Cashing in on collections
By Gerhard Buchner and CJ Hartzenberg

The National Credit Act 34 of 2005 (NCA) aims, as part of its *raison d'être*, to promote a consistent enforcement framework relating to consumer credit. It provides, in s 3(*d*), that its purposes include protecting consumers by promoting equity in the credit market by balancing the rights and responsibilities of credit providers and consumers.

The Debt Collectors Act 114 of 1998 was enacted for similarly idealistic purposes, in introducing a Council for Debt Collectors and providing for the regulation and control of debt collectors' activities. Such regulation extends to the recovery of fees and remuneration by registered debt collectors.

Attorneys as debt collectors

With the unprecedented explosion of consumer debt during the mid-2000s, new opportunities presented in the field of debt collection.

A formidable industry emerged, with some firms of attorneys adopting business models whereby they establish debt collection operations run under the auspices of a corporate entity registered as a debt collector and which conduct business as such. Often such debt collector operations are staffed by specially trained personnel, including attorneys. Large call centres are established. Use is made of sophisticated debt collection techniques.

Invariably, there is a close association between the firm of attorneys and the debt collector entity. In some instances, the attorneys or their close family members effectively own the equity in such entities. Importantly, the attorneys exercise ultimate control over the activities of the debt collector entities. Such entities employ or align themselves in some form or manner with persons who trace defaulting consumers or debtors and cause them to commit themselves to a repayment plan, acknowledge their indebtedness and, often, consent to judgment.

Open to exploitation

In order to maximise recovery for the creditor (in many instances claims are ceded to the debt collector entity, which then seeks the recovery of debts in its own name and for its exclusive benefit), the debt collector and the attorney, it has become standard practice for such acknowledgments, undertakings and consents to include undertakings by the debtor to pay attorney-and-client or attorney-and-own-client costs, as well as collection commission. It is the latter type of undertaking that exposes vulnerable consumers to the risk of exploitation. Not all attorneys engaging in this field of practice are guilty of exploiting consumers. However, by virtue of the nature of the business, such exploitation may sometimes be unwitting and be an unintended result.

In order for this kind of business to be profitable, and having regard to the relatively small size of typical consumer debts relative to fees recoverable by debt collectors (prescribed in annexure B to the Regulations relating to Debt Collectors, 2003) and attorneys' fees, the emphasis is on volume. This, in turn, promotes the use of standardised procedures and documentation, mass produced and processed. It is impossible for each matter to receive individual and meticulous personal attention.

The risks consumers are exposed to are exacerbated by the inability of the courts, particularly the magistrates' courts, to deal meticulously with the large volume of requests for default judgment routinely presented. Taxing masters are faced with similar difficulties with regard to the taxation of bills of costs and are often ill-equipped in terms of the requisite qualifications and experience to deal with bills of costs in a way that ensures consumers' rights are adequately safeguarded.

Regrettably, some practitioners perceive weaknesses in the system as an opportunity to exploit consumers and benefit themselves.

Contributing factors

Some of the causes contributing to this state of affairs are dealt with below. As will be emphasised, the provisions of ss 57 and 58 of the Magistrates' Courts Act 32 of 1944, which survived the enactment of the NCA and the promulgation of the new magistrates' courts rules (the rules), lie at the core of practices calculated to exploit defaulting consumers/debtors.

Chapter VIII (ss 56 – 60) of the Magistrates' Courts Act relates to the recovery of debts, defined as 'any liquidated sum of money due'.

Section 57(1) provides that if a debtor has received a letter of demand or has been served a summons claiming payment of a debt, the debtor may, in writing, admit liability for the amount of the debt and costs claimed, offer to pay the amount of the debt and costs for which he or she admits liability and to undertake payment of any instalment in terms of his or her offer and, further, to pay the collection fees for which the plaintiff is liable in respect of recovery of the debt by way of instalments.

He or she may further agree that, in the event of his or her failure to carry out the terms of the offer, the plaintiff shall, without notice to him or her, be entitled to apply for judgment in the amount of the outstanding balance of the debt and for an order for payment of the judgment debt and costs in instalments or otherwise, in accordance with his or her offer.

In terms of s 57(2), if the debtor fails to carry out the terms of his or her offer, provided certain conditions are met, judgment may be granted against the debtor.

Section 58 provides for where the debtor, on receipt of a letter of demand or service on him or her of a summons claiming payment of any debt, consents in writing to judgment in favour of the plaintiff for the amount of the debt and costs. Provided certain conditions are met, again judgment may be granted against the debtor in terms of such consent.

These provisions have, to an extent, been ameliorated by ss 129 to 133 of the NCA, as well as the new rules, which came into effect on 15 October 2010. The legislature was clearly alive to the conflict between ss 57 and 58 of the Magistrates' Courts Act and ss 129 to 133 of the NCA. Recognition was given to such conflict in s 172(1) of the NCA, read with sch 1, on the basis that, to the extent that ss 57 and 58 of the Magistrates' Courts Act conflict with the NCA, the latter will prevail.

Sections 57 and 58 of the Magistrates' Courts Act provide that the clerk of the court shall (provided certain requirements are satisfied) grant judgment in terms of those provisions against the debtor.

Rule 12(5) of the rules provides that the registrar or clerk of the court shall refer to the court any request for judgment on a claim founded on any cause of action arising out of, or based on, an agreement governed by the NCA or the Credit Agreements Act 75 of 1980.

It is clear from the rules, however, that both ss 57 and 58 of the Magistrates' Courts Act are still firmly entrenched in the law and procedure governing the collection of debts, especially by way of legal proceedings. Practices based on these provisions remain intact and, in many instances, form the cornerstone of business models designed to maximise returns from debt collection operations.

One of the greatest risks consumers/debtors are exposed to is the over-recovery of costs, debt collectors' fees and attorneys' collection commission. It is unfortunate that the legislature did not see fit to repeal ss 57 and 58 of the Magistrates' Courts Act entirely.

Indeed, it would appear that, with the repeal of the Credit Agreements Act, the position of consumers/debtors had, at least in one respect, been weakened: Section 57(2)(*c*)(ii) of the Magistrates' Courts Act provides that an order in terms of which the debtor is ordered to pay the judgment debt and costs in specified instalments, or otherwise in accordance with his offer, shall be deemed to be an order of the court, mentioned in s 65A(1).

Section 19(*d*) of the Credit Agreements Act provides that no court shall make an order referred to in s 65 of the Magistrates' Courts Act for enforcing compliance with any judgment for payment by any credit receiver of any amount payable in terms of, *inter alia*, a credit agreement that is an instalment sale transaction (as many credit agreements are). The effect of this before the repeal of the Credit Agreements Act by the NCA, with effect from 1 June 2006, was that a creditor would not be able to make use of the procedure in terms of s 57 of the Magistrates' Courts Act if his claim fell within the ambit of s 19(*d*) of the Credit Agreements Act.

The NCA does not contain a similar provision to s 19(*d*) of the Credit Agreements Act. The further effect of this was that the field of application of s 57 was substantially enlarged to the detriment of consumers.

According to recent press reports, a forensic audit by law firm ENS of over 40 000 employees of one of its clients revealed that 30% of them had garnishee orders in place. Some employees had as many as 12. It was found, according to the report, that 59% of the orders were defective or invalid.

Many attorneys make use of the services of field agents who obtain signatures from debtors on consents to judgment, emoluments attachment orders and the payment of costs on an attorney-and-client scale. For this, the field agent charges a fee and, in our experience, often obtains these signed consents from debtors under duress and sometimes by impersonating the sheriff of the court.

Guidance on collection costs

Regulation 47 of the regulations under the NCA (as amended) provides:

'For all categories of credit agreement, collection costs may not exceed the costs incurred by the credit provider in collecting the debt –
(a) to the extent limited by part C of chapter 6 of the Act, and
(b) in terms of –
(i) The Supreme Court Act, 1959,
(ii) The Magistrates' Courts Act, 1944,
(iii) The Attorneys Act, 1979; or
(iv) The Debt Collectors' Act, 1998,

which ever is applicable to the enforcement of the credit agreement.'

The Attorneys Act 53 of 1979 does not deal directly with attorneys' fees or attorneys' collection commission.

Section 69(*d*) of the Act provides that the council of each law society is empowered to prescribe the tariff of fees payable to any practitioner in respect of professional services rendered by him or her in cases where no tariff is prescribed by any other law.

In *Blaikie-Johnstone v D Nell Developments (Pty) Ltd and Another* 1978 (4) SA 883 (N) a full court held that a bylaw of the then Natal Law Society that authorised its members to charge collection commission on payments collected at the rate of 10%, subject to a maximum of R 50 per amount collected, was *ultra vires* the then empowering legislation (Act 10 of 1907 (N)). Other law societies had similar bylaws.

In *Scotfin Ltd v Ngomahuru, Ex Parte Law Society of Zimbabwe: In Re Scotfin Ltd v Ngomahuru* 1998 (3) SA 466 (ZHC) it was held that the full extent of work done by the relevant attorney in respect of the collection of uncontested trade debts was not provided for in the tariffs pertaining to the magistrates' courts or the High Courts (of Zimbabwe), with the result that the Law Society of Zimbabwe was entitled to provide 'commission' on such work to be recovered by attorneys. The particular bylaw of the Law Society of Zimbabwe was therefore not *ultra vires* the empowering legislation (at 478G – 480B). The court, however, further held that, although it was permissible for a creditor to enforce a term against a debtor obliging the latter to pay either collection commission or attorney-and-client costs, he or she could not recover both of these. Smith and Gillespie JJ, delivering a joint judgment, held in this regard (having reviewed several judgments in which concerns were expressed relating to the recovery of collection commission):

'The scrutiny that has been given to the subject in this case reveals … that there is an area of real concern and possible duplication of recoveries. This arises from the widespread practice whereby collection commission, when it is claimed from the debtor, is claimed in terms obliging the debtor to pay "costs of suit on a legal practitioner and client basis and collection commission". This claim no doubt is formulated because the agreement in terms of which collection commission is claimed almost invariably contains also an undertaking by the debtor to pay costs on the higher scale. …

It must now be apparent that such a formulation is entirely unacceptable. Collection commission is only claimable in respect of uncontested collections of trade debts. It is only validly provided for where a tariff provides no other fee structure. It must be claimed by the attorney from his client as an alternative to any other fees or disbursements … . Collection commission is designed to be a means of reward that does not require the complicated and expensive procedure of formulating, and even taxing, a bill of fees in respect of innumerable attendances not provided for in a tariff. The agreement for recovery for collection commission by a creditor from his debtor is calculated to ensure that the creditor is not the loser when the debt is finally recovered after resort to legal practitioners.

Attorney and client costs, in comparison, are those costs for which a client becomes liable to his attorney and which are not recoverable as between party and party in accordance with the normal order of costs of suit. All items that are allowed on the party and party bill will also appear on the attorney and client bill, although not necessarily at the same rate, but many items on the latter will not be permitted on the former. As is well known, costs are awarded at this higher rate only in exceptional circumstances. They may, however, be awarded when there is agreement to such effect. The purpose of such agreement, quite obviously, is the same as the intention behind an agreement that a debtor will be liable to reimburse his creditor collection commission. It is to ensure that the creditor does not suffer the inevitable loss which will be incurred as a result of the taxation of a party and party bill, even though he recovers his costs' (at 481I – 482G).

It is noteworthy that there are differences in the fees prescribed for debt collectors (annexure B to the Regulations Relating to Debt Collectors, promulgated in GN 1120, 27 November 2009) and, more particularly, the maximum fee of R 348 on any instalment received by a debt collector from a debtor, and the maximum of such fee (commission) permitted by the bylaws of the various law societies (R 1 000).

The pressure of competition among attorneys, in principle, ought to have the effect that rates of collection commission are driven downwards and at levels lower than the maximum prescribed by the different law societies. However, because of the absence of an arm's length relationship between the attorneys and the debt collector entities over which they exercise control, and the fact that such debt collector entities often take cession of creditors' claims, the tendency is for attorneys to recover the maximum allowable collection commission from debtors, and thus effectively avoiding or lessening competition, maximising their own recovery and prejudicing consumers/debtors.

Conclusion

The NCA and the new magistrates' courts rules have, in some respects, ameliorated the position of defaulting consumers/debtors. In others, they have arguably weakened the position of such debtors. The bedrock of ss 57 and 58 of the Magistrates' Courts Act, on which debt collection through the courts is founded and which continues to facilitate exploitation of consumers/debtors, remains firmly in place, however.

Consideration should be given to repealing these provisions. Legislative reform with regard to the recovery of costs and collection commission is also urgently needed.

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