HOLDERSHIP IN DUE COURSE, MATERIAL ALTERATIONS AND THE REGULARITY OF A BILL OF EXCHANGE

Melamed Finance (Pty) Ltd v VOC Investments Ltd
[2006] SCA 75 (RSA)

1 Facts

Melamed Finance (Pty) Ltd v VOC Investments Ltd may turn out to be a very important decision. The facts are fairly straightforward: On 13 November 2000 VOC Investment's computer system generated four cheques in favour of a payee, Damelin Textiles. All the cheques were drawn on the Standard Bank of South Africa Ltd and bore that date. They were intended to be post-dated but the computer system used for printing the cheques could not produce post-dated cheques. Therefore the date on each cheque was altered in manuscript to reflect the intended date of payment. The alterations were signed by the same two signatories who were authorized to draw the cheques on behalf of VOC Investments. After the dates were changed the payee negotiated three of the cheques to Melamed Finance. One of the cheques was met on presentation but the other two were dishonoured because payment had been countermanded. (The drawer alleged that it countermanded payment when it learned that Damelin Textiles, contrary to its undertaking not to negotiate the cheques, had discounted them with Melamed Finance: para 4.) It was common cause that Melamed Finance was indeed holder of the cheques. (Para 2. As holder it was entitled to certain

rights on the cheques. See Malan and Pretorius (assisted by Du Toit) *Malan on bills of exchange, cheques and promissory notes in South African law* (2002) para 103 (hereafter "Malan") for a discussion of the legal position of a holder of a cheque.)

2 The issue

The only issue the court had to decide was whether Melamed Finance had become the holder in due course of the cheques, since a holder in due course holds a cheque "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 cheque (s 36(b) of the Bills of Exchange Act 34 of 1964). Conradie JA explained this concept thus:

> "The obligations of a debtor liable on a bill to an immediate party arise also from the transaction pursuant to which the bill was delivered. All disagreements arising from such a transaction may be aired when the debtor is sued by the holder of the bill. The holder in due course is above and beyond all such disputes. He may be met only by the so-called absolute defences, those that go to the root of the bill's validity" (para 6).

To settle the issue at hand, the court had to determine whether the holder of a cheque with a material alteration apparent on its face, can be a holder in due course (para 1).

To qualify as a holder in due course, a holder must meet certain strict requirements set out in section 27(1) of the Bills of Exchange Act which provides 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" (see Malan para 114 for a full discussion of these requirements).

One of the requirements, and this was indeed the core of the issue, is that the cheques must have been "complete and regular on the face of it" when they were acquired by Melamed Finance (para 6). Conradie JA pointed out that the expression "on the face of it" means "as far as one can tell by looking at the front and back of it". In this regard the cheque must "speak for itself" and the history and negotiation of the cheque may not be used to establish whether or not its appearance is regular. (Para 7. In *Dependable Aluminium Windows and Doors CC v Antoniades* 1993 2 SA 49 (N) 52E–F Didcott J remarked that the "instrument has to speak for itself . . . unaccompanied by any external voice. No evidence outside it is admissible".)

3 Judgment

The judgment of the court was delivered by Conradie JA (with Scott, Zulman, Brand and Cloete JJA concurring). The judge pointed out that there are two types of irregularity that occur on bills: irregular endorsements and material alterations. The law does not treat them in the same way (para 11). (Conradie JA expressly rejected counsel's argument that the decision in *Sappi Manufacturing (Pty) Ltd v Standard Bank of SA Ltd* 1997 1 SA 457 (SCA) effectively overruled *Estate Ismail v Barclays Bank (DC & O)* 1957 4 SA 17 (T) by holding that the general

suspicion test for judging regularity was a general one, applying to endorsements as well as material alterations. The court in *Estate Ismail* considered the reasonable suspicion test inapposite on the facts before the court. See also the text above.)

3 1 Irregular endorsements

An *endorsement* is considered to be irregular when its form is reasonably such as to put the acquirer on enquiry (para 8). The court referred here with approval to the judgment of Ramsbottom J in *Estate Ismail* 22G—H where he explained that it was for assessing the regularity of an endorsement (and not of a material alteration) that Denning LJ in *Arab Bank Ltd v Ross* [1952] 1 All ER 709 (CA) 716A–B put forward the following test:

> "When is an indorsement irregular? The answer is, I think, that it is irregular whenever it is such as to give rise to doubt whether it is the indorsement of the named payee. A bill of exchange is like currency. It should be above suspicion. But if it is asked: When does an indorsement give rise to doubt?, then I would say that that is a practical question which is, as a rule, better answered by a banker than a lawyer" (see also Malan para 123).

Meiring "Holder in due course, 'regular' indorsements and the reasonable person" 1995 *SA Merc LJ* 430 435 argues that

> "in order to determine whether an instrument is complete and regular on its face (a requirement which can be included in the broad requirement that a holder in due course must take an instrument in good faith), the judgment of the reasonable person taking the instrument with due care must be employed. Just as good faith underlies the law of contract, so it underlies holdership in due course. And since it is the reasonable person who acts in good faith, it is her judgment which must be employed to determine holdership in due course".

3 2 Alterations

An *alteration*, on the other hand, need not give rise to suspicion before it leads to the irregularity of the bill. The court pointed out that regularity and validity are different concepts (para 9). A bill can be valid but irregular, or invalid but nevertheless regular. It need only be apparent and material. The alteration is apparent if it appears from such inspection of the bill as might be expected of someone who is accustomed to handling bills (*ibid*). Furthermore, the alteration is material for purposes of holdership in due course if it "would alter the business effect of the instrument if used for any ordinary business purpose for which such instrument or any part of it is used" (para 12, quoting Brett LJ in *Suffel v The Bank of England* (1882) 9 QBD 555 568). *In casu*, the judge observed that the alterations to the dates of the cheques were patent in the sense that they could immediately be noticed by the person who took the cheques (para 9) and, furthermore, that they were material because they changed the earliest date for presentment of the cheques and thereby altered the business effect of the cheques (para 12). Melamed Finance thus did not qualify as holders in due course because the cheques were not "regular" when Melamed Finance became the holder of the cheques.

4 Comment

It is submitted that the court laid down a very strict test for the regularity of a cheque. As the court observed, the privileged position of the holder in due course comes "at a price" (para 6). As Millner "Material alterations in cheques" 1958

SALJ 9 10 observed almost half a century ago: "To pass in the high company of negotiable instruments, the document must be not only beyond suspicion but also immaculate." (See also Knight "The requirement that a bill be complete and regular on the face of it in order that a holder qualify as holder in due course" 1982 *Responsa Meridiana* 241 246ff and Anon "When is a negotiable instrument complete and regular upon its face?" 1922 *Columbia LR* 159.)

The final aspect that is important in *Melamed Finance* is the whole question of whether the material alteration occurred before the cheques were issued. Here it should be remembered that in *Mobeni Supersave v Suleman* 1992 2 SA 660 (N) 669F–G McCall J held that "an alteration to the crossing would render the cheque irregular unless it would be apparent to a person who takes the cheque that the alteration was made before the issue of the cheque by the drawer". (It should be noted that since the amendment of s 77 by s 35 of the Bills of Exchange Amendment Act 56 of 2000 it "shall not be lawful for any person to obliterate, *cancel* or, except as authorized by . . . [the] Act, to add to or alter such a crossing". The insertion of the word "cancel" probably means that the cancellation of the crossing will in future be disallowed. See Pretorius 2000 *Annual Survey of the South African Law* 573 and Mofokeng "Drawee banks and the risk of the cancellation of a crossing" 1998 *SA Merc LJ* 255 256ff for a discussion of this question.) Because the transferee would not, merely by examining the cheque, be able with complete confidence, to come to the conclusion that the crossing was deleted before the issue of the cheque, the court found the cheque to be irregular (671D–F). (See Meiring "Holder in due course, truncated cheques and presentment for payment: recent developments" 1992 *SA Merc LJ* 377 379 who maintained that "where a deletion is accompanied by the signature of the drawer, the reasonable man would conclude that such deletion was made prior to the cheque being issued, and that such cheque would be regular 'on the face of it' for the purposes of s 27(1)". This view must now be rejected in the light of the decision in *Melamed Finance.* Conradie JA makes it clear that there are passages in *Mobeni Supersave* "dealing with the deletion of a crossing that confuse the test with regard to irregular indorsements and material alterations" (para 11). For the document to be regular it must not only be beyond suspicion but also "immaculate". An endorsement is considered to be irregular when its form is such as reasonably to put the acquirer on enquiry.)

Conradie JA referred to section 62 of the Act that governs the liability of parties to a bill in instances where it is materially altered. Section 62(1) provides:

> "If a bill or an acceptance is materially altered the liability of all parties who were parties to the bill at the date of alteration and who did not assent to it, must be regarded as if the alteration had not been made, but any party who has himself made, authorized or assented to the alteration, and all subsequent indorsers are liable on the bill as altered."

Although a material alteration is not defined in section 62 of the Act, it appears from the case law (summarised by Malan para 136)

> "to be an alteration which would alter the liability of any of the parties to the bill. It includes but is not limited to, alterations of the date, the amount payable, the time and place of payment, and the addition of the place of payment, without the acceptor's assent, on a bill which has been generally accepted . . . An alteration on the back of a bill . . . may be material as in the case of an alteration to an indorsement. The deletion of the name of the payee and the substitution for it of another's name would be a material alteration".

Conradie JA stated that the "material alterations" contemplated by section 62 are clearly alterations made after a bill has been put into circulation and that those who assent to the alteration and all who become parties after the alterations are bound by them. Those parties who do not assent are not bound. He then made the following important assertion:

> "A change to the date on a bill is . . . a material alteration because it alters the liability of parties to a bill. Disturbance of the liability of parties is also the reason that a change of date is by s 62(2) declared to be invalid against all non-assenting parties. But the field of application of s 62 is different to that of s 27 and the fact that s 62 applies only to alterations made after issue does not mean that the ambit of s 27 should be similarly confined" (para 17).

The end result is thus that even if the alteration was made with authority prior to the issue of the cheque, the alteration may still render the instrument irregular if the alteration is material. The recipient of such altered cheque may thus not qualify as a holder in due course because of the alteration.The fact that the validity of the cheque is unaffected by the alteration is irrelevant (para 9).

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