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ACT 34 OF 2005: A TALE OF TWO JUDGMENTS**

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## TO SEQUESTRATE OR NOT TO SEQUESTRATE IN VIEW OF THE NATIONAL CREDIT ACT 34 OF 2005: A TALE OF TWO JUDGMENTS

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### 1 Introduction

The *National Credit Act*<sup>1</sup> aims to promote responsibility in the credit market by encouraging responsible borrowing, the avoidance of over-indebtedness and the fulfilment of financial obligations by consumers, to discourage reckless credit granting by credit providers and to regulate aspects of contractual default by consumers.<sup>2</sup> It attempts to address over-indebtedness through the provision of debt relief, which is accessed by means of the mechanism of debt review. This mechanism is based on the principle of full satisfaction of the consumer's financial obligations, in that the consumer-debtor may, by way of debt review, eventually obtain a rescheduling of his/her credit agreement debt, either by voluntary rearrangement plan<sup>3</sup> with all his/her credit providers or as ordered by a court.<sup>4</sup> Such rescheduling by court entails rearrangement of the consumer-debtor's obligations by extending the period of the agreement and reducing the amount of each payment due accordingly, or postponing during a specified period the dates on which payments are due under the agreement, or a combination of both.<sup>5</sup> Where the debt review process however reveals reckless credit, the consumer is also afforded various forms of debt relief depending on the type of reckless credit extended to him/her.<sup>6</sup> It has already been pointed out in an earlier publication that the aim of the NCA is thus not to deal with those instances where a debtor is insolvent and/or

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1 34 of 2005 (the NCA).

2 S 3 NCA.

3 S 86(7)(b) NCA.

4 S 86(7)(c) NCA.

5 S 86(7)(c)(ii)(aa)–(cc) NCA.

6 S 80 NCA. See also Vessio 2009 *TSAR* 274; Stoop 2009 *SA Merc LJ* 365.

where he/she also has debts that do not qualify as credit agreements in terms of the NCA.<sup>7</sup>

It should also be noted for the purposes of this discussion that the credit provider is compelled in terms of the NCA to comply with certain statutory formalities when attempting to enforce the credit agreement debt against a consumer.<sup>8</sup> These novel measures inevitably affect ordinary debt enforcement provisions. One of the most important requirements introduced by the NCA in this regard is that a credit provider is obliged, as a required step prior to debt enforcement, to provide the consumer-debtor with a Section 129(1)(a) notice in order to notify him/her about certain rights afforded by the NCA, *inter alia*, the right to approach a debt counsellor in order to resolve a dispute or agree on a plan to repay the credit agreement debt. The consumer thus has the opportunity first to seek assistance from a debt counsellor by proposing a debt repayment plan which, if agreed to by the credit provider, would in essence stay the debt enforcement procedure against him/her with regard to his/her credit agreement debt.

Further, it must be noted that the NCA does not deal with the interrelationship between sequestration, either by way of voluntary surrender or compulsory sequestration, and debt review in any way. It could thus have been foreseen that the possible impact of the NCA on sequestration applications would have arisen sooner or later.

In a recent judgment, *Ex parte Ford*,<sup>9</sup> the court refused to grant a sequestration order following three applications for voluntary surrender where the bulk of the debt consisted of credit agreements regulated by the NCA. The fact that no proper consideration had been given in the context of debt-counselling to any other option beyond administered debt collection, such as the possibility of declaring the credit agreements to be reckless credit in terms of the NCA before applying for voluntary

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7 Van Heerden and Boraine 2009 *PELJ* 38 and 55.

8 Ss 129–130 NCA.

9 2009 3 SA 376 (WCC) and see the discussion thereof by Van Heerden and Boraine 2009 *PELJ* and Scholtz *et al Guide* paras 2.4, 11.3.3.1 and 11.7.

surrender, played a significant role in the court's decision not to grant the sequestration order.<sup>10</sup>

In a more recent judgment, *Investec Bank Ltd v Mutemeri*,<sup>11</sup> the respondent-debtors, namely the consumers, opposed an application for compulsory sequestration. The basis of their opposition was that the application for debt review in terms of the NCA barred the applicant from proceeding with the application for compulsory sequestration since they argued that such an application amounted to debt enforcement.

This discussion therefore considers the impact of the debt relief remedies and certain special provisions that apply to debt enforcement in the NCA on sequestration procedures provided for in the *Insolvency Act*<sup>12</sup> in view of the above judgments. With reference to terminology used in this article, it must be pointed out that the NCA has its own terminology. The creditor is usually the credit provider and the debtor the consumer in terms of this Act. These terms will thus be used interchangeably except if it is clear from the context that the creditor or debtor is not a credit provider or consumer in a particular situation.

## **2 Basic requirements for the granting of a sequestration order and the court's discretion in this regard**

### **2.1 General**

It is trite knowledge that sequestration applications may either be brought by the debtor on an *ex parte* basis through voluntary surrender, or by way of compulsory sequestration in an application with prior notice by a creditor. In both instances, the applicable civil procedure involved is a high court application by way of motion that must also comply with the relevant requirements of the *Insolvency Act*.<sup>13</sup>

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10 *Ex parte Ford* para 16.

11 2010 1 SA 265 (GSJ) – hereafter the *Mutemeri* case.

12 24 of 1936.

13 See in general Kunst *et al Meskin* Chps 2 and 3; Sharrock *et al Hockly's Insolvency Law* Chps 2 and 3; Bertelsmann *et al Mars* Chps 3 and 5.

In the case of *voluntary surrender* the court has discretion to accept the voluntary surrender of a debtor's estate and grant a sequestration order if it is satisfied that:<sup>14</sup>

- (a) The debtor is insolvent;
- (b) There is sufficient free residue to defray the costs of sequestration;
- (c) It will be to the advantage of creditors; and
- (d) The formalities in Section 4 of the *Insolvency Act* have been complied with.

The onus of proving that these requirements have been met rests upon the debtor.

Similarly, in the case of *compulsory sequestration* the court also has discretion to grant an application for the sequestration of a debtor's estate if it is satisfied that:<sup>15</sup>

- (a) The applicant is a creditor (or his agent) who has a liquidated claim against the debtor for not less than R100 or two or more creditors (or their agents) who have liquidated claims against the debtor amounting, in aggregate, to not less than R200;<sup>16</sup>
- (b) The debtor has committed an act of insolvency or is insolvent;<sup>17</sup>
- (c) There is *reason to believe* that it will be to the advantage of creditors of the debtor if his estate is sequestered;<sup>18</sup> and
- (d) The formalities in section 9 of the *Insolvency Act* have been complied with.

The onus of satisfying the court on these matters rests on the sequestering creditor and there is no onus on the debtor to disprove any element.<sup>19</sup> It must, however, be noted that in case of compulsory sequestration, the final sequestration order must be preceded by a provisional sequestration order and that a *prima facie* case must be established for the provisional order, whilst the ordinary onus of proof, that is, on a balance of probability is required for the final order.<sup>20</sup>

## 2.2 ***Advantage of creditors: The discretion of the court***

In order to be successful with an application for sequestration an applicant must first and foremost prove that, apart from compliance with intrinsically procedural provisions, the basic requirements as briefly stated above have been met.

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14 Ss 3–7 *Insolvency Act*.

15 Ss 8–12 *Insolvency Act*.

16 S 9(1) *Insolvency Act*.

17 S 8 of the *Insolvency Act* provides for eight acts of insolvency, such as the act quite often relied on as provided for in S 8(g), namely where the debtor gives written notice to a creditor that he/she is unable to pay any of the debts. See *Volkskas Bank ('n Divisie van Absa Bank) v Pietersen* 1993 1 SA 312 (C) 315–317, regarding the test for insolvency.

18 S 12(1) *Insolvency Act*.

19 *Braithwaite v Gilbert* 1984 4 SA 717 (W) 718.

20 Ss 10 and 12 *Insolvency Act*.

Even if a court is satisfied that the aforesaid requirements have been established, it is not bound to grant an order for voluntary surrender or compulsory sequestration. Each case must be decided on its own facts and in each case the court has an overriding discretion that must be exercised judicially and upon a consideration of all the relevant circumstances.<sup>21</sup> It is submitted that each debt situation is unique and that the courts should follow a common-sense approach to decide whether sequestration will be the best solution to a particular debt situation in a specific instance.

The court's discretion usually hinges on the advantage of creditors requirement which is common to both procedures although it is generally accepted, due to the peculiar wording of Section 12(1)(c) of the *Insolvency Act*, that compliance with this requirement can more readily be accepted in case of compulsory sequestration than in case of voluntary surrender.<sup>22</sup>

Advantage of creditors thus plays a pivotal role in the exercise of the court's discretion. It is often on this basis that a court will decline to grant an order for voluntary surrender or compulsory sequestration even though all the other requirements for the granting of such order may have been satisfied. The advantage requirement is more stringent in the case of an application for voluntary surrender where the debtor has to prove actual advantage than in the case of compulsory sequestration where the advantage requirement has been relaxed and it is merely necessary to allege that there is reason to believe that it would be to the advantage of his/her creditors if the debtor's estate is sequestrated.<sup>23</sup>

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21 *Julie Whyte Dresses (Pty) Ltd v Whitehead* 1970 3 SA 218 (D).

22 See also Van Heerden and Boraine 2009 *PELJ* 44 *et seq.* With regard to the advantage principle in general, see Kunst *et al Meskin* paras 2.1.4 and 3.2 and Bertelsmann *et al Mars* paras 3.30 and 5.35 for comprehensive discussions. Only aspects relevant to this discussion are thus discussed here.

23 S 10(c) *Insolvency Act*. See also *Meskin and Co v Friedman* 1948 2 SA 555 (W) 558, in which Roper J stated: "The facts put before the court must satisfy it that there is a reasonable prospect – not necessarily a likelihood, but a prospect which is not too remote – that some pecuniary benefit will result to creditors."

In determining such advantage, the question is whether a "substantial portion" of the creditors,<sup>24</sup> determined according to the value of their claims, will derive advantage from sequestration.<sup>25</sup> In this regard, it is required that sequestration must "yield at the least, a not negligible dividend".<sup>26</sup> If, after the costs of sequestration have been met, there is no payment to creditors, or only a negligible one, there is no such advantage.<sup>27</sup>

However, sequestration is viewed as a drastic measure and courts will therefore also consider alternatives to sequestration when considering the advantage principle.<sup>28</sup> Such alternative measures to deal with the debt may include the advantages of making use of debt repayment plans that may include an ordinary composition with creditors based on agreement, or formal debt relief measures such as administration orders in terms of the *Magistrates' Courts Act*<sup>29</sup> or debt rearrangement<sup>30</sup> or debt restructuring<sup>31</sup> as a result of debt review in terms of the NCA. It must be noted that a repayment plan of whatever nature will in principle depend on the availability of regular income for the debtor in order to make the required payments. Clearly such repayment plans may also not be an acceptable option in a particular instance as creditors may refuse to grant the debtor a rescheduling of the debt, or statutory requirements set for administration orders<sup>32</sup> may not be met in that instance.

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24 *Sharrock et al Hockly's Insolvency Law* para 3.1.3: "Creditors means all, or at least the general body of creditors."

25 *Trust Wholesalers and Woollens (Pty) Ltd v Mackan* 1954 2 SA 109 (N) – hereafter *Trust Wholesalers*; *Fesi v ABSA Bank Ltd* 2000 1 SA 499 (C).

26 *Trust Wholesalers* 111.

27 *London Estates (Pty) Ltd v Nair* 1957 3 SA 591 (D); *Ex parte Steenkamp and Related Cases* 1996 3 SA 822 (W).

28 *Gardee v Dhanmanta Holdings* 1978 1 SA 1066 (N) 1070: "The notion of advantage to creditors is a relative and not an absolute one. Sequestration cannot be said to be to the creditors' advantage unless it suits them better than any feasible and reasonably available alternative course."

29 S 32 of 1944, S 74. Administration orders may not be a viable option in many instances since a debtor may only apply if the total amount of the debt is not more than R50 000. It must further be noted that S 74R specifically states that an administration order is also no bar to the sequestration of the debtor's estate. This is clearly so because the financial situation of the debtor may for instance change subsequent to the granting of the administration order.

30 S 86(7)(b) NCA.

31 S 86(7)(c) NCA.

32 Eg that the debt may be in excess of the amount of R50 000 that constitutes the monetary cap on applications for administration orders.

Although still a rather difficult aspect to deal with in practice, it is submitted that an advantage of creditors in the event of voluntary surrender can to some extent be determined with more certainty than is the case with compulsory sequestration since the court hearing an application for voluntary surrender at least has the advantage of a statement of assets and liabilities compiled by or on behalf of the applicant-debtor to assist in making provisional calculations.<sup>33</sup>

It often happens that certain creditors have obtained judgment and even writs of execution against some of the assets of the debtor issued in their favour. This individual debt collection might then jeopardise the position of other creditors who are not yet in the position to enforce their claims against the debtor. In addition, a creditor who might be at risk of not obtaining a judgment or writ of attachment timeously may revert to compulsory sequestration, since it will prevent the judgment creditors who managed to obtain an attachment of certain of the debtor's assets from proceeding with the sale in execution which might be to the detriment of creditors not yet in possession of a judgment against the debtor. Where the applicant is a judgment creditor who has not proceeded to execution in the ordinary course of debt enforcement, it is still necessary for him/her to demonstrate a reasonable expectation that the anticipated payment to him/her will exceed the likely proceeds of such execution.<sup>34</sup> In the case in which execution is cheaper and more expeditious than sequestration and the applicant is the sole creditor with judgment in his/her favour, there will generally be no reason to believe that sequestration will be to the advantage of creditors.<sup>35</sup> However, in the case in which the applicant has no judgment in his/her favour, the particular circumstances may be indicative that the machinery of the *Insolvency Act* will be quicker and more effective than following the route of issuing summons and moving for judgment and execution.<sup>36</sup> Consequently, a creditor will sometimes indicate in an application for compulsory sequestration that it would be to the advantage of the creditors as a group if a sequestration order is granted, since it will effect a fair distribution of the proceeds of the available assets

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33 Some divisions of the High Court use practice guidelines in this regard; see eg para F4.2 of the Gauteng High Court Practice Directives Manual.

34 *Gardee* case 1069–1070; *Mamacos v Davids* 1976 1 SA 19 (C).

35 *Gardee* case; *ABSA Bank Ltd v De Klerk and Related Cases* 1999 4 SA 835 (E) 839; *Maxwell v Holderness* [2009] JOL 23740 (KZP).

36 Followed in the *Maxwell* case paras 9–11.

amongst the creditors. In many instances, it is alleged in the founding affidavit that it will be to the advantage of creditors if the estate vests in the trustee after sequestration, since the debtor will then be prevented from further disposing of his/her property and the trustee will also be able to reclaim certain estate property disposed of by the debtor prior to sequestration.<sup>37</sup> These last-mentioned reasons advanced to indicate an advantage of creditors are also indicative that there usually is an inherent urgency in compulsory sequestration applications.<sup>38</sup>

In both instances, that is, voluntary surrender and compulsory sequestration, creditors who are not in favour of sequestration of the estate of the debtor may also intervene in the matter and oppose the application. Such interventions will usually be based on the notion that sequestration of the debtor's estate is not the best option in the circumstances and will thus according to the opposing party or parties not be to the advantage of the creditors as a group. Clearly, strong resistance against an application for sequestration by creditors on the basis that it is not to their advantage should also direct the court in exercising its discretion to grant or to deny the relief applied for. However, the court is not bound thereby, but it is generally accepted that each creditor must know what is in his/her own commercial interests.<sup>39</sup>

As indicated above, a provisional sequestration order must first be considered before the court will decide on making it a final sequestration order in case of compulsory sequestration.<sup>40</sup> The court holds a discretion in this regard and in *De Waard v Andrew and Thienhaus Ltd*<sup>41</sup> the court's discretion was expressed as follows: "[T]he Court has a large discretion in regard to making the rule absolute: and in exercising that discretion the condition of a man's assets and his general financial position will be important elements to be considered."

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37 *BP Southern Africa (Pty) Ltd v Furstenburg* 1966 1 SA 717 (O) 720; *Walker v Walker* [1998] 2 All SA 382 (W) 387; *Dunlop Tyres (Pty) v Brewitt* 1999 2 SA 580 (W) 583; *Lynn and Main Inc v Naidoo* 2006 1 SA 59 (N) 68–69; *Commissioner, South African Revenue Services v Hawker Air Services (Pty) Ltd*; *Commissioner, South African Revenue Services v Hawker Aviation Partnership* 2006 4 SA 292 (SCA) 306.

38 See in general *Stride v Castelein* 2000 3 SA 662 (W) and Van Heerden and Boraine 2001 *Obiter* 440–462.

39 *Kunst et al Meskin* para 2.1.5.

40 *Kunst et al Meskin* para 2.1.13.

41 1907 TS 727 733.

Finally, as far as the discretion of the court is concerned, it must also be noted that a court has an inherent jurisdiction to prevent abuse of its processes. Thus, even where all the requirements for granting a sequestration order are met, the court may refuse the order if it amounts to abuse in one way or another.<sup>42</sup>

### 3 *Ex parte Ford* re voluntary surrender and the NCA

#### 3.1 *Case discussion*

In *Ex parte Ford*,<sup>43</sup> three applications for voluntary surrender served before the *unopposed* motion court. It appeared that a major portion of each applicant's liabilities consisted of credit agreement debt to which the NCA applied.<sup>44</sup> The court found this debt to be strikingly disproportionate in relation to the relatively modest income of each of the applicants.<sup>45</sup> In each of the applications, it was averred that the applicants had "become insolvent by misfortune and due to circumstances beyond their control, without fraud or dishonesty on their part".<sup>46</sup> The court consequently indicated that grounds for cogent suspicion of at least some degree of reckless credit extension presented themselves strongly on the disclosed facts in each of the applications.<sup>47</sup> It indicated that one of the objects of the NCA is to discourage reckless credit and it referred to the provisions dealing with same.<sup>48</sup> The court then referred to its powers in terms of Section 85 of the NCA, which provides that, in any court proceeding in which a credit agreement is being considered, if it is alleged that a consumer is over-indebted, the court may refer it to a debt counsellor for debt review and a recommendation to court, or alternatively, the court itself may

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42 See *Kunst et al Meskin* para 2.1.5 and cases referred to.

43 2009 3 SA 376 (WCC); also reported in [2009] JOL 23412 (WCC). Although this case has already been discussed within a somewhat different context in Van Heerden and Boraine 2009 *PELJ*, that discussion is still relied on and relevant for the purposes of this publication, since it attempts to address and to contrast the impact of NCA on both types of sequestration, ie voluntary surrender and compulsory sequestration in view of more recent case law.

44 *Ex parte Ford* para 2.

45 *Ex parte Ford* para 3.

46 *Ex parte Ford*.

47 *Ex parte Ford*. The allegation of absence of fraud by the consumers caused the court to assume that in applying for the credit which became the unaffordable burden that drove the applicants to seek the surrender of their estates, the credit grantors involved were fully informed of the apparent limits of the applicants' inability to service the debt or could easily have ascertained the position had they made reasonable enquiries before granting the loans or credit facilities in question.

48 *Ex parte Ford* paras 4–7.

declare the consumer over-indebted and make an order contemplated in Section 87 to relieve the consumer's over-indebtedness.<sup>49</sup> It pointed out that an evaluation by a debt counsellor may lead to one or more of the consumer's credit agreements being declared reckless credit, resulting in the setting aside of the agreements or the suspension of the force and effect thereof.<sup>50</sup>

In view of the aforementioned, the court deemed it fit to call upon counsel for the applicants to present argument as to why the over-indebtedness of the applicants should not more appropriately be addressed by using the mechanisms of the NCA "instead of the blunter instrument afforded in terms of the voluntary surrender remedy under the Insolvency Act".<sup>51</sup>

The court indicated that, in its opinion, Section 85 is cast in very wide terms as is evidenced by the words "in any court proceedings".<sup>52</sup> Thus, the limitation of Section 85 to "proceedings in which a credit agreement is being considered" does not imply that the proceedings in question are restricted only to those in which the enforcement of a credit agreement is in issue.<sup>53</sup> It is therefore clear that a court may also apply Section 85 of the NCA during a court procedure as with an application for voluntary surrender. The section clearly grants a court additional discretionary power in this context with the view of assisting an over-indebted consumer with debt relief measures provided for by the NCA.

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49 S 85(a) and (b) NCA. See further S 87, which allows the court to declare a credit agreement reckless and/or re-arrange the consumer's credit agreement obligations.

50 *Ex parte Ford* para 9.

51 *Ex parte Ford* para 10.

52 *Ex parte Ford* para 12. See also para 11 in which counsel for the applicant pointed out that the legislature had been pertinently cognisant of the *Insolvency Act* when it enacted the NCA as is apparent from the amendment of S 84 of the *Insolvency Act* by Schedule 2 of the NCA. Counsel stressed this connection that the legislature had not seen fit to make any changes to the provisions of the *Insolvency Act* concerning voluntary surrender. He submitted that S 85 of the NCA was in any event not applicable in proceedings for voluntary surrender under the *Insolvency Act*, relying mainly on the argument that there were no credit agreements before the court in the current matter. In this regard, he thus argued that S 85 only applies to instances in which the consumer resists a credit grantor's claim for performance in terms of a credit agreement on grounds of over-indebtedness. The court, however, did not agree with these arguments.

53 *Ex parte Ford*.

Furthermore, the court pointed out that in terms of the *Insolvency Act*, "a court has to be fully informed of the applicant's proprietary situation<sup>54</sup> and that an applicant for voluntary surrender must also satisfy the court that the surrender of his estate will be to the advantage of creditors".<sup>55</sup> It remarked that these considerations, in a matter like any of the three applications before the court where over-indebtedness is almost exclusively related to debt arising from credit agreements, require the court to take the existence and effect of those agreements into account.<sup>56</sup> It held that the word "consider" referred to in Section 85 has a broad connotation: in context, it denotes that the court proceedings contemplated by the provision must be proceedings in which a credit agreement is taken into account as relevant matter.<sup>57</sup>

The court remarked that the fact that the NCA leaves the provisions of the *Insolvency Act* regarding voluntary surrender generally unaffected, acknowledges that insolvency can arise in a great variety of circumstances, many of them quite unrelated to over-indebtedness arising from credit agreements as defined in the NCA.<sup>58</sup> Therefore, it was of the opinion that insolvents whose misfortune arises out of credit agreement transactions would be well advised for the reasons indicated hereinafter to take into account the policy and objects of the NCA and also the special remedies provided by it before opting to apply for the surrender of their estates under the *Insolvency Act* rather than availing themselves of the provisions under the NCA.<sup>59</sup>

Furthermore, the court pointed out that in all three applications the applicants filed supplementary affidavits in which they confirmed having been made aware of the court's desire to hear argument on the application of Section 85 of the NCA in the context of the apparent character of their over-indebtedness.<sup>60</sup> Each of them testified

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54 *Ex parte Ford* para 13, with reference to Bertelsmann *et al Mars* para 3.15.

55 *Ex parte Ford*.

56 *Ex parte Ford*.

57 *Ex parte Ford*.

58 *Ex parte Ford* para 14.

59 *Ex parte Ford*.

60 *Ex parte Ford* para 15.

that they had indeed considered debt counselling but set out in detail how financially impracticable an arrangement of debt repayment would be.<sup>61</sup>

However, the court was dissatisfied, as there was no indication based on the evidence in any of the three applications that consideration was given in the context of debt counselling to anything beyond an administered debt collection.<sup>62</sup> In particular, there was no indication that the debt counsellors engaged by the applicants gave any consideration to obtaining declarations of reckless credit.<sup>63</sup>

Despite advocating its powers in terms of Section 85, the court still held that, in view of the applicants' resistance to assistance in terms of Section 85 of the NCA, it was not going to refer their credit agreements for investigation and report by a debt counsellor<sup>64</sup> and declared that it was nevertheless open to the applicants to take the necessary steps in this regard on their own initiative.

In addition, the court indicated that it was not prepared to exercise its discretion in favour of granting the applications for voluntary surrender owing to the applicants' failure to properly explain why their credit agreement debt was not amenable to administration under the NCA to their own benefit, as well as to that of their credit-granting creditors who acted responsibly – and not recklessly – in extending credit.<sup>65</sup>

The court considered it as its duty, in the exercise of its discretion in cases such as the present, to have proper regard to giving due effect to the public policy reflected in the NCA, which gives preference to rights of responsible credit grantors over reckless credit grantors and supports full satisfaction, as far as possible, by consumers of all financial obligations.<sup>66</sup>

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61 *Ex parte Ford*. In this regard, the applicants each set out in tabulated form that the application of their disposable income over the next seven years to service their current debt would still leave them heavily indebted at the end of the period. It is not clear why the court did not find this information helpful.

62 *Ex parte Ford* para 16.

63 *Ex parte Ford*.

64 *Ex parte Ford* para 17.

65 *Ex parte Ford*.

66 *Ex parte Ford* para 20.

In closing, the court indicated that the argument that in essence it is for the applicants to choose the form of relief that suits their convenience by mechanically and superficially satisfying the relevant statutory requirements under the *Insolvency Act* is a misdirected approach, especially where the granting of a selected remedy is discretionary,<sup>67</sup> and emphasised that the primary object of voluntary surrenders is not the relief of harassed debtors.<sup>68</sup> The court indicated that there is moreover a consonance between the objects of the relevant provisions of the NCA and the *Insolvency Act*, that is, "not to deprive creditors of their claims but merely to regulate the manner and extent of their payment".<sup>69</sup> However, on the incomplete facts disclosed in the current applications, the court held that it was left with the impression that the machinery of the NCA is the more appropriate mechanism to be used and consequently refused the applications.<sup>70</sup>

In sum, in exercising its discretion against the applicants, the court relied heavily on notions that the credit granted to the applicants may have amounted to reckless credit; the information on their debt review efforts it deemed insufficient to explain why the applicants had not availed themselves adequately of the remedies provided for by the NCA; and that the monetary advantage demonstrated in the applications was marginal.<sup>71</sup>

### **3.2 Some observations with regard to reckless credit**

The judge clearly wanted the applicants in this instance to gain a proper determination on whether their credit agreements amounted to reckless credit, since the court had a suspicion that this was not done.<sup>72</sup> Although this discussion is not intended to deal extensively with reckless credit and its consequences for an over-indebted debtor as such,<sup>73</sup> it must be mentioned that from a debt relief point of view

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67 *Ex parte Ford* para 19, with reference to *Ex parte Hayes* 1970 4 SA (NC) 96C.

68 *Ex parte Ford* para 21, with reference to *Ex parte Pillay; Mayet v Pillay* 1955 2 SA 309 (N) 311E.

69 *Ex parte Ford*, with reference to *Nel v Body Corporate of the Seaways Building* 1996 1 SA 131 (SCA) 138E.

70 *Ex parte Ford* paras 21–22.

71 *Ex parte Ford* para 18.

72 S 83(1) of the NCA also grants a court in any court proceedings in which a credit agreement is considered the power to declare any credit agreement to be reckless as determined in terms of Part D of the NCA. The *Ford* judgment did not consider this possibility in particular.

73 See further Vessio 2009 *TSAR* 272; Stoop 2009 *SA Merc LJ* 365; Scholtz *et al Guide* para 11.4.

the question could be raised as to the effectiveness of the reckless credit remedies in this regard, since this was not indicated by the court.<sup>74</sup>

In brief, the NCA provides for three specifically defined types of reckless credit agreements – prescribing the remedy in each instance. The first and second types of reckless credit in terms of Sections 80(1)(a) and 80(1)(b)(i) render a credit agreement a reckless credit agreement if the credit provider failed to conduct an assessment as required by Section 81(2), or when the credit agreement was made, or at the time when the amount approved in terms of the agreement is increased, the credit provider (despite) having conducted an assessment as required by Section 81(2), entered into a credit agreement with the consumer, despite the fact that the preponderance of information available to the credit provider indicated that the consumer did not generally understand or appreciate his/her risks, costs or obligations under the proposed credit agreement. The third type of reckless credit in terms of Section 80(1)(b)(ii) deals with those instances in which the preponderance of information available to the credit provider indicated that entering into that credit agreement would make the consumer over-indebted and despite this, the credit provider entered into the specific credit agreement with the consumer.

The statutory powers of the court in respect of the first two types of reckless credit referred to are that it may make an order setting aside all or part of the consumer's rights and obligations *under that agreement*, as it deems just and reasonable in the circumstances.<sup>75</sup> Alternatively, it may suspend the force and effect of that specific credit agreement in which instance the provisions of Section 83(3)(b)(i) will apply.<sup>76</sup> Regarding the third type of reckless credit that caused the over-indebtedness of the consumer, the court may suspend the force and effect of such an agreement for a

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74 Some commentators believe that South African law needs a complete overhaul of its debt relief measures since current procedures such as administration orders in terms of the *Magistrates' Courts Act* and the requirements for voluntary surrender are not in line with modern international developments. Criticism against the measures such as debt restructuring introduced in the NCA also exists, since they do not cover all instances and the current procedure is fraught with practical difficulties. The legislature also did not consider their effect on existing procedures. See Boraine 2003 *De Jure* 217; Roestoff "n Kritiese evaluasie van skuldverligtingsmaatreëls"; Roestoff and Jacobs 1997 *De Jure* 189 and Roestoff *et al* 2009 *PELJ* 247 regarding technical difficulties regarding debt review in terms of the NCA.

75 S 83(2)(a) NCA.

76 S 83(2)(b) NCA.

determined period.<sup>77</sup> Without elaborating on this aspect, it is submitted that from a debt relief point of view, a declaration of reckless credit will not necessarily offer a lasting solution to a debtor's over-indebtedness or insolvency. The reasons for this are that even where a court sets all or some of the debtor's rights and obligations under an agreement aside, the credit provider should still in principle be able to claim restoration – the extent of which will depend on the basis of the claim – since the NCA does not state that a reckless credit agreement is illegal and therefore null and void, and restoration is also not prohibited. Where a credit agreement is suspended, it may bring some relief regarding the repayment of finance charges as provided for in Section 84 but once the suspended period has elapsed the consumer will once again become liable to repay at least the capital amount credit.

#### **4 Compulsory sequestration and the NCA following *Investec Bank Limited v Mutemeri***

##### **4.1 Background**

In this case, the applicants applied for the compulsory sequestration of the common estate of the respondents who were deemed to be married in community of property to each other. It appears that the debts relied on by the applicants were all credit agreements in terms of the NCA. It is not clear from the reported facts whether the respondents also had other types of debts that did not qualify as credit agreements. The judgment is based on the initial application for a provisional sequestration order. In essence, the line of defence followed by the respondents was that since the debts amounted to credit agreements in terms of the NCA and as they had already applied for debt review in terms of the NCA by the time that the sequestration application was brought, the sequestration application against them was barred because it amounted to debt enforcement in terms of the NCA.<sup>78</sup>

Before discussing the opposition against the application based on provisions of the NCA, it will suffice for the purposes of this discussion to state that the court accepted that the basic requirements for such an application had been met. From the

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<sup>77</sup> Ss 83(3)–(4) and 84 NCA.

<sup>78</sup> *Mutemeri* para 1.

judgment, it appears that the respondents did not take real issue with any of the details of the applicants' claims except to deny that the third claim was one for R500 000.<sup>79</sup> The court also accepted as common cause that the applicants had substantial liquidated claims against the respondents.<sup>80</sup>

The application was based on alleged acts of insolvency in terms of Section 8(g) of the *Insolvency Act*, and the court apparently accepted, by inference, that their liabilities exceeded their assets.<sup>81</sup> Although the respondents challenged the advantage of creditors requirement, the court found sufficient evidence that there was *prima facie* reason to believe that the granting of the order would be to the advantage of the creditors.<sup>82</sup>

However, this case did not really turn on these basic requirements for compulsory sequestration but rather on the defences argued by the respondents relating to the NCA and its impact on sequestration applications.

#### **4.2 Defences against the application for sequestration based on the NCA**

It was common cause that the applicants' claims against the respondents amounted to "credit agreements", that the applicants were the "credit providers" and that the respondents were the "consumers" in terms of the NCA.<sup>83</sup> The respondents thus raised a number of defences based on the NCA and contended that the applicants were precluded by the NCA from seeking their sequestration in this application.<sup>84</sup>

The respondents firstly argued that they had applied for debt review in terms of Section 86, on which application a debt counsellor accepted that they were over-indebted and gave notice to the creditors of this state of affairs and subsequently applied to the Magistrate's Court for the respondents' debts to be restructured in

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79 *Mutemeri* para 10.

80 *Mutemeri* para 8.

81 *Mutemeri* paras 11 and 12.

82 *Mutemeri* paras 13–17.

83 *Mutemeri* para 18.

84 *Mutemeri* para 19.

terms of Sections 86 and 87 of the NCA.<sup>85</sup> Based on this fact, the argument for the respondents was that until the hearing of their debt-restructuring application (which was enrolled for a date nearly a year after the date of the sequestration proceedings), no legal proceedings could be instituted against them for enforcement of the applicants' claims under the credit agreements and, more importantly for this discussion, that the application for sequestration constituted such debt enforcement proceedings.<sup>86</sup>

In their argument, the respondents relied in the first place on Sections 129(1)(b) and 130(1)(b) of the NCA. The relevant parts of these provisions read as follows:

**129. Required procedures before debt enforcement.**

- (1) If the consumer is in default under a credit agreement, the credit provider—
  - (a) may draw the default to the notice of the consumer in writing and propose that the consumer refer the credit agreement to a debt counsellor, alternative dispute resolution agent, consumer court or ombud with jurisdiction, with the intent that the parties resolve any dispute under the agreement or develop and agree on a plan to bring the payments under the agreement up to date; and
  - (b) subject to section 130(2), may not commence any legal proceedings to enforce the agreement before—
    - (i) first providing notice to the consumer, as contemplated in paragraph (a), or in section 86(10), as the case may be, and
    - (ii) meeting any further requirements set out in section 130.

**130. Debt procedures in a Court.**

- (1) Subject to subsection (2) a credit provider may approach the court for an order to enforce a credit agreement only if, at that time, the consumer is in default and has been in default under that credit agreement for at least 20 business days and—
  - (a) ...
  - (b) in the case of a notice contemplated in section 129 (1), the consumer has—
    - (i) not responded to that notice; or
    - (ii) responded to the notice by rejecting the credit provider's proposals.

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<sup>85</sup> *Mutemeri* para 2. This application to the Magistrate's Court was launched on 15 May 2009 but was only due to be heard on 11 August 2010.

<sup>86</sup> *Mutemeri* para 2.

The respondents were in default by 7 August 2008, on which date the applicants did in fact provide the respondents with the prescribed Section 129(1)(a) notices – apparently with the view of initiating ordinary debt enforcement procedures.<sup>87</sup> Initially, the respondents did not make use of any of the debt relief options provided for by the NCA but promised instead to pay their outstanding arrears under the credit agreements over time and posed a settlement in a letter to the applicants on 22 August 2008.<sup>88</sup> They also indicated that they would seek the assistance of a debt counsellor.<sup>89</sup>

Since this counter-proposal was not acceptable to the applicants, they attempted to enforce the credit agreements by way of an application for payment of their claims on 16 October 2008.<sup>90</sup> Motlaung AJ dismissed this application on 13 February 2009 by holding that the applicants were precluded by Section 130(1) of the NCA from enforcing their claims without first considering and either accepting or rejecting the respondents' counter-proposal.

Suffice to say for the purposes of this discussion that the applicants argued that Motlaung AJ erred in this conclusion and they intended to appeal that judgment. The applicants submitted that they had complied with Section 130(1)(b) because the respondents' failure to adopt and implement the applicants' proposals and their counter-proposal amounted to a failure to respond to, or a rejection of, the applicants' proposals within the meaning of Section 130(1)(b) as quoted above.

Although the respondents had not adopted or implemented any of the applicants' proposals before the above-mentioned application of 16 October 2008 to enforce the credit agreements was launched, they did so while the judgment in that application was pending by applying for debt review to a debt counsellor on 13 January 2009.<sup>91</sup> It is important to note that at the time of the application before Motlaung AJ on 16

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87 *Mutemeri* para 20.

88 *Mutemeri* para 21.

89 *Mutemeri* para 21.

90 *Mutemeri* para 22. It is to be noted that the application procedure is to be used with caution when enforcing a debt, since in general serious factual disputes may be readily entertained in such instances, but in this case it is assumed that the applicants' credit provider did not really anticipate a dispute as to the existence and the amount of the debt.

91 *Mutemeri* para 24.

October 2008 the applicants had not yet applied for debt review. Thus, the effect of a pending debt review on individual enforcement proceedings was not an issue in that matter.

The applicants thereafter decided to apply for the compulsory sequestration of the respondents whose debt counsellor had on 15 May 2009 launched an application for debt restructuring to court on 15 May 2009 but which restructuring, notably, was enrolled for hearing on 11 August 2010 only, which was approximately a year from the date of the sequestration application.

In the subsequent sequestration application, the applicants argued that their default notices in terms of Section 129(1)(a) of the NCA were "steps taken to enforce the credit agreement" as contemplated in Section 129 and that the respondents were therefore precluded by Section 86(2) of the NCA from applying for review of their credit agreements. Without resolving this issue, the court merely observed by way of an *obiter dictum* that the argument exposed an anomaly in the applicants' case and in the NCA itself, in that if a default notice in terms of Section 129(1) were to be regarded as a "step contemplated in s 129" to enforce a credit agreement, the very step to inform the consumer-debtor about his/her rights to – amongst other things – seek assistance from a debt counsellor, would have prevented him/her from doing so.<sup>92</sup> In other words, on this interpretation, the court reasoned that a default notice would propose to the consumer that he/she make application to a debt counsellor but at the same time trigger the bar in terms of Section 86(2) that precludes the consumer from doing so. Since it was not necessary to rule on this issue for the purposes of this judgment, the court merely accepted in favour of the respondents, as Motlaung AJ had found in the application of 16 October 2008 that the applicants did not meet the requirements of the said Section 130(1) and were accordingly precluded from approaching the court "for an order to enforce a credit agreement" by way of a debt enforcement procedure.<sup>93</sup>

The court stated, however, that the real legal issue that had to be answered in the present sequestration application, was whether an application for compulsory

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92 *Mutemeri* paras 25 and 26.

93 *Mutemeri* para 26.

sequestration of the estate of a consumer-debtor amounted to "an order to enforce a credit agreement" within the meaning of Section 130(1) of the NCA.<sup>94</sup> In identifying this question, the court, relying on *Estate Logie v Priest*,<sup>95</sup> mentioned that there is little doubt that a sequestrating creditor's motive in applying for the sequestration of its debtor may be and often is to obtain payment of its debt. However, the court pointed out that the question whether an application for sequestration constitutes an application "for an order to enforce a credit agreement" within the meaning of Section 130(1) of the NCA, depends on the nature of the relief sought by the creditor and not on the sequestrating creditor's underlying motive in bringing the application.<sup>96</sup> Consequently, whatever the underlying motive, an application for compulsory sequestration is not barred by Section 130(1) of the NCA unless it is in fact (regarded as) an application for an order "to enforce a credit agreement".<sup>97</sup>

The court proceeded to consider case law that dealt with the very nature of a sequestration order, or it is submitted, rather an application for compulsory sequestration.<sup>98</sup> In *Collett v Priest*<sup>99</sup> the Appellate Division held that a "civil suit" for the purposes of a statutory provision that dealt with appeals was a "legal proceeding in which one party sues for or claims something from another" and that "civil suit" did not include an application for sequestration.

It is to be noted that the court in *Collett v Priest*<sup>100</sup> made the following very significant statement on the nature of sequestration proceedings:

The order placing a person's estate under sequestration cannot fittingly be described as an order for a debt due by the debtor to the creditor. Sequestration proceedings are instituted by a creditor against a debtor not for the purpose of claiming something from the latter, but for the purpose of setting the machinery of the law in motion to have the debtor declared insolvent. No order in the nature of a declaration of rights or of giving or doing something is given against the debtor. The order sequestrating his estate affects the civil status of the debtor and results in vesting his estate in the Master. No doubt before an order so serious in its consequences to the

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94 *Mutemeri* para 26.

95 1926 AD 312 319.

96 *Mutemeri* para 28.

97 *Mutemeri* para 28.

98 *Mutemeri* paras 29–31.

99 1931 AD 290.

100 At 299.

debtor is given the court satisfies itself as to the correctness of the allegations in the petition. It may for example have to determine whether the debtor owes the money as alleged in the petition. But while the court has to determine whether the allegations are correct, there is no claim by the creditor against the debtor to pay him what is due nor is the court asked to give any judgment, decree or order against the debtor upon any such claim.

In *Prudential Shippers SA Ltd v Tempest Clothing Co (Pty) Ltd*,<sup>101</sup> the applicant applied for the winding-up of the respondent-company's estate. The respondent alleged that the debt, upon which the applicant relied, had arisen from a money-lending transaction subject to the *Limitation and Disclosure of Finance Charges Act*.<sup>102</sup> It asked that the applicant's officers be examined under Section 11 of that Act. The section provided for such an examination in any proceedings "for the recovery of a debt" in pursuance of a money-lending transaction. McEwan J<sup>103</sup> held that an application for the winding-up of a debtor's estate did not constitute proceedings "for the recovery of a debt". It is submitted that although this was not a sequestration application, the same considerations relating to a winding-up would by analogy apply to sequestration applications in this regard.

In the *Mutemeri* case having referred to the aforementioned cases, the court stated that it appeared that the rationale of these judgments was equally applicable to the proper interpretation of Section 130(1) of the NCA, which applies only to an application to court "for an order to enforce a credit agreement".<sup>104</sup> Trengove AJ significantly declared that Section 130(1) of the NCA therefore does not apply to a compulsory sequestration application of a consumer's estate by a credit provider based on a claim in terms of a credit agreement between them, as such application is "not one for an order enforcing the credit provider's claim against the consumer". In further support of its contention, the court referred to Section 9(2) of the *Insolvency Act* that indeed makes it clear that the sequestrating creditor's claim need not even be due, that is, need not yet be enforceable. It indicated that an application for sequestration may be made on the strength of a claim that is not yet enforceable

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101 1976 2 SA 856(W) – hereafter *Prudential Shippers*.

102 73 of 1968.

103 See further *Prudential Shippers* 863D–865A.

104 *Mutemeri* para 31.

because a sequestration order is not an order for enforcement of a claim.<sup>105</sup> The purpose or effect of the sequestration is thus merely to bring about a convergence of claims against an insolvent estate to ensure that it is properly wound up in an orderly fashion and that the creditors are treated equally.

The court pointed out that the reason that the applicant must have a liquidated claim against the debtor is not because the application is to enforce the debt but to show that the applicant has a sufficient interest in the application.<sup>106</sup>

The respondents, however, submitted that even if the sequestration application did not amount to an enforcement procedure envisaged in Section 130(1) of the NCA, such application is in any event subject to Section 130(3) which is not limited to applications for the enforcement of credit agreements but extends to "any proceeding commenced in a court in respect of a credit agreement".<sup>107</sup> Section 130(3) reads as follows:

Despite any provision of law or contract to the contrary, in any proceedings commenced in a court in respect of a credit agreement to which this Act applies, the court may determine the matter only if the court is satisfied that

- (a) in the case of proceedings to which sections 127, 129 or 131 apply, the procedures required by those sections have been complied with.

An alternative submission by the respondents was thus that an application for sequestration, although not a procedure for debt enforcement, at least was a proceeding "in respect of a credit agreement" within the meaning of Section 130(3) and that it thus rendered such an application subject to the requirements of Section 129 of the NCA.<sup>108</sup>

On this point, the court ruled that Section 130(3) did not extend the scope of Section 129 and that it merely provides that in proceedings (already) subject to the requirements of Section 129 the court must be satisfied that there has been

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105 *Mutemeri* para 31.

106 *Mutemeri* para 31.

107 *Mutemeri* para 32.

108 *Mutemeri* para 33.

compliance with those requirements.<sup>109</sup> The court indicated that one accordingly has to turn to Section 129 to determine whether its requirements apply to applications for sequestration.<sup>110</sup> However, it pointed out that the only relevant requirements are those laid down by Section 129(1)(b) but that they only apply to "legal proceedings to enforce" credit agreements and that it had already concluded that applications for (compulsory) sequestration are not debt enforcement proceedings.<sup>111</sup> Sequestration applications are accordingly not subject to the requirements of Section 129(1)(b) and thus do not require the credit provider to first send the consumer a Section 129(1)(a) notice as envisaged by Section 130(3) before the credit provider can commence with sequestration proceedings.

Lastly, the respondents relied on Section 88(3) of the NCA.<sup>112</sup> It provides, *inter alia*, that a credit provider who receives notice of a consumer's application for debt review in terms of Section 86(4)(b)(i) "may not exercise or enforce by litigation or other judicial process any right or security" under a credit agreement between the credit provider and the consumer, until certain conditions have been met. The court also rejected this argument as it held, on the basis of the reasons already mentioned above, that an application by a credit provider for the sequestration of a consumer does not constitute litigation or other judicial process by which the credit provider exercises or enforces any right under the credit agreement between itself and the consumer.<sup>113</sup> The court reiterated that the credit provider may rely on its claim in terms of a credit agreement to qualify as a creditor with standing to bring the application for the sequestration of the consumer – but it does not exercise or enforce its rights in doing so.<sup>114</sup>

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109 *Mutemeri* para 33.

110 *Mutemeri* para 33.

111 *Mutemeri* para 33.

112 *Mutemeri* para 34.

113 *Mutemeri* para 34.

114 *Mutemeri* para 34.

### 4.3 *Intervention by a debt counsellor in sequestration applications*

It is also noteworthy that the respondents' debt counsellor contended that he had a direct and substantial interest in the application for the respondents' sequestration by virtue of his functions as their debt counsellor in terms of Section 86 of the NCA.<sup>115</sup>

In rejecting this argument, the court held that the role of the debt counsellors under the NCA is confined to the functions they perform in terms of Sections 71 and 86 of the NCA. They are facilitators and mediators between consumers who have become over-indebted on the one hand, and their credit providers on the other.<sup>116</sup> The debt counsellor therefore does not have a direct and substantial interest in the application for the sequestration of the respondents' estate merely because he is acting as their debt counsellor in terms of Section 86 of the NCA.<sup>117</sup>

## 5 The meaning of debt enforcement in the NCA

As Trengove AJ stated in the *Mutemeri* case, the crucial question is whether an application for (compulsory) sequestration constitutes "debt enforcement" as meant by the NCA.<sup>118</sup> The answer to this question is of extreme significance, as it can have severe implications for a credit provider. If the answer is affirmative it, *inter alia*, would have the effect that:

- (a) where debt enforcement by compulsory sequestration is sought by a credit provider, such credit provider will have to comply with the requirements of Section 129(1)(a) as a mandatory step prior to debt enforcement<sup>119</sup> as well as any other provisions of the NCA relating to debt enforcement; or

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115 *Mutemeri* para 36.

116 See also *The National Credit Regulator v Nedbank Ltd* 2009 6 SA 295 (GNP).

117 *Mutemeri* paras 37–40.

118 It is submitted that voluntary surrender is a debtor-induced procedure and thus does not give rise to the question of whether it amounts to debt enforcement. Also see 6.2.

119 In fact, *all* the provisions of the NCA relating to debt enforcement would thus apply.

(b) where debt enforcement by compulsory sequestration is sought against a consumer who (as with the Mutemeris) is under debt review<sup>120</sup> by the time that the application for compulsory sequestration is brought, such pending debt review will as a result of the provisions of Section 88(3) of the NCA constitute a bar against compulsory sequestration.<sup>121</sup>

On such a construction, with respect to a natural person consumer, a credit provider who wishes to apply for compulsory sequestration would first be obliged to deliver<sup>122</sup> to the consumer a Section 129(1)(a) notice drawing the consumer's attention to his/her default and requiring him/her to, *inter alia*, consult with a debt counsellor for purposes of resolving a dispute or agreeing on a debt repayment plan. Of course, the sending of a section letter under Section 129(1)(a) in such an instance triggers the yet unresolved debate on whether such natural person-consumer can then apply for debt review<sup>123</sup> – which, if the consumer is competent to apply for it, will trigger the Section 88(3) bar referred to in (b) if the consumer is subject to a pending debt review by the time the credit provider applies for compulsory sequestration.

If the question as to whether compulsory sequestration constitutes "debt enforcement" for purposes of the NCA is answered in the negative, it has the effect that a credit provider can apply to have a consumer sequestered without having to comply with Section 129(1)(a) as a prior step or without having the worry that a pending debt review might trigger the bar contained in Section 88(3) of the NCA, as such bar is only operative in respect of debt enforcement by litigation.

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120 Whether the Mutemeris could have gone for debt review is debatable but need not be resolved for purposes of this discussion.

121 In so far as the second scenario is concerned, namely the bar created by a pending debt review, it should be noted that *juristic* person consumers to whom the NCA applies are not entitled to apply for debt review. Thus, if compulsory sequestration proceedings are regarded as "debt enforcement", it is only in those instances in which the consumer is a natural person that a pending debt review can constitute a bar against compulsory sequestration. It would thus appear that the compulsory liquidation of a juristic person such as a company by a credit provider, if such compulsory liquidation should by analogy be regarded as debt enforcement, would not be hit by the S 88(3) bar.

122 See Van Heerden and Coetzee 2009 *PELJ* for a discussion of *Munien v BMW Financial Services (SA) (Pty) Ltd* 2010 1 SA 549 (KZD).

123 See Scholtz et al *Guide* para 11.3.3.2(D).

It is submitted that in the event of compulsory sequestration not being debt enforcement for purposes of the NCA, the possible effect of a pending debt review on compulsory sequestration proceedings could be that it may impact on the advantage of creditors requirement, which we attempt to address later in this discussion.

From the *Mutemeri* decision, it is clear that although the parties identified the crucial question correctly, they became sidetracked with the issues with the result that the structure of their argument was wrong. What the parties should have done – given the fact that they were apparently under debt review – was to first, on the basis that they contended that compulsory sequestration equates to debt review, have raised their final argument, namely that Section 88(3) barred sequestration. If the court agreed with their contention regarding the nature of compulsory sequestration being a debt enforcement procedure, this would have disposed of the matter entirely and the debt enforcement provisions in Sections 129 and 130 of the NCA would be irrelevant. However, the parties chose to first deal with compliance with the requirements of Section 129(1)(a), which it is submitted, should only have been an issue in this matter if they raised it as an alternative defence on the basis that the court might have found that they were not duly under debt review.

It is, however, submitted that the answer to the question whether sequestration constitutes debt enforcement as referred to by the NCA should be in the negative. To adopt the view that compulsory sequestration amounts to debt enforcement would be too simplistic. In the first instance, in addition to all the reasons the court in *Mutemeri* advanced for compulsory sequestration not being debt enforcement, it should be noted that an application for compulsory sequestration does not result in a civil judgment and does not convert the credit provider into a judgment creditor.

Other arguments that may be raised as to the nature and purpose of sequestration as compared to ordinary debt enforcement is that the insolvent estate vests in the trustee, thereby preventing the debtor from further disposing of estate property, the trustee may hold insolvency enquiries to search for property disposed of by the debtor for instance, the *Insolvency Act* clothes the trustee with extensive powers to trace estate property that could be utilised to pay creditors by holding interrogations

and reclaiming property by way of special insolvency devices such as voidable disposition remedies.<sup>124</sup> There is also some explanation of the essence of insolvency law to be found in the well-known and often-cited *dicta* in *Walker v Syfret*<sup>125</sup> in which the court explained the key concept of *concursum creditorum* following a sequestration order as follows:

The sequestration order crystallises the insolvent's position; the hand of the law is laid upon the estate, and at once the rights of the general body of creditors have to be taken into consideration. No transaction can thereafter be entered into with regard to estate matters by a single creditor to the prejudice of the general body. The claim of each creditor must be dealt with as it existed at the issue of the order.

It must be mentioned that some insolvency law commentators refer to insolvency as a collective debt-collecting device as opposed to the ordinary debt collecting mechanism, that is, debt enforcement by way of summons followed by judgment and execution.<sup>126</sup> These statements were, however, never considered as to their applicability within the ambit of the NCA and sequestration. The difference between these opposing devices is in particular considered by *Westbrook et al*,<sup>127</sup> in which it is explained as follows:

While debt enforcement has a strong and necessary relationship to insolvency proceedings, it has its own important and independent role to play in an economic system. Insolvency proceedings are not effective tools for debt collection as such. A collective proceeding is too cumbersome and expensive ... to be useful for the purpose of forcing payment of a particular debt.

*Sharrock et al*<sup>128</sup> remark that because insolvency law aims to ensure that creditors receive an equitable share of the debtor's estate, it is sometimes regarded as no more than an elaborate system of execution. In some legal systems, insolvency law is classified under civil procedure rather than under mercantile law, as in the South African system. But *Sharrock*<sup>129</sup> submits that the notion that insolvency law is merely

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124 See also Van Heerden and Boraine 2009 *PELJ* 39 *et seq* for a discussion of this aspect.

125 1911 AD 141 166.

126 See for instance Jackson *Logic and Limits* Chp 1; Bertelsmann *et al Mars* para 1.1.

127 *Global View* 9.

128 *Hockly's Insolvency Law* 4.

129 *Hockly's Insolvency Law* 4.

a system of execution is too simplistic because if it were so, sequestration would only affect the debtor's assets whereas it also affects the debtor personally, restricting his/her capacity and freedom to enter into contracts, to follow a chosen vocation, to litigate and to hold office. Sequestration also sometimes affects creditors in the sense that contribution may be levied from them in certain instances.

It should further be noted that Part C of Chapter 6 of the NCA, which contains all the debt enforcement provisions, is entitled "Debt enforcement by judgment and repossession", thus allowing for an inference that the meaning of debt enforcement for purposes of the NCA should be interpreted restrictively in accordance with the aforesaid title. Sequestration nevertheless remains a drastic measure and there must be good reason to put the machinery of insolvency law into operation. It is also notable that Section 20(1) of the *Insolvency Act*, *inter alia*, stays pre-sequestration civil proceedings and executions.

As with the *Ford* matter, this aspect once again illustrates that the legislator, when entertaining new legislation, does not always consider its effects on existing legislation with the result that it is left to the courts to consider its impact and application.

## 6 Final observations and recommendations

### 6.1 General

Given the extensive nature of sequestration, it is submitted that it should rather be viewed as a *sui generis* mechanism that sets a collective procedure in motion aimed at administering an insolvent estate on behalf of the insolvent's group of creditors in order to achieve an equitable distribution of the insolvent's assets.<sup>130</sup> As indicated, compulsory sequestration is not a debt enforcement procedure as envisaged by the NCA<sup>131</sup> although one of its many effects, as with the case of voluntary surrender, is that the claims of creditors are paid as provided for by the *Insolvency Act*. It is further submitted that the fact that compulsory sequestration does not amount to debt

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<sup>130</sup> This procedure is set into motion by both compulsory sequestration and voluntary surrender.

<sup>131</sup> See 5 above.

enforcement and that sequestration is not barred in terms of the NCA does not, however, mean that the NCA cannot still have an influence on insolvency law. It should be noted that whereas voluntary surrender and compulsory sequestration are both forms of sequestration, different considerations apply in each instance, which may have an influence on their possible interaction with the NCA.<sup>132</sup>

## 6.2 Voluntary surrender

In so far as voluntary surrender is concerned, it must be borne in mind that this is a debtor-initiated process in which the debtor bears the onus to prove that the statutory requirements, especially the very stringent advantage of creditors requirement, for its granting have been met. It is submitted that the question (as posed in *Mutemeri* with regard to compulsory sequestration) whether voluntary surrender amounts to debt enforcement, thereby triggering compliance with all the debt enforcement provisions of the NCA, does not arise.<sup>133</sup> The reason therefore is clearly that debt enforcement is *per se* a creditor-induced procedure, whereas voluntary surrender is applied for on the debtor's initiative.

Thus, it appears that within the realm of voluntary surrender, the significance that the NCA may have is in the sense that it may yield another procedure, namely debt review (resulting in an eventual voluntary rearrangement agreement or court-ordered debt restructuring) which might influence the issue of advantage of creditors. The court in the *Ford* matter also alluded to the consequences of determining that the credit agreements that formed part of the debt of the applicants might possibly have amounted to reckless credit.<sup>134</sup> Interestingly, the court played a very active role in considering all possibilities even though no creditor objected to the applications as such.

It is, however, submitted that the court in the *Ford* case did not elevate debt review as an additional prerequisite for sequestration by way of voluntary surrender but that,

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<sup>132</sup> See especially 3 and 4 above.

<sup>133</sup> This would give rise to the absurd situation that a debtor is required to send himself/herself a S 129(1)(a) notice. See further 3 above.

<sup>134</sup> As to the consequences of a declaration of reckless credit, see 3.2 above.

given the fact that the advantage of creditors requirement is of pivotal importance in the exercise of a court's discretion whether to grant or refuse an application for voluntary surrender, the applicant-debtor for voluntary surrender who bears the *onus* to prove the very stringent requirement of advantage of creditors, should consider whether debt rearrangement or debt restructuring as a result of debt review might not be more advantageous than sequestration.<sup>135</sup> It is submitted that although it is thus not formally required from a debtor to apply for debt review before making application for voluntary surrender, the possibility still exists that the court may, on finding or not being convinced that voluntary surrender will be to the advantage of creditors, apply Section 85 of the NCA. It is also possible that a creditor might intervene and argue that debt rearrangement or debt restructuring pursuant to debt review is more advantageous than the surrender of the debtor's estate.

Where an application for voluntary surrender serves before the court, and the debt is mainly credit agreement debt, it is submitted that the debtor before bringing the application should nevertheless ensure that his/her debt situation cannot be dealt with more effectively and to the better advantage of creditors by means of the remedies available in the NCA. It is clear that such option would play a significant role in the exercise of the court's discretion, in particular with relation to the advantage of creditors requirement. It is further submitted that it is open to the court if it has doubts as to the more suitable remedy for purposes of advantage of creditors, to refer a debtor who had not been for debt review or had undergone a debt review that the court deems insufficient,<sup>136</sup> to postpone the application *sine die* and to refer the matter in terms of Section 85(a) of the NCA.<sup>137</sup> Such an approach might be the more cost effective route.

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135 See 2 and 3 above.

136 Eg because the possibility of reckless credit has not been considered, as happened in the *Ford* case.

137 Where the debtor had indeed gone for a proper debt review and his/her credit agreement debt is being restructured in accordance with S 86(7)(c) of the NCA, and the court is satisfied that such debt review addressed both the aspects of over-indebtedness and reckless credit, but still finds that sequestration will not be to the advantage of creditors, the court should decline sequestration.

### 6.3 *Compulsory sequestration*

With regard to compulsory sequestration, it is clear that its dynamics differ considerably from voluntary surrender. As such it is a creditor-induced procedure that, as a result of the creditor's lack of information regarding the debtor's factual financial position, carries a more relaxed onus, namely proof of "reason to believe" that compulsory sequestration will be to the advantage of creditors. Given the unique structure of compulsory sequestration, it has the effect that the sequestrating creditor, who in many cases relies on a Section 8(g) act of insolvency in terms of the *Insolvency Act*, will often not be apprised of the debtor's complete debt situation and will not be able to address a court on the possible better advantage yielded by debt rearrangement or debt restructuring as a result of debt review. Thus, it is submitted that it will be unreasonable for a court to require an applicant-creditor to address it on the possible advantages yielded by debt rearrangement or debt restructuring as a result of debt review unless the debtor has previously gone for debt review and made certain repayment proposals to such creditor. It should be borne in mind that a debt review is a voluntary procedure applied for by a debtor and that a creditor is not in a position to force a debtor to go for debt review so that the creditor will be apprised of information to submit to a court on the issue of advantage should the credit provider seek the sequestration of the debtor. Further, debt restructuring following upon a debt review requires the co-operation of all the debtor's credit providers. It will, however, be possible for a debtor (who has full knowledge of his/her own financial situation) or an intervening creditor to oppose the application for the debtor's compulsory sequestration and argue that debt rearrangement or restructuring pursuant to debt review may be more advantageous to creditors.<sup>138</sup> It is submitted that a debtor (in the case of voluntary surrender or when opposing compulsory sequestration) or an intervening creditor should be armed with facts when approaching a court on the basis that debt rearrangement or debt restructuring as a result of debt review would yield the most advantage to creditors. Mere speculation that debt review might possibly yield better advantage than voluntary surrender or compulsory sequestration will not suffice. A court should not reject an

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<sup>138</sup> See 2.2 above.

application for voluntary surrender or compulsory sequestration on a vague notion that debt review is the more suitable remedy in a particular instance but the court must clearly apply its mind judicially to such an option within the realm of the advantage principle whenever appropriate.

It should further be remembered that debt review by a debt counsellor *per se* is a mere transitory procedure and does not yield advantage but that the advantage or lack thereof is to be found in the eventual debt rearrangement agreement or court-ordered debt restructuring pursuant to debt review.

As indicated,<sup>139</sup> even where an applicant establishes a firm basis for sequestration, the court holds an ultimate discretion in granting the sequestration order in both voluntary surrender and compulsory sequestration. Where a sequestration order is considered, the court must therefore decide whether sequestration will be the best solution under the circumstances when considering the advantage requirement. It is thus submitted that courts should not turn debt review as such into an additional statutory requirement for the reasons as stated above because it may add an additional expense to an already overburdened estate. At best, debt review should remain a factor for courts when exercising their discretion, such as considering administration as an alternative option to sequestration.

It must also be remembered that both administration and debt review have their limitations in the sense that administration orders, although not restricted to one type of debt, may only be granted if the debt does not amount to more than R50 000 and also does not include *in futuro* debts, whilst debt review only applies to one type of debt, namely credit agreements as regulated by the NCA.<sup>140</sup> It thus follows that the type of debt should also be taken into consideration in that where the debt does not amount to a credit agreement in terms of the NCA, or where the debtor has mixed debts, some of which are subject to the NCA and others that fall outside its ambit, debt review might not apply or only apply in a limited respect.

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139 See 2.2 above.

140 See 2.2 n 29 above.

Although the principles relating to the advantage of creditors requirement apply to both voluntary surrender and compulsory sequestration, it is nevertheless submitted that the courts must afford due consideration to the absence or presence of opposition by creditors to the granting of the order. It is submitted that this factor did not receive adequate attention in the *Ford* case. Courts must be mindful of the fact that sequestration applications take time and money and, especially where an application for voluntary surrender is turned down, that the estate will be further depleted of funds that could have been used to repay debt. In this sense, the question may be asked whether it was the best option for the court in the *Ford* matter to have denied the application for voluntary surrender and whether debt review would have solved the debt problems – especially since the creditors did not intervene to oppose the matter. It can be accepted that creditors, especially credit providers in terms of the NCA, probably have a considerable deal of information as to the financial position of their debtors and a decision not to oppose an application for voluntary surrender should thus carry some weight.

The *Mutemeri* case dealt with compulsory sequestration and the granting of the sequestration order hinged on one extremely important question, namely whether an application for compulsory sequestration amounted to a civil procedure or civil suit in the form of debt enforcement.<sup>141</sup> It is submitted that the court came to the correct conclusion in that it ruled that it did not. Suffice it to say that there is sufficient authority to support this conclusion of the court.

Although a Section 129 notice was sent to the debtors in the *Mutemeri* case – apparently for the purposes of ordinary debt enforcement and to comply with the NCA in general in that regard – it is nevertheless submitted that a creditor who has reason to apply for sequestration of his/her consumer-debtor's estate relating to credit agreement debt is not obliged to send a Section 129 notice to such a debtor, since different principles are at play and because compulsory sequestration does not amount to debt enforcement in general or for the purposes of the NCA.

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141 See S above.

It is further submitted that in the absence of a specific prohibitory provision in the NCA and as sequestration is not debt enforcement as envisaged by the NCA (thus not attracting the Section 88(3) bar), the estate of a debtor who is subject to debt review may also be sequestrated. This must clearly be the position, since debt review that amounts to a mere rescheduling of debt, leaving the debtor with a longer repayment period and an increase in the amount of debt, may not serve the purpose of an insolvent debtor who cannot really repay – even on such extended terms and conditions.

#### **6.4 Other observations**

Clearly, a debt situation is also not static and even after the debt rearrangement agreement or restructuring order, the financial position of such a debtor may further deteriorate. It is also clear that neither administration orders nor debt review will cover all debts in every and under all circumstances. These factors are thus indications that even existing debt-restructuring orders should not bar applications for sequestration, either by way of voluntary surrender or compulsory sequestration. The sequestration order should however only be granted if the relevant application meets the requirements in all respects and if the court is convinced that it does not amount to an abuse of procedure and if the advantage of creditors requirement in the given case is met to the satisfaction of the court.

When considering an application for sequestration, courts must also remain mindful of the fact that a particular debtor may have debt in the form of credit agreements, as well as debt that does not comply with the definition of credit agreements. If this is the case, where the debtor applies for voluntary surrender and if the approach is followed that it is almost expected from an applicant-debtor first to apply for debt review, a question arises regarding the non-credit agreement debt that cannot form the subject of debt review in terms of the NCA.

A new discretionary power that courts may exert over and above the general discretion of whether to grant a sequestration order is to be found in Section 85 of the NCA. Section 85 allows a court when considering a credit agreement to refer a matter for debt review. It is submitted that the *Ford* case is correct in its finding that a

court may also apply this provision when hearing an application for voluntary surrender when applicable. It is further submitted that the section may also be applied by a court that hears a matter for compulsory sequestration if its requirements are present – although this was not relevant in the *Mutemeri* judgment. In both such cases, a court may for instance postpone the hearing of the application for sequestration in order to get guidance from the report of a debt counsellor. Clearly, such a report may have a bearing on the discretion of the court when dealing with the advantage of creditors requirement.

In the case of *Mutemeri*, and if it was for instance accepted that compulsory sequestration did amount to debt enforcement, it could have given rise to an anomaly that the applicant who relies on non-credit agreement debt could proceed without complying with the NCA but a credit provider in terms of the NCA would have to comply. If the first-mentioned applicant brought the application, the sequestration order would have included the credit agreement debt as well without a Section 129 notice and compliance with any other relevant provisions of the NCA.<sup>142</sup>

The *Mutemeri* judgment also sounded a warning to debt counsellors not to intervene in a pending sequestration application if they cannot prove a direct interest in the matter.

It is finally submitted that within the context of sequestration of a debtor whose debt consists mainly of credit agreement debt, it thus appears that various scenarios may arise, namely:

- (a) The debtor may decide, without going for a formal debt review, that the debt relief afforded by the NCA will not alleviate his/her hopeless debt situation, and decide to apply for voluntary surrender. In such instance, if the court is not satisfied that voluntary surrender is the best option, it is submitted that depending on the circumstances of the case the court may need to decide to refuse the application for voluntary surrender or to postpone the application *sine*

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<sup>142</sup> See 4 and 5 above.

*die* and refer the debtor for formal debt review in accordance with its discretion in terms of Section 85 of the NCA.<sup>143</sup>

- (b) The debtor who has undergone a formal debt review finds himself/herself in the position that his/her credit providers do not want to agree to debt restructuring and will oppose his/her efforts to obtain same, or it is clear from the debt review that such debt restructuring will not be a viable option for addressing his/her debt situation. In such instance, if the court is not satisfied that voluntary surrender is the best option, it must refuse the application for voluntary surrender. If during the proceedings it transpired that the formal debt review that was conducted was defective in some way or another, for example that the possibility of reckless credit was not considered, it is submitted that the court could postpone the matter *sine die* pending the outcome of a referral to a debt counsellor to the court in accordance with the provisions of Section 85 of the NCA, if the court applied its mind to the effect that a possible finding of reckless credit may have on the debtor's total debt situation. The court also could have considered the question of reckless credit *mero motu*.
- (c) A creditor may wish to seek the compulsory sequestration of a debtor who has mainly credit agreement debt but who has not yet gone for debt review. In such instance, it cannot be reasonably expected from the applicant-creditor to address the court on the possibility that debt review may be a better option for the group of creditors than sequestration. It is not within the power of such creditor to force the debtor to go for debt review or to compel the other credit providers in respect of other credit agreement debt, to agree to a debt-restructuring plan. If the court is finally of the opinion that sequestration is not to the advantage of creditors, it is submitted that the sequestration order should not be granted. In general, it must be noted that other creditors or the debtor himself/herself may intervene at any stage of the proceedings prior to the granting of the final sequestration order to seek to convince the court that sequestration would not be the best option in the specific instance.

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<sup>143</sup> Court may seemingly also refer it to S 85, if it refuses the order for voluntary surrender.

(d) A creditor may wish to seek the sequestration of a debtor who has mainly credit agreement debt and who had already gone for debt review. Various situations may arise here: either the creditor rejected the debt repayment suggestions made on behalf of the debtor and the matter reached a dead end or the debt counsellor lodged an application to court which is still pending or the court made a debt-restructuring order despite the creditor's opposition. In such instance, there will be hard facts available on which a creditor will be able to indicate to the court why he/she is of opinion that sequestration is the better option, for example because the period for repayment and the monthly repayment amounts that are proposed are not viable or that the debtor failed to include all his/her credit agreement debt or that the debtor has, since the court made the debt rescheduling order or since the filing of a voluntary agreement between the parties,<sup>144</sup> stopped making further payments. Where the creditor is able to convince the court that sequestration is the better option, the court should thus grant a sequestration order.

Courts must however be cautioned, especially in those instances in which a debtor has not yet been for debt review against a "matter of course" exercise of its discretion in terms of Section 85 of the NCA where it has doubts regarding the possible advantage that debt relief in terms of the NCA may yield.

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144 As per S 86(7)(b) of the NCA.

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***List of abbreviations***

NCA	National Credit Act
PELJ	Potchefstroom Electronic Law Journal
SA Merc LJ	South African Mercantile Law Journal