenheimer supra* 136; *Swadif (Pty) Ltd v Dyke* 1978 1 SA 928 (A) 938; and *Millman v Twiggs* 1995 3 SA 674 (A) 679-680.

99 *Lex Superior*. The Constitution of the Republic of South Africa Act 1996 which embodies fundamental human rights has, however, changed the face of our law dramatically in that legislation may now be tested by the courts in order to establish the constitutionality thereof – the Constitution being the supreme law of the land.

insolvency legislation and contains the main provisions relating to the administration process of an insolvent estate and applies to both individuals and partnerships.[100]

In contrast with the US, the main aim of the South African Insolvency Act is not to provide debtors with debt relief,[101] and as a result South African consumer insolvency law has traditionally been classified as a pro-creditor system.[102] The South African Law Reform Commission (SALRC) is currently reviewing the South African insolvency law with the view of replacing the 1936 Insolvency Act and is suggesting a unified Insolvency Act which would apply to both individuals and corporate entities.[103]

3 2 Formal insolvency proceedings

As mentioned the Insolvency Act applies to the process to declare a person's estate bankrupt and is referred to as sequestration.[104] Sequestration is initiated by an application to the High Court made by the debtor *or* by a creditor or creditors.[105] In each application to court, it is a requirement that the sequestration should be to the advantage (pecuniary) of creditors.[106] In essence the "advantage to creditors" requirement entails that in order to have access to the formal sequestration proceedings a debtor's

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[100] South Africa has a dualistic system of insolvency law, which means that individual and corporate insolvency are dealt with in separate statutes. See the definition of "debtor" in s 2 of the Insolvency Act.

[101] See *Ex Parte Pillay* 1955 2 SA 309 (N) 311.

[102] The requirement of "advantage to creditors" does not apply in the case of companies and is not common in other legal systems. See *Ex Parte Pillay and Others supra* 311; *R v Meer* 1957 3 SA 614 (N) 619. See also Boraine "Vriendskaplike Sekwestrasies – 'n Produk van Verouderde Beginsels? (Deel 1)" 1993 *De Jure* 230; Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth; The American Experience, and Possible Uses for South Africa" 1996 *TSAR* 315; Roestoff "Skuldverligtingsmaatreës vir Individue in die Suid–Afrikaanse Insolvensiereg: 'n Historiese Ondersoek (Deel II)" 2004 *Fundamina* 115; and Loubser "Ensuring Advantage to Everyone in a Modern South African Insolvency Law" 1997 *SA Merc LJ* 326.

[103] In the case where a company or close corporation is being wound up, one has to turn to the Companies Act or Close Corporations Act in order to find the provisions relating to these entities. These latter Acts are then "connected" to the Insolvency Act by means of "connecting provisions" s 339 of the Companies Act and s 66 of the Close Corporations Act which makes insolvency law applicable also to these types of entities. See Burdette (LLD thesis UP 2002) for a detailed discussion on this topic. See also Boraine and Van der Linde "The Draft Insolvency Bill – An Exploration (Part 1)" 1998 *TSAR* 621 where reference is made to this uniformity.

[104] McKenzie-Skene "Reforming Insolvency Law: A Comparative Study of Scotland and South Africa" 2005 *Nottingham LJ* 48. As regards new provisions for the liquidation of an individual debtor's estate, see *SALRC's Commission Paper* 582, Vol 1 par 3.1-3.14 and par 4.1-4.12.

[105] Ss 3 and 9 of the Insolvency Act. Known as voluntary surrender in the former case and compulsory sequestration in the latter. Although the consequences of the sequestration order are the same in both a voluntary and compulsory sequestration, the procedure and requirements for each method differ in material respects. In a compulsory sequestration, the court must be satisfied that *there is reason to believe* that sequestration will be to the advantage of creditors whereas in a voluntary surrender, the court must be satisfied that sequestration *will* be to the advantage of creditors. See also Roestoff and Renke "Debt Relief for Consumers – The Interaction between Insolvency and Consumer Protection Legislation (Part II)" 2005 *Obiter* 99.

[106] Ss 6(1) and 12(1) of the Insolvency Act.

estate should if realised yield a dividend to concurrent creditors.[107] The rationale behind the "advantage to creditors" requirement in South African insolvency law is *inter alia* that the administration costs are paid out of the estate.[108] In the event of a shortfall in the estate the creditors become liable in the form of contribution payments.[109]

The administration process briefly entails that the trustee sells or otherwise realises the debtor's assets, and after payment of certain administration costs, the proceeds are distributed to the creditors in accordance with their rights.[110] No provisions equivalent to the US Chapter 7 or Chapter 13 bankruptcy procedures exist in South African insolvency law.[111] The South African insolvency process also generally does not include a repayment programme. The only apparent repayment procedure exists in the case where the insolvent receives a salary which is more than is required to support himself and his dependants. In such a case the trustee is, subject to certification by the Master of the High Court, entitled to the surplus income.[112]

One of the consequences of sequestration is the statutory discharge afforded to a debtor by means of a rehabilitation order.[113] After a certain time period an insolvent individual may apply to the High Court for a rehabilitation order which will result in a formal discharge from his pre-sequestration debt and relieves the insolent of every disability arising from sequestration.[114] An insolvent not rehabilitated by the court within ten years from the date of sequestration is deemed to be automatically rehabilitated after the expiry of that period.[115] The release of an insolvent from his pre-sequestration debts was a comparatively recent historical development.[116]

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[107] See *London Estates (Pty) Ltd v Nair* 1957 3 SA 591 (D); *ABSA Bank Ltd v De Klerk and Related Cases* 1999 4 SA 835 (E); *Esterhuizen v Swanepoel and sixteen other cases* 2004 4 SA 89 (W) 102D-G; and see also Smith "The Recurrent Motive of the Insolvency Act – Advantage of Creditors" 1985 *Modern Business Law* 27.

[108] See ss 89 and 97 of the Insolvency Act. See also SALRC's *Working Paper 29 Project 63* "Review of the Law of Insolvency: Prerequisites for and Alternatives to Sequestration" (1989) Schedule 3.

[109] See ss 14(3); 89; 106 of the Insolvency Act.

[110] See ss 82; 89 and 97-102 of the Insolvency Act. Where there are insufficient funds to pay the costs of the sequestration, certain creditors are liable to make a contribution to the costs of the sequestration. For a discussion of the South African insolvency law procedures see McKenzie-Skene 2005 *Nottingham LJ* 51.

[111] S 20 of the Insolvency Act. All assets of the debtor at date of sequestration will be included in the insolvent estate apart from certain exempted property. Excepted property includes *eg* trust property, wearing apparel, certain life policies and contingent interests of *fideicommisary* heirs.

[112] S 23(5) of Insolvency Act.

[113] S 124-129 of Insolvency Act.

[114] A rehabilitation order will also lift the restrictions placed on the debtor by the sequestration. See s 124 of Insolvency Act. See also Roestoff 2004 *Fundamina* 115. The concept of discharge of debt was introduced into South African Insolvency law by the Roman-Dutch law through the Amsterdamse Ordonnansie van 1777.

[115] S 127A of the Insolvency Act. Unless a court orders otherwise prior to the expiration of the period of ten years.

[116] See Smith 3; and *Moti & Co v Cassim's Trustee* 1924 AD 720 733.

3 3 Institutional framework

The High Court has jurisdiction over insolvency matters as South Africa's formal court structure does not include a specialized insolvency court with subject-matter jurisdiction over insolvency cases.[117] The overall supervision of South African insolvency law is in the hands of a government official of the Department of Justice and Constitution Development known as the Master of the High Court (the Master) who has offices in various districts in the country.[118]

Notwithstanding the suggestion in the Master's title that there is an association with the courts, the Master is not a component of the court structure. The Master is a "creature of statute" and as such only has the powers granted to this office by the legislature.[119] The Master does not display similar functions to that of government agencies in most other jurisdictions[120] and does not *inter alia* have the power to administer any estate or function as a judicial officer.[121]

3 4 Insolvency law reform

The South African Law Reform Commission (the SALRC) published its *Report on the Review of the Law of Insolvency* in 2000.[122] This report (the SALRC report) contained a Draft Insolvency Bill and an explanatory memorandum and included recommendations for what were described as mainly technical reforms to non-company insolvency law in South Africa.[123] Some of the main substantive changes proposed in the original 2000 SALRC report[124] include abolition of many of the preferent claims currently provided for in the Insolvency Act,[125] changes in the provisions for setting aside prior transactions, and provisions to regulate the insolvency practitioners' industry.[126] From the tenor of the SALRC's Draft Insolvency Bill,[127] the government is evidently not yet ready to make the paradigm shift

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117 A high level Commission of Inquiry (Hoexter Commission) rejected proposals for specialised insolvency courts: *Third and Final Report of the Commission of Inquiry into the Rationalization of the Provincial and Local Divisions of the Supreme Court* Report number RP 201/97 Pretoria: Government Printing Works 1997 Volume 1 Book 2 Part 3.

118 The Master of the High Court is a public servant who is charged, *inter alia,* with control over the administration of insolvent estates. S 1 of the Administration of Estates Act 66 of 1965 defines "Master" in relation to any matter, property or estate, as the Master, Deputy Master or Assistant Master of the High Court who has jurisdiction in respect of the matter, property or estate. See Calitz and Boraine 2005 *TSAR* 728-744.

119 S 2(2) of the Administration of Estates Act 66 of 1965. See also *The Master v Talmud* 1969 1 SA 236 (T) 690.

120 *Eg*, US Trustee in the US; Insolvency Service in the UK; Superintendent in Canada.

121 *Die Meester v Protea Assuransiemaatskappy Bpk* 1981 4 SA 685 (T) 690.

122 South African Law Commission, Project 63, Commission Paper 582 *Review of the Law of Insolvency* (2000) Vol I and II.

123 See McKenzie-Skene 2005 *Nottingham LJ* 48.

124 *Ibid*.

125 S 97-102 in Insolvency Act.

126 See *SALC Report*, par 20.1 *et seq*.

127 See *Commission Paper* 582 Vol I and Vol II.

that will bring about a change to the underlying philosophy of the "benefit for creditors" requirement that is applied in the case of individual insolvency.[128]

The report also introduces a new provision for a binding composition between a debtor and a majority of creditors to serve as alternative debt relief measure outside the formal sequestration proceedings.[129] It is not clear whether this new form of composition will form part of the final reform proposals as it would probably be subject to clarification of its interaction with other procedures such as the administration order[130] and the new National Credit Act.[131]

In the same year the SALRC published its proposals, the Centre for Advanced Corporate and Insolvency Law at the University of Pretoria (CACIL), acting on a remit from the Standing Advisory Committee of Company Law,[132] produced proposals for a new uniform insolvency law.[133] These proposals by CACIL were based on the SALRC's original proposals for reform of non-company insolvency law but incorporated reformed company insolvency law provisions.[134] The enactment of a unified statute as suggested by the SALRC could possibly reflect a shift in philosophy in our insolvency law also in respect of the type of debtor that will be assisted since, historically, our insolvency law has been structured around the individual.[135]

The final version of the Draft Unified Insolvency Bill reflecting the sum total of the research conducted by the SALRC and CACIL, was eventually presented to the SALRC, *via* the Standing Advisory Committee on Company law, in 2000.[136] In 2003 the Cabinet of the South African government approved the Draft Insolvency and Business Recovery Bill,[137] and it was sent to the Chief State Law Advisors for final certification before being sent to Parliament. However, before the certification process could be completed

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[128] See Burdette (LLD thesis UP 2002) 656. See also Boraine and Roestoff "Fresh Start Procedures for Consumer Debtors in South African Bankruptcy Law" 2002 *International Insolvency Review* 1.

[129] The provisions appear in the form of a new s 74X of Act 32 of 1944. The new composition is designed to provide a solution for the debtor with little or no income, and avoids the disadvantage of a common law composition where the consent of all creditors is required.

[130] The administration orders currently available to the debtor under the Magistrates' Courts Act 32 of 1944 are similar to County Court Administration Orders under the County Courts Act 1984 in England and Wales. In terms of s 74 of the Magistrates' Courts Act 32 of 1944, a debtor who is unable to pay his debts not exceeding an amount of R50 000 may apply for an administration order. See also Boraine 1998 *TSAR* 621.

[131] Act 34 of 2005.

[132] See Burdette *Reform, Regulation and Transformation: The Problems and Challenges Facing South African Insolvency Industry* paper presented at the Commonwealth Law Conference, London, 11-15 September 2005.

[133] Keay "To Unify or not to Unify Insolvency Legislation: International Experience and the Latest South African Proposals" 1999 *De Jure* 62.

[134] See fn 103 above.

[135] Burdette (LLD thesis UP 2002) 9.

[136] See Burdette *Reform, Regulation and Transformation* 6-9.

[137] The name awarded to the Bill when it was envisaged that the Business Rescue provisions for corporate entities would form part of the Insolvency Act.

the absence of a business rescue model was brought under the Department of Justice's attention and the process came to grinding halt.[138]

The Department of Trade and Industry (DTI) is currently engaged in a comprehensive review of corporate laws in South Africa. The process seeks to establish a comprehensive legislation and regulatory framework for the purposes of regulating companies and heralds some major changes to the environment in which companies operate.[139] A draft report has been published for comment and the Bill is said to be published for comment in due course.[140] As part of a policy decision between the DTI and the Department of Justice the provisions for a new business rescue model intended for South African companies will be developed by DTI and will be included in the new Companies Bill.[141] This paves the way for the Unified Insolvency Bill to again enter the legislative process. It remains to be seen when the Bill will receive further legislative attention.

South Africa's credit industry – worth an estimated R500 billion and with more than 20 million customers[142] – has also recently been overhauled with the enactment of the National Credit Act 34 of 2005 (NCA). The NCA which only applies to certain written credit agreements[143] became fully operative on 1 June 2007 and replaced the outdated Usury and Credit Agreement Acts.[144] The NCA has brought about significant changes to the position of over-indebted debtors[145] and places a number of obligations on credit providers, including serious penalties for approving loans that would result in a borrower being over-indebted.[146]

The NCA includes certain debt-relief procedures with the aim of providing the over-committed debtor with an opportunity to reschedule his debt payments.[147] In brief, the provisions entail that during any court proceedings where it is alleged that the debtor is over-indebted, the court may refer the matter to a debt counsellor.[148] A consumer may also apply to a debt counsellor to be declared over-indebted, or if such application is rejected

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138 See Burdette *Reform, Regulation and Transformation* 10.

139 Proposals to end the distinction between close corporations, private and public companies; a possible statutory code of conduct for directors; more reporting requirements for companies including on remuneration, black economic empowerment, environmental and labour issues.

140 *South African Company Law for the 21st Century* http://www.saica.co.za/documents/Draft_policy_document_on_Corporate_Law_Reform.pdf (accessed 2007-08-17).

141 Chapter 6 of Companies Bill.

142 *The Sunday Independent* (2006-05-28).

143 S 8 of NCA. An agreement constitutes a credit agreement if it is a credit facility, or a credit transaction, or a credit guarantee or any combination of the former.

144 Nagel *et al Commercial Law* (2006) 241.

145 According to s 79(1) of the NCA a consumer is over-indebted if the preponderance of available information at the time a determination is made indicates that the particular consumer is or will be unable to satisfy in a timely manner all obligations under all the credit agreements to which the consumer is a party.

146 Ss 80 and 81 of the NCA.

147 The Act introduces the office of the National Credit Regulator that is also tasked to implement programmes regarding financial education for consumers.

148 S 85 of the NCA.

may himself apply to the Magistrate's Court for an order to be declared over-indebted.[149]

A positive development of the NCA is the introduction of consumer-counselling and the regulation of credit bureaus. It is, however, important to note that counselling provided by the NCA does not qualify as traditional consumer education as it is restricted to the jurisdiction of the NCA and only allows for debt counsellors to play a limited role in the evaluation[150] and mediation[151] aspects of the debt-review procedures of the Act. There is also no relationship between debt-counselling in terms of the NCA and any other formal debt-relief procedures such as the sequestration process.[152]

4 SUGGESTIONS ON THE WAY FORWARD

Since embarking on the path to insolvency law reform almost 20 years ago, the South African financial and consumer environment has changed dramatically. It is suggested that, if South Africa is to develop insolvency legislation which is a more accurate reflection of the current South African economic and social environmental circumstances alongside the reform initiatives currently on the agenda, further research should be undertaken.

In terms of specific technical areas for consideration certain key issues for cogitation and research are suggested. These are: (1) re-evaluating our "creditor-friendly" approach and creating affordable access to insolvency procedures which would lead to an eventual discharge;[153] (2) developing a single portal alternative debt-relief system suitable to the debtor to whom the formal insolvency procedure would not be feasible;[154] (3) debt counselling and financial management training as an integral part of insolvency and pre-insolvency procedures;[155] (4) finally, developing a strong institutional framework.[156]

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149 Ss 86 (1)(a) and (b) read with regulation 24 and schedule 2 of the regulations. If the court is of opinion that the consumer is over-indebted the court may declare one or more of the debtor's obligations reckless or may grant an order re-arranging the consumer's obligations by *inter alia* extending the period of the agreement, postponement of dates or both.

150 S 86 of the NCA.

151 Ss 86(5); 86(8)(a) and (b), 87 and 138.

152 The Act also does not allow for any formal discharge provisions and therefore does not qualify as a formal alternative debt-relief procedure. See Boraine *The Reform of Administration Orders within a New Consumer Credit Framework* paper delivered at the International Consumer Law Conference, Cape Town, 11-13 April 2007. On file with the author.

153 Boraine and Roestoff 2002 *International Insolvency Review* 1; Boraine and Roestoff "Developments in American Consumer Bankruptcy Law: Lessons for South Africa." 2000 *Obiter* 66; and Roestoff "Eenvormige Insolvensiewetgewing in Suid-Afrika: Moet die Administrasiebevel Ingesluit word?" 2000 *De Jure* 127.

154 See Boraine "Some Thoughts on the Reform of Administration Orders and Related Issues" 2003 *De Jure* 217.

155 For various views, research and discussion on debt counselling see Niemi-Kiesiläinen 1999 *Osgoode Hall LJ* 409; Ramsay "Mandatory Bankruptcy Counseling: the Canadian experience" 2001 *Fordham Journal of Corporate & Financial law* 536; Niemi-Kiesiläinen 1999 *Osgoode Hall LJ* 473; Martin "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" 2005 *Boston*

If the reform proposals represented in the Unified Insolvency Bill are accepted in their existing form, the substantive law relating to South African insolvency law remains largely unchanged, as does the underlying creditor-friendly system that currently applies.[157] This forcefully raises the question whether facts on the ground which include the presence of growing numbers of over-indebted consumers, and particularly the absence of a publicly funded social safety net,[158] are more important than ideological considerations in determining the content and direction of modern consumer insolvency law.[159] A change in the philosophy of the South African insolvency law should, however, not be oversimplified.

US bankruptcy law has offered debtors a virtually painless path to freedom of debt since 1898, and requiring a repayment plan for all individuals would indeed be a radical departure from US bankruptcy history.[160] The question should, however, be raised whether requiring a payment plan from individuals with the means to do so is indeed so unpleasant.[161] A lesson South Africa can *inter alia* learn from the US experience is that any law reform effort which involves a change in approach and philosophy will be accompanied by a healthy level of criticism and cynicism.

The growing number of over-indebted debtors in South Africa could be as a result of an array of factors.[162] However, the reality is that financially less sophisticated and previously disadvantaged debtors are being induced to make use of increased credit opportunities and are forced to function in a market-based economy without the necessary financial literacy skills.[163] Further research into the development of a single portal alternative debt

College International & Comparative LR 44; and Kilborn 2006 *Vanderbilt Journal of Transnational Law* 77. See also the report issued by INSOL International: *Consumer Debt Report* (May 2001) http://www.insol.org/pdf/ consdebt.pdf (accessed 2007-08-17).

156 World Bank Revised Principles and Guidelines for Effective Insolvency and Creditor Rights System ("Principles and Guidelines") http://web.WorldBank.org/WBSITE/EXTERNAL/TOPICS/LAWANDJUSTICE/GILD/0,,contentMDK:20252025~menuPK:147305~pagePK:64065425~piPK:162156~theSitePK:215006,00.html (accessed 2007-08-20). See also Joyce *The Role of Insolvency Regulators in the past and in the Future* paper presented at the International Insolvency Conference, Singapore, 20 March 2003. On file with the author.

157 The retaining of the "advantage to creditors" requirement as gatekeeper for entering the formal insolvency process as well as the archaic acts of insolvency serves as proof thereof.

158 The social safety net term is used in this context to describe a collection of services provided by the state (such as welfare, universal healthcare, homeless shelters and perhaps various subsidized services such as transit), which prevent any individual from falling into poverty beyond a certain level. *Cf* Ziegel 2006 *Theoretical Inquiries in Law* 299.

159 Ziegel 2006 *Theoretical Inquiries in Law* 299.

160 Tabb "The Historical Evolution of the Bankruptcy Discharge" 1991 *American Bankruptcy LJ* 325 363.

161 Kilborn "Mercy, Rehabilitation and Quid Pro Quo: A Radical Reassessment of Individual Bankruptcy" 2003 *Ohio State LJ* 856.

162 See Gross "Legislative Messaging and Bankruptcy Law" 2005-2006 *University of Pittsburgh LR* 500.

163 Although the new NCA will most certainly have an impact on credit usage and expenditure it only has a limited jurisdiction. See also Gross 2005-2006 *University of Pittsburgh LR* 500.

relief system may yield useful dividends and contribute to develop legislation which is more in touch with the facts on the ground.[164]

Financial education in South Africa also represents a huge challenge. Drawing from the issues identified in regard to the US experience this article does not adopt a firm stance in favour of debt counselling but rather suggests that added research and empirical studies are required to better understand South African consumer behaviour and the relation to consumer insolvency law and policy.[165]

Another policy matter to consider is the institutional and regulatory framework which supports South African insolvency law. It is notable that the US reform process had taken place within a sound and effective institutional framework. Institutional frameworks have been developed in different ways in different jurisdictions, reflecting the divergence in history, tradition and culture.[166] If South Africa is to adopt modern, effective and internationally acceptable insolvency legislation the institutional and regulatory framework supporting our insolvency system will have to be strengthened.

In order to development an effective regulatory framework research and the analysis of existing structures will have to become a priority. In addition, the establishment of a specialist insolvency court, or at least a system of a specialised insolvency judiciary acting within the existing system, will assist in creating predictability and consistency in the South African insolvency system.[167]

5 CONCLUSION

It should be emphasized that there is a substantial difference between the South African and US economic,[168] social and legal environment. The current US bankruptcy system grew directly out of the US's unique capitalist system, which rewards entrepreneurialism as well as extensive consumer spending.[169] In contrast South Africa boasts an emerging economy which includes a legacy of previously disadvantaged consumers with modest exposure to a free-market economy.[170] A complete comparative study of

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[164] Scholars such as Boraine have for years been advocating a holistic approach to the various forms of alternative debt-relief measures. See Boraine and Roestoff 2002 *International Insolvency Review* 1.

[165] See Niemi-Kiesiläinen 1999 *Osgoode Hall LJ* 409; Ramsay "Mandatory Bankruptcy Counseling: the Canadian experience" 2001 *Fordham Journal of Corporate & Financial law* 536; Niemi-Kiesiläinen 1999 *Osgoode Hall LJ* 473; Martin 2005 *Boston College International & Comparative LR* 44; and Kilborn 2006 *Vanderbilt Journal of Transnational Law* 77 for various views, research and discussion on debt counseling. See also the report issued by INSOL International: *Consumer Debt Report* (May 2001) http://www.insol.org/pdf/consdebt.pdf (accessed 2007-08-17).

[166] See Martin 2005 *Boston College International & Comparative LR* 1.

[167] See Calitz and Boraine 2005 *TSAR* 738.

[168] The United States had the world's largest GDP of $13.21 trillion in 2006. See http://www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html (accessed 2007-08-17).

[169] Martin 2005 *Boston College International & Comparative LR* 3.

[170] Martin 2005 *Boston College International & Comparative LR* 8.

consumer bankruptcy within the two jurisdictions will therefore be a very ambitious undertaking.

At the same time, South Africa could benefit from analysing the US experience in adopting new legislation and taking notice of the underlying problems in introducing certain new procedures. It should be appreciated that even in stable, democratic countries, creating sound laws and regulations is a challenge. In developing and transitioning countries, political interference, a lack of experience and resources, and the constraints imposed by weak enforcement agencies often make the task of law drafting even more challenging.[171]

Drawing from the issues identified above it is suggested that the transplantation of any foreign system, especially aspects of the US bankruptcy law with its unique debt culture, should be avoided. Whilst the input and comparison with the US system as well as other international jurisdictions will be beneficial, the contents of supplied laws are only of secondary importance to the process of law development and compatibility of the new laws with pre-existing conditions.[172]

This article does not attempt to spell out a simple recipe for South African insolvency law reform, but rather suggests that role-players take a step backwards and reconsider some of our insolvency law principles which seemed to be cast in stone.[173] As correctly stated in the literature, "legislation on insolvency is a crossroads where all the elements of the legal system in question meet".[174]

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[171] See document on law reform published by the World Bank http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTLAWJUSTINST/0,,contentMDK:20745866~menuPK:1989592~pagePK:210058~piPK:210062~theSitePK:1974062,00.html (accessed 2007-08-17).

[172] Pistor *The Standardization of Law and its Effect on Developing Economies* published as a G-24 Discussion Paper by the UN Conference on Trade and Development (UNCTAD) http://www.g24.org/g24-dp4.pdf (accessed 2007-08-17).

[173] If the research effort into consumer insolvency is to be received with intellectual and practical validity it should be recognized that it involves a plethora of ingredients including legal, economic and social aspects. In order to ensure that the research is well informed and to put in position correct and relevant questions, it will be necessary to engage in inter-disciplinary work with, *inter alia*, sociologists, economists and insolvency practitioners. See Tribe *English and Welsh Personal Insolvency Law: Debtor Education, Debtor Advice and the Credit Environment, a response to Professor Ziegel* paper delivered at The Society of Legal Scholars Annual Conference: University of Keele, Keele, 4 September 2006. On file with author.

[174] Braun "German Insolvency Act: The Special Provisions of Consumer Insolvency Proceedings and Discharge of Residual Debts" 2006 7 *German LJ* 59 60 http://www.germanlawjournal.com/article.php?id=686 (accessed 2007-08-26).