Communiqué:
On SCA Judgments

Issue 2 | September 2011

SCA Judgment on S 86(2) and S 129 and S 103(5) of the NCA

A. Introduction

On 28 March 2011 the Supreme Court of Appeal handed down the judgment in *Nedbank v National Credit Regulator* [2011] ZASCA 35. This was an appeal against various orders handed down by the North Gauteng High Court in *National Credit Regulator v Nedbank Ltd. and Others* 2009 (6) SA 295 (GNP).

B. Sections 86(2) and 129

The Supreme Court of Appeal ruled that, on a proper interpretation of section 86(2), a credit agreement is excluded from debt review where the credit provider has given a section 129(1)(a) notice to a defaulting consumer prior to that consumer applying for debt review.

Practical implications

1. Credit agreements in respect whereof a section 129(1)(a) notice has been delivered to the consumer, i.e. in a manner as provided for in section 65 of the NCA, are to be excluded from debt review.

2. The debt counsellor can still institute voluntary negotiations with the credit provider in order to resolve the matter.

C. Section 103(5)

South African law

The court dealt with two rules in South African law that governs the amount repayable by a defaulting consumer to a credit provider: The common law *in duplum* and the provisions of section 103(5) of the National Credit Act.

Both these rules have as its purpose the prevention of extensive recovery by a credit provider from a consumer that is in default.[1]

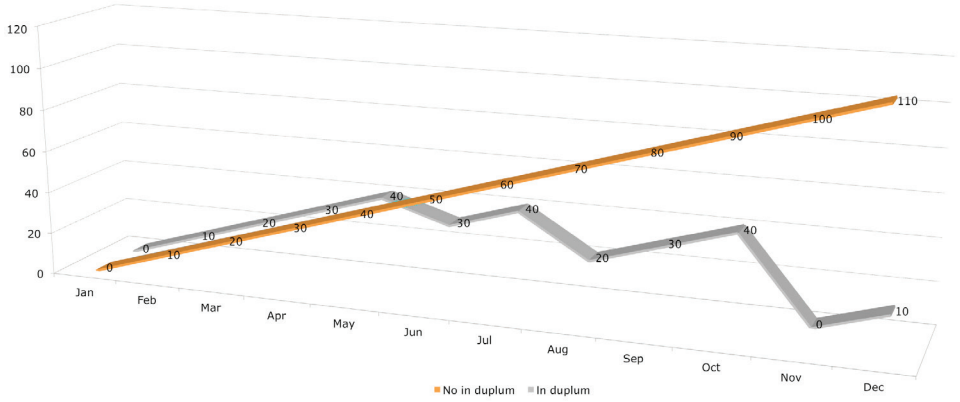
1. [2011] ZASCA 35 paragraph 37 and 39.

National Credit Regulator

The following graph (Graph 1) illustrates this:

Without the *in duplum* rule, the interest will continue to accrue indefinitely as long as the consumer does not completely correct the default. The SCA stated that "[t]he purpose of the rule is to 'ensure that debtors are not endlessly consumed by charges and also to endure that debtors whose affairs are declining should not be entirely drained dry'."[2] The outstanding capital amount in the abovementioned example is at the mark 40, and as such interest on the unpaid amount cannot exceed the 40 mark.

Graph 1: Comparison between no in duplum and in duplum



Common law *in duplum*

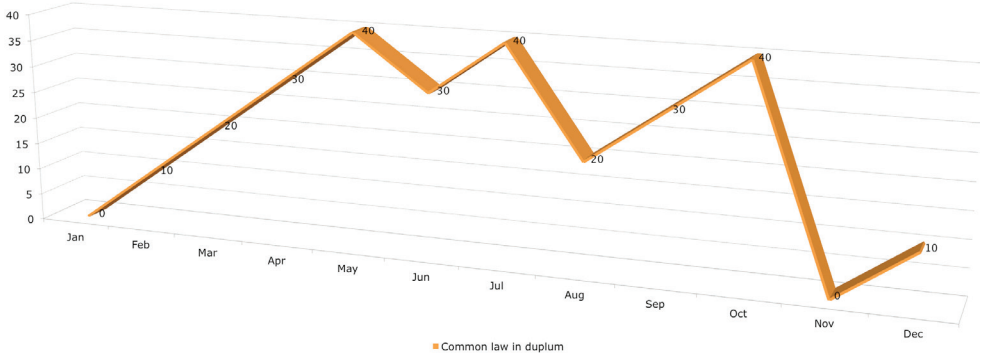
Maximum amount repayable = outstanding amount at time of default (A) + interest equal to amount A.

The total amount repayable is therefore 200% of the outstanding balance at time of default, provided that enough time has elapsed whilst the consumer is in default to allow interest to accumulate to the maximum amount.

In terms of the common law rule only interest were used in the calculation. Furthermore, in terms of the common law rule, when a consumer paid an amount that did not rectify the default, but reduced the maximum allowable repayment amount (i.e. interest had already been charged up to the maximum amount allowed), interest could be charged again until the maximum amount was reached again.

The following graph (Graph 2) illustrates this point by only showing the interest that accumulates. The outstanding amount at date of default is mark 40. Interest accumulates up to mark 40. The consumer pays an amount to bring the total to mark 30. The credit provider then charges interest up to mark 40.

Graph 2: Illustration of common law in duplum



2. [2011] ZASCA 35 paragraph 37.

National Credit Act

Maximum amount repayable = unpaid balance of the principal debt (A) + section 101(1)(b) to (g) fees, interest, charges and costs equal to amount A.

Section 103(5) reads as follows:

"Despite any provision of the common law or a credit agreement to the contrary, the amounts contemplated in section 101(1)(b) to (g) that accrue during the time that a consumer is in default under the credit agreement may not, in aggregate, exceed the unpaid balance on the principal debt under that credit agreement as at the time that the default occurs."

This section of the National Credit Act did not abolish the common law *in duplum* rule – the latter still applies to debts that are not credit agreements subject to the provisions of the National Credit Act. Section 103(5) is "not a code and embodies no more than a specific rule applicable to specific circumstances, that is, to credit agreements subject to the NCA. It is thus a statutory provision with limited operation."

Generally, the common law *in duplum* will have bearing on credit agreements predating 1 June 2007 and all non-National Credit Act matters. [3] Section 103(5) will apply to post 1 June 2007 matters governed by the National Credit Act. [4] A debt counsellor noted that the wording of the National Credit Act is vague in this respect especially with reference to contracts entered into prior to 1 June 2007.

Section 103(5) is not the same as the common law *in duplum* rule even though there are similarities between the common law and statutory rules – the latter incorporates only interest to calculate the maximum extent to which interest may be recovered by a creditor. Section 103(5) takes all the amounts referred to in section 101(1)(b) to (g) into account in order to calculate the maximum amount that may be recovered by the credit provider from a consumer that has defaulted.

Section 101(1)(b) to (g), refers to the following: (b) an initiation fee; (c) a service fee; (d) interest; (e) cost of any credit insurance; (f) default administration charges; (e) collection costs.

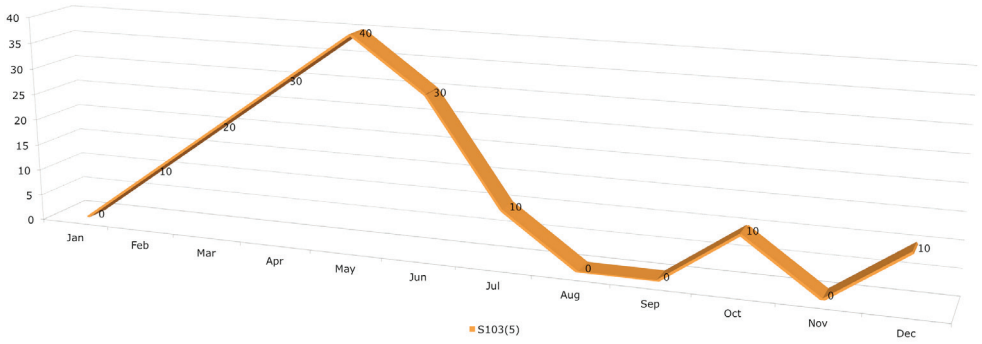
The sum of these amounts after the consumer has defaulted, whether they are paid or unpaid, may only be 100% of the outstanding amount as at default.

Where the consumer repays an amount, but does not completely cover the total amount due within the original contract term, the credit provider cannot charge fees, costs, charges and interest up to the maximum amount repayable as was the case with the common law *in duplum*. The following two graphs illustrate this point. The first graph (Graph 3) illustrates a consumer under a credit agreement that is subject to the National Credit Act that does make payments but only manages to repay the whole owed amount in August. Only the interest that accumulates is shown. The outstanding amount at date of default is mark 40. Interest accumulates up to mark 40. The consumer pays an amount to bring the total to mark 30. The credit provider can then not charge interest up to mark 40 as per the prior example and every payment by the consumer reduces the outstanding amount until the default is cured (paid up).

The second graph (Graph 4) illustrates both the common law and statutory rules. In that graph, payments and defaults are similar up to June, and thereafter the difference is Section 103(5) does not pertain solely to credit agreements subject to debt review, but to all credit agreements that are subject to the governance of the NCA. Generally, the common law *in duplum* will have bearing on credit agreements predating 1 June 2007 and non NCA matters post June 2007. Section 103(5) will apply to post 1 June 2007 matters.

3. Schedule 3 to the National Credit Act, item 4 sets out a table that reflect the extent to which the National Credit Act applies to a pre-existing credit agreement. It is noted that Chapter 5 – Part C (sections 100 to 106) is not applicable to pre-existing credit agreements, conditional upon the provisions of subitem (3) which deals with certain statement requirements that a credit provider must provide to a consumer.
4. Octogen (Pty) Ltd workshop document titled "S 103(5) of the National Credit Act."

Graph 3: Illustration of section 103(5)



Various important differences between the common law *in duplum* and section 103(5) of the NCA were listed by the court. Under the common law rule, arrear and unpaid interest must first reach the equivalent sum of the outstanding capital amount before the accumulation of interest comes to an end. Under the provisions of section 103(5), paid and unpaid fees, costs, charges and interest as referred to in section 101(1)(b) to (g) may not accumulate to more than the amount of the outstanding principal debt under that credit agreement at the time of default.

In terms of the common law rule, payments by the debtor reduces the interest that has accumulated up to the maximum allowable amount, causing the amount owed by the debtor in respect of interest to be less than the maximum allowable amount. Creditors were therefore entitled to charge interest anew until the maximum repayable amount was reached again.

The difference between the common law *in duplum* and section 103(5)

The court further ruled that section 103(5) of the NCA is not similar in all respects to the common law *in duplum* rule. The three main differences are:

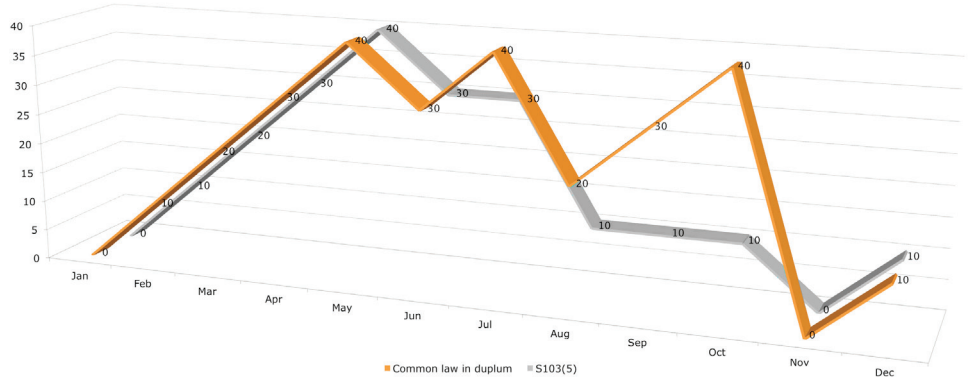
All costs of credit referred to in section 101(1)(b) to (g) are included under the amounts that have limited accrual where the common law *in duplum* only allowed for unpaid and arrear interest to accrue to the amount of the principal debt that was outstanding at time of default.

Section 103(5) does not allow for the credit provider to charge costs, fees or interest where the consumer makes payment and reduces the maximum allowable amount that may be recovered whilst the consumer is in default. This means that the credit provider may not charge interest, fees, costs and charges until the consumer has completely rectified the default. Under the common law *in duplum* the credit provider could charge interest as soon as the consumer paid an amount that decreased the maximum repayable amount.

Section 103(5) includes paid and unpaid amounts whilst the common law rule only includes unpaid amounts to make up the recoverable amount.

In terms of the common law rule, the amount repayable by a consumer that has defaulted on an agreement is the outstanding amount as at time of default plus interest equal to the amount of the outstanding amount at time of default.

Graph 4: Comparison between common law in duplum and section 103(5)



Paid and unpaid charges

The Supreme Court of Appeal decided that the amounts stated in section 101(1)(b) to (g) that make up the amount that must equal the outstanding principal debt at time of default, include paid and unpaid amounts.

	In duplum				S103(5)				Cum Pmt
Month	Capital	Interest	Costs	Payment	Capital	Interest	Costs	Payment	
1	5,000	83.33	40	-100.00	5,000	83.33	40	-100.00	100
2	5,023	83.72	40	-100.00	5,023	83.72	40	-100.00	200
3	5,047	84.12	40	-100.00	5,047	84.12	40	-100.00	300
38	6,181	103.01	40	-100.00	6,181	103.01	40	-100.00	3,800
39	6,224	103.73	40	-100.00	6,224	-	-	-100.00	3,900
100	10,000	166.67	40	-100.00	124	-	-	-100.00	10,000
101	10,000	166.67	40	-100.00	24	-	-	-23.70	10,023.70
102	10,000	166.67	40	-100.00	-	-	-	-	10,023.70

Where the consumer pays an amount equal to the interest and costs, but not enough to cover the capital amount or any part thereof, the calculation will be as follows:

	In duplum				S103(5)				Cum Pmt
Month	Capital	Interest	Costs	Payment	Capital	Interest	Costs	Payment	
1	5,000	83.33	40	-123.33	5,000	83.33	40	-123.33	
2	5,000	83.33	40	-123.33	5,000	83.33	40	-123.33	
41	5,000	83.33	40	-123.33	5,000	83.33	40	-123.33	5,056.53
42	5,000	83.33	40	-123.33	4,943.47	-	-	-123.33	
43	5,000	83.33	40	-123.33	4,820.14	-	-	-123.33	
82	5,000	83.33	40	-123.33	-	-	-	-	10,000

Practical implications

Debt counsellors must have a correct in-depth understanding of section 103(5) in order to identify credit agreements that are influenced by the workings of the section. This means that the debt counsellor must know:

1. How the mechanisms of section 103(5) functions;
2. When section 103(5) becomes applicable;
3. Which amounts are included to calculate the maximum repayable amount;
4. The information that either the consumer and/or the credit providers must provide in order to calculate the amount accurately; and
5. "High risk" credit agreements.

Debt counsellors must also be able to educate and assist defaulting consumers in this regard.

The SCA clarified the matter and in the premises, there is no ground for any credit provider to calculate the maximum amount repayable in any other manner. In this regard, the necessary information must be requested from the credit provider or gathered from documents such as the original agreement, account statements, certificates of balance and/or credit bureau reports. The information needed are inter alia the date of default, unpaid principal debt at time of default, applicable interest rate, applicable fees, charges and costs and any payments made since default.

The following accounts may be seen as accounts where the application of section 103(5) is particularly effective:

1. "High interest accounts";
2. "Home loans/Mortgage bonds";
3. "Short term debts";
4. "Heavily over-indebted clients"; and
5. "Long term loans for instance cars/houses."

Why is it important to apply section 103(5)?

Debt counsellors that apply section 103(5) have noted the following:

- "The *in duplum* rule is of immense importance as this make most restructuring proposals solve";
- "Reduces total terms of payment considerably";
- "It has an effect on the minority of clients, only the heavily over-indebted";
- "No interest towards the conclusion of the payment schedule";
- "It will bring down the repayment period and the client will save on interest over the period";
- "It generally reduces the amount due";
- "We mostly do repayment proposals within the old NDMA rules or now in terms of the DCRS rules. The system reduces interest rates thus seldom if ever are we faced with an *in duplum* problem";

- "…it could affect the outstanding balance to be paid. Nine times out of ten it reduces the outstanding balance as well as the proposed new payment";
- "Repayment terms will cease once *in duplum* amount has been paid, e.g. home loans can be solved quicker than normal bond terms"; and
- Some even indicated that they are unsure as to the exact impact that the section has on proposals as it is a calculation generated by the debt counselling software.

In the premises, debt counsellors are encouraged to apply the provisions of section 103(5) of the National Credit Act where adherence to the Task Team Rules does not result in a case solve.

D. Conclusion

The judgment of the Supreme Court of Appeal (SCA) is currently the leading precedent with regard to the issues that it addressed. The various High Courts have to follow the judgments of the SCA as South Africa has a precedent system. The only court with higher authority than the SCA is the Constitutional Court, but the latter only enjoys jurisdiction over matters of a constitutional nature by virtue of section 167 of the 1996 Constitution.

All stakeholders must therefore comply with the provision of the judgment.

SCA Judgment on 86(10)

The SCA Judgment on section 86(10) also has far reaching consequences for consumers. Judgment on the case was delivered on 27 May 2011. The Supreme Court of Appeal was requested to decide whether a Credit Provider is entitled to terminate a Debt Review in terms of section 86(10) after the matter was referred to the Magistrate Court for an order envisaged by section 86(7)(c) and 87(1)(b) and whilst the hearing is still pending. Following this judgment and the end to the deadline to have all debt rearranged in terms of the Moratorium (i.e. 31 March 2011) by banks, there is a strong likelihood that banks will proceed to terminate applications in terms of section 86(10) where the required thresholds on mortgages and vehicle finance had not been met. The NCR have encouraged banks to accommodate those cases which could not for whatever reason be finalised through a consent or court order by the 30 June 2011. The banks have indicated that it would not make sense to terminate these accounts where the chances of recovery are greater.

Coming back to the Judgment on 86(10) one must take cognisance at the outset, that the NCA aims to balance the rights of credit providers and consumers. In this regard then, any debt arrangement must end in the fulfilment of all financial obligations by the consumer as set out in Section 3(i) of the Act.
The Appeal Court most certainly took this aspect into consideration in handing out Judgment and played an important part in the decision of the court.

The Debt Counsellor therefore has two options. One option is to submit a reasonable repayment proposal to the Magistrate Court in terms of S 87 but nothing prevents the Debt Counsellor to seek agreement from the credit providers and file for a consent as envisaged by S 86(8)(a) and by implication in line with the Task Team Recommendations. The increase in submissions through the Debt Counselling Rules Solution (DCRS) and the compliance of all key stakeholders to the Codes should result in the swift resolution of matters. Nonetheless, should a voluntary re-arrangement not be possible the debt counsellor can submit a responsible proposal to the Magistrate's Court.

The court further held that the credit provider is also unable to terminate the debt review in terms of 86(10) where the consumer is not in default and therefore by implication must await the hearing in terms of section 87.

The requirement of consumers and credit providers in S 86(5) to comply with any reasonable requests from the Debt Counsellor is another issue that has been highlighted in this judgment. It is made clear that Credit Providers are obliged to comply with any reasonable request by the Debt Counsellor to facilitate the evaluation of the Consumer's indebtedness and the prospects for a responsible debt restructuring and an obligation to participate in good faith in the review and negotiations.

The Judgment makes it clear that a Credit Provider's failure to participate in good faith may be the basis of a request to a Court not to grant Summary Judgment.

Debt Counsellors should therefore continue to request Credit Providers' co-operation in supplying relevant information to evaluate the Consumer's indebtedness in order to submit responsible proposals for repayment well within the 60 day period. Noncompliance to reasonable requests can be used as part of a request not to grant Summary Judgment. The judgment clearly made reference to the right of the credit provider to terminate debt review is balanced by section 86(11) and the fact that the Magistrate's/High Court may order that the debt review resume on any conditions that the court finds just under the circumstances.

A final point to be considered is the fact that a credit provider who receives a notice of court proceedings in respect of section 83 or 85, or notice in terms of section 86(4)(b)(i), may not enforce or terminate the agreement.

In the absence of amendments to the Act, we strongly recommend that you follow the debt re-arrangement guidelines as per the TT recommendations.

Codes Of Conduct

A large number of court decisions have shed light on some of the challenges posed by legislation leading to uncertainty amongst magistrates, credit providers, debt counsellors and legal representatives. The report of the Task Team (TT) and the codes of conduct that industry players were requested to subscribe to are bona fide attempts to make the debt restructuring process work. It is hoped that these codes and industry agreements will prove to be more successful than their predecessors, namely the work stream agreements, credit industry guidelines and National Debt Mediation Association (NDMA) restructuring rules. In fact, it is imperative that the industry works together to make these agreements successful as the likelihood for urgent legislative reforms are some way away.

We therefore strongly recommend adherence by all debt counsellors to the Task Team Processes.
The debt restructuring rules as proposed by the Task Team are driven by an outcome that results in the consumer rehabilitating his/her over-indebtedness situation within the shortest possible period given the particular circumstances and available re-arrangement measures.

It is thus recommended that debt counsellors subscribe to the code of conduct in order to foster a culture of collaboration between key role players so that more cases are resolved on a consensual basis. The Code letters were sent by the NCR to debt counsellors during April and May 2011.

If you have not received a copy requesting your subscription to the code and an amendment to the conditions of registrations, please contact the National Credit Regulator (NCR) Registrations Department for a copy of same.

The signed acknowledgement letter should, preferably be faxed to (011) 554 2628 or it can be emailed to codeofconduct@ncr.org.za.

DCs Leaving the Industry

We would like to appeal to all debt counsellors to inform the NCR when you change your contact details or when you are no longer practising as a debt counsellor. If you do not intend practising debt counselling further, we would expect that you fill out a form 10 and send to our registration department. To this end we would appreciate that you find another DC to take over your files and request that the proper transfer procedures are followed or alternatively request that the NCR assist you in this regard so that consumers are not in any way prejudiced by you leaving the industry. Too many DCs have brought debt counselling into disrepute by absconding and leaving clients in the lurch.

Such conduct is unacceptable and the NCR will be taking action against those debt counsellors with a view to prosecuting such offenders as this places a huge burden on the NCR to assist these clients.

Disclaimer

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