Department of Mercantile Law

Law of Negotiable Instruments, Intellectual Property and Competition

Only study guide for

MRL4801

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INTRODUCTION

Welcome to this module, the Law of Negotiable Instruments, Intellectual Property and Competition. From 2010 we have started a brand-new study package, and we hope you will find the new style of presentation informative and thought-provoking.

PURPOSE OF THIS MODULE

As you have noticed, this module comprises four separate and very distinct areas of law, namely negotiable instruments, methods of payment, intellectual property and competition.

This study guide is divided into 3 sections. Section A seeks to introduce you to the fundamental principles relating to the law of negotiable instruments and Section B seeks to develop your understanding of certain methods of payment.

Section C contains information on intellectual property and competition law. The section on intellectual property law, introduces you to the legal principles for the law of copyright and trademark. Last but definitely not least is the section on the law of competition, which will expose you to the general principles governing private competition law.

This module serves as an introduction to these four challenging and exciting areas of law. If you enjoyed studying any of the fields of law covered in this module, you may wish to enrol for an advanced course in your final year.

THE PURPOSE AND STRUCTURE OF THIS GUIDE

We have tried to make the four topics covered in this module as lively and applicable to your life as possible. Each unit follows a similar pattern; the following signposts are there to help you find your way through the study guide:

The outcomes tell you what you must be able to do after working your way through a particular unit. You will find the outcomes bulleted right below the title of each unit.
Introduction

Activity

You will be required to apply your learning to actual problems encountered in everyday life. These applications will take the form of activities. It is essential that you complete these activities to ensure that you understand and have mastered the principles explained in the unit. After all, as a future lawyer you should always substantiate (explain or prove) what you say by referring to legislation, common law, case law and other sources such as the opinions of experts in the field of negotiable instruments, intellectual property and competition law.

Feedback

At the end of each unit you will find comments on each activity. These comments will help you to assess your progress in mastering a particular aspect of the work. If you are unable to do the activities without referring back to the relevant unit, or your answer differs substantially from the feedback provided, you should read the unit again before continuing to the next one.

Summary

At the end of each unit you will find a summary activity that will help you apply principles to identified problems. The summary activities are useful for two reasons: firstly, they are designed to test your application of the knowledge that you have acquired by working through the different units, and secondly, they are set to help you ascertain whether you have mastered the work.

Prescribed reading

In addition to this study guide, you will be required to read work prescribed for this module. A complete list of compulsory readings appears in Tutorial Letter 101 and at the beginning of each unit within a text box. The prescribed readings consist mostly of actual cases and legislation. It is important for you to become acquainted with the language of the law and the way in which legal information is presented.

Please note that the Bills of Exchange Act 34 of 1964 also constitutes compulsory study material. As this Act is absolutely indispensable for the study of the law of negotiable instruments, an abbreviated version containing only the most important provisions will be sent to you in a tutorial letter.

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In this study guide, reference is made to a textbook written by FR Malan and JT Pretorius, assisted by SF Du Toit, entitled *Malan on bills of exchange, cheques and promissory notes* (5th ed, 2006). This book is not prescribed, but if you are interested in acquiring further information on the law of negotiable instruments we encourage you to refer to this text.

In the study guide we have included information that is not examinable. This material will be identified by this icon.

Please note that wherever words are used that refer to the masculine, they include the feminine.

Please let us know if anything in this study guide is unclear, ambiguous or just simply student-unfriendly. You can do this by contacting us personally (see tutorial letter 101 for the contact details for the lecturers for this module), or by completing the feedback questionnaire that you will receive. This will help us improve the quality of this module.

Good luck with your studies in the law of negotiable instruments, intellectual property and competition.

Your lecturers for MRL4801.

**LIST OF ABBREVIATIONS**

BEA — Bills of Exchange Act  
SECTION — s  
SECTIONS — ss
Section A

Negotiable instruments
INTRODUCTION TO THE LAW OF NEGOTIABLE INSTRUMENTS

Outcomes

- distinguish between different types of commercial paper by completing a diagram
- explain the most important characteristics of negotiable instruments based on facts presented in a scenario
- interpret the characteristics of negotiable instruments with reference to a given scenario

Prescribed reading

There is no prescribed reading for this unit.

1 INTRODUCTION

The purpose of this unit is to introduce you to the law of negotiable instruments. Although negotiable instruments, and cheques in particular, play a very important role in the business world, people generally have a very superficial knowledge of the law relating to negotiable instruments. After providing you with a very brief historical overview of the development of the law of negotiable instruments, we will identify different examples of commercial paper and then focus on the two most important characteristics of a negotiable instrument.

2 HISTORICAL OVERVIEW

Bills of exchange probably originated in Italy during the 15th century. This era saw an amazing increase in commercial transactions and the giving of credit among the Lombards in the famous Italian commercial cities of Venice, Genoa and Florence. The merchants and moneychangers found it expedient not to transport the money itself and then to exchange it for
foreign money, but to make use of an oral promise to pay. For instance, a
moneychanger would make an oral promise to pay in a foreign country in
that country’s currency, by means of his representative. At that stage, this
was still a contract of exchange. This also explains where the term bill of
exchange comes from.

Later on, the promise to pay was made in writing, and the moneychanger,
for example, would undertake to pay a sum of money in a foreign country in
the currency of that country. The merchant who received the promise in
writing from the moneychanger would really be buying from the
moneychanger the right to claim a particular sum of money in the foreign
country. By virtue of this promise of payment, the merchant would obtain
the right to claim payment of the amount mentioned in the document from
the moneychanger’s representative in the foreign country. Because the
merchant had bought the promise of payment from the moneychanger with
the money of his own country, it became customary to write the words ‘‘for
value received’’ on the document. The custom of adding these words to
bills and promissory notes has survived to this day.

We find a further step in the development of bills of exchange in the so-
called ‘‘order to pay’, which was later added to the promise to pay.
Together with the written promise to pay, the moneychanger would also
give his agent in the foreign country an order in writing to pay the merchant
a certain sum of money in that country’s currency. The promise to pay later
disappeared, and the moneychanger gave only an order to pay. This order to
pay was the predecessor of the modern bill of exchange.

Suppose merchant C from France wished to have a sum of money available
in Italy in order to buy certain merchandise at an annual market. C would
then pay a sum of money in French currency to a moneychanger, A, in
France. A would give B, his agent in Italy, a written order to pay a
corresponding sum of money in Italian currency to D, C’s trade associate in
Italy, and A would hand the document over to C. C would send the
document to his trade associate, D, in Italy, and D would receive payment
in foreign currency from B on behalf of C. In this way the danger of
transporting money and the inconvenience of exchanging money was
avoided. It subsequently became customary not even to mention D in the
document. Then C himself could appoint the person (D) to whom B had to
pay. This appointment by C was reflected on the document, first on the
front, but later on the back of the document; this is how the concept and use
of endorsement originated. At this stage of the development of the bill,
three names appeared on it. The three persons mentioned in the document
are known as the drawer (A), the drawee (B) and the payee (C). If C
appoints another person who is to be paid, C endorses the document and
delivers it to the endorse (D).

These fixed usages of the merchants caught on elsewhere in Europe, and a new,
uniform ‘law of bills’ originated in countries such as Italy, France, the
Netherlands and Germany, and later on in England as well. The law of
negotiable instruments retained its international basis, but national differences
developed in the course of time. Various attempts have been made to bring
about an international uniform law of negotiable instruments. An example of this was the International Conference for the Unification of the Bills of Exchange, Cheques and Promissory Notes, held in Geneva in 1930. Despite these attempts, there are still differences between the Commonwealth group of countries (which includes South Africa) and the Continental group of countries (which includes France, Germany, the Netherlands, Italy, Russia and Japan).

Before the creation of the Union of South Africa, the law relating to bills, cheques and promissory notes was governed by the following separate statutes of the four provinces that formed the Union:

- Act 8 of 1887 (Natal)
- Act 19 of 1893 (Cape)
- Proclamation 11 of 1902 (Transvaal)
- Ordinance 28 of 1902 (Orange Free State)

These provincial statutes, and their later amendments, were repealed and replaced by the Bills of Exchange Act 34 of 1964, which consolidates and amends the laws relating to bills of exchange, cheques and promissory notes. Since its promulgation, this Act has been amended four times. The most recent amendments were made in 2000 by the Bills of Exchange Amendment Act 56 of 2000, which came into effect on 1 March 2001.

3 EXAMPLES OF NEGOTIABLE INSTRUMENTS

A commercial paper is an instrument which embodies contractual rights, and the possession of the instrument is required to enforce those rights that are contained in it. Although negotiable instruments (eg bills, cheques, promissory notes, certain bearer debentures, bonds and share warrants) are categorised as commercial paper, not all commercial papers are negotiable instruments. Examples of commercial papers which are not negotiable instruments include bills of lading and share certificates.

Some negotiable instruments can be characterised as instruments of payment (eg bills, cheques and promissory notes) whereas others can be seen as instruments of investment (eg debentures, bonds and share warrants).
Activity 1

Complete the following diagram based on the information provided above.

```
COMMERCIAL PAPER

Negotiable instruments

Instruments of payment

Instruments of investment

Other examples of commercial paper
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The negotiable instruments section of this module will only focus on three types of negotiable instruments which are all instruments of payment, namely the bill of exchange, the cheque and the promissory note.

4 CHARACTERISTICS OF NEGOTIABLE INSTRUMENTS

The two basic characteristics shared by cheques, bills and promissory notes are:

- simplicity of transfer
- the possibility of transfer free from equities

Before we consider these two characteristics in detail, we need to ask ourselves why people would want to make use of a negotiable instrument as a method of payment. The main reason for the development of this type of instrument seems to be the advent and subsequent increase of commercial trade in Europe. It became economically expedient to use a bill to effect payment because it was safer than money, and it made the process of effecting payment less time-consuming (the buyer was saved the trouble of having to transport currency from his country to that of the seller).

4.1 Simplicity of transfer

The first common characteristic of bills, cheques and promissory notes is that these instruments (and the rights embodied in the instruments) can be transferred from one person to another without the need to comply with difficult and cumbersome formalities. Generally, negotiable instruments can be transferred from one person to another either by simply delivering them
to the recipient, or by signing them first before delivering them to the recipient. Whether an instrument needs to be signed first before it is delivered depends on whether it is an order or a bearer instrument (see units 2 and 4 for a discussion of distinction between bills payable to order and those payable to bearer and how they may be negotiated).

A buys a fridge from B for R2 000 and pays the full amount by cheque. A hands the cheque over to B. B can do one of two things (as demonstrated in the diagram below):

1) B can take the cheque to the bank and receive R2 000; or  
2) B can use the cheque to pay a third party for goods or services received.

Assume that B decides to use the cheque to pay for food that he has purchased at C’s shop. If the cheque is payable to bearer, it means that B can simply hand over the cheque to C and C will become its holder. However, if the cheque is payable to order, B first has to sign the cheque and then deliver it to C. C then has the same two choices that B has above, and so on ....

![Diagram showing the flow of payment from A to B to C]

4.2 Transfer free from equities

It is a basic principle in our law that **one cannot transfer a better title to another person than the title one has oneself.** Let us explain this principle by means of an example: A is the owner of a car. X, a thief, steals the car and sells it to B, who in turn sells it to C. Both B and C are unaware that the car had been stolen.

If we were to explain why C cannot be the owner of the car we would do so as follows: Because X stole the car from A, X is not the owner of the car and has no rights to the car. When X sells the car to B, X can only transfer those rights that he has, to B. Because he (X) has no rights to the car, X cannot transfer any rights to B. B thus has no rights to the car and is not its owner. In the same way, when B sells the car to C, B in turn, can only transfer those rights that he has. Because B has no rights to the car, he in turn cannot transfer any rights to C. C thus has the same rights as B (that is, no rights to
the car) which are the same rights as X had. Therefore C cannot be the owner of the car despite paying for it and despite being unaware of its theft.

This is one of the foundational principles which you have studied in the Law of Things. If you don’t understand the abovementioned example, go back to your Law of Things study guide.

However, the law of negotiable instruments creates an exception to this rule. The reason for the exception is based on commercial reality. Negotiable instruments will only be used as a method of payment if the person who takes the instrument as payment for a debt obtains ownership and full title to the instrument in the same way he would have if payment was made with cash. In other words, people will not be prepared to accept a negotiable instrument as payment for a debt if there is a possibility that they may be faced with possible defences to their right to claim payment on the instrument that they would not have been faced with if payment was made with money. Commercial reality therefore dictates that, under certain circumstances, negotiable instruments should be treated in a similar manner to cash.

Let us explain this idea by means of an example: Suppose a thief steals a R10 note from your purse. The thief uses the R10 note to buy a loaf of bread from the corner cafe. The shopkeeper (owner of the cafe) will become owner of the R10 note if he is unaware of the theft. His title as ‘owner’ is not dependent on him having received the R10 note from someone who has a valid title to it (compare this with the example above where a car had been stolen). It would not make sense if similar consequences did not flow from the use of a negotiable instrument. In other words, people would be very reluctant to make use of negotiable instruments because it would be more difficult to become owner of a negotiable instrument than it would be to become the owner of money.

In applying this to negotiable instruments, it means that the person who takes the negotiable instrument in good faith acquires ownership of the instrument, even though the person from whom he received the instrument has no title or a defective title to it. In other words, such a person derives his title from the instrument itself and is not subject to defences that could be raised against his predecessor’s title.

However, you must note that negotiable instruments display characteristics which are different to cash as well. It would also defeat the very purpose of using negotiable instruments if negotiable instruments had similar consequences to cash in all circumstances. From the historical overview of negotiable instruments highlighted above, you can see that these instruments were introduced partly as a response to the hazards and inconvenience of physically transporting money across vast distances. Thus, negotiable instruments had to display characteristics that made them “safer” than cash. Suppose a person loses his own R10 note; he is out of pocket by R10 — he cannot demand that someone gives him a R10 note to
replace the one that he has lost. However, the loss of a cheque (an example of a negotiable instrument) does not produce the same results. Where a cheque is lost, the holder of a cheque may, in certain circumstances, ask the drawer to give him a duplicate of the cheque (see unit 6 for a discussion on the rights of a holder).

**Activity 2**

Read the scenario below and answer the questions given. Your answers should include an explanation.

A buys a washing machine from B for R1,500. A pays the full amount by cheque. When the washing machine is delivered, it appears that the machine is defective. A returns the washing machine to B and stops payment on the cheque.

1. Can A be held liable to B for payment of R1,500?
2. Assume that in the meantime, B has transferred the cheque to C as payment for servicing B's motor car. C is unaware of the transaction involving the defective washing machine. C presents the cheque for payment at A's bank but the bank refuses to pay C because the cheque was stopped. Can C hold A liable for payment?

In the units that follow, we will focus on the three types of negotiable instruments that are discussed in the Bills of Exchange Act 34 of 1964, namely bills of exchange, cheques and promissory notes.

**Feedback 1**

COMMERCIAL PAPER

- Negotiable instruments
  - instruments of payment
    - cheque
    - bill
    - promissory note
  - instruments of investment
  - bill of lading
  - share certificate
  - debentures
  - bonds
  - share warrants
Feedback 2

(1) No. A can raise the defence that the payment is not due because the washing machine was defective and had already been returned to B.

(2) Yes. If C meets certain requirements (he must, inter alia, have taken the cheque in good faith and for value), A will now be liable to C for the full amount of R1 500. In such a case A cannot raise the defence against C that payment is not due because A had already returned the defective washing machine to B. By negotiating the cheque to C, B transferred his right to claim R1 500 from A’s bank, to C. In this case, C acquired the cheque free from equities.
UNIT 2

BASIC CONCEPTS AND DEFINITIONS

After studying this unit, you should be able to

- define the following concepts:
  - bill of exchange
  - cheque
  - promissory note

- identify the similarities and differences between bills, cheques and promissory notes
- distinguish between instruments payable to order and those payable to bearer
- identify the parties, the relationships created and their respective capabilities under bills, cheques and promissory notes based on facts presented in a scenario

There is no prescribed reading for this unit.

1 INTRODUCTION

As stated in the previous unit, this section of the module focuses on three types of negotiable instruments, namely bills of exchange, cheques and promissory notes. The definitions of these three types of negotiable instruments are fundamental to your understanding of this module. You are therefore required to memorise these definitions. Please note that the definitions for bills of exchange, cheques and promissory notes appear in different parts of the Act.
2 DEFINITIONS OF NEGOTIABLE INSTRUMENTS

2.1 Bill of exchange

A bill of exchange is defined in s 2(1) of the BEA as follows:

[a] bill of exchange is an **unconditional order** in writing, **addressed by one person to another**, signed by the person giving it, requiring the **person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money** to a specified person or his order, or to bearer.

We have highlighted the eight requirements that have to be met before an instrument is a valid bill of exchange in terms of the BEA. These requirements will be discussed in detail in unit 3.

2.2 Cheque

Section 1 of the BEA defines a cheque as “a bill drawn on a bank payable on demand”. If the definition of a bill (provided above) is combined with that of a cheque in s 1, the definition of a cheque would then be the following:

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.

2.3 Promissory note

A promissory note is defined in s 87(1) of the BEA as an **unconditional promise in writing made by one person to another**, signed by the maker, and **engaging to pay on demand or at a fixed or determinable future time, a sum certain in money**, to a specified person or his order, or to bearer.

---

**Activity 1**

In the table below, we have listed the eight requirements that a negotiable instrument must meet before it can be considered a valid bill of exchange. Using the definitions of a cheque and a promissory note found above, compare the requirements listed below with those needed for the creation of a cheque and a promissory note and indicate in the table below the similarities and differences between the respective instruments.

<table>
<thead>
<tr>
<th>Bill of exchange</th>
<th>Cheque</th>
<th>Promissory note</th>
</tr>
</thead>
<tbody>
<tr>
<td>order</td>
<td></td>
<td></td>
</tr>
<tr>
<td>unconditional</td>
<td></td>
<td></td>
</tr>
<tr>
<td>in writing</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
3 PAYMENT TO ORDER OR BEARER

Depending on its content, a negotiable instrument may be payable to order or to bearer. An instrument payable to order is referred to as an order instrument (an order bill, order note or order cheque, as the case may be). Similarly, an instrument payable to bearer is referred to as a bearer instrument (a bearer bill, bearer note or bearer cheque, as the case may be). For an instrument to be negotiable, it must always be payable either to order or to bearer (this topic is discussed in detail in unit 4).

Remember that the drawer “orders” (gives an instruction or command) that someone (the payee) is to be paid. If the drawer wants the bill to be payable to a specified person (the payee) or his order, the drawer is “ordering” that either the specified person must receive payment, or the specified person can once again give an “order” as to who must receive payment. If the drawer indicates that payment must be made to bearer, the drawer wants anyone who bears (that is, carries or possesses) the bill to receive payment.

However, a negotiable instrument may be payable neither to order nor to bearer. Such an instrument is called a “non-transferable” instrument. A “non-transferable” instrument is payable to a specified person (the payee) only. (See ss 6(5) and 75A of the BEA, which deal with “non-transferable” cheques and are discussed in great detail in unit 14.)

3.1 Instrument payable to order

An instrument is payable to order if it is payable to

- a specified person or his order (e.g. “Pay John Smith or order”)
- to the order of a specified person (e.g. “Pay the order of John Smith”)
- to a particular person (e.g. “Pay John Smith”)
The person to whom payment must be made (the payee) must be either named or otherwise indicated with reasonable certainty (s 5(1)).

3.2 Instrument payable to bearer

An instrument is payable to bearer in the following instances:

- If it is made payable to bearer (s 6(2)). This will be the case when the instrument originally is made payable to “Bearer” or to “John Smith or bearer”.
- If the instrument is payable to “cash or order” or the order of “cash” (s 6(2)).
- If the only or the last endorsement appearing on it is an endorsement in blank (s 6(2)).
- If the payee or endorsee is a fictitious or non-existent person or someone who does not have the capacity to contract. In fact section 5(3) of the BEA states that in these three cases, the instrument may be treated as if it were payable to bearer. A person ‘‘who does not have capacity to contract’’ probably means someone without any capacity to act, such as insane persons (this topic will be dealt with in great detail in unit 5).

An instrument payable to bearer is payable to anyone who is in possession of it (s 1).

**Activity 2**

Identify whether the following are examples of bills, cheques or promissory notes; indicate whether they are payable to order or to bearer, and give reason(s) for your answers.

(1)

<table>
<thead>
<tr>
<th>B Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pay:</strong> Cash or order</td>
</tr>
<tr>
<td><strong>the sum of</strong> Ten thousand rand only</td>
</tr>
<tr>
<td><strong>Signed:</strong> Rudolph Nengome</td>
</tr>
</tbody>
</table>

Rudolph Nengome
4 PARTIES NECESSARY TO A BILL, CHEQUE AND PROMISSORY NOTE

4.1 Bill of exchange

A study of the definition of a bill of exchange reveals that there are three necessary parties to a bill. These are:

- the person who gives the order (the drawer)
- the person to whom the order is addressed (the drawee)
- the person to whom payment must be made (the payee or bearer)

However, there need not be three different persons, since the drawer and the payee (A draws a bill on B in favour of A) or the drawee and the payee (A draws a bill on B in favour of B) may be one and the same person (s 3(1)). But at least two different persons must be parties to the bill, since section 2(1) of the BEA requires a bill to be an order addressed by one person to another.

Note further that where the drawer and the drawee (A draws a bill on A in favour of B) are the same person, the holder may elect to treat the instrument either as a bill of exchange or as a promissory note (s 3(2)).

While there is a limit as to the minimum number of persons who may be parties to a bill, there is no such limitation on the maximum number of persons who may be parties to a bill. There may, therefore, be various drawers and/or drawees and/or payees.

Let us take a closer look at the three parties to a bill mentioned above.
4.1.1 The drawer

The **drawer** is the **person who gives the written order that a sum of money be paid**. He draws the bill and must sign the bill as drawer.

4.1.2 The drawee

The **drawee** is the **person to whom the order to pay is addressed**. There are a number of reasons why the drawer may choose to draw the bill on the drawee. For example, the drawer and drawee may have entered into an agreement in which the drawer was entitled to draw a bill on the drawee (see the discussion of the underlying relationship between the parties below).

The drawee must be named or otherwise indicated on the bill with reasonable certainty (s 4(1)), and until he signs the bill, he incurs no liability on the bill. As soon as the drawee signs the bill, that is, as soon as he **accepts the drawer's order by placing his signature on the instrument**, he is called the **acceptor**.

4.1.3 The payee

The **payee** is the **person to whom payment must be made** — he is the **person whom the drawer names on the bill** as the person in whose favour the bill is drawn. The drawer draws the bill on the drawee in favour of the payee and the drawer then usually issues the bill to the payee. If the payee of an order document wishes to negotiate the bill, he must sign and deliver the bill, in which case he then becomes the endorser.

4.1.4 The bearer

A **bearer** is any **person in possession of a bill payable to bearer** (refer to 3.2 above to see when a bill is payable to bearer).

4.2 Cheque

The fundamental parties to a cheque correspond to the fundamental parties to a bill, since a cheque is, in essence, a bill. Thus in the case of cheques we also have the drawer, the drawee and the payee or bearer. The **drawee** of a **cheque** must, however, always be a **bank**.

When you open a current account with a bank, the bank agrees, among other things, to pay the cheques that you draw on the bank, provided that you have sufficient funds in your account. So, the bank is contractually obliged to pay the cheques that you, its customer, draw on it, provided that there are sufficient funds in your cheque account (see also the discussion of the underlying relationship between the parties below).

Rudolph Nengome draws a cheque on B Bank in favour of "Cash or order". The drawer, drawee and payee or bearer are identified as follows:
4.3 Promissory note

A promissory note differs from a bill or cheque in that there are only two fundamental parties to it (see the definition in s 87(1)). The parties are:

- the **person who promises to pay** (the **maker**)
- the **person to whom this promise to pay is made** (the **payee or bearer**).

Let us look at these parties in greater detail.

4.3.1 The maker

The **maker** is the **person who makes the promise to pay**. He makes the promissory note and must sign it as maker. At first glance one might think that the maker of a promissory note corresponds to the drawer of a bill, but this is in fact not so. The **maker of a note corresponds to the acceptor of a bill** because the maker undertakes to make payment personally.

4.3.2 The payee

The **payee** of a promissory note is the **person to whom the promise is made**, that is, the person in whose favour the note is made. The maker mentions the payee by name in the promissory note and issues the promissory note to the payee. When the **payee negotiates the note** (endorses and delivers it), he becomes the **endorser**.

4.3.3 The bearer

What has been said about the bearer of a bill applies to the bearer of a promissory note as well (see discussion above).

Alvereen Leonard made a promissory note in favour of Michelle Kelly. The parties are identified as follows:
5 RELATIONSHIPS BETWEEN PARTIES TO BILLS, CHEQUES AND PROMISSORY NOTES

These relationships will be explained with reference to a bill. What follows also applies to the parties to cheques and promissory notes.

A draws a bill on B in favour of C or order. C negotiates the bill to D.

From this example, we can identify three sets of relationships between the parties A, B, C and D, namely:

(1) the underlying relationships
(2) the relationships which arise from the agreement to make use of the bill
(3) the relationships on the bill

Using the example above, we can expand the explanation of the various sets of relationships as follows.

5.1 Underlying relationships

There must be some reason why A draws a bill on B; why A draws the bill in favour of C and issues it to C; and why C negotiates the bill to D. There could be various reasons why the parties act as they do. For example: B has given A credit and for that reason allows A to draw bills on him; A has bought a car from C and now A pays C by means of a bill; C has borrowed money from D and for that reason C negotiates the bill to D. These relationships between the parties which lead to the drawing and issuing and later negotiation of the bill may be described as the underlying relationships.

5.2 Relationships that arise from the agreement to make use of the bill

Normally the parties to the abovementioned underlying relationships will pay each other in cash. A bill is not legal tender like cash and the parties can always refuse to accept payment by bill. Thus, before C agrees to allow A to pay by means of a bill, and before D, in turn, accepts the bill from C in
payment, the parties concerned must agree expressly or by implication that a bill will be used to effect payment.

5.3 Relationships on the bill

The bill owes its origin, issue and further negotiation to the above-mentioned relationships, but as soon as the bill has been issued, a new set of relationships arises on the bill itself. The bill still reflects the monetary aspects of the prior underlying relationships, but the parties no longer rely on those relationships to enforce their rights on the bill. They now rely on the bill and derive their rights and liabilities from the various contracts on the instrument; and the right to enforce these rights under the underlying obligations is suspended until the instrument matures. What this means is that the underlying relationships are not replaced by the contracts on the bill; the two sets of relationships coexist. The parties may, for example, still raise defences based on the underlying relationships in order to oppose claims on the bill, except against the holder in due course who acquires an independent right based on the instrument (we shall deal with this concept in great detail in unit 7). The performance of either set of obligations discharges the other.

The study of negotiable instruments relates to these various relationships which are based on the bill or note. **Except for the transferor by delivery, only those parties who have signed the bill in one capacity or another are liable on the bill.** At the outset it is only the drawer who signs the instrument. Both the drawee and the payee may, however, later sign the bill (accept it or endorse it), and in so doing change their capacities and become liable on the bill as acceptor and endorser respectively. On this point, see the first part of section 21 of the BEA which reads as follows: “No person is liable as drawer, acceptor or endorser of a bill if he has not signed it as such...”

A bearer who negotiates a bearer instrument without endorsing it (without signing it), is nevertheless liable to his immediate transferee as a “transferor by delivery” (s 56). (This topic is visited in greater detail in unit 5.)

6 FURTHER PARTIES TO AND Capacities UNDER BILLs, CHEQUEs AND PROMISSORY NOTES

6.1 Acceptor

As soon as the drawee accepts the bill, the drawee’s capacity changes to that of acceptor. The drawee and acceptor are thus one and the same person.

Acceptance is defined in section 1 of the BEA as follows: **‘Acceptance [means] an acceptance completed by delivery or notification’**. A clearer definition is given in section 15(1) of the BEA which provides that: **‘The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer’**.
Although nothing in the BEA prohibits its acceptance, a cheque is usually not accepted.

Section 93(1) of the BEA provides that the provisions relating to bills of exchange apply, with necessary modifications, to promissory notes. In applying the provisions relating to bills, a maker is deemed to correspond to the acceptor of a bill (s 93(2)).

Acceptance will be discussed fully in unit 8.

6.2 Endorser

Section 1 of the BEA defines endorsement as ‘an endorsement completed by delivery’. If the payee wishes to negotiate an instrument payable to order, he must endorse the instrument and deliver it. As soon as the payee endorses the instrument, his capacity changes and he becomes an endorser. In this particular case, the payee and endorser are the same person. As endorser, the payee becomes a debtor on the bill and incurs liability on the bill.

It is not only the payee who may become an endorser. Any subsequent holder who endorses the instrument is also known as the endorser of the instrument.

A promissory note, like a bill, is often endorsed, and there may therefore be various endorsers of promissory notes. Cheques, on the other hand, are not endorsed as often as bills.

Endorsement will be discussed more fully in unit 4.

6.3 Endorse

An endorser may endorse a negotiable instrument specially, that is, he may, above his signature, indicate a specific person to whom payment must be made. The payee may, for example, make the following endorsement: ‘Pay D or order, (signed) C’.

The person who is specified by name, namely D, is known as the endorsee. As soon as D negotiates the instrument further, he in turn becomes an endorser.

6.4 Holder

One of the most important concepts of the law relating to negotiable instruments is that of holder. Section 1 of the BEA defines a holder as follows: ‘A holder [means] the payee or endorsee of a bill or note, who is in possession of it, or the bearer thereof’. Below is a schematic diagram of the definition of holder:
A **holder** is thus either the **payee in possession**, or the **endorsee in possession**, or the **bearer**, who will naturally be in possession. During the life of a negotiable instrument, various persons may qualify as holders, but at any given moment only one person may be a holder (except in the case of joint or alternative holders) since it is essential that the holder be in possession of the instrument.

It is vital that you grasp the definition of holder. The concept of holder is discussed in great detail in unit 6.

### 6.5 Holder in due course

The concept of holder in due course is of fundamental importance in the study of negotiable instruments. The definition of a holder in due course in section 27(1) is as follows:

A holder in due course is a holder who has taken a bill, complete and regular on the face of it, under the following circumstances, namely:

(a) he must have become the holder of it before it was overdue, and if it had previously been dishonoured, without notice thereof; and

(b) he must have taken the bill in good faith and for value, and at the time the bill was negotiated to him, he must have had no notice of any defect in the title of the person who negotiated it.

The various requirements a person must comply with in order to be a holder in due course will be discussed fully later on. **Note that a person may only be holder in due course if he is also holder.**

It is essential that you consult the Bills of Exchange Act and that at this stage you know and understand the definitions and concepts which have been discussed above. You are advised not to proceed to the next unit unless you know and understand them.
Read the following scenario and answer the questions given.

Rudolph Nengome draws a bill of exchange for ten thousand rand in favour of Michelle Kelly or order on B Ltd on 31 December 2009. This bill is payable three months after issue. Eesa Fredericks, on behalf of B Ltd, assents to the order of the drawer.

(1) Illustrate this bill.
(2) Is this bill payable to order of bearer?
(3) Identify the
   (a) drawer
   (b) drawee
   (c) payee
   (d) acceptor

(4) Does Michelle Kelly qualify as a holder of the bill?

---

**Feedback 1**

<table>
<thead>
<tr>
<th>BILL OF EXCHANGE</th>
<th>CHEQUE</th>
<th>PROMISSORY NOTE</th>
</tr>
</thead>
<tbody>
<tr>
<td>order</td>
<td>order</td>
<td>promise</td>
</tr>
<tr>
<td>unconditional</td>
<td>unconditional</td>
<td>unconditional</td>
</tr>
<tr>
<td>in writing</td>
<td>in writing</td>
<td>in writing</td>
</tr>
<tr>
<td>addressed by one</td>
<td>addressed by one</td>
<td>addressed by one</td>
</tr>
<tr>
<td>person to another</td>
<td>person to a bank</td>
<td>person to himself</td>
</tr>
<tr>
<td>signed by the person</td>
<td>signed by the person</td>
<td>signed by the person</td>
</tr>
<tr>
<td>giving it</td>
<td>giving it</td>
<td>giving it</td>
</tr>
<tr>
<td>sum certain in money</td>
<td>sum certain in money</td>
<td>sum certain in money</td>
</tr>
<tr>
<td>to pay on demand or at</td>
<td>to pay on demand</td>
<td>to pay on demand or at</td>
</tr>
<tr>
<td>a fixed or determinable</td>
<td>a fixed or determinable</td>
<td>a fixed or determinable</td>
</tr>
<tr>
<td>future time</td>
<td>future time</td>
<td>future time</td>
</tr>
<tr>
<td>to a specified person or</td>
<td>to a specified person or</td>
<td>to a specified person or</td>
</tr>
<tr>
<td>his order or to bearer</td>
<td>his order or to bearer</td>
<td>his order or to bearer</td>
</tr>
</tbody>
</table>

**The similarities and differences between a bill of exchange and a cheque**

A cheque is a special kind of a bill of exchange, and with a few important exceptions, the general provisions relating to bills apply. It is clear from section 1 of the BEA that, in order for a bill to qualify as a cheque, two important qualifications must be met:

- The order to pay must always be addressed to a bank.
- It must be payable on demand.
Unit 2: Basic concepts and definitions

The similarities and differences between a bill of exchange and a promissory note

This definition corresponds, in several respects, with the definition of a bill. The important differences are that

- a bill is an unconditional order given by one person to another while a promissory note is an unconditional promise made by one person to another.
- in a bill the order to pay is addressed to a third person, whereas in a promissory note the maker of the note promises to make payment.

Feedback 2

(1) This is a cheque as it is drawn on a bank and payable on demand. As it is payable to ‘cash or order’, it is a bearer cheque (s. 6(2)).

(2) This is a promissory note because Alvereen Leonard is promising to pay Michelle Kelly. This is a bearer promissory note because it is payable to a specified person (Michelle Kelly) or bearer (s. 6(2)).

Also see the feedback to activity 1.
Feedback for summary activity

(1)

<table>
<thead>
<tr>
<th>B Ltd ← the drawee</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 December 2009</td>
</tr>
<tr>
<td>B Ltd must pay on or before 31 March 2009 to the order of Michelle Kelly</td>
</tr>
<tr>
<td>↓</td>
</tr>
<tr>
<td>payee</td>
</tr>
<tr>
<td>the sum of Ten thousand rand only</td>
</tr>
<tr>
<td>R10 000.00</td>
</tr>
<tr>
<td>signed: Rudolph Nengome ← the drawer</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>signed: Eesa Fredericks</td>
</tr>
<tr>
<td>Eesa Fredericks on behalf of B Ltd ← the acceptor (once the drawee accepts the drawer’s instruction)</td>
</tr>
</tbody>
</table>

(2) The bill is payable to order because it must be paid to a specified person, namely Michelle Kelly, or her order.

(3) (a) The drawer is Rudolph Nengome who is giving the instruction to pay.
(b) The drawee is B Ltd because it is instructed by the drawer to pay.
(c) The person who is to receive payment is Michelle Kelly, the payee.
(d) Once Eesa Fredericks signs the bill on behalf of B Ltd, B Ltd becomes the acceptor. This signature evidences B Ltd's assent to the order of the drawer.

(4) Michelle Kelly qualifies as holder because she is the payee in possession of the bill.
UNIT 3

BILLS OF EXCHANGE

Outcomes

After studying this unit you should be able to

• decide whether a document created by facts presented in a scenario is a valid bill or not
• identify the non-essential elements contained in a bill based on facts presented in a scenario

Prescribed reading

There is no prescribed reading for this unit.

1 INTRODUCTION

Before discussing the legal consequences that the parties to a bill of exchange will be exposed to, we first have to establish which requirements have to be met in terms of the BEA before a valid bill of exchange comes into existence. In the previous unit we looked at the definition of a bill of exchange found in section 2 of the BEA, which set out the essential elements of a bill. By this time you should have memorised the eight elements required for the creation of a valid bill of exchange. These essential elements are discussed in greater detail below. After this, we will look at the non-essential elements that may appear in a bill.

2 ESSENTIAL ELEMENTS OF A BILL

To recap the information from unit 2, the eight essential elements that a bill has to comply with are (1) an order; (2) in writing, (3) which is unconditional; (4) addressed by one person to another; (5) signed by the person giving it; (6) requiring someone to pay a sum certain in money; (7)
on demand or at a fixed or determinable future time; (8) to a specified
person or his order or to bearer (s 2). A document that does not comply with
one or more of these formal requirements does not qualify as a valid bill
under the Act although it may have validity independent of the Act. A
discussion of these requirements now follows.

2.1 Order

The wording of the bill must be such as to amount to an order and not to an
entreaty or request. In an English case, it was held, for example, that the
following words did not amount to an order and the document could not be
regarded as a bill: ‘Mr Little, please to let bearer have seven pounds and
place it on my account, and you will oblige your humble servant ...’.

The BEA does not prescribe a particular form of wording. The parties can
choose their own words, which may also be courteous, provided that the
phrasing constitutes an order and is not merely the granting of permission or
authority or the making of a request.

2.2 Unconditional

The order to pay must be unconditional. The order to the drawee must not
be made dependent upon the fulfilment of some condition. If the order were
couched in the following terms: ‘Pay to John Smith provided the receipt
form at the back hereof is duly signed’, then the order to pay would be
conditional and the document would not be a bill. A cheque bearing at the
bottom the words ‘The receipt at the back hereof must be signed’ is
unconditional because the instruction to sign is addressed to the payee and
does not form part of the order to pay addressed to the drawee.

Section 2(3) of the BEA specifies certain special orders which may be
incorporated into a bill and which will be regarded as unconditional. An
unqualified order to pay coupled with

- an indication of a particular fund out of which the drawee is to reimburse
  himself, or of a particular account which the drawee must debit with the
  amount; or
- a statement of the transaction giving rise to the bill; or
- a statement on the bill that is drawn against specified documents attached
  thereto for delivery on acceptance or on payment of the bill; or
- a statement on a bill that is drawn under or against a specified letter of
  credit or other similar authority, is unconditional.

However, an order to pay out of a particular fund is conditional.

It is understandable why the order to pay should be unconditional. The very
purpose of a bill is that it should be easily negotiable. This object would be
defeated if the order was conditional, for then payment would be uncertain
and very few people would be interested in taking such a bill.
2.3 In writing
The purpose of negotiability would not be achieved if writing were not a requirement because the right to claim is embodied in the written instrument and this right can be conveniently transferred by the transfer of the instrument.

The BEA does not define any form of writing but section 3 of the Interpretation Act 33 of 1957 provides that unless the contrary appears from any particular Act, writing shall include typing, lithography, photography and other methods which exist to represent words in visual form.

2.4 Addressed by one person to another
The order to pay is addressed by the drawer to the drawee. The drawee, that is, the person to whom the order to pay is addressed, must be named or otherwise indicated on the bill with reasonable certainty (s 4(1)).

A bill may be addressed to two or more drawees whether they are partners or not (A and B), but an order addressed to two drawees in the alternative (A or B), or to two or more drawees in succession (A, and if he does not pay then B), is not a bill of exchange (s 4(2)).

2.5 Signed by the person giving it
The general rule is that no person will be liable as drawer and equally as acceptor or endorser, if he has not signed the bill as such. Signature is an essential element of a bill. The person who must sign the bill is the drawer and as a rule his signature appears at the bottom right-hand side of the document. The signature of the drawer may be placed on a bill at any time, but until such time as the signature is placed, the bill is incomplete.

Signature can be by way of a cross or a mark. Furthermore, the authorised sealing with the corporate seal of a juristic person, or the authorised stamping with an official rubber stamp of a bank or company, is also deemed to be sufficient and equivalent to signature (s 95). It is unnecessary for the drawer to sign the bill with his own hand. It is sufficient if his signature is written on the bill by some other person, who is authorised to do so by the drawer (s 95).

The question of signatures will be discussed more fully in unit 5.

2.6 A sum certain in money
The order must be to pay a defined sum of money. The order may not require anything else other than the payment of money (s 2(2)), and the sum of money which is payable must be definite. If anything else must be done besides the payment of money (eg pay R100 and deliver ten bags of
mealies), or if the sum of money is not defined (e.g., pay R100 and all further amounts which may be owing on due date), the document will not be a bill.

The sum payable will still be certain although it is required to be paid

- with interest; or
- by stated instalments; or
- by stated instalments, with a stipulation in the bill that upon default in payment of any instalment, the whole debt becomes due; or
- according to a rate of exchange indicated, or to be calculated as directed, by the bill (s 7(1)).

The amount payable need not necessarily be expressed in South African currency, but it must be expressed in a recognised currency.

2.7 To pay on demand or at a fixed or determinable future time

The due date or time of payment of a bill may be either on demand, or at a fixed future time, or at a determinable future time.

2.7.1 On demand

According to section 8 of the BEA, a bill is payable on demand in the following instances:

- if it is expressed to be payable on demand, at sight, or on presentation;
- if no time for payment is stated

If a bill is not payable on demand, it must be payable either on a fixed future time or at a determinable future time.

2.7.2 At a fixed future time

The due date is simply named, for example ‘‘payable on 13 January 2010’’.

2.7.3 At a determinable future time

There are four further methods of fixing the due date of a bill, and in all these cases the bill will be payable at a determinable future time.

- A fixed time after date

The bill, for example, can be made payable six months after date (s 9(1)(a)). The bill is now payable at a future time which is determinable. The term ‘‘date’’ means the date on which the bill was drawn and which appears on the bill. If the bill is not dated, then the date of issue is the date of the bill. Section 10 of the BEA provides that any holder may insert the true date of issue.

- A fixed time after sight

The bill may, for example, be made payable three months after sight
Unit 3: Bills of exchange

(s 9(1)(a)). The expression "after sight" strictly speaking means "after acceptance of the bill", but the possibility naturally exists that acceptance will be refused. The period of three months will therefore be calculated from the date of acceptance, if the acceptance is dated (s 12(d)), or from the date of completion of acceptance, where the acceptance is not dated (s 10), or from the date of noting or protest, where the bill is dishonoured by non-acceptance (s 12(d)).

- On the happening of a specified event which is certain to happen
  The bill may, for example, be payable on the occurrence of a specified event which is certain to happen, such as "bill is payable after A's death" (s 9(1)(b)).

- At a fixed period after the happening of a specified event which is certain to happen
  The bill may, for example, be payable three months after A's death (s 9(1)(b)).

The main difference between the two cases above is that in the former case, the bill is payable when the specified event occurs. In the latter case, the bill is payable only once the specified period after a certain event has lapsed.

The determination of the due date is important for the following reasons:

- The due date is important in determining the time of payment. Section 43(2)(a) and (b) of the BEA provides that a bill should be presented for payment on its due date, except when it is payable on demand.
- Payment in due course of a bill can only take place on or after due date.
- Because a bill is only discharged after payment in due course, the due date is also of importance in regard to the discharge of the bill.
- The due date is also important in determining when the bill should be presented for acceptance. This must be before the due date of the bill has expired (s 39(1)(a)). Section 16(1)(b), however, provides that a bill may also be accepted after due date.
- A holder can only be a holder in due course if he receives the bill before the expiry of the due date (s 27(1)(a)).
- A bill may be negotiated after expiry of the due date, but then the new holder takes it subject to defects (if any) attaching to the title of his predecessor on the due date (s 34(2)).

2.8 To a specified person or his order or to bearer

The order to pay must indicate to whom payment must be made.

2.8.1 Payee or payee's order

If a bill is not payable to bearer, it must always be payable to a specified person or his order. The person to benefit, that is the payee, must be named in the bill, or he must be indicated in such a manner that his identity can be determined with reasonable certainty from the document
itself (s 5(1)). The payee may even be indicated by the office which he
holds, for example ‘‘The Registrar of Companies, Pretoria’’ (s 5(2)(c)). A
bill can also be made payable to two or more payees jointly, or to two or
more payees in the alternative (s 5(2)(a) and (b)).

If the bill is payable to a specified person (as payee), and does not contain
any indication that the transfer of the bill is forbidden, then the bill is
payable to that person or his order (s 6(3)). It may also be expressly
provided in the bill, as is usually the case, that the bill is payable to a certain
person or his order, or to the order of a certain person (s 6(4)). Thus the
result would be the same whether the bill were made payable ‘‘to C’’, ‘‘to C
or order’’ or ‘‘to the order of C’’.

Section 6(2) of the BEA states that where a bill is payable to the order of
‘‘cash’’ or to ‘‘cash or order’’, the bill is payable to bearer. However, an
instrument payable to ‘‘cash’’, without reference to the word order, will not
be a bill or note (see below for the effect of the words ‘‘cash or bearer’’).

If a bill has been made payable to an estate or to a trust, it is also not
payable to a person, since neither an estate nor a trust is a juristic person.
However, it has been argued that such an instrument should be interpreted
as being payable to the executor(s) of the estate or the trustee(s) of the trust.

The question now arises whether a bill can be made payable to a partnership
or its order, since a partnership is likewise not a juristic person. Section 2 of
the Interpretation Act 33 of 1957 is applicable in this regard: this section
provides that a ‘‘person’’ shall also include any body of persons, whether or
unincorporated. According to this definition then, an instrument made
payable to a partnership or its order would comply with the definition of a
bill of exchange. In any event, it could be argued that a bill payable to a
partnership should be deemed payable to the partners, a similar case to that
of a bill payable to an estate or a trust.

2.8.2 Bearer
A bill is payable to bearer if

- it is stated to be so payable (eg ‘‘bearer’’, ‘‘cash or bearer,’’ ‘‘C or
  bearer’’);
- the only or last endorsement on it is an endorsement in blank, or
- it is stated to be payable to the order of ‘‘cash’’ or to ‘‘cash or order’’
  (s 6(2)).

In addition, if the payee is a fictitious or non-existing person, or a person
not having the capacity to contract, the bill may be treated as payable to
bearer (s 5(3)).

Activity 1

Look at the example below and answer the question which follows.

Rudolph Nengome draws a cheque for ten thousand rand on B Bank in favour of
Michelle Kelly or order on 31 December 2009. He takes special care to ensure that this cheque is payable to order. Insert the essential elements which are missing.

<table>
<thead>
<tr>
<th>Registered bank</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay:</td>
<td>or bearer</td>
</tr>
<tr>
<td>the sum of</td>
<td></td>
</tr>
<tr>
<td>Signed:</td>
<td></td>
</tr>
</tbody>
</table>

3 THE NON-ESSENTIAL AND OTHER ADDITIONAL ELEMENTS OF A BILL

There are certain non-essential elements of bills, the omission, of which will not affect the validity of the bill.

3.1 Date

A bill does not need to be dated (s 2(4)(a)). It is, however, the practice that the date should be inserted. A bill is likewise not invalid merely because it is antedated, or postdated, or because it bears the date of a non-business day (s 11(2)). Where a bill, or an acceptance, or an endorsement on a bill is dated, the date shall, unless the contrary is proved, be deemed to be the true date of the drawing, acceptance or endorsement, as the case may be (s 11(1)).

If the bill does not mention the date on which it was drawn, and if the date is indeed necessary, for example, to calculate interest or to determine the due date, then the date of issue of the bill is regarded as the date of the bill. Thus section 7(3) of the BEA provides that interest will run from the date of issue of a bill where the bill is undated and payable with interest.

3.2 Place of drawing or payment

A bill is not invalid because it does not specify the place where it is drawn, or the place where it is payable (s 2(4)(c)). The place where the bill was drawn and the place of payment may be important if a bill drawn in one country, is negotiated or accepted or payable in another country. Section 70 of the BEA determines the rights, duties and liabilities of the parties to such an instrument. If the place of drawing is not indicated on the instrument, extrinsic evidence to show where it was drawn, is admissible.
3.3 Amount

The BEA does not require that the amount payable be expressed both in words and figures, but the general practice is to do so. If there is a difference between the two, the sum in words is the amount payable (s 7(2)). However, in the case of cheques, banks will refuse to pay in accordance with bank usage.

3.4 Stamp duty

Stamping is not required by the BEA for the validity of a bill, and a person may be a holder in due course of a bill which is not stamped. Section 100 provides, however, that nothing in the BEA shall affect or in any way restrict the provisions of the laws relating to stamps or revenue. Particulars relating to stamps which are required to be affixed to bills are found in the Stamp Duties Act 77 of 1968 as amended from time to time.

3.5 Sans recours (exclusion of liability)

The drawer and any endorser of a bill, may insert into the bill an express stipulation limiting his own liability to the holder (s 14(1)(a)). The form usually employed makes use of the words "sans recours" or "without recourse" (eg ‘Pay X or order without recourse to me’). The effect is that in such a case the drawer or endorser cannot be held liable at all if the instrument is dishonoured.

The exclusion or limitation of liability by the acceptor is not provided for by the BEA: where the acceptor limits his liability, his acceptance is qualified and the rules concerning qualified acceptance apply (s 17). If the acceptor purports to accept, but at the same time excludes liability completely, then he dishonours the bill (this aspect of the work is discussed in greater detail in unit 8).

3.6 Waiver

The drawer and any endorser of a bill, may insert an express stipulation in the bill waiving as regards himself some or all of the holder’s duties (s 14(b)).

Activity 2

Look at the example below and answer the question which follows.

Rudolph Nengome draws a bill in Pretoria for ten thousand rand on B Ltd in favour of Michelle Kelly or order on 31 December 2009. The bill is payable three months after issue at 109 Adderley Street Cape Town. The drawer waives the duty of the holder to give notice of dishonour. The bill has not been accepted yet. Draw this bill and indicate what the non-essential elements are.
Activity 3

With reference to the example below identify the eight essential elements that a bill has to possess in terms of the BEA as well as all the non-essential elements.

R250 000,00

Draft No: TB 1456
Invoice number: 9854

To: R Nengome and Sons

On 30 August 2009, pay ABC Company (Pty) Ltd

the sum of two hundred and fifty thousand rand

Accepted, payable at
R. Nengome & Sons
109 Adderley Street
Cape Town

(signed): Alvereen Leonard

Rudolph Nengome (signature) Alvereen Leonard

pp R. Nengome and Sons Sans recours

Summary activity

Look at the example below and answer the question which follows.

R10 000,00

To: Eesa Fredericks or Mpheane Lepaku
109 Adderley Street
Cape Town

Without recourse to me, pay on demand to Michelle Kelly or Alvereen Leonard the sum of ten thousand rand only with interest at 15 percent per annum.

signed: Rudolph Nengome

Rudolph Nengome

signed: Eesa Fredericks

Is this a valid bill?
Feedback 1

B Bank
Registered bank

2009

Pay: Michelle Kelly or order

the sum of ten thousand rand only

Signed: Rudolph Nengome

The drawer, Rudolph Nengome, must have signed the cheque and ordered the drawee bank, which is B Bank, to pay. The person who is entitled to payment is Michelle Kelly or her order. Remember, you have to strike out the words “or bearer.” If you don’t, this cheque will still be payable to bearer. The amount may be written either in words or in numerals.

Feedback 2

Pretoria ← place where bill is drawn
31 December 2009 ← date when bill is drawn

To: B Ltd
109 Adderley Street ← place where bill must be presented for payment
Cape Town

Pay three months after date to Michelle Kelly the sum of ten thousand rand only ← amount in words and numbers → R10 000,00
Notice of dishonour is waived ← waiver

Signed: Rudolph Nengome

Note: This bill has not been accepted as yet. No one has, as yet, signed on behalf of the drawee, B Ltd.
**Feedback**

| R250 000,00 ← the amount in words and numbers |
| Draft No: TB 1456 ← number of the bill |
| Johannesburg ← place where the bill is drawn |
| Invoice number: 9854 ← invoice number |
| 1 January 2009 ← date on which the bill is drawn |

This bill is an unconditional order in writing because the instruction in writing is to “Pay”.

The bill is addressed by Alvereen Leonard (the drawer) to R Nengome and Sons (the drawee).

The bill is signed by Alvereen Leonard.

R Nengome and Sons (the drawee, who when he signs it, becomes the acceptor) is required to pay on 30 August 2009 the sum of R250 000 to ABC Company (Pty) Ltd.

The non-essential elements were

- the sum of money does not have to be written in both words and figures — either would have sufficed
- the draft number of the bill
- the invoice number
- the date and place where the bill is drawn
- sans recours (limitation of liability by the drawer)

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**Feedback for summary activity**

No, this is not a valid bill of exchange.

In order for an instrument to qualify as a bill, it must contain a written unconditional order addressed by one person to another to pay a defined sum in money to a specified person, his order or bearer, on demand or at a fixed or determinable future time. The document must be signed by or on behalf of the person giving the order.
The drawer is Rudolph Nengome who signed the bill as such. He however included the words "without recourse to me" which has the effect that he cannot be held liable if the bill is dishonoured (s 14(1)).

The bill is payable to Michelle Kelly or Alvereen Leonard on demand. Although the payees are indicated in the alternative, this is permissible (s 5(2)(a)).

The amount payable is specified and although it is payable with interest, in terms of s 7(1)(a) of the BEA the sum is still certain.

The date here is important to determine the date from which interest is to be calculated as well as whether the bill was presented for payment within a reasonable time from the date of issue. Since the place of payment is indicated, the bill must be presented for payment at the given address.

The instruction to pay is addressed to the drawee Eesa Fredericks or Mpheane Lepaku in the alternative. This is not allowed (s 4(2)) and the bill is therefore invalid.
UNIT 4
ISSUE, NEGOTIATION, DELIVERY AND ENDORSEMENT

After studying this unit you should be able to

- know the definitions of and/or explain your understanding of the following concepts:
  - issue
  - negotiation
  - delivery
  - holder
  - transferor by delivery
  - endorsement
  - endorsement in blank
  - special endorsement
  - restrictive endorsement
  - conditional endorsement

- distinguish between negotiation of bills payable to bearer and those payable to order based on facts presented in a scenario
- apply the principles relating to the concepts of endorsement, delivery and negotiation to given factual scenarios
- apply the principles relating to renegotiation and the negotiation of dishonoured or overdue bills to the factual scenarios provided

There is no prescribed reading for this unit.
1 INTRODUCTION

Before a person can be liable on an instrument, with the exception of a transferor by delivery, he must have signed the instrument and, except in the case of acceptance, delivery of the instrument must have taken place (ss 21 and 19(1)). A drawer and a maker are bound through issue, an endorser through endorsement and an acceptor through acceptance.

2 ISSUE

“Issue” is defined as “the first delivery of a bill or note, complete in form, to a person who takes it as holder” (s 1). The elements of issue are therefore:

— first delivery
— completeness in form
— to a holder

There can therefore be no issue of an inchoate (incomplete) bill, and the person who takes the bill must take it as holder. It is important that you know the circumstances in which a person is regarded as holder.

3 NEGOTIATION

The payee or bearer to whom a bill has been issued, if he so desires, can negotiate the bill, unless the document contains words which prohibit transfer or indicate an intention that it should not be transferable (s 6(5)). If the bill is marked “not transferable”, or “non-transferable” and/or if the bill stipulates that it is payable to a particular payee alone (“pay C only”), or if it is restrictively endorsed (“pay D only”), then it may not be negotiated further (ss 6(5) and 75A).

It may also be mentioned that a crossed cheque marked “not negotiable” may indeed be negotiated in the sense that it may be transferred to a person who can take it as holder but the consequences stipulated in sections 80 and 81 of the BEA will follow (these two sections will be discussed in detail in unit 13). If the words “not negotiable” appear on an uncrossed cheque payable to a specific person, the cheque is probably not negotiable at all. There is no logical reason for this — it is a historical accident. Even lawyers sometimes find it difficult to understand, but it is just one of those funny rules of negotiable instruments.

Apart from these exceptional cases just mentioned, the holder of a bill, cheque or note may transfer it freely to another person. If this transfer is made in accordance with the provisions of the Act, the document is said to have been negotiated.

The provisions of the Act relating to negotiation are to be found, in the first instance, in section 29. In terms of this definition it is clear that a person to
whom a bill is negotiated must become the holder as a result of such negotiation. However, this still does not mean that a person to whom a bill is negotiated necessarily becomes a holder in due course. There are several instances where the Act recognises a negotiation as such but without the transferee becoming a holder in due course. This is the case, for example,

- where a crossed cheque which bears the words “not negotiable” is negotiated (see unit 13)
- where a bill is negotiated after the due date (s 34(2))
- where a dishonoured bill is negotiated to a person who is aware of the dishonour (s 34(5))

3.1 Negotiation of a bearer instrument

Section 29(2) of the BEA provides that a bearer instrument is negotiated by mere delivery.

3.2 Negotiation of an order instrument

Section 29(3) of the BEA provides that an order instrument is negotiated by the endorsement of the holder completed by delivery.

Allen makes a promissory note in favour of Ben or order. Ben as the payee in possession of the note, is the holder thereof (see definition of holder in s 1). If Ben wishes to negotiate the note to Christo, Ben is required in terms of section 29(3) of the BEA to endorse the note as holder and thereafter to deliver it.

(a) Ben may endorse the note in blank, that is simply place his signature on the back of the note, and it then becomes an instrument payable to bearer (s 6(2)). If Ben, after endorsing the note in blank, delivers it to Christo, Christo as possessor of an instrument payable to bearer will be the bearer and thus the holder thereof.

(b) Ben may also endorse to Christo specially (this is known as a special endorsement). In this case Ben writes above his signature on the back of the instrument “Pay Christo or order” (s 6(3)). If after the special endorsement Ben delivers the note to Christo, Christo will become an endorsee in possession, and as such, holder of the note (see again the definition of holder in s 1). This negotiation satisfies the requirements of section 29(3) of the BEA, and the transfer has furthermore taken place in such a manner as to constitute Christo (the transferee) the holder, as required for a negotiation in terms of section 29(1) of the BEA.
The following diagram provides a summary of the requirements for negotiation of order and bearer instruments.

![Diagram of negotiation process]

**Activity 1**
Can a payee become a holder in due course of an order bill after the drawer has delivered the bill to him? Explain your answer fully.

**Activity 2**
With reference to the following scenario, answer the question given.
A draws a bearer cheque on B Bank and delivers it to C. How can C negotiate the cheque to D?

4 DELIVERY

A contract on a negotiable instrument is incomplete and revocable before delivery of the instrument. Section 1 of the BEA defines delivery as the “actual or constructive transfer of possession from one person to another”.

4.1 Functions of delivery

Delivery is mentioned in numerous sections of the BEA and it is clear from these sections that delivery may fulfil different functions in different
circumstances. The different functions that delivery may fulfil are the following:

4.1.1 Negotiation

Delivery is required to **complete the negotiation** of an instrument payable to order (s 29(3)). As we have seen, the holder’s endorsement is required for the negotiation of an instrument payable to order, and the endorsement is completed by delivery.

**What happens if the payee or endorser forgets to endorse the order bill before delivering it?**

If an instrument payable to order is delivered without an endorsement by the holder, negotiation (as laid down in s 29(3)) does not take place and the transferee cannot be its holder. This shows that the use of the wrong method will not bring about a negotiation.

However, delivery of an instrument payable to order without endorsement gives the transferee such title as the transferor had in the bill, and the transferee in addition acquires the right to have the bill endorsed by the transferor (s 29(4)). The transferee does not become the holder as a result of such a transfer, because it merely confers on the transferee possession of a bill payable to order without the transferee being either the payee or endorsee of such a bill.

Our courts have also held that, apart from the provisions of s 29(4) of the BEA, the holder of an instrument payable to order may transfer his rights in the bill by means of an ordinary **cession**.

Allen draws a bill in favour of Ben or order. Ben delivers the bill to Christo but fails to endorse it.

In such a case, Christo (the cessionary) cannot acquire more rights than Ben (the cedent) had. However, Christo acquires Ben’s rights in full. So, Christo (the cessionary) acquires all the rights of a holder in due course if Ben (the cedent) was a holder in due course. However, as Christo’s rights are not apparent from the face of the instrument, Christo will be unable to obtain provisional sentence on it. Notice of the cession to the debtor must be given, because if, in ignorance of the cession, the debtor pays the cedent, he cannot be compelled to pay again to the cessionary.

This illustrates the main difference between negotiation and cession. The person to whom the instrument is negotiated may acquire a better right than that of his predecessor (depending on the circumstances), while in the case of a cession the cessionary can never acquire a better title than that of the cedent.

In the case of an instrument payable to **bearer**, delivery fulfils the function of **transfer**, which is necessary for the negotiation of such an instrument. In terms of section 29(2) of the BEA, an instrument payable to bearer is
negotiated by mere delivery without endorsement. In this instance, delivery
is equivalent to negotiation.

4.1.2 Formation of a contract

Another function of delivery is that it is required for the formation of a
contract on a bill. As we have seen, before a drawer, acceptor or endorser
can be liable on a bill (or the maker or endorser liable on a note), there
are two requirements to be met: the party concerned must place his signature
on the bill or note (s 21) and that party must also deliver the instrument
(s 19(1)).

Section 19(1) of the BEA provides: ‘‘No contract on a bill, whether it be the
drawer’s, the acceptor’s or an endorser’s, shall be complete and irrevocable,
until delivery of the instrument in order to give effect thereto ...’’. Until
such time as delivery of the instrument has taken place, there is no binding
contract on the instrument and the signature may still be revoked and
cancelled. The legal transaction is complete only at the moment of delivery.
Thus, for example, the drawer or endorser must sign and deliver the bill
before he can be liable on it (see s 1).

Suppose Allen draws a bill on Ben in favour of Christo or order, but Allen
dies before delivery to Christo. If Christo were now to find the bill on
Allen’s desk, he would have no claim on the bill against Allen’s estate, on
the grounds that the contract on the instrument was not completed because
delivery to Christo did not take place.

Acceptance constitutes an exception. In terms of s 19(1) of the BEA, the
acceptor will be liable if his acceptance is confirmed by notice instead of
delivery. This also explains s 1 of the BEA where it states: ‘‘Acceptance
means an acceptance completed by delivery or notification’’.
Notification is thus an alternative means to complete the contract of
acceptance.

4.2 Other aspects of delivery

There are certain other aspects of delivery, which we shall touch on briefly:

If a bill is no longer in the possession of a party who signed it as a drawer,
acceptor or endorser, a valid and unconditional delivery by the relevant
party is presumed until the contrary is proved (s 19(4)).

As soon as the bill comes into the hands of a holder in due course,
however, there is an irrebuttable presumption that there has been a valid
delivery of the bill by all parties prior to the holder in due course (s 19(3)).

Delivery must be effected by the drawer, acceptor or endorser himself, or by
or under his authority (s 19(2)(a)).
4.3 Mode of delivery

A debtor may choose how he is going to effect delivery of an instrument. Where the post is chosen as the mode of delivery, the risk of loss is on the sender. However, if the addressee has requested that the instrument be posted or the parties have agreed that the instrument be posted (and if certain requirements implied in delivery of an instrument by post have been met), the risk as well as ownership passes to the addressee immediately when the instrument is posted.

Activity 3

With reference to the example, answer the question which follows.

A draws a bearer cheque on B Bank. A locks the cheque in her drawer. X steals the cheque, but A discovers this and stops payment of the cheque at the B Bank. X presents the cheque for payment but the bank refuses to pay and X now sues A. Will X succeed in this claim?

5 ENDORSEMENT

As we have already seen, the negotiation of an instrument payable to bearer takes place by mere delivery of the instrument, whereas the negotiation of an instrument payable to order takes place by endorsement by the holder, completed by delivery. In the case of an instrument payable to order, the holder’s endorsement is therefore a prerequisite for negotiation.

5.1 What is an endorsement?

An endorsement is defined in section 1 of the BEA as “an endorsement completed by delivery”, but this does not tell us what an endorsement is. Section 30 of the BEA likewise gives no definition of endorsement but it does stipulate at length what requirements an endorsement must meet before it will be a valid endorsement which will bring about a negotiation. The most important requirements are mentioned here briefly:

The endorsement must be written on the instrument itself, or it may be written on a slip of paper appended to the instrument, termed an allonge. This is a French word for a paper attached to a negotiable instrument to enable the writing of endorsements when the back of the bill is full. It must be signed by the endorser and the endorsement must be of the entire instrument (s 30(1)).

The mere signature of the endorser on the bill, without additional words, is sufficient to constitute an endorsement (s 30(2)).

Where the bill is payable to the order of two or more persons who are not
partners, all must endorse the bill, unless the one endorsing has authority to endorse for the others (s 30(4)).

If the payee’s or endorsee’s name is misspelt or if the payee or endorsee is wrongly designated, that party may endorse as so wrongly described, adding his proper signature if he thinks fit (s 30(5)).

In terms of the BEA, therefore, an endorsement consists of a signature, with or without additional words, and it is completed by delivery of the instrument.

5.2 Types of endorsements

The BEA recognises different types of endorsements. According to section 30(7) of the BEA, an endorsement may be made in blank or special, or it may be restrictive.

5.2.1 Endorsement in blank

This type of endorsement does not specify any endorsee to whom payment must be made and the result is that the instrument becomes payable to bearer (s 31(1)).

The front of the note:

<table>
<thead>
<tr>
<th>R 1 000,00</th>
<th>Cape Town</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30 September 2009</td>
</tr>
</tbody>
</table>

I promise to pay Ben or order the sum of one thousand rand on 31 December 2009, for value received.

Signed: Allen

The back of the note:

Ben

Section 31(4) of the BEA contains an important provision regarding the changing of an endorsement in blank into a special endorsement. This may be done by any holder writing above the endorsement in blank a direction to pay the bill to, himself or to his order or to some other person. In other words, an endorsee is now named. As soon as this occurs we no longer have an endorsement in blank, and the instrument payable to bearer is converted into one payable to order (s 6(2). Also see the section dealing with Negotiation above.)

The front of the note:
5.2.2 Special endorsement

This type of endorsement consists of the name of the person to whom, or to whose order, payment must be made, followed by the endorser’s signature, for example ‘Pay Christo or order, (signed) Ben’. In this case Ben is the endorser and Christo the endorsee.

Thus, a special endorsement specifies the person to whom, or to whose order, the bill is to be payable (s 31(2)).

A special endorsement has the effect that the instrument becomes or remains payable to order, as will appear from the following example:

Allen makes a note in favour of Ben or order. Ben endorses the note in blank and delivers it to Christo, who in turn endorses it specially to Daniel and delivers it to him. This promissory note was originally payable to order but thereafter, as a result of Ben’s endorsement in blank, it becomes payable
to bearer; now Christo’s special endorsement has the effect that Daniel, as endorsee, is the holder of an instrument payable to order once more.

The front of the note:

<table>
<thead>
<tr>
<th>R 1 000,00</th>
<th>Cape Town</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30 September 2009</td>
</tr>
</tbody>
</table>

I promise to pay Ben or order the sum of one thousand rand on 31 December 2009, for value received.

Signed: Allen

The back of the note:

Ben ← endorsement in blank

Pay Daniel or order

Christo ← special endorsement

The BEA makes provision for the conversion of an order bill into a bearer bill (s 31(1)) and the conversion of an endorsement in blank into a special endorsement (s 30(4)) but it does not provide for the conversion of a bill originally payable to bearer into one payable to order. **If an instrument is originally payable to bearer, it cannot be converted to one payable to order by a special endorsement. If the holder specially endorses a bearer document, the instrument remains payable to bearer despite such endorsement.**

5.2.3 Restrictive endorsement

Apart from endorsements in blank and special endorsements, the BEA also provides for restrictive endorsements (ss 30(7) and 32). **Restrictive endorsements are those endorsements which affect the negotiability of a bill or note.** There are two types of restrictive endorsements:

- One that prohibits negotiation or transfer altogether
- One that gives the endorsee the right to deal with the instrument as indicated

A restrictive endorsement may **altogether prohibit further negotiation or transfer** of the instrument (s 32(1)).

Suppose Allen draws a bill on Ben in favour of Christo or order and Christo negotiates the bill to Daniel under the following endorsement: ‘Pay Daniel only, (signed) Christo’. In this instance it is Christo’s intention to transfer ownership of the bill to Daniel, but at the same time Christo prevents Daniel from negotiating or transferring the bill further. Daniel acquires full rights
to the instrument, subject to him not being able to negotiate the instrument further. In other words, no one may become holder of the bill after Daniel.

The front of the bill:

<table>
<thead>
<tr>
<th>R 1 000,00</th>
<th>Cape Town 30 September 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>To:</td>
<td>Ben</td>
</tr>
<tr>
<td></td>
<td>150 Adderley Street</td>
</tr>
<tr>
<td></td>
<td>Cape Town</td>
</tr>
<tr>
<td></td>
<td>Pay Christo or order the sum of one thousand rand on 31 December 2009, for value received.</td>
</tr>
<tr>
<td></td>
<td>Signed: Allen</td>
</tr>
</tbody>
</table>

The back of the bill:

Pay Daniel only

Christo

A restrictive endorsement may give the endorsee the right to deal with the instrument as indicated in the endorsement, without ownership of the instrument passing to the endorsee (s 32(1)).

Suppose Allen draws a bill on Ben in favour of Christo or order. Christo may endorse the bill as follows:

“Pay Daniel for the account of Xavier”

“Pay Daniel or order for collection”

The front of the bill:

<table>
<thead>
<tr>
<th>R 1 000,00</th>
<th>Cape Town 30 September 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>To:</td>
<td>Ben</td>
</tr>
<tr>
<td></td>
<td>150 Adderley Street</td>
</tr>
<tr>
<td></td>
<td>Cape Town</td>
</tr>
<tr>
<td></td>
<td>Pay Christo or order the sum of one thousand rand on 31 December 2009, for value received.</td>
</tr>
<tr>
<td></td>
<td>Signed: Allen</td>
</tr>
</tbody>
</table>
The back of the bill:

Pay Daniel for the account of Xavier Christo
or
Pay Daniel or order for collection Christo

What is Daniel’s position as endorsee under these types of restrictive endorsement: May Daniel collect the bill, and may Daniel negotiate the bill further?

A restrictive endorsement gives the endorsee the right to receive payment of the bill, and to sue any party thereto that his endorser could have sued, but gives him no power to transfer his rights as endorsee, unless it expressly authorises him to do so (s 32(2)). In other words, Daniel may collect the bill but he may not negotiate it further (as seen from example (1)) unless the restrictive endorsement expressly authorises him to do so. Only in example (2) above is Daniel authorised to negotiate the bill further because the words ‘or order’ are added.

Suppose the restrictive endorsement authorises Daniel to negotiate the bill further, for example ‘Pay Daniel or order for collection’ and suppose Daniel negotiates the bill to Ethan. What will Ethan’s rights be? Section 32(3) of the BEA supplies the answer to this question. Ethan will take the bill with the same rights, and subject to the same liabilities, as Daniel had. From this it follows that Ethan could only become a holder, and never a holder in due course, of such a bill.

The BEA talks of a restrictive endorsement in the sense of an endorsement which restricts the negotiability of the instrument, and not in the sense of an endorsement which limits the liability of the endorser. Although the addition of words such as ‘without recourse’ has a restrictive effect on an endorsement in the sense that it limits the endorser’s liability, this does not mean to say that it is a restrictive endorsement in terms of the BEA.

5.2.4 Conditional endorsement

Where an endorser purports to conditionally endorse an instrument, section 33 of the BEA provides that the payer may disregard the condition and that the payment to the endorsee will be valid whether the condition is fulfilled or not. A person who takes such an instrument would probably not qualify as a holder in due course, since the insertion of the condition may be taken as notice of a possible defence against a holder’s claim.
5.3 The functions of endorsements

An endorsement of an instrument payable to order performs the **transfer function** (s 29(3)). The endorsement of an instrument payable to order, completed by delivery, brings about a negotiation of the instrument.

An endorsement also fulfils a **guarantee function**. As soon as an endorser endorses a negotiable instrument, the endorser makes certain guarantees to the new transferee and his successors. Among other things, the endorser guarantees that he will pay if the bill is dishonoured after proper presentment and provided that the prescribed procedure on dishonour is followed thereafter (s 53(2)(a)). The endorser’s contract on the bill and the obligations it imposes on him will be discussed in unit 8.

As a rule an endorsement fulfils both the abovementioned functions simultaneously, but this is not necessarily always the case, as will appear from the following examples:

- A draws a bill on B in favour of C or order. C endorses the bill and adds the words “without recourse” to his endorsement (s 14(a)). The addition of these words has the effect of doing away with the guarantee function of the endorsement, and the endorsement only fulfils a transfer function.
- A makes a note in favour of B or order. B is a minor who endorses the note without the consent of his guardian and delivers it to C. Although B’s endorsement serves a transfer function, it does not fulfil any guarantee function. Section 20(2) of the BEA provides that a minor who signs as drawer or as endorser without consent is not liable on the instrument. His signature, however, still serves as a channel through which rights are transferred to his successors (see unit 5).
- A draws a cheque on B Bank in favour of C or order. C endorses the cheque in blank and delivers it to D. D is now in possession of a bearer cheque which he can negotiate by mere delivery without endorsing it first. If D does endorse the cheque, his endorsement does not fulfil any transfer function because the endorsement is in no way necessary for the negotiation. His endorsement is not meaningless. It fulfils a guarantee function, and D can be held liable on the instrument.

5.4 Further provisions with regard to endorsements

The BEA contains various other provisions regarding endorsements and some of these may briefly be mentioned here:

If there are two or more endorsements on a bill, a rebuttable presumption exists that the endorsements were made in the order in which they appear on the instrument (s 30(6)).

Where any person is under an obligation to endorse a bill in a representative capacity, he may endorse the bill in such terms as to negate personal liability, for example “C, executrix testamentary of B”. (See in this connection ss 29(5) and 24(1)).
Activity 4

Identify the different types of endorsement used in the following examples:

(1) Pay Michelle Kelly only
    (signed) Allie Leonard

(2) (signed) Allie Leonard

(3) Pay Michelle Kelly for the account of Rudolph Nengome
    (signed) Allie Leonard

(4) Pay Michelle Kelly on completion of her building contract with Allie Leonard
    (signed) Allie Leonard

(5) Pay Michelle Kelly
    sans recours (signed) Allie Leonard

(6) Pay Michelle Kelly or order for collection
    (signed) Allie Leonard

Activity 5

With reference to the following scenario, answer the question given.

A draws a bill on B in favour of C or order. C endorses the bill in blank and delivers it to D. How can D convert this bill into an order bill?

6 Negotiation back to drawer, prior endorser or acceptor, and negotiation of dishonoured and overdue bills

A negotiable instrument which is initially negotiable remains negotiable until it has been restrictively endorsed or until it is discharged (s 34(1)). The fact that a bill has been dishonoured or that its due date has already expired does not mean that it may not still be negotiated.

6.1 Negotiation back to drawer, prior endorser or acceptor

The BEA recognises the possibility of a negotiable instrument being negotiated back to the drawer, to a prior endorser and even to the acceptor or maker in the case of a promissory note. Such person may then reissue and further negotiate the bill or note as long as the instrument remains negotiable, that is, provided it has not been discharged or restrictively endorsed (s 35).

Suppose A draws a bill on B in favour of C or order and C negotiates the bill under special endorsement to D. D in turn endorses under special endorsement to E. E can now negotiate the bill back to A. This cannot happen, however, if D has endorsed restrictively, for example ‘Pay E only (signed) D’. Section 35 provides further that A is not entitled to enforce payment of the bill against any intervening party to whom he (A) was previously liable. In other words, A, to whom the bill was negotiated back,
may not later enforce payment against C, D or E as endorsers, because A was formerly liable to them as drawer.

The possibility of reissue of a bill or note exists not only where the instrument is negotiated back to a prior party, but also where the instrument has been paid by a prior party. In this case, however, there are certain limitations. If, for example, drawer A in the above example had paid the bill, he could not reissue the bill (s 57(3)). If, however, the bill was originally payable to the drawer's order, he may, after paying the bill, delete his own and subsequent endorsements and renegotiate the bill (s 57(4)). An endorser who pays a bill also has this right (s 57(4)).

6.2 Negotiation of an overdue bill

An overdue bill may still be negotiated, that is it may still be transferred from one person to another so as to make the transferee the holder (s 34(2)). No person, however, can acquire more rights in respect of the instrument than those which the holder had at the time of its maturity, that is, no person may become holder in due course of such a bill after its due date (ss 34(2) and 27(1)(a) of the BEA, which provide that a holder in due course must have become holder of the bill before it was overdue).

A bill with a fixed due date becomes overdue after expiry of such due date. A bill payable on demand becomes overdue when it appears on the face of it to have been in circulation for an unreasonable length of time (ss 34(3), 43(2)(b) and (3)).

A cheque is always payable on demand. Section 72 of the BEA contains specific provisions relating to overdue cheques.

A promissory note payable on demand does not become overdue in the same circumstances (s 90(3)). The reason why an exception is made in the case of promissory notes is that notes are often given as security for debts and are held for long periods.

6.3 Negotiation of a dishonoured bill

A bill may be dishonoured by non-acceptance or by non-payment, and in both cases the bill may still be negotiated. Under certain circumstances, the transferee can even become a holder in due course (s 34(5)). If the bill is not yet overdue, a person who takes it unaware of the dishonour can be a holder in due course (ss 27(1)(a) and 34(5)).

However, if the bill is overdue the transferee cannot become holder in due course, even if he has no knowledge of the dishonour (s 27(1)(a)). A person who takes a dishonoured bill while he is aware of the dishonour, takes it subject to any defect of title attaching thereto at the time of dishonour, even if the due date has not yet been reached (s 34(5)).
To take a dishonoured bill as holder in due course, the transferee must therefore
- be unaware of the dishonour
- take the bill before it is overdue

If the transferee does not comply with both of these requirements, he will merely be a holder. Even if a bill is dishonoured, and even if it is also overdue, it can still be negotiated and the transferee can become its holder even if he is aware of the fact that it is a dishonoured and overdue bill (ss 34(5), read with 34(1) and 34(2)).

Activity 6

With reference to the following scenario, answer the question given.
A draws a bill on B in favour of C or order, payable three months after date. C immediately presents the bill for acceptance, but B dishonours the bill by non-acceptance. C negotiates the bill to D. Can D be a holder in due course? Would your answer be different if B had been dishonoured by non-payment?

The front of the cheque:

| B Bank (Bellville Branch) | 31 December 2009 |
| Pay Michelle Kelly | or bearer |
| the sum of one thousand rand | R 10 000,00 |
| Marlize Jansen | Marlize Jansen |

The back of the cheque:

| (1) Pay Izelda van Jaarsveld | (2) I van Jaarsveld | (3) Pay Allie Leonard for the account of Mpheane Lepaku Eusa Fredericks |
| Michelle Kelly | Marlize Jansen | Marlize Jansen |
With reference to the cheque shown above, answer the following questions:

(1) Who is the drawer of this cheque?
(2) Who is the drawee of this cheque?
(3) Who is the acceptor of this cheque?
(4) Who is the payee of this cheque?
(5) Is this an order or a bearer cheque?
(6) Name two non-essential elements appearing on this cheque.
(7) Identify the endorsements marked (1), (2) and (3) on the back of the cheque. What is the consequence of each of these endorsements?
(8) With reference to endorsement number (1), who is the endorser and who is the endorsee?
(9) What is the consequence of the discrepancy between the amount stated in numbers and the amount in words.

Feedback 1

No, the payee of a bill payable to order cannot become a holder in due course of such a bill. One of the requirements of a holder in due course is that the bill must have been negotiated to the holder (s 27). The first delivery of a bill, complete in form, to a person who takes it as holder is merely its issue (s 1) and not negotiation (s 29).

Feedback 2

As possessor of the bearer cheque, C is the bearer and as such the holder. (Here again it must be emphasised how important it is that you should know the basic definitions thoroughly. Refer again to the definitions of “bearer” and “holder” in s 1.) If C wishes to negotiate the cheque to D, it is sufficient in terms of s 29(2) of the BEA if he delivers the cheque to D. On delivery of the cheque to D, D becomes possessor of the bearer cheque and in turn becomes bearer, and thus holder. If we now go back to the definition of negotiation in s 29(1), negotiation takes place when transfer from C to D occurs in such a manner as to constitute the transferee, D, the holder.

Feedback 3

Remember that this is a bearer cheque and anyone who is in possession of it is its bearer. X as bearer of the cheque is the holder as well, even if he is mala fide. A may however, raise against X’s claim the defence that the cheque was not duly delivered by A. However, A will have to prove that no due delivery took place, since there is a rebuttable presumption that due delivery has in fact taken place. If, however, X has negotiated the
cheque to a third party, who takes it as a holder in due course, A cannot raise the defence of non-delivery against that third party, since the presumption of due delivery in favour of a holder in due course is irrebuttable. A holder in due course is therefore fully protected.

Feedback 4

1. restrictive endorsement
2. endorsement in blank
3. restrictive endorsement
4. conditional endorsement
5. special endorsement negating liability
6. restrictive endorsement

Feedback 5

D is now the holder of a bill payable to bearer (s 6(2)). If D wishes to convert it into a bill payable to order, D can simply write D’s own name above the blank endorsement of C (eg “pay D”) and thus convert C’s endorsement in blank into a special endorsement. The result is that the bill becomes payable to D or order. D does not necessarily have to write D’s own name above C’s endorsement in blank. Suppose D wishes to negotiate the bearer bill as an order bill to E, but at the same time does not wish to incur any liability as endorser. D can now insert the words “Pay E or order” above the blank endorsement of C and then deliver the bill to E. The result will be that E, as endorsee, is in possession of an order bill, that is, E is the holder of such a bill.

Feedback 6

Yes, D may be a holder in due course if the bill was dishonoured by non-acceptance. If C negotiates the bill to D without delay it will still be some time before the due date arrives, and if D is unaware of the dishonour, there is nothing to prevent D from being a holder in due course.

No, D would not qualify as a holder in due course if the bill was dishonoured by non-payment, because a bill such as this with a fixed due date can only be presented for payment on the due date (s 43(2)(a)). D will therefore only be able to receive the dishonoured bill at the earliest on the due date, and even if he alleges that he was unaware of the dishonour, his bona fides will rightly be open to question because he should have asked himself why C did not herself present the bill for payment on that day.
Feedback for summary activity

(1) The drawer of this cheque is Marlize Jansen.
(2) The drawee of this cheque is B Bank.
(3) As cheques are usually not accepted, there is no acceptor in this case. Acceptance of the cheque is not required to create the liability to pay between the drawer and the drawee bank. The liability depends on the contractual relationship between the bank and the drawer, its customer.
(4) Michelle Kelly is the payee of this cheque.
(5) Originally this cheque is an order cheque because it is payable to a specified person, namely Michelle Kelly, and it did not contain words indicating an intention to prohibit transfer.
(6) The date, the branch of the bank at which this cheque is drawn, the amounts in words and numbers.
(7) ENDORSEMENT marked (1) — this is a special endorsement. The bill is payable to Izelde van Jaarsveld or her order.

ENDORSEMENT marked (2) — this is an endorsement in blank and the bill becomes payable to bearer.

ENDORSEMENT marked (3) — this is a restrictive endorsement. The endorsee has the right to receive payment on the bill and may sue any party that his endorser could have sued. The endorsee does not have any right to transfer her rights as endorsee.
(8) Michelle Kelly is the endorser and Izelde van Jaarsveld is the endorsee.
(9) Although the BEA does not require that the amount be stated in words and numbers, if a discrepancy exists, the amount in words will be seen as the amount payable. However, in terms of banking practice, this cheque will be returned to the drawer, unpaid.
UNIT 5
SIGNATURE

After studying this unit you should be able to

- identify and distinguish between different functions of a signature placed on an instrument in terms of the BEA
- explain what the legal consequences are if a forged or unauthorised signature is placed on an instrument
- apply the concept of holder by estoppel in terms of s 53(2)(b) of the BEA, based on facts presented in a scenario
- explain what the effect is if a minor draws or endorses an instrument without any assistance from his guardian in terms of the BEA

It is important that you study the principles of the cases as they are discussed in this unit.

1 INTRODUCTION

The study of negotiable instruments deals with, among other things, the liabilities and responsibilities of parties thereto. Section 21 of the BEA provides that no person will be liable as a drawer, acceptor (or maker) or endorser of an instrument unless he has signed it in that capacity. Therefore, in order for a person to be liable on an instrument, his signature has to appear on it. In the previous unit it was stated that before a person can be bound on an instrument, with the exception of a transferor by delivery, he must have signed the instrument and, except in the case of acceptance, delivery of the instrument must have taken place (see ss 21 and 19(1)). Thus, for a person to become liable as drawer or endorser of an instrument, it is not sufficient that he has signed the instrument; he must also deliver the
instrument, otherwise he incurs no liability on it and may still cancel his signature. Bearing these exceptions in mind, it can thus be said that there are two requirements to be satisfied before a party can become liable on a negotiable instrument, namely:

- he must **sign** the instrument either as drawer, endorser, or maker or in any other capacity, which indicates his willingness to incur liability on the instrument; and
- he must **deliver** the instrument to another person.

*Diagram indicating the requirements to be complied with before a party can become liable on an instrument*

This unit will focus on when and how parties become liable on an instrument. The different functions a signature can fulfil on an instrument and the effect a forged or unauthorised signature has on an instrument are also discussed.

### 2 WHAT IS A SIGNATURE?

Section 95 of the BEA provides that if any instrument or writing is required to be signed, it is not necessary that the person must sign it with his own hand, as it is sufficient if his signature is written or printed thereon by some other person, by or under his authority. The section further provides that the authorised sealing or stamping with a seal or stamp of a corporation will be sufficient and be deemed to be equivalent to the signing or endorsement of any such instrument or writing.

The Act contains a number of provisions relating to signature, but it does not define the term. We therefore have to resort to the common law in order to try to find the answer. In *Van Niekerk v Smit & Others* 1952 (3) SA 17 (T), the court used the following quotation from an English case:

“Signature does not necessarily mean writing a person’s Christian and surname but any mark which identifies it as the act of the party”.

The court also quoted as follows from an old Cape decision:

“To sign, as distinguished from writing one’s name in full, is to make such a mark as will represent the name of the person signing”.
Thus signature can be a sign or mark and does not necessarily have to be the signing of a name, that is, it is not necessary to write the initials and surname because initials alone may be sufficient, or even a cross or the imprint of a rubber stamp. In the light of the reference to rubber stamps, reference may be made to s 95 which reads as follows:

"... the authorized sealing or stamping with a seal or stamp of a corporation shall be sufficient and be deemed to be equivalent to the signing or indorsement of any such instrument or writing".

From the above it is clear that a person can sign personally, by means of a stamp, a cross or even a mark. However, it is not at all necessary that a person affix his signature to the instrument by his own hand. It is sufficient if a person’s signature is written or printed, for example by a computer, on the instrument by some other person, by or under his authority. The authorised sealing with the corporate seal of a corporation (juristic person), or the authorised stamping with an official rubber stamp of a bank or juristic person, is also deemed to be sufficient and equivalent to a signature. A corporation, as juristic person, must inevitably always make use of a natural person to bring about the corporation’s “signature” on the document.

3 FUNCTIONS OF A SIGNATURE

A signature on a bill may bring into being or constitute a bill, guarantee payment or effect the transfer of the bill. In certain circumstances a signature can fulfil more than one of these functions simultaneously, but in no circumstances can a signature perform all three at the same time.

3.1 Constitutive function

A signature — that is, the drawer’s or maker’s signature — is one of the essential elements of a bill, cheque or promissory note, and as such is necessary for the coming into being of the bill, cheque or note (see ss 2(1), 71 and 87(1)). In this regard the drawer’s or maker’s signature fulfils a constitutive function.

3.2 Guarantee function

No person is liable as drawer, endorser, or acceptor of a bill, or equally as maker or endorser of a note who has not signed it as such. If a person does sign in any one or other of these capacities, he will be liable on the document (s 21). In this regard the signature fulfils a guarantee function.

3.3 Transfer function

An order document is negotiated by the endorsement of the holder completed by delivery (see again s 29(3)). The endorser’s signature on an
order document therefore fulfils a **transfer function**. If a holder delivers an order document without endorsing it, there is no negotiation.

**Activity 1**

Complete the following diagram based on the information provided above.

![Diagram](image)

**ALWAYS REMEMBER** → In certain circumstances a signature can fulfil more than one of these functions simultaneously, but it can never fulfil all three together.

### 4 WHAT FUNCTION DOES A PARTY'S SIGNATURE PERFORM?

We will now consider what functions are performed by the signature of the different parties to a negotiable instrument.

#### 4.1 The drawer

4.1.1 Constitutive function

The drawer’s signature is necessary for the coming into being of a bill or cheque (see ss 21 and 71).
4.1.2 Guarantee function
After delivery of the document, the drawer’s signature performs a guarantee function. He undertakes, among other things, to compensate the holder, or a subsequent endorser who is compelled to pay, if the bill is dishonoured after due presentment and provided the requisite proceedings on dishonour are duly taken (s 53(1)). The drawer’s liability will be discussed more fully later.

The drawer’s signature will, for example, fulfil only a constitutive function and not a guarantee function if he signs the bill as a minor without the consent of his guardian. This will be discussed later in item 6.4 below.

4.2 The maker

4.2.1 Constitutive function
The maker’s signature is necessary for the coming into being of a promissory note (see s 87(1)).

4.2.2 Guarantee function
The maker engages, among other things, to pay the note according to its tenor (see s 92).

4.3 The acceptor

4.3.1 Guarantee function
The acceptor’s signature fulfils a guarantee function. He engages among other things, to pay the bill according to the tenor of his acceptance (see s 52). The obligations of the acceptor on the bill will be discussed more fully later.

4.4 The endorser

4.4.1 Guarantee function
The endorser undertakes, among other things, to compensate the holder, or a subsequent endorser who is compelled to pay if the bill is dishonoured after due presentment and provided the requisite proceedings on dishonour are duly taken (s 53(2)). The liability of the endorser will be discussed more fully later.

4.4.2 Transfer function
The endorser’s signature (endorsement) on an order document completed by delivery fulfils a transfer function (see s 29(3)).
Usually the endorser’s signature will fulfil a guarantee and a transfer function. However, his signature will fulfil only a transfer function and not a guarantee function where the endorser adds the words *sans recours* to his endorsement (s 14(a)). On the other hand, the endorser’s signature will only fulfil a guarantee function and not a transfer function where he endorses a bearer document because his endorsement is not necessary for the negotiation of the instrument.

5 FORGED AND UNAUTHORISED SIGNATURES

5.1 General

In the case of *forged signatures* the forger imitates the signature of somebody else with the intention to defraud. Such a signature may not be ratified. In other words, the person whose signature has been forged cannot afterwards give formal approval or consent to the forgery.

In the case of *unauthorised signatures* the signatory signs on behalf of another, but without that person’s consent (authority). The principal (the person on whose behalf the unauthorised signature was made) may authorise and ratify such a signature. To determine exactly when a signature is unauthorised, one must look to the principles of agency. A person may authorise another to act on his behalf, but if the signature is placed on a document without authorisation, the principal will not be bound unless he ratifies the unauthorised signature.

Although s 21(b) of the BEA provides that the signature of a firm upon a bill is binding upon all the partners in the firm, this does not mean that the firm is bound as a matter of course. The facts of the case should always be considered to ascertain whether the person who signed in the firm’s name was actually competent and authorised to do so. The granting of authority is a question of fact. This means that the operation of s 21(b) is dependent upon the factual circumstances of each case.

A person who signs a bill in one of the above capacities and alleges that he signs on behalf of a principal although he, in fact, has no such authority will be personally liable on the bill. As we have seen, the principal or alleged principal may ratify such a signature. It should, however, be kept in mind that if the person receiving the bill from the so-called agent and the so-called agent himself both intended that the signature should still be ratified by the principal, the so-called agent would remain personally liable until the ratification actually took place.

5.2 What are the legal consequences of a forged or an unauthorised signature?

What is the effect of a unauthorised signature? If a person’s signature is placed on the document without his authority, the following will apply:
(1) In terms of s 24(1), the person who so signs shall be personally liable on the instrument.

(2) Section 22 provides that such unauthorised signature is wholly inoperative. Thus the person whose signature it purports to be will not be bound thereby unless he ratifies the unauthorised signature, which he may do in terms of s 22.

What is the effect of a forged signature? A forged signature is also wholly inoperative in terms of s 22, but unlike an unauthorised signature it cannot be ratified. Suppose A draws a bill on B in favour of C or order, and X steals the bill from C and forges C’s signature on the back of the bill as a supposed endorsement. If X thereafter delivers the bill to D, D will not be a holder or a holder in due course even if he takes the bill bona fide. This will be so, because the forged endorsement (the signature) which was placed on the order bill is wholly inoperative.

Let us look more closely at the reasons why D will not be able to become a holder or a holder in due course. “Negotiation” means the transfer of an instrument from one person to another so as to constitute the transferee the holder of it (s 29(1)). A bill payable to order, like the one mentioned in the scenario above, is negotiated by endorsement of the holder completed by delivery (s 29(3)). A holder is defined in terms of s 1 as “the payee or endorsee of a bill who is in possession of it, or the bearer thereof.” Now in terms of s 22, a forged endorsement is wholly inoperative and does not bring about a negotiation or the right to retain the bill, to give discharge for it or to enforce payment of it. Thus, D who received an order bill on which there is a forged endorsement cannot be the holder of it. Because D cannot qualify as a holder, he can also not become a holder in due course, since he needs to qualify as a holder first before he can be a holder in due course (see s 27(1) and unit 7 for a full discussion of the requirements that need to be complied with before a person can become a holder in due course).

Thus, D is actually in possession of a bill payable to C or order and which has not been endorsed by C, and accordingly D is merely a possessor of the bill.

In the same way, if the signature of a drawer is forged, no bill comes into being as a forged signature is wholly inoperative and cannot perform any constitutive function.

We will see below, that in terms of s 22, a forged or unauthorised signature is wholly inoperative, and no right to retain or give a discharge for the bill, or enforce payment thereof against any party, can be acquired through that signature, unless that party is precluded from setting up the forgery or lack of authority as a defence.

5.2.1 The general rule: a forged or unauthorised signature is wholly inoperative

As we have seen, before any person is bound on a bill, he must first have signed the bill. What then is the position where a signature purporting to be
that of a specific person has in fact been forged or has been placed on the instrument without the permission or contrary to the instructions of the person it seeks to bind? In terms of s 22, a forged or unauthorised signature is wholly inoperative and there is no right to retain or give a discharge for the bill or to enforce payment thereof against any party through that signature, unless that party is precluded from setting up the forgery or want of authority as a defence. **Please study s 22 of the BEA carefully and make sure that you understand it.**

A forged or unauthorised signature has no constitutive, guarantee or transfer function except in so far as the person against whom payment is sought to be enforced is precluded, by the operation of the doctrine of estoppel at common-law (Roman Dutch law) or esoppel ex lege (in terms of s 53(2)(b)) from raising the forgery as a defence.

Subject to the possible operation of estoppel, a person who obtains a bill via a forged endorsement acquires no right in the bill against any party thereto to retain the bill or to grant a release in respect thereof or to enforce payment thereof.

- If the **drawer’s signature on a bill** (or the maker’s signature on a note) is forged, neither the payee nor any subsequent holder will be able to obtain payment on the instrument from the drawer (or maker) or any subsequent party who has put his signature on the instrument. This will be so because s 21 of the BEA provides that no person will be liable as a drawer, acceptor (or maker) or endorser of an instrument, unless he has signed it in that capacity. Therefore, in order for a drawer to be liable on an instrument, his signature has to appear on it. Also, a drawee has no mandate to pay out a bill where the drawer’s signature has been forged, even if such a forgery is very well executed. As long as the **drawer’s actual signature** does not appear on the bill, there simply is no mandate to the drawee to pay. In the case where the signature of a drawer of a cheque has been forged, the drawee bank cannot debit the drawer’s (its client’s) account; since the drawer did not sign the cheque there can be no mandate to the drawee to pay. An exception to this would be where the drawer knows or suspects that his signature has been forged, but fails to notify the bank.

- If the **endorsement of the payee or any subsequent holder of an order instrument is forged**, any person who obtains such an order instrument subsequent to the forging will acquire no rights on it against any previous party. The purchaser of an instrument, if he qualifies as a holder, has the power to sue on the instrument and to enforce payment against prior parties (see s 36(a)). The significance of the distinction between order and bearer instruments lies in the manner in which these instruments are negotiated. ‘**Negotiation’** means the transfer of an instrument from one person to another in such a manner as to constitute the transferee the holder of it (s 29(1)). An instrument payable to **order** is negotiated by the endorsement of the holder completed by delivery (s 29(3)). By contrast, an instrument payable to **bearer** is negotiated by delivery only (s 29(2)). Section 1 of the BEA defines **holder** as ‘the
payee or endorsee of a bill who is in possession of it, or the bearer thereof’. ‘Bearer’ is defined as the ‘person in possession of a bill, which is payable to bearer’ (s 1). In terms of s 22, a forged or unauthorised endorsement is wholly inoperative. A forged or unauthorised endorsement does not bring about a negotiation and no right to retain the instrument, to give discharge for it or to enforce payment of it can be acquired through or under such an endorsement. Thus, the purchaser of an order instrument on which an endorsement is forged or unauthorised cannot be the holder of it. Furthermore, a person who receives an order instrument which contains a forged or unauthorised signature will merely be the possessor of it. However, a bearer instrument is negotiated by delivery only and an endorsement is superfluous to constitute the transferee bearer and thus holder of the instrument.

5.2.2 Section 53(2)(b): an exception to the general rule
As stated above, no one can become an endorser or a holder, or a holder in due course of a negotiable instrument after a forged or unauthorised signature has been made on it. No right to enforce payment of it against any party can be acquired through a forged or unauthorised signature, unless that party is precluded by the operation of the doctrine of estoppel at common law (Roman-Dutch law) or by the legislative estoppel in terms of s 53(2)(b) of the BEA (see below) from raising the forgery as a defence. According to the doctrine of estoppel, a person is precluded from denying the truth of a representation previously made by him (intentionally or negligently) to another person if that person, believing it to be true, acted on the representation to his prejudice.

Section 53(2)(b) of the BEA provides for an important exception to the general rule that forged or unauthorised signatures will be wholly inoperative on bills, cheques and notes. This section provides that if the endorser of a negotiable instrument endorses it, he is precluded from denying to a holder in due course the genuineness and regularity in all respects of the drawer’s signature (or the maker’s signature of a note) and all previous endorsements. At first glance, it appears that this provision implies that a person who obtains a negotiable instrument through a forged signature can still become a holder in due course of it. One must bear in mind that this provision is merely aimed at creating something that may be called a legislative estoppel in favour of a later ‘holder in due course’ against an earlier ‘endorser’. As far as the earlier endorser is concerned, the person in possession of the instrument is then in the position of a holder in due course. However, this does not mean that the possessor has the rights of a holder in due course against persons who signed the instrument before the endorsement was forged on the instrument. Even the ‘endorser’ who signs the instrument after receiving it by way of forged endorsement is not really an ‘endorser’, because only the holder of an instrument can ‘endorse’ it.

In other words, s 53(2)(b) gives protection to a ‘holder in due course’ who
is not actually a holder in due course, against an "endorser" who is not actually an endorser. Section 53(2)(b) does not affect the definition of the terms "holder in due course" or "endorser"; it merely creates a hypothesis. All that actually happens, therefore, is that the appearance created in regard to a later possessor is upheld, provided it appears that he would have been a holder in due course if it were not for the fact that he had obtained the bill by way of a forged signature. The fact that the appearance is upheld against the apparent endorser does not yet make the apparent holder in due course an actual holder in due course or even an ordinary holder. At most, one could call such person a "holder by estoppel"; in reality he is still merely a possessor of the instrument. Payment by the drawee or acceptor (or maker) to the apparent holder in due course will accordingly not result in a discharge of the bill in terms of s 57, because it is not a payment in due course since the apparent holder in due course is not actually the holder. According to s 1, payment in due course may be made only to a holder (see unit 9).

The working of s 53(2)(b) may be illustrated by means of the following example: A draws a cheque on B Bank payable to C or order and issues the cheque to C. X, a thief, steals the cheque from C, forges C's endorsement on the back of the cheque and delivers it to E. E then places her endorsement on the cheque and delivers it to F, who takes it in good faith and for value.

In terms of s 22 of the BEA the forged endorsement made by the thief, X, is wholly inoperative, therefore no title was transferred to E which she could then transfer to F. Although it appears that E is the endorsee, in reality she cannot ever be the true endorsee, because there was a forged endorsement and therefore she will merely be the "endorser by estoppel". However, for the purposes of s 53(2)(b) she will be regarded as the endorser of the cheque. F is also not the holder of the cheque, because of the forged signature, and therefore F cannot claim payment from A, B Bank, or even from E (the person who transferred the negotiable instrument to him). He will only be allowed to claim from the thief, X, but such claim will be based on the law of delict and not on the cheque itself. Payment by B Bank to F will not discharge the cheque, as it would not be payment to a holder of it (see s 1).

However, if F can satisfy all the requirements for holdership in due course as set out in s 27(1) of the BEA (except that he must be a holder), he can claim payment only from E, by virtue of s 53(2)(b). In the given example it appears that F would have been a holder in due course, if it was not for the fact that the cheque contained a forged endorsement. Thus, as far as E is concerned, F is a "holder by estoppel" which means that E cannot raise F's defective title as a defence against him. The exception and protection provided for by s 53(2)(b) to parties in a position like that of F is as follows: the s provides that the endorser of a negotiable instrument (in the example it is E), by endorsing it, "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". In other words, s 53(2)(b) provides that if E
endorses the cheque which contains a forged endorsement and delivers it to F, who would have been a holder in due course if it were not for the forged endorsement, E will not be allowed to rely on the principle that the forged signature of the thief, X, is wholly inoperative.

It is important to remember that although E is not really the endorser, in terms of s 53(2)(b) she will be deemed to be and therefore she is referred to as the ‘endorser by estoppel’. In terms of the provisions of s 53(2)(b), F will therefore be able to claim the amount of the cheque only from E, but not from any of the earlier parties to the cheque. Furthermore, F will not really be a holder in due course as there was a forged endorsement, but he would have been if it were not for the forgery. Although we call F the ‘holder by estoppel’, in actual fact he is merely the bona fide possessor of the cheque.

Always remember the following regarding s 53(2)(b):

- The protection provided for in this s only applies to order instruments, since there must be a forged or unauthorised endorsement.
- It can be applied only if there are two parties after the thief (in other words, after the forged or unauthorised signature was placed on the instrument):
  - one that could have been an endorser; and
  - one that could have been a holder in due course

if it were not for the forged or unauthorised endorsement on it.
Diagram illustrating the effect a forged or unauthorised signature has on an instrument

FORGED AND UNAUTHORISED SIGNATURES

\[\downarrow\] \[\downarrow\]

FORGED SIGNATURES

Imitate the signature of somebody else

\[\downarrow\]

May not be ratified

\[\downarrow\]

UNAUTHORISED SIGNATURES

Signed on behalf of another, but without his consent

\[\downarrow\]

May be ratified

\[\downarrow\]

THE LEGAL CONSEQUENCES OF A FORGED OR A UNAUTHORISED SIGNATURE

\[\downarrow\]

GENERAL RULE (S 22) → A FORGED OR UNAUTHORISED SIGNATURE IS WHOLLY INOPERATIVE

No one can become a holder of an instrument after a forged or unauthorised signature has been made on it. No person can become an endorser, or a holder, or a holder in due course of such an instrument. No right to enforce payment of it against any party can be acquired through that signature, unless that party is precluded by the operation of the doctrine of estoppel from raising the forgery or unauthorised signature as a defence.

\[\downarrow\]

ESTOPPEL PROVIDES AN EXCEPTION TO THE GENERAL RULE

According to the doctrine of estoppel a person is precluded from denying the truth of a representation previously made by him (intentionally or negligently) to another person if that person, believing it to be true, acted on the representation to his prejudice.

\[\downarrow\]

Legislative estoppel (Section 53(2)(b))

\[\downarrow\]

Estoppel at common law (Law of delict)
Activity 2

Read the following scenario and answer the question given. Your answer should include explanations.

Suppose A draws a cheque on B Bank payable to C or order. D steals the cheque from C, forges C's signature on the back of the cheque and delivers it to E. E endorses the cheque in his name and delivers it to X, who takes it in good faith and for value. Can X enforce payment against any of the parties?

5.3 Capacity of parties to an instrument

As we have seen earlier, a signature on bill may, in certain circumstances, not perform the guarantee function that a signature normally performs without there being any effect on the validity of the bill or liability of other parties. If a bill is drawn or endorsed by a minor or a person having no capacity to incur liability on a bill, the drawing or endorsement of the bill entitles the holder to receive payment of the bill and to enforce it against any other party thereto (s 20(2)).

The first part of s 20(1) reads: “Capacity to incur liability as a party to a bill is coextensive with capacity to contract.” In terms of this s, a person with full capacity to contract can bind himself completely on the bill. An emancipated minor or one who was granted *venia aetatis* can likewise be bound by the bill. Also, a minor who contracts with the assistance of his guardian can be bound by the bill.

The effect of this subs is that although the minor cannot be liable on a bill to any greater measure than he can be liable in terms of an ordinary contract, the person who takes the instrument from the minor by negotiation acquires, by virtue of the bill, the right to claim payment from any other party to the bill. In other words, here the signature of the minor does not fulfil a *guarantee* function but only a constitutive or transfer function.

A person who has been placed under curatorship may also sign a bill with the consent of his curator, in which case he will be bound thereby.

Activity 3

With reference to the following scenario, indicate whether X is a holder, holder in due course or possessor of the cheque. Your answer should include an explanation.

A draws a cheque on B Bank in favour of C or order and delivers the cheque to C. C is a minor and without the assistance of his guardian he endorses the cheque and delivers it to X, who takes it in good faith and for value.
Look at the following scenario and answer the questions given.

<table>
<thead>
<tr>
<th>Elite Bank</th>
<th>9 February 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PAY:</strong> Felicia Tylo or order</td>
<td></td>
</tr>
<tr>
<td><strong>THE SUM OF:</strong> Two thousand rand only</td>
<td>R2 000,00</td>
</tr>
<tr>
<td>C. Hanson</td>
<td>M. Sigwadi</td>
</tr>
<tr>
<td>34678-8970-9099-80</td>
<td></td>
</tr>
</tbody>
</table>

The back of the cheque:

Pay Greg Vallance  
Signed: F Tylo (19 February 2009)

Consider the above example of the cheque. Imagine that you are a teller at Golden Bank and this cheque is presented to you by Greg Vallance, a client of the bank who has never had to use cheques before. Greg Vallance requests you to explain the following to him: (Remember that your answers should include an explanation in terms of the BEA focusing on signatures)

(1) What a signature is and how a person is allowed to sign a cheque?  
(2) The different functions signatures on a cheque can fulfil.  
(3) The functions of the signatures of the different parties on the cheque.  
(4) Whether he can hold Felicia Tylo (a minor) liable on the cheque?  
(5) What the implications would be if Felicia Tylo were not a minor and her endorsement was forged by a thief before the cheque was delivered to Greg Vallance?
Feedback 1

Diagram explaining the different functions a signature on, for example, a cheque can have

A signature on a cheque can fulfil the following three different functions:

- **constitutive function**
- **guarantee function**
- **transfer function**

<table>
<thead>
<tr>
<th>Function</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>constitutive function</strong></td>
<td>This refers to the placing of the drawer’s signature on a cheque to effect the cheque’s creation. Without such signature no cheque comes into being. <strong>Only the drawer’s signature fulfils a constitutive function.</strong></td>
</tr>
<tr>
<td><strong>guarantee function</strong></td>
<td>This refers to the fact that in certain circumstances the person who places his signature on the cheque undertakes or guarantees to pay the holder of the cheque when the cheque is presented for payment. For example, when the drawer places his signature on the cheque he guarantees to the holder that he will pay when the holder presents the cheque for payment.</td>
</tr>
<tr>
<td><strong>transfer function</strong></td>
<td>This refers to the situation where the signature of a person is necessary to <strong>effect the transfer</strong> of a cheque. An order cheque is transferred by an endorsement (i.e., signature) by the holder of the cheque together with actual delivery of the cheque. In other words, in order to transfer an order cheque from one holder to another validly, the holder of it must put his signature on the cheque and then deliver the cheque to the next person.</td>
</tr>
</tbody>
</table>
What follows next are the key points that we look for when students answer such a question. This question deals with the application of ss 22 and 53(2)(b) of the BEA. In terms of s 22 the forged endorsement made by the thief is **wholly inoperative**, therefore no title was transferred to E which he could then transfer to X. It appears that E is the endorsee, but in fact he cannot ever be the true endorsee because there was a forged endorsement once E has signed and delivered the cheque. E will merely be the “endorser by estoppel”; but for purposes of s 53(2)(b) he will be **regarded as the endorser of the cheque**.

X is also not the **holder of the cheque** because of the forged signature, and therefore X cannot claim payment from A, B Bank, or even from E. He will only be allowed to claim from the thief, but such claim will be based on the law of delict and not on the cheque itself.

If X can satisfy **ALL the requirements for holdership in due course** (s 27(1)), he can claim payment only from E, by virtue of s 53(2)(b). The exception and protection provided for by s 53(2)(b) to parties in a position like that of X is as follows: the s provides that the endorser of a cheque (in this case, E), by endorsing it, “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”. In other words, s 53(2)(b) provides that if E endorses the cheque and delivers it to X, E will not be allowed to rely on the principle that the forged signature of the thief is wholly inoperative. Remember that E is not really the **endorser**, because there was a forged endorsement, but in terms of this section he will be **regarded as one** and therefore he is called the “endorser by estoppel”. In terms of the provisions of s 53(2)(b), X will therefore be able to claim the amount of the cheque only from E, but not from any of the earlier parties to the cheque. Also remember that X will not really be a **holder in due course** as there was a forged endorsement, but he would have been one if it weren’t for the forgery. Although X is called the “holder through estoppel”, in real fact he is merely the **bona fide** possessor of the cheque.

The picture looks like this:

```
A (drawer)
B bank (drawee bank)
C (payee)
DIVIDING LINE
Forging of C's signature by thief, D
E (endorser through estoppel)
X (holder through estoppel and possessor of cheque)
```
A signature on a cheque may in certain circumstances not perform the guarantee function that a signature normally performs, without affecting the validity of the cheque or liability of other parties. If a cheque is endorsed by a minor having no capacity to incur liability on a cheque, the endorsement entitles the holder to receive payment of the cheque and to enforce it against all other parties (in other words any other parties, excluding the minor) to it (s 20(2)). Here the minor’s signature does not fulfil a guarantee function, but it does fulfil a transfer function. X can still become a holder in due course if he complies with all the requirements as set out in s 27(1). In the given scenario it appears that X does comply with these requirements and therefore he will be a holder in due course.

(1) In your answer you should have referred to s 95 of the BEA. Also read the information given under heading 2 (What is a signature?) again.

(2) A signature on a cheque may bring into being or constitute a cheque, guarantee payment, or effect the transfer of the cheque. In certain circumstances a signature can fulfil more than one of these functions simultaneously, but in no circumstances can a signature perform all three at the same time. Also read the information given under heading 3 (Functions of a signature) again.

(3) With reference to the information given under heading 3 (Functions of a signature) and heading 4 (What function does a party’s signature perform?) you should have explained the functions the signatures of C Hanson, M Sigwadi and Felicia Tyla have on the cheque. C Hanson and M Sigwadi’s signatures fulfil a constitutive as well as a guarantee function. Furthermore, it is also important to look at heading 5.3 (Capacity of parties to an instrument) when establishing the functions fulfilled by the signature (endorsement) of Felicia, on the cheque. Felicia’s signature merely fulfils a transfer function but not a guarantee function, if she is a minor who has signed the cheque without the assistance of her guardian.

(4) No, Greg will not be able to hold Felicia liable on the cheque, because her signature does not fulfil a guarantee function. Read the information under heading 5.3 (Capacity of parties to an instrument) again.

(5) In your answer you should refer to s 22 of the BEA. If the endorsement of Felicia is forged and she is not a minor, Greg (who obtains the order instrument subsequent to the forging) will acquire no rights on it against any previous party. Greg will also not qualify as a holder and accordingly he will not have the power to sue on the instrument or enforce payment against prior parties. Read the information given under headings 5.2 (What are the legal consequences of a forged or an unauthorised signature?) and 5.2.1 (The general rule: a forged or unauthorised signature is wholly inoperative) again. It is important to remember that s 53(2)(b) does not apply in the provided scenario, since it can be applied only if there are two
parties after the thief (i.e., after the forged or unauthorised signature was placed on
the instrument), namely, one that could have been an endorser and one that could
have been a holder in due course — if it were not for the forged or unauthorised
endorsement on it [see information under heading 5.2.2 (Section 53(2)(b): an
exception to the general rule)].
UNIT 6
HOLDER

After studying this unit you should be able to

- describe and understand the concept of a “holder” in terms of the BEA
- identify the rights and duties of a holder based on facts presented in a scenario
- explain your understanding of the importance of presentation for acceptance
- explain your understanding of what is meant by presentation for payment and the consequences of failure to present
- analyse a given set of facts presented in a scenario and evaluate the actions taken in terms of the rights and duties of the holder

There is no prescribed reading for this unit.

1 INTRODUCTION

We indicated in unit 2 that one of the most important and central concepts of the law relating to negotiable instruments is that of “holder”. Therefore, in this unit we will establish who may be holders in terms of the BEA. This is important because certain rights and duties are applicable to holders only. In this unit (under heading numbers 3 and 4) we will also establish what these rights and duties are.

At the outset, we must emphasise that one has to distinguish between the position where a bill is drawn payable to order and where it is drawn
payable to bearer. This distinction is critical because there are different requirements for both positions which a person must comply with in order to become a holder. Where the bill is drawn payable to order there are two requirements that must be complied with in order for a person to become the holder of it:

- the person has to be either the payee or endorsee
- he must be in possession of it

Where the bill is drawn payable to bearer, any person who is in possession of it may be a holder. It is clear that possession is necessary in this case as well.

This is illustrated in the sketch below:

<table>
<thead>
<tr>
<th>HOLDER</th>
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<tbody>
<tr>
<td>ORDER</td>
</tr>
<tr>
<td>↓</td>
</tr>
<tr>
<td>PAYEE/ENDORSEE</td>
</tr>
<tr>
<td>+</td>
</tr>
<tr>
<td>POSSESSION</td>
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</tbody>
</table>

<table>
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<tr>
<th>BEARER</th>
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<tbody>
<tr>
<td>↓</td>
</tr>
<tr>
<td>ANY PERSON</td>
</tr>
<tr>
<td>+</td>
</tr>
<tr>
<td>POSSESSION</td>
</tr>
</tbody>
</table>

2 DEFINITION OF HOLDER

Section 1 of the BEA contains a formal definition of the concept of a holder. According to this section a holder is “the payee or endorsee of the bill who is in possession of it or the bearer thereof”. “Bearer,” according to s 1, is defined as the person in possession of a bill which is payable to bearer. Therefore possession of the instrument forms the basis of being a holder. Possession alone, however, is not sufficient. The possessor must, in addition, be either the payee, endorsee or bearer. It is thus clear that a person will not be a holder by virtue of possession alone.

According to the definition, possession and the acquisition of possession of the instrument need not be lawful. A thief, in terms of the definition, can therefore qualify as a holder of an instrument payable to bearer because any person who is in possession of such an instrument is the bearer and every bearer is also a holder. Although a thief may be a holder, he will not be able to enforce payment on the bill. He may, however, be able to pass good title to another and payment to him will indeed be a payment in due course. (“Payment in due course” will be discussed in unit 9 below.)

A draws a bill in favour of C or bearer. X steals the bill from C. It is clear that X is not the payee (C was); he is not the endorsee (there is none); but because he is in possession of a bearer bill, he is indeed the bearer. Thus X is the holder of the bill.
Someone who steals a bill on which he is indicated as payee or endorsee will also qualify as holder in terms of s 1.

A draws a bill on B in favour of **C or order.** C steals the bill from A. C is indicated on the bill as the payee of the bill and will accordingly be the holder of the bill.

A draws a bill in favour of **C or order** and delivers it to C. Upon delivery C endorses the bill “pay D or order” and signs “C”. Before delivery can take place, D steals the bill from C. D is not the payee (C was); but he is indicated as the endorsee of the bill. According to the definition D will be the holder of the bill. One should always bear in mind here that although the thief may be a holder, he will not be able to enforce payment on the bill. He may be able to pass good title to another and payment to him will indeed be a payment in due course. In our example, there was no delivery. Delivery is a prerequisite for liability. This means that C, the endorser, will not be liable on the bill because there was no delivery. D will in effect have no claim against C.

However, a person who is in possession of a bill payable to order which is payable to someone else, either originally or by endorsement, cannot be the holder thereof. The endorsement in this regard obviously refers to a special endorsement. A special endorsement specifies the person to whom, or to whose order, the bill is payable. The person who has acquired a bill through a forged endorsement can also not be the holder because, in terms of s 22, this forged signature (endorsement as explained in unit 4) is wholly inoperative (as explained in unit 5).

A draws a bill in favour of C or order. X steals the bill from C before C endorses it. X is not the payee (C was); he is not the endorsee (there is none); he is also not the bearer (it is an order instrument). X can therefore **not** be the holder of the bill.

A draws a bill in favour of C or order. C endorses “pay D or order” and signs “C”. X steals the bill from D. X is not the payee (C was); he is not the endorsee (D is); and also not the bearer (because the instrument remains an order instrument). X can therefore **not** be the holder of the bill.

3 **THE RIGHTS OF THE HOLDER**

The rights of the holder will now be discussed in detail:

- In terms of s 36(a) of the BEA the holder may **sue on the bill in his name.** The fact that a holder may sue on a bill does not imply that the holder is the true owner. In certain instances the holder may be the owner of the bill, but in other instances he may be the unlawful possessor, such as a thief.

The holder may possess the instrument in the capacity of trustee, executor or curator. In all these instances the holder’s rights will be determined by the position he occupies. The holder may also have
obtained possession of an instrument by force or intimidation. If in such a case the holder takes action on the strength of the instrument, these circumstances may be advanced to oppose the claim. If he obtained possession of the instrument by fraud, this may also be raised as a defence against him. The holder may also possess the instrument by virtue of a lien, or on behalf of his principal. It is therefore clear that the holder of a bill is not necessarily the owner thereof. ‘Holder’ is a neutral concept and must be gauged in the light of the definition of holder. Irrespective of whether or not a person is the owner of a bill, if he is the holder, he will be able to receive payment that will constitute payment in due course, with the result that the instrument is discharged. (Discharge of the bill and ‘payment in due course’ are discussed in unit 9.)

- In the second place, the holder has the power to **present the bill for acceptance**. According to section 39(1), presentment **must** be effected by the holder, personally or through a representative. According to s 41(2), if the drawee refuses to accept the bill, the holder has an immediate right of recourse against the drawer and endorsers and no presentment for payment is necessary. Section 46 is applicable in this regard. It states that notice of dishonour must be given in order to bind all previous endorsers and the drawer on the bill. The effect of this is that the holder will have the right to recover, on dishonour by non-acceptance, from any of the previous endorsers or the drawer of the bill. In terms of s 49(1A)(a), where a bill has been dishonoured by non-acceptance (or non-payment) the holder **may** have it protested for non-acceptance (or non-payment as the case may be).

- In the third place, the holder has the power, and is moreover obliged in terms of section 43, to **present the bill for payment**. The holder is the only person who may present the bill for payment, either personally or through an authorised representative, who may receive payment on the holder’s behalf. The holder also acquires a right of recourse against the drawer and the endorsers if the bill is dishonoured by non-payment. Section 46 is also applicable in this regard in that notice of the dishonour must be given in order to bind the drawer and endorsers.

- The holder also has the power to **supplement certain deficiencies** on the bill. In terms of s 10, details such as the correct date of the issue of the instrument or the date of acceptance, which are not essential requirements of a bill, may be inserted by the holder.

- The holder also has the power to **make certain additions**. In terms of section 31(4), if a bill has been endorsed in blank, the holder may convert this blank endorsement into a special endorsement. This may be done by writing above the endorser’s signature an instruction to pay the bill to himself or his order, or to another person or the order of this last-mentioned person. In terms of section 76(2), the holder may cross an uncrossed cheque either generally or specially. According to section 76(3), if a cheque is crossed generally, the holder may cross it
specially. Lastly, in terms of section 76(4), the holder may add the words “not negotiable” to a crossed cheque.

- The holder has the **right to a duplicate** of the bill. In terms of section 67(1), if a bill (or note) is lost or destroyed, the person who was the holder of it (he is no longer holder due to the loss of possession) may request the drawer (or maker) to give him another bill or note of the same tenor, provided that the bill is not yet overdue. The drawer, on the other hand, may ask for adequate security from the holder to indemnify him against the possibility that the bill, alleged to have been lost, is found again and payment of it is demanded from the drawer also. The holder has no right to apply for a fresh acceptance of the duplicate bill, or for a fresh endorsement of the duplicate bill or note.

- The holder, further, has the power to have the bill **protested for better security**. According to section 49(4), if the acceptor of a bill becomes insolvent or suspends payment before the bill matures, the holder may cause it to be protested for better security. Protest is made against the drawer and endorsers.

### 4 THE DUTIES OF THE HOLDER

#### 4.1 Presentment for acceptance

Normally there is no duty on the holder to **present the bill for acceptance**. Only in the following **three instances** is the holder obliged to do so:

1. When the bill is **payable after sight**. (“After sight” is discussed in unit 3.) When a bill is payable after sight, presentment for acceptance is necessary to settle the date of maturity of the bill. The (payee) holder must present the instrument for acceptance within a reasonable period of time after he has received it. Where the holder has negotiated the bill, the next holder must present it for acceptance within a reasonable period of time after he has acquired it.

   According to section 38(2) of the Act, what will be considered to be a reasonable time will depend on different factors, such as the nature of the bill, business practice, and the circumstances of each case.

2. In terms of the first part of section 37(2), if a bill **expressly states** that it must be presented for acceptance, the holder must do so, and certainly before it is presented for payment.

3. According to the second part of section 37(2), if a bill is drawn **payable at a place other** than the residence or place of business of the drawee, it must be presented for acceptance before it can be presented for payment.

According to section 38(1)(b), where the holder of a bill payable after sight in (1) above does not present for acceptance, the drawer and the endorsers are discharged and they may no longer be held liable on the instrument. **(There is, however, a different rule applicable to cheques in terms of**
section 72. This will be discussed in unit 11 below.) Even in those cases mentioned in (2) and (3) above, the holder may find that, owing to his failure to present for acceptance, the drawer and the endorsers may be discharged. Section 39 determines that, if a bill is presented for acceptance, presentment must take place before the bill’s date of maturation. The holder must normally present the bill for payment and he cannot do it, in the three instances cited above, before it is presented for acceptance. Consequently, also in the cases mentioned in (2) and (3), the holder must present for acceptance timeously, otherwise he will be unable to present for payment in time and then the drawer and endorsers will be discharged according to sections 43(1), 43(2) and 37(4).

In terms of section 37(3), the holder is not obliged to present for acceptance except in the above cases. Obviously, in practice it is usual to present for acceptance simply to secure more rights for the holder. The holder will thus have a right against the acceptor if he accepts and will have an immediate right of recourse against the drawer and the endorsers in the case of dishonour by non-acceptance. The following remarks are made with reference to the statement that the holder has a right against the acceptor:

- The drawee becomes the acceptor after acceptance.
- In terms of section 51, if the drawee does not accept the bill, he is not liable on it.
- Upon acceptance the drawee or acceptor incurs certain liabilities on the bill. There are also certain requirements that must be complied with for there to be an acceptance. These issues are discussed in unit 8 below.

In connection with the above on the duty of the holder in respect of presentment for acceptance, we now turn to the requirements for acceptance.

Section 39 of the BEA contains the rules as to presentment for acceptance. A bill is duly presented for acceptance if it is presented in accordance with the following:

- the presentment must be made by or on behalf of the holder
- the presentment must be made before the bill is overdue
- the presentment must be made to the drawee
- if the drawee is deceased, presentment may be made to the executor
- if he is insolvent, presentment may be made to the drawer or the trustee
- a presentment by post, if in due course, is sufficient.

According to section 39(2), presentment in accordance with what has been said above (the requirements for due presentment) is excused and the bill will be treated as dishonoured by non-acceptance:

- if the drawee is deceased or insolvent, or is a fictitious or non-existing person or a person not having the capacity to contract
- if, after the exercise of reasonable diligence, such presentment cannot be effected
- if, when irregular presentment is made, acceptance is refused on some other ground.
The dishonour of a bill by non-acceptance is one of the conditions on which the liability of the drawer and endorsers depend. In such an event, the holder obtains an immediate right of recourse so that presentment for payment is not necessary.

Section 39(3) provides that the fact that the holder has reason to believe that the bill will be dishonoured on presentment does not make presentment unnecessary.

**Activity 1**

Complete the following activity based on the discussion above. Read the scenario below and answer the question given. Your answer should include an explanation.

C sells some furniture to A. A pays C by means of a bill. The bill is drawn on B in favour of C or order. C further notices that the bill expressly states that it must be presented for acceptance. Upon learning this C approaches you for some advice.

In your own words explain to C the importance of presentment for acceptance.

To get an idea of what happens to a bill after acceptance, and particularly after acceptance has been refused, the following question may be asked: when is a bill dishonoured by non-acceptance?

Sections 40 and 41 are applicable in this regard, stating that a bill is dishonoured by non-acceptance if:

- the bill is presented for acceptance and it is not accepted within the customary time
- it has been duly presented and acceptance is refused or cannot be obtained
- presentment for acceptance is excused and the bill is not accepted

### 4.2 Presentment for payment

Section 43 contains the second important duty of the holder, which is to present the bill for payment. If the holder does not do so, the drawer and the endorsers will not be liable — they will in fact be discharged.

The rules as to presentment for payment are contained in s 43(2). A bill is duly presented for payment if it is presented in accordance with the following:

- A bill not payable on demand must be presented on the day it falls due.
- A bill payable on demand must be presented within a reasonable time after its issue to render the drawer liable, and within a reasonable time after endorsement to render the endorser liable.
- The holder must personally or through an authorised representative present for payment.
• If a bill is drawn on or accepted by two or more persons who are not partners, presentment must be made to them all.
• If the drawee or the acceptor of the bill is deceased and no place of payment is specified, presentment must be made to the executor (if there is one).

Section 43(4) states that a bill is presented at the proper place if:
• when the place of payment is indicated on the bill, the bill is presented there;
• when the place is not indicated, but the address of the drawee or acceptor is given on the bill, it is presented at that address;
• when the place is not given and the drawee’s address does not appear on the bill, it is presented at the drawee’s place of business, or if that is unknown, then at his residence if this is known;
• when none of the abovementioned applies, the bill is presented for payment wherever the drawee or acceptor can be found.

According to s 43(5), presentment by post will suffice if it is done in the normal course of business.

In terms of s 44, presentment for payment by the holder may be delayed or dispensed with. In terms of s 44(1), delay in presentment is excused if the delay is caused by circumstances beyond the control of the holder and is not due to his fault, misconduct or negligence. However, if the cause for the delay ceases to operate, presentment must be made with reasonable diligence.

Presentment for payment is dispensed with in terms of s 44(2):
• if, after the exercise of reasonable diligence, presentment cannot be effected
• if the drawee is a fictitious person
• where the drawee is under no obligation to accept the bill and the drawer has no reason to believe that the bill would be paid if presented
• as regards the endorser, if the bill was accepted and he has no reason to expect that the bill would be paid if presented
• by express or implied waiver of presentment
• if the drawee or acceptor is insolvent

It is further noted that, in terms of s 14, the drawer and the endorsers may also waive as regards themselves some or all of the holder’s duties. In terms of s 44(3), the holder’s obligation to present is not discharged even when he has reason to believe that the bill will on presentment be dishonoured.

• if the holder duly presented it for payment and payment was refused or could not be obtained. (‘Duly presented’ in the context of presentment for payment is described in s 43(2)); and
• if presentment is unnecessary and the bill is overdue and is not paid.

Where a bill is dishonoured by non-payment, the holder immediately
acquires a right of recourse against the drawer and the endorsers, provided, of course, the holder has given notice of its dishonour.

4.3 Notice of dishonour

According to s 46 of the BEA, notice of the bill must be given to the drawer and each endorser if the bill has been dishonoured. Any drawer or endorser to whom notice is not given will be discharged. In other words, the holder will lose the right of recourse against such a drawer or endorser.

The purpose of notice of dishonour is to inform the prior parties that the bill has been dishonoured so that they will be able to avail themselves of the right of recourse against parties prior to them.

Section 46(a) states that if notice of dishonour is not given, the rights of the holder in due course who became such a holder after this omission shall not be affected. (We will discuss the “holder in due course” in unit 7 below.)

Section 46(b) provides that where a bill is dishonoured by non-acceptance, and notification thereof is duly given, notification of a subsequent dishonour by non-payment need not be given again unless the bill was accepted after the first non-acceptance.

**Activity 2**

Complete the following activity based on the discussion above. Read the scenario below and answer the question given. Your answer should include an explanation.

A draws a bill on B in favour of C or order. Upon receipt of this bill, C negotiates it to D by endorsement completed by delivery. D in turn negotiates the bill (by endorsement completed by delivery) to E. After presenting the bill for acceptance, E approaches you for some advice.

In your own words explain to E, under which circumstances he, as the holder, may lose the right of recourse against the endorser, D, and the drawer, A.

**Summary activity**

Complete the following activity based on the discussion above. Read the scenario below and answer the questions given. Your answers should include an explanation.

A draws a bill on B in favour of C or order. A accordingly delivers the bill to C. Upon receipt, C signs the back of the bill and delivers it to D.

1. Does D have any rights on the bill?
2. When is a bill duly presented for acceptance?
3. Under which circumstances may presentment for payment by D be delayed or dispensed with?
Feedback 1

The importance of presentment for acceptance is highlighted by the fact that it is necessary in certain circumstances to settle the date of maturity, such as where the bill is payable after sight (instance (1) at 4.1). In this case, s 38(1)(b) states that if the holder does not present the bill for acceptance, the endorsers and the drawer will be discharged and they may no longer be held liable on the bill. This will also be the position where the bill expressly states (as in the case in this scenario) that it must be presented for acceptance (instance (2) at 4.1), and if the bill is drawn payable at a place other than the residence or place of business of the drawee (instance (3) at 4.1). Presentment for payment in the above three instances may not be effected before the bill is presented for acceptance. Consequently, in all of these instances C (the holder) must present for acceptance timeously, otherwise he will be unable to present for payment in time and then the endorsers (if any) and the drawer (A) will be discharged according to ss 43(1), 43(2) and 37(4).

Obviously, in practice it is usual to present for acceptance, simply to secure more rights for the holder. The holder will thus have a right against the acceptor if he accepts and will have an immediate right of recourse against the drawer and the endorsers in the case of dishonour by non-acceptance. This right of recourse against the drawer arises from the guarantee which the drawer undertakes when signing the bill. The guarantee function of the drawer’s signature has already been discussed in unit 5. One should always remember that s 53(1) is applicable in this regard. This section states among other things that the drawer, by signing the bill, undertakes to compensate the holder if the bill is dishonoured by non-acceptance. (The proviso regarding s 53(1) will be discussed in unit 8)

Feedback 2

E (the holder) will lose the right of recourse where, in terms of s 43, he fails to present the bill for payment and such failure is not excused or dispensed with (in terms of s 44). In this instance the drawer, A, and the endorsers, C and D, will not be liable — they will in fact be discharged.

E (the holder) will also lose the right of recourse against the drawer, A, and endorsers, C and D, where a bill is dishonoured by non-payment and the holder fails to give notice of the dishonour. In terms of s 46, notice of the dishonouring of the bill must be given to the drawer and each endorser of the bill in these circumstances. Any drawer or endorser to whom notice is not given will be discharged.

The provisions of s 46(b) should, however, be kept in mind in this regard. This section states that where due notice of dishonour by non-acceptance has already been given, it shall not be necessary to give notice of the subsequent dishonour by non-payment, unless the bill was accepted after the initial non-acceptance. In other words, it will not be necessary for E (the holder) to give notice of the dishonour by non-payment in this case.
(1) It should first be established whether D is a holder. In our scenario D is not the payee, C is, but C has endorsed the bill in blank and has delivered it to D. A bill that has been endorsed in blank becomes payable to bearer (s 6(2)). D is thus in possession of a bill payable to bearer. According to s 1 of the BEA, a holder is a payee or endorsee of a bill who is in possession of it, or the bearer thereof. A bearer according to the BEA is a person in possession of a bill which is payable to bearer. D is therefore the holder of the bill.

D, being the holder of the bill, now acquires certain rights. He has the right:

- to sue on the bill in his own name
- to present the bill for payment
- to present the bill for acceptance
- to supplement certain deficiencies in the form of the bill
- to effect certain additions
- to apply for a duplicate and
- to protest the bill for better security

It is important for you to be able to list and remember these rights. For a discussion on these rights, refer to heading number 3.

(2) Section 39(1) is applicable in this regard. According to this s, a bill is duly presented if:

- the presentment is made by or on behalf of the holder;
- it is presented before the bill is overdue;
- the presentment is made to the drawee;
- presentment is made to the executor of the drawee, should the drawee be deceased;
- presentment is made to the trustee of the drawee, should the drawee be insolvent; and
- presentment is made through the post in due course.

(3) Section 44 is applicable in this regard. According to s 44(1), delay in presentment is excused if the delay is caused by circumstances beyond the control of the holder and is not due to his fault, misconduct or negligence. According to s 44(2), presentment for payment is dispensed with:

- if, after the exercise of reasonable diligence, presentment cannot be effected
- if the drawee is a fictitious person
- where the drawee is under no obligation to accept the bill and the drawer has no reason to believe that the bill would be paid if presented
- as regards the endorser, if the bill was accepted and he has no reason to expect that the bill would be paid if presented
- by express or implied waiver of presentment
- if the drawee or acceptor is insolvent
UNIT 7

THE HOLDER IN DUE COURSE

After studying this unit you should be able to

- describe and understand the concept of a “holder in due course” in terms of the BEA
- identify and explain the requirements for a holder in due course based on facts presented in a scenario
- identify and explain the rights of a holder in due course based on facts presented in a scenario
- explain your understanding of the effect of absolute and relative defences based on facts presented in a scenario

There is no prescribed reading for this unit.

1 INTRODUCTION

In unit 6 we discussed the concept of the holder in terms of the BEA. In this unit we focus on a particular type of holder, the holder in due course. The concept of, requirements for and rights of the holder in due course in terms of the BEA will be discussed.

2 GENERAL

The holder in due course occupies a central position in the law of negotiable instruments. The holder in due course enjoys the most comprehensive protection and the most rights of all holders. There is a presumption in terms of s 28(2) that every holder of a bill is a holder in due course. The
holder in due course is in the first place a normal holder. It is because the holder in due course complies with certain further requirements that he enjoys additional protection. According to section 36(b) and (c), he acquires ownership of the instrument in his possession even if he acquired this instrument from someone who was not its true owner. The holder in due course also takes this instrument free from defects of title and mere personal defences available to prior parties among themselves. We will return to defects of title (= defects in title) and personal defences later in this unit.

3 DEFINITION AND REQUIREMENTS FOR A HOLDER IN DUE COURSE

A holder in due course, according to section 27, is a holder who has taken a bill, complete and regular on the face of it, under the following circumstances:

- he must have become the holder of it before it was overdue, and if it had been previously dishonoured, without notice thereof; and
- he must have taken the bill in good faith and for value, and at the time the bill was negotiated to him, he must have had no notice of any defect in the title of the person who negotiated it.

From the above definition, the following requirements for a holder in due course are apparent:

1. The holder in due course must be a holder.
2. The bill which he receives must be complete and regular on the face of it.
3. He must have become holder of the bill before it became overdue.
4. If the bill had previously been dishonoured, he must have no knowledge ("notice") of it.
5. He must have taken the bill in good faith (bona fide).
6. He must have given value for the bill.
7. The bill must have been negotiated to him.
8. He must have had no knowledge ("notice") of any defect in the title of the person who negotiated the bill to him. (This follows from the requirement of good faith and will be explained later in this unit.)

We will now discuss each of these requirements in more detail.

1. It is clear that the holder in due course must be a holder. He will thus have to comply with the definition of a holder as contained in s 1 of the BEA (as discussed in unit 6). He will thus have to be the payee or endorsee of the bill in his possession or the bearer thereof before he can be the holder in due course.

2. Section 27(1) requires the holder in due course to have acquired the bill "complete and regular on the face of it".

The word "face" should be taken to refer to the outward or external appearance of the bill. In determining whether an instrument is
“complete and regular on the face of it”, the judgement of the reasonable person taking the instrument with due care has to be borne in mind.

A bill is irregular “on the face of it” if its appearance leads one to the reasonable conclusion that there are prior parties having defences on the bill or that they are entitled to real rights to it. If, for example, one is to determine whether an endorsement of a payee is irregular, one should question whether this endorsement is of such a nature that reasonable doubt exists as to the identification of the payee (endorser).

Not every irregularity constitutes an irregularity for purposes of s 27(1). The post-dating of a cheque, for example, or the alteration of a date on a bill without the signatures or initials of the drawer, does not necessarily constitute an irregularity. It is obvious that a signature which is not required on a bill (or which ought not to be on a bill) is not necessarily an irregularity. Typical examples of irregularities are where the holder receives a torn bill, apparently to indicate that it is cancelled, or where the holder receives an instrument after a thief has erased the name of the payee and substituted his own name. The erasure marks should have warned the holder.

It must be noted that section 27(1) does not set two separate requirements, that is “completeness” and “regularity”. The expression “complete and regular” should rather be treated as one concept. A holder in due course must take a bill, which means that he must acquire an instrument that complies with the requirements of s 2(1) — as discussed in unit 3. If an instrument lacks the essential elements, it will not be a bill of exchange and the person acquiring it will not be holder — and will consequently not be a holder in due course. (We have already observed that the holder in due course is in the first place a holder (requirement 1).) Omissions of non-essential elements, on the other hand, can only disqualify a person from being a holder in due course if claims or defences of prior parties to the bill could reasonably be inferred from these omissions.

(3) According to section 27(1)(a), the holder in due course must have become the holder of the bill before it was overdue. The due date on a bill is the day on which it is payable. Once this day is past, the bill is overdue. A bill which is payable on demand is due the moment it is presented for payment, and the due date is past if the holder waits for an unreasonable time before presenting it for payment. In determining what the reasonable time is, regard shall be had to the nature of the bill, the trade usages with regard to similar bills and the facts of a particular case. (Sections 72(2) and 90(2) contain special provisions in regards to cheques and notes respectively concerning the issue of “reasonable time” for payment.)

A person who acquires an overdue bill cannot be a holder in due course. This person, according to section 34(2), will take the bill “subject to any defects of title affecting it at its maturity”, and he will not acquire nor give better title than that which the person from whom he took it
had. This person takes the bill subject to the defences and claims which could have been raised against his predecessors in title. An overdue bill may still be negotiated. The transferee may thus become the holder. It can, however, not be negotiated in the sense that the transferee takes it free from defences and claims of prior parties. The negotiation of an overdue bill will effect the transfer of the personal and real rights of the transferor only — no more and no less.

(4) The holder should have no knowledge that the bill has previously been dishonoured. A holder who takes a bill with such knowledge can obviously not become a holder in due course.

(5) A holder must take the bill in good faith in order to be a holder in due course. Good faith (bona fides) is defined as follows in s 94:

“A thing is deemed to be done in good faith, within the meaning of this Act, where it is in fact done honestly, whether it is done negligently or not.”

The requirement that the holder must have been in good faith at the time the bill was negotiated to him involves several aspects. It means that he must have taken the bill without knowledge of a previous dishonour and without knowledge of any defect in title of the person who negotiated it to him. It is said that the requirements that the bill be complete and regular and that the holder in due course must have become holder before it was overdue can be included under the broad requirement that his acquisition be in good faith.

The BEA insists on the holder’s honesty. Good faith is therefore measured by determining whether the holder had a certain subjective state of mind when he acquired the instrument. The question is not whether he should have had knowledge of a certain fact but whether he did in fact have such knowledge.

A holder may be dishonest even where he has no knowledge of a specific defect in title. The holder’s acquisition may be in bad faith if he merely suspects that something is wrong or that there is something improper about the bill. If the holder suspects that something is wrong but chooses to remain ignorant of the true state of affairs, he is not acting in good faith.

(6) Section 27(1)(b) requires the holder in due course to take the bill for value. Section 25 of the BEA provides that

‘a holder takes a bill for value if he takes it under onerous title’.

Thus, a person will be a holder in due course where he takes a bill either for due consideration (not as a gift) or on the basis of quid pro quo (literally: something for something).

(7) Section 27(1)(b) requires that the holder must have been ignorant of certain facts “at the time the bill was negotiated to him”, to qualify as a holder in due course. The holder in due course must therefore have acquired the bill in a specific way, that is, by negotiation. A cessionary
or a person who has found a lost bill will not be a holder in due course even if all the other requirements in the definition have been met because the bill was not negotiated to him.

In terms of s 29(2), a bill payable to bearer is negotiated by delivery, while a bill payable to order, in terms of s 29(3), is negotiated by the endorsement of the holder together with delivery. With reference to s 29(3), 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. The payee of an order bill can therefore be the holder of it, but not the holder in due course. In contrast, the first delivery of a bill to the payee of a bearer bill is both “negotiation” and “issue”. Therefore, if all the other requirements have also been met, the payee of a bearer instrument can be the holder in due course. If the payee of a bearer bill is an immediate party of the drawer, there is no benefit in calling the payee the holder in due course. (We have already discussed what is meant by immediate parties in unit 4.)

(8) The holder must have had no knowledge (“notice”) of any defect in the title of the person who negotiated the bill to him. Defects in title are discussed below (par 5.2).

Activity 1

Read the following scenario, and give at least four reasons why D is not a holder in due course.

A drew a bill on B in favour of C or order. C negotiated the bill to D by endorsement and delivery. D did not give consideration for the bill as C intended it as a gift. When D received the bill in her possession, the bill was already past the payment date and she was aware that the bill was originally drawn to finance an illegal transaction, involving an unlicenced firearm, between A and C.

4 RIGHTS OF THE HOLDER IN DUE COURSE

We have indicated in this unit that the holder in due course is, in the first place, a holder. He will accordingly enjoy the rights of an ordinary holder but will, in addition, also enjoy the rights of a holder in due course because of his compliance with the above requirements. Apart from the rights of the holder, covered in unit 6, the holder in due course enjoys the following additional rights:

(1) In terms of s 36(c)(i), if the title on a bill is defective and a holder negotiates it to a holder in due course, the holder in due course obtains a good and complete title on it.

A draws a cheque on B Bank in favour of C or bearer. X, a thief, steals the cheque and negotiates it to D who is a holder in due course. D now
has a valid title against A, B Bank and C. C (who was the owner of the cheque) cannot claim the value from D.

(2) In terms of section 36(b), a holder in due course holds the bill free from any defect in the title of parties prior to him, as well as from mere personal defences available to prior parties among themselves, and he may enforce payment against all parties liable on the bill. There are, however, certain defences that may be raised against the holder in due course, which are known as absolute defences. The discussion on relative and absolute defences will follow at paragraph 5 below.

(3) In terms of section 52(b), the acceptor, by accepting the bill, is precluded from denying to the holder in due course:

- the existence of the drawer, the genuineness of his signature and his capacity and authority to draw the bill;
- where the bill is payable to the drawer’s order, the then capacity of the drawer to endorse, but not the genuineness or the validity of his endorsement; and
- where the bill is payable to the order of a third person, the existence of the payee and his then capacity to endorse, but not the genuineness or the validity of his endorsement.

The acceptor in the context of section 52(b) is sometimes referred to as the acceptor by estoppel.

(4) The drawer of a bill is, in terms of s 53(1)(b) precluded from denying to a holder in due course the existence of the payee and his then capacity to endorse. The drawer in the context of section 53(1)(b) is sometimes referred to as the drawer by estoppel.

(5) The endorser of a bill, by endorsing it, is in terms of section 53(2)(b) 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. The endorser in the context of section 53(2)(b) is sometimes referred to as the endorser by estoppel. (This concept is discussed in detail in unit 5.)

(6) According to section 19(1) no contract on the bill shall be complete and irrevocable until the bill is delivered. Section 19(3) determines that if a bill is in the hands of a holder in due course, a valid delivery of the bill by all parties prior to him is irrebuttably (conclusively) presumed to have taken place. All prior parties will thus be liable to the holder in due course.

(7) In terms of section 54, if a person signs a bill otherwise than as a drawer, acceptor, or drawee certifying a cheque, he thereby incurs the liability of an endorser to the holder in due course.

(8) According to section 10(b), if a wrong date is inserted on a bill and it comes into the hands of the holder in due course, the bill shall not be void, but shall operate and be payable as if the inserted date had been the true date.
(9) In terms of section 18(3), if an **incomplete bill** is not completed within a reasonable time and strictly in accordance with authority given, and it is negotiated to a holder in due course after it is completed, it shall be valid and effectual for all purposes in his hands and he may enforce it as if it had been completed within the time allowed and strictly in accordance with the authority given.

(10) According to section 46(a), if a bill is **dishonoured by non-acceptance**, and **notice of dishonour is not given**, the rights of the holder in due course who became holder after the omission shall not be prejudiced thereby.

5 **ABSOLUTE AND RELATIVE DEFENCES**

We have noticed from the discussion above that absolute defences may be raised against the holder in due course but relative defences may not. It is therefore necessary for us to distinguish between absolute and relative defences. Absolute defences are so called because they are applicable to all holders, including the holder in due course.

5.1 **Absolute defences**

Absolute defences relate to the document itself. The defendant, by raising an absolute defence, avers that although it appears that he has bound himself on the bill, it is not attributable to him. The following remarks are made in respect of absolute defences:

- A person’s capacity to incur liability as a party to a bill accords with his capacity to contract (s 20(1)). The defence that the **defendant lacked capacity** during the signing of the bill may therefore be raised against the holder in due course.
- A defendant may also claim that his signing of the document should not be seen as a valid legal act because such signature was obtained by **vis absoluta** (literally: absolute force), without his consent and by force.
- According to section 21, no person is liable as **drawer, acceptor or endorser** of the bill if he has **not signed it as such**. A holder in due course will according to section 22 not be able to hold a defendant liable, where a signature is **forged or unauthorised**, because such signature is **wholly inoperative**.
- Another absolute defence is that a bill or an acceptance was **materially altered** without the defendant’s consent. The defendant will in effect only be liable on the document as it existed in its original form.
- Another absolute defence is the **non est factum**. An example of this is where a person signs a document unaware that it is a negotiable instrument, or that it will be used as such. The signer of the document must not have created the impression either negligently or intentionally that he binds himself on it.
5.2 Relative defences

According to s 36(b), a holder in due course “holds the bill free from any defect in the title of prior parties, as well as from mere personal defences available to prior parties among themselves, and may enforce payment against all parties liable on the bill”. The same is reiterated in s 36(c)(i) which states that if a holder’s title is defective but the bill is negotiated to a holder in due course, the holder in due course “obtains a good and complete title to the bill”.

There are thus two types of defences that do not apply to (and may not be used against) the holder in due course: the defence of a defect in title (also known as a defence in rem) and a mere personal defence (also known as a defence in personam). These two types of defences together are sometimes referred to as relative defences. They may be defences against others, but not against the holder in due course. The Latin expression of nemo plus iuris (meaning that one cannot transfer more rights than one has) is thus not applicable to the holder in due course in the context of relative defences. The holder in due course may indeed acquire more rights than his predecessor. (In the context of absolute defences, however, the nemo plus iuris rule also applies to the holder in due course.)

The BEA does not provide a definition of either title defences or personal defences. They will thus have to be defined in terms of the common law.

5.2.1 Title defences (defences of {defective} title) (defences in rem)

Defences of (defective) title refer to claims for the recovery of the bill (for example, against a thief) and to defences available against the rights arising from the bill that are based on the contracts on the bill or on the underlying agreements. Section 27(2) provides some examples of this type of defence: the title of the person is defective “if he obtained the bill, or the acceptance thereof, by fraud or other unlawful means, or for an illegal consideration, and is deemed to have been so defective if he negotiates the bill in breach of [good] faith, or under such circumstances as amount to fraud”. This s 27(2) does not provide an exhaustive list — indeed it does not even name the most important title defence, that is, breach of contract. Many other defences may be mentioned in addition: misrepresentation; undue influence; error; payment; set-off; and prescription.

5.2.2 Personal defences (defences in personam)

An example here is that of an unliquidated counterclaim as a personal defence, that is a counterclaim for an as yet undetermined amount.

Activity 2

Read the scenario below and answer the questions given based on the discussion above. Your answer should include an explanation.
Unit 7: The holder in due course

A buys a car from C for R10 000,00. In payment of the purchase price, A delivers to C a cheque drawn on B Bank in favour of C for R10 000,00. C negotiates the cheque to D, who is a holder in due course. The car, however, has a faulty gear transmission and A stops the cheque. D claims payment from A.

1) Does A have a defence against D’s claim because C committed breach of contract by delivering a defective car?
2) Does A have defence against D’s claim if C did not have the capacity to endorse the cheque?
3) Assume that A’s signature on the cheque was forged by one X. X fraudulently presents himself as A’s agent, and takes delivery of the car. Does A have a defence against D’s claim?

Summary activity

Read the scenario below and answer the questions given based on the discussion above. Your answer should include an explanation.

C sells a watch to A. In terms of the agreement, the watch has to be a Rolex. C, however, delivers a cheap imitation of a Rolex. As A is not aware of the fraud, he pays C with a cheque for R50 000,00. The cheque was drawn on B Bank in favour of C or order. C immediately negotiates the cheque to D. D is aware of C’s fraud. When A becomes aware of C’s fraud, he stops his cheque. D claims R50 000,00 from A.

1) Is D a holder in due course?
2) Does A have a defence against D’s claim? Assume for purposes of question 2 that D is indeed a holder in due course.

Feedback 1

Refer to the requirements discussed under heading number 3 (especially requirements 3, 5, 6 and 8). In the context of requirement 8, also see the discussion of absolute and relative defences at heading number 5.

Feedback 2

1) Section 36(b) provides that the holder in due course holds a bill free from any defects in the title of the prior parties. Section 36(c)(i) provides that a holder in due course obtains a good and complete title to the bill even if the title of its pre-
decessor was defective. In terms of s19(3), a valid delivery of the bill by all predecesors is conclusively presumed. From these ss it is clear that D (being a holder in due course) holds the bill free from any defects in title and that he has a good and complete title to the bill. He may thus enforce payment against all parties liable on the bill, including A. None of the parties (including A) may claim a defence of title or a personal defence. The title of C (D’s predecessor) might have been defective because of his breach of contract — breach of contract being the most important example of a title defence (a defence in rem). Title defences, however, are not applicable to a holder in due course. A therefore does not have a defence against D’s claim.

(2) In terms of s 53(1)(b), a drawer of a bill is precluded from denying the payee’s then capacity to endorse to a holder in due course. Therefore A cannot deny C’s capacity to endorse and A does not have a defence against D’s claim.

(3) According to s 21, no person is liable as a drawer of a bill if he does not sign it as such. According to s 22, a forged signature on a bill is wholly inoperative. A is therefore not liable on the bill and his defence against D’s claim will succeed.

Feedback for summary activity

(1) No, as he has knowledge of a defect in the title of C and was not “honest” in terms of s 94. This flows from the requirement of bona fides or good faith. The breach of contract by C is indeed a defect in title: also see the answer to question 2.

(2) See the answer to question 1 of activity 2. If D were a holder in due course, he holds the bill free from any defects in title, such as for instance C’s breach of contract. A therefore does not have a defence against D.
UNIT 8

THE CONTRACTS OF THE DRAWER, ACCEPTOR AND ENDORSER ON THE BILL

After studying this unit you should be able to

- explain your understanding of the drawer's contract on the bill with particular reference to the BEA
- analyse a given set of facts presented in a scenario and explain your understanding of the drawer's contract on the bill
- explain your understanding of the acceptor's contract on the bill with particular reference to the BEA
- explain your understanding of the concept of acceptance in terms of the BEA
- analyse a given set of facts presented in scenario and explain your understanding of the contract of the acceptor and acceptance
- explain your understanding of the endorser's contract on the bill with particular reference to the BEA
- explain your understanding of the fundamental differences between an endorser and a transferor by delivery

There is no prescribed reading for this unit.

1 INTRODUCTION

In previous units, you were introduced to some of the parties that play a role in negotiable instruments: the holder, drawer, acceptor and endorser. In units 6 and 7 we discussed the relationships (liabilities and rights) which the
holder (and the holder in due course) has with the other parties. Our next step is thus to discuss the contracts of the drawer, acceptor and endorser on the bill.

2 THE CONTRACT OF THE DRAWER ON THE BILL

Section 53(1)(a) of the BEA lists the liabilities of the drawer. These liabilities are:

- In the first place the drawer guarantees that the bill will be accepted and paid according to its tenor if properly presented. (The word tenor refers to the actual wording of the bill.) Thus the drawer is a surety in the sense that he undertakes that the bill will be accepted and paid.

- In the second place the drawer undertakes to compensate the holder or endorser, who is compelled to pay on the bill, if it is dishonoured, provided of course that the requisite proceedings on dishonour are duly followed. In other words, the drawer undertakes to pay the relevant party personally if the drawee does not accept the bill or the acceptor (drawee) does not pay on it. The requirement mentioned above refers to proper notice of dishonour, which must be given to the parties concerned upon dishonour. The drawer thus incurs an obligation and is possibly liable. From the above it is clear that the drawer must comply with the following requirements to incur an obligation:

  — signing the document as drawer (ss 2(1) and 21);
  — delivery of it (s 19(1))

The following requirements must be complied with to render the drawer liable:

  — proper presentment for acceptance or payment as the case may be
  — dishonour by non-acceptance or non-payment as the case may be (ss 41 and 45)
  — notice of dishonour (s 46(a))

All these requirements have to be complied with before the drawer may be held liable to the holder or endorser as the case may be.

- In the third place the drawer guarantees to the holder in due course that the payee exists and that he has the capacity to endorse the document. If it should therefore happen that payment is demanded from the drawer by a holder in due course, the drawer is precluded from denying the existence of the payee and that he did not have the contractual capacity to endorse the document at the time when he did so. In this sense, the existence and contractual capacity of the payee is guaranteed to the holder in due course by the drawer. The drawer does not guarantee the signature of the payee to a holder in due course, which means that he does not guarantee that the signature of the payee is genuine.

In terms of s 14(a), a drawer may, however, insert words in the bill which would either exclude or limit his liability towards the holder. Where the
drawer excludes his liability, his signature performs a constitutive function only (brings the document into existence) and he incurs no liability on the document. Where the words limit his liability appear, his liability is varied accordingly.

In terms of section 14(b) the drawer may also waive, as regards himself, some or all of the holder’s duties. An example of this is where he states that the holder does not have to give notice of dishonour. In this case his liability is also varied.

Activity 1

Read the scenario below and answer the question given based on the discussion above. Your answer should include an explanation.

Mr Nkhumise approaches you for some advice. He relates to you that a business associate of his, Allen, had drawn a bill on Ben in favour of him, Mr Nkhumise. Mr Nkhumise presented this bill within the proper time to Ben for payment. This bill, however, was dishonoured. Mr Nkhumise now wants to claim the amount on the bill from Allen, the drawer. Advise Mr Nkhumise whether he will be able to hold Allen liable for payment.

3 THE CONTRACT OF THE ACCEPTOR ON THE BILL AND ACCEPTANCE

The drawee, the person who is ordered to pay by the drawer, is not liable on the bill in this capacity. Section 51 provides that a bill is not an assignment of funds in the hands of the drawee and available for payment. According to this section, if the drawee does not accept the bill, he is not liable on it. By accepting the bill, the drawee becomes the acceptor and does incur liability on it. We will return to the specific liabilities of the acceptor (drawee) later in this unit, but it is more important to discuss acceptance at this point, because the source of the drawee’s liability on the bill is his acceptance.

4 ACCEPTANCE

4.1 Introduction

As we know, a bill is an order given by the drawer to the drawee. According to section 15(1), the acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. As a general rule, only the drawee has the capacity to accept the bill.

4.1.1 When is acceptance necessary?

The acceptance of a bill is not a requirement for its validity, and many bills are created and discharged without ever being accepted. The only
instances that require the holder to present the bill for acceptance are contained in section 37(1) and (2) (which has been discussed in unit 6):

- where the bill is payable after sight and presentment is necessary to fix the due date
- where the bill expressly stipulates that it shall be presented for acceptance
- where the bill is payable at a place other than the place of business or residence of the drawee

According to section 37(3), in no other instance is presentment for acceptance necessary to render a party liable on the bill. This, of course, does not mean that all bills are accepted only in the abovementioned instances. The holder is free to present the bill for acceptance in other instances.

4.1.2 Time for acceptance
According to section 16, a bill may be accepted:

- before it has been signed by the drawer
- while it is otherwise incomplete
- when it is overdue
- after it has already been dishonoured by non-acceptance or non-payment.

4.1.3 Requirements for valid acceptance
According to section 15(2) read with section 19(1), an acceptance will be invalid unless it complies with the following requirements:

- It must be written on the bill and be signed by the drawee.
- The mere signature of the drawee without additional words is, however, sufficient.
- It must not stipulate that the drawee will perform by any other means than the payment of money.
- The contract on the bill will not be complete and irrevocable before delivery of the document.
- If the drawee gives notice to the person entitled to the bill that he has accepted it, the acceptance becomes complete and irrevocable.

4.2 Types of acceptances

By accepting and delivering the bill, the drawee incurs an obligation on it. According to section 52(a) the acceptor (drawee), by accepting it, engages that he will pay it according to the tenor of his acceptance. Section 15 on the other hand, states that the acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. There is clearly conflict between the two sections: section 52(a) states that the drawee will pay according to what he stipulates upon acceptance, while in terms of section 15 the drawee indicates that he regards himself as obliged to pay what the drawer ordered. The BEA thus acknowledges the possibility that an acceptance may differ from the content of the bill, in which case we will
be dealing with a qualified acceptance. Section 17 contains the provisions relating to general and qualified acceptance.

4.2.1 General acceptance
According to section 17(2)(a), a general acceptance is the assent without qualification by the drawee to the order of the drawer. This case is in conformity with the description of acceptance in section 15(1). In terms of section 17(2)(b), an acceptance to pay at a particular place will be deemed to be a general acceptance, unless it expressly states that the bill is to be paid there only and not elsewhere.

4.2.2 Qualified acceptance
A qualified acceptance in express terms, according to section 17(3)(a) varies the effect of the bill as drawn. This case is in conformity with the description of acceptance in section 52(a). Here there is only a partial agreement by the drawee to the drawer’s order. An acceptance is qualified according to section 17(3)(b) if it is:

- conditional — it makes payment by the acceptor dependent on the fulfilment of a condition
- partial — acceptance to only pay part of the amount for which the bill is drawn
- an acceptance to pay only at a particular specified place and not elsewhere
- qualified with regards to time and payment
- the acceptance of one or more of the drawees but not all

According to section 42(1), a holder may refuse to accept the qualified acceptance, and if he is not able to obtain an unqualified acceptance, he may regard the bill as dishonoured by non-acceptance. In terms of sections 42(2) and (3), if the holder chooses to accept a qualified acceptance, then the drawer and all endorsers are freed of their liabilities, except those who have previously authorised the holder to take a qualified acceptance and those who subsequently assented thereto.

Now that we have discussed acceptance we return to the liability of the acceptor. Section 52 sets out the obligations the drawee (acceptor after acceptance) takes upon himself by acceptance, which can be summarised as follows:

He undertakes to pay the bill according to the tenor of his acceptance.

- He guarantees to the holder in due course that the drawer exists, that the drawer’s signature is genuine and that the drawer had the capacity and authority to draw the bill.
- The acceptor guarantees the capacity of the drawer to endorse in the case of a bill drawn payable to the order of the drawer. He does not, however, guarantee the genuineness of the endorsement (s 52(b)(ii)).
- If the bill is payable to the order of a third party, the drawee guarantees by his acceptance the existence of the payee and his capacity to endorse
at the time when he endorsed, but not the validity or genuineness of the endorsement of the payee (s 52(b)(iii)).

**Activity 2**

Read the statement below and answer the questions that follow.

“The drawee, the person who is ordered to pay by the drawer, is automatically liable on the bill in this capacity”

(1) In your opinion is the statement:

(a) completely correct  
(b) completely incorrect  
(c) partially correct

(2) Substantiate your answer with reference to the BEA.

**Activity 3**

Read the scenario below and answer the questions given based on the discussion above. Your answers should include an explanation.

A draws a bill on B in favour of C or order. On the bill it is clearly stipulated that it must be presented for acceptance. C accordingly presents the bill for such acceptance. Upon receipt, B places his signature on the bill with no additional words. B does not return the bill to C but does, however, notify him (C) that he (B) has accepted the bill.

(1) Is this a valid acceptance by B?
(2) If B, the drawee (acceptor after acceptance), had stipulated on the bill that payment by him is dependent on the fulfilment of a particular condition, is the holder, C, obliged (forced) to take this acceptance?

5 **CERTIFIED CHEQUES**

Certified cheques also form part of the discussion on the liability of the drawee. Section 72A(1) of the BEA states that a cheque is certified if a drawee indicates on it in writing that it will be paid or that there are funds available for payment. Section 72A(2) provides that when the drawee certifies a cheque, he undertakes to pay to the holder, drawer or endorser who has been compelled to pay the cheque, the amount recoverable in terms of his (the drawee’s) guarantee.
The drawee is precluded from denying to a holder in due course:

- the existence of the drawer, the genuineness of the drawer’s signature and the drawer’s capacity and authority to draw the cheque; and
- the existence of the payee and his capacity to endorse the cheque.

It must always be kept in mind that although one is dealing with cheques in this regard, the principles of liability relating to bills are applicable as well. One of the differences between a cheque and a bill is the fact that a cheque is drawn on a bank. This means that the drawee in respect of cheques will be a bank but it is not guaranteed that the holder will receive payment on it. The same principle relating to bills is applicable in this regard, in the sense that the drawee bank will only be liable (on the cheque) if it has accepted it.

The position is different in respect of certified cheques, however. According to the provisions of section 72A, the liability of a bank that certifies a cheque is similar to that of an acceptor in that this bank undertakes to pay the holder. Considering what has been said, one can clearly understand why people sometimes insist on payment by means of a certified cheque. The holder of a certified cheque thus enjoys greater protection because the bank guarantees that payment will be made.

6 THE ENDORSER’S CONTRACT ON THE BILL

The payee is not bound on the bill merely because his name is mentioned in it. In this regard the payee is in much the same position as the drawee. As far as the payee is concerned, there is no contract on the bill which places an obligation on him before his signature is placed thereon. Moreover, the payee must deliver the document to another person, after having signed it, in order to create a contract. In the case of the payee, delivery of the document constitutes confirmation of his signature and he is not in a position merely to give notice that he has signed the document.

According to section 53(2) the endorsement brings with it the following liabilities for the endorser:

- He guarantees that on due presentment, the bill shall be accepted and paid according to its tenor and if it is dishonoured, he will compensate the holder or endorser who is compelled to pay it, provided the required proceedings on dishonour are duly taken.
- In the second place, the endorser guarantees all aspects of the genuineness and validity of the drawer’s signature and of all previous endorsements to a holder in due course (see the discussion of s 53(2)(b) in unit 5).
- In the third place, the endorser is precluded from denying to his immediate or a subsequent endorsee that, at the time of his endorsement, the bill was valid and existing and that he had a valid title to the bill at that stage.
7 THE TRANSFEROR BY DELIVERY

In terms of section 56, if a holder of a bill payable to bearer negotiates it by delivery without endorsing it, he is called a transferor by delivery. A transferor by delivery is not liable on the bill because he has not signed it. There is thus a marked distinction between the endorser's liability and that of the transferor by delivery. As we noticed above, the endorser's liability arises from the contract on the bill, and he is liable by virtue of the instrument itself (the endorser's contract on the bill is completed once his signature is placed thereon). The transferor by delivery is therefore clearly not an endorser, because he has not signed the bill in any capacity and is not liable on it. The transferor by delivery does, however, assume certain obligations by negotiating the bill. In terms of the provisions of s 56(3), the transferor by delivery warrants to his immediate successor, if the latter is a holder for value, that:

- the bill is what it purports to be
- he (the transferor by delivery), has a right to transfer it
- at the time of transfer, he (the transferor by delivery) is not aware of any fact which renders it valueless.

Activity 4

What are the fundamental differences between an endorser and a transferor by delivery? All that is required is a brief list illustrating these differences.

Summary activity

Read the scenario below, and answer the questions given based on the discussion above. Your answers should include an explanation.

A draws a bill on B in favour of C or order. B accepts the bill by stipulating on it that he (B) will pay it at a particular place (there are no other stipulations in this regard).

C negotiates the bill to D by endorsement completed by delivery.

1. What must be complied with before A may be held liable on the bill by the holder or endorser?
2. Is there any manner in which A could limit or exclude his liability towards the holder?
3. Is B's acceptance general or qualified?
4. Does B, by his acceptance, guarantee anything to D?
5. What are the consequences of C's endorsement on the document?

Feedback 1

This activity deals with the contract of the drawer on the bill. Section 53(1)(a), among others, states that the drawer undertakes to compensate the holder (in our scenario, Mr Nkhumise) or endorser, who is compelled to pay if the bill is dishonoured, provided the required proceedings upon dishonour are duly taken. In other words, the drawer undertakes to pay the
relevant party himself if the drawee does not accept the bill or the acceptor (drawee before acceptance) does not pay on it. The required proceedings mentioned are the proper notice of dishonour, which must be given to the parties concerned upon dishonour.

The drawer incurs an obligation by:

- signing the document as drawer; and
- delivering it.

He incurs liability if the following has been done:

- proper presentment for acceptance or payment as the case may be;
- dishonour by non-acceptance or non-payment as the case may be; and
- notice of dishonour.

Mr Nkhumise, the holder will thus be able to hold Allen, the drawer, liable for payment of the bill.

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**Feedback 2**

1. This statement is (c) partially correct.
2. The first part of this statement is correct: the drawee is the person ordered to pay by the drawer. The second part, however, regarding the drawee’s automatic liability, is incorrect. Section 51 is applicable in this regard. According to this s, a bill is not an assignment of funds in the hands of the drawee and available for payment. If the drawee does not accept the bill, he is not liable on it but by accepting, he becomes the acceptor and incurs liability on it. Always remember that acceptance is the source of the drawee’s liability on the bill.

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**Feedback 3**

1. Sections 15(2) and 19(1) are applicable in this case. The requirements are:

- The acceptance must be written on the bill and be signed by the drawee.
- The mere signature of the drawee is, however, sufficient. This requirement has been complied with in our scenario.
- It must not stipulate that the drawee will perform by any other means than the payment of money. There is no stipulation by the drawee in our scenario from which we can deduce that there will be payment (performance of his promise) by any other means than the payment of money. Requirement (c) is thus also complied with.
- The contract on the bill will not be complete and irrevocable, before delivery of the document.
- If the drawee gives notice to the person entitled to the bill that he has accepted it, the acceptance becomes complete and irrevocable. This requirement is indeed complied with. There was thus a valid acceptance.

2. Not! In the first place, this is a qualified acceptance. A qualified acceptance varies the effect of the bill as drawn (s 17(3)(a)). Section 17(3)(b) provides among other things, that an acceptance is qualified if it is conditional, that is: it makes payment by the acceptor...
dependent on the fulfillment of a condition. According to s 42(1), a holder (C in our scenario) is not obliged to take this qualified acceptance — he may refuse it. If he is not able to obtain an unqualified acceptance, he may regard the bill as dishonoured by non-acceptance. In terms of sections 42(2) and (3), if C (the holder) chooses to take this acceptance, A (and all endorsers, if there were any) will be freed from liability.

Feedback 4

The main differences are the following:

<table>
<thead>
<tr>
<th></th>
<th>Endorser</th>
<th>Transferor by delivery</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>There is no contract on the bill which places an obligation on the payee before his signature is placed thereon.</td>
<td>The transferor by delivery is not liable on the bill because he has not signed it.</td>
</tr>
<tr>
<td>2</td>
<td>The payee must deliver the document to another after having signed it to create a contract.</td>
<td>The transferor by delivery, being the holder of a bill payable to bearer, only delivers the document — there is no signature in any capacity.</td>
</tr>
<tr>
<td>3</td>
<td>The endorser’s liability arises from the contract on the bill, and he is liable by virtue of the instrument itself</td>
<td>The transferor by delivery is not liable on the bill (he did not sign it) — there is thus no question of liability that arises from the contract on the bill.</td>
</tr>
</tbody>
</table>

Feedback for summary activity

1. A is the drawer of the bill. All of the following requirements must be met before the drawer may be held liable to the holder or endorser. To incur an obligation on the bill, the drawer A must have:
   - signed the document (ss 2(1) and 21)
   - delivered it

   His liability is established if:
   - there was proper presentment for acceptance or payment (as the case may be) (ss 41 and 45)
   - there was non-acceptance or non-payment (as the case may be)
   - the holder gave proper notice of this dishonour (s 46(a))

2. Yes! This is possible in terms of ss 14(a) and (b). In terms of s 14(a), a drawer may insert words in the bill which would either exclude or limit his liability towards the holder.
Unit 8: The contracts of the drawer, acceptor and endorser on the bill

Where the drawer excludes his liability his signature performs a constitutive function only (brings the document into existence) and he incurs no liability on the document. Where the words limit his liability, his liability is varied accordingly. In terms of s 14(b), the drawer may also waive, as regards himself, some or all of the holder’s duties. An example of this is where he states that the holder does not have to give notice of dishonour. In this case his liability is also varied.

(3) It is a general acceptance. Section 17(2) is applicable in this regard. Section 17(2)(a) states that a general acceptance is the assent by the drawee, without qualification, to the order of the drawer. Section 17(2)(b) states that an acceptance to pay at a particular place will be deemed to be a general acceptance, unless it expressly states that the bill is to be paid there only and not elsewhere. In our scenario there is no further stipulation stating that the bill is to be paid at a particular place only and not elsewhere; therefore it is a general acceptance.

(4) Yes! In our scenario, the bill is payable to a third party. Section 52(b)(iii) is applicable in this regard. According to this section, the drawee (B in our scenario) guarantees (by his acceptance) the existence of the payee and his capacity to endorse at the time when he endorsed, but not the validity or genuineness of the endorsement of the payee.

(5) As was explained under paragraph 6, the endorsement brings with it the following liabilities for the endorser:

- He guarantees that on due presentment, the bill shall be accepted and paid according to its tenor and if it is dishonoured, he will compensate the holder or endorser who is compelled to pay it, provided the required proceedings on dishonour are duly taken.
- In the second place, the endorser guarantees all aspects of the genuineness and validity of the drawer’s signature and of all previous endorsements to a holder in due course.
- In the third place, the endorser is precluded from denying to his immediate or a subsequent endorsee that, at the time of his endorsement, the bill was valid and existing and that he had a valid title to the bill at that stage.

Please consult your lecturers should you still be unclear about the answers to this activity.
UNIT 9: The discharge of the debt on the bill, and related matters

UNIT

THE DISCHARGE OF THE DEBT ON THE BILL, AND RELATED MATTERS

After studying this unit you should be able to

- explain your understanding of the concept of discharge of a bill in terms of the BEA
- identify and explain the requirements for payment in due course based on facts presented in a scenario
- identify and explain the most important methods of discharge based on facts presented in a scenario
- analyse a given set of facts presented in a scenario and establish whether or not discharge of a bill has taken place
- explain your understanding of the concept of release of parties to a bill
- analyse a given set of facts presented in a scenario and establish whether there was a release of a party to a bill
- compare the effects of discharge of a bill and release of parties to a bill respectively, based on facts presented in a scenario

There is no prescribed reading for this unit.

1 INTRODUCTION

It should be clear by now that more than one obligation may exist on a bill. There may also be more than one person liable on it, namely the drawer, the acceptor and the endorser. The questions that arise in this respect are: in which ways may the obligations that exist on the bill be completely
discharged, and in which ways may the obligation of a party who is liable on the bill be released? We will therefore discuss the first question as discharge of the bill and the second as release of parties to the bill.

2 DISCHARGE OF THE BILL

As a rule, the instrument is discharged as soon as the acceptor or drawee has effected payment in due course (the discussion of payment in due course will follow at par 2.1). After discharge, the debt on the bill is extinguished, together with all the contracts on the bill. The instrument is no longer negotiable and no recipient can become a holder in due course thereof.

A draws a bill on B in favour of C or order. B accepts the bill. C negotiates the bill to D, D negotiates it to E and E to F. C, D, and E endorsed the bill. F, as the holder, presents the bill for payment on the due date, and B pays in due course. The bill is discharged by payment and not only B, but also drawer A and endorsers C, D and E are released thereby. All the contracts on the bill are discharged — not only the acceptor’s contract on the bill, but also those of the drawer and endorsers.

Suppose B in the example above refuses to pay F on the due date, after F has duly presented the bill for payment — that is, B dishonours the bill by non-payment. Now F must give due notice of dishonour to the drawer, A, and all previous endorsers, that is C, D and E. After this, F may sue any of the previous endorsers or the drawer for payment. Suppose F sues D for payment and D pays. Now D may sue A, B, or C for payment. However, D may not sue E, since E is a ‘‘subsequent endorser’’ as far as D is concerned (s 55(1)). Suppose D sues the drawer, A, and A pays. Now A may sue B only. As long as B refuses payment, the bill is not discharged.

2.1 Methods of discharge

A bill may be discharged in various ways. The most important methods of discharge will be discussed in brief.

2.11 Discharge by payment in due course

Payment in due course protects the acceptor in that it discharges the bill and extinguishes the rights of the owner against him (the acceptor). The acceptor may therefore rely on the appearance of legitimacy created by the possession of the instrument. As a rule, negotiable instruments are discharged in this way, that is, by payment in due course by the drawee or acceptor.

Section 57(1) provides that a bill is discharged by payment in due course if such payment is made by or on behalf of the drawee or acceptor.

Not any payment, but only payment in due course will have this effect. A payment in due course in terms of s 1 entails ‘‘payment made at or after the
maturity of a bill to the holder thereof in good faith and, if his title to the bill is defective, without notice thereof’.

There are thus five requirements that must be complied with for payment in due course:

- There must be a payment.
- The payment must be made in good faith.
- The payment must be made on or after the due date.
- The payment must be made to the holder of the instrument and not to a mere possessor.
- The payment must be made without notice of any possible defect in the holders’ title to the bill (this is also implied by the requirement of good faith).

To effect the discharge of the bill, this payment in due course must be made by or on behalf of the drawee or acceptor, and not, for instance, by the drawer or by an endorser. It should be added that it will be proportionately discharged if part payment is made by or on behalf of the drawee or acceptor. It must also be kept in mind that payment in due course does not mean that payment must be made to a holder in due course.

We now consider these requirements more closely:

(1) There must be payment
Although payment is not defined in the BEA, it is the duty of the drawee or acceptor to make payment of the bill in money. ‘‘Payment’’, therefore, refers to payment in money. It must be noted that ‘‘payment’’ is not the only way in which obligations are discharged, and must therefore be understood to include other methods of discharge.

(2) The payment must be made in good faith
Payment made in due course, is payment made in good faith to the holder of a bill. We have already discussed what is meant by good faith or bona fides in unit 7. In the context of payment made in good faith, it will mean: if the drawee or acceptor pays a person with a defective title, he (the drawee or acceptor) must have no knowledge of such defective title. Note in this regard that element 5 is included in this requirement of good faith.

(3) The payment must be made on or after the due date
The payment of a bill before its maturity will not discharge it, even if the due date has been inserted only for the benefit of the acceptor.

(4) Payment must be made to the holder of the instrument
‘‘Holder’’, as explained in unit 6, is the payee or endorsee of a bill, in possession of it or the bearer thereof. ‘‘Bearer’’ is the person in possession of a bill payable to bearer. The holder is not necessarily the
creditor of the bill but the drawee or acceptor is released by payment of it in
due course.

Let us consider the following examples:

- A draws a bill on B in favour of C or bearer. D steals the bill and
  presents it to B for payment. D is indeed a person in possession of a bill
  which is payable to bearer. D is thus the holder of the document. B pays
  on the bill in due course and the debt is discharged.

- A draws a bill on B in favour of C or order. D steals the document from
  C and presents it to B for payment. B subsequently pays on the bill. D is
  not the payee (C was); he is not the endorsee (there is none); he is also
  not the bearer (it is an order instrument). D is thus not the holder of
  the document. The payment by B has thus not discharged the debt.

Sections 58 and 79 are exceptions to the rule that payment by the drawee or
acceptor must be made in due course to the holder. These sections will be
discussed in later units.

2.1.2 Discharge by way of confusio or merger

In terms of s 59, a bill is discharged if the acceptor is or becomes the holder
of the bill in his own right at or after its maturity. “In his own right”
simply means that the acceptor is or becomes the owner or the creditor
in respect of the bill. The same naturally applies to the maker of a note,
who is equivalent to the acceptor of a bill in terms of s 93(2) (we will
discuss this issue in unit 10). This is an application of the common law
principle of confusio.

2.1.3 Discharge by way of waiver

At its maturity, the holder of a bill may waive (renounce) his rights against
the acceptor wholly and unconditionally (s 60(1)). The renunciation
(waiver) must be in writing on the bill, unless the bill is delivered up to the
acceptor (s 60(2)). According to s 60(3), the holder may also waive the
liabilities of any party to the bill at or after its maturity. In terms of s 60(4),
this s (s 60) will not affect the rights of the holder in due course who had no
knowledge of the renunciation or waiver.

2.1.4 Discharge by cancellation of the bill

In terms of s 61, a bill may also be discharged if the holder intentionally
cancels the bill and the cancellation is apparent on it. The usual manner of
cancellation is by drawing a line through the bill, or striking out a
signature, or tearing up or cutting up the instrument.

2.1.5 Novation

Novation occurs when an existing obligation is replaced with a new one,
thereby extinguishing the old one. A novation is effected by agreement. If
the parties intend to replace the old obligation with a new one, a novation takes place, but not where they lack this intention.

2.16 Set-off or compensation
This is a method by which contractual or other debts are extinguished. It operates when two parties are mutually indebted to each other and both the debts are due. Set-off is made by the operation of law, and it is unnecessary for either party to invoke it. Set-off has the same consequences as payment. A bill is thus only discharged if debts of the acceptor and holder are set off against each other. If set-off is to occur between the holder and any other party, this other party will be discharged but not the instrument itself.

Activity 1
Read the scenario below and answer the questions given based on the discussion above. Your answers should include an explanation.

A draws a bill on B in favour of C or order B accepts the bill. C negotiates the bill to D who negotiates it to E. E negotiates it to F. On the due date, F presents the bill to B for payment and B pays the bill in good faith.

(1) Has payment in due course been effected?
(2) What is the effect of such a payment?

Activity 2
In activity 1 we dealt with payment in due course. Is this the only method of discharge of a bill? If your answer is in the negative, list and briefly explain the other methods.

3 RELEASE OF PARTIES TO THE BILL

The release of parties to the bill means that one or more of the liable parties are released of their obligations on the bill. In this case, one or more of the parties may be released from their obligations, but not all. Those that are indeed released will not be liable on the bill again unless they become parties on it once more. The general rule is that if one party fulfils his obligations in terms of the bill, it acts as a valid fulfilment for all the parties on the bill who could institute an action against him.

A draws a bill on B in favour of C. B accepts the bill. This bill is subsequently negotiated to D, E, and F. If F brings an action against C and
C fulfils his obligation, this fulfilment is also valid for D and E but not for A and B. If C then becomes holder he will not be able to hold D and E liable but can indeed hold A and B liable. If C now holds A liable, he (A) can, in turn, hold B liable. If C, however, holds B liable, B will not be able to bring an action against A on the bill, because it will be discharged.

A few of the most important **ways in which parties to a bill are released** are as follows:

- by **discharge** of the bill
- by **payment which does not give rise to the discharge of the bill** — As we have seen in example (2) (in par 2) above, payment by the endorser D to holder F means that both endorser D and endorser E are freed from further liability, even if the payment does not give rise to the discharge of the bill. The same may be deduced from the example above, where D and E were discharged (if C fulfilled his obligation) without the bill being discharged.
- by **not** fulfilling his obligations — in such an instance **certain parties to the bill will be released**, although the bill itself is **not** discharged. In this regard it may be noted that the drawer and endorsers are, in a certain sense, only conditionally liable to the holder. If the following requirements have not been met, the drawer and endorsers may be released. **It must be noted in this regard that these requirements apply to bills and not to cheques and notes in every case:**
  - the holder must duly present, either for acceptance (ss 37, 38 and 39) or for payment (ss 43 and 44);
  - in the event of dishonour either by non-acceptance (ss 40, 41 and 42), or by non-payment (s 45), the holder must give due notice of such dishonour (ss 46, 47 and 48).

If, for example, the holder of a bill which is not payable on demand **fails to present** the bill for payment **at its maturity**, as required by s 43(2)(a), the drawer and endorsers are released in terms of s 43(1)(b). However, the bill itself is not discharged, and the acceptor remains liable.

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**Activity 3**

Read the scenario below and answer the question given based on the discussion above. Your answer should include an explanation.

A draws a bill on B in favour of C or order. C negotiates the bill to D who negotiates it to E. E further negotiates it to F. F duly presents the bill for payment to B but it is dishonoured by non-payment — in other words B refuses to pay F (after due presentment). After the required notice is given (by F to the other parties), F sues (brings an action against) C for payment and he (C) pays the bill.

Have any of the parties in the above scenario been released from their obligation on the bill?
Unit 9: The discharge of the debt on the bill, and related matters

Draw a comparison between the discharge of a bill and the release of parties to a bill.

Feedback 1

(1) We have to look at B’s payment against the background of what has been said in paragraph 2.11 in this unit (discharge by payment in due course).

According to s 1 of the BEA, a payment in due course is made if it is made at or after the maturity of a bill to the holder thereof in good faith and, if his title to the bill is defective, without notice thereof.

There are thus five requirements for a payment in due course:

(a) There must be payment — there is such a payment (as discussed in 2.11) in our scenario.
(b) The payment must be made in good faith — this requirement is also complied with in our scenario.
(c) The payment must be made on or after the due date — this requirement is complied with in our scenario.
(d) The payment must be made to the holder of the instrument and not to a mere possessor — F in our scenario is an endorsee in possession and as such complies with the definition of a holder in terms of s 1 (also see 2.11)
(e) The payment must be made without notice of any possible defect in the holder’s title to the bill — this requirement which is implied by the requirement of good faith has also been complied with because there are no facts in our scenario that could indicate a defect in the holder’s title to the bill.

Payment in due course has thus been effected.

(2) The instrument is discharged in this way since the drawee effected payment in due course.

- The debt on the bill is extinguished, together with all the other contracts on the bill.
- The instrument is no longer negotiable and no recipient may become a holder in due course thereof.
- Through B’s payment in due course, A’s contract on the bill is extinguished as well as C’s, D’s and E’s.
Unit 9: The discharge of the debt on the bill, and related matters

Feedback 2

No, there are other methods of discharge, as illustrated in paragraph 2.1:
- discharge by payment in due course (this was already discussed in the feedback on Activity 1)
- discharge by way of confusio or merger
- discharge by way of waiver and renunciation
- discharge by cancellation of the bill
- novation
- set-off

For a discussion of these methods of discharge, you may refer to paragraph 2.1 above.

Feedback 3

Yes, C by his payment on the bill fulfils his obligation and is thereby released. This fulfilment is also valid for D and E but not for A and B. One should always remember the general rule in this regard, that if one party fulfils his obligation in terms of the bill, it acts as a valid fulfilment for all the parties on the bill who could institute an action against him. For further clarification, look at the example in paragraph 3 again.

Feedback for summary activity

Discharge of the bill entails the following:
- An instrument is discharged as soon as the acceptor effects payment in due course.
- The debts on the bill are extinguished.
- All the contracts on the bill are also extinguished.
- The instrument is no longer negotiable.
- No recipient can become holder in due course thereof.

The release of a party to the bill, on the other hand, entails the following:
- One or more but not all of the liable parties to the bill are released.
- If a party is released, he will not be liable on the bill again (unless he becomes a party once again).
- If one party fulfils his obligation on the bill, it acts as a valid fulfilment for all the parties on the bill who could institute an action against him.
After studying this unit you should be able to

- explain your understanding of promissory notes as a separate instrument in terms of the BEA
- analyse a given set of facts presented in a scenario and apply your understanding of the functions of a promissory note
- analyse a given set of facts presented in a scenario and apply your understanding of the promissory note as a separate instrument, the application of the BEA, and the maker’s liability on the bill

There is no prescribed reading for this unit.

1 INTRODUCTION

In the previous units we dealt mainly with the bill of exchange as a negotiable instrument. Most of the provisions relating to bills of exchange are also applicable to cheques and promissory notes but there are provisions which apply only to cheques and promissory notes. In this unit we will discuss promissory notes as a separate instrument and we will focus on their functions, the application of the BEA and the liability of the maker of a promissory note.
2 DEFINITION OF PROMISSORY NOTES

In s 87(1) a promissory note is defined as an

"unconditional promise in writing made by one person to another,
signed by the maker and engaging to pay on demand or at a fixed or
determinable future time, a sum certain in money, to a specified person
or his order, or to bearer".

It should be added that, according to s 88, a note is inchoate and incomplete
until it is delivered to the payee or bearer.

The difference between a bill of exchange and promissory note is clearly
seen by the fact that in the case of a bill, there is an order by the drawer to
somebody else to pay and in the case of a note, there is a promise by the
maker that he himself will pay. If the bill is accepted, then the person to
whom the order is addressed has accepted the order, and the drawer in such
a case only guarantees payment in the event of the acceptor not paying. The
maker of a promissory note is really in the same position as the acceptor of
a bill. This is illustrated by the fact that the maker himself engages to pay
the note according to its tenor in the same way as the acceptor himself
undertakes to pay the bill according to his acceptance. Thus, both the maker
and the acceptor pay according to their own undertaking. (This will be
discussed in more detail in par 7 below.)

Each of the following could be the wording of a promissory note:

- ‘I, Sandle Khumalo, promise to pay R1 250,00 to Khomotso Rancho
  on 20 December 2009.’
- ‘I, Haroen Allie, promise to pay R650,00 to J Radebe or order five days
  before Christmas 2009.’
- ‘I, Khomotso Rancho, will pay R7 500,00 to John Willis-Parker or
  order on demand.’
- ‘I, Jannie de Klerk, promise to pay R6 750,25 to bearer on the
  20 December 2009.’

3 COMMENTARY ON THE DEFINITION

Two aspects of the definition of a promissory note need further
commentary:

3.1 Unconditionality

A promissory note is, according to section 87(1), an unconditional promise.
If the promise is, for instance, dependent on the performance of somebody
else, it is conditional. If the note only refers to the reason for the promise
without making it dependent on a certain performance, it is unconditional.

The following example is conditional and can therefore not constitute a
promissory note:
“I, Jannie de Klerk, promise to pay R1 000,00 on demand to Joyce Khumalo if she properly repairs my television.”

The following example is unconditional and may therefore constitute a promissory note:

“I, Jannie de Klerk, promise to pay R1 000,00 to Joyce Khumalo on 20 December 2009 for repairs done on my television.”

3.2 Payment on demand

A promissory note may be payable at a fixed determinable future time or on demand. If a note payable on demand has been endorsed, it must be presented for payment within a reasonable time of the endorsement (s 90(1)(a)). In determining what a reasonable time is, the nature of the instrument, trade usages and the facts of the particular case must be taken into consideration (s 90(2)). If the note payable on demand is not presented in this way, the endorser is discharged (s 90(1)(b)).

Activity 1

Could the following examples be promissory notes? Substantiate your answers.

1. “I, Khomotso Rancho, acknowledge that I owe Jack Rabinowitz the amount of R700,00 for services rendered.”

2. “I, Blacky Swart, acknowledge that I owe Khomotso Rancho R700,00 for services rendered and will pay the amount to her a month after Human Rights Day 2009.”

3. “I, Eesam Khan, promise to pay R1 850,00 to Haroon Allie or order if he, without any damage to my car, properly tows it to Eastern Crown Panelbeaters in Fordsburg.”

4 APPLICATION OF THE ACT

The provisions of the BEA apply, with the necessary modifications, to promissory notes (s 93(1)). The acceptor of a bill must be deemed to refer to the maker of a note. The drawer of an accepted bill payable to the drawer’s order must be deemed to refer to the first endorser of a note (s 93(2)). The provisions in the BEA relating to presentment for acceptance, acceptance, and bills in a set, do not apply to promissory notes (s 93(3)).

5 FUNCTIONS OF THE PROMISSORY NOTE

A promissory note may be used as an instrument of proof, an instrument of obtaining credit or financing, an instrument of investment and an instrument of security. We now discuss each one of these functions briefly.
5.1 Instrument of proof

A promissory note facilitates proving (makes it easier to prove) the existence of a debt. A mere acknowledgment of debt is, however, not a promissory note. To be a promissory note, an expressed promise to pay is needed.

5.2 Instrument for obtaining credit or financing

The possibility of using a promissory note facilitates obtaining credit. A seller will be more willing to sell on credit if the buyer signs a promissory note. The promissory note is thus used to finance the credit sale agreement.

5.3 Instrument of investment

A seller who is willing to accept a promissory note to provide credit to the buyer may negotiate the note to the bank. The bank may present the note for payment on its due date or it may endorse the note. A note which has been endorsed by a bank can readily be discounted in the money market. The discounting of a promissory note is the purchase of a note before maturity (before its due date) at a discount (lower price). Speculation with discounted promissory notes is a method of investment in the money market.

5.4 Instrument of security

Promissory notes may be pledged and as such, function as instrument of security. A’s promissory note in favour of B may be pledged in C’s possession to secure B’s debt to C.

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**Activity 2**

Read the scenario below and answer the question given based on the discussion above. Your answer should include an explanation.

Mr Nengome approaches you for advice. He relates to you that one of his colleagues, Mr Fredericks, intends buying a computer printer from him (Mr Nengome). The amount that Mr Nengome advertised the printer for was R1 000,00 and Mr Fredericks agreed to this price but does not have the money immediately. Mr Fredericks verbally undertakes that Mr Nengome will definitely receive payment on 29 January 2009, that day being the bonus date. Mr Nengome further intends to leave the printer in Mr Fredericks’s possession so that he (Mr Fredericks) can make use of it in the mean time.

Mr Nengome asks you whether there is anything he can make Mr Fredericks agree to that will ensure that he, Mr Nengome, will be paid.
6 JOINT AND SEVERAL LIABILITY

If a note reads “I promise to pay” and is signed by two or more persons, it is deemed to be their joint and several note (this is an irrebuttable presumption). Joint and several liability implies that the creditor may choose to claim the full amount from all or any of the debtors.

In the presence of a contrary intention appearing on the face of the promissory note, any note which is signed by two or more persons is deemed to be their joint and several note. This is, however, a rebuttable presumption in terms of section 89(2).

7 THE MAKER’S LIABILITY

As we know, the maker of a promissory note is in a position similar to that of the acceptor of a bill (s 93(2)). This being the case, it would be interesting to draw a comparison between the provisions of s 52 relating to the liability of the acceptor and s 92 dealing with the liability of the maker.

(1) Section 52 provides that the acceptor undertakes to pay according to the tenor of his acceptance (not according to the tenor of the order, since the acceptance may in terms of s 17 be qualified). (The word ‘tenor’ in this regard must be taken to refer to the actual wording of the bill. The above should then be read as “undertakes to pay according to the actual wording of his acceptance”.)

The maker’s warranty, as contained in section 92(a), amounts to his undertaking to pay according to the tenor of the note, that is, according to the tenor of his promise. Both therefore pay according to their own undertaking.

(2) Section 52(b)(iii) places restrictions on the acceptor in relation to the holder in due course. He is precluded from denying to the holder in due course the existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the bill. Besides this, there is also a restriction on the acceptor regarding a bill payable to the drawer’s order and where a bill is payable to the order of a third person. However, the only provision in s 92(b) (regarding the maker’s restrictions in relation to the holder in due course) is that he (the maker) is precluded from denying to the holder in due course the existence of the payee and his capacity to endorse at that time.

Read the scenario below and answer the questions given based on the discussion above. Your answers should include an explanation.

The following is a written promise between colleagues:

“I, Walter Nhumise, acknowledge that I owe Ernest Maleka R500,00 for repairs done on my computer and will pay the amount to him on Friday the 13th of June 2009.”
Unit 10: Promissory notes

(1) Does the above promise constitute a promissory note?
(2) What is Mr Nkhumise’s position in terms of the BEA?
(3) Does Mr Nkhumise incur any liability on the note?

Feedback 1

(1) According to s 87(1), a promissory note entails a promise to pay. The mere acknowledgment of debt by Ms Rancho does not entail a promise to pay and can therefore not constitute a promissory note.

(2) Mr Swart also acknowledges his debt but combines this with a promise to pay. He does not use the word “promise” but it is generally accepted that the words “will pay” denote the required promise. Mr Swart’s promise is unconditional, as required by s 87(1), and it is not dependent on Ms Rancho’s services but merely refers to the reason for the promise. Although Mr Swart does not promise to pay on demand or at a fixed future time, he nevertheless promises to pay at a determinable future time, which is also allowed in terms of s 87(1). The precise date can be determined using the formula in the promise. Mr Swart’s promise was made by himself to another (Ms Rancho) to pay a certain sum of money (R700,00) to a specified person (Ms Rancho). If the promise was also in writing and signed by Mr Swart (the maker of the promise), all the requirements of s 87(1) are met and the promise will constitute a promissory note.

(3) The promise of Mr Khan is dependent on the performance by Mr Allie and as such is a conditional promise. As one of the requirements for promissory notes in s 87(1) is the unconditionality of the promise, it follows that Mr Khan’s promise cannot constitute a promissory note.

Feedback 2

Yes, Mr Nengone can request Mr Fredericks to draft a promissory note that would act as an instrument of obtaining financing for their credit sale agreement. The possibility of using a promissory note facilitates obtaining credit. A seller will be more willing to sell on credit if the buyer signs a promissory note (par 5.2 of this unit).

The promissory note may further be drafted with the following wording:

“I, Eesa Fredericks, promise to pay R1 000,00 to Rudolf Nengone (or order) on 29 January 2009, as payment under the agreement of sale of his HP computer printer, concluded between us on 29 December 2008.”
Feedback for summary activity

(1) Mr Nkhumise acknowledges his debt and combines it with a promise to pay. He does not use the word “promise” but it is generally accepted that the words “will pay” denote the required promise. (This was the case in feedback (2) of activity 1 as well) Mr Nkhumise’s promise in terms of s 87(1) is unconditional and is not dependent on Mr Maleka’s services — it merely refers to the reason for the promise. It is also made by him to another person (Mr Maleka). Mr Nkhumise promises to pay at a fixed future time. The promise is clearly in writing and it is to pay a certain sum of money. All the requirements of s 87(1) are met and the promise will thus constitute a promissory note.

(2) Mr Nkhumise is the maker of the promissory note. In terms of s 93 (2) of the BEA, the maker of a note (as Mr Nkhumise is), shall be deemed to correspond with the acceptor of a bill. This provision further states that the first endorser of a note shall be deemed to correspond with the drawer of an accepted bill payable to the drawer’s order.

(3) Yes! Mr Nkhumise is the maker of the note and in terms of s 92 he:

- warrants that he will pay the note according to its tenor
- is precluded from denying to the holder in due course, the existence of the payee and his capacity to endorse at the time
UNIT 11
CHEQUES

After studying this unit you should be able to

• explain the bank-customer relationship based on facts presented in a scenario
• define a cheque
• interpret the most important requirements of s 58 by determining the consequences presented in a scenario
• explain the principles related to presentation for payment based on facts presented in a scenario

Section 58.

1 INTRODUCTION

In the preceding unit we discussed promissory notes as a separate instrument. In this unit we discuss cheques as a separate instrument. Although most of the provisions relating to bills of exchange apply to cheques as well, there are certain provisions which govern cheques only. We will first discuss the historical overview relating to cheques to demonstrate how the principles were shaped during the course of history. This will greatly enhance your understanding of the law as it is today. Later in the unit we demonstrate how banks are protected by s 58 where they have paid uncrossed or crossed cheques to somebody who is not the holder.

Cheques are very important in a business environment. We will now show you some of the persons that use cheques for payment while conducting their business:
2 HISTORICAL OVERVIEW

Banks have their origins in the practices of ancient goldsmiths. It was customary for goldsmiths to issue promissory notes to clients who deposited gold with them, and these promissory notes were utilised to pay the client’s debts. In other words, the clients converted the goldsmith’s promissory notes into instruments of payment. But as instruments of payment they had to conform to certain requirements determined by trade. They had to be readily negotiable and readily convertible into gold, and this is the reason why they were made payable to bearer on demand.

The banks also resorted to the issue of this type of promissory note, that is, bank notes. The bank notes in turn incurred the danger of inflation, and consequently their issue had to be limited by legislation in almost all countries. This restriction gave rise to the development of the cheque. When a person deposited money in a bank, the bank no longer issued promissory notes to him. Instead the bank issued a book containing a number of forms and at the same time undertook to comply with all the customer’s instructions regarding payment while the latter had sufficient funds in the bank. In imitation of the old promissory notes, these forms were made payable to bearer and on demand. The old promissory notes were numbered for purposes of differentiation when presented for payment. Similarly the forms issued by the bank to its customer were numbered for purposes of controlling or verifying the instructions already executed or determining to whom the forms were originally issued. We know today that the counterfoils bear the same numbers as the cheques and that banks record the numbers of the chequebooks issued to a customer. The word “cheque” is merely the old English spelling of “check” and has been retained for these documents.

3 THE RELATIONSHIP BETWEEN BANK AND CUSTOMER

For the purposes of this module it is necessary to consider only very briefly the relationship between the bank and the customer or holder of a cheque account. A person who deposits money in the bank, and whose deposit is accepted on the understanding that the depositor’s cheques will be honoured while he has sufficient funds in his account or has made arrangements for overdraft facilities, is a customer of the bank. The relationship between bank and customer is also described as that of debtor and creditor with the particular additional feature that the debtor, that is the bank, should meet his obligations by honouring the cheques of the creditor,
that is, the customer, provided there are sufficient funds in the creditor’s account or overdraft facilities have been arranged.

If the agreement between the bank and customer in the case of a cheque account is analysed, we find that more than one particular type of contract is created. The two most important contracts are

- a contract of loan for consumption (*mutuum*), in terms of which the bank undertakes to borrow all deposits made in the cheque account and to repay the money on demand
- and a contract of mandate (*mandatum*), in terms of which the bank undertakes to carry out all the payment instructions of the customer made by cheque and to collect on behalf of the customer cheques deposited in the account

The most important point is that the relationship between bank and customer is a contractual one and comes into existence by implication when a cheque account is opened. The content of this relationship is governed by the *naturalia* of the specific loan and mandate agreements as well as by the prevailing trade usage.

The relationship exists exclusively between the bank and the customer, and the general principle is that the bank cannot become liable on the cheque to third parties (s 51). The bank is not liable on the cheque as drawee and its duties arise solely from its relationship towards its customer.

The instructions of the customer and therefore also his authority may be revoked. The words “payment stopped” are usually used with regard to a cheque, whereas section 73 uses the words “countermand of payment”. Only the drawer who gave such instruction and authority may revoke that instruction and authority. Countermanding of payment can take place at any time prior to payment by the bank, but proper notice must be given to the branch of the drawee bank where the account is held. Section 73 provides that the duty and authority of the bank to pay its customer’s cheque are terminated when it receives notice of the customer’s death, incapacity, sequestration or winding-up, judicial management, or that his estate has been wound up or he has been declared a prodigal.

### 4 THE CHEQUE

A cheque is a bill drawn on a bank payable on demand (s 1). In terms of section 71, the provisions of the Act applicable to bills of exchange payable on demand apply to a cheque, except as otherwise provided.

You will notice that according to the definition in s 1, the drawee must be a bank and the document must be payable on demand. In terms of s 8, a bill is payable on demand if it is expressly stated to be so payable, or if it is expressed to be payable at sight or payable on presentation or if no time for payment is expressed. The words “on demand” need therefore not appear on the instrument to constitute it as a cheque. (See unit 3.)
You must keep in mind that the cheque is not *per se* intended for circulation, although cheques may circulate just like any other bill. Moreover, the purpose of the cheque is not that it should be retained as continuous security by the person to whom it was made payable, as is the case with promissory notes.

The cheque is an instruction addressed by the customer to the bank to pay the amount stated on the cheque to the person mentioned therein and, as we have explained, this instruction must be complied with by the bank provided there are sufficient funds to the credit of the customer. The bank’s obligation to pay does not, however, acquit the customer of any obligations, since the instruction must be given in a form that will not mislead the bank. The customer must therefore draw the cheque in a manner that will practically eliminate the possibility of fraud, otherwise he will be unable to hold the bank responsible for damages arising from his own negligent act.

The cheque contains the instruction and authority to the bank to pay a designated person. The bank should act according to this authority and if it does so, it is entitled to debit the customer’s account with the amount paid. But the authority should be given in a proper manner and the bank can only justify its act when it pays, if the customer’s signature on the document is genuine or authorised. If the customer’s signature as drawer on the cheque has been forged or is unauthorised, the bank has actually no authority to pay. In other words, the forged signature of the customer (drawer) entails no loss to the customer, but the bank pays at its own risk no matter how good or skilful the forgery may be.

If the customer knows or suspects that his signature as drawer on a cheque has been forged, it is his duty to inform the bank within a reasonable time. If he fails to do so and the bank is prejudiced, the customer will have to bear the loss.

**Activity 1**

Answer the following questions by determining whether the statements are TRUE or FALSE.

1. A bill would not be payable on demand if it is payable at sight.
2. It is a requirement that the words “on demand” must appear on the cheque.
3. X draws a cheque on B Bank in favour of Y for R100, leaving a large space on the cheque. As a result, this enables Y to unlawfully add a zero on the amount, making it R1 000. After receiving the money Y absconds. Under the circumstances, X cannot successfully sue B Bank as the manner in which he drew the cheque facilitated fraud.
The provisions of s 58 are aimed at the protection of the bank where it has paid somebody that is not the holder. This section is of great practical importance and must be studied carefully. First let us start with the general rule that would enable you to understand the section even better. The position at common law is that a bank is obliged to pay cheques to the holder. If it pays some other person, it may not debit the customer’s account and must shoulder the loss itself.

The following scenario applies the common law rule. We will now demonstrate this by way of a scenario:

A draws a cheque on B Bank in favour of C or order. X steals the cheque from C, forges C’s signature on the back and delivers it to D who takes it in good faith. B Bank is not authorised to pay D as he is not the holder because of the inoperative forged signature (remember that nobody can be a holder of a cheque with a forged signature). If it pays him, it may not debit A’s account and must bear the loss.

As you will see from the discussions below, section 58 protects the bank when it has paid the cheque to the nonholder (D in our example), provided it pays in compliance with certain requirements.

In order to be protected, the bank must make payment under the circumstances that meet the requirements of s 58. If these requirements are met, the payment by the bank will be deemed (regarded) to be payment in due course notwithstanding the fact that payment was made to the non-holder. Payment in due course is defined in s 1 as payment made at or after the maturity of the bill to the holder thereof in good faith and, if his title to the bill is defective, without notice thereof. (See unit 9.)

The following are the requirements of section 58:

- **The cheque must be an order one.** It may not be a bearer cheque since anyone in possession of a bearer cheque is a holder of it and no endorsement is necessary. It may furthermore not be a non-transferable cheque, since such a cheque is not payable to order, but to a designated person only.
- **There must be a forged or unauthorised endorsement on the cheque.** The s here refers to the forged or unauthorised endorsement of the payee or subsequent endorser and not to the forged or unauthorised signature of the drawer. The reason is that where the drawer’s signature has been forged we do not have a valid cheque because of the absence of the mandate.
- The person whose endorsement was forged must not be a client of the branch of the bank on which the cheque was drawn.
- The bank must pay the cheque in good faith and in the ordinary course of business.
- The cheque may either be crossed or uncrossed.

If the bank pays in compliance with the above requirements, it is deemed to
have paid the bill in due course. It follows that payment in due course discharges the cheque and relieves the bank of paying the amount for the second time to the real creditor. This means that towards its customer the drawee bank is deemed to have complied with the instruction in the cheque. This section thus qualifies the contractual relationship between the bank and the customer.

It is important to note that not every signature on the back of a cheque is an endorsement in the true sense of the word. If the payee, or a person professing to be the payee, wishes to cash a cheque over the counter at the drawee bank, it is customary for the bank to require that person’s signature on the back of the cheque. That signature serves as an identification and a receipt, and is not placed on cheque to serve as an endorsement — that is, that signature is not placed on the cheque to effect a negotiation of the cheque to the drawee banker. The drawee bank is protected by s 58 only if the forged or unauthorised signature purports to be an endorsement, and not if that signature is placed on the cheque merely for the purposes of identification and receipt. This would be the case when the person who is not the payee professes to be the payee and is asked to sign the cheque on the back for identification reasons only.

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**Activity 2**

Read the different scenarios and answer the questions below:

A draws a cheque on B Bank in favour of C or order. X steals the cheque from C. At the bank X professes to be the payee C and, in the presence of the teller, forges C’s signature on the back of the cheque.

1. In these circumstances, will B Bank be protected by section 58 if the bank pays X?
2. Would your answer differ from the answer to 1 above if, after forging C’s signature, X presents himself at the bank as a holder who has obtained the cheque by virtue of C’s “endorsement”?
3. How would your answer have differed from the answer in 2 above if X did not himself present the cheque for payment, but delivered it to D who received payment from the bank in his own name?
4. Section 58 requires, among other things, that the bank must pay the cheque in good faith. Explain the concept of in good faith.

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6 OTHER FORGERIES

The case where details on a cheque, which has otherwise been drawn and signed by the customer, are forged should be distinguished from the case where the customer’s signature is forged. We have pointed out that it is the duty of the customer to give the instruction to pay in a manner that will eliminate the possibility of fraud in regard to the document. The bank must, therefore, prove that the customer’s instruction was given in a manner which amounted to negligence. The usual example used, is where the
amount on the cheque is entered in such a manner that it can easily be altered by inserting a figure and words before the actual amount. This is also the reason why the customer should ensure that the payee is mentioned on the cheque with reasonable certainty. If the customer names the payee in a manner that enables a third person to cash the cheque, the loss is his by reason of his negligence.

7 PRESENTMENT FOR PAYMENT

Since the function of the cheque is to serve as an instrument of payment, it is obvious that it should be presented for payment at the bank where it is drawn within a reasonable time (s 72(1)). What constitutes a reasonable time will depend upon circumstances.

Mere delay in presenting a cheque for payment within a reasonable time does not discharge the drawer. In practice, banks refuse to pay cheques after a certain time, usually six months after the date of the cheque.

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Feedback 1

(1) False. A bill (under s 8) is payable on demand if it is payable at sight.
(2) False. The words "on demand" need not appear on the instrument to constitute it as a cheque.
(3) True. Owing to his negligence in drawing the cheque, X cannot sue B Bank.

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Feedback 2

(1) If the bank pays X, it will not be protected by s 58 and the payment to X will not be deemed payment in due course. The reason for this is that no endorsement on the cheque has been forged. C's forged signature does not purport to be an endorsement (because the thief X professes to be C), and the bank does not regard it as such, since X is professing to be the payee, C.

(2) In that case C's forged signature does purport to be an endorsement, that is for the purposes of the so-called "negotiation" to X. If the bank pays to X, it will be protected by section 58, and the payment will be deemed a payment in due course to X even though X is not a holder of the cheque. (Here it is assumed that the other requirements of section 58 were also met)

(3) The answer would not differ and the position is the same. The forged signature also purports to be an endorsement the purpose for which is negotiation (as opposed to a mere receipt). If B Bank pays D, it will be protected by section 58, and the payment will be deemed a payment in due course to D even though D is not a holder of the cheque. The consequence is that B Bank is discharged from its obligations. C cannot sue A on the underlying contract because the debt has been discharged. He cannot call upon A for a second payment so long as A is in no default with regard to payment of the cheque on presentation.
(4) In terms of section 94, something is assumed to be have been done in good faith within the meaning of the Bills of Exchange Act if indeed it is done honestly, whether it is done negligently or not. For example, the bank cannot rely on s 58 if the bank knows that the person to whom payment is made is not entitled to payment and the bank purposely fails to institute an investigation. However, although the bank is negligent for not consulting the list of stolen drafts it may still be acting in good faith.
UNIT 12

CROSSED CHEQUES

After studying this unit you should be able to

- distinguish between the different types of crossing that may appear on a cheque
- interpret the effects of a crossing on a cheque by determining the consequences presented in a scenario
- distinguish between the operation of ss 58 and 79 of the Act and solve problems presented in scenario

Sections 29, 58, 75 and 79 of the BEA.

1 INTRODUCTION

In the preceding unit we discussed the law specifically applicable to cheques in general, and how the bank is protected by section 58. In this unit we continue to discuss cheques but more emphasis will be placed on ways in which banks and the drawers can minimise chances of fraud or forgery on cheques. We also discuss the protection of the banks and drawers in terms of section 79. As you learn, you will see how a crossing can make a significant difference in the cheque.

2 TYPES OF CROSSING

The Act provides for two kinds of crossing, namely general crossings and special crossings (section 75). We will now discuss what the crossings are and their importance.

A general crossing is constituted by the addition, on the face of a cheque,
of two parallel transverse lines either with or without the words “not negotiable” (s 75(1)). The words “not negotiable” do not of themselves constitute a crossing.

A **special crossing** is constituted by the addition, on the face of a cheque, of the name of a bank, either with or without the words “not negotiable” or “and company” or any abbreviation thereof (s 75(2)). In the case of a special crossing it is not necessary to add the two parallel lines to the cheque.

The crossing of a cheque can be made at any time before the cheque is discharged through payment. **In terms of section 76 the following persons may cross a cheque:**

- **The drawer** may cross the cheque either generally or specially when drawing the cheque.
- **The collecting bank** may cross the cheque either generally or specially.
- **Any holder** may cross a cheque which is in his possession. A holder who is in possession of an uncrossed cheque may cross it in any manner. Moreover, where a cheque is crossed generally, the holder may cross it specially and may also add the words “not negotiable” to an existing crossing.
- The other person who may cross a cheque, is **the bank** to which a cheque is crossed specially. This bank may add a second special crossing to the cheque, namely, a special crossing for collection.

In terms of section 77, a crossing authorised by the Act is a material part of the cheque and it shall not be lawful for any person to obliterate, cancel or, save as authorised by this Act, add to or alter such a crossing. If a crossing is obliterated contrary to this provision, the liability of those who were parties to the cheque, and who did not assent to the obliteration, addition or alteration, is regarded under s 62(1) as if the obliteration, addition or alteration had not been made. However, the drawer of a cheque may cancel a crossing before delivery.
Activity 1

Study the cheques below and answer the questions that follow:

FIGURE 1

B BANK

__________________________________________ 28/01/2009

NOT NEGOTIABLE

PAY ___________________________ OR ORDER

THE SUM OF ________ ONE THOUSAND ________ RANDS R1 000,00

MVELAPHANDA (PTY) Ltd
(Reg No 1988/344)

SF Mudeu

2003 778256345 03

Authorised signatory

FIGURE 2

B BANK

__________________________________________ 28/01/2009

Bank of Southern Africa
Not negotiable

PAY ___________________________ OR ORDER

THE SUM OF ________ ONE THOUSAND ________ RANDS R1 000,00

MVELAPHANDA (PTY) Ltd
(Reg No 1988/344)

SF Mudeu

2003 778256345 03

Authorised signatory

(1) Identify the type of crossing made in figure 1.
(2) Identify the type of crossing made in figure 2.
(3) Using the above cheques, identify the persons who have the right to cross the cheques.

3 EFFECT OF THE CROSSING OF A CHEQUE

The effect of the crossing of a cheque is that the instruction of the drawer to
the drawee bank is qualified and a specific manner of compliance is prescribed, namely that payment should be made to a bank in accordance with the provisions of s 78. The instruction of the drawer is qualified in this manner not only where the drawer, but also where a holder has crossed a cheque, since a holder is entitled to do so. Although the payment instruction is altered by the crossing, the crossing has no effect on the negotiability of the cheque. Even if the words ‘not negotiable’ are added to a crossing, the cheque can still be negotiated within the meaning of section 29(1), so that the transferee is constituted the holder of the cheque (see unit 13 below).

The result of the crossing of a cheque is that the customer’s (drawer’s) payment instruction to the drawee bank should be carried out in the following manner:

- If the cheque is crossed generally the drawee bank may pay only to a bank, that is, any bank. Suppose A draws a cheque on B Bank in favour of C or order, and adds a general crossing. B Bank may not pay C over the counter; it must make payment to a bank. Thus C will have to present the cheque to his own bank (eg S Bank), which will receive payment from B Bank.

- If a cheque is crossed specially, the drawee bank may pay only to the specific bank to which it has been crossed, or to that bank’s agent for collection, if it is a bank. Special crossings are seldom used in practice, unlike general crossings, which are commonly used.

If the bank on which a crossed cheque is drawn, pays the cheque contrary to the crossing, it does not carry out the drawer’s instruction and cannot debit the drawer’s account, unless, in fact payment has been made to the true owner or his authorised representative. Apart from that, section 78(4) gives the true owner (see unit 13 below on this expression) a claim for damages against the drawee bank, except where the proviso applies.

Activity 2

Read the different scenarios carefully and answer the questions that follow:

1. Suppose A draws a cheque on B Bank in favour of C or order. The cheque is crossed generally. X steals the cheque from C, forges C’s signature on the back of the cheque and delivers the cheque to D, who takes it in good faith. D presents the cheque for payment and B Bank pays it over the counter to D while the crossing is not obliterated.

   Explain how you will advise all the parties concerned.

2. A draws an uncrossed cheque on B Bank in favour of C or order. X steals the cheque from C, forges C’s signature on the back of the cheque and presents the cheque for payment at B Bank. B Bank pays X in good faith and in the ordinary course of business over the counter.

   Explain how you will advise all the parties concerned.

3. How would your answer to activity 2 above have differed if the cheque was crossed?

4. Suppose A draws a cheque on B Bank in favour of C or order. The cheque contains a
4 THE PROTECTION OF THE DRAWEE BANK AND THE DRAWER OF A CROSSED CHEQUE

We have seen in par 3 above that the drawee bank on which a crossed cheque is drawn can be liable if it does not pay in accordance with the crossing. If the drawee bank does pay to a bank in accordance with the crossing, and payment takes place in good faith and without negligence, then in terms of section 79 the drawee bank will be deemed to have paid in due course, although in actual fact it has not (eg because payment has been made to the collecting bank of a thief who was not the holder). Since, in terms of section 79, the drawee bank’s payment is deemed to have been in due course, the cheque is discharged. It follows that the drawer’s liability on the cheque and on any underlying obligation is also discharged. For more information you should read the concluding part of section 79.

You should also keep in mind that section 58 of the Bills of Exchange Act applies to both crossed and uncrossed cheques. This position which overlaps with section 79 may be relevant if the drawee bank pays in accordance with the crossing, but negligently (section 58 merely requires a payment “in good faith and in the ordinary course of business”). A further difference between sections 58 and 79 appears from the proviso to section 58. According to the proviso, section 58 does not afford protection if the forged endorsement purports to be that of a customer of the particular bank branch on which the cheque was drawn. Section 79 does not contain this limitation. Section 79 protects not only the drawee bank, but also the drawer of a crossed cheque.

You should study section 79 carefully and make sure that you understand it.

Activity 3

Read the scenario carefully and answer the following question.

A draws a cheque on B Bank in favour of C or order. The cheque is crossed generally. X steals the cheque from C, forges C’s signature on the back of the cheque, and delivers the cheque to D who takes it in good faith and for value. D deposits the cheque for collection in her banking account with S Bank. S Bank presents the cheque for payment to B Bank. B Bank pays it to S Bank (that is in accordance with the crossing), in good faith and without negligence. B Bank debits the account of its client, drawer A, and S Bank credits the account of its client D. It goes without saying that D was not the holder of the cheque, since she is neither payee, nor bearer, nor endorsee. Under s 22 the forgery is wholly inoperative. Does the true owner C, have any rights against B Bank or drawer A or any other party?
(1) The type of crossing made in a cheque in figure 1 is a general crossing.
(2) The type of crossing made in a cheque in figure 2 is a special crossing.
(3) The persons who could cross the cheques indicated in figure 1 and 2 are:
   (a) Johannes Eriksson as a holder
   (b) Mvelaphanda (Pty) Ltd as a drawer
   (c) B Bank of Southern Africa, to which the cheque is crossed specially, can cross it
       specially for the second time to another bank for collection.
Feedback 2

1. B Bank did not pay to a bank in accordance with the crossing. Consequently, B Bank is not entitled to debit A’s account, the cheque will not be discharged and A’s liability towards C on the cheque as well as on any underlying obligation will remain in existence. If one applies s 78(4) to the situation, C (as true owner) will be able to claim the amount of the cheque as damages directly from B Bank, in which case B Bank in fact may debit A’s account after B Bank has satisfied C’s claim. (See unit 9)

2. B Bank will be protected by section 58 if C is not a customer of B Bank at the branch on which the cheque is drawn, and if the “endorsement” purports to be an endorsement and not a signature for mere identification purposes. If the drawer bank pays X under circumstances where it is protected by s 58, the payment will be deemed to be a payment in due course, even though X is not the holder of the cheque.

3. Although section 58 applies to crossed cheques as well, it provides protection against forged endorsements only. When the drawee bank disregards a crossing, it cannot therefore rely on section 58 for protection.

4. In this case, B Bank has not paid in accordance with the crossing, but since the true owner has in fact been paid, the position would be judged as if B Bank had properly carried out its instruction.

Feedback 3

C’s rights are as follows:

- **Against drawer A:** If the cheque has come into the hands of the payee, drawer A shall be protected, under section 79, “as if payment of the cheque had been made to the true owner thereof.” In this case, the cheque did in fact come into C’s hands (it was stolen from her), and therefore C has no rights against drawer A. If the cheque had not come into C’s hands, C would not have been the owner and A would in actual fact not have paid C.

- **Against drawee bank (B Bank):** Since B Bank paid to a bank in accordance with the crossing, and since it paid in good faith and without negligence, B Bank is protected under section 79 “as if payment of the cheque had been made to the true owner thereof.”

- **Against possessor D and collecting bank (S Bank):** Both D and S Bank were in good faith, and therefore, although the stolen cheque went through their hands, they are not delictually liable to the true owner. See the discussion in unit 13 below, where this aspect is treated in more detail.

- **Against thief X:** Since the thief was *mala fide*, she is delictually liable to C. Alternatively C could also hold him liable on the basis of unjustified enrichment.

Accordingly, it is apparent that the true owner, C, has a right of recourse against the thief only. The true owner of a stolen or lost cheque therefore is in an unfavourable position.
UNIT 13

CROSSED CHEQUES MARKED “NOT NEGOTIABLE”, AND ENDORSEMENT OF CHEQUES DEPOSITED IN A BANK ACCOUNT

After studying this unit you should be able to
- interpret the most important aspects of s 80 presented in a scenario
- interpret the most important provisions of s 81 presented in a scenario
- interpret the most important provisions of s 83 presented in a scenario

Sections 80, 81, 83 and 84 of the BEA.

1 INTRODUCTION

In the previous units we discussed the types of crossing that may be effected on a cheque. In this unit we focus on the crossing on a cheque in which the words “not negotiable” are inserted. A crossing on a cheque that entails the words “not negotiable” brings ss 80 and 81 into operation. In paragraphs 2.2 and 2.3 we show you the legal problems that are encountered when cheques marked “not negotiable” are used in practice and how ss 80 and
81 play a central role in solving these problems. We also discuss sections 83 and 84. The intention of this unit is to prepare learners to solve problems that arise in practice where cheques crossed and marked “not negotiable” are negotiated to somebody. Other problems that learners are expected to solve arise where the finder or thief of these cheques has negotiated them to someone, or where for whatever reasons they are found in possession of a particular person after theft or loss.

2 CROSSED CHEQUES MARKED “NOT NEGOTIABLE”

2.1 Crossings and “not negotiable” marking

The mere crossing of a cheque does not affect the negotiability or transferability of a cheque. A crossed cheque may be negotiated, and it is possible for subsequent holders of it to become holders in due course. Thus the question of whether or not a cheque is negotiable is not influenced by a crossing, and is answered with reference to section 6(1) of the BEA, which reads: “A bill [cheque] must be payable either to bearer or to order to be negotiable.” However, the crossing of a cheque qualifies the instruction to the drawee bank by prescribing the manner of compliance with the instruction; that is, in accordance with the provisions of s 78, payment must be made to a bank.

The addition of the words “not negotiable” to a crossed cheque has two important consequences: with reference to the negotiability of it in terms of section 80, and to the true owner’s rights in terms of section 81 of the BEA. We will now discuss these ss.

2.2 Section 80

Section 80 reads as follows:

If a person takes a crossed cheque which bears on it the words “not negotiable”, he shall not have, and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had.

This implies that notwithstanding the words “not negotiable” the cheque can still be negotiated. It is strange that despite the addition of the words “not negotiable”, the cheque can still be negotiated in the sense in which the word “negotiate” is used in section 29(1), namely a transfer from one person to another in such a manner as to constitute the transferee the holder of the cheque. A person who takes a crossed cheque which bears the words “not negotiable” cannot, in terms of section 80, acquire a better title than that which the person from whom he took it had. The result is that this person will bear the risk that the transferor may have had an invalid title to the cheque. Accordingly, where a drawer adds the words “not negotiable” to a crossed cheque, no subsequent holder can become a holder in due course. Even though a cheque crossed and marked “not negotiable” can
still be negotiated as we have indicated above, the person to whom it is 
transferred cannot become the holder in due course of it.

Note that, under section 76(2), the holder (eg the payee) of an uncrossed 
cheque is entitled to add a general or a special crossing to it; and under s 
76(4) he is also entitled to add the words “not negotiable” to a cheque 
which is crossed generally or specially.

Activity 1

Read the scenario carefully and answer the following question:

A (a gambler) owes B an amount of money after a gambling game. To settle his 
debt A draws a crossed cheque bearing the words “not negotiable”, and delivers 
the cheque to B (the payee) in full payment of a legally unenforceable gambling 
debt. B negotiates the cheque to C, who takes it in good faith and for value. C 
presents the cheque for payment, but the bank refuses to pay for lack of funds.

Determine whether C could sue A or B. Provide reasons for your answer.

2.3 Section 81

By crossing a cheque and adding the words “not negotiable”, not only the 
provisions of section 80 come into operation but also certain rights are 
conferred upon the true owner of it by section 81.

Although a cheque is primarily an instrument of payment which is rarely 
negotiated, it is nevertheless a negotiable and transferable document. The 
drawer or the owner may suffer loss if a cheque is lost or stolen. For 
example, a thief can obtain payment of a cheque by devious means and then 
disappear without a trace. The thief can also “negotiate” (through a forged 
endorsement) or sell a cheque to another person, who then obtains payment 
of the cheque. Theft or loss of the cheque can also cause the drawer or the 
true owner to lose his proprietary rights to, and his personal rights arising 
from, the document, because a subsequent possessor became a holder in due 
course of the cheque. Section 80 however prevents this from happening if 
the cheque is crossed and marked “not negotiable” (see discussion above).

At common law the owner of stolen property has no action for damages 
against a bona fide possessor of his property. The owner can only claim his 
property by using the rei vindicatio. In Leal & Company v Williams 1906 
TS 554 at 558-559 Innes CJ states:

The remedy ... our law gives to the owner of stolen property is this: he 
may follow his property and vindicate it anywhere, provided it is still 
in esse. And he may bring an action ad exhibendum to recover the 
property or its value (should it have been sold or consumed) against
the thief or his heirs, or against any person who has received it with knowledge of the tainted title (our emphasis).

According to this principle, the owner of stolen property cannot claim its value by means of the actio ad exhibendum from a bona fide intermediary; he can only claim his property by means of the rei vindicatio from the possessor.

Let us apply these principles to cheques.

A draws a cheque on B Bank in favour of C or order. The cheque is crossed generally. X steals the cheque from C, forges C’s signature on the back of the cheque, and delivers it to D, who takes it in good faith and for value. D deposits the cheque in his account with S Bank for collection. S Bank presents the cheque for payment and B Bank pays S Bank (that is in accordance with the crossing). Payment is made in good faith without negligence. B Bank debits the account of its customer, drawer A, and S Bank credits the account of its customer D. Take note that D never qualified as holder of the cheque since he was neither payee, nor endorsee, nor bearer. Under section 22, the forgery of C’s signature was wholly inoperative. The question is whether the true owner, C, who in this example suffered loss, has any rights against B Bank or drawer A or any other party. Before examining C’s rights, we should first determine the meaning of the expression “true owner”.

In South African law there is no outright interpretation of the concept: true owner. Principles from the law of things are mainly applied to establish the true owner of a cheque. As the owner, the true owner is normally entitled to possession of the cheque, and is also the person entitled to the personal rights which are embodied in the document.

The principles of the law of things which are applied to determine the true owner of a cheque can be illustrated with reference to cheques delivered by post. If a debtor posts a cheque to his creditor without the latter’s consent or request, and the creditor does not receive it, the debt is not discharged. As the cheque has not been delivered, ownership in it does not pass, and the debtor (because he remains owner) bears the risk of its theft or loss. If payment by cheque may be made by post, the drawer (debtor) is expected to indicate the payee correctly (which in the case of a company includes the ending “(Pty) Ltd” or “Ltd”, and in the case of a closed corporation includes the ending “CC”), to make the cheque payable to order, and to cross it. A loss which is the result of not meeting these requirements is carried by the drawer. If the creditor (payee) authorises payment by posting a cheque, he bears the damage of any interception and misuse or delay in the delivery of the cheque after postage. Otherwise the debtor (drawer) bears this risk. However, where the parties have agreed that payment can be made by the posting of a cheque, and if the cheque meets the requirements as set out above, the ownership of the cheque passes to the creditor on the posting of the cheque. He is then the true owner and carries the risk of interception of the cheque followed by a payment that discharges it.
Let us now return to the example above. You will notice that X stole the cheque from C.

This implies a prior delivery by A to C. C was therefore the true owner. Let us now look at C's rights according to the facts in the example:

- **Against drawer A**: If the cheque has come into the hands of the payee, the drawer is protected in terms of section 79 “as if payment of the cheque had been made to the true owner thereof”. In this example the cheque indeed came into the hands of the payee C because the cheque was stolen from him. Therefore C has no rights against drawer A, since A’s liability on the cheque as well as any underlying obligation has been discharged. Remember that the rules with regard to delivery of cheques by post could influence this answer.

- **Against drawee bank (B Bank)**: Since B Bank paid to a bank in accordance with the general crossing, and since payment was made in good faith and without negligence, B Bank is protected under s 79, “as if payment of the cheque had been made to the true owner thereof”. Therefore, B Bank may debit drawer A’s account.

- **Against thief X**: The true owner will have an action against the thief, who is *mala fide*. His right of recourse is based on delict (or unjustified enrichment) and not on the cheque itself. However, the problem is that thieves, by the very nature of their profession, cannot be easily traced and, should they be traced, they might not earn enough money while in jail to compensate the true owner for his loss.

- **Against possessor D and collecting bank (S Bank)**: Applying the principles explained above, it is clear that at common law the true owner has no claim against D or S Bank. D was in good faith, and that rules out a claim against him. S Bank acted in good faith and without negligence, and therefore it cannot be held liable.

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**Activity 2**

Read the scenario carefully and answer the following questions.

A draws a cheque on B Bank in favour of “C or order”. The cheque is crossed and marked “not negotiable”. Without the agreement C, A sends the cheque to C by post. D steals the cheque in the post before it reaches C. D deposits the cheque in X’s account with X’s consent.

Discuss who the true owner of the cheque is.

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When a cheque is crossed and the words “not negotiable” are added, not only do the provisions of section 80 come into operation (see above), but the true owner of the cheque acquires certain rights under s 81. **Note that the true owner of a lost or stolen cheque acquires rights under s 81 only if the cheque is crossed and marked “not negotiable”.** Under s 81 the true owner of a cheque acquires a right of action against a subsequent
possessor, provided the requirements in section 81 are met. These requirements can be summarised as follows:

- The cheque must have been crossed and the words “not negotiable” must have been added.
- The cheque must have been stolen or lost while it was crossed and marked as set out above.
- The bank on which the cheque was drawn (the drawee bank) must have paid it “under circumstances which do not render such bank liable to the true owner in terms of the BEA”. The only provision of the BEA which renders the drawee bank liable to the true owner is section 78(4) (disregard of a crossing).
- The plaintiff must prove that he is the true owner of the cheque.
- The true owner must show that he suffered loss as a result of the theft or loss of the cheque.
- The possessor against whom a claim is brought must have been in possession of the cheque after the theft or loss. That does not mean that somebody who had the cheque in safekeeping for someone else would simply be liable in terms of s 81, since the next requirement must also be satisfied.
- The possessor must either have given a consideration for the cheque, or must have taken it as a donee. “Consideration” is interpreted in accordance with the ordinary meaning of a quid pro quo, and “donee” should bear the ordinary meaning of someone who takes a gift (including receiving under a contract of donation). Every possessor of such a cheque shall be deemed, until the contrary is proved, either to have given a consideration or to have taken it as a donee (s 81(4)). Any possessor can rebut the presumption in section 81(4) by proving that in fact he neither gave any consideration, nor received the cheque as a gift.

A collecting bank enjoys certain protection. Under s 81(5), a bank which receives payment of a crossed cheque marked “not negotiable” shall not be deemed as having given a consideration for it merely because it has in its own books credited its customer’s account with the amount of the cheque before receiving payment thereof, or because such payment is used towards the reduction or settlement of any debt owed by the customer to the bank. This protection is subject to the provisions of s 81(3), that is, if the bank fails to furnish any information at its disposal in connection with the cheque, it is deemed to have been a possessor of the cheque who either gave a consideration for it or took it as a donee. The collecting bank will also lose its protection if it pays cash over the counter for such a cheque, or if it agrees that its customer may draw immediately against that cheque.

Let us apply these principles to the example given above. Suppose the facts are the same, except that the drawer added the words “not negotiable” on the cheque. The situation is now different as to when the cheque was only crossed and C, the true owner, now has an action against possessor D even if D was bona fide. Thus, adding the words “not negotiable” provides the true owner with a statutory right of action under s 81(1) which he did not
otherwise have at common law. The position of the other parties remains the same as above.

Superficially it may seem as though section 81 has appreciably improved the position of the true owner of a cheque in the event of loss or theft. However, this is not always the case. Normally, the collecting bank will not be liable in terms of section 81. If there has been no further possessor between the thief and the collecting bank, section 81 will not come into play.

Section 81(2) renders a person who pays such a cheque into his bank account after cashing the cheque for someone else (e.g. one who has no bank account) or who pays the cheque in with the intention of paying such other person, liable in terms of section 81(1); section 81(2) provides that the former is, for the purposes of section 81(1), deemed to have been a possessor of the cheque and to have given a consideration for it. Section 81(2) does not apply to collecting banks.

Section 81(3) provides that someone who takes a cheque to which section 81(1) applies into his possession or custody after it has been stolen or lost, and who fails to furnish the true owner, at his request, with information at his disposal in connection with the cheque, is for the purposes of section 81(1) deemed to have possessed the cheque and to have given a consideration for it or to have taken it as a donee. Note that even a messenger who, for example, takes the cheque to the bank, may become liable under this section, if he refuses to furnish the true owner, at the latter’s request, with any information he may have at his disposal in connection with the cheque.

Section 81(7) gives a person who has made good the true owner’s loss in terms of section 81(1) the same rights against possessors prior to her as the true owner had against them in terms of section 81(1). Any possessor who then pays to such person, will in turn acquire the same rights against his own predecessors, and so on until the possessor who immediately succeeded the thief. The thief himself will probably not be liable in terms of s 81(1), because he has not given a consideration for the cheque or taken it as a donee.

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Activity 3

Explain whether s 81 will apply under the following:

1. The cheque is crossed and marked “not negotiable”.
2. There has been no possessor between the thief and the collecting bank.

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3 ENDORSEMENT OF CHEQUES WHICH ARE DEPOSITED IN A BANKING ACCOUNT

The BEA contains certain sections dealing with the endorsement of cheques
which are deposited in a banking account. The provisions of ss 83 and 84 will be discussed in brief.

The purpose of these sections was to abolish the necessity for the endorsement of cheques when they are deposited in the banking account of the payees concerned. The underlying motive for this amendment was to save the commercial banks, and other large institutions who had to “endorse” many cheques, time and labour.

3.1 Section 83

What the provisions of section 83 amount to is that if a drawee bank on whom a cheque is drawn pays that cheque in good faith and in the ordinary course of business (that is payment not over the counter, but to another bank or by crediting the depositor’s account with the drawee bank), the cheque is discharged and the drawee bank incurs no liability merely on the ground that there is no endorsement or that the endorsement is irregular.

The following examples might help you to apply the provisions of section 83:

1. A draws a cheque on B Bank (the drawee bank) payable to C or order. C is also a client of B Bank and deposits the cheque in his account at B Bank, but without endorsing the cheque. B Bank credits C’s account in good faith and in the ordinary course of business. The cheque is now discharged and B Bank incurs no further liability.

2. The position remains the same where C deposits the cheque in his account at Q Bank, and B Bank then pays Q Bank in good faith and in the ordinary course of business.

3. Suppose that in the previous example C did not deposit the cheque but negotiated it to D. D is a client of S Bank and deposits the cheque in his account with S Bank, but without endorsing the cheque. B Bank (the drawee bank) pays S Bank (the collecting bank) in good faith and in the ordinary course of business, and S Bank credits D’s account. At first glance it seems as if the requirements of s 83 have been met and the cheque has been discharged. However, the commercial banks in South Africa have agreed that if a cheque is negotiated and is not deposited in the payee’s account, both the payee’s and the depositor’s endorsements must be placed on the cheque, unless the cheque has been endorsed specially to the depositor, in which case the latter’s endorsement is not necessary. The reason for this arrangement is probably just to enable the collecting bank to know whose account to debit in case the cheque is dishonoured and returned to it.

The effect of this mutual arrangement between commercial banks is that a new “course of business” has been created in our commercial banks. In the case of example (3) above, B Bank will probably not be protected, not because section 83 expressly requires that C and D must have endorsed the cheque, but because B Bank did not pay the cheque “in the ordinary course of business”, as stipulated by the commercial banks. As stated already, D’s endorsement would also not have been necessary in accordance with
commercial banking practice if C’s endorsement had been a special endorsement to D.

Section 83 does not affect the payment of a cheque over the counter by the drawee bank. Here commercial banking practice still requires the payee’s “endorsement”. As you know, such signature is required for the purposes of identification and receipt, and is not an **endorsement** in the true sense of the word. (Also see the provisions of s 58, which have already been discussed.)

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**Activity 4**

Explain in which circumstances the drawee bank will be protected in terms of s 83.

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### 3.2 Section 84

Section 84 provides further that at present the collecting bank (see study unit 15 below) acquires such rights as it would have had if the depositor of the cheque had endorsed the cheque in blank — in other words, the bank acquires the rights of a holder if the depositor were a holder. Normally the collecting bank has no need to become the holder. If the cheque is dishonoured, it merely returns the cheque to its customer and debits his account; the customer must then take the necessary steps to obtain payment himself.

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**Summary activity**

Read the scenario carefully and answer the following questions:

A draws a cheque for R1 000 on B Bank in favour of C or order. A delivers the cheque to C. The cheque is crossed and marked “not negotiable”. T steals the cheque from C and after having forged C’s signature, negotiates it to E who takes it in good faith and for value. E gives the cheque to a messenger, Y, to pay into his (E’s) account at F bank. B Bank pays F Bank in good faith and without negligence.

Discuss the rights of the true owner (C) against the following persons:

1. the drawer (A)
2. B Bank
3. T
4. E
5. the messenger, Y, who refuses to give any information he has on the cheque
6. F Bank
Feedback 1

If C sues A on the cheque, A can raise the defence that C's title is defective since C can have no stronger right on the cheque than B had. If B were to sue A on the cheque, A, could have raised the defence that a gambling debt is legally unenforceable.

Feedback 2

As the cheque belongs to the person who lost it or from whom it was stolen (the true owner), the finder or the thief is not the owner. Where the parties did not agree on the method of delivery and the drawer decides to send the cheque by post, he remains the owner until it reaches the payee. Since there was no agreement as to the method of delivery, A remains the owner of the cheque which was intercepted by D before it reached C. Accordingly, A is the true owner.

Feedback 3

1. It is a requirement for the application of s 81 that the cheque must be crossed and marked "not negotiable".
2. If there is no possessor between the thief and the collecting bank, section 81 does not apply for the simple reason that there is no possessor after the theft.

Feedback 4

The drawee bank is protected when it has in good faith and in the ordinary course of business:

1. credited the account of its customer or
2. paid another bank the amount of any cheque drawn on it. If the drawee bank had paid under these circumstances it would not incur any liability by reason only of the absence of, or irregularity in, endorsement.
C's rights are the following:

(1) **Against drawer A**: If the cheque came into the hands of the payee, in terms of s 79 the drawer is protected “as if payment of the cheque had been made to the true owner thereof.” In this case, the cheque did come into the hands of the payee, C, since the cheque was stolen from him. C therefore has no rights against A, the drawer, since A’s liability on the cheque as well as on any underlying obligations are discharged.

(2) **Against drawee bank (B Bank)**: Since B Bank paid to a bank in accordance with the general crossing, and since the payment was made in good faith and without negligence, in terms of section 79 B Bank is protected “as if payment of the cheque had been made to the true owner thereof.” Therefore, B Bank may debit A’s account.

(3) **Against thief X**: The true owner will have a right of recourse against the thief who was *mala fide*. His right of recourse is based on delict (or enrichment), and not on the cheque itself.

(4) **Against possessor E**: In terms of section 81, C, the true owner, acquires a right of recourse against E, since the following requirements of s 81(1) have been met:

- The cheque was crossed and marked “not negotiable.”
- The cheque was stolen while it was crossed and marked as above.
- The drawee bank paid under circumstances which, in terms of the BEA, do not make the bank liable against the true owner.
- The plaintiff is the true owner.
- C (true owner) must be able to show that he suffered damage as a result of theft.
- E had the cheque in his possession after the theft or loss.
- E gave a counter performance for the cheque (he took the cheque for value).

(5) **Against messenger Y**: Since the messenger failed to furnish the true owner with any information in connection with the cheque at the owner’s request, the messenger is liable in terms of section 81(3), and on application of s 81(1) he is deemed to have been a possessor of the cheque and/or to have given a consideration therefor, or to have taken it as a donee.

(6) **Against collecting bank (F Bank)**: According to s 81(5), a bank which receives a cheque which is crossed and marked “not negotiable” is not to be regarded as having given consideration therefor merely because it has in its own books credited its customer’s account with the amount of the cheque before receiving payment thereof or because any such payment is applied towards the reduction or settlement of any debt owed by the customer to the bank. However, the collecting bank will lose its protection if it paid out cash over the counter for such a cheque, or agreed that its customer could immediately draw against that cheque.
UNIT 14

NON-TRANSFERABLE CHEQUES AND CHEQUES MARKED “A/C PAYEE ONLY”

After studying this unit you should be able to

- explain how a cheque can be made non-transferable based on facts presented in a scenario
- explain your understanding of the content of ss 75A(1), 6(5) and 75A(2) of the BEA
- explain your understanding of how ss 79, 83 and 58 apply to non-transferable cheques by solving problems presented
- explain your understanding of “a/c payee only” in terms of s 6(5) of the BEA

Sections 6, 29, 58, 75A, 79 and 83 of the BEA.

Standard Bank of SA Ltd v Sham Magazine Centre 1977 (1) SA 484 (A).

It is important that you study the principles of the cases that are not prescribed as they are discussed in this unit.

1 INTRODUCTION

In unit 2 we explained to you that we have three types of cheques (see s 6):

- An order cheque is, for example, a cheque that is payable to “a person or his order”. Such a cheque can be easily transferred from one person to another.
- A bearer cheque is, for example, a cheque that is payable to “a person
or bearer”. Such a cheque can also be easily transferred from one person to another.

- A non-transferable cheque is, for example, a cheque that contains the words “not transferable” printed on the face of the cheque and which can only be transferred to one other person, namely the payee to whom payment is made.

While it is possible for a holder to restrict the further transfer of an order cheque (s 31), it is impossible to convert a bearer cheque into a non-transferable cheque (see also the discussion of the “traditional” non-transferable cheque below).

You will see in the paragraphs below that we get two types of non-transferable cheques, the result of an oversight by the legislature when drafting the Amendment Act. The draft Act, which was not followed by the legislature, contained the following words before the place where the provisions of section 75A were inserted (see below):

“notwithstanding the provisions of s 6(5) ...”

Consequently, these words were omitted in the final Amendment Act. As a result of this oversight we now have two categories of non-transferable cheques, namely:

- the section 75A(1) non-transferable cheque on which the words “not transferable” are printed with or without a crossing, and
- the “traditional” non-transferable cheque which, in terms of s 6(5), bears words or conveys an intention to prohibit transfer.

Keep in mind while studying the discussion below that there is a difference between the crossing “account payee only” and the words “pay X (the name of a payee) only”. Furthermore, as was explained in unit 12, a crossing on a cheque is a mere instruction to the drawee bank to pay another bank, the collecting bank, and as such does not influence the nature of the cheque.

2 NON-TRANSFERABLE CHEQUES

Non-transferable cheques are perceived to be safer cheques, because it is impossible to transfer such cheques further. Because only the named payee can be holder of a non-transferable cheque, the chances of theft and fraud of a cheque drawn in such a manner are reduced.

2.1 The section 75A(1) non-transferable cheque

Section 75A(1), provides that where a cheque bears boldly across its face the words “not transferable” or “non-transferable”, either with or without the word “only” after the payee’s name
Unit 14: Non-transferable cheques and cheques marked "a/c payee only"

- the cheque shall **not be transferable** but shall be valid as between the parties thereto;
- the cheque shall be **deemed to be crossed** generally, unless it is crossed specially;
- the words "not transferable" or "non-transferable" **may not be cancelled** and any purported cancellation shall be of no effect.

Non-transferable cheques in terms of s 75A(1) are only valid between the parties to the cheque. Who are the parties to a s 75A(1) non-transferable cheque? The parties to such a cheque are the drawer, the drawee bank and the named payee only, since a non-transferable cheque cannot be transferred to another person (see the definition of a bill in unit 1). Thus, only the **original payee** can be the **holder** of a cheque that contains words prohibiting its negotiation or transfer, such as "not transferable". This is also the position with traditional non-transferable cheques (see s 6(5) which is discussed below).

Please note that the words "not transferable" are not part of a crossing and need not be between two parallel lines. Furthermore, because s 75A(1) non-transferable cheques are deemed to be crossed, they must be paid into the bank account of the payee so that the bank on which they are drawn (the drawee bank) can pay it to another bank (turn to the BEA and read s 78(1) again).

**Activity 1**

Read the scenario below and answer the questions. Your answer should include a detailed explanation.

A draws a cheque on B Bank in favour of "C or order". A also writes the words "not transferable" in big, bold letters across the face of the cheque and delivers the cheque to C. C does not have a bank account and after cancelling the words "not transferable" with a red pen, requests B Bank to pay the value of the cheque to him in cash. B Bank refuses. You are B Bank's legal advisor. C asks you to explain the following to him:

- Why B Bank refuses to pay the amount of the cheque in cash to him
- Whether there is anything that he (C) can do to obtain payment of the cheque

**2.2 Traditional non-transferable cheques**

Cheques are in principle transferable. Section 6(5), however, provides that:

"If a bill contains words prohibiting transfer, or indicating an intention that it should not be transferable, it is valid as between the parties to the bill, but is not negotiable."

A cheque is valid between the parties to it, but is not negotiable when, for example, it is made payable to "C only". Such a cheque contains words which **intend to prohibit its transfer**. Thus, only the **named payee** can be
the holder thereof and he is not entitled to negotiate or transfer it to someone else. If he attempts to do so, the transferee would not become holder of the cheque.

Look again at the definition of ‘‘holder’’ in s 1 of the BEA. A non-transferable cheque, which is only valid inter partes, is not an order cheque nor a bearer cheque. It is in a class of its own. Furthermore, such a cheque cannot be negotiated (see s 29 of the BEA).

Thus, we now have two kinds of non-transferable cheques. Ensure that you know the differences between the two categories and are able to apply them to problem-type questions. Where, for example, the words ‘‘not transferable’’ are not written in ‘‘bold’’ as required by s 75A, the cheque may nonetheless be a traditional non-transferable cheque because it still contains words indicating an intention to prohibit transfer.

The following are methods whereby a cheque may be made non-transferable:

- It is sufficient to write the words ‘‘not transferable’’ clearly on the face of the cheque. Such a cheque is then non-transferable in terms of s 75A.

(If you do not yet understand why a cheque with the words ‘‘not transferable’’ printed on the face of it is called a s 75A non-transferable cheque, you must go back and study the paragraphs above again.)

The word ‘‘order’’ may also be omitted, although mere omission of ‘‘order’’ as such will not be sufficient to exclude transferability. The reason is that in terms of s 6(3) a bill will be payable to order if:

— it is expressed to be payable to a particular person and
— it does not contain words prohibiting transfer or
— indicating an intention that it should not be transferable
— the word ‘‘only’’ can be added after the payee’s name.

Please note that the Supreme Court of Appeal found on occasion that words restricting transferability must be legible (eg the word ‘‘only’’ after the name of the payee).

Consider the following examples:

- A drawer makes a cheque payable as follows: ‘‘Pay A Baker and Sons’’. The words ‘‘or bearer’’ are deleted and replaced with the word ‘‘order’’. The cheque also bears the words ‘‘not transferable’’.

This cheque is non-transferable because the impression of transferability, created by the word ‘‘order’’, is subordinate to the clear indication of non-transferability. Furthermore, remember that one has to look at the cheque as a whole to determine whether it contains words indicating an intention that it should not be transferable.

- A drawer makes a cheque payable as follows: ‘‘Pay A Baker and Sons only’’ and added the words ‘‘not negotiable’’ on the cheque.

The words ‘‘not negotiable’’ on a crossed cheque imply, according to
s 80 of the BEA, that the cheque is still transferable, but that nobody may become the holder in due course of the cheque.

(See unit 13 again if you are still unsure about the meaning of “not negotiable” on a crossed cheque.)

However, if a crossed cheque marked “not negotiable” is made payable to the named payee “only”, the cheque will be non-transferable in terms of s 6(5). In addition, if a cheque is crossed and marked “not transferable” and it is payable to the named payee “only” then we are dealing with a s 75A cheque (provided, of course, that the words “not transferable” are written “boldly” on the face of the cheque).

Activity 2

Briefly explain the differences between the two categories of non-transferable cheques.

2.3 Section 75A(2)

Section 75A(2) concerns the liability of a bank when it fails “to concern itself” with a non-transferable cheque. Section 75A(2) provides that a bank will not be negligent by reason only of the bank’s “failure to concern itself” with

- an endorsement which prohibits the transfer of a cheque or
- words or an intention that indicates that a cheque is non-transferable, other than in the manner provided for in s 75A(1).

The interpretation and application of s 75A(2) on problem type questions is not prescribed for purposes of this course. Therefore, make sure that you know the content, interpretation and application of s 75A(1) and only the content, as set out above, of s 75A(2).

We reiterate: any words on a cheque restricting further transfer of that cheque, such as “transfer prohibited”, will result in the cheque being a “not transferable” cheque even though the wording does not comply with the provisions of s 75A. The point is that there may indeed be a number of words that may indicate an intention to prohibit transfer. It was decided in the Sham Magazine Centre case that the words “account payee only” on a cheque as part of the crossing is not to be interpreted as words prohibiting transfer (for a detailed discussion of this case, see below).

3 NON-TRANSFERABLE CHEQUES AND THE DRAWEE BANK’S LIABILITY

The object of a non-transferable cheque is to ensure that no one other than
the named payee is to receive payment of the cheque. A non-transferable cheque is, however, not free from its own particular problems. One of the problems involves the question whether ss 79, 83 and 58 apply to non-transferable cheques.

3.1 Section 79

With reference to section 79, the question may be put as follows: Can a drawee bank rely on due payment if it pays the amount of a crossed, non-transferable cheque in good faith and without negligence to another bank, which is collecting it for the wrong person?

As far as the applicability of section 79 is concerned, the judgment in *Gishen v Nedbank Ltd* (1984 (2) SA 378 (W)), which was not contested on appeal (see *Volkskas Bank Ltd v Bonitas Medical Aid Fund* 1993 (3) SA 779 (A)), has provided some clarity. The court correctly pointed out that s 79 contains no indication that it applies only to transferable cheques. Consequently, the court held that section 79 does apply to non-transferable cheques.

Thus, the drawee bank will enjoy the protection of s 79 if a crossed cheque is paid to another bank collecting it for the account of the wrong person. The fact that the collecting bank may incur liability because it collected a cheque for the wrong payee is another matter and will be discussed in unit 15.

*(Can you name a new section in the Amendment Act which also offers protection to the drawee bank in certain circumstances? Here is a hint: turn back to paragraph 2.3 above.)*

This will be the case with both the traditional non-transferable cheque (a cheque bearing words or indicating an intention to prohibit transfer, such as “only” after the name of the payee) and the s 75A(1) non-transferable cheque where, for example, the words “not transferable” are printed boldly across the face of the cheque.

3.2 Section 83

Section 83 applies to transferable cheques only. The question whether s 83 may also apply to non-transferable cheques was left open in the *Gishen* case. In our view section 83 (like s 58) clearly applies only to cheques which can be validly endorsed. Non-transferable cheques are therefore excluded.

3.3 Section 58

If a cheque is uncrossed, section 79 (which applies to crossed cheques only) is not applicable. Section 58 applies to cheques made payable to order only, and which are thus transferable. Non-transferable cheques are
per definition payable to a specific person only and may not be transferred further. Therefore a drawee bank paying a non-transferable cheque to another bank, which collected it for the wrong person, will not be able to rely on the protection of s 58.

**Activity 3**

Read the scenario below and answer the question.

A draws a cheque on B Bank in favour of "C only". The cheque is crossed and the words "not transferable" appear in black, bold letters beneath the date of the cheque. A delivers the cheque to C. K, a thief, steals the cheque from C, opens a new account in the name of "C & K" at S Bank and pays the cheque into his new account. S Bank delivers the cheque to B Bank for payment. B Bank pays the amount of the cheque to S Bank in good faith and in the ordinary course of business.

Will B Bank be protected even though it paid the cheque to another bank which collected it for the wrong payee?

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4 CHEQUES MARKED "A/C PAYEE ONLY"

In the paragraphs above we explained that a non-transferable cheque, whether in terms of s 6(5) or in terms of s 75A, may only be transferred to the named payee thereof. In addition, the named payee can become a holder, but never a holder in due course, of a non-transferable cheque. The reason for this has to do with negotiation. You may remember that to become a holder in due course of a cheque, negotiation must have taken place (see s 27 as discussed in unit 7).

The drawer of a non-transferable cheque who delivers it to the named payee, issues the cheque to the named payee (see s 1 where ‘issue’ is defined) who takes it as a holder. A non-transferable cheque cannot be transferred to anyone else and because no negotiation can take place, the named payee of a non-transferable cheque may only become a holder, but never a holder in due course, of the cheque.

(You must study unit 7 again where the term “holder in due course” is discussed if you still do not quite understand the difference between the holder and holder in due course of a cheque.)

Even though the BEA does not make provision for such a marking, a practice was established to add the words “account payee only” (“a/c payee” or “a/c payee only”) on crossed cheques. The meaning of “account payee only” was considered in the case of Standard Bank of South Africa Limited v Sham Magazine Centre 1977 (1) SA 484 (A). Because the Appellate Division (now known as the Supreme Court of
 Appeal) considered the meaning and effect of different types of crossings, reading the judgment should provide you with an excellent summary of many of the principles that are discussed here and in other units. For this reason we urge you to read the case yourself and to study the whole decision of Holmes JA.

4.1 Standard Bank of South Africa Limited v Sham Magazine Centre

In Standard Bank of South Africa Limited v Sham Magazine Centre (1977 (1) SA 484 (A)) the Appellate Division had to decide whether the words “a/c payee only” exclude the transferability of a cheque. Thus, the question put before the Appellate Division was whether the words “a/c payee only” prohibited the transfer of the cheque. If the words “a/c payee only” prohibited the transfer of the cheque, Standard Bank could not have been the holder of the cheque.

(Why do you think Standard Bank needed to be a holder of this cheque? Here is a hint: page back to unit 6 to see what the rights of a holder of a cheque are.)

To decide this question the court had to interpret s 6(5) of the BEA, as well as the words “a/c payee only” on the cheque. Section 6(5) reads:

If a bill contains words prohibiting transfer, or indicating an intention that it should not be transferable, it is valid as between the parties to the bill, but is not negotiable.

In the Sham Magazine case the court made the following remark (at 501–502):

One is not here dealing with ordinary language which is susceptible of interpretation by reference to considerations of grammar and plain meaning. One is dealing with an evolved mystique of hieroglyphs, such as transverse parallel lines; snatches from words, such as “and Co”, verbless expressions such as “a/c payee only”.

The Appellate Division came to the conclusion that Standard Bank, as endorsee, did qualify as the holder of the cheque and was entitled to institute action on the cheque against Sham Magazine Centre as drawer. To find out why the court found in favour of Standard Bank you must read the case. You may also, when reading the Sham Magazine Centre case, ask yourself what the meaning of the words “account payee only” are when placed on an order cheque and when placed on a non-transferable cheque.
Unit 14: Non-transferable cheques and cheques marked “a/c payee only”

Activity 4

Read the case of Standard Bank of South Africa Limited v Sham Magazine Centre (1977 (1) SA 484 (A)) and answer the following questions.

1. Briefly summarise the relevant facts of the case.
2. What is the effect of the words “account payee only” when placed on a cheque?
3. What is the difference in meaning between the words “pay C only” and “account payee only” when placed separately on two different order cheques?
4. Do the words “account payee only” (or “a/c payee only”) exclude the transferability of an order cheque?

Above we have explained to you the meaning of different words that may appear on cheques. You must always try to distinguish between the different kinds of crossings or words that may be added to a cheque (see units 12 and 13). Remember, we have three kinds of cheques, namely order, bearer and non-transferable cheques. These cheques may be crossed or uncrossed.

When answering questions about a cheque in the examination, first try to determine whether there are words on the cheque that prohibit the cheque’s transferability. Only then should you proceed to answer specific questions about the cheque.

The type of question that you may expect in the examination follows below. We cannot emphasise enough that you must study negotiable instruments as a whole.

Summary activity

A draws a cheque on B Bank in favour of “C”. The cheque is crossed and the words “not negotiable” and “no further transfer” are printed on the face of the cheque. A delivers the cheque to C as payment for a debt. D steals the cheque from C, writes on the back of the cheque “pay X” forges C’s signature on it and gives the cheque to X who takes it in good faith and for value. X deposits the cheque into his account at S Bank for collection. B Bank pays S Bank in good faith and without negligence. Advise C in full about the possible liability of the following parties:

1. B Bank
2. X
3. S Bank
Unit 14: Non-transferable cheques and cheques marked “a/c payee only”

Feedback 1

- You must explain the content and effect of section 75A(1) to C. Section 75A(1) states that a cheque will not be transferable when it bears boldly across its face the words “not transferable” either with or without the word “only” after the payee’s name, that such a cheque is deemed to be crossed generally unless it is crossed specially, and that the words “not transferable” may not be cancelled and any purported cancellation will be of no effect.

In this example the cheque is a non-transferable cheque and only valid inter partes (between the parties) to the cheque. The words “not transferable” are not part of a crossing and need not be between two parallel lines. Furthermore, the words “not transferable” may not be cancelled. Thus, B Bank must treat the cheque as a generally crossed cheque that must be paid into the account of the named payee, C (see s 78(1)). (Also see s 78(4) as discussed in unit 12.)

Thus, C, as the holder of a s 75A(1) non-transferable cheque, which is deemed to be crossed, must pay the cheque into a bank account at B Bank for it to be paid.

- C only has two options: he will either have to open a bank account at B Bank or request A to issue another cheque to him.

Feedback 2

The Bills of Exchange Amendment Act 56 of 2000 created a s 75A(1) non-transferable cheque in addition to the BEA’s s 6(5) non-transferable cheque. In terms of s 6(5) a cheque will be non-transferable if it contains any words or intention that prohibits transfer of the cheque. Even though such a cheque may be crossed or uncrossed, the South African clearing banks have decided not to accept uncrossed non-transferable cheques at all for collection. A crossed s 6(5) non-transferable cheque may only be deposited into an account bearing a name identical to that of the payee. A cheque made payable to “C only” is an example of a traditional non-transferable cheque in terms of s 6(5).

In contrast, the s 75A(1) non-transferable cheque must bear the words “not transferable” (or “non-transferable”) boldly on the face of the cheque and will be deemed crossed even if a crossing does not appear on the cheque. A cheque made payable to “C”, where the words “not transferable” appear in bold on the face of the cheque, is an example of a s 75A(1) non-transferable cheque.

Feedback 3

In this question we are dealing with a non-transferable cheque in terms of s 75A(1). B Bank will only be protected if it paid the cheque in terms of s 79 as s 79 is applicable to both transferable cheques and non-transferable cheques. Neither s 58 nor s 83 apply to non-transferable cheques. Look again at the wording of s 58 and s 83. Sections 58 and 83 apply only to cheques which are payable to order.
Therefore B Bank must pay the cheque in good faith and without negligence in accordance with the crossing to be protected by section 79. However, note that B Bank paid S Bank in good faith and in the ordinary course of business.

Because B Bank must pay a cheque in good faith and without negligence, B Bank cannot rely on section 79 for protection. However, if payment was made without negligence, B Bank could have relied on the protection of section 79.

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**Feedback 4**

1. The facts in the *Sham Magazine* case can be found in the decision of Holmes JA. Make a summary of the relevant facts for yourself. As a guideline you may try answering specific questions in your summary, such as:

   - Was the cheque in this matter transferable or non-transferable?
   - Which words were printed on the face of the cheque?
   - What was the question the court had to decide?
   - What were the reasons for the court’s decision?

2. The question of the effect of the words “account payee only” or “a/c payee only” was discussed by Holmes JA at 504H. He said, among others, that the words “account payee only” might operate as some safeguard if the cheque were to fall into wrong hands. They are, in effect, a direction to the collecting banker that the specified payee should receive the money.

   Remember, you have to look at the full judgment of Holmes JA yourself. The answers we are providing here are not sufficient for examination purposes and serve as mere guidelines on what we are expecting of you.

3. You know that an order cheque is in principle transferable unless words restricting its transferability are printed on the cheque (s 6(5)). An order cheque becomes non-transferable when the words “pay C only” appears on it.

   In contrast, the words “account payee only” are nothing more than an instruction to the collecting bank to collect payment of the cheque for a specific payee. In *Standard Bank of South Africa Limited v Sham Magazine Centre* the Appellate Division said that the words “a/c payee only” do not exclude the transferability of a cheque. The court also stated that the words “a/c payee only” might operate as a safeguard should the cheque fall into the wrong hands. They are therefore a direction to the collecting banker that the specified payee should receive the money.

4. No. In the *Sham Magazine Centre* case, Holmes JA came to the conclusion that the words “not negotiable” in conjunction with the words “a/c payee only” do not exclude the transferability of a cheque. The words “a/c payee only” are only an indication that the cheque must be collected for a specific payee. However, note that when these words are used together with words restricting a cheque’s transferability, the cheque will be non-transferable.
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(If you do not know why a cheque becomes non-transferable when the words "a/c payee only" appear on it together with any words restricting its transferability, you must study paragraphs 2.2 and 2.3 above again.)

Feedback for summary activity

We reiterate: You must first determine the meaning of all the words that appear on the face of the cheque to answer such a question correctly. In this example, the cheque is non-transferable. It is a s 6(5) non-transferable cheque because the words "no further transfers" are printed on the face thereof.

In addition, the words "not negotiable" are also printed on the cheque, which means that s 81 is applicable (see unit 13 again). Therefore C may, as the true owner of a stolen, crossed cheque marked "not negotiable", hold X, as possessor of the cheque, liable in terms of s 81 if all the requirements are met.

(Do you remember that the words "not negotiable" may also appear on non-transferable cheques? If not, study unit 13 again.)

C may be advised as follows:

1 The liability of B Bank

B Bank is protected by s 79 because the bank paid the cheque in good faith and without negligence to S Bank, as mandated by the crossing. Therefore B Bank will not be liable towards C.

2 The liability of X

C, as the true owner of a stolen, crossed cheque marked "not negotiable", may hold X liable as possessor in terms of s 81 if he can prove that:

1. the cheque was crossed;
2. the words "not negotiable" were printed on the face of the cheque;
3. the cheque was stolen after it was crossed & marked "not negotiable";
4. he is the true owner of the cheque;
5. he suffered damages because of the theft of the cheque;
6. X was a possessor of the cheque after it was stolen;
7. B Bank made a protected payment in terms of s 79; and
8. X gave consideration for the cheque.

It seems that C will not have a problem proving requirements (1) to (8) of s 81. Thus, C will be able to hold X liable as possessor in terms of s 81.

3 The liability of S Bank

In terms of s 81(5) S Bank will not be regarded as having given consideration for the cheque merely because:
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(1) it has credited the account of X before receiving payment for the cheque, or because
(2) any such payment was applied towards reducing a debt owned by X to S Bank.

S Bank will only be liable as possessor towards C if S bank fails to give any information concerning the cheque to C (s 81 (3)).

Please note that the possible delictual liability of S Bank will also be relevant in this case. After studying unit 15, you should be able to discuss S Bank’s potential delictual liability with reference to both the Indac Electronics and the Columbus Joint Venture case, both of which are prescribed.
UNIT 15
THE COLLECTING BANK

After studying this unit you should be able to

- discuss concisely the operation and legal nature of collecting in relation to a given scenario
- explain the responsibility of the collecting bank with reference to given court cases
- evaluate the possible negligence of the collecting bank under given conditions

Prescribed reading

*Indac Electronics (Pty) Ltd v Volkskas Bank Ltd 1992 (1) SA 783 (A)*
*Columbus Joint Venture v Absa Bank Ltd 2002 (1) SA 90 (SCA)*

It is important that you study the principles of the cases that are not prescribed as they are discussed in this unit.

1 INTRODUCTION

In terms of the Appellate Division’s (now known as the Supreme Court of Appeal) decision in *Indac Electronics (Pty) Ltd v Volkskas Bank Ltd 1992 (1) SA 783 (A)*, the true owner of a stolen cheque can charge the collecting bank with negligence if the collecting bank negligently collects the cheque on behalf of a client who is not entitled to receive payment on that cheque. Before we see what the Appellate Division’s findings were in the *Indac* case, you must first understand the operation and the legal nature of collection.
2 THE OPERATION AND LEGAL NATURE OF COLLECTION

We explained in unit 11 that a drawer, on issuing a cheque, instructs his bank — the drawee bank — to pay that cheque to a specific person or his order or to bearer. In most instances a drawee bank is obliged to carry out the instructions of the drawer (see s 73 for instances where a drawee bank may refuse to pay out a cheque). Crossing a cheque does not change its nature; it simply means that a drawee bank must pay that cheque to another bank (see unit 12).

In studying the operation and the legal nature of collection, you must distinguish between the payment of uncrossed and crossed cheques, and the payment of order, bearer and non-transferable cheques.

2.1 Uncrossed cheques

A holder in possession of an uncrossed cheque can obtain payment of it in three different ways:

- he can present the cheque for payment at the branch of the bank where it is payable; or
- he can request another bank to cash the cheque for him; or
- he can deposit it into his own bank account so that it can be collected by his own bank.

If a bank other than the drawee bank pays an uncrossed cheque across the counter, that cheque has in effect been negotiated to the bank by the holder. The bank then collects the amount of the cheque for itself as the holder. Unless there is another intention, this will apply even when one branch of a bank negotiates a cheque drawn by a client of another branch. The cheque is only paid when it has been decided to debit the drawer’s account.

When an uncrossed cheque is presented at the bank branch where it is payable, no collection takes place. The drawee bank pays the bearer and recovers the payment from the account of the cheque account holder who drew the cheque.

2.2 Crossed cheques

A holder who wants to obtain payment of a crossed cheque must have a bank account. As you know, crossing a cheque means that the drawee bank is only allowed to pay it into a bank, so the cheque must in effect be deposited into the holder’s bank account (see unit 12).

If the drawer and the holder of a crossed cheque are clients of the same bank, though they might bank at different branches, the bank is of course unable to pay the cheque into another bank; it is itself both the collecting and the drawee bank. In this case, it meets the requirements of the crossing by debiting one client’s account and crediting the other’s.
2.3 Order cheques, bearer cheques and not negotiable cheques

As we have stated above, when a cheque has been made payable to order the signature of a holder is necessary to enable the bank to negotiate the cheque and present it for payment as the holder. When a cheque is payable to bearer, no endorsement is required for negotiation. The simple act of delivering it to the bank means that the bank becomes the holder of the cheque.

(If you don’t understand this principle, refer back to unit 4 where we explained negotiation.)

A cheque which is non-transferable is not payable to order or to bearer. For that reason, only the payee of a non-transferable cheque can be the holder. A non-transferable cheque cannot be further negotiated (s 29). This means that nobody can be a holder in due course of such a cheque. The collecting bank will honour a non-transferable cheque only as the representative of the payee and not as the holder.

We pointed out in unit 14 that banks will only accept traditional non-transferable cheques if they are paid into an account with the same name as the holder. Section 75A(1) non-transferable cheques are deemed to be crossed, so all non-transferable cheques may only be paid into a bank, as required by section 78.

Activity 1

A draws a crossed cheque on B Bank in favour of “C or order”, and delivers it to C. D steals the cheque from C, writes on the back “Pay D or order” and presents it for payment at B Bank. Since D does not have a bank account, he insists that B Bank pay him the value of the cheque in cash. Advise B Bank in detail about the possible consequences of such a payment.

3 THE COLLECTING BANK’S RESPONSIBILITY TO THE TRUE OWNER

3.1 Introduction

Refer again to the example in activity 1 above. We are concerned with a cheque which has a general crossing, so the drawee bank pays it in to another bank, the collecting bank. (Do you remember the difference between a general and a special crossing? If not, please refer back to unit 13.)

We explained in unit 11 that the drawee bank’s obligation to pay a cheque to the holder is rendered null and void in certain circumstances by s 58.
units 12 and 13 we discussed the protection provided to a drawee bank by ss 79 and 83 when the drawee bank pays to the collecting bank a cheque from a person who was not entitled to receive payment.

For a long time there was controversy as to whether a collecting bank acquired, or should acquire, delictual liability towards the true owner of a cheque if the bank negligently collected payment of the cheque on behalf of the wrong person. The question of whether negligence was sufficient to make the collecting bank liable was finally settled by the Appellate Division in Indac Electronics (Pty) Ltd v Volkskas Bank Ltd 1992 (1) SA 783.

3.2 Indac Electronics (Pty) Ltd v Volkskas Bank Ltd

The facts in Indac Electronics (Pty) Ltd v Volkskas Bank Ltd are fairly clear. As the case is prescribed for this course, you must read it yourself and you must understand why the Appeal Court decided in favour of Indac Electronics.

The Appeal Court, through Vivier JA, found as follows on the question of whether negligence on the part of the collecting bank is sufficient to make it liable after a cheque has been collected for the wrong person (see 797A):

"There can now be no reason in principle why a collecting banker should not be held liable under the extended lex Aquiliae for negligence to the true owner of a cheque, provided all the elements or requirements of Aquilian liability have been met."

You must study this judgment carefully, as it represents the current legal position. The Appeal Court decided upon exception that a collecting bank which collects the amount of a cheque for the wrong person is indeed liable to the true owner for compensation. A collecting bank is negligent if it fails to take reasonable steps to determine whether its client is ex facie entitled to payment of the cheque (see 797C–D and 799B–D).

In the Indac case the facts point prima facie clearly to negligence. The bank accepted an order cheque (unendorsed) for the account of someone other than the payee of the cheque (see 788G–789D).

Activity 2

What elements must the true owner prove before the collecting bank can be held liable for having paid the amount of the cheque to the wrong person?

The facts of Columbus Joint Venture v Absa Bank Ltd 2002 (1) SA 90 (SCA), like those of the Indac case, are very important for determining the possibility of negligence on the part of the collecting bank.
3.3 *Columbus Joint Venture v Absa Bank Ltd*

Our courts have decided on several occasions that when a **new client** applies to open a banking account, the bank is legally obliged to take reasonable steps to prevent abuse of that account. Usually the bank is expected to take reasonable care to check the client’s personal particulars and identity.

The facts in *Columbus Joint Venture v Absa Bank* are extremely important, as we stated above. This case is also prescribed; you must therefore read it yourself so that you can understand the ruling by the Supreme Court of Appeal.

The Supreme Court of Appeal had to decide whether Absa Bank negligently, as alleged by Columbus Joint Venture, opened an additional account for an **existing** client without checking all the particulars provided by that client. The court concluded that Columbus Joint Ventures could not prove that Absa Bank was negligent in opening another account for its client without conducting an in-depth investigation.

The importance of the verdict is twofold:

- The Supreme Court of Appeal confirmed once more that a collecting bank is **legally obliged** to use caution when opening **new accounts** in order to prevent possible loss to the true owner of a stolen cheque.
- It also stated that the question of whether a collecting bank was or was not negligent could only be decided after careful consideration of all the **facts and circumstances** of the matter.

**Activity 3**

Read the judgment in *Columbus Joint Venture v Absa Bank Ltd* 2002 (1) SA 90 (SCA), and answer the following questions:

1. Why does the Supreme Court of Appeal distinguish between a bank’s **existing clients** and **new clients** who apply for the first time to open accounts?
2. What must a bank do when it opens an account for a new client for the first time?
3. What is the court’s view of the **guarantee** of a client’s honesty provided to the bank?
4. What was the court’s conclusion about Absa Bank’s alleged negligence?

Another example of the findings of the Supreme Court of Appeal on the possible negligence of a collecting bank can be found in *Absa Bank Bpk v Ons Beleggings BK* 2000 (4) SA 27 (SCA). You do not need to study this case for examination purposes, but it is important for you to understand how the facts of a case can affect the court’s judgment.

In this case the court had to decide whether a collecting bank can be expected to investigate the genuineness of an endorsement on a cheque. The relevant facts of the case are that Saambou National Building Society drew a cheque on Volkskas Bank in favour of “Ons Beleggings BK or order”.

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The cheque was crossed and marked "not negotiable". F, an agent of Ons Beleggings BK, received the cheque and instead of depositing it in the account of Ons Beleggings BK, he entered on the back of the cheque the words: "For ONS/SJA". F then paid the cheque into the account of SJA Marketing (Pty) Ltd, a company in which he had an interest. SJA Marketing (Pty) Ltd was subsequently liquidated, and Ons Beleggings brought a case against Volkskas Bank in which it claimed that Volkskas Bank was negligent in collecting this cheque.

The Appeal Court found that although a collecting bank is not obliged to investigate the authenticity of an endorsement, it must check whether an endorsement makes the cheque appear _ex facie_ regular and genuine. Clearly, the name of the endorser (which appeared on the back of the cheque) was not even close to the name of the payee. It should have been _ex facie_ apparent to Volkskas Bank that SJA Marketing (Pty) Ltd was not entitled to receive payment of the cheque. The court accordingly found that Volkskas Bank had collected the cheque for the wrong person in a _negligent_ fashion.

Another example related to the judgment in the _Columbus_ case above is to be found in _Kwamashu Bakery Ltd v Standard Bank of South Africa Ltd_ 1995 (1) SA 377 (D). In this case the relevant cheques were made payable to "Kwamashu Bakery Ltd only" and were therefore not transferable. When the cheques were stolen, an account was opened under the name of "Kwamashu Bakery Ltd Soccer Club". The cheques were deposited into the Kwamashu Bakery Ltd Soccer Club account and payment was obtained. The question is whether the collecting bank was negligent.

The court found that there had been negligence. The name of the account into which the cheques were deposited was not the same as the name of the payee on the cheques, and for this reason alone the collecting bank was _negligent_. The importance of the judgment lies in the court’s finding that the collecting bank must take reasonable steps _when an account is opened_ to ensure that the person opening the account is in fact who he claims to be. If a thief tries to open an account under the exact name of the payee as it appears on the cheque, damage can only be prevented if the bank takes reasonable steps when the account is being opened to ensure that it is not a false account.

Here is a final example which summarises most of the principles dealing with the payment and collection of cheques. It is also the kind of question that you can expect in the examination. You should be aware by now that you cannot study the principles of the law of negotiable instruments in isolation. Make sure, therefore, that you are familiar with the contents of all the units from 1 to 15.

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A draws a cheque on B Bank in favour of "M or order" in settlement of his debt to M. The cheque is crossed and marked "not negotiable" and "for a/c payee only". A delivers the cheque to M. D steals the cheque from M and writes on the back of it: "Pay D signed M". D presents the cheque to C in settlement of his debt to C.
C gives the cheque to his messenger, X, to deposit into C’s account at S Bank. S Bank presents the cheque to B Bank for payment. B Bank pays the amount of the cheque to S Bank in good faith and without negligence. Bank debits A’s account, and S Bank credits C's account.

Answer the following questions:

(1) Is the cheque transferable?
(2) Would your answer be different if the cheque had been marked “not transferable” and “pay M only”?
(3) Is C a holder of the cheque?
(4) Would your answer to (3) be different if the cheque had not been stolen by D and M had endorsed it in favour of C?
(5) Has the payment of the cheque by B Bank to S Bank settled the debt between A and M?
(6) Who was the true owner of the cheque?
(7) Will the true owner of the cheque have any right of recovery towards the following parties: C; X; B Bank; S Bank?
(8) With reference to the possible liability of S Bank, would your answer have been different if A had entered the words “not negotiable” and “not transferable” on the front of the cheque?
(9) Can B Bank be protected by section 79 if the words “not negotiable” and “not transferable” have been entered on the cheque and if B Bank paid the cheque into the collecting bank of the wrong payee?
(10) What does M have to prove in order to hold S Bank delictually liable for collecting the cheque for the wrong person?

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**Feedback 1**

We are dealing with a crossed order cheque. D has to deposit the cheque into a bank account because it is a crossed cheque (s 78(1)). D can only do that if he has a bank account at S Bank. The facts indicate that D does not have an account with S Bank. S Bank will not receive payment from B Bank if the cheque is not paid into a bank account (refer to s 78(4), which determines that a drawee bank that does not pay a crossed cheque into a bank can be held accountable to the true owner for any loss suffered by the true owner). For that reason, S Bank must refuse to honour the cheque to D if D does not have a bank account. (See unit 12 for a discussion of crossings on cheques.) You could also discuss what would be expected of S Bank if D wanted to open a new account with S Bank.

(Refer to the court decisions in the Columbus Joint Venture and Indac Electronics cases discussed above for information on what is expected of a bank when it opens an account for a new client)
Feedback 2

Following the judgment in the Indac case, the true owner of a stolen cheque needs to prove the following five elements in order to be successful in his bid to hold the collecting bank liable for the wrongful collection of a cheque: (see 797C–D):

- There has to be an act or an omission (in this case, the presentation of the cheque by the collecting bank and the receipt of payment).
- The act or omission had to be unlawful (a collecting bank is legally obliged not to collect cheques negligently).
- There must have been intent or negligence on the part of the person who performed the act or the omission (the collecting bank paid in the cheque for the wrong person).
- There must have been loss (usually the amount of the cheque).
- There must have been a causal connection between the act or omission and the loss that was suffered (collecting for the wrong person by the collecting bank meant that the true owner suffered loss).

Feedback 3

(1) In his judgment, Cameron JA distinguished between two instances: firstly when an existing client of a bank applies to open another account, and secondly when a new client wants to open a bank account for the first time. You must find the reason for this distinction in the verdict, and make your own summary of the most important points raised by Cameron JA. Pay special attention to pages 97A and 98F.

(2) The obligation of a bank which opens an account for a new client is set out by the Appeal Court in 97 and 98E–F.

(3) Reread paragraph 98B of the Columbus case. The Supreme Court of Appeal found that a collecting bank did not guarantee the honesty or integrity of his clients. Remember to make your own summary of what else the Court said about this.

(4) The Supreme Court of Appeal concluded that Columbus Joint Ventures was unable to prove that Absa Bank had acted negligently by opening an additional account for its client without an in-depth investigation.

Feedback for summary activity

(1) Yes. The cheque is still transferable regardless of the wording on it (see unit 14).

(2) Yes. In terms of section 6(5) the cheque will now not be transferable because the words that appear on it prohibit further transfer of the cheque. (Read the discussion of non-transferable cheques in unit 14 again if your answer was wrong)

(3) Read the definition of “holder” in s1 of the Act. In this case C cannot be the holder of the cheque because he is not the payee (M is) or the endorsee (there is no valid endorsement) in possession of the cheque.
C is not the bearer in possession of a bearer cheque either. The cheque will only be a bearer cheque if it is, for instance, payable to bearer. You should refer back to unit 2 if you are not able to name the three other cases in which a cheque will be payable to bearer. Remember that C must be in possession of the cheque in order to be the holder (s 1).

Because C is not a holder of the cheque, he cannot be a holder in due course either (see s 27(1) for a definition of a holder in due course). You should realise by now that you will not be able to answer questions like these if you do not know and understand your definitions.

(4) In this case C would be the holder of the cheque because the order cheque was endorsed to him and he is in possession of it. C will not, however, be a holder in due course, because section 80 states that a person who receives a cheque marked “not negotiable” cannot have a better title to it than his predecessor. M was only a holder, so C can also only be a holder.

(Refer again to unit 13 if you are not sure why C cannot be a holder in due course)

(5) Yes. Although B Bank’s payment was not made to the holder of the cheque, which is one of the requirements for payment in due course, B Bank and A are protected by section 79. In terms of section 79, it can be assumed that payment was made to the true owner of the cheque (this has the same effect as a payment in due course) if the drawee bank paid a crossed cheque into another bank in good faith and without negligence. A is protected because B Bank paid the cheque after it came into M, the payee’s possession (s 79). B Bank is therefore entitled to debit A’s account. M is not entitled to ask A for a second cheque because the debt owed to M by A was cleared by B Bank’s payment.

(6) M is the true owner of the cheque. Remember that someone does not need to be in possession of a cheque to be its true owner. It is only in the case of holdership that one has to be in possession of the cheque. “Delivery” was explained to you in unit 4. Note that the rules of delivery by post or otherwise are important when determining who the true owner of a cheque is. When a payee, for instance a creditor, agrees that a drawer (in this example, the debtor) can make payment by post, the risk and the rights of ownership are transferred to the addressee (creditor) when the cheque is posted. The drawer, however, takes the risk that the cheque might be stolen if he organises delivery of a cheque by post without the consent of the payee.

(7) The cheque was crossed and marked “not negotiable,” so C is, in terms of s 81, potentially liable to the true owner (M) if all the requirements of this section have been met (see unit 13). According to the Sham Magazine case (unit 14), the words “a/c payee only” do not change the nature of the cheque — it is still a transferable order cheque. The words “a/c payee only” are simply

— an instruction to the collecting bank that the named payee must obtain payment of the cheque, and

— to serve as a safeguard if the cheque were to fall into the wrong hands. (See Standard Bank of SA v Sham Magazine Centre 1977 (1) SA 484 (A) at 504H)

• X is the messenger not a subsequent possessor who gave value for the cheque. He simply acted on behalf of C, and will not be liable in terms of s 81. X could of course be liable if M were to ask him for information about the cheque and he refused to provide it (see unit 13, where we discuss s 81 (3)).

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B Bank is protected by section 79. As we discussed in 5 above, when the drawee bank paid a crossed cheque to another bank in good faith and without negligence it was as if payment had been made to the true owner of the cheque. B Bank is therefore entitled to debit A's account.

S Bank will not be liable in terms of s 81, because all it did was to collect payment on behalf of C and credit C's account. As such, it did not give consideration for the cheque, nor did it receive the cheque as a gift. S Bank will however have to provide M with all the information about the cheque; if it fails to do so, it may be held liable as a possessor. (See unit 13, where we discussed ss 81(3) and 81(5), and note carefully how S Bank as the possessor of the cheque can be liable to M as the true owner.)

S Bank may be held delictually liable by M. In Standard Bank of SA v Sham Magazine Centre, Holmes JA said that the words “not negotiable”, appearing together with the words “a/c payee only” on a cheque, will not exclude the transferability of the cheque.

The words “a/c payee only” are nothing but an instruction to the collecting bank that a certain payee must receive the amount of the cheque, and also serves as protection if the cheque ends up in the wrong hands (refer once more to unit 14). The fact that S Bank did not make certain that payment was made to the correct person may point to negligence.

(When possible you should always refer to relevant judgments in your answers. For example, the Indac case (as discussed above) might be relevant when you are answering question 7.)

8 In this case not only will the true owner (M) not be protected by s 81, but the cheque will also not be transferable. (See unit 13 and the answer to 7 above.)

As with question 7 above, a strong case could be made out that S Bank was negligent. M, as the true owner of a non-transferable cheque, could claim that S Bank, as the collecting bank, should have taken notice when it received a non-transferable cheque with an endorsement being deposited on behalf of someone other than the stated payee (M). According to Indac Electronics (Pty) Ltd v Volkskas Bank Ltd 1992 (1) SA 783 (A), a collecting bank which acts negligently in collecting the amount of a cheque for the wrong person will be liable to the true owner for damages. The question is whether S Bank took reasonable steps to determine whether its client, C, was entitled to payment ex facie the cheque or not. (See 798D-800A in the Indac case referred to above.)

9 Yes, section 79 will protect B Bank if B Bank, as the drawee bank, paid to the wrong person a non-transferable cheque with “not negotiable” written on it. Refer to unit 14, where we explained that section 79 is applicable to both transferable and non-transferable cheques. The protection offered by section 79 will also cover both the traditional non-transferable cheque in terms of section 6(5) and the section 75A(1) non-transferable cheque on which the words “not transferable” appear.

(Refer back to unit 12, where we discussed the requirements of s 79)

10 In terms of Indac Electronics (Pty) Ltd v Volkskas Bank Ltd M, as the true owner, will have to prove that (refer to 797D-E):

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the collecting bank had received payment of a cheque on behalf of someone who had not been entitled to payment;
- in receiving such payment, the collecting bank had acted unlawfully and negligently;
- the conduct of the collecting bank had caused the owner to sustain loss;
- the damages claimed represented proper compensation for such loss.

You should also refer to other relevant cases that are applicable to the possible delictual responsibility of a collecting bank. You might for instance refer to the *Columbus Joint Venture v Absa Bank* case, as discussed above, in which it was found that the facts and circumstances of a case are, as in the *Indac* case, very important when determining the possible negligence of the collecting bank.

As you will have noticed, before you answer a question you must first identify what the question refers to and what is expected of you. In this case, the cheque was crossed and marked "not transferable" and "a/c payee only".

You should realise that s 81 will be relevant if the words "not negotiable" appear on a cheque. According to Holmes JA the words "a/c payee only" do not affect the transferability of the cheque but are simply an instruction to the collecting bank that a certain payee must receive payment of the cheque. The words "a/c payee only" similarly, serve only as a safeguard if the cheque should fall into the wrong hands.

*(Refer once more to *Standard Bank of SA v Sham Magazine Centre* on 504 and further, and to unit 14 where this was discussed)*
Section B

Methods of payment
UNIT 1

CREDIT CARDS

Outcomes

After completing this study unit you should be able to

- explain your understanding of what a credit card is
- identify the different types of credit card
- discuss how payment is effected
- identify and discuss the different relationships that arise from a credit card agreement
- explain the legal consequences flowing from the unauthorised use of a credit card

Prescribed reading

There is no prescribed reading for this unit.

1 INTRODUCTION

The credit card is one of the more modern methods of payment. In 2006 it was estimated that more than 317 million credit card purchases were made in South Africa with a value of more than R132 000 million.

The credit card is a very convenient and relatively safe method used to effect payment both locally and internationally. It has become common practice to use a credit card to pay for goods ordered by telephone or through the internet.

It provides credit to the cardholder because the card issuer, who compensates the supplier for purchases made by the cardholder, only receives payment from the cardholder at a later stage.

It has certain advantages for the cardholder (ie the debtor) if compared with, for example, cash or cheques. Some of these advantages are the following: it is a relatively safe method of payment for both the debtor and creditor, it provides credit for a certain period to the cardholder, and if the supplier has
agreed with the card issuer to accept the credit card as a method of payment, the cardholder can insist on the credit card being accepted by the supplier as a method of payment.

However, it also has certain disadvantages. First, it is not always a very safe method of payment when paying for goods which are ordered by telephone. Secondly, the credit card is not a negotiable instrument and therefore cannot be transferred from one person to another.

2 DIFFERENT TYPES OF CREDIT CARDS

There are generally two types of credit cards, namely two-party credit cards and three-party credit cards. In the case of a two-party credit card, there are only two parties involved, namely the card issuer (who is also the supplier) and the cardholder. Previously two-party credit cards in South Africa were mainly issued by filling stations to clients who wanted to purchase fuel on credit. Nowadays most large department stores (for example, Edgars, Woolworths, Jet, etc) issue two-party credit cards to their existing clients. The name, the account number and the signature of the cardholder is indicated on the card and the cardholder (or client) is entitled to make purchases on credit at various stores within the chain up to a maximum amount agreed to by the parties.

2.1 Two-party credit card

In the case of a two-party credit card, the two parties are the card issuer on the one hand and the cardholder on the other. Please note that with a two-party credit card the card issuer is also the supplier of the goods or services purchased.

An example of a two-party credit card

![Edgars Credit Card](image_url)

In this example Edgars is both the card issuer and the supplier and Edgar’s client is the cardholder.
Unit 1: Credit cards

Please note that the card issued by some wholesalers to their clients who purchase in bulk (for example, a Makro card or a Trade Centre card) is not considered to be a two party credit card. These cards are merely used to identify a customer and track purchases but cannot be used to make purchases on credit.

An example of a store card (that is not a credit card)

TRADE CENTRE
2582141737 258

Activity 1

Study the following set of facts and then answer the questions.

Pick and Pay Hypermarket issues a Pick and Pay Credit Card to Terry, one of their customers. In terms of the agreement between Pick and Pay Hypermarket and Terry, Terry is entitled to buy merchandise on credit with his Pick and Pay Credit Card from any Pick and Pay outlet.

1. Which type of credit card is the Pick and Pay Credit Card in this set of facts?
2. Which party is the card issuer?
3. Which party is the cardholder?
4. Which party is the supplier?

2.2 Three-party credit cards

In the case of three-party credit cards, there are three parties involved, namely the card issuer (which is usually a bank), the cardholder and the supplier. The card issuer enters into contact with different suppliers who agree to accept the credit card when presented by the cardholder as payment for goods and services purchased. The card issuer also undertakes to reimburse the supplier (subject to certain conditions and minus a specific percentage) for the purchases made by the cardholder. The card issuer also
contracts with the cardholder that the cardholder may make purchases on credit subject to the limit agreed to by the parties.

When the cardholder pays by credit card, a sales slip is completed in duplicate with one copy retained by the cardholder and the other by the supplier. The supplier sends this copy to the card issuer who compensates the supplier and debits the account holder’s account. The account holder is then given a period in which to make payment to the card issuer.

An example of a three-party credit card

This is a typical example a three-party credit card. In this example Standard Bank is the card issuer and W Schulze is the cardholder. Since a three-party credit card is used by the cardholder to buy merchandise from a number of different suppliers, the names of the different suppliers do not appear on it.

Activity 2

Study the following set of facts and then answer the questions.

Standard Bank issues a Master Card to Patsy, one of their customers. Standard Bank also concludes an agreement with MacDonals Ltd, a fast food chain, that the latter will accept all Master Cards issued by the former, as valid payment for purchases made at MacDonals. Patsy buys fast foods to the value of R110,00 from MacDonals and pays for it with her Master Card.

1. Which type of credit card is the Master Card in this set of facts?
2. Which party is the card issuer?
3. Which party is the cardholder?
4. Which party is the supplier?
5. Can MacDonals refuse to accept Patsy’s Master Card as payment?
3 THE LEGAL RELATIONSHIP IN TERMS OF A THREE-PARTY CREDIT AGREEMENT

Because there are three parties involved in respect of a three-party credit card, there are also three different sets of legal relationships flowing from the three-party credit card agreement. These are (i) the relationship between the card issuer and the cardholder, (ii) the relationship between the card issuer and the supplier, and (iii) the relationship between the cardholder and the supplier.

Please note that these relationships are contractual in nature and will be governed by the specific contracts signed by the parties. The following is merely to provide you with an overview of the relationships. Also take note that if you are unsure of the principles relating to the law of contract, we advise you to refresh your knowledge before reading further.

3.1 The relationship between the card issuer and the cardholder

A credit card account is similar to that of a cheque account in that both are examples of current accounts. This means that the individual debts are continuously set-off against each other with only the balance remaining due.

If the cardholder’s account is in debit, the cardholder borrows money from the bank when making purchases by credit card. The cardholder is given a specific amount of time to repay the debt (either as an interest free loan) or in instalments.

If the cardholder’s account is in credit, the cardholder account will attract interest for the loan made to the bank. If purchases are made by the cardholder, the cardholder’s loan to the bank is repaid when the bank makes payment to the supplier.

It is standard practice in this form of agreement to provide that where the card issuer has made payment in good faith, the cardholder’s account may be debited, irrespective of whether the cardholder’s signature has been forged or not. However, most card issuer’s are prepared to carry this and other risks for the payment of an additional fee (which serves as an insurance premium in the event of unauthorised use of the card).

3.2 The relationship between the card issuer and the supplier

This relationship is governed by the express terms of the agreement between the card issuer and supplier. Two of the standardised terms of this agreement are that the card issuer will only pay the supplier if the card used to make purchases by the cardholder is valid or that the amount purchased does not exceed the maximum stipulated in the agreement.
3.3 The relationship between the cardholder and the supplier

A supplier who has concluded a contract with a card issuer is obliged to accept the credit cards when presented as a method of payment. The supplier usually displays his willingness to accept certain cards by displaying the relevant credit card logo on the business premises.

The intention of the parties is that the supplier will receive payment from the card issuer. The cardholder will therefore not be liable for payment to the supplier unless the card issuer fails to pay the supplier. The liability of the cardholder towards the supplier is thus suspended. If the card issuer pays, the liability of the cardholder is extinguished. However, if the card issuer fails to pay the supplier, the suspension of the liability of the cardholder ceases and the supplier may claim payment directly from the cardholder.

The cardholder becomes owner of the merchandise bought by credit card when he or she is put in possession of the merchandise. Because the supplier relies on the card issuer for payment, the presumption arises that the supplier has parted with the ownership of the articles as soon as the cardholder is put in possession of them.

4 THE LEGAL RELATIONSHIP IN TERMS OF A TWO-PARTY CREDIT AGREEMENT

The legal consequences of the loss or theft of a two-party agreement is similar to that of a three-party agreement. The only difference is that once the cardholder has informed the card issuer, it implies that the cardholder has informed the supplier as well. Generally, this means that once the card issuer has been informed the card issuer/supplier bears the risk of loss for unauthorised payments.

5 THE UNAUTHOURISED USE OF A CREDIT CARD

The unauthorised use of a credit card occurs when the credit card is used without the permission of the cardholder. The question that remains is who is responsible for paying where the credit card is used by a thief or some other person who has by chance come into possession of the credit card. The standard contracts concluded between supplier, issuer and cardholder usually contain provisions in respect of such losses.

In the event of theft or loss of the credit card, the standard-terms agreement between the card issuer and the cardholder provides as follows:

- The cardholder bears the risk of loss until such time that the cardholder has notified the issuer. As stated above, it is possible for the cardholder to obtain insurance against this risk by the payment of an additional premium.
- The issuer bears the risk of loss from the moment that it received the notification until such time as the supplier had been notified.
Once the supplier had been notified (usually by receipt of a list of missing cards), the supplier is obliged to refuse to accept the card as payment for purchases made. If the supplier does accept the card, the issuer may refuse to compensate the supplier in respect of the purchases made.

The National Credit Act confirms the trade usage and standard terms relating to the party’s liability for the unauthorised use of lost or stolen credit cards. The Act now provides statutory protection to the cardholder where the cardholder has informed the card issuer of the loss of the card of the PIN. This protection will however not apply where the card issuer can prove that the cardholder has acted fraudulently.

**Activity 3**

Study the following set of facts and answer the questions that follow.

Standard Bank issues a Master Card on 1 March 2008 to Tanya, one of its clients. Standard Bank concludes agreements with the following food stores to accept all Master Cards issued by Standard Bank as a valid method of payment for goods bought from them: Pick and Pay; Hyperama and OK Bazaars. The different relationships between the parties are governed by standard contracts.

In 2008 Tanya buys groceries from the following stores on the following dates: on 20 March from Pick and Pay; on 25 March from Checkers Shoprite; on 3 April from Hyperama. On 19 April Tanya realises that her credit card has been stolen. After she discovers the loss of her card the thief uses her credit card on the following dates to buy groceries from the following stores: on 20 April from OK Bazaars; on 29 April from Woolworths Food Hall; on 5 May from Pick and Pay; and on 9 May from Hyperama. Tanya notifies Standard Bank of the loss of her credit card on 30 April. Standard Bank notifies all the suppliers of the loss of the credit card on 6 May. On all the abovementioned occasions the credit card is accepted as valid payment by the different stores.

Which party will be liable to the food stores for the purchases made on the following dates? Give reasons for your answers. (You may accept that the thief has disappeared.)

1. 20 March
2. 25 March
3. 3 April
4. 20 April
5. 29 April
6. 6 May
7. 9 May
Alvereen Leonard, a customer of Woolworth, is issued with a Woolworth store card that allows her to purchase goods on credit at any Woolworth store in South Africa.

(1) What type of credit card is the Woolworth store card? Explain your answer.
(2) Who is the card issuer?
(3) Who is the supplier?
(4) Can BP Garage (who sells a limited range of Woolworth products) refuse to accept the Woolworth store card as a payment method? Give reasons for your answer.
(5) While Alvereen is in Woolworth (Menlyn), her handbag (which contained her Woolworth store card) is stolen. She immediately informs Woolworth of the theft. Two hours later, her stolen store card is used to purchase R3 000's worth of CD's and games at the Woolworth store in Brooklyn.

Can Woolworth hold Alvereen liable for the payment of the goods purchased on her account at the Brooklyn store? Give reasons for your answer.

### Feedback 1

(1) A two-party credit card.
(2) Pick and Pay Hypermarket.
(3) Terry.
(4) Any outlet of Pick and Pay.

### Feedback 2

(1) A three-party credit card.
(2) Standard Bank.
(3) Patsy.
(4) MacDonal ds.
(5) No, except if the credit card is no longer valid.

### Feedback 3

(1) Standard Bank is liable in terms of the relationship between the card issuer and the supplier.
(2) Checkers Shoprite must bear the loss (or sue Tanya for the money) as it did not conclude an agreement with Standard Bank.
(3) Standard Bank is liable in terms of the relationship between the card issuer and the supplier.
(4) Tanya, as the cardholder, bears the risk from the loss of the card until she has notified the issuer of this loss.
(5) Woolworths Food Hall must bear the loss (or try to claim the money from the thief) as it did not conclude an agreement with Standard Bank.
(6) Standard Bank, as the issuer, bears the risk from the moment it receives notification of the loss until it notifies the suppliers of this loss.
(7) Hyperama, as the supplier, must refuse to accept purchases made against a card which it has received notification of as being lost.

Feedback for summary activity

(1) Two-party credit card
(2) Woolworth
(3) Any Woolworth store in South Africa
(4) BP Garage’s liability depends on whether they have concluded and agreement with Woolworth to accept the Woolworth store card as a method of payment. If they have not, the credit card is only valid between Woolworth stores and the cardholder. As BP Garage is not a Woolworth store, it can refuse the Woolworth Store card as a method of payment.

If however, BP Garage has an agreement with Woolworth not only to sell their products but also to accept their store card as a method of payment, then it may not refuse.

(5) Woolworth may not hold Alvereen liable for payment because Alvereen had informed Woolworth earlier of the theft. Once Woolworth is notified, it has to act (either by blocking her card or cancelling it) so that unauthorised purchases cannot be made. Because Woolworth failed to do this, Woolworth may not debit Alvereen’s account. If they had, they will have to credit it with the amount of the unauthorised purchases.
UNIT 2: Travellers’ cheques

1 INTRODUCTION

Travellers’ cheques has been in circulation for more than 100 years. In view of the fact that travellers’ cheques are obtainable at a variety of different foreign exchanges and that they are accepted worldwide, they are highly suited as a method of payment when travelling abroad.

2 TRAVELLERS’ CHEQUES AND THE BILLS OF EXCHANGE ACT

Currently, there is no legislation which applies specifically to travellers’ cheques. However, it is a vexed question whether a travellers’ cheque amounts to a bill of exchange, cheque or a promissory note as described in the Bills of Exchange Act.

The question whether a travellers’ cheque amounts to, for example, a bill of exchange, is important for the following reason. If a document qualifies as a bill of exchange or promissory note as defined in the Bills of Exchange Act, the provisions of the Act will regulate the relationships on the document. However, if a document does not satisfy the definition of a bill of exchange.
or a promissory note, the parties to the document cannot rely on the provisions of the Act.

In order to answer this question, a distinction is drawn between, on the one hand, those travellers’ cheques in terms of which payment by the issuer of the travellers’ cheque is made conditional on countersignature by the traveller, and on the other hand, those travellers’ cheques in terms of which payment by the issuer of the travellers’ cheque is not made conditional on countersignature by the traveller.

In the case of the former, it does not conform to the essential element of unconditionality as required by the Act. You will remember that one of the essentials of a valid cheque is that the order to the drawee bank to pay must be unconditional (see again units 2–4 in section A above). If payment of the travellers’ cheque by its issuer is subject to the condition that it must be countersigned by the traveller, it is not unconditional as envisaged in the Act.

In the case of those travellers’ cheques in terms of which payment by the issuer of the travellers’ cheque is not conditional on countersignature by the traveller, it would appear that it conforms to the requirements of a bill of exchange (which includes a cheque) as envisaged in the Act.

It must be noted however that the vast majority of travellers’ cheques belong to the former type of travellers’ cheque.

An example of a travellers’ cheque

This is a typical example of a travellers’ cheque that does not qualify as a cheque (or bill of exchange) in terms of the Act since payment by the issuer is conditional upon countersignature by the traveller.

The parties to the travellers’ cheque are as follows:

The issuer is Thomas Cook.
The traveller is P Banda.
The payee/holder is the person who was paid by P Banda.
Activity

Study the following set of facts and answer the question that follows.

World-Wide Cash is a British company which issues travellers' cheques. The following words appear on their travellers' cheques: "World-Wide Cash promises to pay an amount of £100 to the bearer of this document provided that it is presented for payment within 90 days of date." No place for payment is indicated on the travellers' cheque.

Does the Bills of Exchange Act apply to this document?

3 THEFT AND LOSS OF TRAVELLERS’ CHEQUES

In order to ascertain the obligations of the respective parties, one has to look at the wording of the travellers' cheque and the content of the underlying agreement between the buyer and the issuer. Usually the purchase agreement between the issuer and the buyer will determine their obligations in the case of theft or loss of a travellers' cheque.

Generally, the position is as follows. If the travellers’ cheque countersigned before presentment of payment (contrary to the purchase agreement) is paid by the issuer, the purchaser of the cheque will not be able to claim a refund against the issuer in the event of the cheque being lost or stolen.

The position is much more uncertain where the travellers’ cheque is lost or stolen before it has been countersigned. This would imply that the signature of the original purchaser had been forged so as to obtain payment. In such a case, the purchaser’s claim for a refund will depend on the wording of the contract with the issuer and the question of whether the purchaser has complied with all his or her contractual obligations.

Feedback

Yes. There is nothing in the set of facts which indicates that this travellers' cheque does not conform to all the requirements of a promissory note. As the place of payment is not an essential of a bill of exchange (or a promissory note) it does not affect the validity of the document.
UNIT 3

STOP ORDERS AND DEBIT ORDERS

Outcomes

After completing this study unit you should be able to

- explain in your own words what a stop order and a debit order is
- explain how a stop order and a debit order operates
- discuss the differences between, on the one hand, a stop order, and on the other hand, a debit order
- discuss whether or not a creditor derives rights from a stop order and a debit order
- discuss whether or not the acceptance of a debit order by the creditor as a method of payment amounts to payment of the debt

Prescribed reading

There is no prescribed reading for this unit.

1 INTRODUCTION

Two of the most important methods of payment are stop orders and debit orders as the payment is debited directly off the customer’s account.

2 STOP ORDERS

The stop order is not an instrument of payment but rather a method of payment. Furthermore the stop order is not a negotiable instrument as it cannot be transferred from one person to another.

It is a payment mechanism used in conjunction with a transmission account or a savings account. It contains a written instruction from the account holder (that is, the customer or client of the bank) to the bank to pay a fixed
amount on a regular basis to a specific third party and to debit the
customer’s account with the amount.

A stop order is typically used to pay weekly or monthly debts of a fixed
amount such as an insurance premium, property tax payable to a
metropolitan sub-structure (or municipality) or rent.

The legal relationship between the bank and the account holder is based on
the contract of mandate where the account holder is the mandator and the
bank the mandatory. As in the case of payment of cheques, the banks’
obligation to perform is conditional on their being sufficient funds in the
account holder’s account against which the paid amount may be set-off.

Whereas the payment instruction contained in a cheque reaches the bank
indirectly via the creditor, the payment instruction contained in a stop order
is handed directly to the bank by the debtor (the bank’s own client). This
practical difference has important legal consequences as regards the effect
of the different payment instructions on the relationship between debtor and
creditor. These are (i) the creditor does not derive any rights from the stop
order; and (ii) the underlying obligation is not terminated.

2.1 The creditor does not derive any rights from the stop order

The first principle is that the creditor does not derive any rights from the
stop order. The stop order is an instruction by the debtor to his bank to pay a
specified third party a fixed amount of money on a regular basis. The debtor
signs the stop order and hands it to his bank where he holds a current
cheque, credit card or savings account.

The creditor obtains no rights in terms of the stop order against the bank or
the debtor (ie account holder) since the stop order results only in an
obligation between the bank and the account holder. As a result, the creditor
receives payment at the will of the debtor and his bank and the creditor can
therefore never be ensured of payment at a specific date. Thus, if the debtor
revokes payment without notifying the creditor, the latter cannot sue the
debtor or the bank on the stop order.

In the case of a cheque, the creditor (payee) also obtains no rights against
the drawee bank on the cheque but a cheque does result in an obligation
between the drawer (ie the account holder) and the creditor. In terms of
section 53(1)(a) of the Bills of Exchange Act the drawer, by drawing the
cheque, undertakes that the cheque will be paid when duly presented and
that the drawer will compensate the holder if it is dishonoured. Thus, the
creditor may, as a matter of general principle, sue the drawer on the cheque
if the latter has countermanded payment of it. Because a cheque is a liquid
document, this claim may be enforced by means of provisional sentence
unless the drawer can prove that the original debt is unenforceable.

2.2 No termination of the underlying obligation

The second principle is that the underlying relationship between the debtor
and creditor is not terminated by the debtor’s giving the stop order to the
creditor. When a debtor gives a stop order (literally: an order to pay) to his bank no collateral (i.e. ancillary or substitute) agreement comes into existence between the debtor (account holder) and the creditor.

In spite of giving a payment instruction by means of a stop order, the debt owed by the account holder is not paid until the bank has actually paid the amount to the creditor. Therefore, should the bank fail to perform the instruction, the creditor would be entitled to cancel the contract (as the debtor is in breach because of non-payment). The fact that the bank did have reason for non-payment will usually only mean that the bank did not fulfil its obligation towards its customer. In such a case, the customer would then have a claim for damages against the bank on the grounds of breach of contract. In practice the possibility of such a claim is usually excluded, since the stop order form signed by the account holder determines that the person giving the order will have no claim against the bank if the bank inadvertently fails to effect payment in terms of the instruction.

An example of a stop order

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**APPLICATION FOR A STOP ORDER**

The Name: [Name]

Volkskas Bank [Address]

Date: [Date]

APPLICANT

Surname, initials and title: [Surname, initials]

Account number: [Account number]

Branch: [Branch]

Debit card against account number: [Debit card number]

Please state whether above mentioned account will be debited on the first day of the month or on the last day of the month.

**BENEFICIARY**

Count: [Count]

Name: [Name]

Bank: [Bank]

Branch: [Branch]

Reference number: [Reference number]

Other bank information: [Other bank information]

Account number: [Account number]

Bank: [Bank]

Branch: [Branch]

Account Opening Date: [Account opening date]

Account Closing Date: [Account closing date]

Account Number: [Account number]

Bank: [Bank]

Branch: [Branch]

Frequency: [Frequency]

Amount: [Amount]

Date of payment: [Date of payment]

Signature: [Signature]

Cancellation of stop order:

Date on which cancelled: [Date]

Reason for cancellation: [Reason]

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3 DEBIT ORDERS

The debit order is an authorisation by the debtor to his creditor to request an amount from the debtor’s bank, and includes an authorisation to the bank to pay the amount to the creditor. The amount which is requested by the creditor may vary and the bank will, as a matter of general principle, pay the amount which is requested by the creditor. It is obvious that a debtor must sign and hand over a debit order only to a creditor who can be trusted.

A debit order is typically used to pay weekly or monthly debts of a fixed or varying amount such as a telephone account, a bond payment, a water and electricity account or any other regular payment which may or may not be subject to a regular increase, such as a life insurance premium which is linked to an increase clause to combat the effect of inflation.

An example of a debit order

![Image of a debit order form]

NAME OF INSURED

POLICY NUMBER(S)

NAME OF ACCOUNT

(Fill in the name of the account as shown on the bank statement)

FINANCIAL INSTITUTION

BRANCH

BRANCH CODE

TOWN/CITY

TYPE OF ACCOUNT

ACCOUNT NO.

Frequency of Payment (in) Annual □ Half-yearly □ Quarterly □ Monthly □

NOTE

This authority must be accompanied by a cheque drawn on the above account for the first premium calculated as follows:

Normal Payment R (including R VAT)

Annual/Additional month* R (including R VAT)

Cheque hereunder R

*Only required if frequency is monthly

Signature of Account Holder Date (Day/Month/Year) □ □ □

FOR OFFICE USE

The “new” premium stated must equal the amount of the above cheque

CLIENT NO.

VAT Registration No: 406012244

Registered No. 0406012244
Because the creditor is obliged to deliver the debit order slip to the bank, there is consensus between the creditor and the debtor that the creditor will first request the payment through the debit order system concerned. The creditor’s right to payment is therefore suspended until such time as he or she has made the necessary request. Only if the debt remains unpaid after the request has been made may the creditor exercise the rights flowing from non-payment.

3.1 Similarities between a debit order and a stop order

The similarities are the following:

(1) Both are methods of payment.
(2) Both contain an instruction to the bank where the debtor is an account holder to pay a certain sum to the creditor.
(3) Neither of them creates a collateral agreement between the debtor and the creditor. Thus, the creditor cannot sue the debtor on the stop or debit order if the creditor does not receive payment from the bank.
(4) Neither of them is a negotiable instrument.

3.2 Differences between a debit order and a stop order

The differences between stop and debit orders are as follows:

(1) The stop order is a mandate from the account holder to his bank to pay from his account while the debit order is not only a mandate to the bank to pay but also an authorisation to the creditor to request payment from the bank.
(2) Closely allied to the first difference is the fact that the stop order is never given to the creditor while the debit order is handed over to creditor and the duty to request punctual payment rests on the creditor.
(3) The stop order can only be used to provide for a deduction of a fixed amount from the account of the debtor. The debit order, in contrast, may provide for a varying amount to be deducted from the account of the debtor.
(4) The use of a stop order does not suspend the creditor’s right to claim payment directly from the debtor, while the creditor’s right to claim payment from the debtor is suspended when the creditor accepts a debit order from the debtor. The creditor’s right to payment from the debtor is suspended until he has made the necessary request from the debtor’s bank.

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Here you are provided with two lists. The first list contains a number of different types of debt. The second list contains a number of different methods of payment. Rearrange each option in the second list to correspond with the option in the first list which is the most suitable method of effecting payment of the type of debt described. Each option from the second list may only be used once.
List one
(1) A telephone account
(2) The fixed premium in terms of a life insurance policy
(3) A hotel account in London where the guest is a Zimbabwean tourist
(4) A loaf of bread at the corner café
(5) Goods which were advertised on television, ordered by telephone

List two
(a) Cash
(b) Credit card
(c) Stop order
(d) Debit order
(e) Travellers' cheque

Feedback for summary activity
(1) – (d)
(2) – (c)
(3) – (e)
(4) – (a)
(5) – (b)
UNIT 4

LETTERS OF CREDIT

Outcomes

After completing this study unit you should be able to

- describe, in the correct sequence, the steps involved in payment by means of a letter of credit in an international transaction
- describe the parties involved in effecting a letter of credit and the role these parties play

Prescribed reading

There is no prescribed reading for this unit.

1 INTRODUCTION

The use of documentary letters of credit as a method of payment developed as a result of the requirements peculiar to international trade transactions, where the need exists to protect the interests of both the vendor/exporter and the purchaser/importer. In the case of an international contract of purchase and sale, for example, where the contracting parties are in different countries, it is clear that either party is exposed to the risk that the other party may fail to perform, and that the ‘innocent’ party would have to institute a claim based on breach of contract in a foreign country so as to enforce his or her contractual rights. It is accordingly in the interests of the parties to obtain some measure of certainty regarding the other contracting parties’ capability and serious intention to perform prior one of the contracting parties carrying out his or her own obligations. This is when and why a documentary letter of credit is used.

Before looking at the operation of a documentary letter of credit in detail, look at the following example to see when and how a documentary letter of credit works.
Example

Graban ostrich (Pty) Ltd is a company which runs a number of farms in the Oudtshoorn district. The main part of their business is the marketing of ostrich related products on the international market. Recently, they have managed to woo the representatives of a German firm, Velikelezer AG, successfully. As a result, Grabanostrich and Velikelezer have concluded an agreement in terms of which Grabanostrich will export four consignments of grade 1 ostrich skins, each consignment consisting of 1 000 skins, to Germany. Payment will be made in South African rands at R500 000 per consignment. Velikelezer is adamant that the consignments may not reach them any later than 1 March, 1 June, 1 September and 1 December, respectively.
It is clear that at this point, a number of potential problems have not been addressed. One of these is that Grabanostrich is not keen to load a consignment onto a container in Port Elizabeth harbour without knowing whether Velikelezzer will be able to pay for the consignment, and will in fact do so. At the same time, Velikelezzer does not want to pay for the goods unless they can be sure that Grabanostrich will in fact deliver the order and that the order will be up to standard. It is exactly to address these fears that letters of credit are used as a means of effecting payment across international boundaries (they may, of course, operate domestically as well). As a result, Velikelezzer requests on a standard application form that its German bank, the Deutsche Bank, open a letter of credit in favour of Grabanostrich and inform Grabanostrich (i) of the letter of credit being opened, (ii) that payment will be effected on receipt of a bill of lading, an insurance policy and a certificate of quality from Mr I Checkskins.

The onus is then on Grabanostrich to arrange for the inspection and completion of the necessary documentation on shipping the goods. Thereafter, the documentation will be submitted to the bank and, should the bank be satisfied with the documents, it will pay Grabanostrich. Once Velikelezzer refunds its bank, the bank will give the documentation to Velikelezzer which will enable Velikelezzer to take possession of the consignment on arrival in Germany.

There are often other banks involved in a letter of credit. Most often, the issuing bank (in our example, the Deutsche Bank) will approach a bank in South Africa (for example, First National) to act as a confirming bank. First National will then assume the duties of the Deutsche Bank (the issuing bank) by paying Grabanostrich after presentation of the documents. First National will then send the documents to the Deutsche Bank and the last-mentioned, after satisfying itself that First National paid correctly, will then pay First National. Make sure, by using the above set of facts, that you understand the roles that other banks can play in the process.

2 THE OPERATION OF THE DOCUMENTARY LETTER OF CREDIT

STEP 1

The parties to an international trade contract agree, usually as a term of their contract, that payment will be effected by means of a documentary letter of credit. This trade contract is referred to as the underlying agreement of the exchange agreement. One of the most important principles relating to letters of credit is that the credit agreement concluded between the issuing bank and the beneficiary when the letter of credit is issued, is entirely separate and independent from the underlying obligation (see below for a discussion on this point).
STEP 2

The purchaser/importer arranges with the bank (usually a domestic bank) for the issuance of a letter of credit in favour of the vendor/exporter. This takes place by the purchaser having to complete a standard application form supplied by the bank, in which the various terms and conditions of the letter of credit are stipulated. These could include an undertaking by the bank in favour of the vendor that it will pay the vendor in cash a specified amount, or that it will accept and pay bills of exchange drawn by the vendor on the bank up to a specified amount, or that it will pay bills of exchange drawn by the vendor on the bank and discounted to another bank up to a specified amount, provided certain specified documents are handed to the bank. In addition, the manner and time of repayment of the debt by the purchaser is also included.

STEP 3

The bank then issues the letter of credit in favour of the vendor reflecting the terms and conditions stipulated by the purchaser. The letter of credit is forwarded to the vendor (or to another bank in the vendor’s country).

STEP 4

If another bank is employed, this bank may confirm the letter of credit, thereby itself assuming liability towards the beneficiary to pay the relevant amount; or it may merely advise or notify the beneficiary of the issuance of the letter of credit without itself giving an undertaking to pay. The letter of credit may also indicate an advising bank as the bank (the paying bank) to which the documents must be submitted and from which payment can be obtained. This does not, however, create a personal duty on the part of the advising bank towards the beneficiary.

STEP 5

Once the vendor receives or is notified of the letter of credit and if he or she agrees to the terms thereof, the vendor will proceed with the shipment, certification, insurance, etc of the merchandise and will eventually submit all the necessary documents to the issuing, confirming or advising bank (whichever is relevant) in order to receive payment.

STEP 6

Upon receipt of the documents, the bank will inspect the documents in order to ascertain whether they are in strict conformity with the terms stipulated in the letter of credit. If they are, the bank pays the vendor or accepts his or her bills.
STEP 7

The paying bank is eventually reimbursed by the issuing bank. The issuing bank will in turn be reimbursed by the purchaser, and it is evident that the title documents (for example, a bill of lading) serve as the bank’s security for the payment made by it: unless the purchaser pays the bank, the bank will refuse to hand over the documents required by the purchaser in order to take delivery of the merchandise.

It is also evident that the use of a letter of credit to effect payment provides certainty to both the vendor/exporter and the purchaser/importer: the vendor can rely upon the bank for payment of the purchase price, and the purchaser knows that payment will only take place once proof of shipment of the goods is submitted to the bank. In order to ensure that the quality of the merchandise complies with certain standards, the purchaser may specify that one of the documents submitted to the bank be a certificate of quality issued by a reliable third party.

Activity 1

Looking at the example above, identify the following parties involved in a letter of credit:

- The applicant who applies to the bank for issuance of the letter of credit
- The issuing bank
- The beneficiary in whose favour the letter of credit is issued
- The confirming bank
- The advising or notifying bank

3 THE BANK’S UNDERTAKING IS SEPARATE AND INDEPENDENT

The bank’s undertaking is separate and independent in that the bank is strictly bound by the terms contained in the letter of credit when carrying out its obligation towards the beneficiary (vendor). The bank cannot take into account any stipulations in the underlying contract and should not concern itself with claims and complaints by the applicant (purchaser) resulting from his or her relationship with the beneficiary.

Linked to this is that payment in terms of the letter of credit is effected on the strength of a set of documents to be submitted to the bank by the beneficiary. If the documents that are submitted are in strict compliance with the requirements set out in the letter of credit, the bank is obliged to make payment to the beneficiary. The bank deals only with the credit documents, not with the goods sold in terms the contract of sale between the purchaser and the vendor. The bank is not in a position to verify whether the goods actually shipped by the vendor are in accordance with the underlying contract with regard to quality. The bank cannot determine, nor can it
refuse payment should it discover, that there are differences between the goods invoiced and the goods actually delivered to the purchaser, or that there are defects in the goods so delivered.

However, in practice, there are a limited number of exceptions relating to when the autonomy and independence of the credit agreement may be ignored and the terms and conditions of the underlying contract may be taken into consideration. The issuing bank may thus refuse to enforce the letter of credit when the underlying contract is contrary to law, good morals or public policy, or where there is fraud involved.

If the documents tendered by the beneficiary have been forged or deliberately falsified by beneficiary in order to comply with the requirements of the letter of credit while they do not in fact represent the goods or other performance specified, the beneficiary should not receive payment on the letter of credit. On the other hand, where the documents are neither forged or falsified, but where the purchaser discovers that the performance rendered by the beneficiary in terms of the underlying contract is defective or not in compliance with the stipulations of the underlying contract, the courts have indicated that they will not interfere by granting an interdict to prevent the bank from paying on the letter of credit. However, where fraud on the part of the vendor has been alleged and proved by the purchaser a court will grant an interdict to prevent the bank from paying on the letter of credit.

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**Feedback 1**

- The applicant who applies to the bank for issuance of the letter of credit is Velikelezzer AG
- The issuing bank is Deutsche Bank
- The beneficiary in whose favour the letter of credit is issued is Grabaonosrich (Pty) Ltd
- The confirming bank is First National
- The advising or notifying bank — none
UNIT 5

ELECTRONIC FUNDS TRANSFER

Outcomes

After completing this study unit you should be able to

- define an electronic funds transfer
- distinguish between paper-based transfers and electronic funds transfers
- distinguish between bank activated systems (the ACB) and customer activated systems (ATM's, EFTPOS and Home Banking)
- name the three most common types of customer activated systems of electronic funds transfers
- describe the functioning of each of the three main types of customer activated electronic funds transfer systems
- describe the legal relationships involved in the different types of customer activated electronic funds transfer systems
- describe the risks and regulation of the unauthorised use of each of these systems

Prescribed reading

There is no prescribed reading for this unit.

1 INTRODUCTION

An electronic fund transfer can be described as a fund transfer that takes place completely or in part by use of electronic techniques. Electronic fund transfers include all payment instructions which are transmitted through magnetic material such as magnetic tapes, disks or cassettes, or through purely electronic media such as telephones and telex, or by use of electronic transmissions between computers or between a computer and a terminal. These transmissions are used to effect a wide range of electronic fund transfers. Examples include automatic teller machines, telephone banking, home banking, video banking, office banking and internet banking. This value of the system lies in the reduction of costs associated with these
products and the expansion of the time when and places where basic financial services are available (virtually 24 hours a day).

South Africa has not enacted any specific legislation dealing with any these examples of electronic fund transfers. In the absence of such specific legislation the legal relationships between the parties involved in terms of electronic fund transfers are regulated by the general principles of the law of contract as evidenced in the contract between the parties.

Payment (by means other than cash payments) usually comprises two basic steps. In the first place, the payment instruction is given by the debtor to the financial institution which holds the funds. Secondly, that financial institution will transfer the funds to the account of the beneficiary at the same or another financial institution. These underlying principles stay the same, irrespective of whether the procedure is paper-based or purely electronic in nature.

In its most simple form, an electronic fund transfer is therefore similar to a cheque in that the instruction is given by the customer to the bank for the transfer of money to another account or to the beneficiary. The only difference is that in the case of an electronic fund transfer, the instruction is given by means of electronic communication. In this sense, therefore, the bank acts as mandatory of customer and their legal relationship will be governed by the contract of mandate.

2 DIFFERENT SYSTEMS

Electronic fund transfer systems can broadly be divided into customer activated systems and systems which are activated by banks to facilitate electronic fund transfers between banks and to send financial messages.

2.1 Systems which are activated by banks

Electronic bank transfer systems can be used to send financial messages between banks. Although clearing houses are primarily used to bring about settlement between banks, they are also used to effect electronic fund transfers between banks. In South Africa, the Automated Clearing Bureau (Pty) Ltd, commonly known as the ACB, is an example of such a clearing house. It is a company which was established by the banks in 1973 to provide for computerised facilities between banks.

We will not be focusing any attention on these systems as they are outside the scope of this module.

2.2 Customer activated systems

There are mainly three electronic fund transfer systems which are activated by customers. The first system is the ATM (automated teller machine)
which can be described as an electronic vault allowing the user to withdraw or deposit money or obtain other banking services. The second system is EFTPOS (electronic fund transfer at point of sale). In terms of this system, the consumer uses a terminal connected to the seller's cash register and pays electronically for goods purchased from the seller. The agreed amount of the transaction is electronically transferred from the consumer's account to the seller's account and their respective accounts are debited or credited (as the case may be) with the respective amounts. The third system is home banking. The customer of a bank is able to transfer money between accounts or to check his or her balance by using a terminal or personal computer at home or by using a telephone connection between himself and the bank.

2.2.1 ATM (automated teller machine)

The ATM is a machine which is connected to the bank's computer system. By using the machine, the customer can effect a variety of transactions using his savings or transmission accounts. Access to the ATM is obtained by means of a plastic card with a magnetic stripe or a chip (containing encoded information) and a PIN (personal identification number). The advantages of customers using ATMs include the convenience of the customer being able to access his accounts 24 hours per day; the reduction in labour costs and in the volume of paper crossing the bank counter; an increase in the number of customers who can be served; and direct input of information into the bank’s record-keeping system.

2.2.11 Operation of ATM

In an ATM transaction, the plastic card is inserted into the ATM and customer keys in his PIN. When the card is inserted, the encoded information on the magnetic stripe or smart card chip is read. This information identifies the card as a valid card in that system. The customer is required to enter the correct PIN. If the customer is still unsuccessful after a specified number of attempts the card is retained by the machine. As soon as the correct PIN is keyed in, the ATM displays certain information and gives instructions on screen so as to effect the desired transaction. If the customer correctly follows these instructions, the ATM completes the transaction, returns the customer’s card and supplies a transaction slip.

ATMs can either be on-line or off-line. When the ATM is on-line, it is directly linked to the bank’s central computing system. Amongst others, this system can immediately (and in real time) check whether the customer has sufficient funds available in his account to cover the transaction as well as determine whether the card used is lost or stolen.

When an ATM works off-line, each transaction is recorded on a magnetic tape or a disk. At the end of each day a courier takes the tape or disk to the particular financial institution for processing. The dangers associated with a system such this is, for instance, that the balance of the account holder may not be available on any particular day, and that the banks are then exposed
to the possibility of overdrawn account. The possibility of the ‘black list’ not having been updated timeously poses a further danger as it may happen that a lost or stolen card is used at such an ATM.

2.2.1.2 The risk of unauthorised withdrawals

If an unauthorised person gains access to a customer’s ATM card and PIN, the possibility of an unauthorised withdrawal arises. The machine cannot determine whether the person who inserts the card and keys in the correct number, is in fact an authorised person. The ATM acts only on the card and the accompanying correct number. The question is whether the customer may be debited with the amount of such an unauthorised withdrawal.

This question will usually not arise because most financial institutions ensures that the contract that it concludes with a prospective customer contains a clause which specifically excludes the bank’s liability in such an instance. This term usually states that a customer’s account may be debited with all withdrawals made by means of the particular card and accompanying secret number unless the bank is notified of a possible unauthorised withdrawal before it (the withdrawal) takes place.

However, where ATM cards are issued without such an express provision, the question would have to be answered on the basis of general principles. A bank may only debit its customer if the bank has made payment to the customer or acted in accordance with his or her mandate. There seems little doubt that the entering in of the correct PIN is the customer’s mandate for these purposes. However, it may be argued that in the absence of an express term there might quite possibly be a tacit term in the banker-customer contract that the customer would carry the risk of an unauthorised withdrawal. In the event of a dispute between the bank and its customer, all of the surrounding circumstances which exist at the conclusion of the contract will be taken into account when the court has to determine the intention of the parties. A customer who obtains an ATM card realises that the whole system functions by means of a card coupled with a secret number. The customer also realises that the identity of the person who inserts the card and keys in the correct pin number, cannot be checked by the bank. Against this background it seems reasonable to assume that the customer consents to accept his account being debited for any withdrawal made by means of the card and number until such time that the customer informs the bank of the loss and possible unauthorised use of the card.

2.2.1.3 ATM deposits

When a customer makes a deposit over the counter, he receives a copy of the deposit slip. This amounts to an admission by the bank that it has received the indicated amount. Should a dispute subsequently arise as to whether the deposit was in fact made, this admission will place an onus of rebuttal on the bank. In the case of an ATM deposit, the customer does not enjoy this evidential advantage. The transaction slip supplied by the
machine has little evidential value, because it is simply a record of what the customer has keyed into the machine. It does not prove that the customer has actually inserted the alleged amount in cash or a cheque for that amount into the machine.

A question which arises is whether the payment takes place at the moment when the amount to be deposited is inserted into the machine, or only when the deposit envelope is opened and the contents are accepted by the bank. If the deposit is made by means of a cheque, it is clear that payment to the bank takes place only when the cheque is honoured. Even when cash is deposited into an ATM, it seems that payment of such an amount takes place only when the contents of the envelope are removed by the official. Not only does it seem unrealistic to accept that the bank has accepted the contents of the envelope before they have been checked, but the contracts usually concluded in connection with ATMs also normally provide that the amount of such deposit will be credited to the customer’s account only when it has been checked and accepted as correct by the bank.

This then implies that only a contract of deposit exists while the envelope is in ATM. In terms of the general principles of the contract of deposit, the depositary is liable for the loss of the property deposited with him, unless the depositary can prove that such loss was not due to his fault. If this contract of deposit between the bank and the customer were regarded as deposit without reward, the bank’s liability would probably be limited to loss caused by intentional or grossly negligent conduct.

Should the bank prove that the contents of the envelope deposited into the ATM were either lost or stolen without any fault on the bank’s part, it would, therefore, not be liable as depositary towards the customer. Very often a bank will contractually exclude its liability as a depositary.

However, if it is accepted that a cash payment already takes place when the money is placed into the machine, the bank would, as from that moment, already be the borrower of the money. Any subsequent loss would, therefore, be the bank’s loss.

2.2.2 EFTPOS (electronic fund transfer at point of sale)

EFTPOS is the acronym for “electronic fund transfer at point of sale”. This system makes it possible to make an electronic payment in a shop with a credit or debit card. In an on-line system the money is electronically transferred directly from the account of the cardholder to the account of the merchant. In an off-line system, the payment instructions are stored on a magnetic tape or disk for processing at a later stage.

2.2.2.1 Operation of EFTPOS

In a typical EFTPOS transaction, the customer presents either a debit card or a credit card to the merchant. The magnetic strip or smart card chip on the back of the card is swiped through a reader which is either held at the
merchant’s cash register or is wirelessly linked to the merchant’s computerised payment system.

The customer chooses on a keyboard the account to be debited. The merchant keys in the value of the transaction and the customer keys in his PIN. The particulars of the transaction are then transmitted by the merchant’s financial institution or switch network to the cardholder’s financial institution. The PIN and the particulars of the customer’s account and the balance thereof are checked in order to determine whether there are sufficient funds. If it is accepted, the amount will be debited against the account of the customer and the merchant’s account credited. An EFTPOS transaction is, therefore, essentially a debit transfer.

Generally, an EFTPOS transaction means that a PIN is used for authorisation. However, there are EFTPOS systems which still use handwritten signatures. The customer’s card is swiped through a reader and duplicate transaction slips are printed which must be signed by the customer. One copy of the transaction slip is kept by the merchant (and handed to the bank should a dispute arise) and the other is handed to the customer.

2.2.2.2 The legal relationships between the participating parties

Although an EFTPOS transaction consists of a number of adjustments in the bank balances of the respective parties, payment will be complete when the funds are unconditionally credited to the beneficiary’s account. This means that payment between the banks is complete when settlement has taken place. If payment to the beneficiary is complete but erroneous (either in terms of the person paid or the amount paid), the beneficiary will be liable for repayment. The grounds for the recovery of an erroneous payment will be unjustified enrichment unless other contractual remedies have been agreed to by the parties.

In an EFTPOS transaction there are at least three interdependent contracts, namely that between customer/merchant, customer/bank and merchant/bank. Where more than one bank participates in the system, there will of course also be a further contractual agreement between the settlement banks.

2.2.2.2.1 The contract between the customer and the merchant

The contract between the customer and the merchant is a contract of purchase and sale in which the merchant either tacitly or expressly or by implication agrees to accept EFTPOS as a method of payment.

2.2.2.2.2 The contract between the customer (or EFTPOS cardholder) and his or her bank

The second contract is that between the customer or EFTPOS cardholder and his bank. Generally, the relationship between the customer and the bank is governed by the agreement which was concluded when the card was issued to the customer. Although there are differences in the precise details...
agreed to by the different banks, there are certain standard terms that appear in all the contracts.

The most important standard term is that of defining the circumstances under which the bank is entitled to debit its customer’s account. Generally, the customer is liable for all EFTPOS transactions made with his card and/or PIN, irrespective of whether the transactions are authorised by the customer or not. However, most contracts indicate that the customer will only be liable until the bank is informed of the loss of the card or the PIN.

A second term that is standard is the obligation of the customer to keep the PIN a secret. If the PIN is correctly inputted even by an unauthorised person, the contractual conditions under which cards are issued make the customer responsible for loss suffered (unless the customer has informed the bank about the loss of the PIN).

A third important standard term is that the EFTPOS transaction is irrevocable. An EFTPOS payment cannot be reversed if the customer decides to return the goods purchased to the vendor. This means that the customer has to take recourse against the vendor directly and claim the money from the vendor.

2.2.2.2.3 The contract between the merchant (vendor/seller) and the bank

The third contract is that between the merchant and the bank. This contract usually takes the form of a standard commercial bank account contract containing particular terms relating to EFTPOS payments. The most important of these relate to the time at which the merchant’s account at the bank will be credited with an EFTPOS payment, and to the procedures for dealing with erroneous or unauthorised transactions.

As indicated above, there are particular problems which could arise when an off-line EFTPOS transaction takes place. One of the inherent risks is that a customer may not have sufficient funds in his account to pay for the goods or services purchased. The merchant in such a case is only authorised to accept purchases by means of EFTPOS up to a specified amount.

Another question which arises in the case of an off-line system is whether the original claim (personal right) of the merchant against the cardholder is extinguished by novation. In other words, may the merchant still claim from the customer if the card issuer or financial institution does not pay?

Novation will in such a case take place when the creditor (the merchant) obtains a new personal right against a third party (the financial institution) thereby extinguishing the existing personal right that the creditor (merchant) had against the customer. Although the merchant does obtain a personal right against the financial institution, in order for novation to take place, it must also be clear that the parties themselves intended to extinguish the old debt and institute a new one in its place. This intention to novate cannot be clearly deduced from an EFTPOS transaction. The intention is that the merchant obtains a personal right against the financial institution and that the customer is not liable to pay the merchant, provided the
financial institution pays the merchant. If the financial institution does not pay, the customer is still liable to pay the merchant.

A third question relates to the bank's authority to pay the merchant. In an off-line system, the bank undertakes to pay all payment instructions which are accepted by the system provided that the merchant has complied with certain security procedures (such as checking the cardholder's signature or the so-called black list of stolen or lost cards). In an on-line system, if the payment instruction is accepted, the bank will execute payment, not because of the bank's undertaking, but as mandatory of the customer.

The financial institution or bank will naturally also require the merchant to keep secret all information about the customer which comes to his knowledge. The merchant will furthermore have to take care that no unauthorised person obtains access to the EFTPOS system.

2.2.3 Home banking (via the telephone or the Internet)
Home banking gives the consumer the opportunity to make use of several financial services from the privacy of the home by using a telephone or the Internet. These include checking of account balances, asking for provisional statements, transferring funds between accounts, payment of creditors, ordering a cheque book, obtaining financial market information, etc.

The advantages of internet banking includes the convenience in terms of time and cost of not being restricted to transacting at a bank or an ATM machine.

2.2.3.1 The risks of home and Internet banking services
In agreements concluded with customers for the provision of home bank services, the banks usually exclude their liability for any damage that the customer may sustain for using the home banking service. This includes not being liable for damages sustained because of the malfunction of either the customer's computer or the bank's computer system. The bank will, therefore, not be liable for the erroneous or non-timeous performance of the customer's instruction as a result of any of the above-mentioned circumstances. The banks also do not accept liability for any damage the customer may sustain as a result of the fact that the service was not available at any given time.

Access to the home banking system is gained through the use of certain codes which are only made known to the customer. Similar to a PIN, keeping these codes secret is an extremely important component in safeguarding the system. To this end, the obligations imposed on a client are extensively documented in the contract between the bank and its client. Not only is the client obliged to control and limit access to the system but is also obliged to keep secret all access codes, technical data and all information which pertains to the service and system. Such information may be made available only to authorised persons or employees of the customer.
The banks, therefore, do not accept liability for any damage which is sustained as a result of a person’s obtaining unauthorised access to the system by using equipment which is in the possession or under the control of the customer. In the agreements between banks and their customers it is, therefore, usually determined that any instruction or transaction which is initiated by the system, is regarded as having been given or initiated by the customer or someone authorised by him or her.

(1) What is an electronic fund transfer?
(2) Name two main electronic funds transfer systems.
(3) Name three main electronic funds transfer systems which can be activated by customers.
(4) What is EFTPOS?
(5) Name three important interdependent contracts in an EFTPOS transaction.
(6) What is home banking?
(7) What are the advantages of home banking?

Feedback for summary activity

(1) An electronic fund transfer can be described as a funds transfer that is effected largely or completely by electronic techniques. It works just like a cheque in that an instruction is given by the customer to the bank for the transfer of money to another account.

(2) Electronic fund transfer systems can be divided into customer activated systems and systems which are activated by banks to facilitate electronic funds transfers between banks.

(3) ATM, EFTPOS and home banking.

(4) EFTPOS is an acronym for electronic funds transfer at point of sale, a system which makes it possible to make an electronic payment in a shop with a credit or debit card.

(5) The customer/merchant contract, the contract between the customer or EFTPOS cardholder and his bank and the contract between the merchant and the bank. Ensure that you are able to discuss each of these contracts separately.

(6) Home banking gives a customer the opportunity to make use of several financial services from the privacy of his home by using a telephone, videotex services and the Internet.

(7) It is possible to check balances, ask for statements, transfer funds between accounts, stop payment of cheques, order cheque books, obtain financial information and correspond with the bank manager.
Section C

Intellectual property and competition
UNIT 1

INTRODUCTION TO INTELLECTUAL PROPERTY AND COMPETITION LAW

This unit comprises an introductory discussion of the nature of intellectual property and competition law. After studying this unit you should

- know the legal definition of intellectual property
- be able to demonstrate that you can distinguish between the different branches of intellectual property by evaluating different situations
- be able to evaluate the benefits of intellectual property rights protection in terms of intellectual property and competition law

There is no prescribed reading for this unit.

1 INTRODUCTION

In this unit we will explain to you the general principles underlying intellectual property law. We will start by giving you a brief background to the study of intellectual property law.

Where applicable, we will give you specific examples from the various branches of intellectual property law. However, you should keep in mind that we will deal with selected branches fully in subsequent units.

It is very important that you know the legal definition of intellectual property
and that you understand the basic principles that underlie intellectual property law. Although this unit is only of an introductory nature, it forms a very important foundation for your study of intellectual property law.

2 WHAT IS INTELLECTUAL PROPERTY AND COMPETITION LAW?

The law of intellectual property is concerned with incorporeal objects which come into existence through the mental activity of a person but which, once created, have an independent existence, separate from and outside of the person who created them. Intellectual property law may thus be defined as the legal rules governing the origin and control of the independent products of the human mind.

We encounter intellectual property every day of our lives. For example, the music you listened to on your way home from work is protected by copyright. The recipe of the take-away pizza you had for dinner is a trade secret, and the name of the take-out where you bought the pizza is probably a registered trade mark. And if you brushed your teeth with a new, high-tech toothbrush you probably used a patented invention.

You can see that intellectual property law is applicable to the consumer goods that you use every day. The protection of intellectual property is also playing an increasingly important role in international trade relations.

Competition law comprises two distinct spheres: The public law of competition and the private law of competition (law of unlawful competition). The public law of competition is concerned with the legal rules which are directed at the maintenance and promotion of competition. The main source of public competition law is the Competition Act 89 of 1998. The private law of competition (the law of unlawful competition) is concerned with the legal rules which regulate the relationships between business competitors, that is with the unlawfulness of one competitor’s conduct against another. Unlawful competition is characterised by an infringement of a competitor’s right to attract custom or goodwill. Goodwill is regarded as intellectual property and the right to goodwill as an intellectual property right. Accordingly, the private law of competition also forms part of the law of intellectual property. In this section of the study guide we will consider only the private law of competition or law of unlawful competition.

In South Africa (as in the majority of developed countries) intellectual property law is regulated mainly by legislation. We have statutes regulating the position in regard to patents, copyright, designs, (registered) trade marks, and trade names. As yet, however, we have no legislation on the law pertaining to the right to goodwill. The right to goodwill is the most important example of a common-law intellectual property right. You will encounter the right to goodwill in the study units dealing with the law of unlawful competition.
In your study of intellectual property law in subsequent units, you will be required to acquire a thorough knowledge of

- the particular legal objects which are protected in each case;
- the requirements for the creation or subsistence of the rights enjoyed by the holder of such rights;
- the circumstances or acts which will constitute an infringement of such rights; and
- the remedies which will be available to the holder of the rights in the event of an infringement.

**Activity 1**

Look around you. Make a list of all the intellectual property you see.

### 3 THE ORIGIN OF THE LAW OF INTELLECTUAL PROPERTY

The law of intellectual property is a relatively new field of law. It became a point of judicial interest only after the Industrial Revolution, in the second half of the nineteenth century. Initially jurists were reluctant to acknowledge the existence of certain incorporeal products of people’s minds as independent legal property outside of the people themselves.

Earlier jurists tried to classify and deal with mental products like inventions, literary works, and particularly trade marks, on the basis that they remained an inseparable part of man’s personality. Today, however, the independent existence of these products as legal objects outside of and distinct from the human personality has been generally accepted. This is because the technological advances which resulted in these mental products have acquired more economic importance.

The expressions “the law of industrial property” and “the law of immaterial property” are also used to denote this field of law. The expression “the law of intellectual property” has, however, gained international acceptance and will be used in this study guide.

### 4 DEFINITION OF INTELLECTUAL PROPERTY LAW

Most modern jurists accept the theory of intellectual property rights that recognises those mental products which are bound to the personality of the creator, but which exist independently as separate legal objects. The mental products that form this independent category of legal objects, namely intellectual property, are the object of intellectual property rights.

The law of intellectual property is concerned with the relationship between
a legal subject (the bearer of a right) on the one hand, and some or other incorporeal legal object on the other hand. An intellectual property right can therefore be defined as a subjective right having as its legal object some or other product of the human mind. Such a product will be incorporeal and will exist independently and outside of its originator. The law of copyright, patent law, the law of trade marks, design law and the law of unlawful competition all form part of intellectual property law.

**scope**

In essence, the law of intellectual property covers

- the legal rules and principles which determine the nature and scope of a particular class of incorporeal objects;
- the requirements for the creation of such incorporeal objects;
- who will acquire and enjoy rights in respect of such objects;
- the content of (the powers derived from) these rights;
- how and when these rights may be enforced; and
- how and when these rights will be terminated.

**Activity 2**

Explain what is meant by the term ‘intellectual property’. What is intellectual property law concerned with? Recall the legal definition of intellectual property. Do you think it is important to have intellectual property protection?

### 5 BRANCHES OF INTELLECTUAL PROPERTY LAW

**branches**

The nature of the object of the right will determine to which branch of the law of intellectual property the right will belong. For example, if the mental product is an artistic or literary work, the right will fall under the law of copyright; if the mental product is an invention, the right will fall under the law of patents; if the mental product is a trade mark, the right will fall under the law of trade marks; if the mental product is the goodwill of a business enterprise, the right will fall under the law of unlawful competition. There are specific statutory definitions that define the classes of mental products belonging to a particular branch of intellectual property.

In this section of the study guide, we will consider only two intellectual property rights that are created by statute, namely copyright and trade mark rights. We will also discuss the common law intellectual property right, namely the right to goodwill.

### 6 REQUIREMENTS FOR INTELLECTUAL PROPERTY LAW PROTECTION

**requirements**

The requirements for intellectual property law protection depend on the nature of the specific mental product. Copyright protection, for example,
arises automatically if the work meets the inherent and formal requirements for copyright protection, whereas in the case of inventions and trade marks, protection is provided only once the application procedure is complete. We will discuss the requirements of protection for each type of intellectual property in later units.

7 CUMULATIVE PROTECTION

example

The various branches of intellectual property law often overlap. Cumulative protection is therefore common. Look at the following example: A develops a new computer. The computer may form part of a patentable invention. The computer program may be copyrightable. At the same time, certain processes involved in the manufacture of the computer may be protectable as trade secrets. The attractive wrapping may incorporate copyrightable artistic and literary works, and the name under which the computer is marketed may also be protected as a trade mark.

As you can see, one product can be protected by several branches of intellectual property law. The following activity provides another example that illustrates the principle of cumulative protection.

Activity 3

Now consider a situation where B invents an antiwrinkle cream called No More Frown. Complete the following table to indicate which branch of intellectual property law will protect the listed aspects of B’s product.

<table>
<thead>
<tr>
<th>Aspect of product</th>
<th>Branch of intellectual property law</th>
</tr>
</thead>
<tbody>
<tr>
<td>formula of cream</td>
<td></td>
</tr>
<tr>
<td>manufacturing process</td>
<td></td>
</tr>
<tr>
<td>name of product</td>
<td></td>
</tr>
<tr>
<td>picture on jar</td>
<td></td>
</tr>
</tbody>
</table>

Think of other examples where the various branches of intellectual property may overlap.

8 RIGHT HOLDERS AND ASSIGNMENT OF RIGHTS

right holders

One or more persons may be the right holders of intellectual property rights. Authors or inventors are not always the proprietors of copyright or patent rights: statutory provisions and contractual stipulations must be kept in mind. In some instances a number of persons may be involved.

example

For example, where an invention is made by an employee within the course and scope of her employment, the employee is regarded as the inventor, but, in terms of the employment contract, the employer may be the proprietor of
the patent rights which vest in the invention, and a third party may acquire the rights to use the invention for commercialisation or further development through a licensing agreement.

** assignment licensing 

Intellectual property may be transmitted by assignment. The holder of a right may grant a licence to a third party to perform one or more of the rights which are exercisable exclusively by the rightholder, in consideration of which royalties are payable.

### 9 SCOPE OF INTELLECTUAL PROPERTY RIGHTS

** scope of protection 

The scope and nature of intellectual property rights differ, depending on the particular branch of intellectual property law. For example, the proprietor of a patent obtains a statutory monopoly to use the invention to the exclusion of all other parties, whereas the copyright holder only obtains the exclusive right to reproduce her work. Patent protection is comprehensive — where a third party has expended labour and skill in developing a process which falls within the scope of the patent holder’s monopoly, the use of the said process will constitute patent infringement. However, where the same example is applied to copyright law, copyright will be infringed only where the copyright work itself has been copied or adapted. Thus where a third party has created independently a work which is identical to the first work, the copyright vesting in the first work will not have been infringed.

### 10 DURATION OF PROTECTION UNDER INTELLECTUAL PROPERTY LAW

** duration of protection 

The duration of protection differs, depending on the particular branch of intellectual property law. The duration of patent protection is only 20 years, calculated from the date the patent application was lodged. Copyright protection of, for example, a literary work, subsists for a period of 50 years from the end of the year in which the author dies. The duration of protection of a trade secret and a trade mark is theoretically perpetual, provided the confidentiality of the trade secret is maintained and the trade mark registration is renewed every 10 years.

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**Summary activity**

You developed a new type of medication which prevents hair loss.

1. Make a list of all the branches of intellectual property. Which branch will protect the formula of the medication? Give a reason for your answer.

2. Make a list of reasons why you would like the formula of your medicine to be protected by law. Now consider the position of a consumer of your product. Why would a consumer want the medicine not to be protected? Write a short paragraph on the importance of statutory regulation of intellectual property.
Examples of intellectual property are endless. This study guide, your computer, the paintings on your walls, etc are all examples of intellectual property.

Feedback 2

Intellectual property refers to products of man’s mind that acquire independent existence outside man. We can define intellectual property law as the legal rules governing the origin and control of the independent products of the human mind. The law of copyright, patent law, the law of trade marks, design law and competition law all form part of intellectual property law.

Feedback 3

<table>
<thead>
<tr>
<th>Aspect of product</th>
<th>Branch of intellectual property law</th>
</tr>
</thead>
<tbody>
<tr>
<td>formula of cream</td>
<td>patent</td>
</tr>
<tr>
<td>manufacturing process</td>
<td>trade secret or patent</td>
</tr>
<tr>
<td>name of product</td>
<td>trade mark</td>
</tr>
<tr>
<td>picture on jar</td>
<td>copyright</td>
</tr>
</tbody>
</table>

Feedback for summary activity

1. The branches of intellectual property are copyright, patents, trade marks, designs and goodwill. Your medication will be protected by law of patents (that is, if you meet the requirements for protection).

2. For the patentee of medication, it is important to reap the benefits of his invention. Therefore you would want your patent to be protected in order to reap all the financial benefits arising from your patent. If your patent is protected, you will be the only person able to manufacture, or licence the manufacturing of, the medication.
This would, in principle, mean that you can ask any price for your medication and also that no other person may use your medication as basis for their own research. A consumer, on the other hand, would want to acquire the medication at the lowest price possible. It would therefore be to the benefit of a consumer if the patent was not protected so that other medication manufacturers can also manufacture the medication at more competitive prices. If others were allowed to manufacture the same medication without the patentee’s consent, it would result in lower prices for the consumer. It could also lead to further research and improvement of the medication.

The law tries to reach a compromise between these two extremes. On the one hand the law wants to reward the creators of intellectual property for their efforts and on the other hand the law wants to stimulate further creations. Therefore, a creator of intellectual property is awarded a monopoly in relation to his creations, but this monopoly is limited in time.
1 THE NATURE OF COPYRIGHT LAW

As you will remember from the previous unit, intellectual property protects mental products which exist independently outside their creator. The mental products protected by way of copyright include a number of different “works” listed in the Copyright Act. The best known of these are literary, musical and artistic works, cinematograph films and sound recordings. Copyright concerns the relationship between a legal subject (who will normally be the copyright holder) on the one hand, and an incorporeal legal object in the form of a “work” (being one of the group of works set out in the Copyright Act) on the other hand.

Definition

Copyright may accordingly be defined as that right which vests in the copyright holder in relation to an original work (as set out in the Act) and which enables him to prevent the unsolicited copying of his work. The Copyright Act further includes various acts (known as specific acts) which the copyright holder has the exclusive right to do or to authorise. Basically, however, the copyright holder has the exclusive right to do or to authorise the reproduction of his work in any manner or form.
Imagine you see your nephew in grade 8 making a copy of his friend’s latest kwinto CD. You tell him that the CD is protected by copyright and that he is not allowed to make an unauthorised copy. Explain to him the meaning of the term “copyright”. Now give the correct legal definition.

2 THE COPYRIGHT ACT 98 OF 1978

The Copyright Act 98 of 1978 regulates all matters concerning copyright in South Africa. The Act itself provides that “no copyright or right in the nature of copyright shall subsist otherwise than by virtue of this Act or of some other enactment in that behalf” (s 41(4)).

The Act consists of a definition s (s 1) and five chapters.

Chapter 1 deals with copyright in what are termed “original works”. There is no definition of what will be regarded as “original works” for the purposes of the Act. Section 2 of the Copyright Act lists the categories of works which, if original, shall be eligible for copyright. Chapter 1 also contains provisions dealing with the duration of copyright in the various categories of works, what persons will be regarded as the copyright holders in different situations, and the various statutory requirements for the subsistence of copyright protection.

Chapter 2 sets out which acts constitute infringement of copyright and describes the remedies available for such infringement. Chapter 2 also deals with procedural matters, such as the question of burden of proof.

Chapter 3 deals with the establishment of a copyright tribunal. The most important purpose of this tribunal is “to determine disputes arising between licensing bodies and persons requiring licences, or organisations claiming to be representative of such persons” (s 30).

Chapter 4 defines the extension or restriction of the Act’s operation to a particular country.

Finally, chapter 5 deals with a number of miscellaneous and supplementary matters.

In this unit we shall deal briefly with the following matters:

- the works which form the object of copyright (par 3)
- the requirements for the subsistence of copyright in a work (par 4)
- the question of who is the first owner of copyright in a work (par 5)
In unit 18 we shall deal with the following aspects of copyright law:

- infringement of copyright (par 1)
- statutory defences to infringement (par 2)
- remedies for infringement (par 3)
- the duration of copyright (par 4)

3 THE LEGAL OBJECTS OF COPYRIGHT

works protected by copyright

The Copyright Act of 1978 provides copyright protection for a wide variety of works. Section 2 of the Act provides that the following works, if original, shall be eligible for copyright:

(a) literary works
(b) musical works
(c) artistic works
(d) cinematograph films
(e) sound recordings
(f) broadcasts
(g) programme-carrying signals
(h) published editions
(i) computer programs

Only categories (a), (b) and (c) are works which were traditionally the object of copyright. The other categories have been afforded protection by various statutory enactments since 1965.

The mere fact that a work can be classified in one of these categories does not, however, mean that it will necessarily enjoy copyright protection. A work will only enjoy copyright protection after certain basic requirements have been satisfied.

We will first examine the various categories of works and thereafter discuss the requirements for protection.

3.1 Literary works

definition

In terms of s 1(1) the term "literary work" includes, irrespective of the literary quality thereof, and in whatever mode or form expressed (in whatever mode or form it is found):

(a) novels, stories and poetical works
(b) dramatic works, stage directions, cinematograph film scenarios and broadcasting scripts
(c) textbooks, treatises, histories, biographies, essays and articles
(d) encyclopaedias and dictionaries
(e) letters, reports and memoranda
(f) lectures, speeches and sermons
(g) tables and compilations, including tables and compilations of data stored or embodied in a computer or a medium used in
conjunction with a computer, but shall not include a computer program.

**material form**

Please pay attention to the following two aspects. Firstly, for a literary work to qualify as such it need not possess any particular literary merit; and secondly, a literary work need not specifically be in written form. Although the work must indeed be in some or other material form, it does not necessarily have to be in writing. This is clear from the phrase “in whatever mode or form expressed” appearing in the definition, as well as from the wording of s 2(2) which provides that a literary work will not be eligible for copyright unless the work has been written down, recorded, represented in digital data or signals or otherwise reduced to a material form.

**writing and written form**

The term “writing” also has a wide definition in the definition section (s 1(1)) and includes any form of notation, whether by hand, printing, typewriting or any similar process.

Although a literary work is not entitled to copyright protection unless it has been reduced to some material form, the Act places no limitation either upon the manner of its reduction to such a material form, or upon the nature of the material form. This wide interpretation of the concept “literary work” was considered and analysed in the case of *Northern Office Microcomputers (Pty) Ltd v Rosenstein* 1981 (4) SA 123 (C) where the court found that a computer program qualified as a literary work. Please note that we refer to this case only to illustrate the fact that the concept “literary work” is widely interpreted. The Copyright Act has been amended since this judgment. Computer programs are now protected as a separate category of work and are specifically excluded from the definition of a literary work.

### 3.2 Musical works

**definition**

A musical work is defined in s 1(1) as

a work consisting of music, exclusive of any words or action intended to be sung, spoken or performed with the music

The words or actions intended to be sung, spoken or performed with the music enjoy copyright protection as literary works and are therefore specifically excluded here.

### 3.3 Artistic works

**definition**

In terms of s 1(1), the concept “artistic work” includes, irrespective of the artistic quality thereof, the following:

(a) paintings, sculptures, drawings, engravings and photographs
(b) works of architecture (being either buildings or models of buildings)
Unit 2: Law of Copyright

(c) works of craftsmanship which do not fall within either paragraph (a) or (b)

technical drawings

The terms “sculpture”, “photograph”, “building”, “engraving” and “drawing” are defined in greater detail. The term “drawing” is defined as including a drawing of a technical nature, or a diagram, map, chart or plan.

3.4 Cinematograph films

definition

A cinematograph film is defined in s 1(1) as any fixation or storage by any means whatsoever on film or any other material of data, signals or a sequence of images capable, when used in conjunction with any mechanical, electronic or other device, of being seen as a moving picture and of reproduction, and includes the sounds embodied in a soundtrack associated with the film, but shall not include a computer program.

In particular it should firstly be noted that the definition is wide enough to include a video tape; secondly, that it is only the fixation of the images which qualifies as a film; and thirdly, that the soundtrack is also entitled to copyright protection. The term “photograph”, on the other hand, is defined (in s 1(1)) in such a way that it does not include any part of a cinematograph film, whilst a cinematograph film scenario is regarded as a literary work, as indicated above. Computer programs are regarded as a separate category of work.

3.5 Sound recordings

definition

A sound recording is defined in s 1(1) as any fixation or storage of sounds, or data or signals representing sounds, capable of being reproduced, but does not include a soundtrack associated with a cinematograph film.

As was seen above, a soundtrack of course enjoys copyright protection as part of the cinematograph film.

separate works

It must be stressed that in the case of cinematograph films, sound recordings and broadcasts, the copyright in these works exists separately from the copyright in the basic work (whether it be a literary, artistic or musical work). This means that, for example, copyright may subsist in a particular literary work, and simultaneously in a sound recording or a broadcast or a cinematograph film derived from such literary work — the literary work, sound recording, broadcast and cinematograph film each constitutes a distinct (separate) object of copyright.
3.6 Broadcasts

**definition**

In s 1(1), the term "broadcast" connotes

a telecommunication service of transmissions consisting of sounds, images, signs or signals which

(a) takes place by means of electromagnetic waves of frequencies of lower than 3 000 GHz transmitted in space without an artificial conductor; and

(b) is intended for reception by the public or ss of the public

The definition expressly includes the emitting of programme-carrying signals to a satellite.

3.7 Programme-carrying signals

**definition**

A programme-carrying signal is defined in s 1(1) as

a signal embodying a program which is emitted and passes through a satellite

This definition makes it clear that a signal transmitted to and relayed by satellite becomes a programme-carrying signal only once it has passed through the satellite; on the upleg (on its way to the satellite) it qualifies as a broadcast.

However, for purposes of this module you need not study the highly technical concepts of broadcasts and programme-carrying signals; it is sufficient to know that there is copyright in respect thereof.

3.8 Published editions

**definition**

The term "published edition" is defined in s 1(1) to mean the first print of a particular typographical arrangement of a literary or musical work. It is evident, therefore, that a separate, independent copyright shall subsist in the basic literary or musical work, and another in the first published edition thereof.

3.9 Computer programs

The copyrightability of computer programs as a separate category of work was first recognised in the 1992 Copyright Amendment Act. Prior to this amendment, computer programs used to enjoy copyright protection as literary works.

**definition**

Section 1(1) of the Copyright Act now defines a computer program as

a set of instructions fixed or stored in any manner and which, when
used directly or indirectly in a computer, directs its operation to bring about a result.

It is important to note that a work will be regarded as a computer program only once it has reached the stage of development where it can be used, directly or indirectly, in a computer. A preliminary work done in the preparation of a computer program, such as a flow chart, which does not fall within the definition of a computer program, will continue to enjoy protection as a literary work. Only once such material has reached the stage of development where it falls within the definition of a computer program does it cease to qualify under the category of literary work and instead qualifies under the category of computer program.

Activity 2

1. How many categories of works listed in the Copyright Act can you remember? You should know and be able to define each of the categories for examination purposes.

2. What is the meaning of the following concepts

   - literary work
   - artistic work
   - computer program

   in terms of the Copyright Act?

4 THE REQUIREMENTS FOR THE SUBSISTENCE OF COPYRIGHT IN A WORK

As mentioned above, there are certain basic requirements with which a work must comply before copyright will subsist in it. The requirements for the subsistence of copyright are all statutory. They can be divided into two groups — inherent and formal requirements. The inherent requirements relate to the work in question itself, whereas the formal requirements relate to the person of the author and to whether the work was first made in South Africa. A work must meet both the inherent and formal requirements before it will be eligible for copyright protection. There are no formalities prescribed for the subsistence of copyright in a work. Copyright protection arises automatically once the inherent and formal requirements have been met. Unlike patents, trade marks and designs, the Copyright Act does not provide for any form of registration.

4.1 Inherent requirements

There are two inherent requirements for the subsistence of copyright in a
work — originality and material embodiment. A work has to meet both these inherent requirements.

4.1.1 Originality

Section 2(1) basically states that a work is not eligible for copyright unless it is original. There is no definition of what will be regarded as “original works” for purposes of the Act.

works to emanate from author

A fundamental principle of copyright law is that, to enjoy the benefit of copyright protection, the work must emanate from the author himself and must not be copied from some other source (see *Pan African Engineers v Hydro Tube* 1972 (1) SA 470 (W) 472). The requirement of originality is the product of this principle.

original skill or labour

Originality in this context refers not to originality of thought or the expression of thought, but simply to original skill or labour in executing the work. Thus where two authors working independently of each other arrive at the same result, each may conceivably obtain for his result the protection accorded an original copyright work. Nor must it be thought that because the work must emanate from the author himself in order to be original, it must emanate in its entirety from the author and that no use may be made of existing subject matter. It simply means that where use is made of existing subject matter, the work must be more than a slavish copy of such subject matter. Generally speaking, the author will be required to expend sufficient skill or labour to impart to his work some quality or character which the material he uses does not possess and which substantially distinguishes the work from that material (see *Appleton v Harnischfeger Corporation* 1995 (2) SA 247 (A) 262).

infringing works

We now come to a very important question connected with the originality of a work — can copyright subsist in a work that infringes another copyright work? We find the answer in s 2(3), which states that a work shall not be ineligible for copyright by reason only that the making of the work involves an infringement of copyright in some other work. A work can therefore enjoy copyright protection notwithstanding the fact that it infringes on the copyright of another work.

4.1.2 Material embodiment

This requirement simply states that a work should exist in some or other material form before it qualifies for copyright protection. Thus s 2(2) states that a work, other than a broadcast or programme-carrying signal, shall not be eligible for copyright unless it has been written down, recorded, represented in digital data or signals, or otherwise reduced to a material form.
4.2 Formal requirements

There are two formal requirements for the subsistence of copyright in a work: either the work should have been made by a qualified person, or the work should have been first published or made in South Africa. Unlike the position relating to the inherent requirements, a work only has to comply with one of the formal requirements in order to enjoy copyright protection. If the first formal requirement is not complied with, then copyright may still vest in a work, but only if (in such a case) the second formal requirement has been complied with.

4.2.1 Author a qualified person

In terms of s 3(1), copyright shall be conferred on every work eligible for copyright where the author is, at the time that the work or a substantial part thereof is made, a “qualified person”. A “qualified person” is then defined to mean:

(a) in the case of an individual, a person who is a South African citizen or is domiciled or resident in the Republic; or

(b) in the case of a juristic person, a body incorporated under the laws of the Republic

4.2.2 Works first published or made in the Republic

In terms of s 4(1), copyright shall be conferred on every work which is eligible for copyright and which is first published or made in the Republic. In this case the person making the work does not have to be a “qualified person”.

Activity 3

You are an attorney practising in a large commercial firm. Part of your duties are to provide legal advice on whether works created by certain clients enjoy copyright protection. Make a check list of all the relevant principles you should keep in mind in order to determine whether a work enjoys copyright protection.

5 THE AUTHOR AND THE FIRST OWNER OF THE COPYRIGHT

In the field of copyright law it is important to draw a clear distinction between the author of a copyrighted work, and the holder or bearer of the copyright. It is common practice to refer to the holder of copyright as the “copyright owner”. The Copyright Act itself uses the term “copyright owner” (see for example, ss 21 and 22) — although the use of the term “owner” in respect of a right (which is not a corporeal thing) is not correct,
strictly speaking. For the sake of convenience we will (in accordance with the provisions of the Act) use the term ‘copyright owner’. We will, however, also use the term ‘copyright holder’, being technically more correct, to refer to the holder or bearer of copyright.

5.1 The author

**definition**

The Act contains specific provisions to indicate who will be regarded as the author of a particular work in each case. The Act defines the term ‘author’ in s 1(1) as meaning, in relation to

(a) a literary, musical or artistic work, the person who first makes or creates the work;
(b) a photograph, the person who is responsible for the composition of the photograph;
(c) a sound recording, the person by whom the arrangements for the making of the sound recording were made;
(d) a cinematograph film, the person by whom the arrangements for the making of the film were made;
(e) a broadcast, the first broadcaster;
(f) a programme-carrying signal, the first person emitting the signal to a satellite;
(g) a published edition, the publisher of the edition;
(h) a literary, dramatic, musical or artistic work or computer program which is computer-generated, the person by whom the arrangements necessary for the creation of the work were undertaken;
(i) a computer program, the person who exercised control over the making of the computer program.

**creative contribution**

Please note that, although the popular and conventional meaning of the word ‘author’ is the maker or creator of a work, it would appear that this meaning applies only in the case of the first three categories of works mentioned (literary, musical or artistic works). In all of the other cases it is conceivable that someone other than the true creator of the work may qualify as its author. Thus, for instance, it is not necessarily the photographer who will qualify as the author of the photograph taken by him or her; it could be someone else — if that other person was responsible for the composition of the photograph. The same applies in the case of a sound recording and a cinematograph film. The presence of any creative contribution on the part of the ‘author’ is irrelevant, so that it is possible for a person other than the one responsible for the actual making or recording of a sound recording or film to be its legal author.

5.2 The first owner of copyright

**general rule**

The general rule is that the author of a work will also be the first owner of the copyright therein (see s 21(1)(a)). However, there are three categories of
exceptions to this rule which are contained in ss 21(1)(b), (c), and (d). These categories are the following:

1 Where a literary or artistic work is made by an author in the course of his employment by the proprietor of a newspaper, magazine or similar periodical under a contract of service or apprenticeship, and is in fact made for the purpose of publication in a newspaper, magazine or similar periodical, that proprietor (the employer) shall be the owner of the copyright in the work for purposes of such publication in a newspaper, magazine or similar periodical (s 21(1)(b)).

This exception applies only to literary and artistic works, and only affects specific employment situations. The copyright in the work vests in the proprietor (the employer) only in so far as it relates to the publication thereof in a newspaper, magazine or similar periodical. In all other respects (eg the publication of the work in book form), the author will be the owner of the copyright subsisting in the work.

2 Where a person commissions the taking of a photograph, the painting or drawing of a portrait, or the making of a gravure or a cinematograph film or a sound recording and pays for it in money or money’s worth, that person (the person who commissions) shall (subject to the provisions of the preceding subs (b)) be the owner of the copyright in the work (s 21(1)(c)).

In this case only specific works are affected, namely photographs, painted or drawn portraits, gravures, cinematograph films and sound recordings.

3 Where a work is made in the course of the author’s employment by another person under a contract of service or apprenticeship, in a case not falling within either subs (b) or (c), that other person (the employer) shall be the owner of the copyright in the work (s 21(1)(d)).

This exception applies to all works, except those falling under subss (b) or (c).

4 These exceptions to the general rule that the author of a work will also be the first owner of the copyright therein (subss (b), (c) and (d)) can be excluded by way of agreement between the parties involved (s 21(1)(e)).

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**Activity 4**

1 A is employed by B, the owner of the magazine called *Bird World*. B instructs A to write an article on the endangered Merlaw owl for publication in the magazine. He also instructs A to take a photograph of the owl for the purpose of illustrating the article.

(a) Who is the author of the article and the photograph?
(b) Who is the owner of the copyright in the article and the photograph?

2 A is in the employ of B. A writes a computer program, “Smart Doctor”, under the
direct supervision of B. The application of the computer program is to facilitate the administration of a doctor’s practice. A makes a backup copy of the computer program for his own use. Upon leaving B’s employment, A writes a similar computer program. The second computer program is named “Organised Doc”. A makes considerable use of the backup copy of “Smart Doctor” in writing his program “Organised Doc”. Determine the author and copyright owner of “Smart Doctor” and “Organised Doc”.

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**Summary activity**

1. X includes a translation of a large portion of a copyrighted book in his dissertation for his MA degree, without obtaining permission from Q, the copyright owner. Is X’s translation of the work itself the subject of copyright and, if so, in whom does it vest and what is the nature and extent of such copyright?

2. A discovers a photograph of his late grandfather. He commissions B, an artist, to paint an enlarged replica of the photograph in oils, against payment of an agreed sum of money. B executes the commission. Will the painting comply with the requirement of originality to qualify for protection as an artistic work in terms of the Copyright Act? Who is the author of the painting and who is the owner of the copyright, if copyright in fact subsists?

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**Feedback 1**

Copyright may be defined as the exclusive right which vests in the copyright holder in relation to an original work to do or to authorise the doing of specific acts in relation to the work, including the right to prevent the unsolicited copying of his work.

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**Feedback 2**

1. The Copyright Act provides copyright protection for a wide variety of works, namely literary works, musical works, artistic works, cinematograph films, sound recordings, broadcasts, programme-carrying signals, published editions and computer programs.

2. (a) The term “literary work” includes the following, irrespective of the literary quality thereof, and in whatever mode or form expressed:

   (1) novels, stories and poetical works;
   (2) dramatic works, stage directions, cinematograph film scenarios and broadcasting scripts;
   (3) textbooks, treatises, histories, biographies, essays and articles;
(4) encyclopedias and dictionaries;
(5) letters, reports and memoranda;
(6) lectures, speeches and sermons; and
(7) tables and compilations, including tables and compilations of data stored
   or embodied in a computer or a medium used in conjunction with a
   computer but not a computer program.

(b) The concept "artistic work" includes the following, irrespective of the artistic
   quality thereof:

   (1) paintings, sculptures, drawings, engravings and photographs
   (2) works of architecture (either buildings or models of buildings)
   (3) works of craftsmanship

   The Act defines the terms "sculpture," "photograph," "building," "engraving" and
   "drawing" in greater detail. The term "drawing" is defined as including a
   drawing of a technical nature, or a diagram, map, chart or plan.

(c) A computer program is defined as "a set of instructions fixed or stored in any
   manner and which, when used directly or indirectly in a computer, directs its
   operation to bring about a result". It is important to note that a work will be
   regarded as a computer program only once it has reached a stage of
   development where it can be used, directly or indirectly, in a computer. The
   preliminary work in the preparation of a computer program, such as a flow
   chart, which does not fall within the definition of a computer program, will
   continue to enjoy protection as a literary work. Only once such material has
   reached a stage of development where it falls within the definition of a
   computer program does it cease to qualify under the category of literary work
   and instead qualifies under the category of computer program.

It is important to remember that there are no prescribed formalities for the subsistence of
copyright protection. Copyright arises automatically if the requirements are met. You can
determine whether a work will enjoy protection by answering the following questions:

- Does the work fall under one of the categories listed in the Act?
- If so, does the work meet the inherent and the formal requirements for copyright
  protection?
- The inherent requirements: is the work original and is it in a material form?
- The formal requirements: has the work been made by a qualified person, or has it
  been made or first published in South Africa?
1 (a) In answering this question you are required to indicate who is regarded as the author in relation to a literary work (the article) and an artistic work (the photograph). A, the maker or creator of the article, will qualify as author of the article. As far as the photograph is concerned, the person responsible for the composition thereof will qualify as the author. From the facts it is reasonable to assume that A will also qualify as author of the photograph.
(b) In terms of s 21(1)(b), the owner of the copyright in the article is B. Note with regard to s 21(1)(b), that the proprietor of the magazine (B) is the owner only for purposes of publication in any newspaper, magazine or similar periodical. For all other purposes (eg for publication in book form) A, the author, is the owner of the copyright. Section 21(1)(b) applies to both literary and artistic works. As A took the photograph (which is an artistic work — see definition of artistic work) in the course of his employment with B, B will be the owner of the copyright in the photograph for purposes of publication in any newspaper, magazine or similar periodical.

2 The author of a computer program is the person who exercised control over the making of the computer program. According to the facts, the author of “Smart Doctor” is B and the author of “Organised Doc” is A. The author of a work is normally also the copyright owner thereof (see s 21(1)(a)). A is thus the copyright owner of “Organised Doc” and B is the copyright owner of “Smart Doctor”.

1 Copyright can subsist in a work which infringes another copyright work. The mere fact that the translation is an unauthorised adaptation will thus not preclude copyright from subsisting in the translation. Provided the work meets the inherent and formal requirements for the subsistence of copyright, it will attain copyright protection independently from the original work. Copyright will vest in the maker or creator of the work — X. The nature of copyright in the translation will be the same as that of other literary works, but it should be noted that every time X exploits his work (eg by making a reproduction), he will infringe copyright in Q’s original work.

2 A painting is an artistic work in terms of s 1(1) of the Copyright Act 98 of 1978. The author of an artistic work is the maker or creator thereof, therefore B is the author of the painting. The requirement of originality refers to the original skill or labour involved in the execution of the work. The work must have emanated from the author, B, himself, and must not have been copied from some other source (see Pan African Engineers v Hydro Tube 1972 (1) SA 470 [W] at 472). Where use is made of existing subject matter (the photograph), the author must expend sufficient skill or labour to impart to his work (the painting) some quality or character which the material he uses does not possess and which substantially distinguishes the painting from the photograph. The execution of the painting requires artistic skill, and if the painting is more than a mere slavish copy of the photograph, the painting will qualify as an original artistic work in terms of the Copyright Act.
As noted above, B is the author of the painting. The general rule is that the author of a work which is the subject of copyright will be the first owner of copyright subsisting therein. However, where a person commissions the painting of a portrait, and pays for it in money or money's worth, the person who commissions the portrait will be the first owner of the copyright subsisting in the portrait (see s 21(1)(c)). A will therefore qualify as the first owner of the copyright in the portrait painted by B.
UNIT 3

COPYRIGHT INFRINGEMENT

After studying this unit you should be able to

- demonstrate and apply knowledge of copyright infringement by identifying and evaluating possible infringement in various scenarios
- identify the most appropriate remedies available to the copyright owner in the event of copyright infringement in different circumstances

A list of cases that have to be studied for this unit will be supplied in Tutorial Letter 101.

1 INFRINGEMENT OF COPYRIGHT

exclusive rights

When a work is protected by copyright, the copyright owner has the exclusive right to perform certain acts or to authorise the performance of these acts in relation to the work. Sections 6–11 of the Copyright Act contain provisions for each of the categories of works, setting out which acts may be done or authorised exclusively by the copyright owner.

exclusive rights: literary work

For example, s 6 of the Act provides that the copyright owner of a literary or musical work has the exclusive right to do or to authorise the doing of the following acts:

- the reproduction of the work;
- its publication;
- its performance in public;
- a broadcast of the work;
- the making of an adaptation of the work; and so on.
An adaptation with reference to a literary work also means a translation of the work.

**exclusive rights:** Section 11B provides that, in relation to a computer program, only the copyright owner may do or authorise the following acts:
- the reproduction of the computer program in any manner or form;
- the publication of the computer program if it was as yet unpublished;
- making an adaption of the computer program;
- reproducing or publishing an adaptation of a computer program; or
- letting, or offering or exposing for hire by way of trade, directly or indirectly, a copy of the computer program.

**direct infringement** Copyright infringement can be either direct or indirect. The infringement is direct when the infringer does, or causes any other person to do, any of the acts specifically designated in the Act as the sole prerogative of the copyright owner, without having obtained the permission of the copyright owner (see s 23(1)).

**direct and indirect copying** The definition of the term “reproduction” in s 1(1) expressly includes “a reproduction made from a reproduction of that work”. This means that a copyright owner has the exclusive right to make a reproduction (copy) of an existing copy of his work (indirect copying). The making of a copy of an intervening copy of a work thus also amounts to a direct infringement of the copyright in the original work.

**indirect infringement** Copyright infringement is indirect when the infringer, although not actually committing any of the acts so designated, nonetheless, knowing that it would constitute an infringement, commits one of the acts mentioned in ss 23(2) and (3). The following are examples of indirect infringements:
- the importation of an infringing article for a purpose other than for the infringer’s private or domestic use;
- the selling or letting, or the offering by way of trade for sale or hire, of such an article;
- acquiring an article relating to a computer program in the Republic; and
- permitting a place of public entertainment to be used for a public performance of a literary or musical work.

**example** We will explain the difference between direct and indirect infringement by means of the following example:

In terms of s 6, one of the exclusive rights of the copyright owner of a literary work is to reproduce the work in any manner or form. If a person makes a copy of the work, without the consent of the copyright owner, he commits an act of direct infringement. However, if instead of making a copy of the work himself, he knowingly, and without the consent of the copyright owner, imports into the Republic for a purpose other than his private and domestic use an infringing copy already in existence, he commits an act of indirect infringement.

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Activity 1

(1) What is meant by an exclusive right? What exclusive rights are reserved for the copyright owner of a literary work?

(2) The essence of copyright is that only a copyright owner may copy his work. The Act does not use the word "copy". What is the word the Act uses? Give a definition of the word.

(3) In paragraph 1 above, an example is given of direct and indirect infringement. Can you think of another example that illustrates the distinction between direct and indirect infringement? Do you think it is fair that knowledge is a requirement for indirect infringement, but not for direct infringement?

2 STATUTORY DEFENCES TO INFRINGEMENT

2.1 Copyright not infringed

statutory defences As we explained above, the Copyright Act specifically mentions (in ss 6–11) certain acts which the copyright owner has the exclusive right to do or to authorise. If another person performs any of these acts without the authorisation of the copyright owner, he infringes directly the copyright owner’s copyright. However, the Act also lists (in ss 12–19) in relation to the various categories of works, a number of acts the doing of which (even without authorisation) will not amount to an infringement of the copyright. This means that the acts listed in ss 12–19 constitute defences on which a person can rely if the copyright owner institute an action for infringement against him.

The following accordingly constitute statutory defences to infringement:

2.1.1 Fair dealing

fair dealing With regard to literary, musical and artistic works, cinematograph films, sound recordings, broadcasts, published editions and computer programs (ie all works except programme-carrying signals), the following acts shall not constitute copyright infringement:

- Fair dealing with a work
  (i) for the purpose of research or private study or for the purpose of personal or private use
  (ii) for the purpose of criticism or review of that work or another work
  (iii) for the purpose of reporting current events

  (A) in a newspaper, magazine or similar periodical
  (B) by means of broadcasting or in a cinematograph film

However, before someone will be able to rely on a defence of fair dealing,
certain principles apply: the making of a copy of the whole or of a substantial portion of the work concerned will not be permitted; and in cases (ii) and (iii)(A) above the source must be mentioned as well as the name of the author if it appears on the work.

2.1.2 Judicial proceedings

This refers to the use of the work for the purposes of judicial proceedings, or reproducing it for the purposes of a report for judicial proceedings.

2.1.3 Illustration

This refers to the use of the work by way of illustration in any publication, broadcast or sound or visual recording for the purpose of teaching. However, before someone will be able to rely on this defence, certain conditions apply: he must mention the source of the work as well as the name of the author if it appears on the work, and furthermore, his use of the illustration must be “compatible with fair practice” and to the extent “justified by the purpose”.

It is not clear exactly what the legislature had in mind when using the phrases “compatible with fair practice” and “justified by the purpose”. They appear to indicate, at the very least, a desire on the part of the legislature to limit the use of the quotation or illustration to reasonable proportions.

2.1.4 Bona fide demonstration

This refers to the use of a work in a bona fide demonstration of radio or television receivers or any type of recording equipment or playback equipment to a client by a dealer in such equipment.

2.1.5 Quotations

With regard to literary and musical works, cinematograph films, sound recordings, broadcasts and computer programs (all works except artistic works, programme-carrying signals and published editions), copyright shall not be infringed by any quotation from a work which is lawfully available to the public. The following conditions apply: the source must again be mentioned as well as the name of the author if it appears on the work and furthermore, the quotation must be compatible with fair practice and may only be used to the extent justified by the purpose.

2.1.6 Broadcasts

With regard to literary, musical and artistic works, sound recordings, published editions and computer programs, copyright shall not be infringed by the reproduction of the work by a broadcaster by means of its own facilities where such reproduction or any copy of it is intended exclusively for lawful broadcasts of the broadcaster.
2.17 Information purposes

With regard to literary and musical works only, copyright in a lecture, address or other work of a similar nature which is delivered in public shall not be infringed by reproducing it in the press or broadcasting it, if such reproduction or broadcast is for informative purposes. Also, the copyright in an article published in a newspaper or periodical, or in a broadcast, on any current economic, political or religious topic shall not be infringed by reproducing it in the press or by broadcasting it, if such reproduction or broadcast has not expressly been reserved and the source is clearly mentioned.

2.18 Background inclusion

With regard to artistic works only, copyright shall not be infringed if it is included in a cinematograph film, a television broadcast or transmission in a diffusion service, if such inclusion is merely by way of background, or incidental to the principal matters represented in the film, broadcast or transmission. The same applies with regard to the inclusion in the above-mentioned media of such works of art as are permanently situated in a street, square or similar public place. With regard to a work of architecture, or the relevant drawings, copyright shall not be infringed by the reconstruction of such work on the same site and in the same style as the original.

2.19 Three-dimensional reproductions

Copyright in an artistic work shall not be infringed where a three-dimensional reproduction of an artistic work is copied if

- the three-dimensional reproduction has already been made available to the public with the consent of the copyright owner;
- the three-dimensional reproduction has primarily a utilitarian purpose; and
- it has been made by an industrial process (s 15(3A), Dexion Europe Ltd v Universal Storage Systems (Pty) Ltd 2003 (1) SA 31 (SCA)).

We can explain this exception by means of the following example: A, a car manufacturer, has the copyright in the production drawing of a spare part. The production drawing is a two-dimensional utilitarian artistic work. A manufactures this spare part by an industrial process and sells it to the public. The manufactured spare part is a three-dimensional reproduction of the production drawing. B obtains one of these spare parts (ie the three-dimensional reproduction of A’s artistic work) and copies it. B will not infringe on A’s copyright in the two-dimensional utilitarian artistic work.

2.110 Excerpts

With regard to programme-carrying signals, copyright in such signals shall not be infringed by the distribution of short excerpts of the programme so carried
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- that consist of reports of current events; or
- that are compatible with fair practice, and to the extent justified by the informative nature of such excerpts.

However, if the programme-carrying signal represents a sporting event, this exception shall not apply.

2.1.11 Backup copies

A person who is in lawful possession of a computer program or has an authorised copy of the computer program shall not infringe the copyright in the computer program if:

- he makes copies reasonably necessary for backup purposes;
- a copy so made is intended exclusively for personal or private purposes; and
- he destroys the backup copies when possession of the computer program in question, or authorised copy thereof, ceases to be lawful.

The person in possession of an authorised copy of a computer program may make copies thereof to the extent that it is reasonably necessary for backup purposes, but such copies may only be used for the person’s personal or private purposes. Furthermore, such copies must be destroyed when the possession of the computer program ceases to be lawful — for example, where the computer program is transferred to a third person.

2.2 No copyright protection

Where a person performs any of the acts listed above, he will not infringe copyright. Apart of these acts, the Act also provides (in s 12(8)) that certain works will not enjoy copyright protection at all. This means that these works may be used freely, and that any such uses will not amount to copyright infringement. The following do not enjoy copyright protection:

- official texts of a legislative, administrative or legal nature
- official translations of such texts
- speeches of a political nature or in speeches delivered in the course of legal proceedings
- news of the day which consists merely of items of press information

Activity 2

Discuss the exception of three-dimensional reproductions (s 15(3A)). Why do you think this statutory defence exists? When answering this question, think about the viewpoint of the consumer.

3 Remedies for infringement

Section 24 of the Copyright Act sets out the remedies available to the
copyright holder in the event of copyright infringement. Section 24(1) provides that a copyright owner may institute an action for copyright infringement, and that relief would be available to him as would be the case in any corresponding proceedings in respect of infringements of other proprietary rights.

The following relief is available to the copyright owner in event of infringement of his rights:

- damages
- interdict
- delivery of infringing copies, or plates used or intended to be used for infringing copies
- additional damages (s 24(3))

Activity 3

You are an attorney and one of your clients is a best-selling author. His secretary stole a digital copy of his newest book and placed it on a web page on the Internet. For what type of relief would you ask the court if you institute an action for copyright infringement on behalf of your client? Give reasons to support your answer.

4 DURATION OF COPYRIGHT

duration

As a general rule, a work enjoys copyright protection for a period of 50 years calculated from the end of the year in which the author of the work dies (s 3(2)(a)). This means that a work enjoys copyright protection for the lifetime of the author plus 50 years. This rule applies to literary, musical and artistic works (excluding photographs). Please remember that the copyright owner is not necessarily the author of a work. The period of protection is determined with reference to the lifetime of the author.

Copyright in computer programs, photographs and cinematograph films subsists for a period of 50 years from the end of the year in which the work was made available to the public with the consent of the owner of the copyright, or in which it was first published. Where the work has not been made available to the public or published within 50 years from the making of the work, the duration of copyright is 50 years from the making of the work, calculated from the end of the year in which the work is made (s 3(2)(b)).

Summary activity

Read the following scenarios and answer the questions on each.

(1) A is employed by B, the owner of a magazine called Bird World. B instructs A to write an article on the endangered Merdaw owl for publication in the magazine. He also instructs A to take a photograph of the owl for the purpose of illustrating the article.
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(a) Can B prohibit A from making and distributing prints of the photograph to members of the South African Ornithological Society?
(b) What is the duration of the copyright in the article and the photograph?

(2) C is in the employ of D. C writes a computer program, "Smart Doctor," under the direct supervision of D. The application of the computer program is to facilitate the administration of a doctor's practice. C makes a backup copy of the computer program for his own use. Upon leaving D's employment, C writes a similar computer program. The second computer program is named "Organised Doc." C makes considerable use of the backup copy of "Smart Doctor" in writing his program "Organised Doc."

(a) Did C have the right to make a backup copy of "Smart Doctor"?
(b) Does C's act of writing "Organised Doc" amount to copyright infringement?

(3) X includes a translation of a large portion of a book in his dissertation for his MA degree, without any acknowledgement. B is the copyright owner of the book, which was published in 1945. B institutes a copyright infringement action against X. In his defence, X avers that he did not infringe copyright, as his translation of the work does not amount to a "reproduction of the work in any manner or form".

(a) What must B prove to establish copyright infringement?
(b) Discuss the validity of X's defence.
(c) May X raise any other defences? Name them, if any.
(d) What are the nature and extent of the copyright vested in X's translation of the work?
(e) Would your answers to (b) and (c) above have differed had B's book been published in 1920 instead of 1945, and B had died in the year his book was published?

Feedback 1

(1) The exclusive right of a copyright owner is the right to perform or to authorise the performance of certain acts in relation to the copyrighted work. This means that these acts are reserved for the copyright owner. Where a person other than the copyright owner wants to perform any of these acts, he must obtain the copyright owner's permission. Sections 6–11 of the Copyright Act contain provisions for each of the categories of works, setting out which acts may be done or authorised exclusively by the copyright owner. The copyright owner of a literary work has the exclusive right to do or to authorise the doing of the following acts: the reproduction of the work, its publication, its performance in public, a broadcast of the work and the making of an adaptation of the work.

(2) The Act uses the term "reproduction." It is defined in s 1(1) of the Act. It is expressly stated that in relation to any work the term includes "a reproduction made from a reproduction of that work." This means that the making of a copy of an intervening copy of a work (indirect copying) amounts to an infringement of the copyright in the original work.

(3) In terms of s 6, one of the exclusive rights of a copyright owner is to perform his work in public or to authorise the performance of his work. If a person performs a copyrighted song in a restaurant (in other words, in public) without the permission of the copyright
owner, he commits an act of direct infringement. The owner of the restaurant (which is a place of public entertainment), who allows this performance, commits an act of indirect infringement if he knows that this song is being performed without the copyright owner’s consent. (We want to draw your attention to the following: a song consists of two types of works: a literary work for the lyrics and a musical work for the music. The copyright in a song can therefore belong to two different copyright owners.)

**Feedback 2**

Copying a copy of a work (indirect copying) is regarded as an infringement of the original work and the unauthorised copying of a three-dimensional copy of an artistic work will amount to infringement. However, s 15(3A) provides that copyright infringement will not occur in the case of a three-dimensional reproduction of an artistic work provided that the three-dimensional reproduction meets the following requirements:

- it must have a primarily utilitarian purpose
- it must be the product of an industrial process
- it must already have been made available to the public with the consent of the copyright owner

This exception is usually relevant in the manufacturing of spare parts. For example, the copyright in a two-dimensional utilitarian artistic work in the form of a production drawing of, say, a spare part of an implement will not be infringed by a person who obtains an example of that spare part (a three-dimensional reproduction of that artistic work) and copies it, provided the spare part was made available to the public with the consent of the copyright owner and it was made by means of an industrial process.

The reason for the existence of this exception (or statutory defence to copyright infringement) is to provide better competition. The initial manufacturer must be protected, hence the protection of the two-dimensional artistic work. However, to promote competition and to make the public with more competitive prices, other manufacturers are allowed to make copies of the three-dimensional reproduction of the artistic work. You will learn more about competition and the importance thereof for the consumer in the s of this guide dealing with the law of competition.

**Feedback 3**

As you have learnt from other courses, each legal remedy has a different purpose. Since each remedy has a specific purpose, it is best to ask for more than one form of relief. In this case an interdict would prevent the secretary from continuing her web page, damages would make good the damage your client suffered because his book was available on the Internet, and delivery up of the infringing copy would ensure that the secretary no longer has the infringing copy in her possession.
(1) (a) B is the owner of the copyright in the photograph for purposes of publication in a newspaper, magazine or similar periodical. For all other purposes, A remains the owner of the copyright. In terms of s 7, such copyright vests in him the exclusive right to reproduce the photograph in any manner or form. Accordingly, A may make prints of the photograph and distribute them to members of the SA Ornithological Society. B cannot prevent him from doing so.

(b) The duration of the copyright in the article will be the life of the author (A) and 50 years from the end of the year in which he dies. The term of the copyright in the photograph will be 50 years from the end of the year in which it is lawfully made available to the public, or, failing such event, 50 years from the end of the year in which the photograph was taken. Assuming that he is still living, it will not be possible to determine the duration of the copyright in the article. It will only be possible to do so on his death. The duration of the copyright in the photograph is 50 years from the date of its publication in the magazine Bird World.

(2) (a) The person in possession of an authorised copy of a computer program may make copies thereof to the extent that it is reasonably necessary for backup purposes, but such copies may be used only for the person’s personal or private purposes. Furthermore, such copies must be destroyed when the possession of the computer program ceases to be lawful. Thus, C was probably authorised to make a backup copy of the computer program since we may assume that he was in lawful possession of a copy of the computer program and one may argue that he made the copy for backup purposes. However, he should have destroyed the backup copy when he left the employment of D, as he was then no longer in possession of a lawful copy of “Smart Doctor.”

(b) Infringement of copyright on a computer program takes place where one of the exclusive rights reserved for the copyright owner of a computer program is performed without authorisation. The rights that have been reserved for the copyright owner include the right to reproduce or adapt the computer program. It may be assumed that C either made a reproduction or an adaptation of “Smart Doctor” in writing “Organised Doc” since he made “considerable use” thereof. His actions therefore amount to infringement of copyright.

(3) (a) B is the copyright owner of the book. The book is a literary work and the exclusive rights of the copyright owner include the right to reproduce the work and to make an adaptation of it. The term “adaptation”, in relation to a literary work, includes a translation of the work. In order to prove copyright infringement through adaptation of the work, it must be proved that the copyright work had actually been translated. It is not necessary to prove that X knew that he was infringing the copyright in the work in question. It is a question of fact whether copyright has been infringed.

(b) X’s defence that his translation does not amount to a “reproduction in any manner or form” is not valid. B, as the copyright owner of the book, has the exclusive right to reproduce the work in any manner or form, to publish the work, and to reproduce or publish an adaptation of it (see s 6). The definition of the term “adaptation”, with reference to a literary work, includes the translation of it (see s 1). X’s actions therefore amount to an unauthorised reproduction of an
adaptation, which constitutes copyright infringement. Thus X's defence is not valid.

(c) The most important defence which X may raise is that of fair dealing. Section 12(1) of the Act provides that copyright shall not be infringed by any fair dealing with a literary work for the purpose of research or private study by, or the personal and private use of, the person using the work. This provision applies with equal force to the making or use of adaptations of literary works (see s 12(9) and 6(g)) and to a work in its original language or in a different language. Note that as far as “private study” is concerned, it is clear that students may reproduce an extract from a work solely for their personal use, and not with the intention of circulating the extract, or copies of it, among fellow students. “Private use” is confined to the user herself or to a situation where it does not extend beyond her domestic circle. The use of a large portion of B's book will thus not be covered by the terms “private study” or “private use”, since copies of the work will be made for examination purposes and later circulated to other libraries. However, note that the proviso to s 12(1) effectively curtails any meaningful copying of the work. It is clear that the requirement that a work be used “fairly” to fulfil a particular purpose should be taken to refer to the use of a work that does not involve making a copy of a substantial part of the work in question. As X has included a translation of a large portion of the work in his dissertation, this defence will fail.

(d) The nature of copyright in the translation will be the same as that in respect of other literary works, but it should be noted that every time X exploits his work (e.g. by making a reproduction), he will infringe copyright in B's original work.

(e) Yes: if B's book was published in 1920 and B died that same year, the answers to (b) and (c) would be different. Where a literary work is published before the death of an author, the term of copyright endures for the lifetime of the author plus 50 years commencing from the end of the year in which the author dies (see s 3(2)(a)). B's term of copyright in his work would have expired in 1970. Obviously, once the term of copyright has expired the work is no longer protected by copyright and it falls within the public domain. Anyone may then freely copy it. X would then have been able to defend himself against a copyright infringement action by raising the defence that the copyright has expired.
UNIT 4

THE LAW OF TRADE MARKS

Outcomes

After studying this unit you should be able to

- explain your understanding of the nature of a trade mark in terms of the Trade Marks Act 194 of 1993
- determine the registrability of trade marks in different situations
- distinguish between the various forms of infringement in different situations
- apply knowledge of the law of trade marks in response to given scenarios.

Prescribed reading

A list of cases that have to be studied for this unit will be supplied in Tutorial Letter 101.

1 INTRODUCTION

As in the case of copyright law in South Africa, the law in regard to trade marks is also governed by statute.

Although an action had been granted as early as the first half of the 19th century to the manufacturer of goods in cases where his trade mark had been used by others on their goods, the first legislation relating to trade marks was only promulgated in England in the form of the Trade Marks Act of 1875. This Act made provision for the registration of trade marks for the first time, specifically in order that such registration should serve as prima facie proof of the right to such trade marks. Legislation in South Africa prior to Union was based on this Act. After Union the position was governed by the Patents, Designs, Trade Marks and Copyright Act 9 of 1916.
As far as trade marks are concerned, this latter Act was replaced by the Trade Marks Act 62 of 1963. This Act was again replaced by the Trade Marks Act 194 of 1993. The 1963 Act will continue to apply to all applications lodged and proceedings instituted before 1 May 1995 and will also determine the validity of an entry on the register of trade marks existing on 1 May 1995. The 1993 Act applies to all new applications filed, and to opposition, cancellation and infringement proceedings commenced on or after 1 May 1995.

As in the case of the relevant statute governing copyright, the Trade Marks Act is, to a large extent, influenced by British legislation, namely the British Trade Marks Act of 1994.

The Trade Marks Act 194 of 1993 deals with almost all aspects of trade mark law; s 33 in fact provides that no person shall be entitled to institute proceedings to prohibit the infringement of a trade mark which has not been registered in terms of the Act. The s does, however, contain a proviso, namely that the Act does not detract from the rights of a person to institute a common-law action against any person. This proviso obviously refers to the common-law action for unlawful competition which is dealt with comprehensively elsewhere in this guide. It is not the intention in this unit to cover the provisions of the Trade Marks Act comprehensively. Only certain ss have been chosen for comment; these particular ss have been selected to provide you with a knowledge of the fundamental principles of trade mark law.

2 THE NATURE OF A TRADE MARK

**definition of trade mark**

With this we arrive at the first question deserving attention, namely: What is a trade mark? In other words, what legal property forms the object of a trade mark right?

Section 2(1) of the Act contains the following definition of a trade mark:

"trade mark", other than a certification mark or collective mark, means a mark used or proposed to be used by a person in relation to goods or services for the purpose of distinguishing the goods or services in relation to which the mark is used or proposed to be used from the same kind of goods or services connected in the course of trade with any other person.

**definition of mark**

"Mark" is, in turn, defined in s 2(1) as follows:

"Mark" means any sign capable of being represented graphically, including a device, name, signature, word, letter, numeral, shape, configuration, pattern, ornamentation, colour or container for goods or any combination of the aforementioned.

From the definition of a trade mark, its function is apparent, namely that it identifies and distinguishes those goods or services for which it is used from goods or services of the same kind supplied by some other person.
 certification mark A “certification mark” is specifically excluded from the definition of a trade mark. A certification mark is a mark used upon or in connection with goods or services to certify that they have been examined with regard to kind, quality, quantity, intended purpose, value, geographical origin, mode or time of manufacture, or other characteristic, by government or provincial authority, association or person (see s 42). Section 42 authorises and regulates the registration of such certification marks, the purpose of which is not, like ordinary trade marks, to distinguish goods or services, but rather to certify goods or services in regard to certain qualities. Well-known certification marks include the Woolmark and the SABS mark.

collective mark A “collective mark” is also excluded from the definition of a trade mark. A collective mark is a mark used upon or in connection with goods or services to indicate that they are goods or services of members of a particular association (see s 43).

Whereas a certification mark serves to distinguish goods or services certified by the proprietor in respect of quality or some other characteristic, a collective mark serves to distinguish the goods or services of members of an association from the goods or services of nonmembers.

shape From the definition of a mark it is apparent that shape, pattern, ornamentation and colour are included in the concept of a mark and can thus be registered as a trade mark (Beecham Group plc v Triomed (Pty) Ltd 2003 (3) SA 639 (SCA)).

container for goods From the definition of a mark it is apparent that a container for goods is also included in the concept of a mark. The capability of distinguishing (a concept which will be fully explained below) in the case of container marks is to be found in the shape or structure of the container (Die Bergkelder Bpk v Vredendal Koop Wynmakery 2006 (4) SA 275 (SCA)). However, the registration of such a container for goods as a trade mark affords rights of the nature of a trade mark only; in other words, the owner of the trade mark does not acquire a general right to a container of that shape or structure; he merely acquires protection against copying by others of that particular shape or structure of the container for similar goods.

use It should be noted that the definition of a trade mark requires that the mark be used or be proposed to be used in relation to goods or services. The concept of use is of considerable importance and is moreover a fundamental characteristic of our trade mark law. No right to a mark can be acquired unless that mark is used or is proposed to be used in regard to goods or services. The Act in fact makes provision (in s 27) for the cancellation of a registered trade mark in certain circumstances on the grounds of nonuse.

Section 2(2) indicates the wide interpretation to be attached to the concept “use”. It provides as follows:

References in this Act to the use of a mark are to be construed as references to the use of a visual representation of the mark, and in addition, in the case of a container, use of such container and, in the
case of a mark which is capable of being audibly reproduced, the use of an audible reproduction of the mark.

The implication of the foregoing provision is that it is not merely the unauthorised visual reproduction of a mark, but that it is also the unauthorised audible reproduction of a mark that is capable of constituting an infringement of the statutory rights afforded the proprietor of a registered trade mark.

Activity 1

Read the following scenario and answer the questions below. Give reasons for each of your answers.

A, a manufacturer of sweets and chocolates, wishes to market a new range of chocolates. His marketing department suggests that they call the chocolates “Sweet n Smooth”. Another suggestion is that the chocolates be marketed under the name “Beaver”. The marketing department also designs a fancy label and a box for the chocolates.

(1) What is a trade mark?
(2) Can the name “Sweet n Smooth” qualify as a trade mark?
(3) Can the name “Beaver” qualify as a trade mark?
(4) Can the label and box qualify as trade marks?

3 THE REGISTRATION OF A TRADE MARK

Section 5 of the Trade Marks Act provides for the establishment of a Trade Marks Office in Pretoria. (In practice it is combined with the Patents and Designs Offices.) A register of trade marks in which details of registered trade marks are entered is kept at this office (see s 22). An official known as the Registrar of Trade Marks heads the Trade Marks Office (s 6(1)), and all applications for the registration of trade marks must be directed to the registrar.

An application for the registration of a trade mark is made to the registrar in the manner prescribed by the regulations (see Trade Mark Regulations, GN R 578 Government Gazette 5493 of 21 April 1995).

4 REQUIREMENTS FOR REGISTRATION

4.1 Capable of distinguishing

Section 9(1) of the Trade Marks Act states the following:

In order to be registrable, a trade mark shall be capable of
distinguishing the goods or services of a person in respect of which it is registered or proposed to be registered from the goods or services of another person ...

Section 9(2) of the Trade Marks Act provides the following in this regard:

A mark shall be capable of distinguishing ... if, at the date of application for registration, it is inherently capable of so distinguishing or it is capable of distinguishing by reason of prior use thereof.

A careful analysis of s 9(2) discloses that its provisions are actually self-evident: “capable of distinguishing” means that the mark must in fact be capable of distinguishing the goods or services of a particular person from similar goods or services of other persons (Die Bergkelder Bpk v Vredendal Koop Wynmakery 2006 (4) SA 275 (SCA)).

In assessing whether or not a trade mark is capable of distinguishing in terms of the above s, account must be taken not only of the usages and circumstances prevailing in the branch of the trade in which it is proposed to use the trade mark, but also of the nature of the product or service in question and the purpose for which it is to be used (see Ex parte Chemisch-Pharmazeutische Aktiengesellschaft 1934 TPD 366; Die Bergkelder Bpk v Vredendal Koop Wynmakery 2006 (4) SA 275 (SCA)).

The following may be added by way of explanation: s 9(2) refers to trade marks which are inherently capable of distinguishing. Marks having such inherent capability of distinguishing are, for example, coined (or imaginary) marks and arbitrary marks. Coined marks are marks or words which have been made up or thought out, and which therefore were not previously known in the language concerned; accordingly they do not call forth a mental picture or an association when they are encountered for the first time. Examples of such marks are “Xerox”, “Kodak”, “Fanta” and “Sparletta”. Arbitrary marks are words or symbols which are in fact well known, but which are not normally associated with the goods or services for which they are to be used as trade marks. Examples of these are “Camel” or “Lucky Strike” for cigarettes, “Total” or “Shell” for fuel. Descriptive words, on the other hand, have no inherent capability of distinguishing. These words refer directly to the character, quality or purpose of the goods or services in connection with which they are used.

Where a mark has no inherent capability of distinguishing, it may nevertheless become capable of distinguishing (and thus registrable) by reason of prior use of the mark. This will happen where the mark has become recognised in the market place, through use, as a mark capable of distinguishing a particular trader’s goods or services from those of other traders (Beecham Group plc v Triomed (Pty) Ltd 2003 (3) SA 639 (SCA)).

It should be noted that a trade mark can also lose its capability of distinguishing. This can happen where the public accepts such a mark and starts to use it, no longer as a trade mark or trade name, but rather as the general name of the class of goods concerned. This has taken place, for example, in the case of the marks “Aspirin” and “Cellophane.”
Activity 2

Read the following scenario and answer the question.

A, a manufacturer of sweets and chocolates, wishes to market a new range of chocolates. His marketing department’s further suggestions for a name for the chocolates include “Top Marks” and “Silky Smooth.”

Are these two names inherently capable of distinguishing A’s chocolates?

4.2 Restrictions on registration

Section 10 of the Act sets out a number of grounds on which the registration of a trade mark may be refused. (These also provide the grounds on which a trade mark registration may be removed from the register.)

4.2.1 Absolute grounds for refusal

These grounds relate to the inherent unregistrability of marks, the applicant for registration and his conduct, marks applied for in bad faith, and deceptive marks.

- A mark which does not constitute a trade mark cannot be registered (see ss 10(1) and (2)).
- A mark which is not capable of distinguishing the goods or services of the proprietor from the goods or services of another person cannot be registered (s 10(2)(a)). A mark which serves, in trade, to designate the kind, quality, quantity, intended purpose, value, geographical origin or other characteristics of the goods or services, or the mode or time of production of the goods or the rendering of the services, cannot be registered (s 10(2)(b)). These marks are not registrable because they are not capable of distinguishing. They are words or signs which might reasonably be required by other traders for use in connection with their own goods or services. These words or signs are usually, although not necessarily, descriptive or laudatory, for example “perfection”, “marvellous” for any type of goods or services, or “dry white” for wine (First National Bank of SA Ltd v Barclays Bank plc 2003 (4) SA 337 (SCA)). For the same reason, marks which have become customary in the current language or in the bona fide and established practices of the trade cannot be registered (s 10(2)(c)). None of the aforementioned marks will be refused registration if the applicant for registration can show that, at the date of the application for registration, the mark has in fact become capable of distinguishing as a result of the use made of it (proviso to s 10).
- A mark cannot be registered if it consists exclusively of the shape, configuration, colour or pattern of goods where the shape, configuration, colour or pattern is necessary to obtain a specific technical result, or
results from the nature of the goods themselves (s 10(5); *Beecham Group plc v Triomed (Pty) Ltd 2003 (3) SA 639 (SCA)).

- A mark which consists of a container for goods or the shape, configuration, colour or pattern of goods cannot be registered where the registration of such a mark is likely to limit the development of any art or industry (s 10(11)).

- A mark cannot be registered where the applicant has no *bona fide* claim to proprietorship (s 10(3)).

- A mark cannot be registered where the applicant has no *bona fide* intention of using the mark as a trade mark himself or through a licensee (s 10(4)). This requirement of use is also satisfied where there is an intention to use the trade mark through a body corporate still to be formed (s 19(1)).

- A mark cannot be registered if the application was made *mala fide* (s 10(7)).

- A mark which consists of or contains the national flag of the Republic or any convention country (that is a country which is a member of the International Convention for the Protection of Industrial Property) cannot be registered (s 10(8)). Neither can a mark which consists of or contains the armorial bearings or other state emblems of the Republic or a convention country. The prohibition also extends to an official sign or hallmark adopted by the Republic or a convention country and to the flag, armorial bearings, emblems and the name or abbreviation of the name of an international organisation, unless the use of the mark is not likely to mislead the public as to the existence of a connection between the international organisation and the proprietor of the mark.

- A mark which contains any word, letter or device indicating State patronage, or a mark which has been prohibited by regulation, cannot be registered (s 10(9) and (10)). This last category refers to marks which usually belong to public bodies and which have been indicated as being prohibited marks by way of notice in the *Government Gazette*, such as the SABS mark and the emblem of the South African Nuclear Energy Corporation.

- A mark which is inherently deceptive or is contrary to law, *contra bonos mores*, or likely to give offence to any class of persons, cannot be registered (s 10(12)). Inherently deceptive marks include marks which are deceptive as to the origin of the goods (eg a mark depicting bagpipes and tartan used on goods would suggest that the goods are made in Scotland when in fact they are made in South Africa) and marks which are deceptive as to the character or quality of goods (eg the mark MERINO used on cotton goods).

- A mark which might otherwise be registrable cannot be registered if it is likely to cause deception or confusion as a result of the manner in which it has been used (s 10(13)).
Activity 3

Read the following scenario and answer the questions below.

B, a producer of beer, approaches you for legal advice. He informs you that he wishes to market a new beer. His marketing department has suggested the following two trade marks: "Cool 'n Light" and "German Gold". They have also designed a label which will contain the trade mark, a German style beer mug and a script border stating that the beer has been endorsed by the WHO (World Health Organisation). B informs you that he has not obtained permission from the World Health Organisation to use their name.

What advice would you give B concerning the registrability of his proposed marks "Cool 'n Light" and "German Gold" as well as the label? Your answer must be directly related to the scenario.

4.2.2 Relative grounds for refusal

These grounds relate to the conflict between marks and the existing rights of others.

- A mark cannot be registered if its use would be likely to deceive or cause confusion (s 10(12)). A mark may be likely to cause confusion or deception because of its resemblance to other marks in use in the marketplace (both registered and unregistered trade marks), trading styles, telegraphic addresses and the like.

- A mark cannot be registered if it is identical to a registered trade mark belonging to a different proprietor or so similar to it that its use in relation to goods or services in respect of which it is sought to be registered and which are the same as or similar to the goods and services in respect of which the earlier trade mark is registered, would be likely to deceive or cause confusion (s 10(14)). An objection under s 10(14) falls away if the proprietor of the earlier mark consents to the registration of the later mark. Section 14 makes special provision for the side-by-side registration of confusingly similar trade marks in instances where both marks have, in good faith, been used in the marketplace (termed "honest concurrent use") or where other special circumstances are found to exist.

- A mark cannot be registered if it is identical to a mark which is the subject of an earlier application by a different person, or so similar that its use in relation to the goods or services in respect of which it is sought to be registered, which are the same as or similar to the goods or services in respect of which the earlier application is made, would be likely to cause deception or confusion (s 10(15)). This gives a prior application the same effect as a prior registration. However, a mark which is the subject of a prior application cannot be registered if the registration would be contrary to the existing rights of the person making the later application.

- A mark which constitutes, or the essential part of which constitutes, a reproduction, imitation or translation of a foreign trade mark which is well known in South Africa cannot be registered in respect of goods or
services identical or similar to the goods or services in respect of which the trade mark is well known and where such use is likely to cause deception or confusion (s 10(6)).

- A mark may not be registered if it is identical or similar to a registered trade mark which is well known in the Republic and its use would be likely to take unfair advantage of, or be detrimental to, the distinctive character or repute of the registered trade mark, notwithstanding the absence of deception or confusion (s 10(17)). An objection under this s falls away if the proprietor of the well-known mark consents to the registration of the later mark. Note that this “antidilution” provision is not confined to identical or even similar goods or services.

**Activity 4**

Read the following scenario and answer the questions below.

D is the proprietor of the trade mark “Rocky”, which is registered in the USA in respect of beer. D has not registered his “Rocky” trade mark in South Africa. Although “Rocky” beer is not available in South Africa, it has become well known in South Africa through advertisements in most overseas magazines available in South Africa, and also as the sponsor of most major overseas sporting events which are broadcast on the Supersport TV channel. F, a local brewer of beer, has now applied for the registration in South Africa of the trade mark “Rocky” in respect of beer.

1. Advise D whether he can prevent F from registering the mark “Rocky” in relation to beer.
2. Would your advice differ if D had registered his “Rocky” trade mark in South Africa in respect of beer?

**5 EFFECT AND DURATION OF REGISTRATION**

**Effect of registration**

Basically, the effect of a trade mark registration is to grant the proprietor a statutory monopoly which entitles him to use his trade mark in relation to the goods or services in respect of which it is registered, and to prevent other persons from using or registering the trade mark or a confusingly similar mark in relation to the same or similar goods or services.

**Duration**

The duration of a trade mark is ten years, but this period may, on certain conditions, be renewed from time to time (see s 37).

**6 INFRINGEMENT OF A TRADE MARK**

**6.1 Acts constituting infringement**

Section 34(1) of the Trade Marks Act stipulates which acts are prohibited in respect of a registered trade mark and therefore constitute an infringement
of the trade mark proprietor's rights. The acts prohibited in respect of a registered trade mark are discussed briefly below.

The 1993 Act covers three types of infringement.

6.1.1 Unauthorised use in relation to registered goods or services

In the first instance, the rights acquired by the registration of a trade mark are infringed by the unauthorised use in the course of trade, in relation to goods or services in respect of which the mark is registered, of an identical mark or of a mark so nearly resembling it as to be likely to deceive or cause confusion (s 34(1)(a)).

This first type of infringement occurs where some person other than the registered proprietor uses a mark which is either identical or confusingly similar to the registered trade mark in relation to goods or services for which the trade mark is registered. The allegedly侵权ing mark must be used as a trade mark, for example, where the alleged infringer uses the trade mark to identify his own goods or services (Verimark (Pty) Ltd v BMW AG (2007)(6) SA 263 (SCA).

6.1.2 Unauthorised use in relation to similar goods or services

Secondly, the rights acquired by the registration of a trade mark are infringed by the unauthorised use of a mark which is identical or similar to the trade mark registered, in the course of trade in relation to goods or services which are so similar to the goods or services in respect of which the trade mark is registered, that in such use there exists the likelihood of deception or confusion (s 34(1)(b)).

This second type of infringement is not limited to the precise goods or services covered by the trade mark registration. Note that the term "similar" is subject to an important qualification: the test is whether the goods or services are so similar that in use there exists a likelihood of deception or confusion. In applying this test, the court will have to take all the surrounding circumstances into consideration.

6.1.3 Unauthorised use of well-known registered trade mark in relation to any goods or services

Thirdly, the rights acquired by the registration of a trade mark are infringed by the unauthorised use in the course of trade in relation to any goods or services of a mark which is identical or similar to a trade mark registered, if such trade mark is well known in the Republic and the use of the said mark would be likely to take unfair advantage of, or be detrimental to, the distinctive character or the repute of the registered trade mark, notwithstanding the absence of confusion or deception (s 34(1)(c)).

Note that this third type of infringement is only available in the case of registered trade marks which are well known in the Republic. It is not necessary for the offending mark to be used in relation to the same or
similar goods or services for which the trade mark is registered. In fact, use of unrelated goods or services is sufficient. Therefore, it is not necessary for the parties to be trade rivals. Public deception or confusion as to origin, sponsorship or association of the goods or services is not a requirement. However, the use of the offending mark must be likely to take unfair advantage of, or be detrimental to, the distinctive character or repute of the registered trade mark.

The most common form of injury which arises from this third type of infringement is called dilution by blurring. The unauthorised use of a well-known trade mark in relation to noncompeting goods or services leads gradually to consumers no longer associating the trade mark with the trade mark proprietor’s product. The more the trade mark is used in relation to other products, the less likely it is to focus attention on the proprietor’s product. Its unique identity and impact on consumers will become blurred. Although consumers will not be deceived or confused about the origin of the respective products in relation to which the mark is used, the offending use of the mark will erode its commercial magnetism and selling power and dilute its reputation and distinctive character. Where a well-known trade mark is used in relation to inferior products, the positive reputation and good name enjoyed by the trade mark may become tarnished. In a claim of dilution by tarnishment, any detriment relied on by the trade mark proprietor must be unfair and substantial in the sense that it must be likely to cause material commercial harm to the uniqueness and repute of the trade mark (Laugh It Off Promotions CC v South African Breweries International (Financ) BV t/a Sabmark International & another 2006 (1) SA 144(CC)).

6.2 Exclusions

The Act lists a number of situations in which the use of a registered trade mark does not amount to an infringement of the trade mark proprietor’s rights. Basically the following acts in relation to a registered trade mark will not amount to an infringement:

- the *bona fide* use by a person of his own or his predecessor’s name, or the name of his or his predecessor’s place of business (s 34(2)(a))
- the use by any person of any *bona fide* description or indication of the kind, quality, quantity, intended purpose, value, geographical origin or other characteristics of his goods or services, or the mode or time of production of the goods or rendering of the services (s 34(2)(b))
- the *bona fide* use of a trade mark in relation to goods or services where it is reasonable to indicate the intended purpose of such goods including spare parts and accessories, or the rendering of services (s 34(2)(c))

(The use in the abovementioned three cases must be consistent with fair practice.)

- the importation into or distribution, sale or offering for sale in the Republic of goods to which the trade mark has been applied by or with the consent of the proprietor (s 34(2)(d))
• the _bona fide_ use by any person of any utilitarian features embodied in a container, shape, configuration, colour or pattern which is registered as a trade mark (s 34(2)(e))

• the use of a registered trade mark where such use is within the scope of a limitation entered in the register against the registered trade mark (s 34(2)(f))

• the use of any identical or confusingly or deceptively similar trade mark which is registered (s 34(2)(g))

6.3 Remedies for infringement

The Act makes specific provision for the relief which will be available in the case of the infringement of a trade mark. The available remedies are the following:

• an interdict

• damages

• an order for the removal of the infringing mark from all material and, where the infringing mark is inseparable or incapable of being removed from the material, an order that all such material be delivered up to the proprietor

• in lieu of damages, a reasonable royalty which would have been payable by a licensee for the use of the trade mark concerned

7 PROTECTION OF WELL-KNOWN FOREIGN TRADE MARKS

well-known unregistered trade mark

Mention must also be made of the protection afforded by the Trade Marks Act to well-known foreign trade marks. Section 35 prohibits the unauthorised use of a trade mark which has become well known in the Republic. It is not necessary that the mark should have been registered or used in the Republic. The proprietor may restrain the use of any mark which constitutes a reproduction, imitation or translation of his well-known trade mark in relation to goods or services which are similar to the goods or services for which the trade mark is well known, provided such use is likely to cause deception or confusion.

well known

In determining whether a trade mark is well known in the Republic, due regard must be given to the knowledge of the trade mark in the relevant sector of the public, including knowledge which has been obtained as a result of the promotion of the trade mark (s 35(1A)).

A mark will be regarded as well known if it has acquired a reputation in the Republic among a substantial number of persons (for example, potential customers) interested in the goods or services to which it relates (see _McDonald's Corporation v Joburgers Drive-Inn Restaurant (Pty) Ltd_; _McDonald's Corporation v Dax Prop CC_; _McDonald's Corporation v Joburgers Drive-Inn Restaurant (Pty) Ltd and Dax Prop CC 1997 (1) SA 1 (A)).

Section 35 confers rights on the proprietor of an unregistered mark
irrespective of whether or not he carries on business or has any goodwill in South Africa.

The Act preserves local vested rights in trade marks acquired through continuous and bona fide use prior to 31 August 1991 or the date on which the foreign trade mark became well known in the Republic, whichever is the later date (s 36(2); AM Moolla Group Ltd v The Gap Inc 2005 (6) SA 568 (SCA)).

Activity 5

Read the following scenario and answer the questions below.

R is the proprietor of the trade mark “Supersilk” which is registered in respect of cosmetic products. Since 1995 R has marketed his Supersilk cosmetics intensively. According to a recent market survey, the Supersilk brand is one of the most popular brands of cosmetics in South Africa. S commences marketing a new range of cosmetics under the trade mark “Supasilk.”

1. Advise R whether he can prevent S from using the mark “Supasilk” in respect of cosmetics.
2. Would your advice differ if S had marketed toothpaste under the mark “Supasilk”?
3. Would R be able to prevent S from using the mark “Supasilk” in respect of chocolates?

Your answers must be directly related to the scenario.

Summary activity

Read the following scenario and answer the questions below. Your answers must be directly related to the scenario.

M, a German manufacturer, markets a range of clothing under the mark “Roamer.” M informs you his mark “Roamer” is registered in South Africa in respect of clothing. M discovers that P has commenced using the mark “Roma” on clothing and that P has filed an application to register the trade mark “Roma” in respect of clothing in terms of the Trade Marks Act 1993.

1. Will M be able to prevent P from registering the mark “Roma” as a trade mark in respect of clothing?
2. Would your answer in 1 differ if P’s mark consisted of the word “Roma” superimposed on the South African flag?
3. Will M be able to prevent P from using the mark “Roma” in respect of clothing?
4. Will M be able to prevent P from using the mark “Roma” in respect of clothing if the mark “Roamer” is not registered in South Africa but has become well known here as a result of extensive advertising in overseas fashion magazines which are circulated in South Africa?
Feedback 1

1. A trade mark is a mark used or proposed to be used by a person in relation to goods or services for the purpose of distinguishing the goods or services in relation to which the mark is used or proposed to be used, from the same kind of goods or services connected in the course of trade with any other person. It does not include a certification or collective mark.

2. No. The name is completely descriptive and is therefore incapable of distinguishing A's product from similar products. Neither the composite mark “Sweet 'n Smooth” nor the components “Sweet” and “Smooth” are capable of distinguishing A’s chocolates; they are descriptive regarding the nature of chocolates and may reasonably be required by other traders for use in connection with their own chocolates.

3. Yes. The name “Beaver” bears no relation to chocolates and will be capable of distinguishing A’s chocolates from similar products.

4. Yes. The definition of a mark includes a label and a container for goods.

Feedback 2

“Top Marks” is a word which bears no relation to chocolates and will be inherently capable of distinguishing “Silky Smooth”, on the other hand, is descriptive of the nature of chocolates and thus not inherently capable of distinguishing. Note that if this name was already in use, it might be registrable on the grounds that it was capable of distinguishing because of extensive use in the market.

Feedback 3

To qualify for registration as a trade mark, a mark must be capable of distinguishing the goods or services of B from the similar goods or services of other persons (s 9(1)). A mark is capable of distinguishing if, at the date of application for registration, it is inherently capable of distinguishing or it is capable of distinguishing by reason of its prior use. The mark “Cool 'n Light” describes the goods to which it will be applied and so is not capable of distinguishing B’s beer. In this regard s10(2)(b) specifically provides that a mark which serves, in trade, to designate the kind of goods or other characteristics of goods, cannot be registered. Therefore, unless the mark “Cool 'n Light” has become capable of distinguishing B’s beer through extensive use in the marketplace, it will not be registrable in respect of beer.

The mark “German Gold” designates geographical origin. If the beer is actually produced in South Africa, the mark will be inherently deceptive. Section 10(12) provides that a mark which is inherently deceptive cannot be registered. Therefore B’s mark “German Gold” will not be registrable in respect of beer.

Section 10(8) provides that a mark which contains the name or abbreviation of the name of an international organisation cannot be registered unless the use of the mark is not likely to mislead the public as to the existence of a connection between the
international organisation and the proprietor of the mark. In all probability, the name and abbreviation of the World Health Organisation on the mark will be misleading. Therefore B’s label which contains a prohibited abbreviation, namely WHO, will not be registrable as a trade mark in respect of beer.

Feedback 4

1. Section 10(6) prohibits the registration of a well-known foreign trade mark in respect of goods or services identical or similar to the goods or services in respect of which the trade mark is well known and where such use is likely to cause deception or confusion. From the facts it appears that although the trade mark “Rocky” has not been used in South Africa, it has become well known in respect of beer as a result of extensive advertising and promotion. Any use of the same trade mark by F is therefore likely to cause deception or confusion. Accordingly D can prevent F from registering the trade mark “Rocky” in respect of beer in South Africa.

2. Yes. D can rely on s 10(14). Section 10(14) provides that a mark cannot be registered if it is identical to a registered trade mark belonging to a different proprietor or so similar to it that its use in relation to goods or services in respect of which it is sought to be registered and which are the same or similar to the goods and services in respect of which the earlier trade mark is registered, would be likely to deceive or cause confusion. As D’s trade mark “Rocky” is registered in respect of beer, any use of the same trade mark on the same goods by F is therefore likely to cause deception or confusion. Accordingly D can prevent F from registering the trade mark “Rocky” in respect of beer.

Feedback 5

1. This question concerns the possible infringement of R’s “Supersilk” trade mark. Therefore, in advising R, s 34 of the Trade Marks Act should be considered. One of the acts that does constitute an infringement of a registered trade mark, and that may be prohibited, is the unauthorised use in the course of trade of an identical or confusingly similar mark in relation to goods or services for which the trade mark is registered (s 34(1)(a)). Whether a mark is or is not confusingly similar to a registered trade mark can be determined only after due consideration of the sense (meaning), sound and appearance of the two marks. An application of this test shows that “Supersilk” and “Supasilk” have a marked similarity. Also, the two marks are used in relation to the identical goods, namely cosmetics. Accordingly, infringement has taken place, and R will be able to apply for an interdict to prevent S from using the mark “Supasilk” in respect of cosmetics.

2. Section 34(1)(b) prohibits the unauthorised use in the course of trade of an identical or confusingly similar mark in relation to goods or services which are so similar to the goods or services in respect of which the trade mark is registered, that in such use there exists a likelihood of deception or confusion. Whether a mark is or is not
confusingly similar to a registered trade mark can be determined only after due consideration of the sense (meaning), sound and appearance of the two marks. An application of this test shows that "Supersilk" and "Supasilk" have a marked similarity. Also, the two marks are used in relation to similar goods, namely cosmetics and toothpaste. In fact, cosmetics and toothpaste are so similar that use of the respective marks in relation to them is likely to cause deception or confusion of the public: the public is likely to be deceived into believing that S's toothpaste emanates from R and is merely an extension of his cosmetic range. Accordingly, infringement has taken place, and R will be able to apply for an interdict to prevent S from using the mark "Supasilk" in respect of toothpaste. (Note that R cannot rely on s 34(1)(a) because the trade mark "Supersilk" is not registered in respect of toothpaste.)

(3) Cosmetics and chocolates are unrelated goods. If S uses the mark "Supasilk" in relation to chocolates, R will have to rely on s 34(1)(c). To do so he must show that his trade mark "Supersilk" is well known in the Republic. From the results of the market survey it appears that it is, in fact, well known in South Africa. Furthermore, R will have to show that S's use of the mark "Supasilk" in relation to chocolates would be likely to take unfair advantage of or be detrimental to the distinctive character or the repute of "Supersilk". In other words, R will have to show that S's conduct will erode the commercial magnetism and selling power of his "Supersilk" trade mark and dilute its reputation and distinctive character. If he can do so, he will be entitled to an interdict to prevent S from using "Supasilk" in relation to chocolates.

Feedback for summary activity

In answering these questions, it is important to distinguish between the "registrability" and the "infringement" of a trade mark. "Registrability" concerns the question whether a particular mark qualifies for registration in that it satisfies the requirements for registration as set out in ss 9 and 10 of the Trade Marks Act. "Infringement" concerns the question whether the use of a particular trade mark constitutes an infringement of an identical or similar registered trade mark. If so, the proprietor of the registered trade mark may obtain an interdict to prevent the infringer from using the infringing mark.

(1) A mark which is inherently deceptive or the use of which would be likely to cause deception or confusion cannot be registered (s 10(12)). Furthermore, s 10(14) provides that a mark cannot be registered if it is identical or so similar to an already registered trade mark that the use thereof in relation to goods or services for which registration is sought and which are the same as or similar to the registered goods or services would be likely to cause deception or confusion. "Roamer" and "Roma" have a marked similarity. "Roamer" is registered in respect of clothing. Registration of "Roma" is sought in respect of the identical goods, namely clothing. The use of these two marks in relation to the same goods would be likely to cause deception or confusion. M can therefore prevent P from registering "Roma" in respect of clothing.

(2) Section 10(8) prohibits the registration of a mark which consists of or contains the national flag of the Republic without authorisation. This will provide M with additional grounds on which to oppose the registration of P's mark.
(3) One of the acts that does constitute an infringement of a registered trade mark and that may be prohibited, is the unauthorised use in the course of trade of an identical or confusingly similar mark in relation to goods or services for which the trade mark is registered (s 34(1)(a)). Whether a mark is confusingly similar to a registered trade mark or not, can be determined only after due consideration of the sense (meaning), sound and appearance of the two marks. An application of this test shows “Roamer” and “Roma” to have a marked similarity. Also, the two marks are used in relation to the identical goods, namely clothing. Accordingly, infringement has taken place, and M will be able to prevent P from using the mark “Roma” in respect of clothing.

(4) Section 35 prohibits the unauthorised use of a trade mark which has become well known in the Republic. It is not necessary that the mark should have been registered or used in the Republic. The proprietor may restrain the use of any mark which constitutes a reproduction, imitation or translation of his well-known trade mark in relation to goods or services which are similar to the goods or services for which the trade mark is well known, provided such use is likely to cause deception or confusion. M’s mark “Roamer” has become well known here as a result of extensive advertising in overseas fashion magazines which are circulated in South Africa. The two marks “Roamer” and “Roma” do have a marked similarity and are used in relation to the identical goods, namely clothing. The use by P of the mark “Roma” is therefore likely to cause confusion or deception of the public. Accordingly, M will be able to prevent P from using the mark “Roma” in respect of clothing.
1 INTRODUCTION

As you already know, private law governs the legal relationships between legal subjects through a process which defines and balances the subjective rights of legal subjects. Private law also governs the relationship of rivalry between traders. As all rivals are subject to the rules of private law, those traders who conduct their business in contravention of the rules of private law can obtain wrongful advantages over their rivals. A few examples will serve to illustrate this point:

- A and B are cool drink manufacturers. A spreads untrue allegations that B’s product contains poisonous substances.
- A and B are cigarette manufacturers. In an advertising campaign, A publicises the claim that his product is manufactured from imported tobaccos and is marketed on a large scale abroad. In fact, his cigarettes contain an inferior local tobacco and are only marketed locally.
- B owns a countrywide chain of self-service stores with a very high
turnover and a trade name which has become well known. A starts a self-service undertaking with a trade name spelt somewhat differently but pronounced in virtually the same way.

- Taxi owner A employs hoodlums to intimidate taxi owner B’s prospective passengers.
- Cafe owner A persuades cool drink manufacturers to boycott his competitor B by no longer delivering stocks to him.

Private law, as it relates to and is applied to the problems of rivalry in trade, has acquired a distinctive character, and this aspect of private law can be termed the private law of competition or law of unlawful competition. The private law of competition consequently deals with the legal rules which regulate the relationships between business rivals or competitors; in other words, with the unlawfulness of one competitor’s conduct as against another.

We must draw your attention to the fact that in 1947 South Africa became a member of the Convention of Paris for the Protection of Industrial Property, which was signed in Paris in 1883 and has since been revised periodically. Article 10bis of the Paris Convention obliges member countries to provide effective protection against unfair competition.

South Africa has no single comprehensive statute covering unfair competition as such. From this it does not follow that foreign competitors will not have a remedy against unlawful competition. In South Africa protection against unlawful competition is provided at common law. Today South African law recognises a general action for unlawful competition. There are also a number of isolated statutory provisions which overlap or supplement the protection provided by the common law. The most important of these are the

- Merchandise Marks Act 17 of 1941
- Business Names Act 27 of 1960
- Companies Act 61 of 1973
- Trade Practices Act 76 of 1976
- Close Corporations Act 67 of 1984
- Harmful Business Practices Act 71 of 1988
- Trade Marks Act 194 of 1993
- Counterfeit Goods Act 37 of 1997

A discussion of these statutory provisions is beyond the scope of this course.

As you can deduce from the few examples mentioned above, unlawful conduct in the competitive struggle may take many forms. In commerce, new competitive techniques are constantly developed and it is often difficult to state categorically whether or not they are wrongful. For this reason it is important that you should be able to approach the problems that arise in this sphere on the basis of general principles.

Roman-Dutch authorities do not offer much direct assistance, by which is meant that they do not deal with specific instances of unlawful competitive conduct, nor, indeed, is it to be expected of them (*Gous v De Kock,*
Combrink v De Kock (1887) SC 405, 410). However, this does not mean that our common-law principles do not adequately provide for a suitable remedy for every unlawful act of competition.

As you know, the South African law of delict is based on the *actio legis Aquilae* and the *actio iniuriarum*. The *actio iniuriarum* is aimed at obtaining satisfaction on the ground of the intentional infringement of a right of personality. A trader who has been the victim of unfair competition is scarcely interested in satisfaction for intentional injury to her personality, but rather in compensation for the patrimonial loss which she has suffered (Van Heerden & Neethling: *Unlawful competition*. Butterworths 1995:54–56). Since we are dealing with the delict of wrongfully causing patrimonial loss (*damnum iniuria datum*), it is the *actio legis Aquilae* which applies if one competitor causes another loss (*Geary & Son*(Pty) Ltd v Gove 1964 (1) SA 434 (A) 440).

An important implication of this is that the broad and ample basis of the *lex Aquilia* is available to provide a remedy to the wronged trader, even in the absence of direct precedent (*Dun and Bradstreet*(Pty) Ltd v *SA Merchants Combined Credit Bureau* (Cape) (Pty) Ltd 1968 (1) SA 209 (C) 218; Stellenbosch Wine Trust Ltd v Oude Meester Group Ltd, Oude Meester Group Ltd v Stellenbosch Wine Trust Ltd 1972 (3) SA 152 (C) 161; *Schultz v Butt* 1986 (3) SA 667 (A)). Thus, a trader who is the victim of unlawful competition does not have to attempt to force his action into the framework of some or other recognised delict.

2 LIABILITY FOR UNLAWFUL COMPETITION

**Aquilian action**

As you know from your study of the law of delict, for a competitor to incur liability for unlawful competition in terms of the Aquilian action, the following elements of liability should be established:

1 *An act or conduct*: A competitor’s conduct may consist not only of an act in the strict sense but also behaviour consisting of an omission (a failure to act).

2 *Wrongfulness*: The competitor’s act or conduct must be wrongful (unlawful). The question as to the wrongfulness of competitive conduct is of cardinal importance in the field of unlawful competition. It raises vexed questions and will be discussed in greater detail in the next s.

3 *Fault*: A plaintiff who suffered damages as a result of unlawful conduct should, in principle, succeed if he can prove either intent or negligence on the part of the defendant (*Matthews v Young* 1922 AD 492, 504–507). Provided that the requirements for an interdict have been met, the wronged competitor should be entitled to an order restraining the unlawful conduct irrespective of intent or negligence on the part of his rival (*Kenitex Africa*(Pty) Ltd v *Coverte* (Pty) Ltd 1967 (3) SA 307 (W) 309; *Elida Gibbs*(Pty) Ltd v *Colgate Palmolive* (Pty) Ltd 1988 (2) SA 350 (W); *Long John International*(Pty) Ltd v *Stellenbosch Wine Trust* (Pty) Ltd 1990 (4) SA 136 (D); *William Grant & Sons Ltd* v *Cape Wine & Distillers Ltd* 1990 (3) SA 897 (C)).

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4  **Causation:** The competitor’s conduct must be the cause of the damage suffered by the plaintiff (*Dun and Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) (Pty) Ltd* 1968 (1) SA 209 (C); *Geary & Son (Pty) Ltd v Gove* 1964 (1) SA 434 (A)).

5  **Damage:** A plaintiff who wishes to recover damages must show that he has actually suffered patrimonial loss, and its extent. Damage is usually suffered through loss of trade or custom.

### 3 UNLAWFULNESS

#### infringement of right to attract custom

Before one competitor incurs Aquilian liability in respect of another competitor all the elements of delict must, of course, be present. The element which causes most difficulty in this area, and which must therefore be discussed, is wrongfulness. (It has become customary to refer to “unlawful” competition in this context.)

The prevailing view is that unlawful competition is characterised by an infringement of the competitor’s right to attract custom or goodwill (*Van Heerden & Neethling: Unlawful competition. Butterworths 1995: 94 and further; Geary & Son (Pty) Ltd v Gove* 1964 (1) SA 434 (A) 440; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Gwiano (Pty) Ltd* 1981 (2) SA 173 (T) 182).

We cannot elaborate here on the precise nature of goodwill. It is sufficient for our purposes to point out that it is an immaterial but often very valuable part of the trader’s patrimony (not of his personality) which can be sold and transferred (*Ashby v Fernandes* 1959 (3) SA 770 (W); *Botha v Carapax Shadeports (Pty) Ltd* 1992 (1) SA 202 (A)). It has been described as the totality of attributes that entice clients to support a particular business (*A Becker & CO (Pty) Ltd v Becker* 1981 (3) SA 406 (A)). Goodwill has been regarded as moveable incorporeal property (*Cotas v Williams* 1947 (2) SA 1154 (T); *Tof’s Estate v Minister of Finance* 1948 (2) SA 283 (N) 291–293). Writers are inclined to regard goodwill as intellectual property and not as a thing (*Van Heerden & Neethling supra 95 and further; A Becker & Co (Pty) Ltd v Becker* 1981 (3) SA 406 (A)). In any event, the fact remains that in unlawful competition the wrongfulness lies in the infringement of a competitor’s right to attract custom or goodwill.

### 4 THE CRITERIA FOR UNLAWFULNESS

#### fairness and honesty

The question which now arises is the following: When is one dealer’s interference with another’s goodwill lawful, and when is it wrongful? In dealing with this question our courts have declined to formulate a general definition of the limits set to competition by Aquilian liability. Their approach has been to decide in each instance whether the particular conduct under consideration could be recognised as an infringement of the plaintiff’s right (ie the rival trader’s right), and therefore as a delict in our law. In this process emphasis was initially placed on the criteria of “fairness and honesty in competition” (see *Gous v De Kock, Combrinck v De Kock*
(1887) 5 SC 405, 409; Geary & Son (Pty) Ltd v Gove 1964 (1) SA 434 (A) 441; Dun and Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) (Pty) Ltd 1968 (1) SA 209 (C) 218–219; Stellenbosch Wine Trust Ltd v Oude Meester Group Ltd 1972 (3) SA 152 (C) 161. In the Dun and Bradstreet case Corbett J said that these criteria (fairness and honesty)

... are themselves somewhat vague and elastic terms but, while they may not provide a scientific or indeed infallible guide in all cases to the limits of lawful competition, they are relevant criteria which have been used in the past and which may be used in the future in the development of the law relating to competition in trade (218–219).

**boni mores**

In Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd 1981 (2) SA 173 (T) 188–189, however, Van Dijkhorst J came to the conclusion that unfairness and dishonesty per se could not be the criteria for unlawfulness, but that the norm to be applied is the objective one of public policy, that is, the general sense of justice of the community — the **boni mores** — manifested in public opinion. In determining and applying this norm in a particular case, the interests of the competing parties have to be weighed, bearing in mind also the interests of society. The morals of the market place — the business ethics of that s of the community where the norm is to be applied — are of major importance in its determination.

This view was reaffirmed in Lorimar Productions v Sterling Clothing Manufacturers 1981 (3) SA 1129 (T); Schultz v But 1986 (3) SA 667 (A); Times Media Ltd v South African Broadcasting Corporation 1990 (4) SA 604 (W); Union Wine Ltd v E Snell and Co Ltd 1990 (2) SA 189 (C); William Grant & Sons Ltd v Cape Wine & Distillers 1990 (3) SA 897 (C); Taylor & Home (Pty) Ltd v Dental (Pty) Ltd 1991 (1) SA 412 (A); Jennifer Williams & Associates v Life Line Southern Transvaal 1996 (3) SA 408 (A).

The **boni mores** test is thus an objective test based on reasonableness. The conflicting interests of the plaintiff and the defendant must be considered by the court in the light of all the relevant circumstances and pertinent factors, including the public interest, in order to decide whether the infringement of the plaintiff's interests was reasonable or unreasonable.

**competition principle**

Besides the above principles which were formulated by the courts, the “competition principle” has been proposed as an alternative standard by Van Heerden & Neethling (128) for judging the wrongfulness of behaviour between rivals. In terms of this standard, the rival who renders the most meritorious performance justifiably succeeds in trade at the expense of a rival who renders a weaker performance.

If, for example, trader A doubles his turnover because he reduces the price of his product or improves its quality, rival B cannot complain about the prejudice which he suffers as a result of A’s merit competition. A’s advantage does, in fact, find its equivalent in the actual or potential prejudice of his competitor, but it is the merit of his performance which is the decisive factor. Merit competition is competition in accordance with the competition principle. In principle, merit competition is always lawful. We say “in
principle’’ since a single qualification must be made. In terms of the objective
criterion of reasonableness, even merit competition can be wrongful if too
great an imbalance exists between the benefit the act entails for the doer, and
the prejudice it causes the party affected (Van Heerden & Neethling 139).

As an example of this one may cite the American case of Tuttle v Buck 107
Minn 145 (1909). In this case a banker opened a barber shop with the sole
object of ruining a certain other barber. He cut his prices to below the profit
margin and made no secret of his intention of closing down as soon as the
other barber had been ruined. Any possible benefit (there was none) which
he could acquire was out of all proportion to the prejudice which the other
barber suffered. Although his acts were based on merit competition, they
were wrongful in terms of the additional criterion of reasonableness.

In a number of cases, acts which constitute wrongful competition assume
stereotyped forms. The best known of these are discussed in the following
unit. The possibility cannot be ruled out, however, of new forms of
wrongful competition developing. It should be noted that particular
instances of unlawful competition may sometimes involve various forms of
unlawful competition occurring at the same time. One particular unlawful
competitive act can therefore be simultaneously classified as various
different forms of unlawful competition.

Activity 1

Read the following scenario and answer the question below.

M is a brewer of beer. M manufactures a new beer that tastes so much better than any other
beer that everyone buys it. As a result, R, M’s competitor, suffers financial harm because of
enormous lost sales. Can R institute an action against M for unlawful competition? Give
reasons for your answer. Your answer must be directly related to the scenario.

5 Remedies

In practice, the action of the victim of unfair competition is almost
invariably directed at obtaining an interdict — and further, as is often the
case, at obtaining compensation. A competitor ought to be able to obtain an
interdict solely on the grounds of threatening or continuous infringement of
his right to goodwill; there is no reason why there should be further
requirements, such as fault, in addition to the unlawfulness of the
(threatening) act. Damages in accordance with ordinary principles should be
recoverable only if there is fault on the part of the wrongdoer, that is, where
the competitor’s right to his goodwill has been infringed either intentionally
or negligently.

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Unit 5: The private law of competition

Read the following scenario and answer the questions below.

T is a wealthy industrialist. W runs the local chicken takeaway a block away from T’s factory. T dislikes W and out of sheer malice decides to open a chicken takeaway in competition with W. T however does not really need the income from the chicken outlet, and sells his chicken at a loss merely to drive W out of the market.

(1) What type of action is at the disposal of a competitor whose right to attract custom has been infringed?

(2) Advise W what criteria must be considered in order to ascertain whether or not T’s actions constitute unlawful competition. Your answer must be directly related to the scenario.

Feedback 1

M and R are competitors as they both manufacture beer. But competition itself is not unlawful. It will only be unlawful if it infringes R’s right to goodwill. If M makes a better beer than his competitors, his conduct is, according to the objective criterion of the boni mores, reasonable and therefore lawful. If M increases his turnover because of his improved beer, R cannot complain about the financial loss which he suffers as a result thereof. As R will not be able to prove the element of wrongfulness and therefore an infringement of his right to goodwill, he will not be able to institute an Aquilian action for unlawful competition against M.

Feedback for summary activity

(1) The wronged rival’s action is Aquilian and based on delict.

(2) This question relates to the element of wrongfulness as a requirement for liability under the private law of competition. The wrongfulness here lies in T’s infringement of W’s right to attract custom or goodwill. In deciding whether T’s actions are wrongful you should first consider the criteria for wrongfulness, together with the relevant case law relating to this issue. The requirement of the boni mores must be considered. You should also consider the competition principle proposed by Van Heerden and Neethling as an alternative standard for wrongfulness. T’s conduct is directed at destroying W’s business through the marketing of chicken at a loss. Conduct where the sole purpose is the infliction of harm for its own sake, is unreasonable. In terms of the objective criterion of the boni mores, it is clear that T’s conduct is wrongful.
UNIT 6
RECOGNISED FORMS OF UNLAWFUL COMPETITION

After studying this unit you should be able to

- distinguish between the various recognised forms of unlawful competition
- apply knowledge of the general principles relating to the various forms of unlawful competition in relation to given scenarios.

A list of cases that have to be studied for this unit will be supplied in Tutorial Letter 101.

1 INTRODUCTION

In this unit we will discuss the best-known forms of conduct which may constitute an infringement of the right to attract custom or goodwill. We will explain the nature of each form of unlawful competition and requirements for liability.

2 DECEPTION CONCERNING ONE’S OWN PERFORMANCE

Examples of this form of unlawful competition are the following:

A advertises that he is selling copper trays, whereas in fact he has copper-coloured trays of an inferior alloy for sale; or A advertises that he sells clothes at factory prices, whereas in reality he charges the normal retail price; or A, with the intention of attracting customers to his shop,
announces that he has rare Persian carpets for sale, whereas in reality he has no such carpets in stock. The wrongfulness of A’s conduct does not lie in the fact that he misleads the public but lies in the fact that by deception, he prevents clients from drawing a clear distinction between his performance and that of his competitors (Van Heerden & Neethling supra 149 and further; John Waddington Ltd v Arthur E Harris (Pty) Ltd 1968 (3) SA 405 (T) 417).

Our courts view interference with the goodwill of a competitor by means of deception of the public as to the quality, extent, nature, etc of one’s own enterprise or performance as unlawful. A practical example from our case law of this type of deception is found in Geary & Son (Pty) Ltd v Gove 1964 (1) SA 434 (A). Here B carried on business in competition with A. A manufactured springs for motor vehicles and B did not. A alleged that B had habitually led the public of the city in which they both worked to believe that he (B) manufactured springs; that B had sold, as being of his own manufacture, springs which in fact were manufactured by A. A had allegedly suffered damages as a result of B’s conduct. Action was instituted for damages and for an interdict. A relied on “wilful falsehood”, that is, intentional unlawful action on the part of B. The Appellate Division per Steyn CJ stated, inter alia, that A’s action was Aquilian, and the right upon which he might be presumed to rely was his right to attract custom, and further that “... it seems clear that interference of the nature indicated is recognised as an infringement of a trader’s rights and therefore as a delict in our law” (at 441).

Although fault is a requirement when damages are sought, fault (intent or negligence) is not a requirement for an interdict, and even innocent deception as to one’s own performance is unlawful (Elida Gibbs (Pty) Ltd v Colgate Palmolive (Pty) Ltd 1988 (2) SA 350 (W); William Grant & Sons Ltd v Cape Wine & Distillers Ltd 1990 (3) SA 897 (C); Long John International Ltd v Stellenbosch Wine Trust (Pty) Ltd 1990 (4) SA 136 (D)).

The puffing by a trader of his own product must be distinguished from deceptions. We are all aware of the fact that puffing occurs daily. It was decided in Post Newspapers (Pty) Ltd v World Printing and Publishing Co Ltd 1970 (1) SA 454 (W) that mere puffing does not constitute unlawful competition. In Spinner Communications v Argus Newspapers Ltd 1996 (4) SA 637 (W) it was however stated that the exaggeration of circulation figures of a newspaper publication was not mere puffery. Circulation figures may be the basis on which revenue of publications is determined, and exaggerated figures (a misrepresentation) could wrongly divert advertising revenue to the person making the misrepresentation. The distinction between unlawful deception and lawful puffing can raise difficult questions, but no further consideration of this aspect is necessary for our purposes.
Read the following scenario and answer the question below.

A and B are competing cosmetic manufacturers. A launches a new perfume called PROVENCE. The words “Provence. Manufactured in Paris, France” appear on the label of the perfume bottle. It transpires that A’s perfume is not made in France but is produced at his Durban factory. B loses sales of his competing perfume, as it appears that women prefer imported perfume. Can B take legal action against A? Give reasons for your answer.

3 PASSING OFF

**Definition**

Passing off is one of the most common forms of unlawful competition. It takes place where a trader represents to the public that his enterprise, goods or services are those of his competitor. He does so by using or imitating his competitor’s distinctive marks. In *Capital Estate and General Agencies (Pty) Ltd v Holiday Inns Inc* 1972 (2) SA 916 (A) it is said that:

The wrong known as passing off consists in a representation by one person that his business (or merchandise, as the case may be) is that of another, or that it is associated with that of another, and, in order to determine whether a representation amounts to a passing-off, one enquires whether there is a reasonable likelihood that members of the public may be confused into believing that the business of the one is, or is connected with that of another.

**Distinctive marks**

A trader can use distinctive marks to distinguish his business, goods or services from those of other traders. In the case of a business we are dealing with a trade name, in the case of goods with a trade mark or get-up (a particular method of packaging), and in the case of a service with a service mark. In all these cases the use or imitation of the distinctive mark by a competitor may constitute unlawful competition. (As you have already seen, trade marks in respect of goods or services can be registered under the Trade Marks Act. The particular trader then acquires a statutory remedy for infringement, in addition to the common-law remedy for unlawful competition which is available irrespective of whether or not the trade mark has been registered. You will also see that trade names acquire additional statutory protection in terms of the Business Names Act, without their being registered.)

The general principle was stated as follows in *Pasquali Cigarette Co v Diaconicolas andCapsopolus* 1905 TS 472, at 474–47:

Now the principle of law which has to be applied to cases of this nature is an extremely simple one, and the principle is this, that no man is allowed to pass off his goods as the goods of another person; no
manufacturer of goods is allowed to represent to the public that the goods which he is selling are the goods of a rival manufacturer. That is the simple principle. It is in the application of that principle that the difficulties occur. There are many ways, of course, in which a dishonest trader may represent to the public that his goods are the goods of a rival manufacturer. He may do so by adopting his name or by imitating his trade mark, or by getting up his goods so as to resemble the goods of the rival manufacturer, and thus to induce the public to purchase his goods as the goods of the other.

**requirements**

In a passing-off action a plaintiff must prove the following two things:

1. that the trade mark, get-up, service mark or trade name which he claims has been imitated is known in the market and has acquired with the public a reputation associated with his goods, service or business
2. that the defendant’s conduct is calculated to deceive the public

A few remarks on these two requirements.

**reputation**

### 3.1 Reputation

This requirement, which in essence means that the plaintiff’s mark, get-up or name must have become distinctive in relation to the goods, service or business concerned, has been repeated in numerous cases (eg *Brian Boswell Circus v Boswell-Wilkie Circus* 1985 (4) SA 466 (A); *Jennifer Williams & Associates v Life Line Southern Transvaal* supra; *Caterham Car Sales & Coachworks Ltd v Birkin Cars (Pty) Ltd* 1998 (3) SA 938 (A); *Premier Trading Co (Pty) Ltd v Sportopia (Pty) Ltd* 2000 (3) SA 259 (SCA); *Blue Lion Manufacturing (Pty) Ltd v National Brands Ltd* 2001 (3) SA 884 (SCA)).

Where a trader has established a business reputation in a particular area, he is entitled to prevent another trader from carrying on business under his name in that area. In the case of a retail business, the area in which its goodwill is affected is the same area from which it draws its customers (see *Deans Man Shop (Pty) Ltd v Momberg* 1975 (1) SA 841 (W) 842; *Scott and Leisure Research and Design (Pty) Ltd v Watermaid (Pty) Ltd* 1985 (1) SA 211 (C)).

Where a trade mark, trade name business or product of a foreign trader has acquired a reputation within South Africa, he will be entitled to protection against passing off, despite the fact that he has never traded or carried on business there (*Caterham Car Sales & Coachworks Ltd v Birkin Cars (Pty) Ltd* 1998 (3) SA 938 (A)). Note that s 35 of the Trade Marks Act 194 of 1993 also enables the proprietor of an unregistered trade mark which is well-known in the Republic to restrain the use of it where such use is likely to cause deception or confusion. The proprietor of such a well-known trade mark will therefore be protected against passing off in South Africa despite the fact that he does not carry on business or have any goodwill here.
We will now draw your attention briefly to a few practical issues related to the question of reputation.

In the first place, the courts are reluctant to come to the assistance of a trader whose trade mark or get-up is of a form or colour “common to the trade”, that is, generally used in the trade (Hirsch Loubser & Co v Coovadia 1913 WLD 202; Lasar v Sabon Precision Machine Co (Pty) Ltd 1954 (2) PH A37 (W)).

In the second place, the courts will only protect a trader who uses a word in its ordinary sense or meaning in connection with his business if there are exceptional circumstances which indicate the word has acquired a secondary meaning among his customers, that is, where the word has become distinctive in respect of that undertaking (Seeco (Pvt) Ltd v Zambezia Furnishers (Pvt) Ltd 1972 (4) SA 95 (R); Sea Harvest Corporation (Pty) Ltd v Irvin & Johnson Ltd 1985 (2) SA 351 (C)).

In the third place, protection is more readily afforded the trader who uses a “fancy” or “invented” name or mark for his goods, service or business than the trader who makes use of a descriptive name (a name which is descriptive of his goods, business or service). Descriptive names must again be shown to have acquired secondary meaning through their association with the goods, service or business before they will be protected (Truck and Car Co Ltd v Kar-N-Truck Auctions 1954 (4) SA 552 (A); Kellogg Co v Bokomo Co-operative 1997 (2) SA 725 (C)).

In the fourth place, it can of course happen that a person wishes to use his surname in respect of his goods, services or business, but that the name is already being so used by a rival. The newcomer must restrict himself to the use of his name and must avoid any actions which may otherwise cause confusion (Policansky Bros Ltd v L and H Policansky 1935 AD 89; Brian Boswell Circus v Boswell Wilkie Circus 1985 (4) SA 466 (A)).

3.2 Deception

Whether the defendant’s trade mark, get-up, service mark or trade name is so similar to that of the plaintiff that it is likely to confuse or deceive the ordinary customer, must be decided in the light of all the available evidence. An “ordinary customer” or purchaser is neither very careful nor very careless and ignorant, but rather someone between the two extremes. As far as goods are concerned, he is a person who is more or less aware of the particular characteristics of the article he wants; he has a general idea of the appearance of the article; and although he does not examine it closely, he has some idea of its general appearance (Pasquali Cigarette Co Ltd v Diaconicolas and Capsopulos 1905 TS 472, 474). However, as far as the danger of confusion is concerned, the class of persons who are likely purchasers must also be taken into account. Where the article is likely to circulate among illiterate persons, the average purchaser may be a person of a very low standard of education (Glenton and Mitchell v Keshavjee & Sons 1918 TPD 263, 265; International Power Marketing v Searles Industrials 1983 (4) SA 163 (W); Moroka
Swallows Football Club Ltd v The Birds Football Club 1987 (2) SA 511 (W); Royal-Beech-nut (Pty) Ltd v United Tobacco Co Ltd 1992 (4) SA 118 (A).

It is unnecessary for a trader seeking relief to prove that anyone has actually been misled or that confusion has actually risen (Solmike (Pty) Ltd v Slipper's Cabin v West Street Trading Co (Pty) Ltd v Slipper Bar 1981 (4) SA 705 (D)). Proof of these facts may strengthen his case, but if there is a clear possibility that deception or confusion may arise, he is entitled to insist that his trade mark, get-up, service mark or trade name may not be used (Pockets (Holdings) Ltd v Oak Holdings Ltd supra 661; Royal-Beech-nut (Pty) Ltd v United Tobacco Co Ltd 1992 (4) SA 118 (A)). As is to be expected, fault on the part of the respondent is not necessary for an interdict restraining passing off (Ketinetx Africa (Pty) Ltd v Coverite (Pty) Ltd 1967 (3) SA 307 (W); Adidas Sportschafabriken Adis Dasier KG v Harry Walt 1976 (1) SA 530 (T)).

unclean hands

In conclusion it must be stated that where the plaintiff himself has made a material false representation (e.g. by claiming in his trade mark that his Worcester sauce is manufactured in some other part of the world when there is evidence that purchasers prefer imported Worcester sauce) the court will, in terms of the equity doctrine of unclean hands, afford him no protection (Zyp Products Co Ltd v Ziman Bros Ltd 1926 TPD 224, 232–234). The doctrine is however applied only if there was fraud, dishonesty, or mala fides on the part of the plaintiff (Rusmarch (SA) (Pty) Ltd v Hemdon Enterprises (Pty) Ltd 1975 (4) SA 626 (W); Scott and Leisure Research and Design (Pty) Ltd v Watermaid (Pty) Ltd 1985 (1) SA 211 (C)).

Activity 2

Read the following scenario and answer the questions below. Give reasons for your answers:

A is a producer of cosmetic products which he markets under the name ROMA. A's cosmetic products are marketed in a distinctive blue and white striped packaging. The ROMA range of cosmetics has been on the market for five years and has proved to be very popular. B, a competitor, commences marketing a range of cosmetics under the name ROAMER. B's cosmetics are sold in a blue and silver striped packaging.

(1) Does B's conduct amount to passing off?
(2) What must A prove to succeed with an action against B for passing off?

4 COMPEITION IN CONTRAVENTION OF A STATUTORY PROVISION

infringement of right to goodwill

In a competitive relationship, competitor A may not do something that another competitor B is not allowed to do — this disturbs the equality principle which is the foundation of the law of competition and which
maintains the harmonious balance in the relationship between rivals. If A, for example, sells his goods in conflict with a statutory provision, competitor B would not be able to counter A’s competition. The balance in the competitive relationship between the parties is disturbed by an act against which B cannot defend himself except by breaking the law — something which obviously he is not permitted to do. It must however be remembered that competition in contravention of a statutory provision results in unlawful competition only if the transgression has infringed or will infringe the plaintiffs right to goodwill. In other words, A’s conduct is not wrongful against B merely because he contravenes the statutory provision. A’s conduct is wrongful against B only if it interferes with his right to goodwill.

requirements

One of the earliest decisions in which competition in conflict with a statutory provision was recognised as a form of unlawful competition was *Patz v Green & Co* 1907 TS 427. In this case the applicant (appellant) traded in the vicinity of a mining compound. The respondents carried on a similar business on claim land at the entrance of the compound. The applicant based his application for an interdict on the fact that trading on claim land was prohibited by statute. The court first pointed out that, where an act is prohibited in the interests of a particular person or class of persons, for the purposes of an interdict the court will presume that this person or class of persons is damned (has suffered loss or damage) and grant relief without requiring evidence of damage. Secondly, where the statutory prohibition is in the public interest, any member of the public, including a rival trader, who can prove that he has sustained damage, or that he is reasonably likely to sustain damage, is entitled to his remedy. Whether a prohibition is intended to protect a specific person or class of persons, or is in the public interest is, of course, dependent upon the interpretation of the provision concerned (see also *Bophuthatswana Transport Holdings (Edms) Bpk v Matthysen Busvervoer (Edms) Bpk* 1996 (2) SA 166 (A)).

An example of a prohibition in the interests of a particular person or class of persons (such as manufacturers) is where a trader applies a false trade description to his goods — an act which is defined and made an offence in the Merchandise Marks Act 17 of 1941 (*Sheffield Electro-Plating and Enameilling Works Ltd v Metal Signs and Nameplates (Pty) Ltd* 1949 (1) SA 1034 (W); *Monis Wineries Ltd v Mouton* 1966 (2) SA 89 (SWA); *John International Ltd v Stellenbosch Wine Trust (Pty) Ltd* 1990 (4) SA 136 (D); *Reckitt & Colman SA (Pty) Ltd v SC Johnson & Sons SA (Pty) Ltd* 1993 (2) SA 307 (A)).

An example of a prohibition in the public interest is where a dealer applies for an interdict against a rival who is conducting business without having obtained a licence as required by some statute or local bylaw (*Patz v Green & Co* 1907 TS 427; *Du Toit v Wok See* 1951 (3) SA 756 (T); *Macropulos v Mullinos* 1966 (1) SA 477 (W); *Modern Appliances Ltd v African Auctions and Estates (Pty) Ltd* 1961 (3) SA 240 (W); *Silver Crystal Trading v Namibia Diamond Corporation (Pty) Ltd* 1983 (4) SA 884 (A); *Begemann v Cirota* 1923 TPD 270; *Trustees, BKA Besigheidstrust v Enco Produkte en
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_Đienst_ 1990 (2) SA 102 (T); _Bophuthatswana Transport Holdings v Matthysen Busvervoer_ 1996 (2) SA 166 (A).

Under either of these two types of prohibition, the wronged trader who has sustained actual loss has an action for damages, provided, of course that there was fault on the part of the defendant (_Patz v Greene & Co_, supra, 432–435; _Begemann v Cirota_ supra; _Van Heerden & Neethling_ supra 266).

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**Activity 3**

Read the following scenario and answer the questions below.

Section 9 of the Trade Practices Act 76 of 1976 prohibits any advertisement which is false or misleading in material respects. A is a manufacturer of cosmetic products which he markets under the name ROMA. In an advertisement A claims that his ROMA cosmetics are manufactured in the USA and that they contain antioxidants which prevent skin cancer. An investigation reveals that all these claims are false and/or misleading.


2. What must B prove to obtain an interdict against A?

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5 MISAPPROPRIATION OF A COMPETITOR’S TRADE SECRETS OR CONFIDENTIAL INFORMATION

**trade secret**

Where a trader by any means whatever acquires and uses the confidential information or trade secrets of a competitor, he interferes with his competitor’s goodwill. Such conduct is contrary to the competition principle and is wrongful, in principle. Note that not only disclosure of secret information is unlawful but obtaining and using it is also unlawful.

To qualify as a trade secret, the information must be confidential and have economic value. This means that the information must not be generally available to or known by others. Also it must be of value to its holder (_Van Heerden & Neethling_ 225).

The following are examples of information which the courts have recognised as trade secrets: price lists and tender prices, credit records, customer lists, customer connections, business conversations, a technical process, computer software, the know-how of an undertaking and an unpublished trade mark. Some cases in which trade secrets and confidential information have been dealt with are the following:

_Dun & Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) Pty Ltd_ 1968 (1) SA 209 (C), particularly at 221–222; _Stellenbosch Wine Trust Ltd v Oude Meester Group Ltd_ 1972 (3) SA 152 (C); _Coolair Ventilator Co (SA) (Pty) Ltd v Liebenberg_ 1967 (1) SA 686 (W); _Harvey Tiling Co (Pty) Ltd v Rodomac (Pty) Ltd_ 1977 (1) SA 316 (T); _Harchris_.
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**basis of protection**

We wish to draw your attention to the fact that more than one field of law may apply where someone acquires and uses his competitor’s confidential information.

**implied contractual term**

In an appropriate case a trader may also rely on an express or an implied term in a contract of service against the prejudicial use of confidential information by an employee. For example, an employee may become acquainted with his employer’s trade secrets or confidential information. Without authorisation and while still in the employ of his employer, the employee then divulges this information to a rival of his employer, or, after the termination of his employment he uses this information in his own undertaking, or in the undertaking of a rival of his former employer. The employer is then entitled to protection from unfair competition (*Coolair Ventilator Co (SA) (Pty) Ltd v Liebenberg* supra). Here the employer has contractual remedies at his disposal, as well as an action based on unlawful competition. It should however be taken into account that although an employer’s rights to his trade secrets are worthy of protection, a former employee is still entitled to use his own skill and experience, even to attain a similar result (*Northern Office Micro Computers v Rosenstein*, supra; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd*; *Easyfind International (SA) (Pty) Ltd v Instaplus Holdings 1983 (3) SA 917 W*).

**copyright**

Copyright may also play a part in certain circumstances (*Dun & Bradstreet (Pty) Ltd v SA Merchants Combined Credit Bureau (Cape) Pty Ltd* supra).

**fiduciary duty**

A further aspect of the protection of trade secrets is that the unauthorised use of such information can involve the breach of a fiduciary duty which a director owes his company (*Sibex Construction (SA) Pty) Ltd v Infectaseal CC 1988 (4) SA 541 (T)*).

**breach of confidence**

The question has also arisen whether the English legal principles of breach of confidence could be a source of protection (see *Harvey Tiling Co (Pty) Ltd v Rodomac (Pty) Ltd*, supra). However, it is now generally accepted that the English legal action for breach of confidence is merely a manifestation in our law of the Aquilian action for unlawful competition or the action for breach of contract (see *Atlas Organic Fertilizers v Pikkewyn Ghwano*, supra; *Schultz v Butt 1986 (3) SA 667 (A)*).
Activity 4

Read the following scenario and answer the question below.

While in the employ of A, a perfume manufacturer, P becomes acquainted with A’s secret perfume formula. P’s job description is that of ‘perfume blender’. P resigns from his position with A and commences employment as a perfume blender with B.

Can A prevent P and B from using his perfume formula?

6 MISAPPROPRIATION OF A RIVAL’S PERFORMANCE

piracy or slavish copying

This form of unlawful competition occurs where a rival trader uses the performance of another as the basis for his own performance. He does not merely use the idea or distinctive marks of a competitor, but copies a substantial part of the rival’s performance.

In the absence of statutory protection (such as patent, copyright or design protection), a rival may copy the idea on which his rival’s product is based, provided he uses that idea to create his own product. But where a trader uses not only his rival’s idea but also his performance, we are concerned with the piracy of a rival’s performance.

In Schultz v Butt 1986 (3) SA 667 (A), for example, S used the mould of B’s boat to build his own boat. Notwithstanding the fact that S sold the boats under his own trade name (which would otherwise also have amounted to passing off if he had used B’s name) the court decided that his conduct constituted unlawful competition. The court stated:

In South Africa the Legislature has not limited the protection of the law in cases of copying to those who enjoy rights of intellectual property under statutes. The fact that in a particular case there is no protection by way of patent, copyright or registered design, does not license a trader to carry on his business in unfair competition with his rivals. Therefore, Mullins J [in the lower court] was right in his conclusion that Schultz’s conduct amounted to unfair competition, against which Butt was entitled to be protected. (683)

attitude of our courts

According to Van Heerden and Neethling supra 242, piracy is not confined to the direct misappropriation of a rival’s performance (as in Schultz v Butt) but includes the making of an identical or substantially identical copy. However, our courts are reluctant to regard the making of an identical or substantially identical reproduction as unlawful (see Bress Designs (Pty) Ltd v G Y Lounge Suite Manufacturers (Pty) Ltd (supra); Premier Hangers CC v Polyoak (Pty) Ltd 1997 (1) SA 416 (A)).

In Bress Designs (Pty) Ltd v G Y Lounge Suite Manufacturers (Pty) Ltd (supra) at 474–E the court found the copying of a certain lounge suite to be as effective as in Schultz v Butt (supra), but added that not all imitation is unlawful and that imitation may be said to be the essence of life. However,
looking at the motive for the copying, the court found that the community would condemn as *contra bonos mores* the malicious destruction (in other words the motive of the wrongdoer) of a sound business through the marketing of identical furniture at cut-throat prices, out of personal vindictiveness. See also *Taylor & Horne (Pty) Ltd v Dentall (Pty) Ltd* supra; *Premier Hangers CC v Polyoak (Pty) Ltd* 1997 (1) SA 416 (A); Van Heerden and Neethling 242 and further.

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**Activity 5**

Read the following scenario and answer the question below.

A is a manufacturer of perfume which he markets under the name ROMA. A designs and manufactures a new type of spray for use with his perfume which he markets under the name ROMA MIST. According to A much skill and effort has been put in by his employees in designing and manufacturing the spray. B, a competitor, commences manufacturing and marketing a perfume spray similar in appearance and construction to A's spray. B's spray is marketed under the name MEGA SPRAY. A alleges that he has suffered a vast reduction in sales of his ROMA MIST spray as a result of B's conduct. Can A institute an action against B for unlawful competition? Give reasons for your answer.

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**7 DISPARAGING A RIVAL’S ENTERPRISE, GOODS OR SERVICES**

**infringement of right to goodwill**

The infringement of a competitor’s goodwill by spreading untrue, disparaging allegations about his enterprise, goods or services is wrongful in principle. Such conduct is usually directed at preventing the merits of the competitor’s performance from winning the day and so is in conflict with the competition principle. The disparagement may be directed at a competitor’s undertaking as a whole, for example by alleging that the undertaking no longer exists, or it may be directed against the performance rendered by the undertaking by, for example, stating that a rival’s products are harmful to consumers.

**appropriate action**

In 1916 the Appellate Division intimated *obiter dicta* in *GA Fichardt Ltd v The Friend Newspapers Ltd* 1916 AD 1 that the *actio iniuriarum* was the appropriate action in cases concerning disparaging allegations. This approach clashes not only with common law authority, but also with the Appellate Division decision in *Matthews v Young* 1922 AD 492. This unfortunate approach apparently led to our courts to the acceptance that damages could be claimed either with the *actio iniuriarum* where *animus iniuriandi* must be proved, or with an Aquilian action based on *dolus* (*International Tobacco Co Ltd v United Tobacco Co (South) Ltd* (1) 1955 (2) SA 1 (W) 24; *GA Fichardt Ltd v The Friend Newspapers Ltd* 13; *Bredell v Pienaar* 1924 CPD 203, 213). Van Heerden and Neethling (supra 286) point out that the *actio iniuriarum* is available only in instances of the infringement of a personality
right of the prejudiced person, and that the action is used for claiming satisfaction, and not patrimonial damages. A competitor whose goodwill has been infringed is not interested in satisfaction, but in compensation for the financial loss (patrimonial damages) which was caused by the infringement (the disparagement). Further, the claim (resulting from disparagement) is not based on the infringement of a personality right, but on the ground of the infringement of the competitor’s right to the goodwill of his undertaking, which is a patrimonial right. Thus, even if an iniuria is present, the Aquilian action and not the actio iniuriarum is the appropriate remedy with which to claim damages for patrimonial loss resulting from an iniuria.

The mere fact that a trader’s statements in advertising material contain a comparison (comparative advertising) of his goods, services or business with those of a rival trader does not constitute wrongfulness. It is only when statements contain untruths which amount to a disparagement of the rival’s goods, services or business that the rival becomes entitled to relief (Post Newspapers (Pty) Ltd v World Printing and Publishing Co Ltd 1970 (1) SA 454 (W) 459–460).

Activity 6

Read the following scenario and answer the question below.

A and B are competing manufacturers of cosmetic products. In an advertisement B unfavourably compares his cosmetic products with those of A and concludes that A’s cosmetics pose a danger to the public and may even cause skin cancer. Can A institute an action for unlawful competition against B to prevent him from publishing the advertisement? Give reasons for your answer.

8 HARASSMENT OF A RIVAL’S CUSTOMERS, EMPLOYEES OR SUPPLIERS

In this context, harassment means the exertion of improper physical or psychological pressure aimed at discouraging others from having trade relations with a rival.

Classic examples of this type of competitive act (like scaring a competitor’s clients away by shooting at them) were the product of what Callmann calls “a more rugged age” (The law of unfair competition and trade marks 2nd ed vol 2 [1950] 774). In the light of the competition principle, the wrongfulness of such acts is self-evident.

Exerting psychological pressure on likely clients or customers occurs more readily in contemporary society. An example of this is setting up pickets which discourage prospective buyers from entering a competitor’s premises. In Ebrahim v Twala 1951 (2) SA 490 (W), an interdict was granted where a group of taxi owners assaulted and intimidated another taxi owner’s taxi drivers and apparently also the prospective passengers, thereby causing him patrimonial loss. See Van Heerden and Neethling supra 320 and further.
9 THE INSTIGATION OF A BOYCOTT AGAINST A RIVAL

A distinction can be drawn between primary and secondary boycotts.

**primary boycott**  In the case of primary boycotts an undertaking (e.g., a supplier of goods) refuses to have trade relations with another undertaking. Since an undertaking is free to decide for itself with whom it wishes or may not wish to have trade relations, in general, a primary boycott will be completely lawful. For example, in *Times Media Ltd v SABC* 1990 (4) SA 604 (W) the SABC (respondent) refused to broadcast a television advertisement of the Sunday Times (applicant) because it referred to M-Net, a rival of the SABC. The court found that this did not amount to a boycott and unlawful competition.

**secondary boycott**  A secondary boycott involves systematically endeavouring to induce other undertakings to exclude a particular undertaking from trade (Van Heerden & Neethling supra 308). A trader who instigates a boycott against a rival trader interferes with the goodwill of the rival. Such conduct is, in principle, unlawful and may only be justified in exceptional circumstances. The perpetrator incurs Aquilian liability if he infringes the rival’s right to goodwill either intentionally or negligently. Fault is not a requirement for an interdict (see *Hawker v Life Offices Association of SA* 1987 (3) SA 777 (C)).

It should finally be noted that the instigation of a boycott may often constitute conduct which might also be classified as infringement in the form of harassment, discussed above.

10 GROUNDS OF JUSTIFICATION

Since wrongful competition constitutes a delict, it should follow logically that various grounds of justification can arise in this context, for example, self-defence, necessity and the public interest (see generally Van Heerden & Neethling supra 325).

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**Summary activity**

Read the following scenario and answer the question below.

A is the manufacturer of toothpaste which he markets under the name FLORITYNE. FLORITYNE toothpaste is sold in a distinctive green and yellow packaging which contains the name FLORITYNE in italic script. A’s toothpaste utilises a secret formula which is based on a recipe that A obtained on a remote Indian island. S, a chemist in A’s employ was instrumental in adapting the recipe for use in A’s toothpaste. S has left A’s employ and is now employed by B, a competitor of A. A discovers that B is using his secret formula and has commenced marketing a new brand of toothpaste and mouthwash under the name FLORADYNE. The packaging of the FLORADYNE products is similar to that used by A for his FLORITYNE toothpaste. In an advertisement, B claims that his products are manufactured strictly in accordance with the USA Food and Drug Administration Guidelines and that they contain a secret formula that prevents tooth decay. He also claims that A’s FLORITYNE toothpaste is made from inferior ingredients, consists mainly of ash, and causes tooth decay. All these claims are false and/or
misleading. A wishes to institute an action for unlawful competition against B. Identify the various forms of unlawful competition which can form the basis of A's action.

Feedback 1

A's conduct is unlawful. He is infringing B's right to attract custom by deception concerning his own product. The wrongfulness of A's conduct does not lie in the fact that he is misleading the public, but lies in the fact that by his deception, he prevents clients from drawing a clear distinction between his perfume and that of his competitors. B can obtain an interdict against A. He can also recover damages for lost sales provided he can prove fault on the part of A.

Feedback 2

Passing off takes place where a trader represents to the public that his enterprise, goods or services are those of his competitor. He does so by using or imitating his competitor’s distinctive marks. In a passing-off action a plaintiff must prove the following two things:

(1) that the trade mark, get-up, service mark or trade name which he claims has been imitated is known in the market and has acquired with the public a reputation associated with his goods, service or business

(2) that the defendant’s conduct is calculated to deceive the public

Whether or not the defendant’s trade mark, get-up, service mark or trade name is so similar to that of the plaintiff that it is likely to confuse or deceive the ordinary customer must be decided in the light of all the available evidence. An “ordinary customer” or purchaser is neither very careful nor very careless and ignorant, but rather someone between the two extremes.

As far as goods are concerned, he is a person who is more or less aware of the particular characteristics of the article he wants; he has a general idea of the appearance of the article, and although he does not examine it closely, he has some idea of its general appearance.

However, as far as the danger of confusion is concerned, the class of persons who are likely purchasers must also be taken into account.

As A's products have been on the market for five years and have proved to be popular, he should be able to establish the required reputation for his mark ROMA in relation to cosmetics. ROMA and ROAMER are confusingly similar and the use by B of the name ROAMER for cosmetic products is likely to deceive or confuse the public. Accordingly A should succeed with an action for passing off against B.
Feedback 3

B can institute an action against A for unlawful competition. His action would comply with the requirements for competition in contravention of a statutory provision as formulated in *Patz v Greene*. In this instance it is necessary to study the wording of the relevant provision. Where the conduct is prohibited in the interests of a particular person or persons (such as traders), for the purposes of an interdict the court will presume that the person, that is B, is dammified and will grant relief without requiring evidence of damage. Where the statutory provision is in the public interest, any member of the public, including B, who can prove that he has sustained damage, or is reasonably likely to sustain damage, is entitled to an interdict.

Feedback 4

This problem relates to the misappropriation of a competitor’s business ideas, and more specifically to the misappropriation of a rival’s trade secrets or confidential information as a form of unlawful competition. Firstly, the perfume formula appears to qualify as a trade secret: it is secret or confidential and is of economic value. A may institute a delictual action against P and B for unlawful competition in the form of misappropriation of confidential information. A may also rely on an express or implied term in the contract of service which he concluded with P.

Feedback 5

In the absence of statutory protection (such as patent, copyright and design protection), B may freely copy A’s idea provided he uses that idea to create his own product. But where B uses not only A’s idea but also A’s product, we are concerned with misappropriation of A’s performance. In such a case, A will be able to institute an action for unlawful competition against B.

Feedback 6

In terms of our law, purely comparative advertising is not wrongful. Wrongfulness occurs only if the competitor is discredited by untrue allegations. If B’s advertisement contains untruths, A can obtain an interdict to prevent the publication of the advertisement.
A can institute an action for unlawful competition against B. A’s action can be based on the following forms of unlawful competition:

(a) The use of the secret formula by S and B constitutes misappropriation of A’s confidential information or trade secrets.

(b) By using a similar mark — FLORADYNE — and a similar packaging, B is attempting to pass off his products as those of A.

(c) B’s advertisement, which falsely claims that his products are manufactured strictly in accordance with the USA Food and Drug Administration Guidelines, amounts to deception concerning his own product or performance.

(d) B’s false claims that A’s product is made from inferior ingredients, consists mainly of ash and causes tooth decay amount to disparaging allegations concerning A’s product.