# THE SUPREME COURT OF APPEAL
# OF SOUTH AFRICA

1.1 Case no: 13664/2003
1.2 REPORTABLE

In the appeal between:

**STANDARD BANK OF SOUTH AFRICA LTD**
i Appellant

**DIRECTOR OF PUBLIC PROSECUTIONS, TRANSVAAL**
Second Appellant

**MINISTER OF JUSTICE & CONSTITUTIONAL DEVELOPMENT**
Third Appellant

and

**P W S PEENS (Senior)** First Respondent
**P W S PEENS (Junior)Thomas Frederick van ROOYEN**
RSecond Respondent
**J A PEENS** Third Respondent

**Before:** Harms JA, ~~Howie P, Scott~~Cameron JA, ~~Cloete~~Conradie JA, Heher JA and Comrie ~~Ponnan~~ AJA
**Appeal:** ~~5~~Monday 13 September 2004
**Judgment:** Wednesday 29 September 2004

*Bank – Fraudulent 'cross-firing' scheme – Bank's attempt to dishonour fraudulent cheques outside time allowed by clearing house rules thwarted by objection from collecting bank – Customer never countermanding original instructions – Bank entitled to revert to original pre-dishonour debits*

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## JUDGMENT

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**CAMERON JA:**

[1] Cheque 'kiting' or 'cross-firing' (also known as 'round-tripping') takes place when customers of one or more banks draw cheques in favour of one another on different banks or branches of the same bank, depositing them to one another's accounts in order to draw against the deposits before the proceeds of the cheques have been collected. The object is to trap the bank into paying out against the deposit in the expectation that the cheque will be met. The scheme generally requires the collusion of two or more account holders. It constitutes the criminal offence of fraud.[1] It exploits two factors: (a) a current banking account in which drawings can be made against cheques that have been deposited but have not yet been cleared;

Compare the explanation by Williamson J in *Volkskas Bpk v Zagnoiev* 1958 (2) SA 550 (W) 553A and 553H.
[1] *S v Judin* 1969 (4) SA 425 (A) 430H-435H; *S v MacDonald* 1982 (3) SA 220 (A) 234E-243C.

and (b) delays that occur in clearing such cheques that are drawn on other banks or other branches of the same bank.[2]

[2] This application for leave to appeal concerns a massive cross-firing operation perpetrated in 1998 and early 1999 by several companies within a set called the 'Weenen group'. Each of the three respondents, all Peens family members ('the defendants'), was a director of all or some of the Weenen group companies. They signed surety to the applicant bank ('the plaintiff', as in the court below) for the companies' debts. The defendants' liability to the plaintiff, which is at issue in this matter, depends on whether the companies are indebted to it. That in turn depends on how the plaintiff dealt with the cross-firing operation when it got wind of it.

[3] The Peens companies' cheque fraud involved also other banks; but we are concerned only with the scheme as it exploited the group's accounts held at the plaintiff, together with an account held by another company in the group, Price Busters, at ABSA Bank Ltd ('ABSA'). Cheques in very considerable amounts were drawn on the group's accounts with the plaintiff, and deposited with ABSA, and vice versa. Round and round the false credits went. None of the cheques could be met. But the 'round-tripping' for a while created a giddy illusion of credit in the companies' accounts at both banks.

[2] *S v MacDonald* 1982 (3) SA 220 (A) 236B per Corbett JA.

And while that illusion lasted, huge amounts of money were fraudulently diverted to the companies and those controlling them.

[4] In early 1999, when the plaintiff realised that it and ABSA and other banks were being defrauded on an enormous scale, it gave instructions that all cheques drawn on Weenen group accounts held with it should forthwith be dishonoured. The instruction took effect on 6 January. Cheques as far back as 28 December 1998 were returned to ABSA unpaid. ABSA, as the collecting bank, had presented the great majority of the cheques thus dishonoured. The result of the instruction was that massive debit entries in Weenen group accounts held with the plaintiff, as the drawee bank, were extinguished, since cheques drawn on those accounts that had been deposited with ABSA were now dishonoured. In the case of one of the companies, a credit balance was even created.

[5] Soon after, ABSA also gave instructions for cheques drawn on it by Price Busters to be dishonoured. But it was left in much the worse position, and objected to the plaintiff's dishonours. As between it and the plaintiff, it had indisputably good reason for doing so. This was because the attempted dishonours took place outside the time limits allowed by the Agency Agreement between the South African Clearing Banks (commonly known as the 'clearing house rules'). These rules stipulate that generally a drawee bank must return

cheques being dishonoured 'on the business day following the physical receipt of the cheque, but not later than the closing time of either the drawee bank or the collecting bank, whichever is the earlier' (rule 14.3.1). (There are concordant rules for Fridays and public holidays.)

[6] After the period allowed for dishonour has elapsed, the collecting bank is entitled to insist (though it may choose not to do so) that the cheque be paid.[3] ABSA's objection was thus well-founded, and led to negotiations between it and the plaintiff. On 10 February 1999 the two institutions concluded an agreement ('the 10 February agreement'). Its main effect was that the cheques each bank had dishonoured on group accounts were now allocated as they would have been had they been honoured at the time of presentation in the ordinary course of business in terms of the clearing house rules. In other words, each bank rescinded the purported late dishonours of cheques drawn on the other in the cross-firing operation, and 'honoured' (or, rather, re-honoured) all cheques not dishonoured timeously. This meant that debits arising from cheques originally honoured, but subsequently dishonoured late, were reinstated.

[7] The effect, as between the two banks, was that ABSA received a credit of over R31 million, while the plaintiff received a credit of just

[3] *Burg Trailers SA (Pty) Ltd v ABSA Bank Ltd* 2004 (1) SA 284 (SCA), para 10, per Harms JA.

over R18 million, plus what the judge in the court below called ‘some R17.5 million of worthless paper’.

[8] The Peens companies had in the meanwhile been placed in liquidation. When the plaintiff instituted action on the suretyships, the defendants objected that the 10 February agreement brought about a post-liquidation creation of credits and debits in the companies’ various accounts, the plaintiff’s mandate to honour the cheques having lapsed on liquidation: section 73 of the Bills of Exchange Act 34 of 1964.[4] The entries the plaintiff effected in pursuance of its agreement with ABSA were unauthorised, the defence ran: so the sureties could not be held liable for the amounts entered in the plaintiff’s books as owing to it after liquidation and pursuant to the 10 February 1999 agreement.

[9] When the matter came to trial in the Pretoria high court, the plaintiff closed its case after calling two witnesses – Papadakis, a forensic and investigative accountant; and van Sittert, then an inspector in its internal audit division. The defendants provisionally closed theirs, subject to questions about quantum. The parties then argued the

[4] Section 73 of Act 34 of 1964: ‘**Revocation of bank's authority**
The duty and authority of a bank to pay a cheque drawn on it by its customer are terminated by receipt of –
(a) countermand of payment;
(b) notice of the customer's death or incapacity;
(c) notice of the customer having been sequestrated or wound-up or placed under judicial management or declared a prodigal:
Provided such countermand or notice identifies the cheque, in the case of countermand, and the customer with reasonable particularity and gives the drawee a reasonable opportunity to act on it.’

sureties' liability in law. Bertelsmann J upheld the defence, granting the defendants absolution from the instance with costs. He later refused leave to appeal.

[10] After leave to appeal was refused, the plaintiff obtained senior counsel's advice and thereafter deliberated its implications before lodging a petition for leave to appeal. A rule-breaching delay of some four months occurred. This court ordered that the application for leave to appeal and for condonation of the delays be set down for argument, and that the parties be prepared to deal with the merits of the matter.

[11] Mr Wallis who appeared for the plaintiff (though not in the court below) conceded that the delays are not entirely satisfactorily explained. But it was common cause that the lapses were not egregious, that they caused no prejudice, and that condonation should be granted if the plaintiff's appeal was good on the merits.

[12] The plaintiff, Bertelsmann J found, had not established its cause of action:

> 'The debits upon which it relies were not created by consensus between banker and client but by an agreement between banks attempting to limit damage inflicted upon them as a result of a blatant fraud which had been perpetrated upon them. It is obvious that such debts could not be created after liquidation, quite apart from the fact that the cheques had been dishonoured and were unilaterally reinstated and debited to the company accounts after liquidation.
> …
> It is also clear that, once the cheques had been dishonoured, regardless of whether the sureties or the principal debtors were aware of the dishonour or not …, a banker cannot without either finding his client's account in credit or having

an express instruction from the client, honour a cheque which has previously been dishonoured without notice to the client.'

[13] As can be seen, the learned judge considered that the adjustments to the group's various accounts pursuant to the 10 February agreement created new debts. The corollary of his approach is that the account entries effected when the cheques were purportedly dishonoured in January were immutable for purposes of the banker/customer relationship. The late dishonours, in other words, had to prevail over the pre-dishonour position. The subsequent agreement could not undo their effect.

[14] In my view, this approach was not correct. It wrongly focuses on the effect of the agreement between the two banks. The plaintiff's claim is not based on any entitlement arising from that agreement. It is based on the debits in the group's accounts in January 1999. These were created by the bank honouring its customers' mandates to pay – before it attempted the unavailing dishonours.

[15] That this is so emerged clearly from the evidence. What the plaintiff did when it originally received the fraudulent cheques was described in van Sittert's testimony. Counsel for the defendants put to him that the 10 February agreement entailed that the plaintiff and ABSA had decided, 'just let us agree that we undo [the dishonours]

by honouring the cheques that were dishonoured'. To this, van Sittert pointed out:

'Well, before we sent them back we actually had honoured them.'

The exchange proceeded:

'On which date were they honoured? -- Well, if you send a cheque back late, if you return a cheque on 6 January and it has already been through the client's account on 28 December, then it is deemed that you have paid the cheque. There are many cheques that were sent back late which are then deemed to actually be paid. So in effect all we did was to reinstate the account[s] to the effect of the fraud that was committed. In actual fact the uncleared effects [perpetrated through the round-tripping scheme] are now reflected on the […] bank accounts. … We returned the accounts to what they would have been had we not sent back cheques late.'

[16] Papadakis's evidence was to the same effect. Asked what the effect was of the banks' agreement, he stated:

'The effect M'Lord would have been simply to reinstate the debits which had originally been processed to these accounts ... So the original cheques that were drawn on these accounts and initially debited, were simply reinstated.'

[17] This evidence was not disputed. In my view it must form the basis on which the matter is decided. The fact is that the plaintiff originally honoured the cheques drawn on accounts the Peens companies held with it. Later, when it discovered the massive fraud, it tried to limit its losses by purporting to dishonour those same cheques. But the clearing house rules that ABSA invoked precluded this expedient. It then reverted to its original stance, which was that it had honoured the fraudulent cheques.

[18] Bertelsmann J, in refusing leave to appeal, was no doubt right in observing that as between it and its account-holders the plaintiff was

entitled to dishonour the cheques. Clearly so: they were fraudulently made and fraudulently deposited; and in any event the companies' overdrafts far exceeded the limits the bank set. But focusing on the attempted dishonours overlooks the fact that the account-holders never countermanded payment of the cheques. This distinguishes the matter from those cases debated in argument that concern the effect of the clearing house rules when a customer countermands payment before the time for dishonour has expired (*Volkskas Bank Bpk v Bankorp Bpk (h/a Trust Bank)*);[5] where a bank gives late notice of dishonour to the detriment of the payee (*Riedell v Commercial Bank of Australia Ltd*);[6] or where the bank gives late notice but the payee can prove no resultant damage (*National Slag v Canadian Imperial Bank of Commerce*);[7] or where, within the time for dishonour, payment is countermanded and an attachment in execution occurs (*Burg Trailers SA (Pty) Ltd v ABSA Bank Ltd*).[8]

[19] The present case is concerned solely with the position between banker and customer where the banker chooses to disregard the customer's fraud on it and, there being no countermanding instructions, maintains the original debits effected in accordance with the fraudulent cheques. In my view it is clear that the banker is

[5] 1991 (3) SA 605 (A).
[6] (1931) VLR 382 (Supreme Court of Victoria).
[7] (1982) 140 DLR (3d) 473 (Ontario High Court).
[8] 2004 (1) SA 284 (SCA).

entitled to correct the bank statements by reinstating the original debits.[9] The plaintiff's ineffective attempt to dishonour the cheques did not create rights for the customers. On the contrary, its reversion to 'honouring' the cheques was an acceptance that it had credited ABSA according to its customers' unrevoked instructions to pay the cheques according to their tenor.

[20] The fact that as between itself and its customers the plaintiff was entitled to dishonour the cheques does not mean that it was obliged to do so. Confronted with ABSA's objection, it was entitled to correct the book entries honouring its clients' unrevoked instructions to debit their accounts. That it chose to overlook the fraud cannot avail the defendants.

[21] In effect the defence the trial judge upheld sought to limit the plaintiff's options to dishonouring the cheques because they were fraudulent. This was not only unfair to the plaintiff; in view of the clearing house rules it was unrealistic; and it overlooked the fact that the customers' instructions to pay the fraudulent cheques remained standing.

[22] The fact that the 10 February agreement was concluded after the companies were liquidated is irrelevant to this conclusion. The fact is that the plaintiff was entitled assert the debits it originally made to its

[9] *Standard Bank of South Africa Ltd v Oneanate Investments (Pty) Ltd (in liquidation)* 1998 (1) SA 797 (SCA).

customers' accounts in the amount of the cheques they drew. It follows that the debts were not created after the companies' liquidation.

[23] In argument before us counsel for the defendants sought by detailed reference to the schedules included in Papadakis's evidence to contend that the plaintiff's claim included cheques that were dishonoured timeously (and which could not thereafter have been honoured), and that the 10 February agreement therefore covered more than merely late dishonours. He also sought to establish that the plaintiff failed in implementing its own decision timeously to dishonour certain cheques that could have been dishonoured timeously after 6 January in terms of clearing house rules. On this basis he sought to contend that the plaintiff's cause of action in fact derived from debit entries created by the agreement between the two banks.

[24] But this was not what was at issue in the trial, nor what was debated with the plaintiff's witnesses. Papadakis's evidence that the cheques in question in issue were all dishonoured late (and therefore ineffectively) after 6 January was never challenged, and indeed the trial judge recorded it as common cause – and counsel when pressed confirmed – that the cheques in question were all dishonoured late. What is more, the customers gained no rights from

the plaintiff's decision to dishonour cheques after 6 January. Any failure on the plaintiff's part to give effect to its own decision cannot enure to the customers' (and therefore the defendants') benefit.

[25] So counsel's attempt to fashion a new case for the defendants cannot be countenanced. The plaintiff's argument must in these circumstances be upheld, and the relief it seeks be granted.

**ORDER**:

1. Condonation is granted for the late application for leave to appeal.

2. The application for leave to appeal is granted.

3. The appeal succeeds with costs, including the costs of two counsel.

4. The order of the trial court granting absolution from the instance is set aside. In its place is substituted:

   'The application for absolution from the instance is dismissed with costs, including the costs of two counsel.'

5. The case is referred back to the trial court to determine quantum and to give judgment accordingly.

**E CAMERON**
**JUDGE OF APPEAL**

**CONCUR:**
**HARMS JA**
**CONRADIE JA**
**HEHER JA**
**COMRIE AJA**