INTRODUCTION

- The Law of Banking and Negotiable Instruments is a vast area of Commercial Law governing various commercial transactions involving banks and their activities, negotiable instruments such as checks, shares or stocks and warehouse goods deposit certificates and insurance companies' and their activities.
- A bank or banker is a business organization or a person engaged in the business of accepting money, valuable things and documents on deposit, lending the money it accepted on deposit to others, depositing and managing securities, buying and selling foreign exchange and gold and silver bullions/gold and discounting commercial instruments and transferable securities having a future maturity date.

- **The Law of Banking is a special area of Commercial Law that incorporates rules dealing with;**
- the definition of banks and banking transactions
- the specific requirements for the establishment and operation of banking business
- the various types of banks, i.e., commercial banks and central or national banks and their functions
- the powers and duties of central or national banks
- the various types of banking transactions or operations such as deposit of funds, bank transfers, deposit and management of securities, lending deposit of valuable things and documents, discount of commercial instruments and securities
- the rights and duties of banks and their customers.

- **Negotiable Instruments** are documents or papers incorporating or containing various types of rights which are transferred by endorsement and delivery or by mere delivery of the document.
- ***Negotiable'*** means '***transferable by delivery'*** *and* '***Instruments***' means a ***written document*** by which a ***right is created*** in favor of a person.

➢ Thus, *'negotiable instrument'* refers to a document containing ***rights that can be transferred by delivery***.

➢ Any document incorporating a right to an entitlement in such manner that it is not possible to enforce or transfer the right separately from the instrument.

i. **Commercial Instruments** (right to the payment of money)

ii. **Transferable Securities**: share certificates, bonds and debentures, life insurance policies etc. (right to Profit)

iii. **Documents of Title to Goods**: include bills of lading, air way bills, warehouse goods deposit certificates (though it is assimilated to commercial instruments) etc. (ow/p right)

- The Ethiopian Commercial Code recognizes three types of documents as negotiable instruments, i.e., commercial instruments /bills of exchange, promissory notes, checks, travelers' checks/, securities / shares or stocks, bonds/ and documents of title to goods / bills of lading and other types of way bills, warehouse goods' deposit certificates./

Commercial Instruments

- They carry an unconditional order or promise to pay certain sum in money and include:

❖ bill of exchange;

❖ promissory notes;

❖ cheques;

❖ travelers cheques and

❖ warehouse goods deposited certificate.

- **The Law of Negotiable Instruments is a branch of commercial law dealing with;**
- the definition and types of negotiable instruments
- the formal requirements for the issuance and circulation of valid negotiable instruments
- the mode of transfer of negotiable instruments
- the definition, form and effect of endorsements
- the definition, form and effects of acceptance, acceptance for honor and payment or acceptance by intervention of negotiable instruments
- the rights and duties of the parties to negotiable instruments
- the performance of obligations arising out of negotiable instruments
- the remedies available to holders of negotiable instruments in cases of non performance.

- This teaching material, which is prepared and presented in the form of a compilation, is organized in two parts based on the two areas of law it incorporates, i.e., Law of Banking and Law of Negotiable Instruments
- Part One, Law of Banking, has two chapters.
- Chapter One is a general introduction to banks, banking transactions, types of banks and their functions, the requirements for the establishment and operation of banks and the economic significance of banks.
- Chapter Two discusses the various types of banking transactions recognized under the Ethiopian Law in detail.
- It also deals with the rights and duties of the parties to the various banking transactions.

- **Part Two**, Law of Negotiable Instruments, incorporates three chapters.
- **Chapter one** is a general introduction to negotiable instruments, the types of negotiable instruments and the mode of their transfer, their nature and significance.
- **Chapter Two** focuses on Commercial Instruments and their types, the specific formal requirements for the issuance of a valid commercial instrument, the mode of their transfer, the definition, form and effect of endorsement, the rights of a holder of a commercial instrument and the performance of obligations arising

- **Chapter three** deals legal remedies to a holder of commercial instruments in case where obligations arising out of commercial instruments are not properly performed.
- This material heavily depends on the **Commercial Code of Ethiopia**, which is the main law governing these areas. The Monetary and Banking Proclamation No 83/1994, The Licensing and Supervision of Banking Business Proclamation No 84/ 1994, The Licensing and Supervision of Insurance Business Proclamation No 86/ 1994 and The Civil Code of Ethiopia.
- Furthermore, the Convention on International Bills Of Exchange and International Promissory Notes of 9 Dec 1988 contains rules

PART ONE: LAW OF BANKING
CHAPTER ONE
INTRODUCTION

1.Definition

- The term bank refers to an institution that deals in money and its substitutes and provides other financial services. Banks accept deposits, make loans, and derive a profit from the difference in the interest rates paid and charged respectively. Some banks also have the power to create money.
- Principal types of banking in modern industrial world are commercial banking and central banking.
- A commercial banker is a dealer in money and in

- The banker also provides a variety of other financial services.
- The basis of the banking business is borrowing from individuals, firms, and occasionally governments—i.e., receiving “deposits” from them. With these resources and with the bank's own capital, the banker makes loans or extends credit and invests in securities.
- The banker makes profit by borrowing at one rate of interest and lending at a higher rate

- A bank must always have cash balances on hand in order to pay its depositors upon demand or when the amounts credited to them become due..
- a bank can create credit for use by its customers by issuing additional notes or by making new loans, which in their turn become new deposits.
- The amount of credit it extends may considerably exceed the sums available to it in cash.
- Another type of banking is carried on by central banks, bankers to governments and “lenders of last resort” to commercial banks and other financial institutions. They are often responsible for formulating and implementing monetary and credit policies, usually in cooperation with the government.

- In some cases—e.g., the U.S. Federal Reserve System—they have been established specifically to lead or regulate the banking system; in other cases—e.g., the Bank of England—they have come to perform these functions through a process of evolution.
- Some institutions often called banks, such as finance companies, savings banks, investment banks, trust companies, and home-loan banks, do not perform the banking functions described above and are best classified as financial intermediaries.
- These financial intermediaries cannot, however, create money (i.e., credit) as the commercial banks do; they can lend no more than savers place with them.

The Development of Banking Systems: General Overview

The Development of Banking: General Overview

Banking is of ancient origin, though little is known about it prior to the 13th century. Many of the early "banks" dealt primarily in **coin and bullion**, much of their business being money changing and the supplying of foreign and domestic coin of the correct weight and fineness.

Another important early group of banking institutions was **merchant bankers**, who dealt both in goods and in bills of exchange, providing for the remittance of

- ✓ Their business arose from the fact that many of these merchants traded internationally and held assets at different points along trade routes.

- Another form of early banking activity was the acceptance of deposits. These might derive from the deposit of money or valuables for safekeeping or for purposes of transfer to another party; or, more straightforwardly/directly they might represent the deposit of money in a current account.
- English bankers in particular had, by the 17th century, begun to develop a deposit banking business, and the techniques they evolved were to prove influential elsewhere.

- The London goldsmiths kept money and valuables in safe custody for their customers. In addition, they dealt in bullion and foreign exchange, acquiring and sorting coin for profit.
- It was found that when money was deposited by a number of people with a goldsmith or a scrivener a fund of deposits came to be maintained at a fairly steady level. Over a period of time, deposits and withdrawals tended to balance.
- In any event, customers preferred to leave their surplus money with the

- About the same time, a practice grew up whereby a customer could arrange for the transfer of part of his credit balance to another party by addressing an order to the banker. This was the origin of the modern check.
- A check was a claim against the bank, which had a corresponding claim against its customer.
- Another way in which a bank could create claims against itself was by issuing bank notes.

- In Britain the check soon proved to be such a convenient means of payment that the public began to use checks for the larger part of their monetary transactions, reserving coin (and, later, notes) for small payments.
- As a result, banks began to grant their borrowers the right to draw checks much in excess of the amounts of cash actually held, in this way "creating money"—i.e., claims that were generally accepted as means of payment. Such money came to be known as "bank money" or "credit."
- When a check is drawn and passed into the hands of another party in payment for goods or services, it is usually paid into another bank account.

- One of the most important factors in the development of banking in England was the early legal recognition of the negotiability/ transferablity or passable of credit instruments or bills of exchange. The check was expressly defined as a bill of exchange.
- In continental Europe, on the other hand, limitations on the negotiability of an order of payment prevented the extension of deposit banking based on the check.
- Continental countries developed their own system, known as giro payments, whereby transfers were effected on basis

The Birth and Development of Banking Services in Ethiopia

- It was in 1905 that the first bank, the “Bank of Abyssinia”, established based on the agreement signed b/n Ethiopian Government and National Bank of Egypt, which was owned by the British. Its capital was 1 million shillings.
- According to agt, bank was allowed to engage in commercial banking (selling shares, accepting deposits and effecting payments in cheques) and to issue currency notes. The agt prevented establishment of any other bank in Ethiopia, thus giving monopoly right to the Bank of Abyssinia.
- The Bank, which started operation a year after its establishment agt signed, opened branches in Harar, Dire Dawa, Gore and Dembi- Dolo as well as an agency office in Gambela and a transit office in Djibouti.
- Apart from serving foreigners residing in Ethiopia, and holding government accounts, it could not attract deposits from Ethiopian nationals who were not familiar with banking services.

- The Ethiopian Government, under Emperor Haile Sellassie, closed the Bank of Abysinia, paid compensation to its shareholders and established the Bank of Ethiopia which was fully owned by Ethiopians, with a capital of pound Sterling 750,000.
- The Bank started operation in 1932. The majority shareholders of the Bank of Ethiopia were Emperor and political elites of the time.
- The Bank was authorized to combine functions of central banking (issuing currency notes and coins) and commercial banking.
- The Bank of Ethiopia opened branches in Dire Dawa, Gore, Dessie, Debre Tabor and Harrar.
- With the Italian occupation (1936-1941), the operation of the Bank of Ethiopia came to a halt, but a number of Italian financial institutions were working in the country. These were Banco Di Roma, Banco Di Napoli and Banca Nazionale del Lavora.
- It should also be mentioned that **Barclays Bank had opened a branch and operated in Ethiopia during 1942-43.**

- In 1946 Banque Del Indochine was opened and functioned until 1963.
- In 1945 the Agricultural Bank was established but was replaced by the Development Bank of Ethiopia in 1951, which changed in to Agricultural and Industrial Development Bank in 1970.
- In 1963, Imperial Savings and Home Ownership Public Association (ISHOPA) and the Investment Bank of Ethiopia were founded.
- The later was renamed Ethiopian Development Corporation S.C. in 1965. In the same year, the Savings and Mortgage Company of Ethiopia S.C. was also founded.
- With the departure of the Italians and the restoration of Emperor Haile Selassie's government, the State Bank of Ethiopia was established in 1943 with a capital of 1 million Maria Theresa Dollars by a charter published as General Notice No. 18/1993 (E.C).
- The Bank which, like its predecessor, combined the functions of central banking with those of commercial banking opened 21 branches, including one in Khartoum (the Sudan) and a transit office in Djibouti.

- In 1963, State Bank of Ethiopia split into the National Bank of Ethiopia and the Commercial Bank of Ethiopia S.C. with purpose of segregating the functions of central banking from those of commercial banking. The new banks started operation in 1964.
- The first privately owned company in banking business was the Addis Ababa Bank S.C., established in 1964. 51% of the shares of the bank were owned by Ethiopian shareholders, 9% by foreigners living in Ethiopia and 40% by the National and Grind lays Bank of London.
- The Bank carried our typical commercial banking business. Banco Di Roma and Banco Di Napoli also continued to operate.
- Thus, until the end of 1974, there were state owned,

- Following 1974 Revolution, on January 1, 1975 all private banks and 13 insurance companies nationalized and along with state owned banks, placed under coordination, supervision and control of the National Bank of Ethiopia.
- The three private banks, Banco Di Roman, Banco Di Napoli and the Addis Ababa Bank S.C. were merged to form “Addis Bank.” Eventually in 1980 this bank was itself merged with the Commercial Bank of Ethiopia S.C. to form the “Commercial Bank of Ethiopia,” thereby creating a monopoly of commercial banking services in Ethiopia.
- In 1976, the Ethiopian Investment and Savings S.C. was merged with the Ethiopian government Saving and Mortgage Company to form the Housing and Savings Bank .
- The Agricultural and Industrial Development Bank continued under the same name until 1994 when it was renamed as the Development Bank of Ethiopia.

- Thus, from 1975 to 1994 there were four state owned banks and one state owned insurance company, i.e., the National Bank of Ethiopia (The Central Bank), the Commercial Bank of Ethiopia, the Housing and Savings Bank, the Development Bank of Ethiopia and the Ethiopian Insurance Corporation.
- After the overthrow of the Dergue regime by the EPRDF, the Transitional Government of Ethiopia was established and the New Economic Policy for the period of transition was issued. This new economic policy replaced centrally planned economic system with a market-oriented system and ushered in the private sector.
- Several private companies were formed during the early 1990s, one of which is Oda S.C. which conceived the idea of establishing a private bank and private insurance company in anticipation of a law which will open up the financial sector to private investors.

Economic Significance of Banks

- The existence of a strong and effective banking system is very important for the economic development of a country.
- Banks through acceptance of deposit of money from persons who do not need it at the present and lending it to persons who want it for investment, serve as financial intermediaries thereby providing ideal source of fund for investment that is crucial in increasing production, exports, creation of jobs and foreign exchange earnings of the country.
- Similarly bank lending to customers who need the money for consummation, purchase of various goods and services, construction of houses, and education increases demand for those goods and services, thereby encouraging producers and service providers to expand their undertakings and increase production. Expansion and increase in production requires employment of additional workers, thereby creating new jobs, encourage producers and suppliers of raw materials to increase their production and supply.
- Banks also play a positive role in encouraging savings by providing an incentive to save through payment of interest on deposits/savings and providing safety and security.
- Saving is also an important source of future investment and the improvement of the living standards of the society.

- The power of the national bank in fixing interest rates is particularly crucial in both investment and saving. If the rate of interest fixed by the bank on deposits /i.e. the interest banks pay on money deposited on saving and other accounts / is attractive, it will encourage people to save their money rather than spend it. However, such interest should not discourage people from investment and productive activities and turn them to rent collection /potential investors may decide to deposit their money and collect interest/.
- The existence of a network of banks covering all parts of a country facilities business transactions in the country by making payments easier, safer and cheaper.
- Payment through banks also avoids the risk of loss or theft of money.

Types of Banks
National Bank
Central Banks: General Overview

- It refers to an institution, such as the Bank of England, the U.S. Federal Reserve System, the Bank of France, or the Bank of Japan, that is entrusted with the power of regulating the size of a nation’s money supply, the availability and cost of credit, and the foreign-exchange value of its currency.
- Regulation of the availability and cost of credit may be nonselective or may be designed to influence the distribution of credit among competing uses.
- The principal objectives of a modern central bank in carrying out these functions are to maintain monetary and credit conditions conducive to a high level of employment and production, a reasonably stable level of domestic prices, and an adequate level of international reserves.

- **Central banks also have other important functions, of a less-general nature.**

- These typically include acting as fiscal agent of the government,
- supervising the operations of the commercial banking system,
- clearing checks, administering exchange-control systems,
- serving as correspondents for foreign central banks and official international financial institutions,
- and, in the case of central banks of the major industrial nations,
- participating in cooperative international currency arrangements designed to help stabilize or regulate the foreign-exchange rates of the participating countries

- Central banks are operated for the public welfare and not for maximum profit. The modern central bank has had a long evolution, dating back to the establishment of the Bank of Sweden in 1668.
- In the process, central banks have become varied in authority, autonomy, functions, and instruments of action. Virtually everywhere, however, there has been a vast and explicit broadening of central-bank responsibility for promoting domestic economic stability and growth and for defending the international value of the currency. There also has been increased emphasis on the interdependence of monetary and other national economic policies, especially fiscal and debt-management policies.
- central banks have played a major role in developing the institutional arrangements that have given form to such cooperation.

- Central banks traditionally regulate the money supply by expanding and contracting their assets.
- An increase in a central bank’s assets causes a corresponding increase in its deposit liabilities (or note issue), and these, in turn, provide z funds that serve as the cash reserves of the commercial banking system—reserves that commercial banks, by law or custom, must maintain, generally in a prescribed proportion of their own deposit liabilities.
- As banks acquire larger cash balances with the central bank, they are in a position to expand their own credit operations and deposit liabilities to a point where the new, larger cash reserves no longer produce a reserve ratio greater than the minimum set by law or custom.

- Central banks typically alter the volume of their assets by six ways:
- 1. **“Open-market operations”** consist mainly of purchases and sales of government securities or other eligible paper, but operations in bankers’ acceptances and in certain other types of paper often are permissible.
- Open-market operations are an effective instrument of monetary regulation only in countries with well-developed security markets.
- Open-market sales of securities by the central bank drain cash reserves from the commercial banks. This loss of reserves tends to force some banks to borrow from the central bank, at least temporarily.

- Conversely, purchases of securities by the central bank tend to lead to credit expansion by the financial system and to lower interest rates, unless the demand for credit is rising at a faster rate than the supply, which normally is the case once an inflationary process gets underway; interest rates then will rise rather than fall.
- Changes in domestic money-market rates resulting from central-bank actions also tend to change the prevailing relations between domestic and foreign money-market rates, and this, in turn, may set in

- 2. **Loans to banks, generally called "discounts" or "rediscounts,"** are short-term advances against commercial paper or government securities to enable banks to meet seasonal or other special temporary needs either for loan-able funds or for cash reserves to replace reserves lost because of shrinkage in deposits.
- The Bank of England ordinarily deals with discount houses rather than directly with banks, but the effect on bank reserves is similar. The provision of such advances is one of the oldest and most traditional functions of central banks. The rate of interest charged is known as the "discount rate," or "rediscount rate." By raising or lowering the rate, the central bank can regulate the cost of such borrowing.
- The level of and changes in the rate also indicate the view of the central bank on the desirability of greater tightness or ease in credit conditions.

- Some central banks, especially in countries that lack a broad capital market, extend medium- and long-term credit to banks and to government development corporations in order to facilitate the financing of domestic economic-development expenditures and to alleviate the deficiency of financial savings. Such longer-term lending is not regarded as an appropriate central-bank activity by many authorities, however, and is considered a dangerous source of inflationary pressures.
- **3.Direct government borrowing from central banks generally is frowned/lowered upon as encouraging fiscal irresponsibility** and commonly is subject to statutory limitation; nevertheless, in many countries the central bank is the only large source of credit for the government and is used extensively.
- In other countries indirect support of government financing operations has monetary effects that differ little from those that would have followed from an equal amount of direct financing by the central bank.

- 4. **Central banks buy and sell foreign exchange to stabilize the international value of their own currency**. The central banks of major industrial nations engage in the so-called “currency swaps,” in which they lend one another their own currencies in order to facilitate their activities in stabilizing their exchange rates. Prior to the 1930s, the authority of most central banks to expand the money supply was limited by statutory requirements that restricted the capacity of the central bank to issue currency and (less commonly) to incur deposit liabilities to the volume of the central bank’s international reserves. Such requirements have been lowered or eliminated by most countries, however, either b/c they blocked expansions of the money supply at times when expansion was considered essential to domestic economic-policy objectives or because they “locked up” gold or foreign exchange needed for payments abroad.

- Many central banks have the authority to fix and to vary, within limits, the minimum cash reserves that banks must hold against their deposit liabilities.
- In some countries, the reserve requirements against deposits provide for the inclusion of certain assets in addition to cash.
- Generally, the purpose of such inclusion is to encourage or require banks to invest in those assets largely than they otherwise would be inclined to do and thus to limit the extension of credit for other purposes.
- Similarly, especially lower discount rates sometimes are used to encourage specific types of credit, such as agriculture, housing, and small businesses.

- In periods of intense inflationary pressure and shortage of supplies, especially during wartime and immediately thereafter, many governments have felt a need to impose direct measures to curb the availability of credit for particular purposes—such as the purchase of consumer durables, houses, and nonessential imported goods—and often have had these controls administered by their central banks.
- Such controls typically establish maximum loan-value to purchase-price ratios and maximum maturities that must be prescribed by lenders.
- These controls often apply to non-bank lenders as well as to bank lenders, and this is necessary for effectiveness in countries in which non-bank lenders are important sources of the types of credit being curbed. The general experience of central banks with direct credit controls has not been favorable; opportunities for evasion are too easy, especially if overall credit conditions are not extremely tight, and inequities in the impact of the controls become socially and politically troublesome. An early example of selective credit-control authority vested in a central bank and one that, on balance, has worked tolerably well is the authority conferred on the U.S. Federal Reserve Board in 1934 to establish margin requirements on stock-market credit.

The National Bank of Ethiopia

- The National Bank of Ethiopia was created by order No 30/1963 and reconstituted/reconstructed by the Monetary and Banking Proclamation No 83/1994 as an autonomous organ, which is engaged in the provision of regular banking services to the government and other banks and insurance companies'.
- The main purpose of the bank is to forester monetary stability financial system and such other credit and exchange conditions as are conducive to the balanced growth of the economy of Ethiopia. / Art 6/
- The bank will have the following powers and duties that will help it to achieve its purpose, /Art 7/

✓ Mint coin, print and issue legal tender currency.

✓ Regulate the supply and availability of money and fix the minimum and maximum rates of interest that banks and other financial institutions may charge for different types of loans, advances and other credits and pay on various classes of deposits. (Art 7 and Art 30).

✓ Implement exchange rate policy,

✓ allocate foreign exchange,

✓ manage and administer the international reserve fund of Ethiopia. This reserve fund consists of gold, silver, foreign exchange and securities, which are used to pay for imports into the country and pay foreign international debts and other commitments (Art 50).

- License, supervise and regulate banks, insurance companies and other financial institutions such as savings and credit associations/co-operatives and postal savings.
- Set limits on gold and foreign exchange assets that banks and other financial institutions, which are authorized to deal in foreign exchange, can hold in deposits (Art 39).
- Set limits on the net foreign exchange position and on the terms and the amount of external indebtedness of banks and other financial institutions.
- Make short and long term refinancing facilities available to banks and other financial institutions.
- Accept deposits of any type from foreign sources.
- Act as banker, fiscal agent and financial advisor to the government/Art 24, 25/.
- Promote and encourage the dissemination of banking and insurance services throughout the country.
- Prepare periodic economic studies together with forecasts of the balance of payment, money supply, prices and other statistical indicators of the Ethiopian economy used for analysis and for the formulation and determination by the bank of monetary, savings and exchange policies.

- Pursuit of Excellence and Professionalism

The vision, mission and goals of the National Bank of Ethiopia emanated from the overall vision of the government which is *"to see a country, wherein democracy and good governance are prevailed upon the mutual consent and involvement of its people, wherein social justice is reigned, and wherein poverty reduced and income of the citizens reach to a middle economic level".*

- **Vision of the Bank**

To be one of the strongest and most reputable central banks in Africa

- **Mission of the Bank**

To maintain price and exchange rate stability, to foster a sound financial system and undertake such other functions as are conducive to the economic growth of Ethiopia.

- **Values of the Bank**

***A)* Core value**

- Promoting financial and monetary discipline

***B)* Individual Values**

- Integrity /honesty
- Neatness and good appearance
- Punctuality
- Team work spirit

C) Operational Values

- Commitment to Excellence in Service
- Confidentiality
- Continuous Improvement
- Transparency
- Accountability

D) Organizational Strategic Values

1. Vision, Mission and Goals of the National Bank of Ethiopia

- **Strategic Goals**
- **Goal 1**: Carry out extensive and sound institutional transformation tasks.
- **Goal 2**: Maintain price and exchange rate stability.
- **Goal 3**: Maintain adequate international reserves.
- **Goal 4**: Improve the soundness of the financial system.
- **Goal 5**: Play a decisive role in economic research and policy advice to the Government.
- **Goal 6**: Create an efficient Payment System.
- **Goal 7:** Improve the currency management of the Bank.
- **Objectives**
- **Objectives of Goal 1**
- Identify and conduct Quick win activities on continuous basis.
- Implement BPR studies conducted and ensure their sustainability.
- Review and update the SPM document of the Bank every two years.
- In 2005/06, devise a result-based scheme that measures the performance evaluation of the work units and individual employees.
- Identify and have adequate change agents.
- Improve service delivery of the Bank.
- Strengthen its service and enhance the computerization process of the Bank.
- Enhance the capacity of the Bank.

- **Objectives of Goal 2**
- Contain annual core inflation (non-food inflation) within a single digit._
- Maintain the exchange rate of Birr close to the equilibrium exchange rate._
- Contain the premium between the official and parallel market exchange rate to the level below 1.5 percent._
- Maintain the premium of respective buying and selling rates of the USD between the NBE and commercial banks below 2 percent.
- **Objectives of Goal 3**
- Ensure that the international reserve of the country is not less than three and a half months of imports of goods and non-factor services._
- Manage the country's Foreign Exchange Reserve efficiently and effectively.
- Ensure and manage the effective use of the country's Foreign Exchange.
- **Objectives of Goal 4**
- Ensure the average level of NPLs of commercial banks is reduced to below 15 percent._
- Conduct effective on-site inspection of banks._
- Conduct effective on-site inspection of insurance companies._
- Conduct effective on-site inspection of micro finance institutions._
- Issue seven new directives within the SPM period._
- Amend the existing directives/policies._
- Ensure systematic risk management framework for each bank._
- Introduce CAMEL rating of banks._

- **Objectives of Goal 5**
- Finalize the Ethiopian macro econometric model and start its application
- Strengthen the Bank's research and policy advisory capabilities and the dissemination of its findings in terms of published research papers and policy discussion forums by 100% each from 4 and 2 to 8 and 4 respectively.
- **Objectives of Goal 6**
- Create a National Payment System framework.
- Conduct structural reforms on the existing payment systems.
- **Objectives of Goal 7**
- Ensure the availability and distribution of the Birr notes and coins.
- Ensure the automatic provision of Birr notes exchange services
- Increase the daily note sorting and verification capacity of the bank from the existing Birr 650,000 pcs per day by 60%.
- Increase the note destruction capacity of the Bank from the existing Birr 700,000 pcs per day by 30%.
- Assess counterfeiting situations.

Commercial Banks

- Commercial banks are banks with the power to make loans that, at least in part, eventually become new demand deposits. Because a commercial bank is required to hold only a fraction of its deposits as reserves, it can use some of the money on deposit to extend loans.
- When a borrower receives a loan, his checking account is credited with the amount of the loan; total demand deposits are thus increased until the loan is repaid. As a group, then, commercial banks are able to expand or contract the money supply by creating new demand deposits.
- The name commercial bank was first used to indicate that the loans extended were short-term loans to businesses, though loans later were extended to consumers, governments, and other non-business institutions as well. In general, the assets of commercial banks tend to be liquid and carry less risk than the assets held by other financial intermediaries.
- The modern commercial bank also offers a wide variety of additional services to its customers, including savings deposits, safe-deposit boxes, and trust services.
- The Commercial Bank of Ethiopia and all the privately owned banks in Ethiopia fall under this category as they are primarily engaged in receiving money on deposit and providing loans to the public.

Savings Banks

- A savings bank is a financial institution that gathers savings and that pay interest or dividends to savers. It channels the savings of individuals who wish to consume less than their incomes to borrowers who wish to spend more.
- The savings deposit departments of commercial banks, mutual savings banks or trustee savings banks (banks without capital stock whose earnings accrue solely to the savers), savings and loan associations, credit unions, postal savings systems, and municipal savings banks serve this function. Except for the commercial banks, these institutions do not accept demand deposits. Postal savings systems and many other European savings institutions enjoy a government guarantee; savings are invested mainly in government securities and other securities guaranteed by the government.

- **Savings banks** frequently originated as part of philanthropic efforts to encourage saving among people of modest means. The earliest municipal savings banks developed out of the municipal pawnshops of Italy.
- Local savings banks were established in The Netherlands through the efforts of a philanthropic society that was founded in 1783, the first bank opening there in 1817. During the same time, private savings banks were developing in Germany, the first being founded in Hamburg in 1778.
- The first British savings bank was founded in 1810 as a Savings and Friendly Society by a pastor of a poor parish; it proved to be the forerunner of the trustee savings bank. The origin of savings banking in the United States was similar; the first banks were nonprofit institutions founded in the early 1800s for charitable purposes. With the rise of other institutions performing the same function, mutual savings banks remained concentrated in the northeastern United States.
- This type of specialized banking service is not yet introduced in Ethiopia and hence there is no bank, which may be considered as a savings bank. However, the commercial banks accept savings as one form of money deposit.

Investment Banks

- Investment bank is a firm that originates, assurances /guarantees , and distributes **new security issues of corporations and government agencies**. The investment-banking house operates by purchasing all of the new security issue from a corporation at one price and selling the issue in smaller units to the investing public at a price sufficiently high to cover expenses of sale and leave a profit. The major responsibility for setting the public offering price rests on the investment bank because it is in close contact with the market, is familiar with current interest rates and yields, and is best able to judge the probable demand for the issue in question.
- In the underwriting and distribution of most security issues, a syndicate of investment banking firms is organized.
- If the amount of capital sought is large enough to

- If the market coverage that can be obtained by the members of the syndicate/ organization is deemed insufficient, selected dealers are used to bring about a wider distribution.
- Securities are sold to the dealers at a reduction (known as a concession), which reimburses the dealer for his expenses and provides him with a profit if the distribution is performed skillfully.
- When new securities are to be issued, an investment firm having close contact with the corporation is likely to be asked to originate the issue. This process often is called private negotiation. An alternative arrangement is competitive bidding, under which the corporation itself settles upon the terms of the issue to be offered and then invites all banking firms to submit bids. The issue will be sold to the highest bidder.

- The fact that Ethiopia is a predominantly agrarian state and business in general is limited to a small scale under takings by individuals, the idea of investment through purchase of stocks/ shares and bonds is common.
- Further, more, the very few companies that were established to wards the end of the imperial era, were nationalized by the military government which adopted the Socialist ideology and economic system, which does not allow private ownership of big manufacturing, agricultural and service providing undertakings or businesses.
- This fact has prevented the introduction of investment banking in Ethiopia. Though a market economic policy has been adopted after the fall of the military government and business in general and companies in particular are expanding, companies have not started offering their shares to the public and hence there was no conducive environment for the establishment and operation of these types of banks in Ethiopia.

Development Banks

- It refers to a national or regional financial institution designed to provide medium- and long-term capital for productive investment, often accompanied by technical assistance, in less-developed areas.
- The number of development banks has increased rapidly since the 1950s; they have been encouraged by the International Bank for Reconstruction and Development and its affiliates. The large regional development banks include the Inter-American Development Bank, established in 1959; the Asian Development Bank, which began operations in 1966; and the African Development Bank, established in 1964. They may make loans for specific national or regional projects to private or public bodies or may operate in conjunction with other financial institutions.
- One of the main activities of development banks has been the recognition and promotion of private investment opportunities. Although the efforts of the majority of development banks are directed toward the industrial sector, some are also concerned with agriculture.

- Development banks fill a gap left by undeveloped capital markets and the reluctance of commercial banks to offer long-term financing. Development banks may be publicly or privately owned and operated, although governments frequently make substantial contributions to the capital of private banks. The form (share equity or loans) and cost of financing offered by development banks depends on their cost of obtaining capital and their need to show a profit and pay dividends.
- The Development Bank of Ethiopia is established with the purpose of providing long-term loans to agricultural and industrial undertakings, which are considered crucial in the development of the economy. It was intended to serve as the major financer for the various co-operatives and government owned farms and factories.
- Now it also provides long-term loans to private investors who are engaged in agricultural and manufacturing activities.

Islamic Banking
General Overview of Islamic Banking

- "Islamic banking refers to a system of banking activity that is consistent with the Islamic law (Sheria). It is guided by principles of Islamic economics. At this juncture, it is important to note that Islamic law prohibits usury, that is, the collection and payment of interest which is commonly known as riba in Islamic discourse. In addition, Islamic law prohibits investing in businesses that are considered unlawful, or harem (such as businesses that sell alcohol or dork or business that produce media such as gossip columns or pornography which are contrary to Islamic values.
- In line with this, in the late 20th century a number of Islamic banks were established.

The Meaning of Riba

- **The word riba literally means increase or excess. It covers both usury and interest. In Quranic verses it essentially refers to the practice of lending money for predetermined rate of return or interest. Riba can also be interpreted as the addition to the principal sum advanced through loan from the lender to the borrower. The Shariah disallow riba and there is now a general consensus among Muslim economists that riba is not restricted to usury but encompasses interest as well. The Qur'an is clear about the prohibition of riba. You who believe fear Allah almighty and give up that remains of your demand for usury if you are indeed believer.**
- **Muslim scholars have accepted the word riba to mean any fixed or guaranteed interest payment on cash advance or on deposits. Several Quranic verses expressly admonish the faithful to shun interest.**

History of Islamic Banking

- The history of interest free banking could be divided into two parts. First, when it still remained an idea; second when it became a reality by private initiative in some countries and by law in others.
- **A, Interest Free Banking as an Idea**
- Interest free banking seems to be of very recent origin especially in our country. But the earliest reference to the reorganization of banking on the basis of profit sharing written by Anwar Qureshi (1946), Naiem Siddiq (1948) and Mohamed Ahmed (1952). In the last forties it was followed by more elaborate exposition by Mawdudi in (1950). They have all recognized the need of commercial banks that use in profit and lose sharing mechanism and have proposed a banking system based on the concept of mudarabh (profit and loss sharing). In the next two decades interest free banking attracted more attention because of the emergence of young Muslim economists. The first such works emerged in that of Muhammed vzair (1955). Another set of works emerged in the late sixties and early seventies, Abdullah al-araby (1967), Nejatullah Siddigi (1961.1969), Al Najjar (1971) and Baqir al-sadr (1961, 1974) were the main contributors.
- The early seventies saw the institutional involvement that is conference of the finance Ministers of the Islamic countries held in Karachi in 1970, the Egyptian study in 1972, the first international conference on Islamic Economics in Mecca in 1976 etc.

- **B, the Coming in to Being of Interest Free Bank**
- “The institutional and governmental involvement led to the application of theory to practice and resulted in the establishing of the first interest free banks”. The Islamic development bank, an inter-governmental bank established in (1975) was born of this process. The first private interest free bank is the Dubai Islamic bank; it was set up in 1975. Before this modern bank experiment, Islamic banking was undertaken in Egypt without projecting on Islamic image for fear of being seen as manifestation of Islamic fundamentalism that was an anathema to the political regime.
- The pioneering effort led by Ahmed El-Najjar took the form of saving bank based on profit sharing in the Egyptian town of Mit Ghamr in 1963. By this time there were Nine (9) such banks in the country. In ten years, since the establishment of the first private commercial bank in Dubai, more than 50 interest free banks have come into being. In most countries the establishment of interest free banking had been by private; in Iran and Pakistan, however, it was undertaken by government initiative and covered all banks in the country.

Principles of Islamic Banking

- “The Islamic beliefs prevent the believer from dealing that involves usury or interest (riba). Yet Muslims need banking service as much as anyone else and for many purposes to finance new business ventures to buy a house, car, to facilitate capital investment, to undertake trading activities, and to offer a safe place for savings”.
- Islamic banking based on the Quranic prohibition of charging interest has moved from a theoretical concept to embrace more banks operating in 45 countries with multi-billion dollar deposit world-wide. Islamic banking is widely regarded as the fastest growing sector. An estimated $ US 70 billion worth of funds are now managed according to shariah.
- The best known feature of Islamic banking is the prohibition of interest. The Quran forbids the charging of riba on money lent. The Sharia disallow riba and there is now a general consensus among Muslim economists that riba is not restricted to usury but encompasses interest as well.

- Let us look at the rule regarding Islamic finance, which is simple and can be summed up as follows:
- 1. Any predetermined payment over and above the actual amount of principal for any is prohibited. Islam allows only one kind of loan and that is qard-el hassan (literally good loan), where the lender does not charge any interest or additional amount over the money lent.
- 2. The lender must share in the profits or losses arising out of the enterprise for which the money was lent for the business. Islam encourages Muslims to invest their money and to become partners in order to share profits and risk in the business instead of becoming creditors.
- As defined in the Shari'ah or Islamic law, Islamic finance is based on the belief that the provider of capital and the user of capital should equally share benefit and the risk of business ventures.

- The principle, which thereby emerges, is that Islamic Law encourages investments in order that the community may benefit.
- 3. Making money from money is not Islamically acceptable; money is only a medium of exchange, a way of defining the value of a thing it has no value in itself and should not be all owed to give rise to more money through fixed interest payments, simply by being put in a bank or lent to someone else. "Muslim jurists consider money as a potential capital rather than capital, meaning that money becomes capital only when it is invested in business" 15
- 4. Gharar (uncertainty risk or speculation) is also prohibited; and any transaction entered into should be free from uncertainty risk and speculation. Contracting parties should have perfect knowledge of the counter values intended to be exchanged as a result of their transactions.
- 5.Investments should only support practice or products that are not forbidden. Trade in alcohol, for example would not be financed by an Islamic bank, a real estate loan could not be made for the construction of a casino and the bank could not lend money to other banks at interest, even if it is profitable.

1.5 Banks and the Money Market

1.5.1 Commercial Banks

- Commercial banks are at the centre of most money markets, as both suppliers and users of funds, and in many markets, a few large commercial banks serve also as intermediaries. These banks have a unique place because it is their role to furnish an important part of the money supply.
- In the course of issuing money, the commercial banks also actually create it by expanding their deposits, but they are not at liberty to create all that they may wish whenever they wish, for the total is limited by the volume of bank reserves and by the prevailing ratio between these reserves and bank deposits—a ratio that is set by law, regulation, or custom.
- The volume of reserves is controlled and varied by the central bank (such as the Bank of England, the Bank of France, or the Federal Reserve System in the U.S.), which is usually a governmental institution, always charged with governmental duties, and almost invariably carries out a major part of its operations in the money market.

1.5.2 Central Banks

- The reserves of the commercial banks, which are continually being redistributed through the facilities of the money market, are in fact mainly deposit balances that these commercial banks have on the books of the central bank or notes issued by the central bank, which the commercial banks keep in their own vaults.
- As the central bank acquires additional assets, it pays for them by crediting depositors' accounts or by issuing its own notes; thus the potential volume of commercial bank reserves is enlarged. With more reserves, the commercial banks can make additional loans or investments, paying for them by entering credits to depositors' accounts on their books. And in that way the money supply is increased. It may be reduced by reversing the sequence. The central bank can sell some of its marketable assets in the money market or in markets closely interrelated with the money market; payment will be made by drawing down some of the commercial bank reserve balances on its books; and with smaller reserves remaining, the commercial banks will have to sell or reduce some of their investments or their loans. That, in turn, results in shrinkage of the outstanding money supply. Central bank operations of this kind are called open-market operations.

- The central bank may also increase bank reserves by making loans to the banks or to such intermediaries as bill dealers or dealers in government securities. Reduction of these loans correspondingly reduces bank reserves. Although the mechanics of these lending procedures vary widely among countries, all have one feature in common: the central bank establishes an interest rate for such borrowing—the bank rate or discount rate—pivotally significant in the structure of money market rates.
- Money market assets may range from those with the highest form of liquidity—deposits at the central bank—through bank deposits to various forms of short-term paper such as treasury bills, dealers' loans, bankers' acceptances, and commercial paper, and including government securities of longer maturity and other kinds of credit instruments eligible for advances or rediscount at the central bank. Although details vary among countries, the touchstone of any money market asset other than money itself is its closeness—i.e., the degree of its substitutability for money. So long as the institutions making use of a money market regard a particular type of credit instrument as a reasonably close substitute—that is, treat it as “liquid”—and so long as the central bank acquiesces in or approves of this approach, the instrument is in practice a money market asset. Thus, no single definition or list can apply to the money markets of all countries nor will the list remain the same through the years in the money market of any given country.

1.6 Responsibilities of Central Banks

- Modern market economies are subject to frequent fluctuations in output and employment. Although the causes of these fluctuations are various, there is general agreement that the ability of banks to create new money may exacerbate them. Although an individual bank may be cautious enough in maintaining its own liquidity position, the expansion or contraction of the money supply to which it contributes may be excessive. This raises the need for a disinterested outside authority able to view economic and financial developments objectively and to exert some measure of control over the activities of the banks. A central bank should also be capable of acting to offset forces originating outside the economy, although this is much more difficult.
- The first concern of a central bank is the maintenance of a soundly based commercial banking structure. While this concern has grown to comprehend the operations of all financial institutions, including the several groups of non bank financial intermediaries, the commercial banks remain the core of the banking system. A central bank must also cooperate closely with the national government. Indeed, most governments and central banks have become intimately associated in the formulation of policy.

1.6.1 Relations with Commercial Banks

- One source of economic instability is the supply of money. Even in relatively well-controlled banking systems, banks have sometimes expanded credit to such an extent that inflationary pressures developed. Such an overexpansion in bank lending would be followed almost inevitably by a period of undue caution in the making of loans. Frequently the turning point was associated with a financial crisis, and bank failures were not uncommon. Even today, failures occur from time to time. Such crises in the past often threatened the existence of financial institutions that were essentially sound, and the authorities sometimes intervened to prevent complete collapse.
- The willingness of a central bank to offer support to the commercial banks and other financial institutions in time of crisis was greatly encouraged by the gradual disappearance of weaker institutions and a general improvement in bank management. The dangers of excessive lending came to be more fully appreciated, and the banks also became more experienced in the evaluation of risks.
- In some cases, the central bank itself has gone out of its way to educate commercial banks in the canons of sound finance. In the United States, the Federal Reserve System examines the books of the commercial banks and carries on a range of frankly educational activities. In other countries, such as India and Pakistan, central banks have also set up departments to maintain a regular scrutiny of commercial bank operations.

- The responsibility of the central bank to protect banks that have been honestly and competently managed from the consequences of a sudden and unexpected demand for cash. In other words, the central bank came to act as the “lender of last resort.” To do this effectively, it was necessary that the central bank be permitted either to buy the assets of commercial banks or to make advances against them. It was also necessary that the central bank has the power to issue money acceptable to bank depositors. However, if a central bank was to play this role with respect to commercial banks, it was only reasonable that it or some related authority be allowed to exercise a degree of control over the way in which the banks conducted their business.
- Most central banks now take a continuing day-to-day part in the operations of the banking system. The Bank of England, for example, has been increasingly in the market to ensure that the banks have a steady supply of cash, even during periods of credit restriction.
- In the United States, the Federal Reserve System has operated in a similar way by buying and selling securities on the open market and by lending to dealers in government securities based on repurchase agreements.
- The Federal Reserve may also discount paper submitted by the

1.6.2 The Central Bank and the National Economy

1.6.2.1 Relations with Other Countries

- Since no modern economy is self-contained, central banks must give considerable attention to trading and financial relationships with other countries. If goods are bought abroad, there is a demand for foreign currency to pay for them. Alternatively, if goods are sold abroad, foreign currency is acquired that the seller ordinarily wishes to convert into the home currency.
- These two sets of transactions usually pass through the banking system, but there is no necessary reason why, over the short period, they should balance. Sometimes there is a surplus of purchases and sometimes a surplus of sales. Short-period disequilibrium is not likely to matter very much, but it is rather important that there be a tendency to balance over a longer period, since it is difficult for a country to continue indefinitely as a permanent borrower or to continue building up a command over goods and services that it does not exercise.
- Short-period disequilibrium can be met very simply by diminishing or building up balances of foreign exchange.
- Long-period equilibrium is more difficult to achieve. It may be approached in three different ways: price movements, exchange revaluation (appreciation or depreciation of the currency), or exchange controls.

- The objective may be achieved more directly by revaluing a country's exchange rate. Depending on the circumstances, the rate may be appreciated or depreciated, or it may be allowed to “float.”
- Appreciation means that the home currency becomes more valuable in terms of the currencies of other countries and that exports consequently become more expensive for foreigners to buy.
- Depreciation involves a cheapening of the home currency, thus lowering the prices of export goods in the world's markets.
- In both cases, however, the effects are likely to be only temporary, and for this reason the authorities often prefer relative stability in exchange rates even at the cost of some fluctuation in internal prices.

1.6.2.3 Supervision and Promotion of Banking Services

- Another responsibility of the central bank is to ensure that banking services are adequately supplied to all members of the community that need them. Some areas of a country may be “under-banked” (e.g., the rural areas of India and the northern and more remote parts of Norway), and central banks have attempted, directly or indirectly, to meet such needs.
- In France, this need underlay the early extension of branches of the Bank of France to the departments.
- In India, the authorities encouraged the opening of “pioneer” branches by the former Imperial Bank of India and its successor, the State Bank of India, later by all the nationalized banks, and particularly their extension to rural and semi rural areas.
- In Pakistan, officials of the State Bank of Pakistan played an active part in the foundation of the semi public National Bank of Pakistan with a similar objective in view.

- A different sort of problem arises when the business methods of existing banks are unsatisfactory. In such circumstances, a system of bank inspection and audit organized by the central banking authorities (as in India and Pakistan) or a system of bank “examinations” (as in the United States) may be the appropriate answer. Alternatively, the supervision of bank operations may be handed over to a separate authority, such as France's Banking Control Commission or South Africa's Registrar of Banks.
- In developing countries, central banks may encourage the establishment and growth of specialist institutions such as savings institutions and agricultural credit or industrial finance corporations. These serve to improve the mechanism for tapping existing liquid resources and to supplement the flow of funds for investment in specific fields.

Banks and Banking Transactions in Ethiopia

- Book IV Title III of the Commercial Code of Ethiopia which deals with banking transactions fails to provide a definition of a bank and banking transactions though the latter may be gathered from the various sections governing the various types of transactions undertaken by banks. Therefore, we have to refer to other laws to define and determine what banks and banking transactions are under the Ethiopian legal system.
- According to Art 2 (12) of the Monetary and Banking Proclamation No 83/1994, banking business means any operation involving receiving money on deposit, lending money, receiving commercial instruments on deposit, accepting, negotiating/ transferring, discounting commercial instruments and other evidences of debt, and buying and selling of gold and silver notes and foreign exchange. Similarly, Art 2 (2) of the Licensing

- Any business involving acceptance of money on deposit, using such funds or deposits, in whole or in part, for loans or investments on the account of and at the risk of the person undertaking the business, purchasing, selling and deposit of negotiable instruments (shares, bonds and other securities/ and checks, bills and notes, and buying and selling of gold and silver bullions and foreign exchange).
- On the other hand, the term bank is defined, under Art 2(1) and (4) of the same proclamation, as a share company whose capital is wholly owned by Ethiopian nationals and/or business organizations wholly owned by Ethiopian nationals and which is registered under Ethiopian laws and which has its head office in Ethiopia and licensed to undertake banking business by the national bank of Ethiopia.
- In addition to this, Art 4(2) of the same proclamation clearly prohibits foreign nationals and business organizations from undertaking banking business in Ethiopia. The definition of a bank and this provision exclusively reserve the banking sector to Ethiopian nationals or business organizations wholly owned by Ethiopian nationals mainly on the ground of protection of domestic banks which are at an early stage of development, at least until they develop their financial and manpower capabilities, to be able to compete with foreign banks which have enormous financial strength, experience, technology and knowhow.

Role of Micro Finance Institutions

- According to the preamble of Proclamation No. 40/1996, the monetary and banking laws in force do not provide for micro financing institutions catering for the credit needs of peasant farmers and others engaged in small scale production and service activities. So it has become necessary to legislate on the licensing and supervision of the business of micro financing institutions.
- So the development of microfinance in Ethiopia should be viewed as (a) an identification of considerable levels of unrealized demand and potential market growth for financial services and (b) a shift by the NGO sector and government from relief assistance to sustainable development which intersects at the point of institutionalization of microfinance provision (Fiona, 1999).

- Although the development of microfinance institutions in Ethiopia started very recently, the industry has shown a remarkable growth in terms of outreach particularly in number of clients.
- Since the issuance of Proclamation 40/1996, which provides the establishment of microfinance institutions, sixteen microfinance institutions (MFIs) have been legally registered by the National Bank of Ethiopia (NBE) and started delivering services, and two more applications by new MFIs are currently being processed.
- According to the Micro start Project document of UNDP (1999), the economically active poor in Ethiopia who can potentially access financial services are about 6 million. Out of this, about 8.3% of the active poor have gained access to the licensed microfinance institutions. Despite the obvious disadvantages of the microfinance industry in Ethiopia such as poor communication and infrastructure, weak legal systems, banking sector and technical capacity when compared with other Sub-Saharan countries, the sector has been growing at a significant rate.

The Regulatory Framework for the Microfinance Industry and Micro and Small Enterprises

- The delivery of efficient and effective microfinance services to the poor required conducive macroeconomic policies and the establishment and enforcement of legal and regulatory frameworks of a country.
- An effective financial system provides the foundation for a successful poverty alleviation program. However, regulations in the microfinance industry do not only mean government regulations; it also involves self-regulations and code of conducts introduced by networks or associations.
- Regulatory frameworks governing the microfinance industry should ensure that the MFI has a sound portfolio performance; low delinquency or default rate; high diversification to reduce the risk of specializing in the delivery of one loan product; ensure the safety of deposits through equity capital; ensure lower levels of

- There are numerous policies, laws and directives which affect the development of microfinance industry and micro and small enterprise development in Ethiopia. An attempt is made here to review only the most relevant and recent policies affecting the industry.
- The Monetary and Banking Proclamation No. 83/1994 empowered the National Bank of Ethiopia (NBE) to license, supervise and regulate financial institutions such as banks, insurance companies, microfinance institutions and savings and credit cooperatives.
- The Licensing and Supervision of Banking Business Proclamation No. 84/1994 allowed for the first time the establishment of private financial institutions, thus breaking the state monopoly. To date, six private banks and eight private insurance companies have been established.
- Since micro-credit delivery and savings mobilization in Ethiopia were performed by NGOs, government

- Microfinance industry Proclamation No. 40/1996, which aims to provide for the licensing and supervision of the business of micro financing clearly indicates the requirements for licensing microfinance institutions by empowering the National Bank of Ethiopia to license and supervise them. According to article 4 of the Proclamation, any institution that needs to engage in microfinance activity should fulfill the following:
- obtain license from the National Bank of Ethiopia;
- formed as a company governed by the commercial code of 1960 (a share company owned fully by Ethiopian nationals and having its head office in Ethiopia);
- deposit the minimum capital required, i.e., 200,000 Birr in a bank;
- the directors and other officers meet requirements set by the bank.
- Furthermore, as to the purpose and duty of macro finance institutions, article 3 of the same proclamation provides:

- The purpose of micro financing institutions is granting credit, in cash or in kind, the maximum amount of which shall be determined by the bank.
- subject to conditions set under this Proclamation, a micro finance institution may carry out some or all of the following activities:
- accepting savings as well as demand and time deposits;
- drawing and accepting drafts payable within Ethiopia;
- borrowing money for its business purpose against the security of its assets or otherwise;
- purchasing such income generating financial instruments as treasury bills;
- acquiring, maintaining and transferring of any moveable and immovable property including premises for carrying out its business;
- providing counseling services to its clients;
- encouraging income generating projects for urban and rural micro-operators;
- rendering managerial, marketing, technical and administrative advice to borrowers and assisting them to obtain services in those

- To realize the above purposes and duties, the National Bank of Ethiopia has also issued 12 directives, which have been consistent with Proclamation No. 40/1996. These included setting a loan ceiling of 5,000 Birr and loan duration of one year. The interest rate has been waived and MFIs are now free to set their own interest rates ceiling. There is also a requirement for re-registration once an MFI mobilizes deposits greater than one million Birr.
- The regulatory framework has affected the welfare-oriented NGOs in Ethiopia which focus on welfare programs by providing free or subsidized micro-credit services. They tend to provide credit services at very low interest rate (below market interest rate) focusing on the poorest of the poor (based on humanitarian reasons) rather than on sound credit management principles.
- As a result, many of the NGOs, providing micro-credit services in Ethiopia, are in a transition from highly subsidized credit programs to a finance based system. Although the initial reactions of the NGOs in Ethiopia to the implementation of the regulatory framework (Proclamation No. 40/96) were negative, they have now realized that the regulatory framework has institutionalized and unified microfinance services in the country.

- The required minimum paid-up capital payment for MFI in Ethiopia (about 25,000 US Dollars) is low and affordable. The recent full liberalization of lending interest rates is also a positive development towards implementing an operationally sustainable strategy for MFIs. This assists to adequately price small-scale and risky loans and microfinance operations.
- The government has recognized the importance of micro-enterprise development to the overall economic growth of the country and poverty alleviation. It has established the Micro and Small Enterprise Development Agency to co-ordinate and support the sector. According to Proclamation No. 33/1998, the Agency shall be involved in designing policies and strategies for the development and expansion of the micro and small enterprise; study the demand for training and conduct training; establish skill up-grading, technical and demonstration centers in different regions

- In addition to addressing poverty and food security issues, micro-enterprises teach the poor new skills and help them generate greater savings for investment and promote inter-sectoral linkages.
- The main constraints of micro and small enterprises include lack of finance, business information, business premises, skills and managerial expertise, access to appropriate technology, lack of adequate infrastructure and in some instances discriminatory regulatory practices. In the Ethiopian context, and in terms of partially solving the problem of financial resources, the agency has to integrate its activities with the microfinance industry.
- The Federal Government of Ethiopia has produced the Micro and Small Enterprises Development Strategy to address the above problems and create an enabling environment for the growth of these enterprises. It has identified criteria and prioritized the target beneficiaries of the support program. The support program will consider those micro and small enterprises using local raw materials and/or labor intensive technologies, having greater inter-and intra-sectoral linkages; potentially competitive and have objective of exporting their products; and those engaged in facilitating and promoting tourism. The support program focuses on creating an enabling legal framework; streamlining existing regulatory conditions; facilitating access to finance; training in entrepreneurship, technical and management skills; facilitating access to market, raw materials and fostering partnership; and facilitating the availability and access to adequate infrastructure.
- Proclamation No. 83/1995 provides for the establishment of primary and secondary agricultural cooperatives on voluntary basis and democratic principles. One of the objectives of the new Proclamation 147/1998. (Co-operatives Societies Proclamation) is to develop and promote saving and credit services for members to participate actively in the free market economic system.

Implementing, Monitoring and Evaluating the Regulatory Framework of the Microfinance Industry

- The process of policy formulation, implementation, monitoring and evaluation is, by and large, the same whether it refers to the policy formulated at macro or micro levels. It applies equally to policies formulated by the government, a particular private firm or by an NGO. Just as in a project, the formulation, implementation and monitoring process of financial policy, or any development policy, should follow a defined path. The process starts with the identification of financial policy constraints which impede the achievement of the stated objectives. This is then followed by the analysis of the constraints, formulation of alternative financial policy options or remedial measures, appraisal and approval, implementation and finally monitoring and evaluation of the effects and impacts of the financial policies of the regulatory framework of the microfinance industry. We can call this the financial policy cycle instead of the project cycle.
- The search for appropriate change in the regulatory framework and identifying the problems starts when the stated government objectives and targets fail or are failing. The need for financial policy reform or change could also start when concerned government departments (such as the National Bank of Ethiopia) or stakeholders realize that existing regulatory frameworks are having unanticipated negative consequences. The identification of a financial policy reform for the microfinance industry and designing appropriate policy options could start when one of the following situations or a combination of these occur.

- When the Ethiopian government itself, the National Bank of Ethiopia or the Prime Minister's Office believes that the envisaged financial policy objectives and targets are not met or realized.
- When the government, with an external pressure e.g., from the IMF or World Bank, considers that current financial policies are not sustainable in the long term.
- When existing regulatory frameworks result in negative consequences that were not envisaged or the effect has been underestimated at the time of their conception.
- When the government realizes that there are better financial policy options to bring about an accelerated development in the microfinance industry.
- When stakeholders such as the practitioners in the microfinance industry demand a change in the current policies or regulatory framework.
- Thus, the possible identification of a change in the regulatory framework of the microfinance industry could originate from (a) government line departments; (b) multilateral and bilateral donors; (c) organized and unorganized stakeholders such as the practitioners in the microfinance industry; and (d) research institutes acting as think tanks for policy analysis, financial policy monitoring and evaluation.

- In Ethiopia, there is no government department which follows up the overall development of the microfinance industry. Currently, there are no research institutes involved in microfinance development and policy research which recommend a change in the regulatory framework. There are attempts, however, by the Prime Minister's Office and the Ethiopian Economic Association to establish an Economic Policy Research Institute.
- In the Ethiopian context, multilateral and bilateral organizations do not have the mandate and responsibility of identifying and changing government policies through direct or indirect pressure.
- The last option to the microfinance industry is to use the network which is established with the objective of creating a forum to discuss policy issues and problems of the industry and share experiences.
- The Association of Ethiopian Microfinance Institutions

– Summary

- The term bank refers to an institution that deals in money and its substitutes and provides other financial services. Banks accept deposits, make loans, and derive a profit from the difference in the interest rates paid and charged respectively. Some banks also have the power to create money
- The significance of banking is that the existence of a strong and effective banking system is very important for the economic development of a country.
- When we come back to the development of banking, it is of ancient origin, though little is known about it prior to the 13th century. Many of the early “banks” dealt primarily in coin and bullion, much of their business being money changing and the supplying of foreign and domestic coin of the correct weight and fineness.
- In Ethiopia, it was in 1905 that the first bank, the “Bank of Abyssinia”, was established based on the agreement

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- Later on the Ethiopian Government, under Emperor Haile Sellassie, closed the Bank of Abysinia, paying compensation to its shareholders and established the Bank of Ethiopia which was fully owned by Ethiopians. The Bank was authorized to combine the functions of central banking (issuing currency notes and coins) and commercial banking.
- In 1963, the State Bank of Ethiopia split into the National Bank of Ethiopia and the Commercial Bank of Ethiopia S.C. with the purpose of segregating the functions of central banking from those of commercial banking. The new banks started operation in 1964.
- Finally, during the Emperor's Era, the first privately owned company in banking business was the Addis Ababa Bank S.C., established in 1964.
- Thus, until the end of 1974, we can safely say that there were state owned, foreign owned and Ethiopian owned banks in Ethiopia.
- Following the 1974 Revolution, on January 1, 1975 all private banks and 13 insurance companies were nationalized and along with state owned banks, placed under the coordination, supervision and control of the National Bank of Ethiopia. For this very reason, from 1975 to 1994 there were four state owned banks and one state owned insurance company, i.e., the National Bank of Ethiopia (The Central Bank), the Commercial Bank of Ethiopia, the Housing and Savings Bank, the Development Bank of Ethiopia and the Ethiopian Insurance Corporation.
- After the overthrow of the Dergue regime by the EPRDF, the Transitional Government of Ethiopia was established and the New Economic Policy for the period of transition was issued. This new economic policy replaced centrally planned economic system with a market-oriented system and ushered in the private sector. Several private companies were formed during the early 1990s one of which is Oda S.C. which conceived the idea of establishing a private bank and private insurance company in anticipation of a law which will open up the financial sector to private investors. Following the Transitional Period, the legal system is more conducive than ever before for the private sector in banking transaction.

To have a full-fledged understanding of this chapter, it is important to have a general overview on the principal types of banking. So that let us scoring the conventionally principal ones.

- Central bank is a banker to governments and “lenders of last resort” to commercial banks and other financial institutions. They are often responsible for formulating and implementing monetary and credit policies, usually in cooperation with the government.
- Commercial bank is a bank which deals with money and in substitutes for money

Banks and Banking Transactions in Ethiopia

- Book IV Title III of the Commercial Code of Ethiopia, which deals with banking transactions fails to provide a definition of a bank and banking transactions though the latter may be gathered from the various sections governing the various types of transactions undertaken by banks. Therefore, we have to refer to other laws to define and determine what banks and banking transactions are under the Ethiopian legal system.
- According Art 2 (12) of the Monetary and Banking Proclamation No 83/1994, banking business means any operation involving receiving money on deposit, lending money, receiving commercial instruments on deposit, accepting, negotiating/ transferring, discounting commercial instruments and other evidences of debt, and buying and selling of gold and silver notes and foreign exchange. Similarly, Art 2 (2) of the Licensing and Supervision of Banking Business Proclamation No 84/1994 defines banking business as any business involving acceptance of money on deposit, using such funds or deposits, in whole or in part, for loans or investments on the account of and at the risk of the person undertaking the business, purchasing, selling and deposit of negotiable instruments (shares, bonds and other securities/ and

- According to the preamble of Proclamation No. 40/1996 the monetary and banking laws in force do not provide for micro financing institutions catering for the credit needs of peasant farmers and others engaged in small scale production and service activities. Hence it has become necessary to legislate on the licensing and supervision of the business of micro financing institutions.
- Although the development of microfinance institutions in Ethiopia started very recently, the industry has shown a remarkable growth in terms of outreach, particularly in the number of clients. Since the issuance of Proclamation 40/1996, which provides the establishment of microfinance institutions, sixteen microfinance institutions (MFIs) have been legally registered by the National Bank of Ethiopia (NBE) and started delivering services, and two more applications by new MFIs are currently being processed.
- The main constraints of micro and small enterprises include lack of finance, business information, business premises, skills and managerial expertise, access to appropriate technology, lack of adequate infrastructure and in some instances discriminatory regulatory practices. In the Ethiopian context, and in terms of partially solving the problem of financial resources, the agency has to integrate its activities with the microfinance industry.

Review Questions

- Briefly discuss the development of banking systems in the world and particularly in Ethiopia.
- Verify the different types of banks.
- Discuss the Economic Significance of Banks.
- Discuss the role of National Bank, Commercial Banks, Saving Banks, Investment Banks, Development Banks and Islamic Banks taking into consideration their specialization.
- Discuss how the supervision and promotion of banking service could be realized.
- List down the vision, mission and goals of the National Bank of Ethiopia.
- Discuss banking transactions in Ethiopia.
- Under the Ethiopian Banking system there is Nationality Test; could this frustrate Ethiopian accession to WTO.
- Pin point the role of micro finance Institutions in the realization of development.
- Clearly show the regulatory framework for the microfinance industry and Small Enterprises

Deposit of Funds

- A deposit of funds is a contract whereby a person agrees to deliver and transfer the ownership of specified amount of money to a bank which agrees to repay them under the conditions agreed up-on in the contract or on the demand of the depositor. The bank, as the owner of money deposited, has right to use it in respect of its professional activities, i.e. the bank may lend it to its customers or invest it in areas which are allowed by the national bank /Art 896/. The contract of deposit of funds is almost identical to contracts of loan of money or other fungible things under Art 2471 of the Civil Code of Ethiopia in which the borrower becomes the owner of the money or fungible he borrowed and has the right to dispose of in any manner he wishes.
- However, where the deposit relates to “coins and other individual monetary tokens” and where there has been an agreement that they shall be refunded to the depositor in kind, the bank does not acquire the right of ownership and hence cannot dispose of such items. /Art 896 second proviso/. This rule applies, it seems, not to coins and paper money that are a legal tender currency at the time of deposit unless they bear special signs which are of historic or sentimental importance to the depositor. It also applies to currencies or coins used previously in the history of a country and which are considered by the owner/depositor of historic importance.
- The contract of deposit of funds results in the opening of an account in the name of the depositor by the bank in which the latter enters all transactions made with the depositor. The bank credits the account of the depositor with all deposits made by the depositor and debits the account where the depositor makes withdrawals or order payments to third parties. (Art 897).

- The type of account opened may either be a current account in which the depositor has the right to dispose of the deposit at sight or on demand. This type of account also is a check operated account, i.e., the holder may demand repayment of part or the whole of the deposit by drawing a check on the bank payable to himself or a third party. As the repayment may be demanded at any time, this type of deposit does not bear interest. / Art 897, 898. /
- The account may also be a saving account, which is interest bearing and the right of the depositor to demand repayment may be limited. The insured may be prevented from withdrawing an amount which is greater than a certain amount of money within a certain period or to give notice of withdrawal. /Art 897, 98. /

- It may also be a time deposit or account in which the depositor can not demand repayment or withdrawal before the lapse of the agreed period of time.
- This type of deposit normally bears interest at a rate agreed upon between the parties provided that it does not exceed the maximum limit determined by the National Bank. Art 897, 898 (2). Where the person has several accounts, each account shall operate independently unless the parties agree otherwise. /Art 902/
- However, a contract of deposit of funds does not entitle the depositor to demand withdrawal of an amount that is grater than the balance in his favor in the account. In other words, the right of the depositor to demand repayment is limited to the amount of money held in account in his favor and he does not have the right to overdraw his account without a special agreement to this effect, which is one form in which banks give loan to their customers. /Art 899,945 of the Comm. Code and Art 2471 Civil Code. /

Bank Transfers

- This transaction represents one mode of transferring money from one account to another upon the written and signed order of the transferor, and a means of performing money obligations. As a result, it is always a secondary transaction by which the debtor performs his obligations by payment of money. According to Art 903(1) of the Comm. Code, a bank transfer is a transaction whereby the bank, upon the written order of the depositor /transferor, debits the account of the transfer and credits the account of another depositor/the transferee with the amount specified in the instruction or transfer order. In cases where the intended beneficiary of the transfer does not have an account of his own, transfer may till be made through the account of another person. In such cases, the person to whose account the amount is credited shall

- This type of transfer, which requires the existence of two separate accounts, has to be distinguished from international transfers and local transfers that do not require accounts by the transfer and the transferee and hence are commonly used modes of transfer. There are no rules governing these types of transfer, and the rights and duties of the parties are determined by the contract concluded between the bank and the transfer.
- Bank transfer as defined by Art 903(1) may be internal where the accounts of the transfer and the transferee are opened within the same branch or external where the accounts of the transfer and the transferee are opened at two different branches of the same bank Art 904.

Deposit of Securities

- Though the relevant provisions of the commercial code do not provide a definition of this transaction, a contract of deposit of securities may be defined as a contract whereby an owner or of securities (shares or stocks, government bonds and company bonds (debentures) or other right holder agrees to deposit the securities with a bank which agrees to provide safe custody and handle or manage them for consideration. In other words, this is a transaction by which banks keep securities in their custody and perform all functions relating to them such as the collection of yields arising from securities deposited, i.e., dividends from shares/stocks, capital repayments and interest arising from bonds and handle purchase and sale of securities in the name and on behalf of the depositor.
- According to Art 912 and 914 of the commercial code, the bank which deposits securities has the duty to handle the securities deposited and to collect interest, dividends, capital repayments amortization and any other entitlements arising out of securities as soon as they can be claimed. It also has the duty to deposit the money collected by entering them in the deposit account of the depositor of the securities..

- From the definition provided above and the these provisions of the code, we can understand, that this transaction is not a contract for deposit alone but a contract which involves handling or management of securities by the bank including sale and purchase of securities in the name and on behalf of the depositor, (Art 912 and 913(2)).
- Regarding degree of care expected of the bank, Art 913(1) provides that the bank must ensure the custody of the securities and act in relation there to (handling and management) with due care required of paid bailee, i.e., a person to whom goods are entrusted for specific purpose. The degree of care expected of the bank is that paid bailee, since the bank provides this service for consideration in the form of service charge or commission.
- A gratuitous bailee is only bound to take the same care of the property entrusted to him as a reasonably prudent and careful man might fairly be expected to take care of his own property of the same nature and shall be liable only in cases of gross negligence

- However, a paid bailee, on the other hand, is liable for loss through mere negligence and must safeguard the property and the rights arising there from by every means in his power and provide the most effective possible appliances to this end. /please compare Art 2211(3) and 2720-22-civil code.
- The bank must also take necessary measures and comply with formalities necessary to preserve the rights, arising out of securities such as renewal of coupon and payment of stamp duty. The bank must also notify, through registered letters, the depositor before making decisions which involve several options, for instance, between receiving dividends on shares or to receive additional stocks or shares issued in lieu of cash. However, the bank shall make a decision to on one of the options where the depositor fails to give instructions within a reasonable period. (Art 915).
- Finally, where the contract of deposit of securities is terminated either by the decision of the depositor, the bank has the duty to restore them to the depositor or his agent or his creditors, even where the securities are registered in the name of a third party. Securities deposited by the usufractuary may be restored to the bare owner if the latter produces evidence of the death of the former./ Art 916 and 917 of the Commercial Code/
- But the law does not contain rules applicable in cases of deposit of other types of property, such as valuables, and documents such as title deeds, wills and insurance policies, except the second proviso of Art 896, which governs the deposit coins and other individual monetary tokens.

Hiring of Safes

- Banks take charge of their customers' valuables like jewelry, negotiable securities, and documents of title to properties, will, and deposit them, as they can be conveniently stored. Such deposits are special in nature and thus do not fall under the general category of banks' deposit.
- The acceptance of valuables for safekeeping from their customers is one of the essential, though subsidiary, services of banks. The right of a bank to render this service is recognized as a legitimate banking transaction. Though deposit or storage companies can render the service as well, the fact that the modern bank, for its own protection, is well equipped with safes and strong rooms it particularly suitable for rendering this service.
- Banks deposit their customer's values in either of the following two ways:
- By accepting the valuables for safe-custody or
- By hiring out safe deposit boxes to their customers.
- In the first case, customer's valuables are handed over to the bank either openly or in a sealed cover box. The particulars of the deposit may be known to the bank in which case a record of them will be made in the safe custody register. However, as it was said above, valuables constitute special deposit and, as a matter of principle, special deposit should not be commingled with the banks' other deposits. Banks usually place the valuables in their safes together with other deposits. This service is known as 'safe - custody'.
- Nowadays, safe-custody service is being abolished, because of the nature of the service in increasing the liability of banks for the loss of customer's valuables; undoubtedly, the banks will be held liable for their customers, as bailers will to their bail ees.
- At present in correspondence with their customers, banks usually avoid the term safe-custody' preferring to use the term 'safe-deposit'. Facilitating safe deposit of valuables by hiring out safe boxes for their customers is the dominant service of banks in most countries of the world, including Ethiopia. This mode of deposit, also known as safe deposit, constitutes the second way of depositing valuables. In this case, the bank hires out safe boxes and the valuables to be deposited are not as such handed over to the bank; rather the customers themselves place them in the hired safe boxes. The particulars of the deposit will not be disclosed to the bank. This service is known as 'safe-deposit.
- Some banks provide a service whereby they make available to their customers a safe deposit box to which the customer himself keeps the key and to which he may have access during

- business hours.
- In safe deposits or hiring of safes the bank and the customer execute a contract specifying the conditions on which the safe will be hired the contract includes the customer's duty to pay rental charges and the method of payment. Sometimes, the customer may be made to open a saving account and deposit a certain amount of money from which the bank could debit the rental charges whenever they are due. The nature of the relationship created by the contract is a subject of argumentation. It will be discussed in chapter four.
- When a customer enters into a contract for hiring of safe, a safe or compartment of a safe will be placed at his disposal for a specified period. The key of the safe box, with its reserves, will be given to the customer. This key will be at his exclusive possession during the terms of the contract. The customer can use the safe box to deposit any article that he wants as far as the article to be deposited in the safe box is not dangerous in such a way as to cause damage to the bank's and other customers' property or is not thought to be harmful to the public at large.
- Having exclusive possessions of the key to the safe box, the customer and his duly authorized agent are the only ones who could have access to the safe box, and they are also the only persons who could have direct control over the deposited valuables. To ensure this the customer will be provided with an access identification card when he enters into the contract.
- The bank maintains a safe deposit register in which it will take down the customer's name, address and safe box number. The customer's specimen signature will also be taken on the signature card. As an additional safeguard to identify the customer and his signature, he may be required to choose a 'code word' or a 'pass word' which he will communicate to the strong room attendant when he comes to visit his safe box.
- The safe boxes are placed in the strong rooms of the bank. The customer can not

- The customer's right to deposit anything he wants in the safe box can be restricted in the contract based on different considerations, like the bank's and other customers' security and security of the public at large. The customer is not obliged to disclose the contents of his safe box. As a matter of fact, the bank has no interest in knowing the contents of the safe box since in such a case it is less likely to be held responsible for any loss or damage to the contents of the safe box.
- A safe box may be hired in the joint names of two or three persons. In such a case the banker should get the mutual consent of all the hirers in executing any instructions or making subsequent modifications.
- The contract for hiring of safes can be terminated at the will of the parties although both parties have the right to unilaterally terminate the contract; the bank, as a service rendering institution to the general public, should show good cause to terminate the contract. The contract could also be terminated at the death of the customer or an individual banker. At the event of the customer, the bank should deliver the contents of the safe box only when the person requiring delivery presents a document from a court evidencing the fact that he is the legal representative of the deceased. The laps of the period of the contract and failure to pay the rental charges by the customer may also be grounds for terminating the contract.
- Under Ethiopian law, a contract of hire of a safe is defined as a contract whereby a bank agrees to place at the disposal of the hirer a safe or a compartment of a safe for a specified period of time on payment of a rent. The bank under this transaction has the duty to prepare a room where the safes are to be kept called a strong room and prepare safes for the hirer, and take the necessary measures to ensure the up keep and safe custody of safes. However, the bank is under no obligation for the deterioration or damage of the contents of the safe. A person may hire a safe in a bank to deposit valuables such as gold, silver, diamond (jewelries), important documents such as title deeds, insurance policies, wills, inventions and works of art.

- In addition to making sure that the safe and the strong room are not endangered by fire, water or breach by unauthorized third parties, the bank must give immediate notice of the danger to hirers and enable them to empty the content of their safes before the risk materializes. The bank has this obligation even where the danger occurs outside working days and hours of business. However, the bank is not required to give individual notices to each hirer. The bank may notify the hirers by means such as local radio or TV stations or through public announcements. /Art 920/
- The bank has also the obligation to allow the hirer or his agent to have access to the safe by providing him with keys and identification cards during working days and of hours of business. / Art 921/
- The obligation of the hirer on the other hand is the obligation to pay the rent on time and return the keys to the safe by emptying the contents of the safe upon termination or cancellation of the contract. /Arts 919 and 923/1//
- The contract of hire of a safe shall terminate as of right where the hirer fails to pay a rent within a period of one month from the date of notice by registered letter given by the bank. Where the hirer fails to pay a rent for a single term, the bank demands payment by a registered letter. The contract shall terminate as of right where the hirer fails to pay the rent within a period of one month from the date when the bank gave the notice, and the bank shall take possession of the safe at the end of the period of notice by calling the hirer to be present on the date and time fixed. Where the hirer fails to appear on the fixed date and time or refuses

Discount

- Discount is a contract whereby a bank agrees to pay to a holder of a commercial instrument or security having a future date of payment an amount which is lesser than its actual value, against the surrender of the instrument and the undertaking to repay the value of the instrument by the holder where payment is not made at the maturity of the instrument. A bank discounts a commercial instrument for consideration, which is the difference between the value of the instrument and the discounted amount paid by the bank to the holder. /Art 941. /. On the other hand, a holder of a commercial instrument agrees to receive an amount which is lesser than the actual value of the instrument in most cases because he needs the money for immediate uses and his rights in the instrument do not mature until a distant future date and he cannot get the money he needs from other sources and the need does not allow him waiting until that date.
- The amount of commission and interest charged by the bank which discounts the instrument shall be calculated by taking into account the time remaining until maturity of the instrument and the value of the instrument respectively. /Art 941/2/ and 942/

- The bank, which discounts a commercial instrument or a security, shall acquire all the rights of the beneficiary of discount on the instrument including the right to demand payment from the person or persons who are liable on the instrument. In addition, where the bank receives the full value of the instrument at maturity, the obligations arising out of discount shall be extinguished. However, if the bank is not successful in its claim for payment at maturity, it will have two alternative remedies, Art 944(1).
- It may proceed against parties liable on the instrument under Art 790 of the commercial code, or the company which issued the share or bond, or
- It may proceed against the beneficiary of the discount on the of basis the contract of discount (Art 941(1) and 943).
- However, the right of the bank is limited to the amount of money it has paid to the beneficiary plus commission, interest and expenses (944(2)).

Bank Lending

- Bank lending or credit services provided by banks are one of the most common and traditional functions of banks which, if properly used, may play a vital role in a country's economic development.
- Art 2471 of the Civil Code, which also applies to loans provided by banks, defines a contract of loan of money or other fungible things as a contract where by a party called the lender, under stakes to deliver to the other party, the borrower, a certain amount of money or other fungible things and to transfer to him the ownership thereof on the condition that the borrower will return to him as much of the same amount and quality.
- Contracts of loan of money or other fungible things are not subject to special form and may be made in any manner. However, the contract or the repayment of loan of money exceeding five hundred Birr has to be

- However, where the contract of loan is concluded between a bank and its customers, the contract of loan or its repayment may be proven even by witnesses or presumptions /compare Art 2020-26 of the civil code/. As we have seen in the definition of contracts of loan, loans under ordinary circumstances are given by the lender by way of delivering the agreed amount of money at once. However, under special circumstances the loan may also be given by allowing the customer of the bank to overdraw his account up to the agreed amount for

- This type of loan is given usually for traders as means of payment of their obligations. / Art 945. /
- An open credit or overdraft loan may be given for limited or unlimited period of time, i.e. the bank may allow the customer to over draw his account for a period of one year, for instance, and the customer is expected to have the amount put at his disposal by the bank plus interest by the end of the period. The bank has the right to cancel contracts of loan made for unlimited period at any time.
- Similarly, the bank may also cancel the contract on the death, incapacity of the beneficiary, or suspension of payment even where it is not established by a judgment of a court or because of his gross negligence in the use of credit granted. /Art 946/

Documentary Credits

A documentary credit is a credit provided to persons engaged in foreign trade particularly importers who need to pay the price of goods in foreign exchange. This type of credit is required because it is only banks which are allowed to handle and deal in foreign exchange and importers are required to pay the price of goods imported from abroad through opening letters of credits.

So an importer who intends to import goods into the country has to apply to a bank to open a letter of credit in which the seller of the goods is the beneficiary.

Where the bank accepts the application of the importer, it opens the letter of credit equivalent to price of the goods and transmits or communicates it to its branch (if it has a branch at the place where the seller is situated) or to a bank with which it has a

- The correspondent bank, which has received the letter of credit, shall notify the seller/beneficiary of the credit. And the correspondent bank shall pay the price of the goods to the beneficiary of the credit after receiving documents representing the goods such as an invoice, a bill of lading, a packing list and an insurance policy covering risks associated with transportation (Where according to the contract of sale insurance is the obligation of the seller) and after confirming that the documents presented by the seller confirm with terms and conditions of the credit.
- The payment may also be made to third parties such as holders of bills of exchange to

- The correspondent bank which has paid the agreed amount to the seller or third parties to whom the right to receive payment is transferred, shall send the documents it has received from the seller to the opening bank and the opening bank will hand over these documents to the importer after receiving the amount equivalent, in Ethiopian Birr, to the amount paid to the seller, interest and service charge (commission) for the service provided.
- In the absence of a contrary agreement, the bank is entitled to the hold and dispose of the goods imported (represented by the documents at its hand) and recover the amount of money it or its correspondent has paid plus interest and service charge or commission. /Art 959/

- Art 961 recognizes two types of document credits:
- - Revocable credits, which credits do not constitute a binding agreement between the opening bank and the beneficiary. Hence, it may be modified or cancelled by the opening bank at any time by a notice communicated to the correspondent bank prior to payment or negotiation, or the acceptance bills there under by the latter. A documentary credit is presumed to be revocable in the absence of a provision that clearly specifies that it is irrevocable. / Art 962,961. / And, -Irrevocable credits: are credits, which, on the other hand, represent a definite undertaking between the opening bank and the seller/beneficiary or good faith holders of bills of exchange, drawn by the beneficiary. Hence, the bank is obliged to pay the money specified in the credit. / Art 963. / This type of letter of credit may also be confirmed by the correspondent bank upon the request of the opening bank, and where irrevocable letters are confirmed by the correspondent bank / confirming bank/, a binding relation will be created between the beneficiary of the credit and the correspondent bank and the latter will be liable on the letter of credit. /Art 964 /

Summary

- A deposit of funds is a contract whereby a person agrees to deliver and transfer the ownership of a specified amount of money to a bank which agrees to repay them under the conditions agreed upon in the contract or on the demand of the depositor. The bank, as the owner of money deposited, has the right to use it in respect of its professional activities.
- The contract of deposit of funds results in the opening of an account in the name of the depositor by the bank in which the latter enters all transactions made with the depositor. Where the person has several accounts, each account shall operate independently unless the parties agree otherwise. However, a contract of deposit of funds does not entitle the depositor to demand withdrawal of an amount that is greater than the balance in his favor in the account.
- This type of transfer, which requires the existence of two separate accounts, has to be distinguished from international transfers and local transfers that do not require accounts by the transferor and the transferee and hence are commonly used modes of transfer.
- There are no rules governing these types of transfer and the rights and duties of the parties are determined by the contract concluded between the bank and the transferor.
- As we have seen above, the transferee acquires right of ownership over the money at the time when the account of the transferor is debited and even before the account of the transferee is credited with the amount transfer.

Deposit of Securities

- Though the relevant provisions of the commercial code do not provide a definition of this transaction, a contract of deposit of securities may be defined as a contract whereby an owner of securities (shares or stocks, government bonds and company bonds (debentures)) or other right holder agrees to deposit the securities with a bank which agrees to provide safe custody and handle or manage them for consideration.
- The bank must take necessary measures and comply with formalities necessary to preserve the rights, arising out of securities such as renewal of coupon and payment of stamp duty.
- Finally, where the contract of deposit of securities is terminated either by the decision of the depositor, the bank has the duty to restore them to the depositor or his agent or his creditors, even where the securities are registered in the name of a third party.
- Securities deposited by the usufractuary may restore to the bare owner if the latter produces evidence of the death of the former.

Hiring of Safes

- Banks take charge of their customers' valuables like jewelry, negotiable securities, and documents of title to properties, will, and deposit them, as they can be conveniently stored. Such deposits are special in nature and thus do not fall under the general category of banks' deposit.
- Banks deposit their customer's values in either of the following two ways:
- By accepting the valuables for safe-custody or
- By hiring out safe deposit boxes to their customers.
- Facilitating safe deposit of valuables by hiring out safe boxes for their customers is the dominant service of banks in most countries of the world, including Ethiopia.
- In safe deposits or hiring of safes the bank and the customer execute a contract specifying the conditions on which the safe will be hired and the contract includes the customer's duty to pay rental charges and the method of payment. Sometimes, the customer may be made to open a saving account and deposit a certain amount of money from which the bank could debit the rental charges whenever they are due.
- When a customer enters into a contract for hiring of safe, a safe or compartment of a safe will be placed at his disposal for a specified period. The key of the safe box, with its reserves, will be given to the customer. This key will be at his exclusive possession during the terms of the contract. The customer can use the safe box to deposit any article that he wants as far as the article to be deposited in the safe box is not dangerous in such a way to cause damage to the bank's and other customers' property or is not thought to be harmful to the public at large.
- The safe boxes are placed in the strong rooms of the bank. The customer cannot have access to his safe box without the permission of the strong room attendant.

- The customer’s right to deposit anything he wants in the safe box can be restricted in the contract based on different considerations, like the bank’s and other customers’ security and security of the public at large. The customer is not obliged to disclose the contents of his safe box. As a matter of fact, the bank has no interest in knowing the contents of the safe box since in such a case it is less likely to be held responsible for any loss or damage to the contents of the safe box.
- **Discount**
- Discount is a contract whereby a bank agrees to pay to a holder of a commercial instrument or security having a future date of payment an amount which is lesser than its actual value, against the surrender of the instrument and the undertaking to repay the value of the instrument by the holder where payment is not made at the maturity of the instrument.
- A bank discounts a commercial instrument for consideration, which is the difference between the value of the instrument and the discounted amount paid by the bank to the holder.

Bank Lending

- **Bank lending or credit services provided by banks are one of the most common and traditional functions of banks which, if properly used, may play a vital role in a country's economic development.**
- **<u>Documentary Credits</u>**
- **A documentary credit is a credit provided to persons engaged in foreign trade particularly importers who need to pay the price of goods in foreign exchange. This type of credit is required because it is only banks which are allowed to handle and deal in foreign exchange and importers are required to pay the price of goods imported from abroad through opening letters of credits. So an importer who intends to import goods in to the country has to apply to a bank to open a letter of credit in which the seller of the goods is the beneficiary.**
- **Where the bank accepts the application of the importer, it opens the letter of credit equivalent to the price of the goods and transmits or communicates it to its branch (if it has a branch at the place where the seller is situated) or to a bank with which it has a correspondence. The correspondent bank, which has received the letter of credit, shall notify the seller/beneficiary of the credit.**

- **And the correspondent bank shall pay the price of the goods to the beneficiary of the credit after receiving documents representing the goods such as an invoice, a bill of lading, a packing list and an insurance policy covering risks associated with transportation (Where according to the contract of sale insurance is the obligation of the seller) and after confirming that the documents presented by the seller confirm with terms and conditions of the credit. The payment may also be made to third parties such as holders of bills of exchange to whom the right to receive the part or the whole of value of the letter of credit is transferred.**
- **The correspondent bank which has paid the agreed amount to the seller or third parties to whom the right to receive payment is transferred, shall send the documents it has received from the seller to the opening bank and the opening bank will hand over these documents to the importer after receiving the amount equivalent, in Ethiopian Birr, to the amount paid to the seller, interest and service charge (commission) for the service provided. In the absence of a contrary agreement, the bank is entitled to the hold and dispose of the goods imported (represented by the documents at its hand) and recover the amount of money it or its correspondent has paid plus interest and service charge or commission. Art 961 recognizes two types of document credits; revocable credits and irrevocable credits.**
  - **Review Questions**
- **1, Discuss what deposit of funds is under the Ethiopian Banking system.**
- **2, Verify the legal orientation and the role of Bank Transfers under the Ethiopian legal system.**
- **3, Discuss what securities and deposit of Securities is.**
- **4, Discuss the legal base and orientation of hiring of safes.**
- **5, Define what discount is on the basis of the Commercial Code of Ethiopia.**
- **6, Discuss the role of Bank Lending in the realization of economic development.**
- **7, Pin point the types and roles of documentary Credits.**

PART TWO: LAW OF NEGOTIABLE INSTRUMENTS
CHAPTER ONE
INTRODUCTION
Definition of Negotiable Instruments

- The word negotiable means ‘transferable by delivery’ and the word ‘instruments’ means a written document by which a right is created in favor of a person. Thus, the term negotiable instruments literally refers to a document containing rights that can be transferred by delivery.
- Similarly, Article 715(1) of Ethiopian Commercial Code of 1960 defines the term negotiable instruments as any document incorporating a right to an entitlement in such a manner that it is not possible to enforce or transfer the right separately from the instrument.
- The rights that could be incorporated in negotiable instruments may be rights for payment of money arising out of various contracts such as the contract of loan, sale, lease, or any other contract performed by payment of a certain amount of money.
- Such rights may also arise from ownership in companies or loan made to the government or to a share company.

- The rights that are incorporated in negotiable instruments may be rights to receive goods under voyage or deposited in a warehouse. According to this provision, the holder of negotiable instruments can transfer the rights incorporated in the instrument by transferring the instrument. Similarly, a person who claims the rights incorporated in negotiable instruments may enforce or exercise them only if he has possession of the instrument, i.e., he should be a holder to whom the instrument is issued or transferred following the rules governing its transfer. He must also present the instrument to the person who is supposed to perform the obligations arising out of the instrument. (See also Art 716/1/). The fact that the rights incorporated in negotiable instruments may be transferred by the transfer of the instrument and the fact that a person may not exercise or enforce them unless he is in possession of the instrument are the two main features which distinguish negotiable instruments

- Another point that has to be noted here is that negotiable instruments are issued or negotiated based on other contracts. For instance, a person may issue a bill of exchange to repay the money he has borrowed from the payee, the company issues a share certificate or debenture certificate as evidence of the person's right arising out of contract of partnership creating the company or a contract of loan respectively. / Art 211 and 429 of the Commercial Code/. The warehouse person or the carrier issues the warehouse goods deposit certificate or the bill of lading / consignment note based on contracts of warehousing or carriage respectively. Finally, the definition of negotiable instruments under the Ethiopian law is much wider than the one adopted by most legal systems, particularly those following the Common Law tradition. This is evident from the Uniform Commercial Code of the United States and the Bill of Exchanges Act of 1882, which restricts the concept to bills of exchange, checks and promissory notes.
- Based on the purpose and rights incorporated in the instruments, Article 715(2) of the Commercial Code categorizes negotiable instruments into three main types, i.e., Commercial Instruments, [Transferable] Securities and Documents of Title to Goods.
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Nature and Purpose of Negotiable Instruments

- Negotiable instruments represent one form of property rights, i.e., exercised over incorporeal things “chose in action.” In other words, they are property rights in relation to objects of property which do not have physical or material existence and hence which cannot be perceived by the senses. A right of action under contract is a class of property known as ‘chose in action’ and can be distinguished from a corporeal movable property/ a ‘chose in possession’ which represent property rights exercised in relation to objects which have material or physical existence and hence can be perceived by the senses such as a book, a table or a watch. A holder of this type of property right must have actual possession of the object to exercise rights arising there from. Rights incorporated in negotiable instruments, rights of an inventor arising out of a grant of a patent in respect of his invention, rights of a copyrights holder, rights of a trader in respect of his trademark, trade name and goodwill are instances of chose in action.
- Negotiable instruments also represent one kind of contract as every instrument embodies a contract or promise to pay a certain amount of money or to deliver goods according to terms agreed up on. As contracts, the general rules of contract shall apply unless they are specifically excluded from application by the special law applicable to negotiable instruments. As a result, the requirements necessary for the formation of a valid contract must be fulfilled for issuance of a valid and enforceable negotiable instrument. Hence, the parties who sign a negotiable instrument must have capacity under the law to enter into juridical acts, i.e., minors and judicially interdicted persons may not create a valid contract through negotiable instruments. Compare Art 733 of the Commercial Code. Furthermore, as a contract, any declaration or promise made on negotiable instruments must be accompanied by the signature of the person bound by such declaration or promise.

- Art 734/1/ of the Commercial Code and Art 1728 of the Civil Code/. Failure to comply with the requirements as to capacity and signature may be raised as a defense against any person who claims based on the instrument even against the holder in due course who, under other cases, is considered to be free from defenses available against the person who transferred the instrument to him. Art 717/2/. The parties must give their consent, which must be free from defects such as mistake, fraud, duress.
- The object of the contract must also be legal and possible. Where the contract does not fulfill requirements as to consent and object, a party affected may raise it as a defense to avoid the contract and liability under the instrument. Art 717 /1/ of the Commercial Code and Art 1676 /1/ of the Civil Code./ However, because of the special nature of these instruments, such defenses cannot be raised against a person who acquires the instrument following the rules of transfer applicable to the instrument, and in good faith. See Art 717/3/ of the Commercial Code.

- Furthermore, the transfer of negotiable instruments has a special effect compared to the transfer of other forms of property and other contracts.
- A person to whom such instrument is transferred, following the rules governing its negotiation or transfer, in good faith, before its over due and before it is dishonored / a holder in due course/ will have a better right on the instrument than the transferor because he acquires it free from claims and defenses that could have been raised against the transferor. Similarly, a person who has lost or who is dispossessed of a negotiable instrument may not recover it from the holder in due course.
- Hence, the general principle governing contracts which transfer rights to other forms of property, particularly immovable properties and special movable properties, i.e., no one may transfer a better title than he has, does not apply in the case of transfer of negotiable instruments. See Art 717 /3/, 751/2/, 752, 849 and 850 of the Commercial Code. Compare Arts 1161-1167 and Art 1966 of the Civil Code.

- The main purpose of negotiable instruments is facilitation of commercial transactions. Commercial instruments are substitutes for money and are used as means of performance of money obligations. Dealing with them reduces the risk of loss or theft and the ease with which they can be transferred creates convenience which will in turn facilitate business.
- Transferable securities have the purpose of raising capital in the form of contributions made by purchase of shares and bonds, which is used for starting new businesses or expansion of existing businesses thereby increasing the production of goods and services in the country.

- A document of title to goods, whose negotiation transfers the goods represented by them, creates convenience and facilitates transactions involving the goods.
- For instance, a person selling warehoused goods can do so by endorsing and transferring the certificate of deposit and without the need to actually deliver the objects. When we come to the specific purposes of commercial instruments, promissory notes can be used as means of borrowing money, buying goods and services on credit and as method of evidencing a pre-existing debt.
- Certificates of deposit can be used as “device for encouraging individuals to deposit funds in banks, in return the holder of the certificate has the right to receive interest. Bills of exchange on the other hand have the purpose of collecting accounts financing, the movement of goods, and transfer funds.
- Checks serve as “vehicles for transfer of money and also used to aid in keeping records, reduces the risk of loss and destruction and theft of currencies.”

Types of Negotiable Instruments
Commercial Instruments

- Commercial instruments are negotiable instruments incorporating rights for payment of a specified amount of money. They are issued and negotiated on the basis and with the purpose of performing an obligation that can be performed by payment of a certain amount of money.
- Hence, they are used as a substitute for money. These are bills of exchange, promissory notes, checks, travelers' checks and warehouse goods deposit certificates as the types of commercial instruments recognized under the Ethiopian law.

Transferable Securities

- Securities are negotiable instruments incorporating rights for payment of money. The sources of such rights may be investments made in companies or loans provided to the government or its subdivisions through purchase of government bonds and treasury bills or to companies through the purchase of debentures.
- A person who invests in a company is entitled to share in the profits of the company if any, i.e., he has the right to receive dividends and to share in the assets of the company where the company is dissolved. /Art 345/ On the other hand, the person who has purchased a government bond or a treasury bill or a company bond, also called a debenture, acquires the right to receive repayment of the money he has given on loan plus interest. /Art 433/. Refer also to the provisions of Arts 2490-2511 of the Civil Code.
- However, all securities are not negotiable instruments. What makes securities negotiable instruments is their transferability according to rules of negotiation. Therefore, if it cannot be negotiated, it is difficult to circulate as money.
- Bonds, stocks and transferable shares are instances of securities which are negotiable instruments considered.

Documents of Title to Goods

- These are negotiable instruments containing rights of ownership over goods that are being transported or goods which are warehoused and which enable their holders to receive such goods. Refer Arts 571-576 and 610-619 of the Commercial Code regarding documents of title to goods under voyage and Arts 2814-2824 of the Civil Code regarding documents of title to goods warehoused.

– **Summary**

- The word negotiable means transferable by delivery and the word ‘instruments’ means a written document by which a right is created in favor of a person. Thus, the term negotiable instruments literally refers to a document containing rights that can be transferred by delivery.
- The rights that could be incorporated in negotiable instruments may be rights for payment of money arising out of various contracts such as the contract of loan, sale, lease, or any other contract performed by payment of a certain amount of money. Such rights may also arise from ownership in companies or loan made to the government or to a share company. The rights that are incorporated in negotiable instruments may be rights to receive goods under voyage or deposited in a warehouse. According to this provision, the holder of negotiable instruments can transfer the rights incorporated in the instrument by transferring the instrument. Similarly, a person who claims the rights incorporated in negotiable instruments may enforce or exercise them only if he has possession of the instrument, i.e., he should be a holder to whom the instrument is issued or transferred following the rules governing its transfer. He must also present the instrument to the person who is supposed to perform the obligations arising out of the instrument. See also Art 716/1/. The fact that the rights incorporated in negotiable instruments may be transferred by the transfer of the instrument and the fact that a person may not exercise or enforce them unless he is in possession of the instrument are the two main features which distinguish negotiable instruments from other documents evidencing rights such as a title deeds whose transfer does not transfer the rights they establish. /Refer to Art 1185 and 1195 of the Civil Code/
- Based on the purpose and rights incorporated in the instruments, Article 715(2) of the Commercial Code categorizes negotiable instruments into three main types, i.e., Commercial Instruments, [Transferable] Securities and Documents of Title to Goods.

Nature and Purpose of Negotiable Instruments

- **Negotiable instruments represent one form of property rights, i.e., exercised over incorporeal things "chose in action." In other words, they are property rights in relation to objects of property which do not have physical or material existence and hence which cannot be perceived by the senses. A right of action under contract is a class of property known as 'chose in action' and can be distinguished from a corporeal movable property/ a 'chose in possession' which represents property rights exercised in relation to objects which have material or physical existence and hence can be perceived by the senses such as a book, a table or a watch. A holder of this type of property right must have actual possession of the object to exercise rights arising there from. Rights incorporated in negotiable instruments, rights of an inventor arising out of a grant of a patent in respect of his invention, rights of a copyrights holder, rights of a trader in respect of his trademark trade name and goodwill are instances of chose in action.**
- **Negotiable instruments also represent one kind of contract as every instrument embodies a contract or promise to pay a certain amount of money or to deliver goods according to terms agreed upon. As contracts, the general rules of contract shall apply unless they are specifically excluded from application by the special law applicable to negotiable instruments. As a result, the requirements necessary for the formation of a valid contract must be fulfilled for issuance of a valid and enforceable negotiable instrument.**

- **The main purpose of negotiable instruments is facilitation of commercial transactions. Commercial instruments are substitutes for money and are used as means of performance of money obligations. Dealing with them reduces the risk of loss or theft and the ease with which they can be transferred creates convenience which will in turn facilitate business. Transferable securities have the purpose of raising capital in the form of contributions made by purchase of shares and bonds, which is used for starting new businesses or expansion of existing businesses thereby increasing the production of goods and services in the country. A document of title to goods, whose negotiation transfers the goods represented by them, creates convenience and facilitates transactions involving the goods. For instance, a person selling warehoused goods can do so by endorsing and transferring the certificate of deposit and without the need to actually deliver the objects. When we come to the specific purposes of commercial instruments, promissory notes can be used as means of borrowing money, buying goods and services on credit and as method of evidencing a pre-existing debt. Certificates of deposit can be used as "device for encouraging individuals to deposit funds in banks, in return for which the holder of the certificate has the right to receive interest. Bills of exchange on the other hand have the purpose of collecting accounts financing, the movement of goods, and transfer funds. Checks serve as "vehicles for transfer of money and also used to aid in keeping records, reduces the risk of loss and destruction and theft of currencies."**
  - **Review Questions**
- **Define what negotiable instruments are**

CHAPTER TWO
COMMERCIAL INSTRUMENTS
Definition

- Commercial instruments are negotiable instruments incorporating rights for payment of a specified amount of money. They are issued and negotiated on the basis and with the purpose of performing an obligation that can be performed by payment of a certain amount of money. Hence, they are used as a substitute for money.
- Article 732(1) of the Commercial Code of Ethiopia defines commercial instruments as negotiable instruments setting out on entitlement consisting in the payment of a sum of money. Sub-Article (2) of the same Article provides that bills of exchange, promissory notes, checks, travelers' checks and warehouse goods deposit certificates as the types of commercial instruments recognized under the Ethiopian law. However, treating warehouse goods deposit certificates, which evidence contracts of warehousing and the right to receive the goods warehoused, as commercial instruments does not seem to be in accordance with the definition of commercial instruments, i.e., documents containing right for payment of money.

Types of Commercial Instruments
Bills of Exchange

- Bills of exchange are negotiable instruments incorporating an unconditional order, 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 certain sum in money to or to the order of a specified person.
- Bills of exchange, therefore, involve an order to pay money rather than a promise to pay money. The person issuing the order is the drawer, the person ordered to pay is the drawee and the person who receives the payment is the payee.
- The Commercial Code of Ethiopia does not provide a definition of bills of exchange. However, Art 735 enumerates the requirements to be fulfilled for drawing a valid bill of exchange from which one may deduce the definition of the term under Ethiopian law.
- Accordingly, a bill of exchange must contain;
- The term “bill of exchange”
- An unconditional order to pay a certain sum in money
- The name of the person who is to pay (the drawee)
- The time of payment
- The place of payment
- The name of the person to whom or to whose order payment is made or an indication that it shall be payable to bearer
- The date when and the place where the bill is issued.
- The signature of the person who issues the bill (drawer)

- A bill of exchange that does not contain any one of the above requirements shall not be valid and the drawer or any other party to the instrument can raise defect of form against any person who claims based on the bill. Art 717/1/ However, a bill which does not contain the time of payment is presumed to be payable at sight or on demand. A bill which does not mention the place of payment, shall be deemed to be payable at the domicile or at the address of the drawee, and a bill which does not provide place of issue, is deemed to have been drawn at the place mentioned beside the name of the drawer.

- **Promissory Notes**

- A promissory note is defined as a document incorporating an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person or to bearer. This, definition implies that promissory notes are promise to pay money and they are only two parties i.e., the maker of the promise and the payee to whom payment is effected.
- Similar to the cases of bills of exchange, the Commercial Code of Ethiopia does not provide the definition of a promissory note apart from the requirements provided under Art 823 for validity of promissory notes, which are identical with the definition given above. These requirements are essential for the validity of a promissory note.
- Thus, a promissory note must contain;
- The term “promissory note”
- An unconditional promise to pay a sum certain in money
- The time of payment
- The place of payment
- The name of the person to whom or to whose order payment is to be made or a statement that the note is payable to bearer
- The date when and the place where the note is issued
- The signature of the person who issues the instrument

- These requirements should be observed for promissory note to be negotiable instrument. Failure to comply with these requirements results in the invalidity of the instrument except in the cases provided by Art 824, which fills gaps in case of absence of time of payment, place of payment and the place of issuance. Accordingly, a promissory note which does not specify time of payment, shall be deemed to be payable at sight or on demand, a promissory note which fails to indicate the place of payment is presumed payable at the address of the maker of the promise and note which does not indicate the place of issuance deemed to have been drawn at the place indicated beside the name of the maker.
- It is important to note the following distinctions between bills of exchange and promissory notes, i.e. a promissory note contains promise to pay whereas a bill of exchange contains an order to pay. The maker of promissory note is always primarily liable and its liability is the same as the acceptor of a bill of exchange, but in case of drawer of bill of exchange once the bill is accepted he is only liable as surety in the event of dishonoring of bill of exchange. The concept of acceptance is not applicable to promissory notes unlike bills of exchange that may be accepted. Finally, promissory notes involve two parties only as opposed to bills of exchange that under normal circumstances involve three parties.

Checks

- A check is the most widely used form of commercial instrument. It is bill of exchange drawn on a bank and payable on demand. The English Bills of Exchange Act of 1882 defines a check under Art 73 as a bill of exchange drawn on a banker payable on demand.
- Therefore, since check is defined by reference to a bill of exchange, most provision governing bills of exchange are applicable to check. The check is an unconditional order in writing, addressed by one person, the drawer, to a banker, signed by the drawer, requiring the bank to pay, on demand, a sum certain in money to or to the order of specified person or to bearer.
- The following are the main differences between checks and bills of exchange. A check is always drawn on a banker and is always payable on demand while a bill of exchange may be drawn on any one and may be made payable on demand or at fixed or a determinable future time and a check can be crossed in several ways but bills can not be crossed. Acceptance is not necessary for a check since it is payable on demand as opposed to bills of exchange which may be made payable at fixed or determinable future time presentment for acceptance may be necessary.

- It is also important to note that a drawer of a bill of exchange and a check or the maker of a promissory note may antedate or postdate it, provided that he has not committed a fraud. In other words, unless the drawer or maker intended to jeopardize the interest of the payee by causing the rights contained in the instrument to lapse, the mere fact of antedating or post dating an instrument does not make it invalid.
- If, for instance, A sold furniture worth 1000 Birr to B on credit and the latter issued a bill of exchange on 1/4/07 payable 60 days after date, and ante dated it, i.e., indicated a date prior to date of actual drawing, say 1/1/07, since this bill has to be presented for payment on March 2, 3 and 4 2007, it means that A has already lost his right on the bill before it is issued. B/ the drawer of the bill/ has committed a fraud or fault because he has caused the rights of A to lapse by antedating and hence such bill is invalid. /.Arts 744/.

Crossed Checks and Checks Payable into Account

- A crossed check is a check containing two parallel lines drawn across its face by the drawer or holder. A check may be crossed generally or specially.
- A check is crossed generally where it bears the two parallel lines only or where the word “bank’ or ‘banker’ is inserted between the lines. The crossing shall be special where the name of a specific bank is inserted between the lines. A check crossed generally can only be paid to a bank, which is the banker of the payee or holder, or to a person who is the customer of the drawee. A check crossed specially can only be paid to the bank specified in the crossing. Such bank may have the check collected by another bank. Where the bank whose name appears in a special crossing is the drawee itself, the check may be paid to a person who is the customer of the drawee. However, a bank may not collect crossed checks on behalf of persons other than their customers or other banks. Art 864

- The whole purpose of crossing checks is to make sure that the check is paid to the intended person by preventing payment to other persons into whose hands the check might fall.
- It also helps to avoid or at least minimize risks associated with loss or theft of checks i.e. to trace and identify the person who actually received payment for the purpose of recovery., because crossed checks are paid to either banks or customer of banks whose addresses are known and traceable.
- However, the fact that a check is crossed does not mean that it cannot be negotiated as open checks. Negotiation of crossed checks shall have the same effect as the negotiation of open checks and the person to whom such check is transferred shall have the status of a holder in due course if the requirements are fulfilled. However, the drawer or holder may prohibit negotiation by inserting words such as ‘not negotiable’ or 'not transferable’ in the same manner as the drawer or endorser of an open check.
- A person to whom a crossed check containing such a provision is transferred shall not acquire a status of a holder in due course and does not acquire a better title than the transferor/ Art 865. / See also Art 842, which provides for the effect of transfer a non negotiable open check.

- A bank, which violates the provisions of Art 864 and pays the check to a person who is not entitled to receive payment, shall be liable to pay compensation to the drawer or holder which does not exceed the value of the check. /866/1//
- However, a drawee which paid a check in which a crossing has been altered, struck out or modified contrary to the law, in good faith, and without negligence- believing that it is paying to the appropriate person- shall not be liable under Art 866(1).

- A bank which receives payment on crossed checks on behalf of its customers shall be liable for damages to the drawer or the holder to the extent of the value of the check, where it is shown that the customer on whose behalf it collected the crossed check has no right to the instrument or that his rights is defective and subject to personal defenses.
- Where the drawer or holder of a check writes transversally across the face of the check words such as ‘payable in account’ or any similar expression, the drawee may not pay the check in cash to a person who is not its customer. Such check can only be settled by means of crediting an account, by transferring from one account to another, set off …Art 867(1).
- The bank that violates this provision and pays the check in cash at the counter shall have the liability to pay damages provided under Art 866.

Certificates of Deposit

- A certificate of deposit is a form of commercial instrument issued by a bank. It is an instrument containing an acknowledgement by a bank that it has received a sum of money on deposit and a promise to repay the sum of money. When a person deposits money in a bank he will be given the document showing the deposit of money which could be withdrawn by the depositor or the holder of the certificate.
- Under our law, a certificate of deposit is not considered as a commercial instrument. It is not even mentioned in our law but in common law countries, it is treated as a commercial instrument because it serves as means of payment of money similar to other type of commercial papers.

Agreements as to Payment of Interest

- According to Art 739 and 825 bills of exchange and promissory notes payable at sight or at a fixed period after sight may contain a provision regarding payment of interest. It also clearly prohibits agreements as to the interest made in relation to bills and notes payable at a fixed period after date and those payable on a fixed future date.
- On the other hand, the Amharic version of Art 835 of the Commercial Code provides that any provision according to which the drawer of a check agrees to pay an interest shall be of no effect. Now let us see these provisions in light of the purpose of interest.
- The borrower of money or the buyer of goods on credit may be required to pay interest on the loan or the price of the goods as a service charge or price for the use of money by the borrower or buyer of goods on credit and a ‘compensation’ for the lender or seller on credit for giving up his right to use the money for various purposes and the benefit or gain he has lost as a result.
- When we see the provision of Art 739(1) in light of this purpose of interest, we may understand that agreement as to payment of interest inserted in bills of exchange and promissory notes payable at fixed period after sight is appropriate. Because in such cases the payee or holder of the instrument (the creditor) has given-up his right to receive payment and use or invest it until the date of maturity and hence may be entitled to receive interest.

- However, the question is as to why the provision prohibits agreements as to interest in bills and promissory notes payable at a fixed period after date or those payable on a fixed future date which are similar to bills payable at a fixed period after sight, i.e., both are payable on a determinable future date.
- Taking into account the purpose of the agreement as to payment of interest and the maturity of these types of instruments, i.e., a future date, it is possible to conclude that payment of interest in these instruments is appropriate and there is no acceptable economic or legal ground to prohibit such agreements.
- Furthermore, by allowing such agreement to be made in cases of bills of exchange and promissory notes payable at sight, Art 739 contradicts the provision under Art 835 that prohibits the parties from agreeing on payment of interest in checks, which are always payable at sight or demand. Allowing agreement as to payment of interest in cases where the economic and legal reasons justifying payment of interest are not present, i.e., on bills and notes payable at sight or demand may even encourage a person to wait until the last date of the period within which payment may be demanded with the purpose of collecting the interest and result in litigations and delay contrary to purpose of commercial instruments.
- Therefore, the provision of Art 739 has to be read and interpreted in light of the purpose of interest and the spirit of Art 835, which prohibits such agreement on instruments payable at sprit or on demand.

Opposition, Payment and Discharge

- The drawer or an endorser of a bill of exchange may oppose the payment of the value of the bill at any time before payment on the grounds of the bankruptcy of the holder.
- Similarly, the holder of a bill may oppose payment of a bill on the ground of loss or theft of bill before payment is made. /Art 779. / Opposition on these grounds may be made by notifying, in writing or orally, the drawee of the grounds of the opposition.
- However, payment of a check may be stopped by the instruction of the drawer at anytime before payment without the need to prove the existence of a valid ground to do so. / Art 857. /
- The drawer who pays a bill at maturity or a check is validly discharged and cannot be held liable unless he has violated the opposition of payment or 'stop payment' order respectively. /Art 776 and Art 861/ The drawer must verify the signature of the drawer but not the signature of endorsers, as it does not have the specimen of signatures of all the potential endorser of the bill or check . /Art 776(3) and Art 860/
- The drawer which fully pays a bill or a check and the maker who full pays the note shall demand the surrender if the instrument is receipted by the holder. /Art 859(1) and Art 775(1). / Where the cover held by the drawer is lesser than the amount of the instrument, the holder cannot refuse partial payment if the drawer decides to effect partial payment. In such a case the drawer cannot demand the surrender of the instrument as the holder cannot enforce the remaining rights without instrument / Art 71511) 716(1) /. However, the drawee can demand the holder to specify such payment in the instrument and to give a receipt. / Art 859(4) and Art 759(3)/

Negotiation of Negotiable Instruments

- The mode of negotiation /transfer of negotiable instruments and proof of lawful ownership by the owner /holder depend on the type of negotiable instrument concerned, which in turn depends on the manner in which the beneficiary of the rights contained in the instrument is named or designated.
- Negotiable instruments issued in the name of a specified person may be transferred by canceling the name of the transferor followed by entering the name of the transferee in the instrument and entering the name of the beneficiary in the register kept by the person issuing the instrument or by issuing a new instrument in the name of the transferee and entering the name of the transferee in the register kept by the person who issued such instrument. The person who issues the instrument may be the company in cases of shares/stocks and company bonds/ debentures. /Art 325-346, 429-444 of the Commercial Code/ or the drawer or maker in cases of bills of exchange and checks and promissory notes respectively.
- This mode of transfer is, however, inconvenient and impractical to most types of negotiable instruments for the following reasons. Firstly, it may result in suspicion and unacceptability because of the cancellation of the name of the transferor in the instrument, which in turn results in reluctance of people to accept such instrument. Secondly, it is incompatible with the purpose and nature of commercial instruments which are supposed to circulate freely as substitutes for money because persons will not be willing to receive an instrument which contains cancellations. Finally, the registration of the name of the transferee in the register kept by the person issuing the instrument is impossible in cases of commercial instruments as there is no such register kept by the drawer or maker, apart from the piece of paper which remains in the check book or bill of exchange or promissory note which cannot be considered as a “register” in any sense of the term.
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- Endorsement made according to the above requirements shall transfer all the rights arising out of the instrument from the endorser to the endorsee .The endorsee, as an owner of the rights, may enforce the rights by presenting it to the person who is supposed to pay /drawee/ where it is a check or a bill of exchange and to the maker where the instrument is promissory note and to the company where it is a stock or share or a debenture. Refer to Arts 726(1), 749(1), and 845(1) of the Commercial Code.
- Where the endorsement does not contain the name of the endorsee, i.e., where it is endorsed in blank the endorsee may fill up the blank with his own name and exercise the rights or fill it with the name of another person and deliver it thereby transferring all his rights to the transferee or he may re-endorse it blank or to a specified person or he may transfer it and all his rights without filling up the blank and without re-endorsing it. Refer to Arts 726/2/, 749/2/ 845/2/ of the Commercial Code.
- Here it has to be noted that transferring such instrument without re-endorsing it, has a significant legal effect on the transferor which may be advantageous to such person, because he will not be a party to the instrument and no action for recovery may be made against him based on Arts 727, 750, 846 and 790 of the Commercial Code which makes the endorser jointly and severally liable on the instrument with the drawer, acceptor where the person who is supposed to pay the instrument fails to pay.
- However, not all endorsements have the effect of transferring the rights arising out of negotiable instruments from the endorser to the endorsee. Endorsement may have other purposes such as creating agency and pledge contracts between the endorser and the endorsee.

- Where an endorsement is accompanied by words such as “value in collection”, “for collection”, “by attorney”… or any other word implying agency, it creates a contract of agency between the endorser and the endorsee. Hence, the latter may exercise all the rights arising out of the instrument including the right to re-endorse and transfer it on behalf of the former without becoming a signatory of or a party to the instrument. In other words, endorsement of negotiable instruments with such words constitutes a special way forming a contract of agency.
- In such cases, a party liable on the instrument and who is sued may not refuse payment or raise defenses based on his relations with the endorsee who is acting as an agent of the endorser. He may refuse payment or raise defenses only based on his relations with the endorser i.e. the principal. Agency created by endorsement of negotiable instruments shall not

- Similarly, where an endorsement is accompanied by words such as “value in security”, “value in pledge” or any similar word indicating pledge, it is intended to create a contract of pledge between the endorser and the endorsee. Therefore, the latter (the pledgee) may exercise all the rights arising out of the instrument including the right to re-endorse and transfer it on behalf of the former (the pledgor) without becoming a party to or signatory of the instrument. See Arts 729 and 754 of the Commercial Code.
- The holder of an instrument to order which is not yet transferred/ endorsed shall prove the fact that he is a lawful possessor of the instrument in the same manner as the holder of instrument in the name of a specified person, i.e., by producing documents such as identity cards or passports or driving licenses and proving that he is the person whose name appears in the instrument and the register kept by the person issuing the instrument.
- However, where the document has been endorsed and transferred, the holder shall prove his lawful possession by showing the existence of an endorsement by which the instrument and the rights therein are transferred to him. Moreover, where the instrument is transferred more than once, the person who acquired such instrument must show the existence of uninterrupted series of endorsements. Refer to Arts 724(2) 751(1),

- Negotiable instruments to bearer are transferable by simple delivery of the instrument to the transferee 721(1). This mode of transfer also applies to simple corporeal things or chattels under the law of property. Compare Art 1186/1/ of the Civil Code.
- The holder of such instrument shall prove the fact that he has acquired the instrument in accordance with the rules governing the transfer of bearer instruments i.e. simple delivery or handing over from the transferor by the sole fact of his possession and presentment of the instrument to drawee or maker for payment. In other words, the holder of such instrument is presumed to be its lawful holder unless the person challenging it produces evidence showing that the holder found a lost instrument or stole the instrument from a lawful holder. /Arts721 (2) 340(2) Art Commercial Code. /
- Despite the above rules, the generally accepted principle regarding transfer or negotiation of negotiable instruments in general and commercial instruments in particular is that any type of instrument (even if not drawn payable to order) may be transferred by endorsement and delivery unless the instrument contains words such as “not negotiable”, ‘not to order’ , “not transferable” or any other word indicating the prohibition of negotiation or transfer made by the maker, drawer or endorser of

Maturity of Commercial Instruments

- Bills of exchange and promissory notes may be made payable either at sight or on demand, at fixed date, at a fixed period after sight/acceptance or at a fixed period date. Refer to Arts 769 and 825 (1) (b).
- Bills of exchange and promissory notes payable at sight or on demand are mature starting from the time of issuance and are payable on presentment. The holder of such instrument should present it for payment within a period of one year from the date of their drawing or making at the pain of loss of the rights arising from the instrument. The drawer or maker of the instrument may shorten or extend this period by a provision made in the instrument. The endorsers of the instrument may also provide a shorter period by a provision made at the time of endorsement.
- The drawer or maker of instruments payable at sight or demand may also stipulate that the instrument shall not be presented before a certain date where the drawer of the bill or maker of the note doesn't have sufficient amount of money to pay the instrument before such date (Arts 770/2/ and 825 (1) /b/ of the Commercial Code).

- The maturity of bills of exchange payable at a fixed period after sight shall be determined by the date of acceptance or the date of protest, where acceptance is refused. Regarding promissory notes payable at a fixed period after sight, their maturity shall be determined based on the date on which it is presented for the Visa of the maker because acceptance is not applicable to promissory notes as they do not involve a person who makes acceptance i.e. the drawee /Arts 823, and 826 /2/.
- For instance, if a bill of exchange is drawn on 01/01/07 and made payable 15 days after sight, the maturity, i.e., date on which it shall be determined by taking into account the date on which the drawee expresses his agreement to pay the bill at its maturity/ acceptance/ or where he refuses to accept the bill, it shall be determined based on the date on which the evidence proving his refusal is drawn. Let us assume that the date of acceptance or protest is on 1/3/07, the bill shall be payable after 15 days from 1/3/07, i.e., on 17/03/07.

- On the other hand, the maturity of bills of exchange and promissory notes payable at a fixed date after date shall be determined based on the date of drawing or making. For instance if a promissory note is made on 01/01/07 and is made payable 15 days after its date, it matures or it becomes payable 15 days after its date of making, i.e., 01/01/07 and matures on 17/01/07. Note that the date on which the instrument is drawn or made or the date of acceptance or protest shall not be taken into account in calculating the date of maturity./ See Arts 821 and 884 of the Commercial Code./
- Regarding the maturity of bills of exchange and promissory notes payable on a fixed date, such instruments shall mature on the date specified on the instrument. Where, for instance, a bill of exchange is drawn on 01/01/07 and is made payable on 01/07/07, it matures on July 1, 2007.
- Regarding the time within which bills of exchange and promissory notes payable at a fixed period after sight, at a fixed period after date and those payable on a fixed date, Art 774/1/ requires that they be presented for payment either on the date on which it matures or on one of the two working days following the date of maturity. In other words, these instruments should be presented for payment within a period of three days including the date of

- Art 774, which determines the period within which bills of exchange except those payable at sight should be presented for payment, is not made applicable to promissory notes by the reference provision /Art 825/. However, this omission does not seem to be intentional, because the legislature has not provided any other alternative and this would leave promissory notes other than those payable at sight without a period for presentment for payment. Furthermore, there is no particular difference between bills of exchange and promissory notes regarding their maturity and which would have justified exclusion of the application of Art 774 to promissory notes other than those payable at sight. The fact that the legislature has made Arts 769 – 773 which govern the types of maturity of bills of exchange and the time within which bills payable at sight should be presented for payment also applicable to promissory notes also shows that the omission is not intentional and hence Arts 774-779 should be applicable to promissory notes.
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- The maturity of checks and the period within which they must be presented for payment are different from those of the bills of exchange and promissory notes. This is because checks are always payable at sight or on demand. Furthermore, checks have to be presented for payment within a period of six months from the date of their drawing irrespective of the date of their issuance. /Art 854 and 855 of the Commercial Code /
- This provision implies that a check may contain a date of drawing which is different from the date of issuance, i.e., the date on which the check is actually written and signed. It also implies that such date may be a date that is either before the date of issuance (an antedated check) or after the date of issuance of the check (a post-dated check). However, the law governing checks doesn't contain a provision which clearly allows ante-dating or postdating of checks similar to Art 745 which clearly allows the antedating or postdating of bills of exchange provided that the drawer does not have a fraudulent intention in doing so.

Acceptance of Commercial Instruments

- Acceptance of commercial instruments refers to the agreement of the drawee to pay the value of the instrument to the holder at its maturity. Acceptance shall be made on the instrument and may be expressed by words such as ‘accepted’ ‘agreed’ or any other similar expression implying agreement of the drawee and signed by the latter. A mere signature of the drawee on the bill shall also constitute acceptance. Acceptance should also indicate the date when it is given, particularly in cases where the instrument is required by the drawer to be presented for acceptance within the time specified in the bill of exchange and in cases where a bill is payable at a fixed period after sight. This is because, in the first type bill, the date when acceptance is given is essential, as failure to present the instrument for acceptance within the period stipulated might result in the loss of right of the holder. In the second type of bills, such date is important to determine the maturity of the bill. Where the date of acceptance is not shown on these types of bills, the holder must authenticate the omission of the date of acceptance by protest drawn within the period provided for drawing up of a protest. Refer to Art 761 and 764 of

- Furthermore, no condition may be attached to acceptance because this may hinder the negotiability of bills a person may not be willing to receive such a bill and it would also be contrary to the definition of commercial instruments containing unconditional order to pay a specified amount of money. However, acceptance may be made to part of the value of the bill and in such cases the holder of the instrument may proceed against the drawer and other parties liable on the bill, such as endorsers for the part of the value of the instrument not accepted by the drawee. However, the drawee may not modify any other term of the bill in the name of acceptance as this would constitute varying the terms of the contract to which he is not a party and a violation of the intention of the parties to the instrument. /See Art 762 of the Commercial Code. /
- The drawee who wants to consult with the drawer regardingthe bill may demand the holder who presented the bill for acceptance to present the bill on the next day. This is intended to enable the drawee to consult the drawer and ascertain facts contained in the instrument. Where the holder fails to present the bill on the next day as instructed by the drawee, a party sued on such bill may raise such failure as a defense where such demand is mentioned on the bill and on the protest. Furthermore, if the drawee accepts such a bill the holder may demand that the date of presentment and not the date of acceptance be written on the bill, particularly where the bill is payable at a fixed period after sight or a bill which is required to be presented for acceptance within a time specified by the drawer or endorser. Art 760/1/ and 761/2/ of the Commercial Code.

- Now let us see the types of bills of exchange in respect of which acceptance is appropriate. From the prevision of Art 757, we can understand that acceptance may be required in cases of bills which are payable on a definite future date, i.e. acceptance will not be necessary with respect to bills which are payable at sight or on demand, because in such cases acceptance, i.e., the agreement of the drawee to pay the bill on its maturity does not make any sense as the bill has already matured and the drawee should pay it right away rather than promising to pay in the future. Therefore, we can conclude that acceptance may be required by the drawer in any type of bill of exchange except those payable at sight or demand, with or without fixing a period within which the bill should be presented for acceptance. The drawer may also prohibit the acceptance of a bill or may stipulate that the holder may not present the bill for acceptance before a fixed date if the drawer wants to push the date of maturity further ahead and to be able to consult with the drawee and reach an agreement as to the payment. Endorsers may also require that the bill be presented for acceptance with or without fixing the period of time within which it must be presented provided that the drawer has not prohibited the presentment of bill for acceptance. See Arts 757 and 758 of the Commercial Code.
- However, the drawer may not prohibit the presentment for acceptance in the following two types of bill of exchange. /Art 758/2/.
- - Bills of exchange payable at a fixed period after sight because acceptance is necessary to determine their maturity of this type of bills, and
- - Domiciled bills, i.e., bills made payable not at the domicile of the drawee which is the normal place of payment but at the address of another person,

- The drawer of a domiciled bill is not allowed to insert provisions prohibiting acceptance of this type of bill because such prohibition may prevent the holder from acquiring the promise of the drawee to pay and the guarantee acceptance provides to the holder if the holder could not find the place of payment. Acceptance of a domiciled bill will also help the holder to ascertain the exact place / address of payment before hand and to avoid any risk of loss of right that may result from failure to present the bill within the period within which the bill should be presented for payment, in case where he is not able to locate the exact place of payment.
- Regarding the time within which acceptance may be required by the holder, Art 759 (1) provides that bills of exchange payable at a fixed period after sight must be presented within a period of one year from the date of drawing, unless this period is shortened or extended by the drawer or shortened by the endorsers. However, other types of bills must be presentment for acceptance within the period specified by the drawer or endorser. However, where the period for presentment is not specified by the drawer or endorser, the bill must be presented for acceptance before the maturity date of the bill. /Art 757 of the Commercial Code. Failure to comply with limits of time provided by the law or the drawer or endorsers results in loss of right of the holder. (Art 796 (1)).
- Finally, acceptance of a bill by the drawee makes him a party to the instrument that is jointly and severally liable to the holder together with the drawer, endorsers and other parties enumerated under Art 790 in case of non-payment. /Art 764/

- The concept of acceptance applies to bills of exchange and not to promissory notes and checks because of the following reasons. A promissory note shall not be accepted as it does not involve a drawee whose agreement constitutes acceptance and the maker of a promissory note is considered as an acceptor of a bill of exchange who has already expressed his agreement to pay the agreed amount on a future date. On the other hand, a check cannot be accepted because it is always payable at sight or on demand and the drawee shall pay the value of the check on presentment. Note that acceptance is applicable to bills with a future date of payment.

– Certification of Checks

- As we have seen above the concept of acceptance does not apply to commercial instruments payable at sight and hence to checks. However, checks may be certified by the drawee, upon the request of the drawer, provided that it has a sufficient cover. Where checks are so certified, the drawee will have the obligation to keep the amount of such check in a separate blocked account for the benefit of the holder of the check until the expiry of the period provided for presentment for payment i.e., six months from the date of drawing. /Art 832. /
- In effect, the drawee, which certified the check, is considered as the acceptor of a bill of exchange who has agreed to pay the value of the instrument on maturity. Similar to acceptance of a bill, a check is certified by signature of the drawee on the face of the instrument.

Acceptance for Honor

- Acceptance for honor represents a guarantee to pay the value of commercial instruments by any person who may even be a signatory of the instrument. A person may guarantee the payment of the whole or part of the value of a commercial instrument on its maturity by accepting it for the honor of any one of the parties liable to the holder. In other words, acceptance for honor constitutes a special way of forming a contract of surety ship guarantee in which a person guarantees the performance of obligations arising out of commercial instruments. [Art 766] Such acceptance may be given either on the commercial instrument or a separate piece of paper attached to it, called an along or by a separate act or contract. Expressions such as ‘accepted for honor’ or ‘good as acceptance for honor’ or any other word implying guarantee plus the signature of the acceptor constitute acceptance for honor. Furthermore, it may also indicate the person for whose honor it is

- The person who accepts a commercial instrument shall be liable on the instrument in the same manner as the person for whom he has become a guarantor. For instance, where such acceptance is given for the honor of the drawer of a bill of exchange or check, the acceptor shall be treated in the same manner as the drawer and would be obliged to pay the amount he guaranteed where the drawee fails to pay the check. Upon payment the acceptor will acquire the right to proceed against other persons liable on the bill or indemnity right of the guarantor against the person guaranteed. (Art 768 (1)).
- However, contrary to general rules governing suretyship or guarantee which extinguish the obligations of the guarantor, where the primary obligations of the person guaranteed are extinguished, Art 768 (2) provides that the acceptor's obligation shall continue to be valid even where the person for whose honor he accepted the instrument is released because of his obligations under the instrument for any reason other than defect of form, i.e. failure to comply with requirements for the validity of the instrument provided under Art 735 (Bills of exchange) Art 823 (promissory notes / and Art 827 (checks). Here it is important to note that the provisions dealing with acceptance for honor apply equally to all commercial instruments. (Art 825 (3) and 853).

Intervention for Honor

- A person may accept or pay a commercial instrument by intervention for the honor of any person against whom the holder may have a right of recourse. Acceptance or payment by intervention may be made by any person including persons who have already signed the instrument and are liable on it except the acceptor. The person who pays or accepts the instrument by intervention shall have to give notice of his intervention to the person for whose honor he has intervened within two working days from the date of such intervention. This seems to be intended to avoid double payment by debtor. The person who pays or accepts a commercial instrument may be named in the instrument at the time of issuance by the drawer or the maker or at the time of endorsement by the endorser.
- Acceptance by intervention for honor may be given according to Art 803(1) in case where the holder has a right of recourse (the right to institute legal action based on the commercial instrument) before maturity on any type of bill except those payable at sight or on demand. As a result, this type of acceptance is not applicable to checks, which are always payable at sight, and to promissory notes, which are not capable of acceptance; they do not involve a drawee whose agreement to pay the value of the instrument at its maturity constitutes acceptance.

- Where this type of acceptance is given by a person who is specified in the instrument, the holder of the instrument cannot exercise his right of recourse before maturity for non- acceptance against the person who named the intervening person and subsequent signatories of the instrument without first presenting the bill to the referee and if the referee refuses to accept, without first having a protest drawn up for non-acceptance. The point that has to be noted here is that the person who is named a referee or to accept the instrument by intervention in case of need, is required to accept only when the drawee refuses to accept.
- Acceptance by intervention may also be made by a person who is not named for the purpose, and in such cases, the holder may refuse to allow acceptance and start to exercise his right of recourse against persons who are liable on the instrument. However, if he allows the instrument to be accepted by such person, he cannot exercise his right of recourse against the person for whose honor the bill is accepted by intervention and subsequent signatories. (Art 803)
- This type of acceptance is expressed by words such as “accepted by intervention for the honor of” or similar words implying acceptance by intervention and the signature of the acceptor. It should also indicate the person on whose behalf it is given, in the absence of which the law presumes that it has been given on behalf of the drawer. (Art 804)
- The acceptor in such cases shall have the obligation to accept the bill, and where the bill is not paid by the drawer, to pay the bill at its maturity to the holder or persons who signed the instrument subsequent to the person on whose behalf the acceptance is given. (Art 805(1)). The acceptor who pays the bill shall acquire the rights arising out of the bill and may claim payment on the bill from the person on whose behalf he accepted the bill and against parties who are liable to the latter. Endorsers subsequent to the party for whose honor such acceptance and payment has been made shall be discharged from the liability on the bill. (Art 810).

- Regarding payment by intervention, a person who is named as a referee to pay in case of need or any other person may pay the value of the bill to the holder who has a right of recourse, either before or after maturity, against the person on whose behalf payment by intervention for honor has been offered. Such payment shall be valid only if it is made before the expiry of the period provided for drawing up of a protest for non-payment. /Art 806/3/ Payment made by intervention for the honor must be supported by a receipt on the bill and it must indicate the person for whose honor it has been paid. In the absence of such indication, the law presumes that it has been made for the honor of the drawer of the bill or maker of the promissory note concerned. The person who pays by intervention shall have the right to require the holder to surrender the bill or note any protest if any. (Art 809).

Summary
Commercial Instruments

- Commercial instruments are negotiable instruments incorporating rights for payment of a specified amount of money. They are issued and negotiated on the basis and with the purpose of performing an obligation that can be performed by payment of a certain amount of money. Hence, they are used as a substitute for money.
- **Types of Commercial Instrument**
- **Bills of Exchange**
- Bills of exchange are negotiable instruments incorporating an unconditional order, 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 or to the order of a specified person.
- Bills of exchange, therefore, involve an order to pay money rather than a promise to pay money. The person issuing the order is the drawer, the person ordered to pay is the drawee and the person who receives the payment is the payee.

Promissory Notes

- A promissory note is defined as a document incorporating an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at fixed or determinable future time, a sum certain in money, to or to the order of a specified person or to bearer. This, definition implies that promissory notes are promise to pay money and there are only two parties, i.e., the maker of the promise and the payee to whom payment is effected.
- It is important to note the following distinctions between bills of exchange and promissory notes, i.e. a promissory note contains promise to pay whereas a bill of exchange contains an order to pay. The maker of a promissory note is always primarily liable and its liability is the same as the acceptor of a bill of exchange, but in case of a drawer of a bill of exchange once the bill is accepted he is only liable as surety in the event of dishonoring of bill of exchange. The concept of acceptance is not applicable to promissory notes unlike bills of exchange that may be accepted. Finally, promissory notes involve two parties only as opposed to bills of exchange that under normal circumstances involve three parties.

Checks

- A check is the most widely used form of commercial instrument. It is bill of exchange drawn on a bank and payable on demand. The English Bills of Exchange Act of 1882 defines a check under Art 73 as a bill of exchange drawn on a banker payable on demand. Therefore, since check is defined by reference to a bill of exchange, most provisions governing bills of exchange are applicable to checks. Checks, are an unconditional order in writing, addressed by one person, the drawer, to a banker, signed by the drawer, requiring the bank to pay, on demand, a sum certain in money to or to the order of specified person or to bearer.
- The following are the main differences between checks and bills of exchange. A check is always drawn on a banker and is always payable on demand while a bill of exchange may be drawn on any one and may be made payable on demand or at fixed or a determinable future time and a check can be crossed in several ways but bills cannot be crossed. Acceptance is not necessary for a check since it is payable on demand as opposed to bills of exchange which may be made payable at fixed or determinable future time presentment for acceptance.
- It is also important to note that a drawer of a bill of exchange and a check or the maker of a promissory note may antedate or postdate it, provided that he has not committed a fraud. In other words, unless the drawer or maker intended to jeopardize the interest of the payee by causing the rights contained in the instrument to lapse, the mere fact of antedating or postdating an instrument does not make it invalid.

Crossed Checks and Checks Payable into Account

- A crossed check is a check containing two parallel lines drawn across its face by the drawer or holder. A check may be crossed generally or specially.
- A check is crossed generally where it bears the two parallel lines only or where the word “bank’ or ‘banker’ is inserted between the lines. The crossing shall be special where the name of a specific bank is inserted between the lines. A check crossed generally can only be paid to a bank, which is the banker of the payee or holder, or to a person who is the customer of the drawee. A check crossed specially can only be paid to the bank specified in the crossing. Such bank may have the check collected by another bank. Where the bank whose name appears in a special crossing is the drawee itself, the check may be paid to a person who is the customer of the drawee. The whole purpose of crossing checks is to make sure that the check is paid to the intended person by preventing payment to other persons into whose hands the check might fall.

Certificates of Deposit

- A certificate of deposit is a form of commercial instrument issued by a bank. It is an instrument containing an acknowledgement by a bank that it has received a sum of money on deposit and a promise to repay the sum of money. When a person deposits money in a bank he will be given the document showing the deposit of money which could be withdrawn by the depositor or the holder of the certificate.
- **Agreements as to Payment of Interest**
- According to Arts 739 and 825, bills of exchange and promissory notes payable at sight or at a fixed period after sight may contain a provision regarding payment of interest. It also clearly prohibits agreements as to interest made in relation to bills and notes payable at a fixed period after date and those payable on a fixed future date.
- **Opposition, Payment and Discharge**
- The drawer or an endorser of a bill of exchange may oppose the payment of the value of the bill at any time before payment on the ground of the bankruptcy of the holder.

Negotiation of Negotiable Instruments

- The mode of negotiation /transfer of negotiable instruments and proof of lawful ownership by the owner /holder depends on the type of negotiable instrument concerned, which in turn depends on the manner in which the beneficiary of the rights contained in the instrument is named or designated.
- The generally accepted principle regarding transfer or negotiation of negotiable instruments in general and commercial instruments in particular is that any type of instrument (even if not drawn payable to order) may be transferred by endorsement and delivery unless the instrument contains words such as “not negotiable”, ‘not to order’, “not transferable” or any other word indicating the prohibition of negotiation or transfer made by the maker, drawer or endorser of the instrument.
- **Maturity of Commercial Instruments**
- Bills of exchange and promissory notes may be made payable either at sight or on demand, at fixed date, at a fixed period after sight/acceptance or at a fixed period date. The maturity of checks and the period within which they must be presented for payment are different from those of the bills of exchange and promissory notes. This is because checks are always payable at sight or on demand. Furthermore, checks have to be presented for payment within a period of six months from the date of their drawing irrespective of the date of their issuance.

Acceptance of Commercial Instruments

- Acceptance of commercial instruments refers to the agreement of the drawee to pay the value of the instrument to the holder at its maturity. Acceptance shall be made on the instrument and may be expressed by words such as ‘accepted’ ‘agreed’ or any other similar expression implying agreement of the drawee and signed by the latter. A mere signature of the drawee on the bill shall also constitute acceptance. Acceptance should also indicate the date when it is given, particularly in cases where the instrument is required by the drawer to be presented for acceptance within the time specified in the bill of exchange and in cases where a bill is payable at a fixed period after sight. This is because, in the first type bill, the date when acceptance is given is essential as failure to present the instrument for acceptance within the period stipulated might result in the loss of right of the holder. In the second type of bills, such date is important to determine the maturity of the bill. Where the date of acceptance is not shown on these types of bills, the holder must authenticate the omission of the date of acceptance by protest drawn within the period provided for drawing up of a protest.
- The concept of acceptance applies to bills of exchange and not to promissory notes and checks because of the following reasons. A promissory note shall not be accepted as it does not involve a drawee whose agreement constitutes acceptance and the maker of a promissory note is considered as an acceptor of a bill of exchange who has already expressed his agreement to pay the agreed amount on a future date. On the other hand, a check cannot be accepted because it is always payable at sight or on demand and the drawee shall pay the value of the check on presentment. Note that acceptance is applicable to bills with a future date of payment.

Certification of Checks

- As we have seen above the concept of acceptance does not apply to commercial instruments payable at sight and hence to checks. However, checks may be certified by the drawee, upon the request of the drawer, provided that it has a sufficient cover. Where checks are so certified, the drawee will have the obligation to keep the amount of such check in a separate blocked account for the benefit of the holder of the check until the expiry of the period provided for presentment for payment i.e., six months from the date of drawing.
- In effect, the drawee, which certified the check, is considered as the acceptor of a bill of exchange who has agreed to pay the value of the instrument on maturity. Similar to acceptance of a bill, a check is certified by signature of the drawee on the face of the instrument.

Acceptance for Honor

- Acceptance for honor represents a guarantee to pay the value of commercial instruments by any person who may even be a signatory of the instrument. A person may guarantee the payment of the whole or part of the value of a commercial instrument on its maturity by accepting it for the honor of any one of the parties liable to the holder. The person who accepts a commercial instrument shall be liable on the instrument in the same manner as the person for whom he has become a guarantor.
- **Intervention for Honor**
- A person may accept or pay a commercial instrument by intervention for the honor of any person against whom the holder may have a right of recourse. Acceptance or payment by intervention may be made by any person including persons who have already signed the instrument and are liable on it except the acceptor. The person who pays or accepts the instrument by intervention shall have to give notice of his intervention to the person for whose honor he has intervened within two working days from the date of such intervention. This seems to be intended to avoid double payment by debtor.
- This type of acceptance is expressed by words such as “accepted by intervention for the honor of” or similar words implying acceptance by intervention and the signature of the acceptor. It should also indicate the person on whose behalf it is given, in the absence of which the law presumes that it has been given on behalf of the drawer.

– **Review Questions**

- Discuss the legal elements that should be fulfilled for an instrument to be called commercial instrument.
- Verify what a bill of exchange, promissory notes, and checks are.
- Discuss what generally and specially crossed checks are.
- Discuss what certification of checks is.
- Discuss the legal orientation of interest in relation to commercial negotiable instruments.
- Discuss what opposition, payment, and discharge are.
- Discuss what negotiation of negotiable instruments means.
- Clearly state what we mean by maturity of commercial instruments.
- Discuss what acceptance of commercial instruments means.
- Discuss in brief what acceptance for honor is.
- Discuss what intervention for honor is.

CHAPTER THREE
RIGHT OF RECOURSE OF A HOLDER OF COMMERCIAL INSTRUMENTS

Definition

- The right of recourse refers to the right of a holder of commercial instruments to institute legal action based on the instrument for the purpose of recovering the unpaid value of the instrument. This right may be exercised before maturity in cases of bills of exchange, which are capable of acceptance i.e. all types of bills of exchange except those payable at sight or on demand, or after maturity in cases of non-payment of commercial instrument. (Arts 780 and 868).
- The holder may exercise his right of recourse against parties liable on the instrument, i.e., signatories of the instrument in various capacities. These parties include the drawer of a bill of exchange and a check, the maker of a promissory note, endorsers, acceptors, acceptors for honor and the acceptor by intervention for honor.

- As parties to a commercial instrument are jointly and severally liable to the holder, the holder may sue all these persons individually or collectively without being required to follow the order in which they signed the instrument and became a party to the instrument. Proceedings against one party shall not prevent the holder from instituting an action against the other parties even where such other parties signed the instrument subsequent to the party first proceeded against.
- The extent of the right of recourse of the holder is limited to the unaccepted or unpaid value of the instrument, interest where provision as to interest has been inserted in the instrument as per Article 739, interest at the rate of 9% to be calculated starting from the date of maturity on the unpaid amount of the instrument, commission not exceeding 0.3% and expenses. However, if the right of recourse is exercised before maturity, /Art 780/ the holder shall be entitled to a discounted amount to be calculated based on the official rate applicable at the place where the domicile of the holder is situated.

- The holder who intends to exercise a right of recourse must have a protest drawn up. Protest is a written document drawn up by a notary public or by a court registrar evidencing non-acceptance or non-payment of a commercial instrument. However, since the office of the notary pubic are not established as intended and the registrars of courts do not draw up protests, both because of lack of awareness of their function in this respect and because commercial instruments, particularly bill of exchange and promissory notes are not commonly used, it is not possible at present to have protests drawn up by these officials. So, the only alternative way of drawing up of a protest is according to Book VI of the Commercial Code containing the Transitory Provisions. Art 1178 provides that where there is no notary public or court registrar readily available (or performing the function of drawing up a protest) a protest may be drawn up by any person who is capable to perform juridical acts in the presence of two witnesses following the relevant provisions of the code.

- The law also provides the time within which protest has to be drawn up. Accordingly, protest for non-acceptance has to be drawn up within the period of time provided for presentment of the instrument for acceptance by the law or the drawer or endorser. / Refer to Arts 759,757,758 and 781(3)/. A protest for non-payment of a check shall be drawn up within the period provided for presentment for payment under Art 855, i.e., it must be drawn before the period of six months lapses (Art 869(1). However, where the check is presented for payment on the last day of the period provided for presentment for payment, a protest may be drawn up on the following working day. Similarly, a protest for non-payment of bills of exchange and promissory notes shall be drawn up within the period of time provided for presentment for payment provided under Arts 770(1) and 774(1). In other words, protest for non-payment of bills of exchange and promissory notes payable at sight shall be drawn up within a period of one year from the date of drawing. However, in case of nonpayment of the other types of bills and notes, the protest has to be drawn up either within the period provided for payment or one of two working days following the last day on which the bill is payable, i.e. the protest may be drawn on one of the three days on which the instrument is payable or one of the two working days following the lapse of this period. /See Art 774(1) and Art 781(4). / Failure to have a protest for non-acceptance or non-payment within the period provided by the law will result in the loss of right of recourse of the holder (Art 796, 876).

- However, there are certain cases in which the holder may exercise his right of recourse without the need to have a protest for non – acceptance or non – payment. These are:
- A declaration of non – acceptance or non – payment of the bill by the drawee written on the instrument by the drawee or maker unless where the drawer or maker made a provision requiring a formal protest to be drawn up by a public officer. (Art 781(2),886,825(1)(C))
- A judgment in bankruptcy of the drawee or of the drawer of a bill which cannot be accepted/payable at sight/ or of the maker of a promissory note shall replace a protest.
- Where the holder is released from the obligation to have a protest drawn up by provisions such as “retour sans frais”, “sans protet” or any similar expression implying permission to the holder to exercise his right of recourse without the need of a protest. (Art 789,871). This release may be made by drawer or maker, or endorsers. Where it is made by the a drawer, it shall be effective against all the parties to the instrument, but where it is made by any other party, the release shall be effective against the person who made it. In such cases the holder must have a protest drawn up in order to exercise his right of recourse against other persons. (See Art 789, 871 and 825).
- The other requirement which the holder of a commercial instrument must comply with before exercising his right of recourse is to give notice of nonpayment or non acceptance to his endorser /if any/ and to the drawer or maker of the instrument. Such notice has to be given within a period of four working days from the day of protest or from the day of presentment where drawing a protest is not necessary. Each endorser who has received a notice must also give a similar notice to his endorser within the period of two working days and this shall continue until the drawer or the maker is reached

- This notice may be given in any form or by returning the instrument to the endorser, the drawer or the maker. However, failure to give notice or to comply with specific requirements as to time and the names and addresses of the persons who have given notice shall not result in loss of right of recourse of the holder. It shall only result in the liability of the holder who failed to give notice or who gave incomplete notice to pay damages to the person who incurred losses/expenses/ because of such failure or incomplete notice. Because, the purpose of this notice is to give parties liable on the instrument an opportunity to take up the instrument and pay, thereby avoiding expenses resulting from litigations. However, such liability shall not exceed the value of the instrument. [Art 870,825(1) (C)]
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Loss of Right of Recourse

- According to Art 796, the right of recourse of the holder shall be lost on the following grounds;
- Failure to present the instrument for acceptance or payment within the time provided by the law or the instrument. However, where the limit of time for presentment for acceptance is provided by the drawer, the holder loses his right of recourse against endorsers, the drawer and other parties liable on the instrument with the exception of the acceptor.
- Failure to have a protest drawn up in cases where the right of recourse cannot be exercised without a protest drawn up by a public officer or any person as per Art 1178 Art 796,825(1) (C).
- Even though the provisions of Art 796 are not made applicable to checks and there is no provision which deals with the grounds for loss of right of recourse of a holder of a check in the laws governing checks, we can deduce from the provision of Art 876 that the holder of a check shall also lose his right of recourse on the above grounds.
- However, the holder who is prevented from presenting the instrument for acceptance or for payment within the time provided by law or the instrument or from having a protest drawn up within the time provided for drawing a protest by a force majeure as defined in the law of contracts, the holder does not lose his right of recourse. In such cases, the periods of time shall be extended. However, the holder, to benefit from this provision, must give a written, signed and dated notice of the force majeure to his endorser (if any) [or to a drawer/maker] immediately. The holder must also present the instrument for acceptance or payment or have a protest drawn up immediately after the force majeure has terminated. However, if the force majeure continues to operate beyond thirty days after maturity, the holder may exercise his right of recourse without the need to present the instrument or to draw up a protest. Art 797,876,825(1) (C)
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- The law of checks, however, does not contain a provision that provides for the loss of right of the holder of a check though it provides for the cases of force majeure in which the holder's right of recourse is not lost.
  - **Alternative Remedies to a Holder Who Has Lost His Right of Recourse**
- A holder of a commercial instrument who has lost his right to recourse/ the right to seek judicial remedy to recover the unpaid value of a commercial instrument) may still have an opportunity to recover his money based on the obligation underling the issuance or the transfer of the commercial instrument or the provisions of the law (unlawful enrichment)?

Causal proceedings

- These are proceedings based on the contractual or extra-contractual obligations for the performance of which the instrument is issued or transferred. According to Arts 800 and 886, the right to institute legal action based on the relations on which the issuance or the transfer of the bill or a check is based shall subsist (unless it is proved that it has been extinguished by novation). Therefore, according to these provisions, the holder of a bill of exchange or a check who has lost his right of recourse may sue the drawer or endorser who has issued or transferred the instrument to him based on the contractual or extra contractual obligation and recover the unpaid value of the bill of exchange or a check.
- However, for the holder to institute a causal proceeding, he must have a protest for non-acceptance or nonpayment and must offer to return the instrument together with the protest to the drawer or endorser. However, it will be a contradiction in terms to require a person who has lost his right of recourse because of failure to a protest drawn up within the time provided by the law. Similarly a person who lost his right of recourse because of failure to present the instrument for payment or acceptance within the time provided by the law can not have a protest drawn up as the time for drawing up a protest overlaps with time for presentment and the lapse of the one means the lapse of the other. See Arts 759 and 781/3/, 770/1/ and 781/4/ and 855 and 869/1/.
- Art 825, which enumerates the provisions applying to bills of exchange that are also applicable to promissory notes, fails to refer to this provision and the question that has to be raised here is whether this omission is intentional and based on acceptable grounds. Taking into account the nature of promissory notes, it seems that there is no reason why the holder of a promissory note who has lost his right of recourse cannot institute a legal action based on the underlying obligations for the performance of which the note is issued or transferred.
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B. Proceedings for unlawful enrichment

- A holder whose right of recourse is extinguished by reason of limitation of action /Arts 817 and Art 881/ or by reason of failure to present the instrument for acceptance or payment or failure to have a protest drawn up within the period provided by law or the instrument /as can be inferred from Art 799 (4)/, may institute an action based on the rules of unlawful enrichment against the drawer and acceptor up to the amount of money by which they have unlawfully enriched themselves at his expense. The holder will be able to institute proceedings based on the rules of unlawful enrichment only if he is not able to bring causal proceedings (Art. 799).
- This right is given to the holders of a bill of exchange and checks (Art. 799, 886), but there is no reason why the holder of a promissory note should be prevented from exercising this right to recover the value of the instrument from the maker who has unlawfully enriched himself at his expense.

– **Summary**

- The right of recourse refers to the right of a holder of commercial instruments to institute legal action based on the instrument for the purpose of recovering the unpaid value of the instrument. This right may be exercised before maturity in cases of bills of exchange, which are capable of acceptance, i.e. all types of bills of exchange except those payable at sight or on demand, or after maturity in cases of non-payment of commercial instrument.
- The holder may exercise his right of recourse against parties liable on the instrument, i.e., signatories of the instrument in various capacities. These parties include the drawer of a bill of exchange and a check, the maker of a promissory note, endorsers, acceptors, acceptors for honor and the acceptor by intervention for honor. The holder who intends to exercise a right of recourse must have a protest drawn up. Protest is a written document drawn up by a notary public or by a court registrar evidencing non-acceptance or non-payment of a commercial instrument.

- Failure to have a protest for non-acceptance or non-payment within the period provided by the law will result in the loss of right of recourse of the holder.
- However, the holder who is prevented from presenting the instrument for acceptance or for payment within the time provided by law or the instrument or from having a protest drawn up within the time provided for drawing a protest by a force majeure as defined in the law of contracts, the holder does not lose his right of recourse. In such cases, the periods of time shall be extended.
- The other requirement which the holder of a commercial instrument must comply with before exercising his right of recourse is to give notice of nonpayment or non acceptance to his endorser /if any/ and to the drawer or maker of the instrument. Such notice has to be given within a period of four working days from the day of protest or from the day of presentment where drawing a protest is not necessary. Each endorser who has received a notice must also give a similar notice to his endorser within the period of two working days and this shall continue until the drawer or the maker is reached.
- This notice may be given in any form or by returning the instrument to the endorser, the drawer or the maker. However, failure to give notice or to comply with specific requirements as to

Alternative Remedies to a Holder who has lost his Right of Recourse

- A holder of a commercial instrument who has lost his right to recourse/ the right to seek judicial remedy to recover the unpaid value of a commercial instrument may still have an opportunity to recover his money based on the obligation underling the issuance or the transfer of the commercial instrument or the provisions of the law unlawful enrichment. That is through causal proceedings and proceedings for unlawful enrichment.

– **Review Questions**

- Define what right of recourse is.
- Discuss what loss of right of recourse is.
- Discuss the importance of notice in relation to commercial instruments.
- Pin point the alternative remedies to a holder who has lost his right of recourse.
- Discuss causal proceeding.
- Discuss what proceeding for unlawful enrichment is.
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