

NEGOTIABLE INSTRUMENTS DISCUSSION CLASS NOTES

- CLA2602

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A. CHEQUES

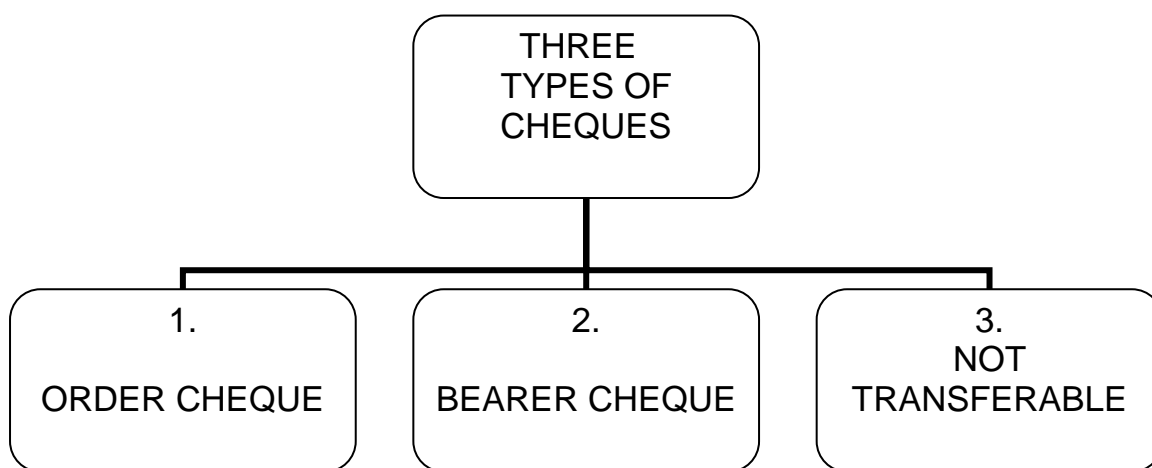
1. Section 1 - Definition of a Cheque

A cheque is an unconditional order in writing, addressed by one person to a bank, signed by the person giving it, requiring the bank to whom it is addressed to pay on demand a sum certain in money to a specified person or his order, or to bearer.

2. Parties to a Cheque

- Drawer
- Drawee
- Payee
- Endorser
- Endorsee
- Acceptor

3. Types of Cheques



❖ **Order Cheque**

A cheque payable to order:

- a specified person or his order
("Pay John Smith or order")
- to the order of a specified person
("Pay the order of John Smith")
- to a particular person
("Pay John Smith")

❖ **Bearer Cheque**

BEA Section 1 – A cheque payable to bearer is payable to anyone who is in possession of it.

A cheque payable to bearer:

- payable to bearer
('Bearer' or "John Smith or bearer")
- payable to 'cash or order' or an order of 'cash'
- if the only or the last endorsement appearing on it is an endorsement **in blank**
- fictitious or unknown person or person who does not have the capacity to contract.

❖ **Not Transferable Cheque**

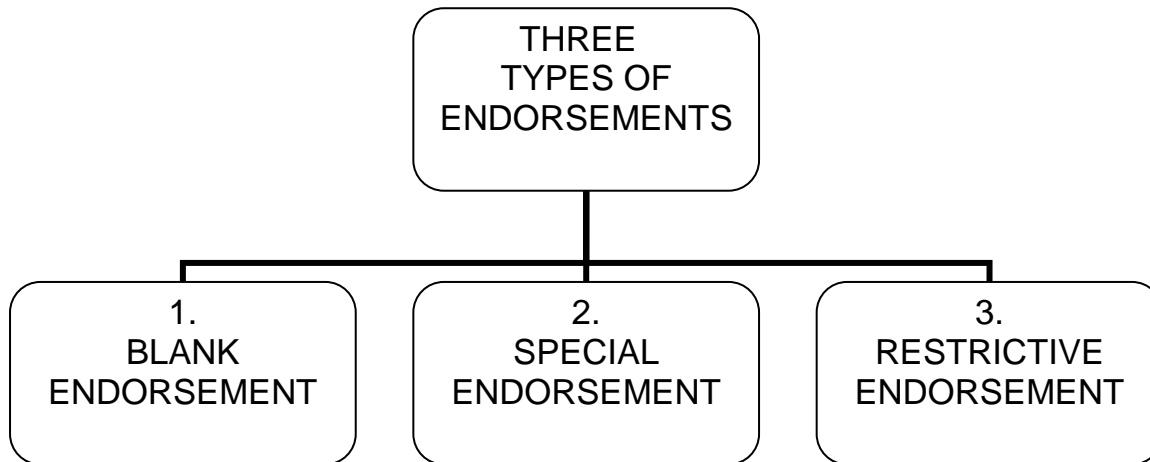
- payable to a specified person only (the payee).
- 2 categories on non-transferable cheques –self study.

4. Essential and non-essential Elements on a Cheque

Valid Cheque	:	to meet requirements of definition of a cheque
Non-essential elements	:	date, place of drawing or payment, amount, stamp duty, Sans recours (exclusion of liability, which results in drawer or endorser cannot be held liable if cheque is dishonoured)

5. Endorsements

- ❖ What is an endorsement?
- ❖ Types of endorsements



BLANK ENDORSEMENT

It does not specify name of endorsee to whom payment must be made. As a result – becomes bearer cheque

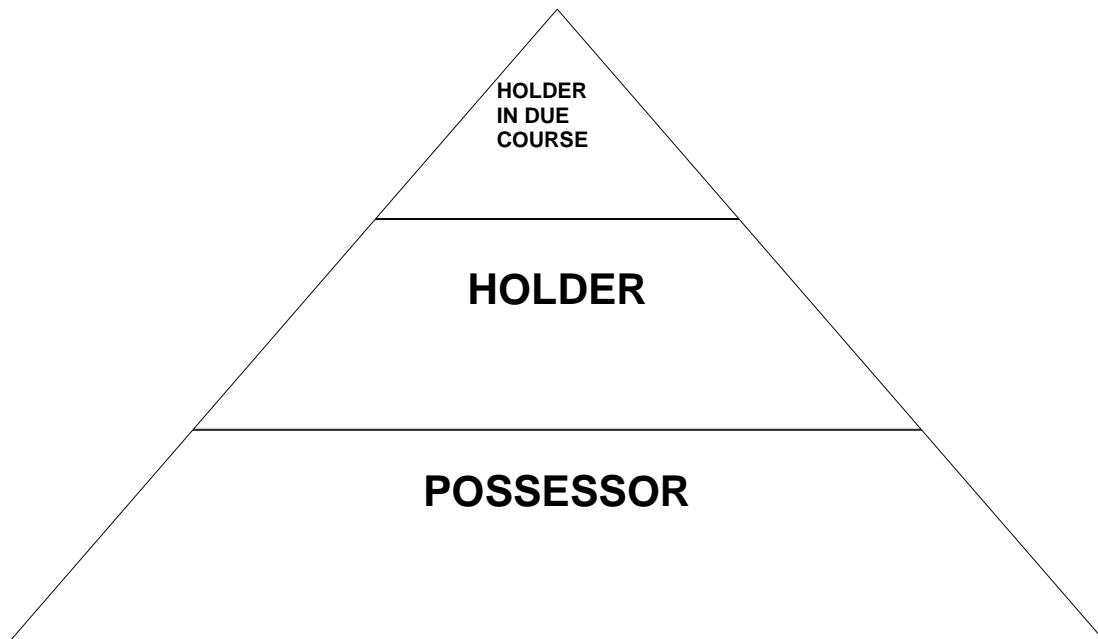
SPECIAL ENDORSEMENT

It specifies name of endorsee to whom payment must be made, or to whose order the cheque is payable. As a result – cheque remains payable to order

RESTRICTIVE ENDORSEMENT

May prohibit further negotiation or transfer of the cheque, for example: 'pay C only'. It may give the endorsee the right to deal with the cheque as indicated in the endorsement, without ownership of the instrument passing to the endorsee for example – 'pay C for the account of E.

B) DEFINITIONS



POSSESSOR

In possession of cheque

No rights on the cheque

HOLDER

DEFINITION:

“the payee or endorsee of the bill who is in possession of an order instrument or the person in possession of a bearer cheque”

Rights of a holder:

- sue on a cheque in his own name
- may present cheque for payment
- may make certain additions and alterations to the cheque
- may request duplicate if cheque is lost

HOLDER IN DUE COURSE

Definition / requirements

- He must be a holder
- The cheque must be negotiated to him
- Must receive cheque complete and regular on the face of it
- Must take cheque before its due date
- Must take cheque without knowing that it has been dishonoured in the past
- Must take cheque in good faith
- Must not know of any defect in title of the person who transfers the cheque to him
- Must take the cheque for value



NB! NB! To identify in exam questions:

- HOLDER
- NEGOTIATED

(But you must still be able to identify the others!)

Rights of a holder in due course:

- relative defences may not be raised against a holder in due course as HIDC holds cheque free from equities (rights not affected by previous defective title eg. Breach of contract, fraud, undue influence, illegal consideration). Can enforce payment against all parties
- absolute defences may be raised against a HIDC eg. Lack of capacity, forged or unauthorised signature.

ISSUE

“The first delivery of a bill or note, complete in form, to a person who takes it as holder”

NEGOTIATION

- Negotiation occurs if a cheque is transferred from one person to another and such person becomes the holder of the cheque.
- The holder of a cheque may freely transfer it from one person to another.
- BUT EXCEPTIONS EXIST, WHERE THE CHEQUE MAY NOT BE NEGOTIATED FURTHER:
 - a cheque marked “not transferable” or “non transferable”
 - a cheque stipulating that it is payable to a particular payee alone (“pay C only”) or
 - a cheque that is restrictively endorsed (“pay D only”)
 - an **uncrossed** cheque marked “not negotiable” and is payable to a specific person

NB!!

NEGOTIATION OF A CHEQUE

ORDER CHEQUE



ENDORSEMENT

+

DELIVERY

BEARER CHEQUE



DELIVERY ONLY

PRACTICAL EXAMPLES

QUESTION 1

A draws a cheque on B Bank in favour of C *or order*. X steals the cheque from C.
Is X the holder of the bill?

STEP 1: What kind of cheque is this?

An order cheque.

STEP 2: Look at the definition of a holder:

The payee or endorsee of the bill who is in possession of an order instrument, or the person in possession of a bearer cheque.

STEP 3: Apply the definition of a holder to the facts given.

X is not the holder, as he is not the payee or endorsee of the order cheque. X is a mere possessor of the cheque,

QUESTION 2

A draws a cheque on B Bank in favour of C *or bearer*. X steals the cheque from C.
Is X the holder of the bill?

STEP 1: What kind of cheque is this?

A bearer cheque.

STEP 2: Look at the definition of a holder.

The payee or endorsee of the bill who is in possession of an order instrument, or the person in possession of a bearer cheque.

STEP 3: Apply the definition of a holder to the facts given.

X is the holder, as he is in possession of a bearer cheque.

QUESTION 3

A draws a cheque on B Bank in favour of C or order and delivers the cheque to C. Is C the possessor, holder or holder in due course?

STEP 1: What kind of cheque is this?

An order cheque.

STEP 2: Is C the possessor of the cheque? Yes, because he is in possession of the cheque.

STEP 3: Is C the holder of the cheque? Look at the definition of a holder.

The payee or endorsee of the bill who is in possession of an order instrument, or the person in possession of a bearer cheque.

STEP 2: Apply the definition of a holder to the facts given.

Yes, C is the holder, as he is the payee in possession of an order cheque.

STEP 3: Is C the holder in due course? Look at the requirements for a holder in due course.

*Must have been a **holder** to whom a cheque has been **negotiated***

- *that is **complete and regular on the face of it***
- ***before its due date***
- *without **notice** that it was **dishonoured** in the past*
- *without **knowing** of any **defect in title** of the person who transfers the cheque to him*
- ***in good faith***
- ***for value***

STEP 4: Apply the requirements for a holder in due course to the facts given.

C is the holder, but C is not a holder in due course. The cheque has not been negotiated to C. An order cheque is negotiated by endorsement and delivery. The first delivery of an order bill to the payee cannot constitute negotiation because the delivery is not accompanied by the holder's endorsement. The first delivery of a bill constitutes issue, and not negotiation. Therefore, C is not a holder in due course.

QUESTION 4

A draws a cheque on B Bank in favour of C or order as payment for a pair of Oakley sunglasses. C delivers the sunglasses to A. Three days later A notices that the sunglasses are “Oakies”, not Oakleys. A countermands payment.

May C hold A or B Bank liable?

A's liability: No. C did not act in good faith.

Because C is a holder of the cheque (the payee in possession), A may raise both relative and absolute defences against C's claim for payment. C breached his contract with A by delivering a counterfeit pair of sunglasses. This breach of contract is an example of a relative defence that may be raised by A against having to pay C.

B's liability: None. B is not liable on the cheque and acted in accordance with client (A's) instructions.

Suppose that immediately after delivering the sunglasses to A, C uses the cheque to pay a debt that he owes D. C endorses the cheque in favour of D and delivers the cheque to D. May D hold A liable?

What kind of cheque is this?

An order cheque.

Is D a holder?

Yes, D is a holder, as he is the endorsee in possession of an order cheque.

Is D a holder in due course?

Yes, he is the holder in due course because the cheque has been negotiated to him and he is the holder of the cheque (+ assuming that all the other requirements were met).

Is A liable to D?

Yes, A may not raise the defence that C (in breach of his contract) delivered counterfeit sunglasses to A, because D is a holder in due course. Therefore relative defences may not be

raised against him. D's rights are not affected by a previous defective title – C's breach of contract to A/fraud.

Would your answer be any different if D was aware of the fraud?

Yes, D would not qualify as a holder in due course because he would fail to meet the requirement of good faith.

Functions of Signatures on Cheques

- Functions of Signatures:
 - Constitutive Function - effect is creation
 - Guarantee Function - guarantee to pay
 - Transfer Function - endorser's signature effects transfer
- Difference between forged and unauthorized signatures
 - Forged – imitates signature of someone with intention to defraud. May NOT be ratified.
 - Unauthorised – signs on behalf of another without consent. Use of own signature. May be ratified.
- Consequences of UNAUTHORISED signature
 - S24(1) - person who so signs shall be personally liable on the instrument
 - S22 - wholly inoperative i.e. person whose signature it purports to be will not be bound unless ratified by him. There is no right to retain or give discharge of the cheque or to enforce payment thereof against any party through the signature.
- Consequences of FORGED signature
 - S22 - wholly inoperative BUT cannot be ratified.
 - A forged signature is worthless, but the cheque stays valid although no rights can be conferred or transferred.
- GENERAL RULE: forged or unauthorised signatures are wholly inoperative.
EXCEPTION: S53(2)(b) – re: FORGED SIGNATURE

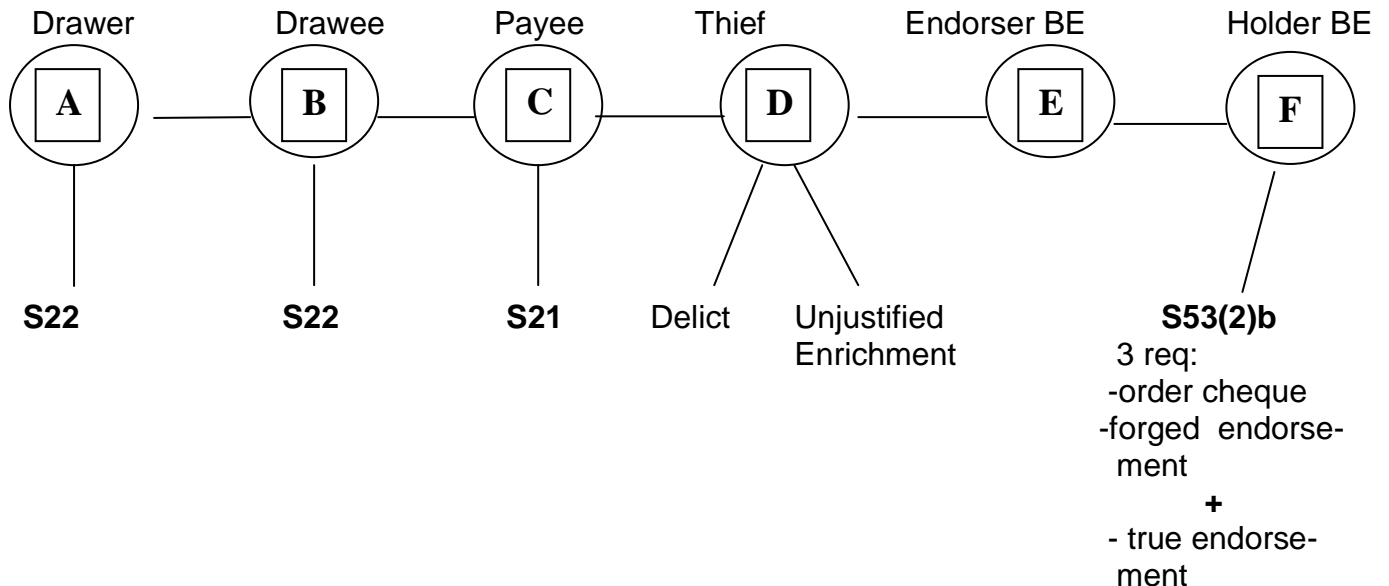
Crossings on Cheques

- Instruction to the Bank
- Doesn't change the nature of the cheque
- Cheque must be paid into a bank account – not over the counter

	General Crossing	Special Crossing
Example	<ul style="list-style-type: none">❖ Two parallel lines only❖ Two parallel lines with 'not/non negotiable'	<ul style="list-style-type: none">❖ Name of a bank with or without parallel lines❖ Name of bank with 'not negotiable'❖ Name of a bank with 'and company' or abbreviation
Effect	Drawee bank pays any other bank (collecting bank)	Drawee bank pays bank as specified in the crossing

IMPORTANT SECTIONS OF THE BEA

APPLIES WHEN COLLECTING BANK DID NOT RECEIVE PAYMENT APPLICATION TO S53(2)(b) SCENARIO



S53(2)(b)

What is section 53(2)(b) about?

General Rule (s22) – a forged or unauthorised signature is wholly inoperative. No one can become a holder, endorser, or holder in due course of a cheque after a forged signature has been made on the cheque.

BUT : Exception to general is S53(2)(b): 'The endorser of the cheque is precluded from denying to a holder in due course the genuineness and regularity in all respects of the drawer's signature and all previous endorsements'. Whether negligently or intentionally the endorser misled the endorsee, the endorser will be held to that impression where the endorsee acted on the impression to his prejudice. Endorser is known as 'endorser by estoppel' and endorsee is known as 'Holder by estoppel'.

Requirements of S53(2)(b) have to be met:

1. order cheque (as bearer cheque transferred by mere delivery and endorsement by thief would not have been necessary)
2. forged endorsement plus
3. true endorsement

SCENARIO 1:

A draws a crossed cheque on B Bank payable to C or order. A thief (D) steals the cheque from C and forges C's endorsement on the back of the cheque and delivers it to E. E then places his signature on the cheque and delivers it to F who takes it in good faith and for value. F deposits the cheque into his bank account at I bank. F does not receive payment.

Fully **advise F** as to who can be held liable.

notes

-NB: Bank (and therefore F) has not received payment

-no mention of 'not negotiable' even though it is crossed = S81 won't apply

- whether cheque is crossed or not is not relevant in this scenario

-then possible use of S53(2)(b)

- 3 requirement of S53(2)(b) must be met.

Answer

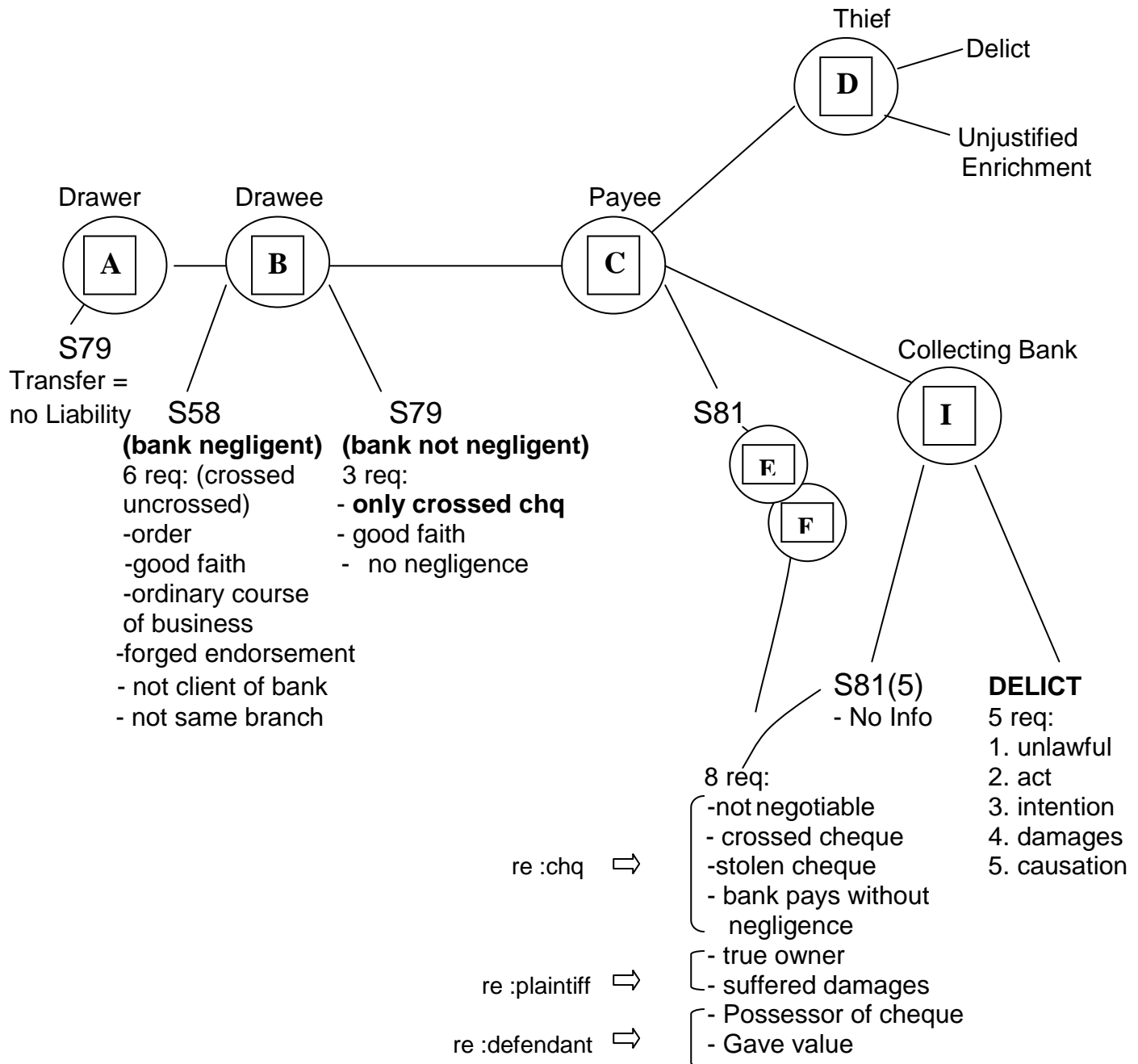
- A : In terms of S22, A will not be liable because the forged signature is wholly inoperative.
- B : In terms of S22, B will not be liable because the forged signature is wholly inoperative. No right to enforce payment against any party can be acquired through the forged signature.
- C : In terms of S21, no one can be held liable as drawer, endorser or acceptor unless he has signed the bill. C did not place any signature on the cheque and is accordingly not liable.
- D : To be liable on the cheque, D, the thief must have placed his own signature on cheq. The thief was never a party to the cheque. The thief forged a signature, he did not place his own signature on cheque. Therefore, the thief is not liable in terms of the cheque. If the thief can be found, he can be held liable based on delict or unjustified enrichment.
- E : E endorsed the cheque after the forged endorsement. S53(2)(b) applies and requirements are met. E known as endorser by estoppel. S53(2)(b) provides that

the endorser of the cheque is precluded from denying the genuineness and regularity in all respects of the drawer's signature and all previous endorsements. E will therefore be held liable to F. E will not be able to rely on the principle that the forged signature of the thief renders the cheque wholly inoperative as S53(2)(b) applies. NB: F will be able to claim payment for the amount of the cheque from E, BUT, not from any earlier parties before the forgery.

IMPORTANT SECTIONS OF THE BEA

APPLIES WHEN COLLECTING BANK RECEIVED PAYMENT

APPLICATION TO S81 SCENARIO



S81

What is section 81 about?

Protects: true owner of the cheque

The true owner has a right of recourse against subsequent possessors if all requirements are met

Consequence: true owner can hold subsequent possessor liable

SCENARIO 2:

A draws a crossed cheque with the words 'not negotiable' on B Bank payable to C or order. A thief (D) steals the cheque from C and forges C's endorsement on the back of the cheque and delivers it to E. E then places his signature on the cheque and delivers it to F who takes it in good faith and for value. F sends his driver X to deposit the cheque into his (F's) bank account at I bank. B bank effects payment to I bank in good faith and without negligence.

Fully **advise C** as to who can be held liable.

Notes

- NB payment has been made to collecting bank

- '**not negotiable**' + crossed = S81 applies

Answer

- A : In terms of S79, the cheque has come into the hands of the payee, C, and A is therefore not liable on it. A's liability has been discharged.
- B : S79 - B paid in accordance with a crossed cheque in good faith and without negligence. B is protected by S79 as the requirements of S79 are met. S79 states 'as if payment of the cheque had been made to the true owner thereof'. B rightfully debited A's account and is not liable to C.
- D : To be liable on chq, D the thief must have placed his own signature on chq. The thief was never a party to the cheque. The thief forged a signature, he did not place his own signature on the cheque. Therefore, the thief is not liable in terms of the cheque. If the thief can be found, he can be held liable based on delict or unjustified enrichment.

- E : E was a subsequent possessor of the cheque and he endorsed the cheque after the forged endorsement.
E is liable to C because in terms of Section 81 the true owner can hold subsequent possessor liable.
- F : F was a subsequent possessor of the cheque.
F is liable to C because in terms of Section 81 the true owner can hold subsequent possessor liable.
- X : X merely took cheque to bank. Did not sign cheque and therefore not a party to it and not liable on it.
- I : I bank is not liable to C. [*Could be found liable if the requirements for a delict are met. Or, if I Bank refused to give information about its client to C, C could have held I Bank liable in terms of S81(5).*]