BAHIR DAR UNIVERSITY

DISTANCE EDUCATION PROGRAMME



Law of Banking, Insurance and Negotiable Instruments

(Laws 562)

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Module I

Law of Banking

Introduction

Dear distance learner, in this course you are going to have three modules. The first module is on the law of Baking. This module is about banking transactions and the laws that apply to the area as provided under Article 896-969 of the Commercial Code. A general introduction is made driving the distance learner back to the history of banking tracing the Reign of Menelik II to the formation of the National Bank of Ethiopia experiencing different developments and changes till the present day. The second unit is devoted to the rules and regulations that apply to deposit of funds which begins with defining the concept and detailing some concepts and legal consequences thereof. Banks also involve in bank transfer that entails passage of money from one customer to another either account to account, or otherwise. This bank undertaking has its own features and consequences. The legal aspects involved and some practical considerations are discussed. Emphasis is given to the law of hiring of safes which involves submission of safe boxes by banks for the safekeeping of valuables of the depositor. Unit Six is about discount which also requires the involvement of a bank facilitating credit to the holder of a commercial instrument or other negotiable securities. It has its own rules of interaction that goes between the banks and a customer. A brief study is made about this issue as well. As principal professional engagements of banks, credit transaction has given emphasis as involving a credit facility to customers by way of availing money under the disposal of the beneficiary. The transaction is backed by security devices including pledges, mortgages on properties both tangible and intangible. It creates legalities between bank and a borrower resulting strict legal consequences of disposal of the securities pledged or mortgaged in case where the beneficiary failed to duly repay the fund he/she borrowed. A brief study of

documentary credits such as letter of credit is also made as a facility to foreign trades. Unit Seven is dedicated to these issues that relate to credit transaction either documentary or other cases. Finally, some rules applicable to the duty of secrecy of banks in relation with rendering banking transactions are explained.

Unit One

1.1. General Introduction

Dear distance learner, you should bear in mind the need to know some theoretical aspects of a certain legal rule. Banking transaction and its regulatory guidelines are not creations of over night effort. It passed through specific developments one evolution after another from the primitive to the present day compicated and net-worked engagement. So as to understand today, it is important to trace what looks like yesterday. It enables the legal rules to be framed taking into account the nature of the transaction and the changing circumstances within it. Hence, the distance learner deserves to know some backgrounds of banking for it enables him/her to understand the detail subject matter under consideration.

1.2. Emergence and Development Banking in Ethiopia

Dear distance learner, can you imagine the period when banking transaction as a modern system, emerged in Ethiopia? Do you know the first bank in Ethiopia? When do you think national bank was established?

As organized nation state, Ethiopia pursued different developments of governance. These varied governances left varied histories. Among others, the history of banking takes its own place. Modern banking emerged in Ethiopia in 1905 during the reign of Menelik II through the formation of a bank called “Yehabesha Bank” literally “Abyssinia Bank” in collaboration with English Bank situated in Egypt. The bank

officially started operation as an out come of 50 years joint ownership agreement between such English Bank situated in Egypt and the Ethiopian government.It opened branch offices of Harar, Dire Dawa, Goire and Dembidolo and had agent office in Gambella and Transit office in Djibuti. The bank was of limited service like government account holding and hold limited money foreign trade among others. It was only foreigners and few Ethiopians who were entitled the bank for the majority of the people had no idea of banking service.

Other subsequent banks were seen in Addis Ababa for example Agriculture and Trade Promotion Bank as established in 1908 and Indo-china Bank and East African which is established in 1915.

As Abyssinia bank was foreign attached and was proved to be weak coupled with it mere profit making motivated orientation, Emperor Haile Silassie I liquidated and substitute it by notice bank called Bank of Ethiopia. The latter started its undertaking with the capital of 750,000 pounds in October 1932. Bank of Ethiopia, in addition to undertaking banking business, had been authorized to print paper money and mint coins. It had branch offices at Dire Dawa, Gore, Dessie, Debre Jabor and Harar together with the agent office at Gambella and transit office in Dijbuti. As compared with Abyssinia Bank, Bank of Ethiopia played an important day to day economic role as it was established in the interest of the existing government and being the asset of the state.

During the invasion of Fascist Italy, several Italian affiliated banks including Banco De Roma stayed undertaking business in Ethiopia. After the end of the invasion came state Bank of Ethiopia in 1941.

1.3. Unit Summery

In Ethiopia modern banking emerged by the opening of Abyssinia Bank during the reign of Minellik II in collaboration with English bank situated in Egypt through it was a foreign individual benefit oriented which resulted in its dissolution by Emperor Haile Silassie I and replacing it by bank of Ethiopia. Certain Banks like Agriculture and trade promotion bank in 1908 and indo-china bank and east Africa co were witnessed to appear as banking transactions in Ethiopia. Such development of banking in Ethiopia was supplemented by the Italian banks like the establishment of Banco De Roma during the Italian invasion. Eventually, state bank of Ethiopia took the step following exclusion of the invasion in 1941. Then came National Bank of Ethiopia in 1963 in order to conduct commercial and control banks business. By central Bank it represents the business of example, minting coins,, printing paper money, supervise the functions of financial institutions, supervise the monetary policy, etc by commercial banking it refers the issuance of noted checks, opening of deposits, running current account advancing loans etc. Change of the nature of government also changed the banking system during the Derg regime which declared itself as pursuing socialist order nationalizing all the private banks and following command economy. Banking transaction fully centralized avoiding all commercial banks and other financial institutions except some government owned banks.

Later on the introduction of free market economy in the country by the situational government since 1991 changed the situation and restructured the banking system of Ethiopia in pursuant to proclamations 83 and 84 of 1994. The former widened the scope of national bank of Ethiopia given the authority to mainly act as a central bank, through not exclusively and the latter facilitated the expansion

of commercial banking in Ethiopia. Accordingly the National Bank of Ethiopia has the mandate to lead the monetary policy of the country discharging different responsibilities among which is issuing license for commercial banking transaction which is subjected to different detailed conditions and minimum standard requirements as enshrined in the above proclamations and different directives of the national bank of Ethiopia with varied legal consequences.

1.4. Summary Questions

1. Do you think banking transaction requires legal regulation? Why?
2. Explain the development of modern banking in Ethiopia.
3. Why up need national bank of Ethiopia currently?
4. Commercial bank in Ethiopia operating currently can play the greatest role to the economy of the country how?
5. What minimum major prior considerations will you advance to a person who wishes to engage in banking transaction in Ethiopia?

Unit Two

Deposit of Funds

2.1. Unit Introduction

Dear distance learner, in the preceding part of the module, you have studied some introductory concept about banking in Ethiopia in particular. You are assumed to have some idea about the area. Now you are passing to the next detailed consideration of one the several banking transactions which the 1960 commercial code of Ethiopia incorporated, i.e. deposit of funds. It is covered Title III chapter 1 and

section of the code covered under Article 896-902. Accordingly, the material provided the meaning of deposit of funds by either making implied references to the same code or taking general scholarly definitions. It also determines the nature and scope of the kind of transaction under consideration. Deposit of funds, at the same time involves certain categories as classified in to three groups each representing its own nature and legal consequence. You will be acquitted with some ideas about these classifications. Since this unit is dedicated particularly to deal with deposit of funds that regards deposit of money, detailed consideration is made as part of the deliberation. Deposit of funds, as a banking transaction, presupposes parties to it. It is not a Len lateral transaction. It involves a contractual interaction involving corresponding parties creating banker customer relationship with the possible legal consequences. The question of who is a banker and who is a customer on the one hand and the issue of what legal bonds may come about on the other hand obtain their own part in the material. Here, as the main focus the distance learner obtains important legal knowledge Finally, the whole discussion will be summarized with self-check question. Bear in mind, at the same time that in text activities supplement the endeavor to enable the distance learner get familiar with the theoretic and legal concepts involved.

At the end of this unit, the distance learner will be able to:

- Define bank deposit of funds;
- Determine the nature and scope of deposit of funds as a banking transaction
- Classify deposit of funds in to different categories;
- Explain each classification of deposit of funds;
- Discuss what involves in deposit of money.

- Define banker and customer putting the two in different categories
- Determine the right-duty relationship between the banker and the customer.
- Settle practical cases as arisen falling under the legal regime of deposit of funds.

2.2. Meaning, Nature and scope of deposit of funds

Dear distance learner, what do you think it means by deposit of funds? You try to define the phrase by your self before reading the note.

Though the definition of deposit of funds is not specifically provided in the governing provisions of the issue under the Commercial Code, one can, however, infer a definition from the reading of the elements of Article 896 of the same. It states,

The contract of deposit of funds renders the bank the owner of funds deposited, irrespective of the mode of deposit. The bank may dispose of these funds in respect of its professional activity subject to repayment under the conditions provided in the contract: provided that the bank shall not acquire the title to nor the right to dispose of conies or other individual monetary tokens in respect of which there is a provision that they shall be refunded in kind.

This provision, in fact, contains may things that may come in to picture as an out come of the specific legal transaction involving banking business. Bust still one can derive a definition of deposit of funds certain elements of the provision. We can see that it is a contract involving agreement of the concerned parties, i.e. the bank

and the depositor in which the former receives funds or coins or some other individual money tokens from the latter and keeps safely under the condition of the repayment or give back to the depositor. It is a contract under the definition provided in Article 1675 of the 1960 Ethiopian civil code regarding an economic matter.

The transaction involves an obligation to do as is stated lender Article 1712(1) an undertaking requiring the debtor of the obligation to do, in our case, duty to preserve the anemone of money deposited or coin entrusted to be kept with the legal duty to give back to the depositor depending in whether it is at spot or time demand what is time demand and refund at spot will be discussed later on.

Attached to the issue of nature of contract of deposit, a question of whether It is a contact of adhesion needs specific discussion. There is no doubt as to the need to have offer and acceptance transaction between the bank and the depositor. The matter here is whether the terms of the contract are subjected to mutual bargaining one term after an offer and determination according or to be made based on already fixed standards of terms of agreement by one of the contracting parties. Contract of adhesion is a type of contract which the conditions are fixed by one of the parties in advance and are open to acceptance by any one. The contract which frequently contains many conditions is presented for acceptance embolic and is not open to discussion. When we come to our issue one can see the practice of commercial banks of Ethiopian that there are standard forms each person should fill when he/she /it wishes to deposit funds in a particular bank. The offer and acceptance is made against those already fixed standards by the depositor by way of responding to questions or filling blank space provided in the form ready in advance. The terms of negotiations are already determined in advance. There is

no open door to modify even a word during the exchange of obligation between the parties. Those who wish to deposit have the option either to respond to the terms fixed in advance or leave the vicinity. This is the common practice in all banking transactions including deposit of funds. Hence, it can be said that the standard forms offered by the banks are typical examples of contract of adhesion. This is the manifestation that contract of deposit of funds involve a nature of contract of adhesion, i.e. adherence to the terms of agreements determined and offered by they particular bank in advance.

Deposit of funds is applicable on matters that regard deposit of money, deposit of coins or deposit of other individual monetary tokens. The reading of Article 896 of the commercial code, the principal provision defining the nature and scope of deposit of funds, guides the same.

2.3. Creation of Banker Customer Relationship

Banking transaction has automatic effect of creating banker-customer relationship what ever nature the undertaking involves. This includes deposit of funds as one of bank undertakings recognized under the Commercial Code. The banker is the one that undertakes banking business by way of receiving money or other deposits from his customers and collect instruments representing money on behalf of the customers on the understanding of refunding all money received and collected, either on demand or at some definite date agreed up on between them. The banker is the bank in the Ethiopian context. The customer is the party who looks for banking service from the banker. The relationship between the ranker and the customer is contractual. The contractual relationship is a complex one governed founded up on the customs and usages of the bankers including the applicable law.

Banker-customer relationship represents immediate debtor-creditor relationship imposing corresponding rights and duties. But the debtor aspect outweighs on the part of the banker for it is duly entrusted to due refund of the amount of money, for example, deposited in the hands of the banker or restoration of the thing deposited for safekeeping up depending on the nature of the banking transaction at hand. Dear distance learner, so as to banker and customer relationship as creating debtor and creditor legal tie by going through several previsions of the Commercial Code. The clear reading of for instance, Article 896 represents such relationship making the banker the duty bearer and the customer right holder the former to refund the amount of money deposited and the latter exercise the right to claim refund the amount of money deposited as an out come of the agreement entered between them. Such right-duty relationship entails several legal consequences as we will see it the several implications of deposit of funds as discussed in the following deliberation.

2.4. Unit Summary

Dear distance learner, you have studied that contract of deposit is a banking transaction in Ethiopia as addressed under Articles 896-902 of the 1960 commercial code involving barker-customer legal relationship in which the latter entrusts money like proprietary interests in the hands of the former. The legal engagement has a consequence of making the banker the owner of the deposit when it comes to money deposit with the full entitlement of free disposal of it for its professional activities with the duty, of course to refund total or part of it when required by the depositor in pursuant to the terms of the contract. In other cases, however, the bank is required to safely keep the items deposited and restore in kind when required to do so by the depositor. Bank deposit is categorized in to three

classifications as general deposit, special deposit and specific deposit depending on the nature and the consequence thereof. In the transaction, the parties involved are the banker who under takes the banking business and the customer who deserved the particular banking service. Deposit of baking results in several legal consequences like that of opening of accounts in which the record of the total transaction is made by way of debit and credit undertakings whenever the depositor wishes to deposit or withdraw funds with or from the bank respectively.

The nexus may be pursued in the same office where the account is opened or in different of offices of the same bank depending on the contractual agreement set in advance or later on. In cases where the depositor opened separate accounts in the same bank or different branches of the same banks, since the transactions emanate from different contracts they get treated separately. It is possible however, that all should get involved under one transaction by way of fixing as such through the agreement made or to be made between the bank and the depositor. The customer as the manifestation of the contract of deposit of funds, can withdraw the fund partly or totally the latter case terminating the total relationship which is the reflection of absence of automatic right of the depositor to require over draft, i.e. refund beyond the account balance yet, overdraft is not totally excluded by the law for by way of making agreements between them the bank may facilitate over draft setting certain strict conditions of securing its refund. Ultimately the whole transaction need to have a balance anticipating the future possible legal bound between the bank and the depositor.

2.5. Self-Check Questions

1. “Contract of deposit of funds always entitles the banker to ownership of the financial interest entrusted to for deposit by the depositor.” Evaluate the legality of the statement in light of the applicable provision of the commercial code.
2. Contract of deposit of funds is contract of adhesion. Explain the statement.
3. Assume you are the legal advisor of a certain commercial bank. The bank wishes to draw a policy as to whether there is need to permit over draft or not. The bank then approaches you to give a legal advice on the possible advantages and disadvantages of making such an arrangement with the possible suggestion of strict conditions of making the arrangement, if it is desirable what legal advice would you give to the bank taking into account the contribution or otherwise of the potential transaction?
4. Give a brief explanation of the possibility of making several contracts of deposit of banks between the same depositor and the rules applicable there of in treating the separate deposits in light of the applicable banking law in Ethiopia.
5. Opening of account is the automatic effect of deposit of funds. Why the law does dictate the same?
6. Contract of deposit of funds follows two different rules as to refund of the deposits to the depositor the thing itself or the equal value-first specify the distinction and explain the background behind the differentiated rules.
7. Distinguish between the different categories of bank deposit and determine the specific place of each under the Ethiopian commercial code.
8. Read Article 879(2) of the commercial code and try to specify the possible transaction that may be excluded from entering into the account of deposit.

9. Which category of deposit can you classify deposit of funds under the commercial code? why?
10. What is the difference between time deposit and demand deposit.

Unit Three

Deposit of Securities

3.1. Unit Introduction

The commercial code provided several banking transaction each representing its own feature and legal implications. This unit is devoted to deposit of securities, one of the several banking businesses. It involves in providing the particular meaning to the transaction, searching into its nature and determining its scope of application as envisaged under the Ethiopian legal context. An attempt is also made to specify certain classification of deposit of funds based on general principles of applicable to the area and certain implications of the commercial code. In dealing with the subject matter the possible legal chains that may arise between the persons in the transaction will be addressed as well. Basically there is an exhaustive discussion is made about the legal effects of which deposit of funds may bring about. In addition, certain remarks are made making distinctions between deposit of funds and deposit of securities. Unit summary touching the important points in this part of the module together with self-check questions ends the deliberation questions and activities refresh the distance learner as he/she goes through the reading. The total discussion is based on Articles 912-918 of the commercial and other related principles.

At the end of the unit therefore, the distance learner is expected to:-

- define deposit of securities
- identify the nature and determine the scope of deposit of funds;
- categorize deposit of funds
- be able to explain the legal nexus which may be created as an out come of the transaction;
- enumerate the legal effects of deposit of securities;
- give legal advice on questions that relate to deposit of securities;
- distinguish between deposit of funds and deposit of securities;
- decide on cases of deposit of securities among others.

3.2. Meaning, Nature and Scope of Deposit of Securities

Dear distance learner state in your terms what constitutes deposit of securities for that purpose. Go through Articles 912-918 and try to find a definition of the matter? Did the commercial code provide a definition? If not, can you derive your own definition from the reading of the whole text? What nature of transaction and what scope of application does deposit of securities involve in? It is these and other related questions that this section of the unit deals with.

As a matter fact, the 1960 commercial code failed to define deposit of securities. It simply escapes into providing the legal principles that apply to the area. Hence, it is better to device a definition to the concept by way of making reference to different resources which made an inquiry into it.

For better understanding, it is advisable to spilt the phrase deposit of securities in to two: deposit on the one hand and securities on the other. Black's law dictionary, the renowned reference in giving meaning to legal concepts, defined securities as stocks, bonds, notes convertible debentures, warrants or other documents that represent a share in a company or a debt owed by a company or government entry, evidences of obligations to pay money or of rights to participate in earnings and distribution of corporate assists; instruments giving to their legal holders rights to money or other property. They are, therefore, instruments which have intrinsic value and are recognized and used as in the regular channels of commerce. The same dictionary, at the same time defined deposit as an act of committing to custody, or laying down or placing or putting or pledging for safe keeping of something. It may means also lodging a fuming as a pledge to entrust to the care of another. Hence, in combination we can say that deposit of securities a kind of transaction that that involves in placing safely of documents money claims or rights which can be assessed in terms of money in the hands of a person who engages is such activity. Such person is usually a bank which undertakes the transaction professionally.

Thomson's dictionary of banking defined securities as including advances, bearer bonds, bill of lading, bond of credit, certificate, collateral security, container, debenture, debts-assignment, dock warrant, goods guarantee, inscribed stock, lien, life policy, negotiable instruments, shares ship, subrogation, title deeds.

Still by way of inference from the deep reading of, for example, Article 914 (1) of the commercial code securities are document that yield interest, dividends capital payment amortization and any other entitlements incorporated in the securities. In addition to this Article

912 impliedly embraces the idea that securities are things that incorporate rights which are capable of calculation in terms of money and exercisable by the owner.

Hence deposit of securities stated under Articles 912-918 of the commercial code may be understood in light of the above description as a generally applicable representation or specific address under the commercial code.

The transaction involves handling of securities by banks and exercise of the rights relating there to exclusively on behalf of the depositor as is stated under Article 912 of the commercial code. It involves bilateral engagement having the bank on the one hand and the depositor of the concerned security on the other. But whether such nature of transaction is contractual is not specifically stated under the code unlike deposit funds which is addressed under Article 896 of the commercial code. Then, dear distance learner how shall we identify the nature of the traction with out specific stipulation of the law maker? Articles 912 and 914 specified the aspect of agreement by way of excepting certain engagements as looking for specific other wise deliberation as between the parties concerned. Here we can imply that the initial transaction as emanating from the parties agreement. The agreement regards creating banker-depositor legal relationship which involves the deposit of specific security in the hands of the bank for the depositor. Without such pre-engagement one can not think of the feasibility of creation of the relationship. Another inference of the need to have a contractual relationship is the statement again envisaged under Article 912 of commercial code stating that… a bank may handle securities and exercise the rights relating there to exclusively on behalf of the depositor. It is about a consequence resulting from a legal transaction. What is expected on

the part of the bank is an act on behalf of the depositor, i.e. agency relationship as envisaged under 2199 and 2201(1) of the commercial code, furthermore raises the concept of bailment under the civil code which is typically of a contractual nature under Article 2779 of the civil code. All these implications and the nature of the transaction itself manifested that deposit of security is a contract in which the bank undertakes to place securities safely and exercise the right there in on behalf of the depositor. This is coupled with the requirement of restoring the securities to the depositor as is stated under Article 916 of the commercial code.

The contract applies to such documents stated in the definition as things incorporating claims subjected to assessment in terms of money looking for the state keeping of the same for ultimate restitution to the depositor by the bank which is entrusted for this sake.

3.3. Obligations of the Parties in Contract of Deposit of Securities

Dear distance learner, go through the provisions of the commercial code that deal with deposit of securities and identify the corresponding specific obligations of both the parties. What particular obligations the deposition assumed? What other obligations should the bank discharge?

Contracts are by their nature creations of obligation as defined in the agreement concerned in pursuant to article 1675 of the civil code. There is no exception to contract of deposit of securities with this

regard. Almost all provisions that covered deposit of securities address the corresponding obligations the bank and the depositor owe each other.

3.3.1. Obligations of the Bank

The obligations of the bank may be categorized as directed to the depositor or third parties.

A. **Obligations of the depositor**:- this is the principal ground for which deposit of funds is necessitated. It involved coupled duties that the bank should duly perform. The first and foremost obligation of the bank is provide due custody to the thing deposited as set under articles 912 and 913/1/ of the commercial code which may include keeping the security under the conditions other than agreed up on in case of urgency and even entrust it to a third party custody or alienate it where it is in imminent danger of loss or deterioration provided notice should be given to the depositor in accordance with article 2785 of the civil code. As part of such an obligation of care of the security deposited, the bank is, under articl3 914(4) of the commercial code, dictated to carry out transactions for the safe-keeping of the rights arising out of the securities, such as regrouping, exchange, renewal of coupon sheets and stamping. This act updates the claims embraced in the security which is in the hands of the bank.

The bank, as part of the under taking in deposit of securities should open deposit account in the name the depositor. Why the bank should do this? Is there any debit and credit transaction? First, the

engagement itself requires record of the deposit itself. Second, the bank is placed to act on behalf of the deposition to collect the yields of the security like the amount of interest, dividends, capital payments, amortization and other entitlements arising under the securities when their payment is mattered under Article 914(1). As one can see the nature of the yield, that are to be collected is the form of money. Then, what should the bank do with these collected funds? There must be a mechanism of keeping these fruits of the security so that the depositor can exercise his/her right over them. The need to have account in the name of the depositor comes in to picture and Article914(2) implies its necessity. Here the bank is required to enter the collected yields in the deposit account of the depositor. It should be credited and placed at the depositor should be credited and placed at the disposal of the depositor so that the latter can consume them or order their consumption to a certain beneficiary under the same provision. Therefore, here is another obligation of the bank to open book of account in the name of the depositor, collect the fruits of the security and enter the same in eh account making the situation fertile to the depositor to do whatever he/she likes against the yield as an owner of the new entry. In addition to this the bank should have deposit account is the name of the depositor for the depositor in order to discharge its obligation of collecting free scrip and join (enter) them to the deposit under sub (3) of the same provision of the commercial code.

The bank, is behaving on behalf of the depositor as the custodian of the security and as representative of the depositor in transactions that touch the deposit, should keep the securely in its hands unless surrender of the security is required due to the nature of the transaction at hand under Article 913/2/. What transactions can be predicted entailing surrender by the bank of the security deposited?

Here one can think of several market situations one of which may be order of a court of requiring the bank to deliver the security to a certain judgment debtor in execution of a decision made by a court for example, under article 918 of the commercial code. We can think, also, of the need to deliver the securities in case of execution of succession as a result of the death of the depositor. Still it is possible to anticipate the legal possibility of the order of the depositor him/her self requiring the bank to make delivery of the security to a particular beneficiary in accordance with the terms of contract of deposit. In case of satisfying the claim of third parties under Article 918, however, the bank should communicate the matter to the depositor. Contract of deposit of securities by its nature, involves safekeeping of the subject matter for ultimate delivery of the same to the owner. As forming part of that duty Article 916 provided.

1. A bank shall restore securities at anytime, up on demand of the depositor, and with the periods of time provided in the conditions of custody and subject to any right of retention which the bank may be entitled to claim.
2. Restitution shall be made at the place where the deposit was made. It shall relate to the title deposited unless restitution of different titles has been agreed by the parties or is permitted by law.

Here is a manifestation that safe-keeping is necessitated for the ultimate proper use of the rights attached to the security deposited. That proper final consumption of the economic yield in the security requires full control of the matter. Hence, under the contract such condition is made as element of the right duty relationship between the bank and the depositor. The bank then should give the security back to the depositor on demand of the latter keeping the terms of contract of deposit of securities intact. The question of to whom the deposit should be delivered is addressed under Article 917(1) of the

commercial code. It is the issue of to whom performance of contract should be made. It is natural in general principle of contract under the civil code that performance should be made to the creditor or to a third party who is duly represented by and act on behalf of the former. The same principle is reiterated under the commercial code when it comes to due discharge of contractual obligation on the part of the bank in contract of deposit of securities. The above provision underlined, “restitution shall only be made to the depositor… or to the person appointed by him…”

The bank furthermore, is required to make decisions on behalf of the depositor in times when there arisen transaction which possibly involve benefit to the depositor after making due communication of the matter to the latter under Article 915 of the commercial code. Here the provision envisages voluntary economic transaction which the deposit may enter into so as to prosper him/her self. It is contractual transaction which the circumstance may not compel the depositor to enter into but it is advantageous for him/her to do so. Such options often made by any reasonable person in a way that yields economic merit. When such a case arises, as the representative of the depositor, the bank should communicate the matter to the depositor looking for instruction. But still the depositor can make decision that is benefiting to the principal. Such a kind of autonomy to the bank has the sharp edged economic merits one serving the depositor, the immediate beneficiary and the other feeding the market and promoting the general economy by way of injecting market agent. It involves micro and macro-level economic advantages. Other extra obligation may be provided under the terms of the contract as well.

B. **Obligation to third parties:-** what obligations and why do you think, dear distance learner, the bank is compelled to accomplish for third parties?

Contracts naturally create obligations between the parties concerned as rule of general contract dictates under Article 173(1) of the civil code for example. But under certain exceptional circumstances sometimes contractual obligations may involve third party tie based on certain legal situations. The same is true to the area of deposit of securities, as economic engagements. Accordingly, the bank may be required to perform obligations to third parties under the legal tie between through contract of deposit of securities. This may be the case of which is visualized under Article 917(1) opening the legal possibility that restitution may be made to those having rights from the depositor. Who can be such persons? The claim may be made to those having rights from the depositor who can be such persons? The claim may be arisen as an out come of opening of succession in the exercise of right of succession by law which goes to heirs or through testamentary statement which may indicate certain legatee(s) to exercise right over the security deposited. In such a case the bank is required to make delivery of the deposit to one or more of beneficiaries in accordance with the law applicable. These heirs/ legatees are third parties to the legal relationship the persisted between the bank and the depositor. But the law creates a chain of the need to perform the obligation of delivering the security with its yield to third parties.

Such third parties may be creditors of the depositor as a result of some other contractual ties or creditors of, for example, maintenance obligation. Pursuant to due court litigation and ultimate decision the execution of which requires a particular performance, a court may

order, under Article 918 the bank to deliver the security to such judgment-creditor. The bank is under legal obligation to make the ultimate performance to a third party, a creditor of the depositor. As stated earlier however, the bank should communicate the matter to the depositor. There is an obligation to a specified *usufructuary* under Article 917(2) when the latter is alive.

3.3.2. Obligation of the Depositor

Dear distance learner, what possible contractual/legal obligations may the depositor owe to the bank?

The relationship between the bank and the depositor is contractual imposing corresponding obligations, in principle, between them. Thus, it is not only the bank that should assume obligations towards the depositor but the vice versa is also true. The depositor performs certain contractual obligations towards the bank. Under Article 914(4 of the commercial code the bank carries out certain activities for the proper upkeep of the security as a bailee on the one hand and an agent on the other hand. Such activities may entail expenses. Since all is made in the interest and on behalf of the depositor, he/she should bear the costs of up keep which the bank accomplished in the form of either regrouping, renewal of coupon and stamping. It is up dating the value and legality of the security. This is an act of management. Such expenses of the act of management should be born by the owner of the thing who is the ultimate exclusive beneficiary of the whole endeavor. It is the depositor who shall refund the costs to bank.

The bank in entering into contract of deposit of securities is engaging in its professional activity and in doing such undertaking it is in the assumption of obtaining economic benefit. This economic benefit can be secured in the form of imposing service charge upon the customers

as the practice discloses the fact. The depositor in contract of deposit of funds is one of the customers who is looking for bank service. Everything is however, subject to determination during offer and acceptance. Hence, the depositor is under duty to respect the terms of the contract set during such interaction. One of the terms of the contract can be payment of the service charge to the bank.

In addition to this, the depositor is under legal duty to cover the costs which the bank made in communicating a matter looking for optional decision under Article 915(1) of the commercial code.

Ultimately, Article 916(1) last statement provided the right of retention of the bank operative against the depositor. This right may, as it is stated above, emanate from the terms of the contract or as an out come of failure of the depositor to duly cover the costs explained above. Other extra-obligations may be set by agreement as well.

3.4. Unit Summary

Dear distance learner, in this unit you have been guided to certain legal concepts that revolve around deposit of security which involves the safe-keeping transaction by the bank on behalf of he depositor instruments which incorporate rights which can be assessed interims of money. The instruments may be stocks, debentures, note, warrants, advances, bearer bonds, bill of lading, goods guarantee, life policy, negotiable instruments, title-deeds etc. Deposit of securities is a banking transaction which involves handing over of such documents to the bank by the depositor, for the safe-upkeep and collection of yields on behalf of the latter when they due securities may be classified as interest bearing or non-interest bearing on the ground of whether they produce interest to the owner or not. They may also be classified as bearer instruments, instruments to order or instruments

to a specified name based, on making reference to the beneficiary of the rights incorporated.

Deposit of security as a contract creates immediate legal chains as between the bank and the depositor. The first may be bailor-bailee relationship in accordance with Article 912,9131.1 and 914(4) of the commercial code together with Article 2779 of the civil code. The second legal chain is agent-principal relationship which may be seen by the application of Article (912, 9141) of the commercial code together with Article 2199 and 22041.1 of the civil code. It also creates other right-duty relation ships between the bank and the depositor looking for due care on the part of the bank in keeping the safety of the deposit to its proper restitution to the depositor or his/her representatives or other persons legally entitled to have exercise of the right in the security deposited. The depositor is also required to pay, to the bank service charges and costs of up keep and collection of yield of the securities deposited.

The distance learner should simultaneously note the important distinctions between deposit of funds and deposit of securities as involving subject matter distinctions, transaction differences and consequence dissimilarities.

3.5. Self-check Questions

1. Define deposit funds and determine its scope and nature.
2. Deposit of coins and individual monetary tokens and deposit of securities can be considered as similar banking transaction for both involve delivery of the same thing deposited. Comment on the legality of the statement.

3. Deposit of securities creates baillor-baile and agency-principal relationship between the bank and the depositor. Explain how?
4. What is your legal advice to the bank about the legal remedy it can resort to in case where the depositor failed to discharge the duty to pay certain amount of money for service charge or administrative expenses to safely keep the security?
5. Make important distinctions between deposit of funds and deposit of securities.
6. Do you think the provisions provided to govern deposit of securities as exhaustive dealings of the subject-matter? What recommendation would you make to the law maker if you feel there is some thing missed?
7. The bank in deposit of securities may be required to perform the obligation to restitute the deposit to a third party. Explain the possible legal grounds for this effect.
8. There is no need to open deposit account in deposit of securities unlike deposit of securities. Do you agree with statement? Why yes? Why No?
9. Classify securities
10. Can the bank surrender the securities as an act of transactions? How and under what legal authority?

Unit Four

Bank Transfers

4.1. Unit Introduction

Bank transfers as a banking transaction. It involves certain undertaking which the bank plays the role of intermediate or as between different parties.

This material has a definition part together with determining the nature and scope of the transaction. The kind of banking involvement under consideration has also its own categories based on the circular of transfer of funds. The law provided the concept of bank transfer in the idea that it serves certain economic purpose as regulated under the commercial code of Ethiopian. There is a brief explanation of the purpose of the transaction. The unit also contains description of certain legal principles that apply to bank transfers envisaged in the law. Moreover, what legal consequences applicable between whom is given its own consideration being part of the discussion. Summary remarks with self-check questions will remind the distance learner the whole endeavor made to import the legal concepts in involved. Activities and in text questions, as supporters of the communication to the student, are provided in due delivery of the lesson. Therefore, at the end of this unit, the distance learner will be able to.

- Define the concept of bank transfer;
- determine the nature and scope of the transaction;
- Classify bank transfer;
- Enumerate guiding principles of the area;
- Explain the legal effects of the transaction in bank transfer;
- Resolve disputes that arise in connection with bank transfer, among others.

4.2. Meaning, Nature and Scope of Bank Transfer

Dear distance learner, give your own definition of bank transfer first and determine its nature and scope of application.

The term transfer is defined in the Black's Law Dictionary as an act by which the title of a property is conveyed from one person to another. It includes the sale and every other method, direct or indirect, of disposing of or parting with a property or with an interest there in, or with the possession there of, or of fixing lien upon property or upon an interest their in, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as conveyance, sale, payment, pledge, mortgage, lien, encumbrance gift security or other wise. The definition is a general one. Banking transfer may be included, however, for the definition is inclusive of almost all interest of a person which can be calculated in terms of money, i.e. proprietary interests. Resorting to the definition of banking transfer as a particular transaction having its own nature, in the 1960 Ethiopian Commercial Code, Article 903(1) defined it saying, "A bank transfer is a transaction by which a bank debits the account of a depositor, up on his written instruction, and credits by its entry another account with same amount." Look in to the contents of the definition as expressly provided and as can be implied. The definition presupposes pre-existing banker–customer legal relationship between the transferor and the bank on the one hand and between the transferee and the bank on the other. Because the bank is to debit one account and credit another account in pursuant to an order made by the transferor. The nature of the relationship between these coupled parties with the bank is a separate contract of deposit of funds as a consequence of which the bank opened respective deposit accounts. This is the first consideration in the definition and the other is banking transfer creates legal chain between two different parties, who may have had some other legal ties, setting the bank play a role of intermediation. The transferor orders-the bank executes- the execution is to the benefit of the transferee. It is a tripartite legal

bond, the bank standing in the middle and reacting between the transferor and the transferee. Hence, in the wordings of the commercial code, bank transfer involves an undertaking that the transferor instructs a bank to debit his account and credit the amount in the written instruction in to the account of the transferor.

The nature of the transaction is contractual which is a voluntary action in its very origin and through applies to the transfer of money from one person to another by the medium of the bank. The bank chains the undertaking with regard to the necessity of deposit account of the transferor and the transferee is the same bank. There is a disparity between the law and the practice. The definition is strictly requiring the two parties two have deposit account in the bank so that the latter can involve in debiting and crediting one account in to another respectively. But the day to day activities of the banks discloses that it is not important for a person to have an account in the same bank so as to transfer money to some one else. The banks provide a form that is available to all who wish to transfer money to another person irrespective of whether there is a deposit account in the same bank or not. The service is equally available for those who have a deposit account and those who have no deposit account in the bank.

The difference, however, is those who have deposit account can instruct, in the form provided by the bank to debit their account and transfer the amount of money specified in the order to the transferee regardless of whether the latter has deposit account.

Those who have not the deposit account may, at the same time, instruct the bank to transfer the amount of money specified and pay the amount to the bank on the spot and the latter executes the order

accordingly. It follows that, though the law envisaged the application of transfer of funds to the customers in whose name a dep0sit account is opened, the practice is inclusive of non-customers, i.e. who require bank transfer service on the spot.

4.3. Classifications of Bank Transfers

Bank Transfer may be grouped into categories based on criteria's set under the law in the area of rendering the same service. Accordingly, bank transfers may be:

a. Internal Bank Transfers: are the mode of transfer which involves instruction of transfer of a fixed amount of money from the account of another who has deposit account of money is the same branch of the bank. Here what is required is the transferee and the transfer or should have deposit account of money in the same branch of the bank intermediating the transaction. This you can see from the reading of Article 904 of the commercial code.

b. External Bank Transfers: are the mode of bank transfer which regards the written instruction of a fixed amount of money to be debited from the deposit account of the deposing making the order and be credited in to the account of another person in another branch of the same bank. What is important here is existence of account in the name of the transferor in one branch and in the name of the transferee in another branch. It is branch to branch transferring transaction. The matter is, at same times, treated under Article 904 of the commercial code.

This classification disregards any bank transfer which may be made in the absence of account either in the name of the transferor or the transferee for the law is designed in such a manner that failed to predict such a banking practice in all commercial banks of the country. It manifests that the law need to fit the practical needs of the transaction. We can see the area of consideration holds an out dated provisions. The practice runs forward while the law lags behind. Bank transfer in the existing days can be either.

a. From one account in to an other account in the same branch or
b. From one account in to another account in the another branch of the same bank or
c. From a person having no account in to an account belonging to the transferee in the branch where the instruction is made or
d. From a person having no account in to an account belonging to the transferee in another branch of the same banker
e. From one account to a person having no account in to another branch.

In addition to this transfer of the same bank, there is actual interaction between different banks. In accordance with the term of agreement that could be made as between the different banks, one person can transfer money to another by way of drawing a check. Dear distance learner, you can see how the current banking transaction networked which the law does not address.

4.4. The Legal Effects of Bank Transfer

Bank transfer is a legal transaction that entails its own consequences attaching rights to the transferee, the transferor, the bank and third parties each endowed with respective claims implying corresponding obligations as can be claimed from the particular duty bearer. The following discussion deliberates on the matter.

4.4.1. The Rights of the Transferee

The transferee being beneficiary of the transfer instruction the transferor, has the right claim credit in to his/her account by the bank the amount of to be debited from the account of the transferor under Article 903/1/and 906(1)the beneficiary obtains ownership of the transfer simultaneously with the bank executes the instructor of the transferor. The transfer may regard already deposited fund or an amount to be deposited in the future as is agreed between the depositor, the existing transferor and the bank. This an indication that the transfer may make order of transfer of a certain sum of money which will be entered in the account with in the time fixed earlier.

However, the beneficiary is not entitled the sum of money under instruction until the bank debits the account of the person making order of transfer as can be seen from the reading of Article 906/1/. The time when the bank debits the account of the transferor is the particular point at which the beneficiary is legally entitled to own the transfer. This right, as an out come of such a banking transaction of transfer of fund, the beneficiary can enjoy.

In addition to this, the transferee may be given the opportunity to claim payment from the bank by mere presentation of the instruction of the transferor based on predetermined term of agreement made between the bank and the transferee under Article 903/2/ and 907/1/ of the commercial code. In such circumstances, the bank debits on presentment of the instruction issued in accordance with the applicable legal rules. If such an arrangement is made the bank stays the appearance of the beneficiary of the order and it will be after ascertainment of legal the fulfillment of all legal requirements that the

bank tends to execute the instruction in favor of the specified person as the ultimate creditor of the transaction.

Legal transaction that involves contractual dealings when they involve consideration amount of money, usually involved in creating a security device backing the due performance of the principal contract. Such guarantee may be executed form of pledge surrendering a movable including incorporeal (securities) to the creditor or arranging mortgage of immovable. The guarantee may be arranged by the debtor him/her self or a third party as can be observed from the consideration of, for example, Article 2826 and 3049 of the civil code to pledge and mortgage respectively. The principal cause of the bank transfer may be performing such a kind of contractual agreement which is guaranteed and enforceable between the transferor and the transferee being debtor and creditor respectively. The question here is whether the securities guaranteeing the principal contract will be released upon, issuance by the transferor, of the bank transfer ordering debit of his/her account and credit the same amount in the account of the transferee? Article 909 of the commercial code is provided addressing the issue. It is the right of the transferee to stay securities and collaterals in his/ her hands or where they are safeguarding safe performance of the contract. It is only if the bank credited the transfer in the account of the beneficiary that the latter should release such securities. Until then, all guarantees where they stayed.

In other cases of the practices of bank transfers in different commercial banks of Ethiopia, the beneficiaries can appear and claim payment ensuring the transfer in their name what is expected to them is establishing their identity to the bank intermediating the legal communication between the transferor and the transferee.

4.4.2. The Rights of the Transferor

The first entitlement of the transferor may begin with the issue of whether he/she can revoke the instruction he/she made to the bank requiring the transfer of some amount of into the account of the transferee? Article 906(2) provided a rule that the transfer order may be cancelled until the bank debited the account of the transferor. This is possible in two cases.

i. In case where the order is made in respect of sums to be entered in the account of the transferor within the period fixed in advance as an arrangement between the bank and the transferor under the second limb of Article 905 of the commercial code, or
ii. In cases where the bank debits the account of the transferee at the end of the day together with all transfer orders coming within the same category received during that day under the last statement of Article 907/2/.

In these two cases, the transferor may have open time to block the action of the bank of debiting the account in favor of the beneficiary. But in cases where the debit is on the spot, it is difficult for the transferor to get the benefit of the application Article 906(2) since banks usually based on the instruction immediately execute the order leaving no time gap for the transferor to take action of revocation. This is indeed operative in transfers that involve debit and credit of the accounts in the same bank of the transferor and the transferee respectively.

However, watching the practice in other cases discourses that the transferor can cancel the order he/she made until the beneficiary receives the sum in the instruction from the bank.

In addition to such a claim of revocation of the order the transferor can require the bank to deliver a receipt execution. Particularly, the banks issues receipt of the transaction. Moreover, the transferor can reclaim the amount transferred in cases where the beneficiary failed to claim it and this operates in transaction that involve no account to account transfer which the practice of commercial banks manifests.

Further more the transferor may oppose the execution of the transfer unless order on the ground of declaration of bankruptcy of the transferee unless the bank validly debited the account in pursuance to the cumulative application of articles 910 and 911 of the commercial code.

4.4.3. The Rights of the Bank

The bank concerned, intermediating the bank transfer that goes between the transferor and the transferee, is engaging in its professional activity. This activity involves expense and delivery of expertise. In addition to this, the bank in its day to day activity aspires economic benefits. This is by way of devising way of generating income. One of these mechanisms is delivery of service of bank transfer to the customers. The service delivery involves in service charge. Hence, the bank has the right to claim service fee from the transferor as the transaction is qui pro qua. The bank further, has the right to refuse transfer under Article 980.

What if the transferee failed to receive the amount ordered and the transferor simultaneously failed to reclaim the sum in cases of bank transfers that involve no debit-credit transactions? Can the bank own it? What do you say dear distance learner? See Article 1192 of the civil code.

4.4.4. The Right of Third Parties

Dear distance learner, can third parties obtain any right as an out come of the bank transfer? Under what circumstances? Third parties may appear being either heirs or creditors both contractual extra contractual and maintenance claims by the application of the law. In case where the beneficiary is died, his/her heirs at law may legally appear and claim the execution of payment in their favor based on the applicable civil law. Creditors of the beneficiary who obtained final court decision may also claim the execution of the debt under article 378 of the 1964 civil procedure code cumulative with articles 379, 404 (d)and (e), 406 and 413 of the same activity.

4.5. Unit Summery

Dear distance learner, in this unit an exhaustive deliberation is made about bank transfer being a commercial bank undertaking. It involves transfer of money from on person to another through intermediary financial activity of a bank. It, under the law, is classified as internal and external based on the existence of account in the name of the transferee and the transferor in the same branch or different branches of the same bank. The law devised bank transfer to be carried out between such persons having an account in a bank. But the practical consideration of the custom of commercial banks reflected that banking transfer can be made between persons having no account in the bank undertaking the transfer. It is not only between branches of the same bank but there is a transfer transaction between different branches of different banks based on prior

agreements made between the banks concerned. The huge influx of money in the market as an out come of effective commercial transactions currently urged the banks to devise their own way of facilitating business activities beyond what is envisaged under the law which was enacted to govern limited market chains. Now a days the situation is different looking for a fitting law makeup. Bank transfer has the mutual benefit of the transferor and the transferee, the bank and the market at large promoting the fast and effective movement of money. It must be carried out keeping strict principles of law that set minimum standards of guidelines. As a legal engagement, bank transfer attaches rights to the parties involved in the transaction and third parties in certain cases.

4.6. Self-check Questions

1. Assume a transferor ordered the transfer of certain sum money of owner to a certain beneficiary. The beneficiary owes an obligation to a certain creditor. The later obtained final court decision against the beneficiary. While the creditor is looking for financial resource of the beneficiary, he came to know that there is a bank transfer in favor or such debtor. Accordingly, the creditor attached the transfer. The transferor is mad of the situation and required the bank to cancel the bank transfer. What would you decide if you were the judge before whom the matter appeared for final legal solution?
2. List at least, four purposes of bank transfer.
3. Bank transfer involves contractual transaction creating legal chain between multiple parties. Explain the statement in light of the rules of the commercial code.

4. Bank transfer is a juridical act which is absolutely irrevocable evaluate the legality of the statement.
5. What are the principles in bank transfer?
6. Discuss bank transfer in light of current trends of commercial banks in Ethiopia.
7. Bankruptcy of the beneficiary always entitles the transfer or to oppose the execution of the instruction of bank transfer. True or false? Why?

Unit Five

Hiring of Safes

5.1. Unit Introduction

Dear distance learner, you are guided to know one legal aspect of one banking transaction after another and now the concept of hiring of safes being a bank undertaking takes its own turn. The material contains in the first place some introductory points about the issue under consideration. A distinction between some legal concepts having nexus with hiring of safes is made as one deliberation of the unit. The student is also introduced into the purpose hiring of safes may accomplish being regulated under the legal regime of Ethiopia. The questions of what things are to be deposited under the umbrella of the area of consideration at hand. As is true in all other legal transactions including bank undertakings, hiring safes gives birth to certain right-duty relationship between the parties involved. Such aspect of the matter is also given emphasis in this part of the module. The legal regime affecting third parties, positively, in connection with this specific banking transaction is discussed as well. Contract in its nature is about creating, modifying and terminating obligations that matter money related issue between parties concerned as defined under Article 1675 of the civil code. Hiring of safes operates in this umbrella and it has emerging and ending points. Accordingly, the legal grounds that may terminate contract of hiring of safes are given place as part of the study in this section. All what is discussed is summarized and self-check questions posed. You should also never forget that in text questions and interim activities refresh your journey in reading this unit.

It follows that, at the end of the unit, the distance learner will be able to:-

- define hiring of safes
- identify the nature and determine the scope of the subject matter;
- make distinctions between certain transactions that have direct or indirect connection with the area of discussion;
- list down the purposes of hiring of safes;
- explain the legal consequences of contract of hiring of safes enumerating the right-duty relationship between the parties;
- decide whether third parties may get benefited in the transaction
- state the grounds of terminating the contract;
- give legal solution to disputes arisen in relation with hiring of safes.

5.2. Meaning, Nature and Scope of Hiring of Safes

Dear distance learner, define hiring of safes in your terms, identify its nature and try to determine its scope of application. Did you ever encounter the matter in your past experiences? What do you think it involves in? Which things it specifically intended to deposit? Where?

To define the concept of hiring of safes, we shall first resort to general meanings and then making reference to the definition given by the commercial code. This helps to better understand the subject matter before going through the detail considerations. The word hiring derived from the Latin terms location conduction which means a letting for hire, which includes, among several categories, location custodian meaning the hiring of care… as when the bailee is to

protect the thing bailed. Safe-deposit box is defined as well as a lock box stored in vault to secure customer's valuables. It usually takes two keys (one held by the bank and the other held by the customer) to open the box. This is what we can see the two chained words are defined separately Black's law dictionary. We may combine the two meanings define hiring of safes. The statements represent a kind of bank activity depositing valuables (things deserving for safekeeping) in a safe box in the bands of a bailee (the bank) giving protection in such a manner leaving access to the depositor in technical terms the bailor. Banks take charge of their customers'; valuables like jewelry, negotiable securities, documents of title to properties and wills and deposit them as they can be conveniently kept. Such deposits are special in nature. The acceptance of valuables for safekeeping from the customers is one of the essential, through subsidiary, service of banks. Such a kind of service is recognized as a legitimate bank transaction. Though the service can be rendered by deposit or storage companies as well, the fact that the modern bank, for its own protection, is well-equipped with safes and strong rooms making banks exceptionally suitable for rendering this service. Banks may deposit their customers valuables either.

1. by way of accepting the valuables for safe custody or
2. by way of hiring safe deposit boxes to the customers

The things are termed as valuables for they have financial value at the time of the deposit or in the future whether they are corporeal movables or incorporeal (instruments or securities that embrace money which can not be enforced separated of the document). In the first case, customers 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. But for security purpose the banks tend to particularly know the valuable and secure their safe custody. It is,

however, being abolished now a days. Currently, in correspondence with their customers, banks usually avoid ‘safe-custody’ resorting to the second option. The dominant service of banks in this connection is facilitating safe deposit of valuables by hiring out safe boxes to their customers. The position of the Ethiopian law will be seen subsequently. The activity constitutes an undertaking in which the bank hires out safe boxes. The valuables to be deposited are not as such handed over to the bank, rather they are placed in the hired safe box by the customers themselves. This is what safe deposit represents. It is another terminology for hiring of safes.

This transaction is given due recognition under the Ethiopia private law regime being regulated in the 1960 commercial code realized as a special contract requiring special treatment. Article 919 provides:-

> “a contract of hire of a safe has its object to place at the disposal of the hirer a safe or compartment of a safe for a specified period of time on payment of a rent.”

You can see the definition as constituting important elements. It is a contract, an economic engagement of a proprietary interest as defined under the general contracts provisions of the 1960 civil code. It requires the cumulative fulfillment of the relevant elements applicable the area. The nature of the transaction is hire of a safe which a bank the hire submits to the customer, the hirer in which the latter deposits his/her valuables. The legal bond is for a definite period of time involving a service charge. In short, the relationship should be clearly defined as such posing an obligation to provide a safe box to the customer who owes an obligation to pay for rent for the particular time stated in the agreement. From the definition provision, simultaneously, one can clearly perceive that the Ethiopian legal system that regulates banking adopted the second alternative stated above, of service delivery of bank in the area of consideration. It

involves renting the safe deposit or hiring safe to the customers who wish to keep the valuable in the box provided given the full access to it. It is a banking business as is covered under the title that deals with banking transactions covered under the commercial code of Ethiopia.

Dear distance learner, it is discussed that the bank is to provide a safe deposit box to the customer for the purpose of safe keeping up of the valuable concerned. What is the safe deposit box? The safe deposit box is a compartment usually of steel, in the strong room of a bank. The actual service delivery shows it has two different keys-one of the keys, with its reserves, will be given to the customer and the other is a master key which will be retained by the bank in the hands of an employee assigned for this job. The master key can unlock many compartments in the strong room. The state box can be unlocked only the two keys operating together i.e. the key in the hands of the customer and the key in the hands of the bank you can see here that neither the customer nor the strong room employee /attendant/ could open the safe box in the absence of either of them. Banks provide different kinds of safe boxes which differ in their size and shape. They may range from a small drawer to a moderate size safe. The rental charges for the safe box proportionately increase as the size increases.

Dear distance learner, using this opportunity you can observe that the original banking transaction by Goldsmith is still in operation but, not all things rather on valuables.

5.3. Things to be deposited

Often a person hires a safe box for the purpose of depositing valuables like jewelry, documents of title to goods, negotiable

securities, will and other things which he/she thinks deserve special protection. There are certain things which are prohibited to be deposited in safe boxes. Article 922 of the commercial code provided legal restriction on the hirers dictating them refrain from depositing any thing which is dangerous in itself. This dangerous thing may be something that cause fire by itself or which is likely to explode or which can cause damage to the deposit boxes. Something inflammable, explosive, acidic substances, poisons and other related objects may endanger the life of persons, cause damage to property, coins and currency. The prohibition against depositing inflammables and explosives is deserved for the protection of the life of customers, bank employers and the like. It protects the safety of properties in the bank and even the welfare of the business of the bank and the existence of the bank itself. The prohibition emanates, for public security on the one hand and from the perspective of the interest of the bank to have money in circulation encouraging customers to deposit money by way of the disposal of the bank to utilize it for professional activity and so on.

5.3. The Legal Consequences of Contract of Hiring of Safes

5.4.1. The Rights of the Hirer

The depositor first and for most, is entitled to a safe box to his/her disposal under Article 913 so that he/she can exercise exclusive right of access to the safe box at any time (time of business run of the bank) under Article 921(1). The depositor may exercise this right of full access him/her self or through an agent duly authorized. In addition, the depositor has the right of safe keeping of the valuables deposited and for that purpose the bank is under a legal obligation to take all necessary measures to ensure the upkeep and custody of safes under

Article 920(1). As part of safe keep and custody of the valuables deposited, the depositor has the right to immediate communication of any potential risk to the security of safes so that he/she can take all the necessary steps to safeguard his/her interest before the risk materializes under sub (2) of the same provision. Consequently, the depositor has the right to claim any damage that may be caused against the deposit because of the bank's failure to communicate any potential danger against safes. Further, the depositor exercises rights fixed under the detailed terms of the contract which the banks deal with their clients.

5.3.1. Rights of the Bank

The bank has the right to claim payment of rent fee which the depositor agreed to respect under Article 919. Failure of the depositor to pay the rent charges entitles the bank to terminate that contract of hiring of safes under Article 923 The bank, simultaneously, has the right to cancel the contract of hiring of safes on the legal ground that the depositor (hirer) places in his/her safes anything which is dangerous in itself by virtue of the application of Article 922. Moreover, in pursuant to Article 921(2), the bank has the right to ownership of the keys delivered to the hirer for full access to safe boxes. Further, the bank exercises the rights as specified in the detailed terms of hiring contract which the banks often prepare in advance requiring adherence of the same by the hirer.

5.3.2. Rights of Third Parties

Though hiring of safes is a contract operative between the bank and the hirer, there may be circumstances which entitle third parties to claim against the deposits compelling the bank to behave accordingly.

Third parties may be heirs, legatees or creditors. The creditors may be those who pray performance of contracts or enforcement of extra-contractual liability. The heirs or legatees are for example, entitled to have access to a will deposited via the Liquidator of succession in case where the hirer dies. The creditors can enforce their right as finally decided by a judicial body dealing with rendering such a kind of disposal as established under the 1965 civil procedure code through the application of Article 924 of the commercial code.

5.4. Extinction of Contract of Hiring of Safes

Contract of hiring of safes can be terminated based on one of the following grounds.

A. Extinction on Lapse of Time of Contract

Contract of hiring of safes is to be made for a definite period of time under Article 919. Hence, end of such period of time has automatic consequence of extinguishing the contract of hiring of safes.

B. Extinction by Agreement

Hiring of safes is a contract under the definition Article 1675 of the civil code. The parties creating it can end its effect lay by subsequent agreement by virtue of Article of the same

C. Unilateral Declaration of Extinction

i. Enforcing a term of agreement

The bank and the hirer can fix legal ground the occurrence of which entitles one of the parties to end the effect of the contractual relationship in hiring of safes. Accordingly, one of he parties may

enforce the contractual provision that paves the way for unilateral terminating and untie the legal bond.

ii. Unilateral Extinction for failure to pay rent

The bank submits the safe box looking for rent charge is return under Article 919 and the hirer is under duty to perform the same. Consequently, the failure, by the hirer, of to pay the rent though for a single term enables the bank to unilaterally end the effects of contract of hiring of safes. What is important is the bank should give one month due default notice to the hirer. Expiry of such time results in unilateral termination by the bank which latter on takes the possession of safe box opening in the presence of the hirer. The failure of the hirer to present on such due time ignoring the notice of the bank to the same effect entitles the bank to open the safe box in the presence of court official.

D. Extinction Due to Death or Incapacity of the Hirer

Like that of other contracts, hiring of safes extinguishes with the death or incapacity of the hirer.

E. Bankruptcy or Dissolution of the Bank

The bank is a business entity given legal capacity under the applicable law. Such capacity may be taken away when it dissolves or declared bankrupted. This causes end of the contract of hiring of safes.

5.5. Unit Summary

Dear distance learner, we have been concentrated in this unit on the legal concepts that around avowed hiring of safes, a business dealing which banks legally pursue. It is about a contractual undertaking between the bank and a depositor to the effect that the bank avails

safe box to the latter enabling deposit of Valuables and making circumstances accessible for such prepare. The service involves charge as agreed in the contract the things which can be deposited may include jewelries, historical family objects, instruments like testamentary statements, negotiable instruments and so on. Hiring of safes as contractual engagement entailing custody of things, involves particular distinction with some general similar activities and particular banking activities. The distinction negate be related to the object, nature, scope and consequences of the respective legal undertakings. Banks is dealing with the transaction of availing sates to the customer accomplish distinct purposes that may include guaranteeing safekeeping of valuable things, preservation of their historical as well as economic value and generation income to the bank, among others. Hiring of safes creates legal bond between the hirer and the bank introducing corresponding right-duty chains. It also benefits third parties like heirs. Legatees and creditors enabling them exercise their executable right against the deposit pursuant to the applicable law. As a banking transaction involving contractual arrangement, Hiring of safes has its ending point either by way of cancellation under Article 922 of commercial code or termination on contractual terms which may result in unilateral extinction or mutual cut. It may also result in the failure the hirer of paying sent under Article 923 of the commercial code. Further, the death or incapacity of the hirer or the dissolution or the bankruptcy of the bank can result in ending the effects of contract of hiring of safes.

5.6. Self Check Questions

1. How and what procedures third parties may get benefited from hiring of safes? Respond to the question making particular illustrations.

2. Distinguish between hiring of safes and general hiring contracts based on the applicable law.
3. Distinguish between hiring of safes and other deposit bank transactions making reference to the applicable law.
4. List, at least, five purposes of hiring of safes.
5. What things may be objects of hiring of safes and why?
6. Discuss the legal grounds of extinction of hiring of safes.
7. Give brief explanation of the corresponding right-duty relationship between the bank and the hirer in contract of hiring of safes.
8. In hiring of safes engagement access to the safes is given to the hire but the safes are to be opened in the presence of an employee who is assigned for this purpose. By the same token, such employee has no access to the articles deposited done why do you think is the reason?

Unit Six

Discount

6.1. Unit Introduction

Dear distance learner, in this unit you are going to learner about discount, a kind of bank engagement with certain customers who wish to obtain money in advance submitting a commercial instrument which has its own maturity date. The first section deals with the meaning, nature and scope of discount followed by discourse of the purpose sought to be achieved under this device. Discount involves its own legal consequences creating right and duty relationships between the bank and the customer. The issue is governed under Articles 914-944 of the Commercial Code. There is unit summery with subsequent self-check questions.

Therefore, at the end of the unit, the distance learner will be able to:-
- define discount;
- identify the nature and determine its scope;
- explain the purpose of discount;
- determine the right and duty relationships between the bank and the customer;
- decide on practical cases

6.2. Meaning, Nature and Scope of Discount

Webster's New Third International Dictionary defined discount as:

> "an abatement or reduction made from the gross amount or value as a deduction made for interest in advancing money upon or purchasing a bill or a note due; payment in advance in interest upon money."

Black's Law Dictionary defines it as well stating,

> "Discount is an advance deduction of interest when a person lends money on a note, bill of exchange or other commercial paper, resulting in its present value."

The two definitions almost represent the same ting that signifies discount as an engagement of a bank lending money, charging interest, to a person holding an instrument that incorporate some amount of money.

Article 941 of the Commercial Code provided the definition of discount in a similar fashion stating;

1. Discount is an agreement where by a banker undertakes to pay in advance to the holder the value of commercial instruments or other negotiable securities having a definite time of payment, which the holder assigns to the banker subject to repayment of their value if not paid by the person principally liable.
2. This transaction gives to the banker the right to charge interest and further an endorsing or other commission.
3. A special agreement commission may provide for a fixed discount.

Elements in the definition:

a. <u>It is a contract</u>:- discount rests in the realm of contract under the definition of Article 1675 of the 1960 Civil Code being an undertaking between a bank and a customer.
b. <u>The subject matter is instruments bearing right</u>:- Discount is a legal device creating chain between the parties based on the rights attached to commercial instruments or negotiable securities i.e instruments holding rights which have ultimate payment and negotiable in the market.
c. <u>The contract involves repayment of the value of the instruments</u>:- The instrument issue and subjected to discount has specific time schedule of claiming payment of their content from the payor indicated therein. The failure of the latter to pay the stated sum of money entitles the bank to require repayment from the debtor in contract of discount.

d. The contract bear interest:- The lending bank changes interest against the amount of involved.
e. The bank enters the instrument to the market:- The bank can endorse the instrument and pass to third parties or involve in obtaining other commissions using the instrument in the contract of discount
f. The discount may be fixed:- The discount involved may be entitling the bank to obtain a fixed sum of charge than interest.

6.3. Legal Effects of Discount

Discount is a legal relationship creating right and duties between the bank and holder of an instrument bearing money/security negotiable. Each party owes an obligation to the other.

The holder of the instrument under contract of discount can require payment of some of money agreed. Therefore, it is this right such person may exercise principally as a result of the undertaking. Many of the rights in this relationship go to the banker. First of all, the bank has the right to claim delivery of the instrument. Having the instrument in its hands it can involve in endorsement or other commissions as stated under Article 941(2) of the Commercial Code. In addition to this, the bank can charge the customer in contract of discount interests agreed on or fixed in accordance with sub (2) and (3) the same provision. Calculation of interest is based on the time till maturity and the value of the instrument by virtue of Article 942 of the Commercial Code. The bank moreover, can claim reimbursement of unpaid instruments or securities under Article 943 and require enforcement of all the rights arising out of the instrument from all the debtors who are jointly liable for final payment of all sum of money

stated in the commercial paper by virtue of Article 944 of the Commercial Code.

6.4. Unit Summary

Dear distance learner, discount is a legal mechanisms whereby the bank provides a facility of loan to a person having a commercial instrument or negotiable securities having a fixed time of payment. In doing so the bank is entitled to have the instrument in its hands, charge interest against the debtor, negotiate on the instrument by way of endorsement, require the payment of the rights therein the instrument etc. The debtor of the discount can require release of the loan up on formation of the contract. Discount has the purpose of facilitating loan, generate income to the bank, facilitate market and boost the economy.

6.5. Self Check Questions

1. Explain the rights which the bank can exercise in contract of discount
2. Why do you think the law provided discount?
3. Discount facilitates market. How?
4. The bank exercises as many rights as greater than the debtor in contract of discount. Do you agree? Why?

Unit Seven

Credit Transactions

7.1. Unit Introduction

Dear distance learner, still we have another aspect of a legal transaction which need the due involvement of commercial banks. It regards credit transactions, a principal professional activity which the banks involve in under certain limitations and precautionary undertakings. Its meaning nature and scope is discussed in the first part of this unit. The purpose of credit transaction has its own part in presenting the subject matter. The activity is made through some stringent requirements one of which involves the need to submit security either a property movable or immovable including securities embracing right which can be calculated in terms of money. Each has its own requirements legal effects. These all are given consideration in the detail discussions of this unit. The credit facility may be made through a mechanism of availing documentary credit which has its own nature and consequences. This is also part of the delivery. Summery remarks are made with some self-check questions.

At the end of the unit, the distance learner will be able to

- define credit transactions;
- identify the nature and determine the scope of the transaction;
- explain the legal consequence of credit transactions,
- justify the necessity behind the device of making banking environment conductive to such transaction.
- explain the nature of documentary credit
- discuss the types of securities and their legal effects nexus with credit transaction,

- solve legal problems attached to credit transactions.

7.2. Securities in Credit Transaction

Securities are guarantees which can be used so as to guarantee to the proper performance of the loan contract. Webster's Dictionary defined securities as something given deposited or pledged to make certain the fulfillment of an obligation (as a payment of debt: property given or serving to make secure the enjoyment or enforcement of a right. Black's Law Dictionary by the same token defined security as a collateral given or pledged to guarantee the fulfillment of an obligation, especially the assurance that the creditor will be repaid any money or credit extended to a debtor.

Thus, banks in involving in credit transaction put a requirement of the provision of securities which may be made in the form of pledge of corporeal chattels under the meaning of Article 2825 of the Civil Code stating that a contract of pledge is a contract where by a debtor undertakes to deliver a thing, called the pledge, to his creditor as security of the performance of an obligation. Third party may also stand pledgor of the debt by virtue of Article 2826 of the same. Security may also be provided in the form of mortgage of immovable under the spirit of Articles 3045-3050 of the Civil Code.

Guarantee may also be provided by way of subjecting documentary instruments holding money to such arrangement under Article 947 of the Commercial Code which deals with advance on securities, transaction by which a banker grants a credit against securities belonging to the beneficiary under credit or to a third party who has agreed to the pledge. It should satisfy the formality requirement under the subsequent provision that needs the arrangement to be

provided in written contract containing the designation of securities deposited, the name and domilile of the owner or other beneficiary under the credit and the amount and conditions under which the credit is granted. In addition to this, any transferable security may be pledged as such to safeguard the performance of loan contract by virtue of Article 950-952 of the Commercial Code which provided the possibility that transferable securities may be pledged to guarantee the execution of any obligation making the pledgor stand a material surety to the obligation under Article 953 of the same.

7.3. Legal Consequences of Credit and Securities

Credit transaction is devised in such a manner that the debtor obtains some amount of money from the bank by way of loan under the strict condition that he/she will pay it back to the bank with the interest fixed and within the time limit agreed. Therefore, it gives the beneficiary to have the right to get the amount of money determined by agreement in his/her disposal under Article 945(1) of the Commercial Code and utilize it for the purpose for which the credit transaction is created. Indeed, such arrangement may be cancelled at any time by the banker if it is created for unlimited period of time in pursuant to sub(2) of the same provision or following the death incapacity or bankruptcy of the beneficiary in accordance with Article 946 of the same.

The corresponding obligation of the beneficiary is repay the amount to the bank keeping the legal bound in touch. The bank, then, exercises full right of requiring payment, by the beneficiary, of the same.

The corresponding obligation of the beneficiary is to repay the amount to the bank keeping the legal bound in touch. The bank, then exercises full right of requiring payment, by the beneficiary, of the loan within the time agreed together with interest.

The bank, at the same time can require delivery of a movable pledged or placement of the same in the hands of a third party under Article 2825 or 2531 of the Civil Code respectively. In cases where the pledge is a transferable security the bank can require surrender of the pledged security to him/her under Article 952 of the Commercial Code. These all are so as to ascertain the proper performance of the obligation by the beneficiary of credit transactions entail drastic legal consequences. The failure of the beneficiary to discharge his/her obligation as set in the contract of loan results in disposal of guarantees in accordance with the applicable laws. Proclamation no. 97/1998 which deals with property mortgaged or pledged with the banks, provided under Article 3 that notwithstanding the provision of Article 2851 and 3060 of the Civil Code, an agreement authorizing the creditor with which a property has been mortgaged or pledged and whole claim is not paid within the time stipulated in the contract, to sell the said property by auction upon giving a prior notice of at least 30 days to the debtor and to the transfer of ownership of the property to the buyer shall be valid. This provision is, indeed amended by Proclamation No 217/2000 Article 2(1) stating if no buyer appears of the second auction and have the ownership of the property transferred to it is inserted after the word ‘buyer’ on the eight line of the Article.

Accordingly, the bank can enforce this provision and secure the repayment of the loan following the relevant Civil Procedure provisions set under Article 394-449 of the 1965 Civil Procedure

Code. The sale made in pursuant to such arrangement is considered as has been executed on behalf of the debtor by virtue of Article 6 of the Proclamation. In case where the guarantee is business mortgage under the sprit of proclamation No 98/1998 Article 13 of the same provided that not with standing the provision of Article 189 of the Commercial Code, an agreement which authorizes a secured creditor bank whose claim is not paid to sell the mortgaged business, by auction upon giving a prior notice of at least 30 days to the debtor and to transfer the ownership of the business to the buyer or to take over the business, in consideration of its estimated value as specified in the contract of loan, and have the ownership there of registered in its own name; in cases where bidders fail to appear upon a second public auction having been held shall be valid. In doing so the provisions of Article 394-449 of the Civil Code shall mutantis mutandis, be applicable while the bank is exercising its power of selling the business mortgage by auction by virtue of Article 16 of the sale made in accordance with Article 13 shall be deemed to have been executed on behalf of the debtor as per Article 15 of the proclamation.

In addition to all these, Article 949 of the Commercial Code provided that where the borrower does not fulfill his lender taking to maintain the percentage of margin or fails to repay the loan in accordance with the terms of the contract, the banker may sell the securities. The same rule is provided under Article 958 of the same stating that where the pledgor fails to meet his obligation, the debt guaranteed shall become due immediately, unless new securities of an equivalent amount are produced without delay to replace the security which does not longer exist or is imperiled. The bank exercises preferred rights of the pledge subsist at the date thereof both as between the parties and as regards third parties on the proceeds, amounts reimbursed or

instruments of replacement of the securities pledge in accordance with Article 957.

Consequently, dear distance learner, you can see that the bank is in a legal position to require repayment of the loan when they due and if the borrower failed to perform his/her duty duly within the time fixed in the agreement, the bank can have its money repaid by way of selling securities in its hand or owning properties mortgaged or pledged in accordance with the established applicable law.

7.4. Documentary Credits

Documentary credit is loan arrangement by a bank based on submission of documents representing goods, for example, without which disposal of the good is legally impossible. This documentary credit often occurs in export and import transactions which are to be made between absent parties, i.e. between persons in distance. Banks play the greatest role in facilitating payment of price and due delivery of goods between such persons. This is made by way of making arrangements between corresponding banks situated in the localities of the corresponding parties. Such a scheme is technically called letter of credit in which involves payment of, for instance, the price of the good to be imported to the exporter abroad by way of an arrangement with a bank situated there. Such a device is recognized under the 1960 commercial code in Articles 959-967. A documentary credit is then defined as,

> *"[It is a] credit opened by a bank providing for payment against presentation of specified documents to the opening bank or its agent. Goods represented by such documents may be held and disposed of by the bank in*

accordance with the terms agreed between the bank and its principal."

Let's see the matter by way of illustration. Assume that there is an exporter of ceramics Delhi, India and there is importer in Addis Ababa, Ethiopia. It is not important that these two persons negotiate physically to engage in a contract. They can enter into contract the exporter being in Delhi and the importer being here in Addis Ababa. The question is how these parties perform their contract? Here comes the role of banks. These parties ascertain the performance of the respective duty, i.e. delivery of the things and payment of the price by the exporter and importer respectively by way of arrangement via banks. The scheme is to be made between two corresponding banks i.e a bank in Addis Ababa and a corresponding bank in Delhi. The exporter in Delhi contracts the corresponding bank there for an arrangement of delivery of the goods by way of presenting documents representing such goods, for example bill of lading and the importer appears before a bank in Addis Ababa which shall open a letter of credit, a documentary credit ascertaining that payment will be made on delivery of the documents representing the goods. The two banks react and involve in such contractual arrangements intermediating between the two parties, exporting and importing. In such a manner the two banks play agency role between the parties and delivery of goods will be made and payment of price will be made to the concerned parties. There is a regulation of International Chamber of Commerce which codified customary law of such transaction regulating the behavior of the bank opening the documentary credit in the name of the importer and the corresponding bank opening the same in corresponding bank in the name of the exporter.

Documentary credit may be classified into revocable and irrevocable depending on the consequence of respecting the ultimate guarantee of due performance of the contracts. Revocable credits are not legally binding undertakings between banks and beneficiaries as stated under Article 962. Hence, this device is not often utilized for its uncertainty of due performance of contracts. Banks often involve in irrevocable documentary credits as stated under Article 963 of the Commercial Code which states irrevocable credits as undertakings by an issuing bank and constitute the engagement of that bank to the beneficiary, or as the case may be, to the beneficiary and bona fide holders of drafts drawn there under that the provisions for payment, acceptance and negotiation contained in the credit, will be duly fulfilled provided that the documents or as the case may be the documents and the drafts there under comply with the terms and conditions of the credit. This is a manifestation that the banks ascertain the satisfaction of performance of the contracts. What is important is the fulfillment of the requirements which the documents should contain so as to enforce the right there in a required by the same provision and sanctioned by Article 960 of the same code. Hence, such irrevocable credits entail consequences of definite undertaking devoid of modification or cancellation of the documents without the agreement of all persons concerned and sending the original documents accordingly enabling due enforcement of the rights in pursuant to Article 964 of the Commercial Code.

7.5. Unit Summary

Dear distance learner, you have been dictated that credit transaction is a bank facility to a beneficiary lending money for business transaction in return of which there exists the duty on the side of the latter to repay the loan fully with the interest on due date(s). It is a contractual transaction imposing respective corresponding duties on

the parties involved. Credit transaction is made under the supervision of National Bank of Ethiopia. It has several purposes which prosper the individual beneficiary, the bank and the general economy at large if made duly. Credits transaction has collaterals for its due performance. Collaterals are safeguards which may be made by way of submitting thing movable in form of pledge or immovable and business in the form of mortgage or securities (documents incorporating money value) in the form of pledge to the bank as a guarantee for due repayment of the loan. In the case where the borrower failed to repay the credit in accordance with the agreement, the bank can enforce its right by selling or owning the collateral(s). Credits, by the same token, may be made by way of documentary credits which ascertain discharge of the respective obligations between distant parties who involve in import and export transactions. It is made in the form of issuing letter of credit by banks that assures due performance of the obligation in whose favor the documentary credit is opened.

7.6. Self Check Questions

1. Distinguish between documentary credits and other credits.
2. Discuss the nexus between loan transaction and guarantees with specific illustration.
3. Explain the reason why national bank of Ethiopia supervises loan transactions.
4. Why we need credit transaction?
5. What is letter of credit?
6. Explain the elements in credit transaction
7. What is the difference between revocable and irrevocable documentary credits? Banks usually involve in irrevocable credits. Why not in revocable credits?

8. Distinguish between the different guarantees of loan contract.

Module II

Law of Insurance

Introduction

Hello dear distance learner! Welcome to the second module on the law of insurance, the area that deals with risk that entails material loss and its possible management under a kind of guarantee that gives hostage to such injury which a person may encounter in his/her life span. The course is divided into five units. The first unit contains introductory matters about transfer of risk to an insurer by way of purchasing a policy that refer a particular coverage of one or more of several contributors in the same category. There is also a brief explanation of the historical development of insurance business in general and in Ethiopia in particular. In the second unit there is an exhaustive discussion about the nature insurance as a body of law of contracts but with its peculiar features governed under the doctrines of utmost good faith of the parties, contract of adhesion, indemnity, subrogation, as the concept of insurable interest and other related ideas. The general rules that apply to insurance industry in Ethiopia are also discussed making reference to the applicable provisions in the 1960 commercial code. The basic features of insurance of objects as a property insurance covering risks which may be man made or natural like fire, earth quack, flood, burglary etc. are deliberated exhaustively with the corresponding right- duty relationship between the insurer and the insured. Unit three of the module contains this area of consideration. The subsequent unit is about insurance of liability for damages which refer an insurable interest subject to the probable peril of payment of compensation to a third party based on different sources governed under the civil law regime. Finally, insurance of persons with its distinguished features is dealt with as a coverage of risk of death, injury, illness forming a guarantee not in compensation terms, but to be agreed upon flexibly and to be paid regardless of injury once it is determined is the policy to satisfy a

particular beneficiary. Each unit has a summery statement and some self cheek questions.

Consequently, at the end of the course, the distance learner will be able to:-

- define insurance in general and identify each form of insurance,
- explain the development of insurance business,
- describe the objective of insurance,
- explain the applicable principles to the area,
- discuss each type of insurance with its peculiar features,
- give explanation about what insurable interest involve in particular policy,
- critically analyze the law,
- give workable solutions to practical problem that arise in insurance business, among others.

Unit One

General Introduction

1.1. Historical Development of Insurance

1.1.1. General

The present state of deployment of insurance is the result of contributions made by different countries and markets. Insurance has its beginning in the Ancient Babylon, its theoretical development in Europe, its modern structure is Britain, its fullets expansion in USA. Sources indicate that practices having competent concepts and elements of insurance existed as far back of the Babylonian Era. Humnurabi, ruler of Babylon from 1792-1750 BC was cited for developing a set of laws, known as Code of Hanamurabi, which was used to govern the Babylonian society. This code incorporated law reflecting rudimentary concepts and practices of insurance. A crude form of the insurance i.e. financial protection designed to protect Marine merchants existed in Babylon around 2000 BC. In those periods Babylon was said to be the centre of early world trade involving countries of Europe, Africa and Asia. Goods were flowing into Babylon through various surface and sea trade routes. During this time, caravans carrying tradable goods were exposed to robbery. Sea traders were facing marine risks, e.g. pirates, fire, storms along their voyages losing their property due to such risks and hence were unable to pay the financing money borrowed from the lending merchants. These uncertainties gradually led to decline in trade and commercial activities.

To deal with such risks, Babylonians were said to have devised a system that could provide protection to the ship owners and marine merchantss. Under the system, the creditor and the ship owner or the merchant entered into a contract where by the creditor advanced loans to the ship-owner or the merchant for the business venture. The loan was repayable only up on the safe arrival of the ship at the destination. The creditor used to cancel the loan if the ship faced accidental misfortune during the voyage and that the ship or the property was lost. Thus, the risk was being shifted from the sailors to

the creditors or money lenders. If the ship or cargo arrived stafely, the money lenders would collect their loans, including the nominal interest pluse some extra-charge for assuming the risk, i.e. risk premium. Due to such arrangement, ship owners and marine merchants were encouraged to conduct their ventures without fear of financial loss. Ship owners were pledging their ship as a security for cargo loans. Such arrangements were known as *Bottomry contracts (loans) and respondentia* contracts. Bottormy refers to vessel which is used as collateral, while these respondentia refers to the cargo, cargo used ased as collateral, the vessel carried. Under the provision of Bottermy loans, the trader who borrowed money for the expedition was exempted from his/her obligation in the event the cargo was lost due to accidental misfortune. Bottermy loans, therefore, laid a more refined conceptual foundation for the development of insurance.

In Ancient Greece, the concept of “general average” in connection with marine expeditions, which indeed, a fundamental doctrine is marine insurance is the present day; in Ancient China, and in Romans the concept and practice of insurance existed. The Romas had a rudimentary form of life insurance which was called “Collegial”, an association of persons some purpose, social or trade. Under the practice of for *Collegia, members prepaid contribution formed a fund. Benefits were extended, when a member of the collegiums* died, in the form of paying for burial expenses and other expended incurred by the family of the deceased person. The Romans used burial clubs as a form of life insurance, providing funereal expenses for members and later payments to the survivors.

The growth and modernization of insurance business is very much associated with the growth of business activities, commercial, in dustrinal or service. In other words, insurance and business activates

are very much interrelated. Insurance contracts were being concluded on a form called, "*Pollizza*" an Italian word from which the phrase "Insurance policy " is derived. Italian merchants were also credited for introducing marine insurance to Britain and Western Europe. The Great Fire of London (1666), which caused huge property loss and lives, brought increased awareness about fire risk and the introduction of modern fire insurance in England. This incident led to the formation of the first fires office in England in 1667. England is also said to be the place where the beginning of modern life insurance took place. In USA, some sources indicate that marine issuance was the first to be introduced and getting foothold by learning the experience from the British system. In Africa, the introduction and development of modern insurance is associated with the colonial era. Various insurance products were developed in the 19cth. The expansion can be due to dynamism in the business and economic activities. Urbanization and industrialization have also led the growing demand for insurance to get protection from wide ranges of risks partly emanated from the dynamism itself. Consequently, insurance companies had to cope up with such changes. They had to develop new products and carry out insurance business at a level of sophistication.

1.1.2. In Ethiopian Past and Present

Dear distance Learner, when do you thing insurance business emerged is Ethiopian? How it developed and touched the present day peak? The emergence of insurance business in Ethiopian was closely linked to expatriots and foreign insurance companies operating in Ethiopia. in addition, expatriots and foreign companies operating in Ethiopia participated actively is the establishment of the first insurance company. According to various sources, the emergence of

modern insurance in Ethiopia was traced to the opening of Bank of Abyssinia which was established as the first Ethiopian Bank. The Bank had been acting as an agent for a foreign insurance company to underwrite fire and marine policies.

There were a good number of foreign insurance companies undertaking insurance business in Ethiopian through the agents prior to 1951. The first domestic insurance company, namely, Imperial Insurance Company of limited coverage was established in 1951. There after, until 1960 one domestic and numerous foreign insurance companies represented by agents were operating insurance business in Ethiopia. The number of foreign companies operating insurance in Ethiopia increased to 17 in 1954, Thus, the period 1920-1950s can be lebelled as the period of agents of foreign insurance companies. The focus was on life, marine, fire and general accident insurances. The business in the past was limited to cities like Asmara. Addis Ababa and Dlire Dawa where most businesses were located and commercial activities were taking place. All the foreign insurance companies had their agents in Addis Ababa and their business were largely concentrated there.

Following the growth of engagement in commercial activities and the tendency to have insurance companies fitting such changes, later on, the 1960 Commercial Code of Ethiopia was established providing particular courage under Title III of the code in Articles 654-712 classifying the kinds of risks and their coverage with the minimum standards of involving in the undertaking. The 1960 Maritime Code of Ethiopian also contained provisions pertaining to maritime insurance, a class of insurance that provides cover against marine risks. It is provided under title VII of the code in Articles 288-356 presenting various aspects of marine insurance.

In 1970 the government issued the first insurance proclamation, Proclamation No 393/71 to regulate and control the insurance industry in the country. In March 1971, the government issued Legal Notice No. 393/75 which dealt with licence, renewal, qualification, auxilaries and the like.

During the command economy the Provisional Military Government passed a decision on January 1, 1975 to transfer the ownership of banks and insurance companies to the government. In December 1975, the Provisional Military Administration Council issued Proclamation No 68/1975 monopolizing the insurance market.

During the market economy, re-emergence of private insurance companies assured under proclamation No. 86/1994 by the Transitional Government of Ethiopia. This Proclamation classified insurance business in to two categories, i.e general insurance business and long term insurance business. Long term insurance business includes life insurance, annuities, pension business and permanent health insurance business. All other types of insurance business are lebelled as general insurance. This proclamation gives the mandate of supervisory authority with regard to insurance business to the National Bank of Ethiopia which is entrusted to formulate a policy in accordance with Article 3,

a. to promote the business of insurance in Ethiopia,
b. in respect of reinsurance of investment of insurance funds, and
c. on such matters as may be conducive to the attainment of sound insurance business in Ethiopia.

The proclamation provided standards to carry on insurance business in Ethiopia stating,

a. the entity undertaking insurance must be share company, (Article 4(a));
b. the share capital should not be less than
    1. Birr 3, 000,000 to carry on a general insurance business
    2. Birr 4,000,000 to carry on a long term
    3. Birr 7,000,00 to carry on a both general and long term insurance businesses (Article 4(b));
c. the minimum capital requirement indicated should be paid up in cash in full and deposited in a bank in the name of the company, (Article 4(c));
d. the company should obtain license in accordance with Article 6 of the proclamation, (sub(2).
e. the company's appointed principal officers should meet the standard set by the National Bank of Ethiopia as issued by subsequent directives in accordance with Art 41 of Proclamation 83/1994 Monetary and Banking Proclamation and Article 42(8) and other relevant provisions of Proclamation 86/1994.

The National Bank of Ethiopia issued subsequent directives utilizing its power under the Monetary and Banking Proclamation and Licensing and Supervision of Insurance Business Proclamation No.86/1994 posing respective additional requirements to run insurance business. Accordingly, for example, under directive No SIB/17/98 Article 2 each insurer shall submit to the Supervision Department of the National Bank of Ethiopia separate quarterly reports for general and long-term insurance business within 20 days after the end of each quarter. In addition, any insurance company that fails to apply renewal of business licence within one month of the expiry date of such license shall be subjected to a fine of birr 500:00 (the hundred) by virtue of Directive No SIB/19/98 Article 3(1). Moreover any insurance company that fails to comply with the

requirements of any of the directives of the National Bank of Ethiopia shall be subject to fine or birr 10,000:00 for each violation. This is in addition to the kind of penalty which is provided under Article 41 of Proclamation No 86/1994 for violation of any of its rules entailing fine of 15, 000:00 to 30, 000:00 birr plus imprisonment of 5-10 years based on the circumstance of the case. At present, there are several companies running insurance business.

1.2. Unit Summary

The subject matter of insurance went through different development from the ancient practices that are governed under the Code of Hammurabi to the present day sophisticated general development. In Ethiopia, modern insurance has its own history beginning from the establishment of the Bank of Abyssinia during the Reign of Menelik II passing through subsequent developments including the provision of rules that apply to insurance under the respective 1960 Commercial and 1960 Maritime codes, Proclamation No 281/1970, Legal Notice No 393/71, during the Haileslassie I regime, the command regime avoiding private insurance business since January 1975 including the establishment of Ethiopian Insurance Corporation by virtue of Proclamation No.68/1975. Following the establishment of the Transitional Government in 1991 a change arised in the area of engagement in insurance business as a consequence of issuance, by the government, of Proclamation 83/1994 dealing with Monetary and Banking issues and Proclamation 86/1994 that deals with Licensing and Supervision of Insurance Business in Ethiopia. Accordingly, the National Bank of Ethiopia is given the power to supervise the undertaking by way of issuing directives.

1.3. Self Check Questions

1. Under the present day situation of insurance business in Ethiopia, insurance is classified into general and long-term insurance. What is the point of distinction?
2. Explain the minimum requirements which an entity should fulfill to undertake insurance business in Ethiopia at present.
3. Development of commerce and development insurance are two faces of a coin. Do you agree? Why?
4. Discuss the steps in risk management and make connection with insurance.

Unit Two

Insurance Contract

2.1. Unit Introduction

Dear distance learner, in this unit you are going to study insurance making, first reference to its nature, classification and distinguishing features. The making of the contract involves its own peculiarities. It begins with identifying the parties to be involved in the transaction. Then the concept of insurance policy and its contents are discussed in detail. Attached to this, the question of how the parties involve in offer and acceptance take its own part in the deliberation of this part of the module. Since insurance is a particular contract with its own features, it results in subsequent particular rights and duties which each party enjoys pending the operation of the insurance policy. Whether enforcement of insurance policy has period of limitation and under what circumstances is also discussed. All what are raised turn after turn get summarized and subsequent to which the distance learner is provided with self-check questions reminding what has been exhaustively discussed in each specific sub-titles of the unit. There are also self check questions enabling the student involve in digesting ideas.

At the end of the unit, the distance learner will be able to:-

- identify the clear nature of contract of insurance;
- classify insurance as having different categories;
- indicate parties to contract of insurance;
- discuss the particular feature of the making of offer and acceptance;
- determine the rights and duties of the parties;

- decide on practical questions, among others.

2.2. The Nature of Insurance Contract

The contract of insurance is basically governed by the rules of which form part of the general law of contract, but equally there is no doubt that over the years it has many principles of its own to such an extent that is perfectly proper to speak of a law of insurance. Some of the documents of the standard insurance contract, principally the proposal form and policy take its own form. In considering the nature of the contract of insurance it is necessary to distinguish between the subject matter of the contract of insurance and the subject matter of insurance as it has been tried to be explained in the preceding unit.

The protection given by a contract of insurance is not a protection against accident in that the contract can prevent an accident from happening. It merely secures for the assured (insured), when the accident happens, the payment of some of money. The subject matter of the contract of insurance is, therefore, money, and it must be distinguished from the subject matter of insurance which exists independently of the contract. It has be an established principle that the subject matters of the contract of insurance is money and money only. The subject matter of insurance is a different thing from the subject matter of the contract of insurance.

A contract of insurance necessarily contemplates the existence of something to which an accident may happen, and anything, to which an accident may happen, may, therefore, be the subject matter of insurance. Strictly speaking, an accident can only happen to a physical object. There are, however, certain kinds of insurance intended to protect the insured in cases where he/she requires protection not against accidents to physical objects, but against the

consequences to him/her self of such accidents. In these kinds of insurance, the interest of the insured which will be affected by the happening of the accident insured against, is to be regarded as the subject matter of insurance.

2.3. Classification of Contracts of Insurance

Dear distance learner, can you classify contract of insurance based on the above enumeration? In what ways?

Generally, contracts of insurance may be classified in three different ways. Either

1. according to the nature of the event on which the sum insured becomes payable, or
2. according to the nature of the interest affected, or
3. according to the nature of the insurance.

A. According to the Nature of the Event

Four main classes of insurance are to be distinguished:

i. Marine Insurance- in which the sum insured becomes payable on the happening of a marine peril. Under the Ethiopian legal regime, the matter is coverable under the relevant provisions of the 1960 maritime code by virtue of Article 655(2) of the commercial code.

ii. Fire Insurance:- in which the sum insured becomes payable on happening of a fire. This is related to a risk affecting property which may be governed under articles 654(2) cumulative with 675 seq. of the commercial code.

iii. Life Insurance:- in which the sum insured becomes payable on death or life as may be covered 691 seq. of the commercial code.

iv. Accident Insurance:- in which the sum insured becomes payable on the happening of any other event as may be subjected to article 654(2) cumulative with articles 655 seq. of the commercial code.

B. According to the Nature of the Interest Affected

The different classes of insurance are distinguished according to the manner in which the insured is prejudiced by the happening of the specified event. He/she may die or suffer personal injury, his/her property may be lost or damaged, or he/she may be involved in liability.

i. Personal Insurance:- in this type of insurance specified event operates on the person of the insured or on that of a third party. This class of insurance comprises life insurance, personal accident insurance, and sickness insurance as recognize under article 654(3) cumulative with 691 seq. of the commercial code.

ii. Property Insurance:- in this type of insurance, the specified event operates on the property of assured. It comprises marine insurance, fire insurance, burglary insurance, fidelity insurance, solvency insurance, insurance against loss of property by accidental causes, etc as may be covered under article 654(2) cumulative with articles 675 seq. commercial code.

iii. Liability Insurance:- here, the specified event imposes upon the assured a liability towards third persons. This class comprises.

a. Public liability insurance, e.g. Insurance in respect of liabilities connected with particular building, motor vehicles or machinery.

b. Employers' liability insurance

The same policy may combine several insurances belonging to different classes. The combination may be based simply on convenience, e.g. in the case of householders comprehensive policy which combines insurance against fire and burglary with an insurance against employer's liability. In other cases, the combination is necessary if the insured is to be fully protected, seeing that it is possible for the same event to affect his/her interest in more ways than one. Thus, a motor accident may cause damage to the vehicle and personal injury to its owner, and may at the same time involve him/her in liability to third parties. A boiler explosion may destroy the boiler and wreck the building containing it. It may cause death or injury to the workmen in employment of its owner, and may, in addition, damage adjoining buildings and injure members of the public. Hence, a motor policy or a steam-boiler policy is usually framed to apply to all or most of the cases mentioned.

c. According to the Nature of the Insurance

Some contracts of insurance merely secure the payment of money on the happening of the specified event. Other types of contracts, however, are contracts of indemnity.

2.4. Distinguishing Characteristics of Insurance of Contracts

Dear distance learner, what distinguishing remarks may you suggest to insurance contract? On what basis?

All valid contracts must satisfy the essential features of a valid contract as articulated in the civil code if a court is to enforce their

provisions. Insurance contracts are distinctive as detailed as follows with applicable legal principles to the area.

1. Principle of Indemnity

Insurance contracts provide compensation for an insured's losses. The insured, however, should not profit from an insurance transaction or else the insurance will provide an incentive to non fraudulent losses. Indemnity means the insured should be placed in the same financial position after as before the insured's loss. Any departure from this rule should be on the risk of under compensation. Insurers enforce the principle of indemnity through the insurable interest requirement, actual cash value settlements, and the operation of subrogation as set under article 683 of the commercial code.

Life insurance is exception to the principle because economic value of human life can not be measured precisely before death. Hence, life insurance can not be a contract of indemnity. A person could not be put in exactly the same financial position occupied before the death because that position includes unknown future income. Nevertheless, life insurance underwriters are careful not to over insure by allowing insured to acquire more life insurance than their financial position justifies.

2. Rules of Insurable interest

If people could insure property or a life in which they had no financial interest insurance would become gambling. A man is interested in a thing to whom advantage may arise or prejudice happen from circumstances which may attend it. To be interested in the preservation of a thing is to be so circumstanced with respect to it as

to have benefit from its existence, prejudice from its destruction. Examples:

a. Property Insurance

This is the essence of insurance laws today; no one may collect insurance proceeds unless she or he shows a personal loss from the insured event. In property insurance, one must show a legally recognized form of ownership such as title deed, or other demonstrable financial interest. Insurable financial interest not involving property ownership include bailment, mortgage or other transactions.

b. Life Insurance

In life insurance, the policy owner must show a recognized interest in having the insured's life continue. This interest must be shown when the policy is purchased. People are presumed to have unlimited insurable interest in their own lives and may purchase any amount of insurance on their own lives that an insurer issues. Unlike the case of property insurance, the insurable interest must be demonstrated at the time the life insurance is purchased.

An interest to be insurable must have a pecuniary value. Its nature, however, is broadly speaking immaterial. An insurable interest need not be a permanent or continuing interest; it is nonetheless insurable because it is defensible since it is a valid interest until it is defeated. The fact that the interest of the insured is precarious and that other persons are entitled at any movement to call upon him to hand over the object insured to them, does not therefore prevent his/her interest from being sufficient to support a contract of insurance. The interest must, however, be a real interest, since the mere expectation of acquiring an interest, however probable, does not give the right to

insure the property out of which the expectation arises. So long as there is a real interest, it is not necessary that the insured should be entitled to a present enjoyment. A right to future possession, or a future interest, however remote, is equally insurable, since the insured's prospect of benefit is clear and the prejudice, which he/she suffers by reason of the object insured being destroyed by the peril insured against, can not be attributed with absolute certainty to any other cause than the peril.

3. The Principle of Subrogation

Subrogation is the legal substitution of one person is another's place. It is supported by the theory that, if a person must pay a debt for which another is liable, such payment should give the person a right to collect from a third party after paying its insured's claim.

4. Contract of Adhesion

The terms of the contract of insurance are often made by the insurer using the skilled lawyers they have. The insured purchases that prepared policy with no reservation. Because the unequal knowledge and unequal bargaining power are perceived to give the insurer a significant advantage over the insured, insurance contracts are termed as contracts of adhesion.

5. Insurance Has Personal Feature

When parties to an insurance contract reach agreement, one of the points they agree to is to do business with each other. Each has considered the other's character and conduct. For good reasons, neither wants the other party to find a substitute party to the agreement.

6. The Doctrine of Utmost Good faith

A person buying insurance is held to the highest standard of honesty in dealing with the insurer. The penalty for a lesser level of truthfulness is the insurer's right to void the contract the high level of good faith an insured owes an insurer is reflected in the legal doctrines of warrants, representation and concealment as addressed, for example, under Articles 667-669 of the commercial code.

7. The Aleatory Feature

Insurance contracts are aleatory. This means that the parties to the contract know in advance the money they will exchange will be unequal. The insured pays the premium and collects a large sum if a large loss or collects nothing if no loss occurs. The opposite is true for the insurer. In most instances, it collects a premium and pays nothing. In few cases, it collects relatively small premium and pays a large amount. The aleatory feature of insurance policies differ from other business contracts where consideration of equal value is exchanged. We call equal exchange contracts commutative contracts.

2.5. The Making of the Contract

The essential function of a contract is to create expectations and impose duties, legally enforceable. The requirements for the legal validity of a contract may be based on:

a. a manifestation of consent to its terms by parties who make the contract;
b. a sufficient determination of each duty;
c. legal capacity of the parties;
d. the object of the contract not stands against public policy or otherwise illegal
e. the formality considerations in applicable cases.

This is often applicable to contracts in general under the umbrella of Article 1679 seq. of the civil code. This is inclusive of contract of insurance for it is defined under Articles 654 of the commercial code as a contractual make up involving the insurer on the one hand and the insured on the other hand for subsequent right duty chains.

Insurance is a special contract having its own unique future in its formation constituting particular negotiations for its make up including the provision of insurance policy as annex to the contract under Art 657(1) of the commercial code.

2.5.1. Insurance Policy

Dear distance learner, you have been looking at the important points about the formation of insurance contract going through the way how an offer to insurance can be made and acceptance to be expressed. Now you are to deal with insurance policy, a very important thing in contract of insurance. What do you think insurance policy constitutes? Is that different from the contract or is it the particular expression of contract of insurance?

To answer the question, it is better to explore into the meaning which is tried to be conveyed in the commercial code as well as in another law. Under article 654(1) of the commercial code it is stated that an insurance policy is a contract whereby a person, called the insurer, undertakes against payment of one or more premiums to a person, called the beneficiary, a sum of money when a specified risk materialize. Here, it can be understood that insurance policy is the contract of insurance that operate between the insured and the insurer who are parties in insurance contract. Article 657(1) of the

same, simultaneously provided that the contract of insurance shall be supported by a document called an insurance policy. This expression seems to designate insurance contract as a distinct agreement under the definition of Article 1675 and manifestation under 1680 and 1681 of the civil code on the one hand to provide a rule that there is a supplementary distinct document, insurance policy that backs the contract instrument and insurance policy is another independent instrument, indeed, supporting the insurance contract. Don't you see discrepancy between two provisions of the commercial code? Insurance policy defined as contract under Article 654(1) is made a supporting document to insurance contract under sub (1) of Article 657 of the same law. Which one should we adhere to? Should we consider the two provision as applying distinctively or try to make a reconciling device that draw a consistent application of the two provisions together, representing one thing by way of interpreting them making reference to the nature and purpose of the law, the scope of the provisions and the meaning to the matter given by anther law that particularly apply to insurance contract? It is discussed above that the offer of insurance contract is expressed interms of filling the proposal which is prepared by the insurers for this purpose. It is also shown that one of the ways in which acceptance of the offer may be made is issuing insurance policy. Insurance contract is conclusively established through an instrument that contains the full insured and insurer relationship. When we come to the position of the 1960 commercial code while article 654 determined what constitutes insurance contract explaining it interms of insurance policy, Article 657 underlined the way how the extence of insurance contract should be proved. The titles of the two respective provisions are clear indications of this explanation. Article 654 is a definition and Article 657 is about proof of contract of insurance. By insurance policy, the law tried to mean a written instrument that proves the existence of

insurance contract fixing the terms of relationship between the insurer and the insured. It is nothing but the manifestation of the settled rules that govern the right-duty ties between the parties. It is a general contract principle that all contracts need not be made through written agreements. It is only in certain exceptional situations that a written agreement is necessary as one can consider Article 1681 cumulative with articles 1723 and 1725 of the civil code for example. One of such situations is involving in making insurance contract as stated is Article 1725(b). Insurance contract must be made in a written form. Then, Article 657 is the manifestation of this written form. The insurance policy defined under Article 654 should be expressed in terms of evidencing it by a written instrument. The written instrument is the contract. The contract is the policy. The policy is the written instrument. In oral contracts, the existence of such contract may be proved by showing there existed oral offer and acceptance. This may be by way of presenting witnesses who know the oral communication. In implied contracts the existence of the relationship can be shown witnessing the conduct of the parties. In written contracts, the contract can be proved by producing that written document. Insurance contract is such a legal relationship that can be proved to exist by adducing a written agreement. That policy is contract of insurance and insurance policy is the contract itself. There exists a contract and it is existence is to be shown by a document that contains the terms of the legal chain between the parties, i.e. insurer and the insured. It is the final settlement of the negotiation between the parties through a proposal. We can consult Art 657 (2) which required the policy to be amended via another written document that form part of the terms of the relationship. Sub (3) of the same provision stated that the insurer and the beneficiary shall be bound where, prior to the signature the policy, or endorsement, the insurer hands to the beneficiary a document setting up a provisional

guarantee until the policy or endorsement is signed. This also a clear indication that the ultimate determination of the rights and duties of the parties in insurance contract are to be stated in the written expression of the agreement of the parties which is practically prepared by insurer amending document if any. It does not mean, however, before such a document is provided there can be no legalities. The insurer can provide the insured with a provisional guarantee even before the issuance of the policy. Hence, we can say that the contract of insurance is the agreement between the insurer and the insured to manage a particular risk as is determined in the insurance policy which is the final expression of the offer and acceptance. Another example for the above explanation is Article 2(8) of proclamation No 559/2008 provided for vehicle insurance against third party risks. It defined insurance policy as a contract whereby an insurer undertakes to pay compensation to any third party for death, bodily injury, or damage to a property caused by the vehicle of an insured person. Here, we can also see that insurance policy is termed as the contract. The contract is the agreement between the insurer and the insured by way of providing a settled document that contains provisions of the corresponding legal bond. Therefore, in providing article 657(1), the law maker was not intending to state a contradictory rule against Article 654(1). But it is supplementing the definition that insurance contract should be proved to exist by adducing written document manifesting the agreement. Insurance policy is the contract between the insurer and the insured which should be proved through a written instrument. In other legal system it is termed as cover page Article 657(1) is about proof of the contract showing the offer and acceptance is expressed in the policy. Hence, either one says insurance policy or insurance contract; it is about the same thing. What is important is the contract should be proved to exist via presenting a written document. Having settled the issue in

such a manner, now we shall escape into certain points about the policy.

Article 658 provided that the policy shall show:

a. the place and date of the contract,
b. the name and address of the parties,
c. the item, liability or person insured,
d. the nature of the risks insured,
e. the amount of the guarantee,
f. the amount of the premium,
g. the term of which the contract is made,

This is bout the contents of the contract we can see the policy need to include things that chain the parties. It is all about the details governing the relationship between the parties creating the bond including a third party beneficiary. Still we can see the insurance policy as embracing the minimum standards that regulate the legal bond.

Having said this, there are important points which require consideration in relation with the nature of insurance policy. Insurance contract is not always necessary be made between the insurer and the insured, the latter making it personally. It may be negotiated and concluded between the insurer and an agent of the insured under the sprit of article 2199 of the civil code. This can be seen from the reading of Article 661(1) of the commercial code which articulates that an insurance policy may be made by an acceredit agent. The same is true even in the absence of such agency tie between the person who conclude insurance contract and the person in whose name the contract is made. In such a case there can be conclusive insurance coverage to such person provided that he/she

accepted the agreement that made him/her a beneficiary. It is not necessary that the acceptance should be made immediately. The beneficiary may express the acceptance after the occurrence of the risk subject to the insurance policy. The duty of paying premium to the insurer stays attached to the person concluding the insurance contract with the insurer. Once the insured accepted the policy, all will pass to him/her. You can see this principne from the reading of Article 661(2) of the commercial code. There can be a question of how a person can claim coverage for realization of a risk against his/her interest without expressing the necessary consent in advance before the risk materializes. Can we consider a contract of insurance as existing between the insurance company and the insurance? Is it a deviation from the rule that requires a contract to fulfill offer and acceptance between the parties concerned? Remember that we discussed the economic impact of economic loss of an individual person. A benefit at the micro-level when added together brought about a general benefit in aggregate at the macro-level. A loss to an individual is a loss to the general economy at large. The law by providing insurance principles play the function of a double sharp edged knife. The first one safeguards the individual while the other operates infavour of the general interest. Hence, the law encourages individuals to enter into insurance contract on behalf of another without authority so that a certain juridical act would be made in his/her behalf due to a justifiable reason. But there may be a necessity that his/her interest should be given shield against risk which may materialize economic loss. In such circumstances, a good citizen may make the arrangement with an insurer in the belief that the insured would make the same decision had he/she known the possible risk against the interest which is sought to be given cover. This is a kind of recognition of unauthorized agency under the aspiration of Article 2257 of the civil code on the condition that the insured person

accepted the undertaking made in his/her behalf. The assumption here is that the offer and the acceptance is made between the insurer and the insured through unauthorized agent who act in the latter's favour. Not only the conclusion of the contract but also payment of the premium and discharge of other related duties are to be performed by such person until the beneficiary takes over it. Another assumption here is that the beneficiary will ratify any undertaking that gives economic shield to his/her pecuniary interest. A person is assumed to accept on activity that protects his/her financial matters. Based on these assumptions, the beneficiary is expected, at the same time, to cover the expenses made by that unauthorized agent to safeguard his/her interest. You can see the provision as stating.

> *"An insurance policy may be made on behalf of a third party even where the subscribe is not an agent. The beneficiary may avail himself of the insurance policy where he accepted it. Such acceptance may be given even after the risk insured has materialized. The subscriber shall incur all the liabilities under the contract until the policy is accepted by the beneficiary."*

The question is what is the beneficiary rejected the insurance policy entered in his/her favor? What about the expenses made by the subscriber expecting the acceptance? Shall we consider as no contract existed? What will be the consequence between the insurer and the subscriber? Possibly, the policy should be considered as if not made reinstating the persons involved in the position where they were before the negotiation and the making of the arrangement that went in favour of the insured who duly refused the coverage.

A further consideration is that question of how the beneficiary should be stated in the insurance policy. An insurance policy may be

designed in such a manner that specifies the name of the beneficiary or to the order of the person whose name is specified in the policy or without specification of the name.

In case of determination of the beneficiary through the order of the person stated in the policy, any liability attached to the policy which a beneficiary should discharge can be claimed by the insurer from such ultimately refereed person by virtue of Article 660(2). In addition to this, the party who left beneficiary unspecified should cover the premium and once the beneficiary is known, if there is any claim which the party to the insurance policy left not discharged, the beneficiary discharges under Article 662(2) which says that the beneficiary of a policy under sub (1) shall be liable to pay the premiums. The insurer might set up against the beneficiary the defenses which he could have set up against the subscriber.

Ultimately, the insurance policy comes into force on the day when it is signed as per Article 659(1) of the commercial code. However, such may be precluded by otherwise determination which may be by law or by agreement. An example is what is stated under Article 657(3) as fixed by the law and what is stated under Article 659(2) which paves the way for otherwise determination by the consent of the parties. It reads, “Provisions may be made to the effect that the policy shall only come into force after the first premium has been paid.” Accordingly, the policy may come into force before endorsement or after endorsement and the payment of the first premium.

2.6. Rights and Duties of the Parties

Dear distance learner, would you explain the rights which the insurer can claim from the insured and the vice versa? It is obvious that a

particular legal relationship creates rights and duties between the subjects of the chain. There is no exception with this regard to insurance contract. The following discussion is devoted for addressing this areas of deliberation.

2.6.1. The Right of the Insured

The right to guarantee:- The very objective behind making contract of insurance is to cover a loss that is caused due to the occurrence of a specified risk. It is a legal requirement that the parties to an insurance policy should agree upon the nature of the risk against a particular interest either an out come of ownership, usufruct or other right on a property, a liability or personal welfare. The shield against the particular risk is the guarantee determined to be paid to the insured in the form of compensation which is calculable in terms of money. Hence, the principal right to the insured is obtaining guarantee from the insurer to the effect that the loss due to the specified risk should be recovered by way of payment of a fixed maximum amount of money or in any other form. The question of which causes of the risk should be the grounds to require enforcement of the guarantee requires deliberation. Is that the risk due to foreseen event unforeseen even, an event, due to the negligence of the insured, a loss due to the fault of the person to whom the beneficiary is insurable? What about a risk which is materialized due to the intentional behavior of the answerable? Dear distance learner the guarantee operates irrespective of the occurrence of the risk due to the foreseen or unforeseen event or negligence of the beneficiary. The application of such a rule may only be precluded by agreement of the parties specifically fixing rules of coverage. But the risk should not be caused by the intentional conduct of the beneficiary which is a manifestation of bad faith that is

condemned in insurance law. Insurance policy is necessitated to tackle uncertainties. Such uncertainties are difficult to be seen in advance in most of the cases. They are not predictable which is the reflection of unforeseen nature of the risk. Hence it is natural in insurance relationships that the parties should not foresee all the possible events which may causes against the interest insured the consequence of which should be providing a shield to such damage due to unforeseen fact. In addition, it is an intentional behavior that accelerates the risk which is denounced as an expression of introducing bad faith poisoning the purpose of insurance law. Negligence of the insured is not considered as a bad faith for the insured involved in such conduct in a under normal circumstances which is one of the aspirations of insurance law to bother about. Risk may be materialized while the insured is exercising his/her.

Right duly. In doing so, the beneficiary may not always be expected to be always perfect in all aspects of the management of his/her affairs. He/she may encounter loss to such what not intentional but as he/she normally behaves. Such possibilities are one of the several reasons behind the necessity to deal with insurance policy. These, risk, though materialized due the negligent behaviour of the beneficiary, can not be presented as a defense to deny the established guarantee.

What is disused is articulated gender Article 663 of the commercial code that stipulates.

> “1. The insurer shall guarantee the beneficiary against the risks specified in the policy.
> 2. Unless otherwise agreed, risks arising out of the beneficiary shall be covered by the insurance.

1) Notwithstanding that any provision to the contrary, risks arising out of the intentional default of the beneficiary shall not be covered by the insurance”

The guarantee con not exceed the agreed amount in high of Article 665/2/.

The right to assignment of the insurance policy: The insured has the right to assign the policy to some other third party as one can imply from the reading of Article 660(2) and particularly 672 (1) of the commercial cod which provided that… the policy shall continue with the assignee where the object inured is assigned. Assignment of the insurance policy is transfer of the rights incorporated in the contract from the insured to a third party so that the latter collects the benefits therein. This may be either voluntarily by the application of Article 1962 of he civil code or involuntary under Article 671(1) of the commercial code or the application of law of succession under Article 826 of the civil code cumulative with Article 672 (1) of the commercial code. In such cases, however, the trustee in Article 67(2), 1, the heirs in Article 672 (2) and the assignee in Article 673(2) can terminate the insurance policy agreement with the insurer.

The right to vary or terminate the policy:- It is discussed earlier that the insurance policy is a contract that falls under the spirit of the definition given is Article 1675 of the civil code which articulates the possibility of creating, modifying or ending the effects of the undertaking. This is a reflection that the policy can be varied by a later agreement between the insured and the insurer the contract can be extinguished by a subsequent agreement or enforcement of a provision in the policy by virtue of Article 1807/b/ of the civil code.

The right to coverage timely:- the insured has the right to claim payment of the sum agreed in case where the risk under the policy is materialized against the insured interest. This right includes the right to be paid in the time fixed by the agreement as enshrined in Article 665 (1) stating that the insurer shall pay the agreed sum within the time specified in the policy or when the risk insured against occurs or at the time specified in the policy.

Dear distance learner, you should bear in mind that the insure is duty bound to respect and enforce these rights of the insured.

2.6.2. The Duties of the Insured

The insured has to discharge certain obligations towards the insurer since the rights go with corresponding duties. The duties may be explained in terms of adhering to certain legal rules discussed as follows.

The Duty pay Premium

The premium is the consideration which the insurer receives from the insured in exchange for its undertaking to pay the sum insured in the occurrence of the event insured against as one can understand from the definition set in Article 654(1) of the commercial code. Any consideration sufficient to support a simple contract may constitute the premium in a contract of insurance. The amount of the premium is purely a matter of contract depending upon the insurer’s estimate of the risk. It is payable in money which may be a sum total risk. It is payable in money which may be a sum total to be made in one payment or installments consistent with the agreement. Article 666 is provided to address the issue imposing an obligation on the part of the insured to pay the premium fixed at the time agreed. However, failure to pay the premium has no automatic effect to end the contract

of insurance. Rather, the insurer gives one month notice of payment to the insurer the lapse of which entitles the former to suspend the relationship. Once such a period is expired, the insurer has two options, i.e. either require the payment of the premium or demand the contract of insurance to end its effects which stayed operating between the insurer and the insured. But, the payment of the premium results in operation of the force of the insurance policy again. This principle is not applicable to life insurance for it is subjected to the rules stated under Article 709. We shall discuss this provision later on.

The Duty to State Correct and Full Information

It is a fundamental principle of insurance law that the utmost good faith must be observed by each party. Insurance is a contract upon speculation. The special facts upon which the contingent chance is to be computed, i.e. more commonly in the knowledge of the insured only. The insured is especially required to show due diligence and act in the utmost Good faith when he/she offers to the insurer to enter into an insurance contract. Good faith for bids the insured by concealing what he/she privately knows, to draw the insurer into a bargain and from such ignorance and believing the contrary decide a premium, for example, which is less than what it should be in the circumstance of the case. Insurance contract is undertaking that looks for utmost good faith, and it is of the gravest importance to commerce that it should be observed. Article 667 of the commercial code recognized this importance and provided that on making proposal for a policy, the beneficiary should state exactly all the circumstances within his knowledge and which are likely to assist the insurer to appreciate fully the risks he undertakes to insure. It is discussed in the previous unit that what causes the existence of insurance is the

question of risk against a particular interest of a person, an interest which one can calculate in money terms. It is a kind of device that operates in managing risk. The insurer and the insured come into the legal chain based on the estimated risk against the interest to be insured. The risk can be assessed based on the facts of the interest to be guaranteed. It is these facts which enable the insurer to decide on the prospective relationship. All the facts are in the hands of the insured. Hence, the insured is under a legal duty to reveal the relevant information in his/her knowledge around the interest under consideration. This is with the purpose of backing the insurer to fully appreciate the risk and decide accordingly. The insurer can fully estimate the risk to be covered and determine the premium to be paid in consideration of the cover it intends only when the insured discloses on the material facts that might reasonably influence the coming into existence of the policy and the decision on the amount of the premium. The disclosure plays an important role in furnishing the insurer with the information that is relevant to understand the nature and extent of the risk. It is the duty of the insured to help the insurer to come to the right conclusion. Thus, it is the duty of the insured not only to be honest and straight forward, but also to make a full disclosure of all the relevant material facts. Further, all the statements made by him/her during negotiations must be accurate.

The extent of the duty to disclose all material facts may be based on actual knowledge. The special facts distinguishing the proposed insurance are, as a general rule, unknown to the insurers who are not in a position to ascertain them. They lie, for the most parts, solely within the knowledge of the proposed insured. It is the duty of the proposed insured to disclose to the insurer all the material facts within his/her actual knowledge. The insurer is in the highly favorable position that it is entitled not only to bona fides on the part of the

applicant, but also to full disclosure of all knowledge possessed by the applicant that is material to the risk. Good faith, therefore, requires that the insured should not, by his/her silence, mislead the insurer into believing that the risk, as proposed, differs from the risk which it will actually run. On the contrary, he/she should help the insurer by every means in his/her power to estimate the risk at its proper value. The duty of disclosure is contained to such facts as are within the actual knowledge. Dear distance learner, can we extend the rule to presumed knowledge to the proposed insured to extend to all material facts which he/she ought in the ordinary course of business to have known?

A failure on the part of the insured to disclose a material fact is termed as concealment which implies the keeping back or suppression of something which it is the duty of the insurer to bring specifically to the notice of the insurers. Such conduct results in drastic legal consequence as provided under Article 668(1) of the commercial code. It reads:

> *"The policy shall be of no effect where the beneficiary intentionally concealed facts or made a false statements and such concealment or false statement cause the insurer wrongly to appreciate the risks to be insured so that, had he been aware of the truth, the insurer would not have entered into the policy or would have imposed terms less favorable to the beneficiary. The insurer shall retain all premiums paid."*

The provision is the reflection of the attitude of the law as strictly standing against non-disclosure of facts around the insurable interest. Concealment of material facts results in making the policy voidable with a consequence of waiver of premium paid. It is, however,

conditioned upon the fulfillment of two cumulative situations explained as follows.

i. The concealment or the false statement of the material fact should be intentional. This is a conduct of the insured person having full knowledge of the circumstance and full cognizance of the consequence of his/her statement he/she made a statement which contain hidden facts or divert the truth. It is a deliberate and planned action to misguide the insurer in assessing the facts and decide accordingly. This is a manifestation of bad faith which is contrary to the rule that requires utmost good faith of the parties to insurance contract.
ii. The concealed facts or the false statements made should be relevant to the situation. This is to mean, the hidden facts or the false statement should be material to the policy based on which the risk might be estimated. They should have the power to direct the insurer to wrongly appreciate and accord an undertaking which it would not have entered into had it been aware of the true situation. Relevancy of the concealed facts should be measured in terms of guiding the insurer to decide what it would not have made in otherwise circumstances which may be fixing a higher premium or rejecting the proposal to form contract of insurance. This second condition can be implied from the deep reading of the above sub provision.

The two conditions are framed in such a manner that condemns bad faith. Intentional behaviour is legally assumed as reflections of evil motives of the wrong doer and sanctioned under the above provision as obstacles to commerce and the objective of insurance law. Intention entails a presumption that all is made in bad faith. It follows that, it is not all concealments that entail invalidating the policy but those deliberate conducts. Accordingly, the behaviour of the insured should be investigated based on the issue of whether he/she acts

contrary to the standard deliberately in bad faith or not deliberately in good faith. If the answer is in the positive, what is explained above will be enforced. If the answer is in the negative the case falls under sub (2) of the same provision. That is, unintentional behavior of the insured in communicating facts misguiding the insurer in appreciating the situation and fixing the premium is considered as not standing contrary to the principle of utmost good faith. Since it is not a deliberate action, it is considered as made without evil motive and contaminating commerce as well as the object which the law sought to achieve. The policy remains valid. The consequence is, then evaluated in terms of the question of when the concealed facts or false statements are discovered by the insurer, i.e. before or after the risk materializes.

i. Before the risk materializes:- The insurer has two options i.e. either to terminate the policy giving one month notice or maintain it increasing the premium by virtue of sub(2) (a) of Article 668.
ii. After the risk materializes:- The insurer is under duty to enforce the policy with the right to deduct the sum of money equal to the amount which could be added on the premium fixed had all the facts been disclosed at the time when the policy is established as one can see from the reading of Article 668 (2)(b).

C. The Duty to notify Increase of Risk

Dear distance learner, what constitutes increase of risk? Generally, an increase of risk assumed by the insured arises as a result of alternation, i.e. a change(s) that might take place during operation of the policy affecting the subject matter of the undertaking or its circumstances. Every thing is in motion in this world as the law of evolution tries to prove. As time lapses or situations change, the circumstances having connection with the risk referred in the policy

may not continue to be in the same state for the future. They might be susceptible to undergo changes which ultimately and inevitably affect the obligation assumed by the insurer. But, it is not every alternation which constitutes an increase of risk. It is only those changes which could have the effect of making the risk assumed more hazardous than that which existed at the time when the contract of insurance was made. A real increase of risk could happen only when the change of circumstances has the effect of increasing the chance of loss. In order to qualify an increase of risk within the meaning of the law, the change in circumstance should have the effect of substantially affecting the risk to materially increase the risk. Since increase of risk has the effect of affecting the situation of enforcing the policy, the insured is legally dictated to notify increase of risk.

Article 669(1) articulates:

> *"Where the risks increase in such a manner that the insurer, had he known the facts at the time when the policy was made, would not have entered into the policy or would have imposed terms less favorable to the beneficiary, the beneficiary shall inform the insurer within fifteen days from the occurrence increasing the risks, where such occurrence is due to the beneficiary, or within fifteen days from the beneficiary being aware of such occurrence. These periods may not be shortened in the policy."*

Still the duty revolves around the material facts of the subject matter of the insurance policy. The facts are the basements on the ground of which the insurer appreciates the value for which it assumes a legal duty of guarantee and fix the amount of the premium. The proximate person to know any change of facts that increase risk against the subject matter guaranteed is the insured person like the facts at the

time of the formation of insurance contract. This is a requirement that material facts are considerations here as well. The test of materiality is provided under the provision the fulfillment of which is a necessary prerequisite to show the risk as increased entailing greater burden upon the insured. It exists only when “the insurer, had he known the facts at the time when the policy was made, would not have entered into the policy or would have impose terms less favourable to the beneficiary.” The time reference to measure the risks increased in the time when the insurance contract is made. In order to decide on the increment, the existing position of the insurer should be taken back to the time of assuming the obligation stated in the insurance policy. Then, the question of whether the insurer could have entered in to such undertaking with such existing terms or would have agreed to a less favourable benefit to the insured should be raised. The issue should be addressed in the way a reasonable and prudent insurer could have evaluated the circumstance and agreed there to in a manner that poses a balanced obligation.

Let’s illustrate the above explanation with a hypothetical example. Assume the original (initial) insurance policy is designed to cover a liability for damage to a third party by automobile which is destined for personal service of the insured. The risk of loss is determined to be an accident. Later on, the insured changed the purpose of the vehicle and start to render taxi service to the public obtaining the relevant license. There is full change of circumstance of using the automobile. The vehicle will involve in continuous motion from one place to another according to the service need of the customers. The more the vehicle is to move from one area to another giving transport service frequently, the greater the tendency to involve in accidents than that of the function it gives personal service to the owner. The movement of the owner is usually limited driving the automobile him/herself. Taxi service may require employing a driver and moving

every direction of the place where the undertaking is to be made. These all manifest increase of risk for the more it moves, the greater the probability to involve in accident. Hence, the insured in such vehicle liability accident is duty bound to inform the change of the circumstance entailing increase of risk. You can imagine the insurer would have behaved otherwise than what is shown in covering liability risk of a vehicle destined to give personal service had it be for a risk of liability of a vehicle that is devoted to give public transport service. The insurance company knows the risk is greater in the latter case than the former.

Another good example would be increase of risk where a building which was declared to be used as a residence and insured against fire started to involved in dry cleaning business using a highly inflammable cleaning liquids. Under this situation, the assumption of the insurer was to cover the losses for the risks on the premise only while it is used for dwelling purpose. It is obvious that the insurer would have provided a less favourable situation to the beneficiary had it known the fact that there is highly risky activity in the building accelerating fire. Consequently, the beneficiary is under duty to inform change of circumstances such as increasing the risk assumed in the insurance policy.

Increase of risk involves three possible consequences depending on the behavior of the beneficiary, in relation with the change of situation, disclosing or not disclosing the increase risk resulting in increase of the risk. These may be

i. Once increase of risk is reported, the insure has the option of terminate the policy investigating the situation and the burden it brings about under the first phrase of Article 669(2) or

ii. Informed of the increase of risk by the insured, the insurer maintains the policy with the legal entitlement to provide a less favorable situation to the beneficiary, for instance, by way of increasing the premium as stated in the second phrase of the same sub-provision.
iii. Failuere to give due information to the insured involves grave consequences of either.
    a. entailing no effect of the policy in case where the failure is intentional or deliberate by way of feeding false information as provided under Article 668(1) or
    b. brings the application of Sub(2) of Article 668(2) in case where the failure to disclose increase of risk is not deliberate and not in bad faith. You can consult such legal consequences from the reading of article 669(3).

The Principle, however, is not operative on life insurance under Article 669(4). The reason emanates from the nature of the risk and the value given to human life than other interests that we assess in terms of money. It is not based on compensation. What other justification can you think in excepting life insurance?

C. The Duty to Notify Occurrence of the Risk Assumed in the Policy

The duty of the insured to give information to the insurer is not only limited to the obligation to give full and clear information of the risk and the duty to report increase of risk but it also extends to the obligation to report to the insurer that the risk assumed is occurred resulting loss and looking for the later act according to the policy. Here also there is no other closer person than the beneficiary to know the risk as materialized against the insured interest. The duty is automatic in the sense that it requires the beneficiary to act forthwith

or within few day of the occurrence of the risk. This enables the insurer to take the necessary steps to immediately investigate into the situation and valuate the loss and determine the amount of coverage in accordance with the policy.

It is not the claim that comes into picture. What the beneficiary should do is inform the insurer that the risk assumed in the insurance policy is materialized urging the insurer to undertake the necessary activities as required under the circumstance and the policy operating.

In determining the due time to give information to the insurer the law provided two options, i.e. “as soon as he (the beneficiary) knows” or “within not more than five days”. The question revolves around how soon it should be in the first alternative. Is that to mean the same day the next day, fifteen days, greater than that? The English version looks confusing with this regard. With the second alternative, there is no problem for it fixed a clear time limit. Shall we consider the first alternative in light of the second option to be interpreted in such a manner that should not exceed five days? If that is the case, is that not sufficient to provide this second option only? In addressing the first option the Amharic vision stated the corresponding meaning saying, “*መድን የሆነበት አደጋ መድረሱን እንዳወቀ መዲያውኑ*” This is expression that the insured should report the occurrence of the risk forthwith. How forthwith should be construed consistent with the second alternative, i.e. within five days. We can consider the latter possibility as providing the bench mark of the maximum delay in forming the situation to the insured. The insured should report the occurrence of the risk immediately. If that is not practicable within five days which can not be shortened by contrary agreement in light of Article 679 (2). However, the report may be in a time that exceeds the above two

situations where the beneficiary is prohibited to act within the specified short period of time due to force major as described under Articles 1792-1794 of the 1960 civil code. The duty to notify the occurrence of the risk covered is provided under Article 670 of the commercial code that states,

1. Unless he is prevented by force majeure, the beneficiary shall inform the insurer of any occurrence likely to render the insurer liable as soon as he knows of such occurrence or within not more than five days.
2. This period may not be shortened in the policy.” One additional thing which the distance learner should bear in mind is that the report to the insurer should be such an occurrence that has relevance to enforce the policy entering the obligation of the insurer into maturity. The law, however, escapes the consequence of failure to report. Dear distance learner, you should take notice, at the same time that the duties of the insured incorporate the corresponding rights of the insurer. That means the insurer has the right to claim payment of the premium, to obtain correct and full information of the to know any fact that increases risk and to get notified of the occurrence of the risk assumed so that it can take the appropriate action to enforce the policy. Rights and duties are correlatives.

2.6.3. The Duties of the Insurer

It is stated earlier that what the insured can claim as rights are duties of the insurer. Having such duties in mind, the principal obligation of the insurer is to pay the agreed sum of money to the beneficiary within the due date once the risk is materialized. The very objective behind establishing the insurance policy is the need to cover the losses which the beneficiary suffers due to the risk which is sought to

be managed under the ambit of insurance undertaking. There is no other motive behind. Insurance policy has an object to compensate the losses as agreed between the parties. Article 665 specified such duty of the insurer stating:

"1. The insurer shall pay the agreed sum within the time specified in the policy or when the risk insured against occurs or at the time specified in the policy.
2. The insurer's liability shall not exceed the amount specified in the policy.

The provision requires explanation. What the law wants to convey by "pay the agreed sum within the time specified" or "at the time specified"? Is that legally possible to fix such a time? To which nature of insurance? Dear distance learner, it is possible to have such instance undertaking to cover a loss that may occur at a specific time reference like that of life insurance which imposes a duty upon the insurer to pay a specified capital or life interest provided the insured person is alive at a date fixed in the policy by virtue of Article 962 (2) (We shall discuss it latter on). Under such nature of insurance, there can be a fixed date of maturity of insurance policy i.e. due date to pay a sum of money to the beneficiary.

The insurer in the policy is under the legal duty to pay the agreed sum only. This is to say that it is not the maximum amount of loss that may be covered but the agreed such usually insurance companies enter into assuming to cover a risk stating the maximum cover they will advance. For example, in an insurance policy of a building for fire risk the insurer may agree to cover 100,000,000 birr in case loss occurs due to the risk referred in the policy. Assume, the risk occurred destroying the building. At the time of destruction is 200,000,000 birr. The insurer's duty, however is not the total loss, but the agreed sum, i.e. to pay 100,000,000 birr. Here you can see that in making

insurance contract the insurer may assume less than the actual value of the interest or its equal value. It is not, however, possible to fix a greater value, you should simultaneously, bear in mind that the insurer. May not fully pay the agreed amount if the estimated loss is less than the agreed sum what the insurer should pay is the actual loss not greater that the agreed but equal or less than such value depending on whether a lesser damage or equal damage is materialized a paints the interest insured from the estimated risk. This is how to the distance learner should discern the duty of he insure. (We will have exhaustive discourse about this issue when we consider each kind of insurance).

2.7. Bankruptcy or Death of the Insured and Period of Limitation in Insurance Contract

Dear distance learner, what do you think is the fate of insurance policy if the beneficiary dies or declared bankrupted? May the insurance policy end its effect immediately? Is there any period of limitation to enforce a right by either the insurer or the insured in the insurance policy?

How long it operates? you read the following brief explanation.

A. Bankruptcy and its effect on insurance policy

Declaration of bankruptcy of the insured person under article 968 seq. the commercial code shall not have immediate legal effect of ending the consequences of operation of insurance policy. it rather render the trustees to collect the benefits of the policy with the corresponding duty of paying unpaid premiums. The policy is viable for three months but subjected to termination in a time less that such period by the decision of the trustees and the insurer. What will be the legal consequence if it is not terminated within three months is not addressed under the law. The commercial code under Article

671(2) deals with the period of time when the parties involved can terminate the effects of the insurance policy. The reason why such period is determined is not clear for it doesn't entail any clear consequence. Sub (1) of the same provision does not imply any thing about the time limit than that of stating the consequence of the policy effective between the trustees and the insured. Having such problem under the law is mind, the question of bankrupted beneficiary is operating on traders under the spirit of Article 968 of the commercial code.

A different rule is provided under Article 671(3) of the same resulting in termination of the insurance policy within one month after the insured has been declared bankrupt. Though the consequence of ending the effects of the insurants policy in such a case is not specifically addressed under the provisions that deal with insurance law, any claim of the insured from the insure will be governed under the rules that operate to bankruptcy schemes.

B. Death of the Insured or Assignment of the Object Insured and its Effect on the Policy

Insurance policy seems to be subject to succession in the sense that it continues between the heirs of the insured and the insurer regardless of contrary stipulation as provided under Article 672 (11) of the commercial code. The reason may be the presumed intention of the insured to pass an inheritance which is duly given shield under the insurance policy. Once such beneficiary passed the a safe pecuniary interest to his/her heirs, it is apt to them either to perpetuate the relationship based on a kind of settlement after liquidation or terminate its consequences within three months as stipulated under sub(2) of the same provision.

The same principle applies when the object insured is assigned, i.e. transferred to a third party Article 673 provides,

> "(1) Notwithstanding any provision to the contrary, the policy shall continue with the assignee where the object insured it assigned.
> (2) The assignee and the insurer may terminate the policy within three months from the assignment."

Dear difference learner, the principle that applies to assignment operates in case where the nature of the insurance policy is insurance of objects or liability for damages. By the same token, the rule that applies of transfer of the policy to the heirs in case of death of the insured is not operative is insurance policy that covers the risk of death of the insured under Article 692(2) of the commercial code.

C. Period of Limitation in Contract of Insurance

Period of limitation involves the effect of taking away a claim which a certain creditor has against a particular debtor of an obligation as applied to the civil law context. It is operative by way of fixing a certain period of time the lapse of which results in prohibiting the creditor to require the enforcement of his/her right. Under the rules that apply to contracts in general, the period of limitation is effective upon lapse of ten years by virtue of Articles 1848 of the civil code.

Insurance contract is a special commercial engagement governed by a special law. This specialty includes providing a particular period of limitation that specially apply to the area in pursuant to Article 674 of the commercial code. Right that due in order to get enforced under insurance policy, can be claimed within two years of their occurrence or within two years of their disclosure to the parties involved in the transaction. This includes enforcing a right by the insurer for a case of hiding facts or making false statements contrary to the duty of the

insured to give full and correct information under Article 668. The time runs since the insurer knew the contrary conduct of the beneficiary. This period of limitation can neither be prolonged nor shortened by otherwise agreement of the parties.

2.8. Unit summary

Dear distance learner, so far you have been given due explanation of the nature of insurance contract as standing to cover a loss out of a risk, not preventing the occurrence of risk. It can be classified a to different categories depending either on the nature of the event, the nature of the interest affected or the nature of insurance under consideration. Insurance contract also involves the consideration of applicable principles to the area like the principle to indemnity, the rule of insurable interest, the principle of subrogation, the doctrine of utmost good faith and the like. Under the Ethiopian legal regime the legal chain between the insurer and insured is governed under the terms of the agreement enshrined in the insurance policy that duly adheres to the applicable rules of the 1960 commercial code. Under the insurance policy, the beneficiary has the right to guarantee of the interest that gives rise to the policy, the right to assign the polices to a third party, the right to cover timely which is operative with discharging corresponding duties to pay premium, state correct and full information of the risk, and report increase of risk and so on. The insurer should pay the required amount stated in the policy to the beneficiary upon the occurrence of the risk covered or maturity of the time agreed. Neither death, bankruptcy, nor assignment has the immediate effect of terminating the insurance police but can be negotiated to determine the future of the policy between the insured and the concerned parties after the occurrence of one of such events. It is also discussed that the period of limitation of enforce a claim

arising out of contract of insurance is two years as the area of engagement is special governed under special law.

2.9. Self check Questions

1. Explain the ways in which insurance contract can be classified.
2. Insurance contract is necessitated to prevent the occurrence of a particular risk. Do you agree? Why?
3. Discuss the applicable principles of insurance contract.
4. How do you explain insurance policy as is recognized under the 1960 commercial code?
5. What constitutes increase of risk in insurance contract?
6. Give a brief explanation of the right- duty relationship between the parties in insurance contract.
7. The insurer should pay the exact amount stated in the insurance policy despite the loss materialized is valued to be less. Evaluate the legality of the statement.
8. Explain the ways is which the beneficiary can be stated in the policy.

Unit Three

Insurance of Objects

3.1. Unit Introduction

Dear distance learner, you have been introduced into the nature of insurance contract in the preceding parts of the module. Particularly, in the second unit the applicable rules on insurance in Ethiopia is discussed exhaustively covering all natures of insurance, except maritime insurance which has it own scope under the 1960 Maritime Code. The present unit is devoted to insurance of objects, a particular category of protection of interest of he insured. Its meaning, nature and scope are given due attention is the first part of the deliberation. Insurance of objects may be classified in to certain categories based on the nature of the risk which requires coverage in the insurance policy. Such kinds of coverage are also addressed. It is a known doctrine that there must be insurable interest so that insurance should involve in operation covering a particular risk. The question of what constitutes insurable interest has its own place is this part of the module. Moreover, the making of the policy of insurance of objects needs an exhaustive explanation as part of the subject matter and

there is a consideration of how the policy is to be made creating a legal chain between the insurer and the insured. Since the nature of insurance of objects is for ultimate compensation as agreed and up on the occurrence of the referred risk, the issue of indemnity with its ramification has been given due attention. Finally, summary remarks are made with some self-check questions.

At the end of the unit, the distance Learner will be able to:-

- define insurance of objects;
- identify the nature and determine the scope of insurance of objects;
- classify the subject matter into some categories based on the kind of risk to be covered;
- discuss the nature of insurable interest in insurance of objects
- explain indemnity and related issues;
- describe subrogation as a principle in the area of consideration, and
- provide legal solutions of practically arises cases of insurance of objects.

3.2. Meaning, Nature and Scope of Insurance of Objects.

Dear distance learner, what do you think is the subject- matter of insurance of objects? what it refers by “object” as the point of reference of the transaction?

Insurance of objects particularly refers to property insurance as designed to protect the insurable interest in that object against a specific risk which is a peril that results in material damage against a thing. It is about good upon which a person exercise certain rights either ownership, usufruct or other right in rem under property law

regime. The purpose is to protect such interest attached to the right referred as calculable in money terms. Thus, we can say insurance of objects is a form of property insurance where by the insurer, undertakes, for consideration of a premium to indemnify the insured against any financial loss the may directly or indirectly sustain as a result of the happening of an insured event to the subject matter of such form of insurance compromises. anything or physical object to which fortuitous loss or damage may be occasioned; and the peril insured against may be any insurable peril in respect of which the insured seeks and the insurer is willing to give protection. Article 675 of the commercial code can be made reference to imply such a kind of definition as applied together with Article 654 of the same. Any person having material interest on a thing may enter into insurance undertaking for the purpose of preserving such interest against a particular risk. The person may be someone who exercise direct or indirect interest in the subject matter.

Insurance of objects works with the general theories and principles of law of insurance where the principle of indemnity and other related concepts prevail. It is a property insurance which solely involves is indemnity insurance. Indemnity is the only and legitimate concern that the value of interest lost will be subject to recovery in the policy. Hence, any contract of insurance on objects (things) entitles the insured the right to recover the value equal to the actual loss despite a greater amount is agreed. It is compensation that is conceived in such type of insurance as one can read Article 678 of the commercial code. It reads;

> *"A contract for the insurance of an object is a contract from compensation. The compensation shall not exceed the value of the object insured on the day of the occurrence*.

Consequently, one see that insurance of objects is an insurance policy on property interests covering the insured against a particular risk buy the insurer for a loss which can be assessed in money terms so as to make the damage good by compensating with equal amount of economic value of the interest injured. It is contractual in the sense that it comes into picture by agreement of the injurer and the beneficiary and the subject matter is property interest incase of the insurer of which due to an insurable peril results in indemnifying the beneficiary by the insurer. The interest at hand may be direct indirect. An exhaustive deliberation will be made about the concept of direct or indirect interest later on.

3.3. Classification of Insurance of Objects

There is a wide range of perils because of which property may be lost or damaged. The types of insurance policies in insurance of objects differ accordingly. To consider this, one needs only to take certain premise, supermarket or motor vehicle and imagine the different ways in which damage or loss may be occurred upon and the different possible insurance covers it can be devised to protect the resulting losses. It follows that, there are so many insurance policies which may be made to guarantee a kind of risk of loss to appear against a particular property. It would be fire, motor, vehicle, burglary, livestock, aviation insurance, among other pursuant to which insurance policies may commonly be classified into three categories stated as follows.

A. All Risk Insurance of Objects

It refers to a type of insurance policy which covers every loss that may happen, i.e. it protects loss against all risks and perils. Indeed, there may exist a provision to preclude certain risks a contractual provision

or a legislative provision like that of the case of Article 676(1) of the commercial code for the latter option stating losses or damages due to international or civil wars will not make the insurer to pay compensation to the beneficiary.

This kind of policy is said to avoid any unknown category of risk in enforcing an insurance cover. It is wider form in the sense that it is developed on the realization that uncertainty of loss can not be restricted certain specified risks, like theft, fire, flood or to risks occurring on particular places such as the insured's premise. Therefore, the twin objectives of such policies are to provide cover for the whole number of accidental losses or damages.

B. Specified Risk Insurance of Object

It refers to a policy that particularly address a specific peril. Certain types of risks have peculiar features that they require such particular type of under writing or policy statement. The type of risk may differ from theft, fire, flood, earth quack, burglary, motor insurance, etc. Some are explained here in above.

C. Combined or Comprehensive Policies

A certain premise or other property may be susceptible to more than one peril or risk of loss so that it may require cover to such contingent risks at the same time. For example, a certain shop or warehouse into addition to fire insurance may require burglary insurance. In such a case, insurance which is covering a wider scope may be provided by the so called combined or comprehensive policies which represent the combination of separate policies with one folder. This form of policy is usually available for household goods and personal effects, which the insured or member of the insured's family owns or is legally responsible for safe keeping in the described premises. It may also

occur in automobile insurance as a convenient form of loss protection which includes coverage to damage or loss protection which includes coverage to damage or loss to the vehicle, personal injury caused to the person operating the vehicle and liability of the insured for insures to another person or damage to other properties is using the vehicle. These combined and comprehensive forms of policies are said to be advantageous that they are less costly from the administrative point of view, such as only one premium and one renewal date to worry about, less chance to overlooking one form of cover and easier to make protection by one policy rather than several independent polices. This is to the prospective of the side of the insured. However, the wider coverage has its own problem that insurer may involve in large loses as the probability of the happening of damages may result in a substantial increase in frequent compensation eroding the amount of capital questioning the very existence of the firm dealing with insurance business.

3.4. Insurable Interest in Insurance of Objects

Dear distance learner, we have discussed that risk and insurance have direct relationship for the latter is necessitated to cover the loss that resulted due to the occurrence of the former. In insurance industry the starting point is the concept of risk. It is risk that primarily motivates the person who wishes the cover to purchase an insurance policy by way of transfer of the risk safeguarding an insurable interest. All property risks can be insured as insurance is the mechanism whereby one’s loss by happening of a certain risk is protected. The parties to insurance policy agree on the risks the insurer shall cover. The question here is what interest in property is legally subject to an insurance policy? Making reference to the

applicable law let’s discourse into the idea as applied to insurance of objects.

Article 675/2/ provided that any person in the preservation of an object may insure it. By the term “object” the commercial code refers to things having economic value. It refers to corporeal goods for the Amharic version typically gives a corresponding meaning to the term stating “ የዕቃዎች ኢንሹራንስ” as sub title of the area of consideration and the Wording of sub (1) of the same provision reads “ዕቃውን ከጉዳት ለመጠበቅ የሚፈልግ…” coming to our point the subject matter insurance of objects preservation of an object a thing having money value, i.e. something which can be calculated in terms of money. The interest revolves around such benefit. As stated earlier to be interested in a preservation of a thing, is to be circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction. The property of a thing and the interest desirable from it may be very different; of the first the price is generally the measure, but by interest in a thing every benefit or advantage arising out of or depending on such thing may be considered as comprehended. In property insurable interest may be based on ownership which may be sole or joint this is an explanation that insurable interest in insurance of objects involves in a kind of economic benefit in the preservation of the thing and a loss in the destruction of the thing which is the subject matter of the policy. Two contract possible situations must exist alternatively depending on whether the thing is preserved or not. Preserving the thing generates economic benefit to the person desiring an insurance policy which operates in his/her favour. Injured to the thing i.e. destruction result is economic loss or damage to the person looking for a policy to run on his/her part. The law requires the existence of interest in the preservation of a thing. This interest can be inferred from matter that it is an object which embraces a material

value. In short, insurable interest in property insurance would mean such a interest as will make loss of property of a pecuniary damage to the insured unless preserved and when a particular risk is materialized. It is a right, benefit or advantage out of the property or which might be affected by the contemplated peril. There must be loss or gain to the person praying for insurance coverage behind the preservation or otherwise of the object. The extent of coverage is exhaustively discussed in unit two of this module making reference to the application of Article 663 and 664 of the commercial code. Hence, the distance learner is advised to remind that deliberation to determine extent of coverage of insurance of objects since these provisions are applicable to all natures of insurance including the present consideration.

In addressing insurable interest in insurance of objects Article 675 is stated referring it as the existence of interest the preservation of which adds pecuniary benefit to the injured. In addressing the matter this provision further articulated under sub (2) that any direct or indirect interest in a risk may be insured. This clearly shows that the insurable interest may be direct or indirect. What constitute direct interest looking for preservation what constitutes indirect interest that regards preservation for economic advantage? The law escaped the questions without particular reference in the commercial code. Hence, there is a need to explore into answering the questions making reference to related legal concepts either borrowing contractual or property law principles.

An owner of a thing exercises three cumulative rights which may legally be termed as abusus which is the free disposal right, usus which is the right to use and exploit the thing and fructus which constitutes consumption of the fruit of the thing out of the

exploitation. This can be clearly extracted from the application of Article 1204 and 1205 of the civil code. The exercise of these rights is to the inclusion of intrinsic elements of a thing as stated and governed under Article 1131-1134 and accessories which is regulated under Article 1135-1138 of the same. This is a reflection that an owner of a thing has interest in the preservation of the object and a prejudice in case where the object is lost or damaged. Hence, an owner exercise full and direct right over a thing under his/her ownership. This is financial interest the preservation of which preserves pecuniary value. one can see here that an owner of a thing has direct interest over the thing he/she owns and can be considered as having direct insurable interest having the legal protection to obtain coverage against a particular risk be fire, burglary, flood, earth quack, motor vehicle insurance or some other depending on the nature of the interest and nature of the risk. Not only in case where a person exercises full ownership over the object that he/she can be said to have direct insurable interest but also in times when a persons exercises bare ownership that he/she can be considered as having direct insurance interest as one might refer Article 1320 (1) of the civil code which stated that the owner and the usufructuary may, where they think fit, insure their respective rights. The owner referred here is the bare owner for the use and fruit rights are extended to the exclusive utility of the usufructuary under Article 1309(1) and 1311 of the same. By the same token, the usufractuary might be considered as having insurable interest over the respective right he/she exercises over the thing either corporeal movable or immovable by the application of the above provisions. Joint owners can also be considered as having direct joint insurable interest by the application of Article 1257 and 1265 of the civil code. One may also refer the dominate tenement in exercise of servitude under article 1359 and 1373(1) as having direct insurable interest on the immovable being servient tenement in the exercise of

the right. These are interests which a person can directly exercise a pecuniary right, an advantage which each subject of the right enjoy directly being principal rights holders as opposed to subsidiary rights whose existence depends on the existence and protection of a principal right.

Indirect insurable interest emanate from a financial interest that depend on a certain principal right. The person aspiring coverage of a particular risk has no direct real right upon a certain property. But it may be a claim which a person may have as an out come of a principal claim against another person for example, that of a contractual right expecting future performance. For example pledge is a right which is created contractually between either a debtor or a third party to the benefit of the debtor and the creditor subjecting movable to serve as security for the proper performance of a certain obligation which could be contract by virtue of Article 2825 and 2826 of the civil code. The relationship makes the pledge on the property pledged the right of a creditor which is right in personnem as opposed to right in rem by virtue of Article 283(1) of the same. Here one can see that the very reason for the creation of pledge contract is the claim which a person (the pledgee) has against another person, a particular claim the performance of which is looking for security. Hence, the security is subsidiary to the principal contract between the creditor and the debtor. In case where performance is failed on the part of the debtor the creditor has the right to require the enforcement of the contract against the pledge. This manifested that the creditor has material interest against the thing emanating indirectly from the contract existed between the creditor and the debtor. It is a financial interest the loss of which will indirectly affect the interest of the creditor. thus, such creditor can be considered as having indirect insurable interest for the preservation of the same has ultimate the pecuniary

benefit and the loss of which might result in material loss of the creditor in case where the debtor failed to duty perform the principal contract such a kind of continent interest may be preserved by way of entering an interest. The same is true for a mortgage right on an immovable property under Article 3041 of the civil code for the due discharge of another right in personnem either contractual or extra contractual.

The next issue that need due regard under the present exposition is the time when the insurable interest should exist so that it obtains coverage under insurance policy. To this end, certain reference is made to the experience of foreign legal systems and to the position of the commercial code. In property insurance some jurisdictions authorities require insurable interest to exist both at the time of inception of insurance contract and at the time of loss, while many others hold sufficiency of the presence of insurable interest only at the time of loss, merely demanding good faith of the insured at the formation stage. The name scholar called Keeton, is an objection to an assertion made in a case for the necessity of insurable interest to exist both at the time of insuring and at the time of loss, said that the necessity for insurable interest at the time of insuring was dictum and doubtlessly ill considered; the necessity at the time of loss is, nevertheless, rational. This is because property insurance adheres to the principle of indemnity and strict adherence to this principle requires insurable interest at the time of loss. This is a position that underlines the need to have insurable interest of the person insured at the time of loss or damage due to the occurrence of the risk covered in the insurance policy. It is not necessary that the beneficiary should prove that there exists insurable interest at the time of the making of the policy. In support of this position it is also argued as, “in order that insurance of property shall be valid an interest must exist in the

insured at the time of loss. It is not necessary that an interest shall exist at the time of the issuance of the policy, provided the parties entered that the risk shall attach only when an interest accrues to the insured. The absence of expression provision to that effect, will not suspend the insured's interest during the currency of the policy, not defeat a recovery if an interest has been required before the loss occurred. But there is much argument to the effect that the insured must possess an insurable interest at the time the insurance is issued as well as at the time of loss. One can see from the above statement that two prevailing arguments existed as to when insurable interest should appear. The first requires the existence of insurable interest at the time of the making of insurance policy referring a particular risk on a specified property and at the time of occurrence of the risk resulting in loss or damage. The other takes the position that insurable interest should exist only at the time insurable interest should exist only at the time of loss fitting the nature of the kind of interest that is property which requires compensation in case of loss.

Dear distance learner, which argument do you foavour? Which one do you think the commercial code adhere to? Would you read article 682 and 677 and may it be helpful to determine the stand of the Ethiopian legal system? Under the commercial code of Ethiopia there is no express and clear provision determining the time when insurable interest should exist. Article 682(1) provided that the policy shall be of no effect, where at the time of when it is made the object is already lost or no longer exposed to risk. This repeats, indirectly, the requirement for a valid contract the obligation must be possible to perform under Article 1678(b) of the civil code. An obligation is possible only if the subject matter of the undertaking exists. This shows that one can enter into a valid contract of insurance only when the object is existent at the time of the making of the contract.

Normally, the person insuring the property having insurable interest is the person having legal right like an owner who seeks to have an insurance protection for the object. This is a legal principle that one can not have an insurable interest on a property which does not exist for there is nothing to be protect as having economic value. Material interest can not be asserted in the abstract. In addition, the policy, though made in the existence of insurable interest shall terminate when the object is lost for a reason not specified in the policy by virtue of Article 677 of the commercial code. Accordingly effecting an insurance contract on an object does not necessarily entail an implication that the person has an insurable interest upon such object. The person entering into insurance contract may not have any title upon the object but may still be interested in its preservation and a valid contract of insurance may be made for the future protection of property in which the insured has no present right or right. For example, a person has usufruct right over 1000 Orange trees which will give Orange after one year. Here the usufructuary has no insurable interest currently but he/she will have insurable interest over Orange fruits in the future. There will be material benefit in the preservation of the fruits and material loss in the damage of the fruits in the future. There can be insurance contract covering certain risk like pest against the future fruit. Therefore, at the time of entering into an insurance contract the existence of actual insurable may not be said to be a requirement in such cases. The law provided restriction on something already lost or on something which no longer is exposed to risk. It does not prohibit insurance for an interest to exist certainly in the future.

The existence of insurable interest at the time of loss is necessary for serving the objective of the principle of indemnity as enshrined in Article 678 of the commercial code. One can suffer pecuniary loss

from loss or damage of property arising from an event insured against even through the insured has no interest at the time when the contract was made save in the case of an interest already lost or no more suffer a risk. As property insurance is an indemnity insurance by its nature, insurable interest should exist at the time of when the specific risk in the policy materializes resulting material pecuniary damage. This satisfies the purpose of indemnifying the beneficiary to the extent of the value of the interest lost as particularly stated in the second statement of Article 678. These all prove that the Ethiopian legal system adapted the principle that insurable interest should exist at the time of loss of the object which is insured against a specified risk.

3.5. Maturity of Indemnity in Insurance of Objects

Dear distance learner, what conditions precedent are necessary enabling the beneficiary of an insurance policy to claim indemnity from the insurer?

When the risk insured materializes and loss has been sustained, the liability of the insurer matures entitling the beneficiary the payment of the actual amount of loss or damage according to the terms of the policy. However, as stated in the previous unit, the right of the insured to demand such payment can not be enforced until he/she has performed certain duties imposed both by the law and the policy. The contract of insurance usually requires the insured to provide the insurer with notice of loss, to make formal claim and to show such particulars and proofs of the loss the insurer reasonably needs. The practice shows that notice of loss is made while the insured fills claim notification form provided by the insurer which at the same time is used to state the particulars of the loss within the time required to

notify the insurer. However, as notice is to acquaint the insurer with the happening of the loss and provided that the notice of loss is sufficient to accomplish its purpose, the fact that the insurer received actual notice of loss is more important the manner in which such notice is given. Hence, unless, a written notice is required in the policy, the insured may use every convenient method to give due notice to the insurer such as by telephone, letter or any other means that would satisfy the notice which will be followed by particulars of the claim. It is this which can be understood from the reading of Article 670(1) of the commercial code. Remember an exhaustive discussion is made about this provision in the preceding unit.

The other important thing that requires due attention in the area of maturity of insurance policy is the need to prove loss. It is to say that, after the insurer has received due notice there still remains on the part of the insured to comply with the requirement of proof of loss. Proofs are evidences to be furnished to the insurer about the loss with such particulars and necessary data to enable it determine its liability and the amount of compensation thereof. This requirement is necessary in the sense that the beneficiary should sufficiently show the fact that the material loss is occurred against the interest insured due to the materialization of the risk covered in the insurance policy. For example, the insured should proved that the object insured is lost due to reason specified in the policy contrary to the application of Article 677 of the commercial code which declares, “The policy shall terminate as of right where the object insured is lost for a reason not specified in the policy.” in addition to this and in the absence of contrary agreement to that effect, the insured should have a legal position that the insurer can not prove the fact that the risk insured is materialized against the object causing loss due to civil or international war as stated under Article 676 of the commercial code.

The requirement of proof loss, in addition to the above explanation is almost an invariable practice of insurers. Polices commonly provide that the insured or a claim and under the policy should furnish the necessary particulars of loss and other necessary information of various policy terms to such effect, indeed, differs according to the nature of the particular insurance. But they are generally framed on the same general line that the insured is required to deliver a proof and other particulars of the loss within a specified time. For the delivery of the particular of the loss usually a claim form is provided by the insurer using which the beneficiary would state the loss. The proof should show the full particulars of the loss as articulated in the policy. This means, it should contain the best particulars which the insured, as far as the circumstance permits, can reasonably give and upon which the insurer would not be dissatisfied. This idea is in support of the statement made under Article 670(1) dictating the need "… to render the insurer liable…" the insurer would be liable to the extent the risk is proved to be occurred resulting a loss to the insured interest as stated in the policy. Therefore, the insured should give all possible and material information showing that he/she is entitled to hold the insurer liable to cover the loss occurred. If the proof does not contain the information which the policy requires to be given and within the power of the insured to do so, the insurer has the right to reject the claim as supported by insufficient evidence.

What will be the effect of non-compliance of discharge such duty of information and proof of loss requires consideration. Non-compliance to give due notice and sufficient proof of loss may arise either from a fraudulent claims of the insured or due to failure to comply with the time requirement. Fraudulent claims usually pertain to the conduct of the insured such as pretext of loss or supporting a false evidence or

make excessive claim with the object of misleading the insurer. The assertion is against dishonest conduct. For example under a cargo vehicle policy with covers a risk of accident which may cause part or full damage of the insurable interest, the insured may involve in deliberated action of causing damage dropping a vehicle into a gorge pretending that the damage is occurred under a fortuitous situation. The objective may be to obtain compensation which will enable the insured to have sufficient amount of money to purchase a new one. There the insured would prove that a total loss is occurred due to damage to the large but the insured could disprove the fact that the damage is not as required by the policy. This intentional behaviour constitute fraudulent conduct entailing a consequence of absence of coverage under Article 663(3) of the commercial code which stated that not with standing any provision to the contrary, risks arising out of intentional default of the beneficiary shall not be covered by the insurance. This is a manifestation that the fraudulent behaviour which is intentional conduct of the insured can be a ground for the insurer to reject a claim as an ascertain of non-compliance of the former to duly notify the occurrence of the risk and prove the loss as articulated under the law and the policy which particularly addresses the legal chain. Hence, the failure to give genuine notice or furnish the required proof within the required time limit would preclude the insured from any claim of payment under the policy. The law under Article 670 seems posing no consequence for if only requires the beneficiary to furnish a proof of occurrence of the risk within specified time limit. This introduces a problem of determining the sanctity of the provision and the policy. But unless the rules in the law and stipulations in the policy are fulfilled there must be no claim. Otherwise putting legal limits and preconditions for a claim would be purposeless.

3.6. Claim and their Settlement

3.6.1. The Making of the Claim

The making of the claim for indemnity for loss begins with the notification by the insured to the insurer as to the happening of the loss. When the insured complies with the policy and legal conditions and in particular those relating to notification and proof of loss, the insured is duty bound to respond to the claim. Having the notification the first step which the insurer takes is to verify whether the policy on which the beneficiary based the claim is still in force, the peril and the particular circumstance under which the loss occurred is covered in the policy and the interest affected is as referred in the policy or not. Once the insurer gets itself liable under the terms of the policy, it should respond to the claim of the beneficiary making the loss good by way of compensation. The payment is usually made in cash. But the insurer may resort to option of either repair the loss or replace the property destroyed. The extent of the liability of the insurer to indemnify the insured depends on the amount determined in the policy which sometimes may be less than the full value of the object insured that may arise in case of underinsured as stated under Article 679 of the commercial code in which case the beneficiary is considered as his/her own insurer of the remaining value. In any case, however, the extent of indemnity is to be determined making reference to the value of the thing at the time of loss.

With regard to the claim settlement, in countries where insurance industry is developed, claims are to be settled on the basis of a survey report submitted by an independent surveyors known as loss assessors. The primary duties of the surveyors is to investigate the cause of the loss to ascertain the extent of loss and advise the parties

on loss minimizing measures. However, in Ethiopia a third party assessment is rare for the activity is usually made by the insurer often creating doubt to the beneficiary and causing disputes since it is natural that a party to the contract should not unilaterally decide on the extent of his/her liability. This is because of the clear doubt as to the making of impartial decision. Beneficiaries question the assessment on the time value of the loss. It is also difficult to the judicial bodies to decide on the disputes based on unilateral assessment of the insurer, the debtor of indemnity claim of the beneficiary in contract of insurance.

3.6.2. Indemnity to Claims of Loss

The principle of indemnity is the basic concept in insurance. It is the very purpose behind the undertaking as well. It has an objective to put the insured in the same financial position after the occurrence of the risk as he/she enjoyed before it materialized. This is to say that contract of insurance on property, as a peculiar form of contract of indemnity, entitles the beneficiary to receive the sum necessary for the loss accessioned by the peril insured against, not more. The reason behind the principle of indemnity is public policy when strongly underlines the doctrine that the insured should not make profit from insurance. The payment of indemnity is limited to the actual loss the insured has sustained and is not to be a source of profit. On such bases, there is a strong nexus between the principle of indemnity and insurable interest as it is the insured's insurable interest that involves in the insurance policy being the subject matter. As a result of such link, the payment to be made to the insured in the event of loss can not exceed the value of such interest, i.e. the insured has the right to be indemnified only to the extent of the financial loss he/she suffered from the occurrence of the risk insured. Otherwise,

the undertaking would amount to a mere gambling transaction. Hence, the parties can not over note or preclude the principle by otherwise agreement.

As stated, in brief earlier, the Ethiopian legal system adhered to the principle of indemnity providing Article 678 of the commercial code which stipulates.

> *"A contract for the insurance of an object is a contract for compensation. the compensation shall not exceed the value of the object insured on the day of the occurrence."*

The principal objective of indemnity is compensation equal to loss. The provision is the guiding rule in insurance of objects that the financial loss of the insured is determined based on the value of the object at the time of the occurrence of the risk causing the material loss, a damage which can be assessed in economic terms. The value of the object is taken to be to standard of compensation. This is because, if the payment is greater than the insured's financial loss, he/she will have made a gain, and this would be variance with the basic purpose of insurance. Hence, to rule an insured might recover regardless of the value of the interest at state would remove the policy from the class of indemnity against loss to which agreements to insure must be confined to their being gambling contracts and so against public policy.

In fact the operation of indemnity works with the terms of the particular insurance policy is contract of objects. It follows that some factor determine the amount of compensation. That is to say though indemnity refers compensation equal to the damage occurred due the specified risk cover, there may be a situation in which the extent of indemnity the insurer should pay and rests less than the actual

damage. This might be because of a fixed amount of coverage determined in the contract of insurance for an object. This can inferred from the stipulation for example, of article 665 of the commercial code determining payment of the maximum payable under the insurance policy. In such a case, although the principle stated that the indemnity is equal to the loss, there might be cover less than the loss as evaluated in terms of the agreed amount in the policy. But the policy may not provide a greater amount of than the loss due to the application of Article 678 of the same. For example, under a certain policy for insurance of a private motor vehicle, the amount of coverage which the insurer undertook is up to 40,000:00 birr loss of the particular risk stated in the policy, like that of damage of the vehicle by accident. Base on this prospective liability, the premium is fixed. During the terms of the cover, the said risk occurred damaging the insured private vehicle totally. The actual loss is proved to be 90,000:00 birr. Had it been full compensation the insured would have obtained full indemnity that is compensation equal to the total loss. But in the present hypothetical case, the amount of coverage is up to 40,000:00 birr which the insured should make to the beneficiary in the policy. Because, the liability of the insurer is to the extent agreed in advance in the policy. Indemnity is less that loss but based on the terms of agreement between the insured and the insured in light of Article 665 (2) that states. “The insurers liability shall not exceed the amount specified in the policy. Such a situation is, in insurance terms, expressed as object under insured by virtue of Article 679 which we shall discourse its all implications latter on. Still the amount of compensation may not exceed the extent of loss though a greater cover is legally promised to be paid by the insured. For example, an insurance policy is operative between the insured and the insured for a business building against fire. The agreed cover is up to 500,00:00 birr on the occurrence of the risk. While the legal tie functions the

risk materialized against the building resulting in material loss. The actual damage is proved to be 350,000:00birr. Though the extent of coverage is up to 500,000:00 what the beneficiary actually suffered is 350,000:00 birr loss which is considered to be the actual value of compensation at the time of damage. The insure is required to pay not the full value agreed, i.e. 500,000:00 birr but the equal amount the beneficiary actually involved in loss i.e. 350,000:00 birr since the purpose of insurance of objects is compensation which is equally to the actual damage. This also leads us to the legal idea that the policy is enforceable to the extent of the value of thing as standing against a kind of undertaking which is made based on greater valuation of the thing at the time of the making of the policy. For example, insurance policy operates between the insurer and the beneficiary for a warehouse whose actual value at the time of the making of the policy less that what is stated in the terms agreement. The situation is legally termed as over insurance as stated under Article 680 of the commercial code with its consequence which we shall see later on.

Hence, the claim by the insured for compensation depends on the agreement and the legal limits. That is to say, the amount of compensation depends on the compensation application of Article 665(2) and 678 and the policy statement which might entail coverage equal to the actual value of the object insured at the time of loss or lesser amount, but not greater. The two provisions should be read together in the cause the liability of the insurer should not be greater than what is fixed in the agreement under Article 665(2) but might be less than the agreed sum due to the fact that compensation should not exceed the value of the object (coverage) at the time of the damage under Article 678. Although the insurer is under duty to cover equal amount stated in the policy, the lesser actual damage may be proved at the time of loss requiring coverage by the insurer. The insurer

should pay this actual amount for the purpose of insurance of objects is compensation which is equal to damage. Under Article 579, the phrase “the value of the object” referees the actual loss which the insured suffered due to the risk. The loss is the material damage which shall be made good by awarding the victim (in our case the insured) an equal amount in damages as can be seen from the reading of Article 2090 and 2091 of the civil code. If the value of the thing lost is less than the sum insured the insurer is bound to pay not more than its actual regardless of a greater amount fixed in the policy.

3.6.2. Measuring Indemnity

A claim under a policy of indemnity and especially in property insurance, is said to be a claim for un liquidated damage where the exact amount of the compensation is not known before the loss. It is repeatedly explained that in contract of indemnity the insured can obtain cover, within the limits of indemnity, no more than the actual loss. The amount payable is the actual value of the loss due to the damage subject to the sum insured and the amount of the pecuniary interest or insurable interest. To measure the amount of indemnity, which is the extent of the liability of the insurer to make the damage by the insured good, one important thing requiring due consideration is one important thing requiring due consideration is determination of the extent of the loss. The extent of the indemnity that should be made to the insured depends upon the extent of the loss or damage and the value of the assessment measure taken to properly to put the latter back to the position he/she was before the occurrence of the risk.

A loss may be sustained on the property insured totally where the property is fully damaged or particularly where part only of such

property is damaged with remaining parts safe. A loss is said to be total when the object insured is damaged to the point irreparable or ceases to exist to be used for its usual purpose. In order the loss to be total there need not be a complete destruction of the property, but it is sufficient that is so damaged as to be deprived of having the character in which it way before or that the ruins can not be used to advantage in reconstructing the property. It may be actual or constructive. For example, there we can say, is actual loss where a warehouse is damaged and it had lost its identity and specific character and no longer said to be property designated as a building; or where the remnants of the material can not be used in reconstructing it. A constructive loss, on the other hand, is that where a substantial amount of loss has been sustained but with remains of constructing materials or ruins, but the remaining parts can not be used to the advantage of reconstructing or reinstating the warehouse in the above example without incurring greater expense than if they were not so utilized.

Partial loss a situation where the risk when materialized left part of the object or property insured standing or undamaged that can be reasonably adapted as the basis upon which to restore the object to the condition where it was before the incident. In such a case the insured can not abandon the property remaining undamaged and claim a total loss. For example, in a policy for insurance of vehicle for fire, if the risk occurred and damaged part of the vehicle including the four tyres, gear, windows and door leaving the engine and other spare parts safe, it does not constitute to full loss enabling the insured claim full coverage. The cover operates to the part of the vehicle sustaining damage.

However, the policy subsists to successive losses that all the losses insured to the remaining property within the period of the insurance are covered provided the total sum paid per event and during the period operating does not exceed the maximum amount of the insurers liability under the policy, save in otherwise determination of the policy keeping the minimum standard of the applicable law. What if part of the loss is due to a risk covered in the policy and part of the damage is due to a later risk not insured? For example, a building with its contents insured against fire accident which occurred destroying part of the building like doors, windows, wall, the roof and house hold materials leaving the remaining part of the building safe. Three days latter flood resulting from risen flow of a river caused the damage of the remaining building. The case manifested that part of the loss is due to a risk insured and the remaining by a kind of risk not insured. The loss with respect to the property is a total loss. But for the purpose of the insurance policy it is as if it is partly damaged with the view of assessment as the former loss of the building would be taken as a damage to be covered in the policy requiring the insurer to cover such part loss.

The value of the property lost or damaged as the basis of the measurement of indemnity is to be determined by the value of the property at the time and place of the loss. The fundamental rule is that the insured would be adequately indemnified if he/she is restored to the position he/she had occupied at the time of the occurrence of the risk resulting in the damage in material terms. Therefore, any value of the property at any other time is immaterial particularly the prime i.e. the value entered in the policy, although it may be considered as evidence of its value in connection with depreciation of the property. The value to be taken is the intrinsic value of the property at the time of loss, no addition or allowance is to be made for

mere sentimental values on or for loss of prospective profits or other consequential losses. That is why the immediate report of the occurrence of the risk is required under Article 670 of the Commercial Cod.

To determine the actual value of the object lost or damaged, the commonly used basis are assessment of loss with respect to market value or reinstatement cost of the same object. The market value basis is the actual and most commonly applied method that involves calculating the liability of the insurer or the amount to recovered the insured in a particular case. With respect to property of such a nature that its markets value can be referred readily, this market value has been usually regarded as the actual cash value of the object at the time of its loss. It is applied where the property in question is marketable commodity which is normally sold and bought in the market with the ordinary course of dealings. Such value of same property will be taken as the value of the object lost representing adequate indemnity where by the insured entering into the market can get a similar object so that he/she might be restored to his/her original position. However, the market value basis, although is an easy way of determining the actual value of the object lost, in most cases properties may not have recognized market value as a fair indicative of their actual value at the time of loss. This is because the same property, with the same depreciation condition with that of the lost one may not be found in the market. In such a cases, for the purpose of indemnity, the value of the property as new minus depreciation is normally applied as the presumed market value of the property. To explain it is an easy way, if a certain machine has a life time of ten year to be used properly at work, and the properly at the time of the loss has been used for the past five years, the value of the

property at the time of the loss would be estimated to be half of the value of the new.

Still, in certain cases it is generally recognized that market value would not be a fair measure of indemnity of insured's loss, because the actual value of the loss may not be its market value but the cost of reproduction minus depreciation. These are cases where the damage caused can not be made good except based on the reinstatement value basis. Such may be institutions where the insured still has also made extra expenditures of repairing or replacing the thing damaged or destroyed. Unless he/she is entitled to sufficient sum to enable him/her to restore the property to the condition it was before the loss, payment based on market value can not restore him/her to the original position which may be against the purpose of indemnity. Reinstatement cost is thus, the cost of restoration of the property affected by the peril to the condition it was before the loss. It occurs in the case of partial loss for replacing the damage and in the case of total loss the cost to rebuild a building insured for example or replacing the thing by equivalent value.

These being the usual measurement of the loss on the part of the insured, therefore, the indemnity to the made is only in respect of the damage on pecuniary interest in the subject matter of insurance that in estimating the actual damage, prima facie, an insurance on property covers the loss or damage to the property insured, but no consequential losses. The result of the principle, in other words, is that the measure or recovery under property insurance polices does not include economic loss against damage to an interest like that of earnings, rents, profits of business. The cover is the value of the property only. This is what one can discern from Article 678 of the commercial code.

Such losses which may happen consequently can be different kinds but are generally said to be loses of earnings which might have been earned had the property, not been destroyed such as loss of rents, business profits, etc. or those expenditures the destruction of property may involve the insured in additional working costs, which otherwise would not have incurred, as rent of car, building etc. These consequential losses, although are not normally covered under insurance on property, their insurability as economic risks due to loss of property pending indemnity, however, is well recognized. They may be specifically insured to enable the insured to recover them. Consequently, these consequential losses would be recovered only if they are they are separately insured or expressly provided in the policy.

All the above discussion shows that the beneficiary in an insurance policy will be entitled to recover the loss, whether total or partial, to the actual value of the pecuniary damages he/she suffered. The purpose is so as to place the insured in the same financial position he/she was before the risk occurred, save in the limit of the sum in the insurance policy.

3.7. Under, Over or Cumulative Insurance

Dear distance learner, what constitutes underinsurance over insurance or cumulative insurance? What is the place of such transactions under the Ethiopian legal system? Would you try to determine the potential legal consequence? It is the nature and the legal effects of these undertakings that you will be acquainted with in this sub-section of the unit. We shall see each one after another.

A. Underinsurance

A property insured is said to be underinsured when the value for which it is insured in the policy i.e. the sum insured is less than the actual value of the property. It mainly arises in case of inflation upon the property where the value of the property is continually changing, particularly in time of high inflation levels. It may also occur where the person insured the property for an amount less than its actual value. This may be for a reason that the insured can not afforded adequate premium for the full value of the property or in the first loss insurance cases where the insured wants the policy cover only up to a certain specified sum which he/she feels will not normally incur a loss more than that. It is, however, said that not favorable to both the insurer and the insured. The insurer under normal circumstance would receive the proper premium from the adequate sum but to underinsurance the gross premium will be reduced proportionately which may simultaneously affect the insurer's profit and costs. From the insured's point of view, he/she is still at risk for the excess value uninsured.

In the common law legal system, a policy of insurance which is subject to under insurance, other than a policy to marine insurance, is not subject to proportional sharing of partial loss and the insured is entitled to recover the whole amount of loss up to the sum insured, whether the loss is total or only partial. In such a case the insured, once he/she realizes that the probability of total loss in slight, may probably tempted to underinsure the property as he/she will receive an adequate indemnity for a partial loss but with a reduced premium. Due to such problems, in order to prevent under insurance and enable the insurer earn a higher premium, non-marine property insurance policies are usually made incorporating a condition commonly called 'first' or 'pro rata' condition of average which provides that it at the

time of the loss the sum insured is less than the value of the subject matter of insurance, the insured is to be considered as his/her own insurer for the difference, and to bear a rate proportion to the loss accordingly. The effect of such clause is to pay the insured that portion of the loss which he/she has paid of the true premium. As a result, if the sum is inadequate, total loss will be paid up to the sum insured and partial losses will be paid up to the sum insured and partial losses will be reduced in the same ratio to that of which the sum insured bore to the total risk.

Article 679 of the commercial code looks to adopt such pro rata concept stating,

> *"Where on the day of the occurrence the object insured is of a value greater than the amount for which it is insured, the insured person shall be deemed to be his own insured for the difference and shall share proportionately in the damage, unless otherwise provide in the policy."*

This is a reflection that, insurance polices, normally thought otherwise stipulations, in the invent of loss the insured shall receive the specified sum insured; and in the event of partial loss, he/she is entitled to receive only in proportion of the sum insured to the value of the damage caused. The proportionate value is to be computed with respect of the amount of the loss having the sum insured as numerator and the value of the subject matter as denominator, which the mathematical formula for the measure would be:

$$\frac{\text{Sum insured amount of loss}}{\text{Actual value}} \text{ x Amount of loss}$$

For example, a property, let's assume a building has an actual value of Br. 1000,000.00 at the time of loss. but it has been insured for a sum

of Br 600,000.00 in case of loss the insured would be entitled to the sum insured as the maximum limit of recovery equal to Br 600,000.00 and would be his/her own insurer for the rest 400,000.00 In case of partial loss, say for instance, for a loss of 400,00 average value, the pro rata sharing basis applies that the insured will receive for the partial loss in proportion to that of the total loss with respect the sum insured which will be:

$$\frac{600{,}000.00}{1000{,}000.00} \times 400{,}000.00 = \text{Br. } 249.000.00$$

B. Over Insurance

As opposed to underinsurance, a property is said to be over insured when it is excessively insured or over valued in the policy than its actual value. Article 680 of the commercial code specified the situation as establishing a policy devising compensation in case of loss for a risk insured, exceeding the actual value of the thing. The law entails consequences as well depending on the circumstance of the case. It classified the legal consequences based on two alternative mental situations of the parties either fraudulent or non-fraudulent expositing at the time of the making of the policy on the one hand and two possible alternative legal effects in case of non fraudulent conduct on other.

The question of why fraud may exist can be answered depending on the issue of who committed the fraud. The insurer may involve in fraud of over insuring the objects for the purpose of collecting greater premium while the insured might react in such fraudulent exposure so as to ultimately obtain greater compensation than the actual value of the object at the time of loss. Over insurance as a result of the fraudulent conduct of one of the parties entails the drastic consequence of aborting the effects of the insurance policy together

with claim of damage for any martial harm the party in good faith suffers by virtue of Article 681(1) for its is stands against the principle of the need to show utmost good faith in a particular insurance contract.

In the absence of fraud i.e. where the over insurance is made in good faith with no malicious motive, the policy is operative to the extent of the actual value of the object insured against a particular risk as stated under sub (2) of the same provision. Having such immediate legal consequence in hand, the insured, may require reduction of the premium imposed based on the over estimation of the value. The reduction has a purpose of fitting the premium to the actual value of the thing insured. However, previous premiums paid based on the over value remain in the hands of the insurer as the Amharic version clearly shows than the ambiguous expression of the English version of the subsequent sub provision of the same.

The purpose of the legal restriction on over insurance directed to the effect that no one should be entitled to be indemnified under insurance contract greater than what he/she actually deserves. Fraud, a general ground of invalidating a contract as vice of consent is reiterated being against public policy contaminating the market policy contrary to healthy economic development. It also safeguards the insured from paying undue premium which is greater than the normal value.

C. Cumulative Insurance

Cumulative insurance is another situation where an object may be over insured. It occurs when a person insures the same object against the same risk in two or more insurance polices. The insured involving

in such behavior obviously made is so as to obtain greater amount of compensation than the actual value of the loss he/she may suffer in case where the risk insured is materialized.

In the common law legal system, cumulative insurance is dealt under the principle of contribution, and is usually known as double insurance. It lies under the rule that, unless prohibited by the policy, any person may take as many policies as he/she chooses against the same risk and is free to claim payment from his/her insurers in such a way as he/she thinks fit. However, in such course, the principle of contribution as a corollary of indemnity looks for that the insured doesn't receive more than his/her actual loss through having policies covering the same accident, and enables the claim to shared by insurers in an equitable manner. the principle of contribution asserts the right of the insurer to call upon another similar liable to the same insured to share the cost of an indemnity payment so that the one that pays a full indemnity can require an equitable proportion from the other insurer risk referred. With respect to the insured, the principle underlines that until he/she has received the full amount he/she is entitled to ask any of his/her insurer cover the loss.

The Ethiopian commercial code addressed the matter under Article 681 which states:

> *"(1) Where several insurers insure the same object against the same risk so that the object is over insured, each insurer may where there has been fraud on the part of the beneficiary, require the termination of the policy and may in addition require damage".*

(2) Where the beneficiary is in good faith, each injurer shall, where the risk materializes, pay compensation in proportion to the value inured by him."

The question of cumulative insurance requires due regard especially in the present situation of insurance industry in Ethiopia where the number of insurance companies is increasing season by season as a consequence of the enforcement of Proclamation No 86/1994. Hence, the application of the above provision is at its critical period. The law regulated the matter in a system that resembles the common law solution to the problem but with certain express and implied conditions and alternative legal consequences which apply depending on the state of mind of the insured as can be seen from the reading of the provision. The conditions are:

i. There must be the same subject matter of insurance, i.e. the item insured should be the same.
ii. The risk covered should be the same such peril as fire, for example, in both several policies.
iii. There must be the same interest in the item, i.e. the insurable interest in the object should be the preservation of the actual value of the object as stated under Article 675(1).
iv. The policies must be enforceable at the time of loss. The policies should be operative at the time of loss in the sense that a policy terminated, invalidated or not legally binding is not included in the situation.

While the first three elements can be seen as expressed in sub(1) of Article 681, the last element can be implied from the nature of the transaction.

Up on the satisfaction of these conditions together, the law devised two possible legal consequences based on the issue of whether the

insured in the cumulative insurance acted fraudulently so as to such obtain greater benefit than what he/she actually suffered or in good faith simply looking for the preservation of the actual value of the insurable interest in the thing insured. If the insured behaved in fraud posing defect in exchange of consent during the formation of the policy with the several insurers, as a ground of invalidation of contracts, each insurer is legally entitled to require the ambition of the policy with the right to claim damage for any kind of damage each suffer due such a conduct of the insured. Bear in mind, however, that the final determination of ending the effect the policy at hand is by a court of law. The law does not provide the possibility of unilateral termination since the term ‘require’ refers action for ending the effects of the policy and such is before a court of law. Still the damage each may require, as suffered due to the behavior of the particular insured, is against to be determined by the court.

However, if the insured, in involving in cumulative insurance, in good faith, the consequence is affirmative in the sense that each policy stays in force shouldering upon each insurer to indemnify the insured proportionate (pro rata) to the value covered on its part. Here, dear distance learner, you can see the principle of contribution as adopted under the Ethiopia legal system treating commutative insurance positively when it is involved by the insured in good faith. The liability is to be computed as that each insurer will be liable with respect to the loss in proportion to the sum insured by its particular policy to that of the total sum insured by all the polices. The mathematical formula of the ratable proportion of one policy (insurer) would be

$$\frac{\text{sum Insured by particular insurer}}{\text{total sum insured by all insurers}} x the los$$

For example:- the insurance regards a hotel building with its contents The insured entered into cumulative insurance of fire with

a. RBA Insurance Company for 500,000.00 Br.
b. KLO Insurance Company for 400,000.00 Br
c. SWN Insurance Company for 600,000.00 Br
d. CBR Insurance Company for 450,000.00.Br

- Assume the risk is materialized and all polices are enforceable.
- the actual loss proved is 300,000.00 Br

To know the pro rata contribution of each insurer you can use the above mathematical formula. Let's determine RBA'S liability. It would be:

$$\frac{500,000}{1,950,000.00} x 300,000.00 = 76,923.08$$

These all discussion show that insurance of objects is strictly adhered to the principle of indemnity in principle, save in otherwise circumstances like that of underinsurance in which case the beneficiary obtains a cover equal to the agreed some in the policy and considered as his/her own insurer to the remaining sum. One can at the same time assert that determination of the amount of compensation in insurance of objects is the cumulative application of articles 665(2), 678, 679, 680 and 681 of the commercial code.

3.8. The Principle of Subrogation in Insurance of Objects

Dear distance learner, what do you know about subrogation? How do you think it applies to insurance of objects? You remember that, the principle of subrogation is referred, in the first introductory part, as a doctrine applicable in insurance. It is operation of the law by which a third person who pays a creditor succeeds to his rights against the debtor as if he were assignee. In other words, subrogation is the

substitution of one person to stand in the place of another to avail him/herself of the rights and remedies available to the person whose place he/she takes. The importance of subrogation is not only simply that the subrogee receives an action by which he/she may reimburse him/herself, but also that the subrogation right will retain the subrogee's hands with all the characteristics and accessories it had in the hands of the subrogor.

In insurance, the concept expresses the insured's right, on payment of loss, to be placed in the insured's position to be entitled to the advantage of rights and remedies against third parties. It is a fundamental principle in indemnity insurance adopted for the purpose of ascertaining that has not recovered more than his/her loss. As a fundamental rule, it does persist even though there is no mention of third parties agreement making any reference of subrogation. It follows that, in property insurance the insurer has always the right of subrogation to claims of the insured against other person even if neither the policy not any other agreement made in respect of setting the claim contains any reference of subrogation. The fundamental issue addressed by way of subrogation is that the insured is not entitled to be over indemnities. So that, although the insured is, *prima facie*, entitled to receive the full amount of loss within the limits of the policy, if he/she has any other means of diminishing the loss, the result of the use of such means belongs to the insurer. This, indeed, does not mean that the insured can not recover from a source in addition to his/her own insurer. But it follows from the rule that where the insured has rights both against the insurer and against a third party who is the cause of the loss, he/she can not take with both hands an aggregate sum substantially in excess of the loss. As a result, if the insurer has fully indemnified the insured's loss, it has the right to claim the damage from the third party liable.

The commercial code typically addressed the concept of subrogation under Article 683 under respective sub-rules entailing respective consequences. Sub (1) reads

> *"The insurer who has paid the agreed compensation shall substitute himself to the extent of the amount paid by for the beneficiary for the purpose of claiming against third parties who caused the damage."*

The relation between the insured and the third party liable for damage may arise from either contractual claims, where the non-performance of the contract by the third party renders the damage against the insured or from extra-contractual liability of the third party to the insured. The mere fact that there is a third party against whom the insured can institute a valid claim does not, however, alter the claim relationship between the insured and the insurer. The insurer is still liable to pay the claim irrespective of any right the latter may have against the third party in relation to the loss, but is entitled to the advantage of the insured towards the third party which may diminish or extinguish the loss.

However, subrogation is possible based on the fulfillment of corresponding obligation in the sense that it is contingent on a condition precedent which the insured should satisfy and the vice versa is true. The insurer, to take the place of the insured and required the enforcement of the claim against the third party liable to the loss by the insured, should first pay the amount of damage which is proved to be the actual value of the thing at the time when the risk materializes. That is to say, indemnity to the insured is a condition precedent for subrogation as one can clearly watch from the above sub-provision. Yet, there may be a situation in which the insurer may

refuse payment of the indemnity to the beneficiary leaving the substitution back. This is in case where the beneficiary makes subrogation impractical for the insurer. In such a case, the beneficiary is presumed to waive his/her right to claim the cover for loss from the insurer as articulated in the policy. Sub (2) of the same provision stated that where the beneficiary makes substitution under sub (1) impossible, the insurer may be relieved in whole or in part of the liabilities to the beneficiary. Here is a principle that the payment of compensation by the insured in case of a loss by a third party is contingent on the genuine behavior of the insured enabling the insurer get replaced in his/her position so as to enforce the liability of such party with the pain of loss of indemnity in whole or in part. The deprivation is whole may be in a situation whereby the damage caused is fully coverable by the insurer and part payment may be in cases where the beneficiary is underinsured as is discussed earlier. It is because of this reason that it has been said above that subrogation is based on the fulfillment of corresponding conditions that operate compelling the parties to an insurance policy to behave accordingly entailing a drastic consequence of relieving the insurer from its liability of making the indemnity true to the insured in case where the latter failed to facilitate situation of subrogation to the insurer against the third party.

With regard to the question of against whom the principle of subrogation operates the law provides exclusionary rules stating, under sub (3) of the article 683, that notwithstanding any provision to the contrary, the insurer may not claim against the ascendants, descendants, agents or employees of the insured person not against persons living with him, unless such persons acted maliciously. This sub provision proves the wise drafting of the law keeping consistency of the rule of subrogation with Article 664(1) of the commercial code

which stipulated that that insurer shall guarantee the beneficiary against the losses or damages due to the fault of the persons for whom the beneficiary is responsible. The above stated persons under the exclusionary provisions are persons for whom the insured is assumed responsible sub (3) of Article 683 explains as well, the gravity of the fault under sub (2) of Article 664 as not including malicious, i.e. intentional faults of such person. Such a kind of conduct precludes the application of the exception about subrogation against third parties.

3.10. Unit Summary

Dear distance learner, in this unit you have been guided to the applicable rules regulating insurance of objects making cross reference to the generally applicable rules and particular laws that are incorporated under the 1960 commercial code. It is underlined that insurance of objects govern an insurance policy which regard a property insurance against a particular risk or all risks governed under specific policy or combined policies. It is a kind of covering risk based on the principle of indemnity as stated under Article 678 of the commercial code underlining payment of compensation equal to the actual value of the thing insured at the time of loss unless the policy manifests underinsurance. The opportunity exists to those who have a direct or indirect insurable interest on the thing either being on owner, usufuctuary, owner of an immovable which is dominant tenement, plegee in mortgagee, etc. At the time when the risk is materialized, the loss should be ascertained in such a manner that enables the insured obtain the compensation. This requires notifying the occurrence of loss proving damage and measuring indemnity. An insurance policy may be found to be containing underinsurance which entails coverage less that the actual value of the loss in which case

the insured is presumed to be his/her own insurer of the remaining damage. The policy may also contain over or cumulative insurance entailing coverage of compensation greater than the actual loss. This entails the possibility of termination of the policy when the concerned party is found to be involved in frequent conduct in the making the policy. However, good faith of such party has a consequence of keeping the policy intact but with some modifications and altered effects. Indemnity may be made by way of payment in cash or restoring the insured in his/her position before the occurrence of loss. There are circumstances that may require payment of compensation of third parties like secured creditors who exercise preferential right over the things.

3.11. Self-check Questions

1. What is the subject matter in insurance of objects? Give an exhaustive explanation.
2. Elaborate on the concept of insurable interest in insurance of objects.
3. Classify insurance of objects giving specific examples.
4. Explain the pre-requisites to claim compensation for a loss in insurance of objects.
5. Brief on the major activities in measuring indemnity in insurance of objects.
6. Insurance of objects is indemnity insurance why?
7. Distinguish between over, under, and cumulative insurance with the possible legal consequence.
8. In what manner the insurer discharges it duty of compensation?
9. Compensation is necessarily equal to the actual value of the thing lost in insurance of objects. Do you agree? Why?

10. What constitutes subrogation and what purpose it achieves in insurance of objects?

Unit Four
Insurance of Liability for Damages

4.1. Unit Introduction

Dear distance learner, in the preceding unit you have been dealing with studying insurance of objects whereby economic interest of a person on a property is given protection under the umbrella of insurance machinery. In the present unit, you are going to study insurance of liability for damages, another area which affects the economic interest of a person due to a kind of indebtedness to another person. The matter is governed under Article 685-688 of the commercial code, other relevant provisions of the civil code and other related laws applicable in Ethiopia. A discourse is made to the meaning, nature and scope of the subject matter followed by some classification in the area of consideration. As part of the deliberation, what constitutes insurable interest in insurance of liability for damages requires due regard. Accordingly, a kind of discussion is made addressing this issue. One of the several grounds of establishing insurance of liability for damage is automobile insurance which has its own compulsory regime in pursuant to Proclamation No 559/2008. This is given its own place in providing the unit. The question of maturity of claim for coverage of liability with its preconditions and consequences occupies an explanation with the idea of the place of subrogation in insurance of liability for damages. Finally, summery remark followed by self-check questions takes the distance learner back to remind what has been covered in the discussions. In text questions and activities are also provided with the view help the learner gets familiar with the concepts involved at the end of the unit, therefore, the distance learner will be able to-

- define insurance of liability for damages,

- identify the nature and determine its scope,
- classify the subject matter into different categories,
- explain insurable interest in the area of consideration,
- answer questions attached to compensation in insurance of liability for damages,
- address the issue of subrogation nexus with it,
- give solution to practically arisen cased that regard insurance of liability for damages, among others.

4.2. Meaning, Nature and Scope of Insurance of Liability for Damages

Dear distance learner, what it constitutes by insurance of liability for damages, what is the source of liability, can you identify its nature and scope, what are the distinguishing points with insurance of objects? Try answer to the question in your own terms before reading the following note. Liability insurance was initially developed to provide an insured with indemnification for damages, up to the policy limits, for which the insured was responsible as a result of tort liability to a third person. But latter on the area is developed into covering contractual damages which the insured brought against the corresponding parties, for example, by way of non-performance. The term liability may be defined as, “Amenability or responsibility to law; it is the state for which one is responsible or liable.” The source of liability may be contract, duty imposed by law or as a consequence of torts committed. Liability may be divided into criminal and civil responsibility dichotomies. The former is about involving in violation of a criminal law by way of omission or commission. The latter may arise either from contractual relationships or non-contractual consequences, the different being in the source of the right and duties of the operates as a safeguard to the peace, order and security of the public and the state as can be seen from the reading of Article 1 of the

2004 FDRE Criminal Code. It is not something that one can assess in terms of money and the liability would be enforced either by way of imprisonment or/and fine or capital punishment depending on the degree of quilt and the gravity of danger which is introduced against the society at large. There is no open room for criminal liability insurance. A number of attempts have been made as history of insurance shows, to insure a person against the results and penalties of criminal acts, but in the main they have been frowned upon largely on the ground that they are against the public policy behind criminal law. However, civil liability involves a responsibility in material terms, i.e. a person's liability will be enforced by way of requiring the wrong feasor pay a sum of money equal to the extent of damage introduced because of his/her behavior against another person. In contractual relationship it arises from breach of contractual terms and in non-contractual chains it results from a behavior giving rise to material or moral loss against a third party. The liability may be created between to persons having no previous legal ties preceding the damage that gives rise to the liability against the person liable. Civil liability may also arise from a legal duty that should be respected such as in the area of compulsory vehicle insurance. Hence, one can see that insurance coverage applies to civil liabilities for these are risks which result in negative consequence against the economic stand of the person which is the subject matter of insurance dealing in its very inception. Therefore, insurance of liability for damages may be defined as "an insurance against loss resulting from liability for injury or damage to the persons or property of others." The maximum amount which a liability insurance company agrees to pay as a result of a single accident or injury to a single person. It is a kind of undertaking in which a risk of liability for damage to a third party inured materiality and/or physically. Such damage of the third party may be actual or future as articulated under Article 2091 and 2092 of

the civil code, for example. The damage requires the insured person to compensate the victim an equal amount in damages under Article 2090 of the same. It involves a loss to the insures insurance of liability for damages is necessitated to cover such a risk of loss which may emanate from contractual or non-contractual consequence. The consideration has the object of reimbursing (refunding) the insured. The extent of the reimbursement depends on the contents of the policy, but not greater than what the insured made to the third party. This refund is a kind of compensation to be made to the insured for the liability he/she discharged to the third party. Under the definition of Article 654 of the commercial code that apply together with Article 684 of the same one may in aggregate describe insurance of liability for damages as

> *"An insurance policy where by the insurer undertakes, against one or more premium of the insured to compensate an equal amount of money which the latter paid to a third party for a civil liability of personal or property damage against such person."*

The undertaking has the nature of bringing the insured back of his/her financial position which he/she was before making the third party material or moral damage good. It is objective is compensation for a loss due to civil liability which may arise contractually or extra contractually. Hence, insurance of liability for damaged revolves around safeguarding the insured from material loss caused because of discharging civil liability. It is not always necessary that the liability is caused due to the behavior of the insured person. The liability might come into picture because of the behavior of one of persons to whom the insured is liable like that of employees, agents, children or for the reason of owning a property or producing a material which resulted

the damage to the third party at hand as well will see the detail latter on in another consideration.

Insurance of liability for damages should be understood as distinguished from insurance of objects in that in the latter case the risk feared has the effect of diminishing the economic status of the insured resulting direct damage to the property interest against a thing upon which the insured has material benefit that can be assessed in money terms. The insurer undertakes to compensate such loss as discussed in the previous unit. Where as, in insurance of liability for damages the insurer covers not direct loss of the property of the insured, but a loss that results in expenditure of a certain amount of money from the pocket of the latter so as to cover a property or personal damage to a third party. In effect, what the insurer does is bringing the insured back to his/her financial position by way of indemnity of the loss of property or the payment made. The basic difference is of subject matter. The two kinds of insurances don’t over lap; each has its own scope of coverage though involve in compensating the insured’s loss within the limits of the policy.

4.3. Classification of Insurance of Liability for Damages

Dear distance learner, can you classify insurance of liability for damages. Liability for damages, under what categories? Insurance of liability for damages can be categorized into certain groups based on either the source of liability, the type or nature of the damage at hand.

A. Based on Source of Liability

Insurance of liability for damages can be categorized in to three groups based on source of liability.

I. Liability based on contractual obligation:- A civil liability might come requiring the insured to pay a certain amount of money to a contracting party. Such may be the case where the insured being a debtor to a certain contract, failed to duly perform the obligation. The contract may be specifically enforced under Article 1771(1) commutative with Article 1776 or cancelled under the former provision for example, but entailing damage to the creditor a damage that can be calculated in economic terms. The debtor, in either of the cases, is required to take the damage good under Article 1790 and 1971. This is a civil liability arising out of contractual legal chain. It is a kind of risk which results in loss of some amount of money which an insurance company undertakes to compensate once the insured paid to the injured contracting party.

II. Liability based on non-contractual obligation:- A certain civil liability may arise injuring a third party who is entitled to compensation of equivalent value of the kind of damage he/she encountered. Such liability emanates from one of the three possible legal grounds which may be either:

a. Liability based on fault in view of Articles 2028-2065 of the civil code on the ground of violation certain standards with negligently as a consequence of which a third party suffered property or personal damage or
b. Liability based irrespective of fault by the application of Article 2066-2089 of the civil code on the legal ground that the owner of a property, for example, is subject to liability for the kind of damage a third party faced in material or moral terms or
c. Vicarious liability in which a person is legally liable for a kind of loss a third party involves in due to the behaviour of persons answerable, like employees, to the person liable to

pay compensation for the loss as enshrined under Article 2124-2136 of the civil code.

In one of such circumstances the insured is guaranteed against one of the risk which brings material loss of payment of compensation to the third party insured. Due to such payment the insured suffers from diminish of his/her economic position which the insurer is to recover by way of making refund of the equal sum or an amount within the limits of the policy. The liability to be insured is said to be extra contractual because it stems from no previous legal tie between the person liable and the third party insured, but a certain nexus legally established as a kind of social balance of justice between certain behaviors that obtain criminal law coverage and some conducts that secure contractual shield. There is a risk of paying compensation to the third party concerned.

Insurance of liability for damages has the objective of enabling the insured to recover obtaining refund from an insurance company (insurer) through the making of insurance policy with such nature.

III. **Compulsory Vehicle Liability:**- This refers to vehicle insurance providing coverage against third party risks under proclamation No 559/2008. Under this proclamation Article 3(1), no person shall drive or cause or permit any other person to drive a vehicle on a road unless he has a valid vehicle insurance coverage against third party risks in relation to such vehicle so as to cover the extent of finance under Article 16 of the same law for the loss a person suffers paying compensation to a third party insured. The risk is such liability due to a motor vehicle accident against a third party.

B. Liability based on the Subject of Damage

Insurance of liability for damages may be classified depending on the damage which a third party may suffer posing liability on the insured. It may be one of two damages.

i. **Liability for personal damage**:- The risk which an insurance company assumes to cover might be the liability which the insured should pay to a third party who suffers from injury of his/her person as a consequence of which damage that can be assessed in terms of money occurs. Such injury may be against the body or life of such person. The material damage that such a person encounters may be loss of current or future income or the economic loss which his/her dependents might suffer due to death of this person. Since it is this risk the insurer covers in the insurance policy, we may term the insurance a coverage for liability for personal damage of the third party.

ii. **Liability for property damage**:- The injury to the concerned third party may be against his/her property interest. An injury to a property is a loss to such person and the loss should be compensated by the injured on the ground of established legal rule. It is this risk the insurer assumes to cover in case where the insurer is answerable to make the damage good in terms of money which is equal to the material loss occurred. This involves cost of the insured requiring the latter to count money and pay resulting in reduction of his/her economic position. The insurer is there to reinstate the insured to his/her economic position before he/she made the damage to the third party good by way of payment of compensation within the limits of the policy.

C. Liability Based on Kind of Damage

Insurance of liability may also be classified in to one of two categories depend on the kind of damage the third party suffers.

i. **Liability for material damage**:- The liability which the insured assumed to the third party might be the material loss resulted in against his/her property or welfare of the person. It is to say, the liability is to the damage of the third party in money terms or in material loss calculable in money. Such loss is to be made good by the insured. Then, the insurer undertakes to recover the insured from loss due to this incident. Since the insurer assumes this responsibility of restoring the insured to his/her economic position by way of refunding the loss, in can be termed as an insurance of liability for material damages. The risk to be covered is the liability to the third party.

ii. **Liability for moral damage**:- This kind of liability might occur against the insured for a moral damage of the third party due to a certain property or personal damage he/she suffers from the behaviour that gives rise to the liability. The moral damage is to be compensated in terms of money which entails certain economic loss to the insured, though minimal in our legal system. This risk of liability might be the one which takes coverage in an insurance policy. The insurer undertakes to cover the insured for the payment the latter may be required to cover and paid accordingly. Hence, on such basis, one may distinguish the kind of insurance for a liability to moral damage.

Dear distance learner, may you device other grounds of classification on some other bases? Would you try to look for such extra grouping?

4.4. Insurable Interest in Insurance of Liability for Damages

The insurable interest in each category of insurance differs from the nature of risk which requires coverage under a particular insurance policy. Hence insurance of liability for damages has its own specific focus of risk assumption and undertaking based on the interest at

stake due to the probable future occurrence of a certain fact giving risk to loss in economic terms. Because of the distinctive risks associated with opportunities for net gain from receiving insurance proceeds, insurers ordinarily wish to make contract only with or for the benefit of persons who have an interest in the subject mater of the insurance. The making of the contract is only to pay benefit not in excess of the interest the person or persons with whom or for whose benefit they are agreeing to make payments if the described fortuitous event occurs.

Accordingly, the risk that involves in insurance of liability for damages is the answerability of the insured to a particular third party to cover material and/or moral damages. This requires, as has been tried to be explained earlier, some amount of payment of compensation which is equal to the injury that third party sustains. The liability may stem from either because of the fault of the insured, because he/she owns a property, because he/she is employer, father, guardian, because of a product by the insured, etc. Such attachments involve in a certain probable risk causing a loss in economic terms against the person liable since the reading of, for example Article 2090-2092 of the civil code dictates the requirement of making the respective present or future damage good by way of compensating the victim of the injury with equal value of the harm. Because a person, due to his/her contractual or extra-contractual legal chains, might involve in such undertakings as introducing damage to a third party, there would be a legal obligation to bring the latter into the possible previous position. This is the risk that should be taken care of under a risk management device and insurance is appropriate machinery. Consequently, the insurer makes a contractual agreement with the insured subject to such a kind of risk with a view to cover the loss upon the occurrence

of the peril which may be accident or involving fault of the insured depending on the circumstance of the case.

Let’s see certain instance of extra-contractual liability risks under the civil code. Article 2085(1) of the civil code stated that a person who manufactured goods and sells them to the public for profit shall be liable for any damage to another person resulting from the normal use of the goods. The provision refers persons who involve in producing goods for public consumption. Such persons often produce items and supply to the public. Without any fault of the dealers, the manufactured goods may affect the health of incalculable consumers even under normal uses. The cause may be beyond the control of the manufacturer like that of climate change resulting in contamination of, for example, packed industrial products like foods. The damage against the third party consumers may begin with medical expenses up to short term or long term economic losses either against him/herself or his/her family in case where the person dies because of the product. It implies a greater loss for the manufacture since the stated liability when calculated in money terms involves a greater risk. This is because the same law requires the manufacturer to cover the damages equal to the value which the victim(s) suffered from the injury by virtue of the relevant provisions as 2091-20912 of the civil code. The indemnity which the manufacturer should pay to the third party victims highly touches the economic position of the manufacturer. Hence, the latter encounters such a risk in his/her undertaking which keep future uncertainty, indicating probable future economic loss. This loss revolves around affecting the interest of the injured negatively. There is a high risk of involving in liability to pay damages to third parties who may consume the products. This is coverable under an insurance policy of liability for damages in which the insurer undertakes to indemnify the insured with equal amount of

money which the latter made to the third party or an amount determined in the policy not greater than the actual loss. The liability to the third party is the insurable interest which the insured has to claim from the insurer. The same is true to other losses due to related liabilities based on the applicable law either motor vehicle accident, liability for the fault of employee and the like.

The question of whether liability based on fault involves insurable interest requires discourse. The need to raise the issue comes into picture because of the application of Article 663(3) of the commercial code that articulates, “Notwithstanding any provision to the contrary, risks arising out of intentional default of the beneficiary shall not be covered by the insurance.” This is a manifestation that an insurance policy can not be made for a covering a risk of liability that might be caused by intentional act of the insured. For example, a person may involve in an act that falls under the spirit of Article 2035 of the civil code resulting in damage against a third party by way of infringing a particular law. The act is intentional. Would the insurer cover the liability of the insured in such a case? The question, in other works, revolves around the issue of whether civil liabilities of extra contractual nature based fault are coverable under an insurance policy or not?

Fault resulting in extra-contractual liability is stated as consisting of either intentional act or mere negligence, under Article 2029 of the civil code. The activity may result in damage to a third party who is entitled to claim compensation from the tort feasor this shows that it is not only intentional conducts but also negligent exposures which are considered to constitute fault for the purpose of establishing extra contractual liability, a risk which entails material loss. Intentional behavior are described as standing against the public safety and

penalized under the public law regime of criminal law and private law dichotomy, for example, of the commercial law Article 663(3). Therefore, the insurability of liability based on intentional fault under the ambit of Articles 2028 of the civil code and the subsequent provisions must be seen in light of the application of Article 663(3) of the commercial law which provided the need to cover behavior which is not contrary to good faith. Intentional behavior of the person insured is assumed to be contrary to the standard of utmost good faith that is expected of parties to an insurance contract. Therefore, civil liability, i.e. a risk of paying compensation to injury sustained by a third party, must not be accelerated by the person insured so as to get coverage under an insurance policy. This particularly refers to intentional fault that gives rise to civil liability. Thus, one can see that insurable interest in liability insurance is to the exclusion of intentional faults due to the application of Article 663(3) of the commercial code. But liabilities based on the negligent conduct of the insured under Article 2029(1) and the relevant provisions of the civil code together with Article 663(2) of the commercial code are interests insurable which an insurance policy should cover. Remember the discussion in unit two about the behavior of the person insured in relation with coverage of risks. The assertion in short is to underline that the insurer will not be liable to cover the payment made by the insured to a third party for the damage by such party by the intentional fault of the insured under extra-contractual regimes. But this applies to the inclusion of coverage of liability of the insured for his/her fault made negligently.

4.5. Compulsory Motor Insurance in Ethiopia

This insurance refers to vehicle insurance against third party risks. The third party risks are those having the nature of creating liability

of the insured to a third party injury by a vehicle. There is a recent law regarding the issue under Proclamation No 559/2008 which entered into force on 9th day of January 2008. It is enacted on the premise or background of the escalating day by day occurrence of vehicle accidents resulting in loss of the lives, bodily injuries and damages to properties of persons creating social problems. The proclamation has the objective of establishing a system for facilitating the provision of emergency medial treatments of victims of vehicle accidents, and compelling owners of vehicles to have third party insurance coverage against third party risks. It is a kind of compulsory regime of covering risks requiring owners of vehicles to enter into insurance policy that covers the risk of liability for damages of third parties by vehicle accidents. Hence, it can be termed as the law that provided additional rules to the exiting commercial code provisions governing insurance of liability for damage. It is a compulsory regime or risk management device under the umbrella of the latter

4.6. Compensation in Insurance of Liability for Damages

It has been stated earlier that insurance of liability for damages is for devising a mechanism of compensation to be covered by the insurer to the insured for the payment made by the latter as a consequence of any personal or property damage of a third party victim. The system has its own procedures of making the claim for compensation and providing the insured with the necessary facility for reinstatement into his/her position before the loss.

4.6.1. Conditions Precedent to Claim Compensation

A. Notice of Occurrence of Risk

When the risk insured materializes and loss has been sustained the liability of the insurer would normally mature and the insured would be entitled to the payment of the amount loss according to the terms of the policy. However, as explained in unit two, the right of the insured to demand such payment can not be enforced until he/she has performed certain duties imposed upon by law or the policy terms, the due performance of which is taken to be the necessary precondition to the liability of the insurer. Thus, a contract of insurance usually requires the insured to supply the insurer with a notice of loss and there is no exception to insurance of liability for damages with this regard. Notice of loss is communication to be made by the insured to inform the insurer that the risk insured has materialized. The requirement is set on the purpose to afford the insurer an adequate opportunity for investigation of the causes of the loss at the earliest possible time and enable it to form an intelligent estimate of its rights and liabilities to pay. The duty of giving notice of loss seems to exist apart from any stipulation in the policy, seeing that the fact of the loss is one which the insured, having control of the subject matter, must be assumed to know, whilst the insurer can not reasonably expected to have any private knowledge whatever the state or condition of the subject matter at any particular time. The duty of good faith imposes the obligation of giving notice so that the insurer may be in a position to take the necessary steps for ascertaining the causes and extent of loss. It is also a legal requirement as discussed in unit two, under Article 670(1) of the commercial code that the beneficiary shall inform the insurer any occurrence likely to render the insurer liable. The exception is the ability of the insured to make it possible for a situation beyond his/her control.

Usually notice of loss is made while the insured fills claim notification form which at the same time is used to state the particulars of the

loss. The purpose of the notice is to acquaint the insurer with the happening of the loss and as far as the notice of loss is sufficient to accomplish its object, the fact that the insurer received actual notice of loss is more important than the manner in which such notice is given. Therefore, unless a written notice is required by the policy terms, the insured may use every convenient method to give due notice. Accordingly, the notice need not be in writing, it need not be given by the insured him/her self and need not be given to the insurer personally, can be communicated through telephone or by letter provided it made within the time prescribed. However, the insured is required to deliver particular of the loss which includes stating its cause, nature and extent. The particulars must be given with such details are reasonably practicable.

B. Proof of Loss

The insurers are usually empowered, by stipulation in the policy, to call on the insured to prove that the loss is covered by the policy and to verify the particulars given by such documentary or other proofs as they may require. It is a condition precedent to the liability of the insurer. In requiring proofs, however, or in deciding whether the proofs given are sufficient, the insurers can not act capaciously, unreasonably or unjustly, by requiring evidence which is not necessary to satisfy it on any reasonable view of the case. It is sufficient if the insured lays before the insurer evidence with which reasonable man would be satisfied, and it is unnecessary to show that the insurer has been in fact satisfied.

C. Effect of Non-Compliance with the Condition

Non-compliance of with the conditions of notice and proof of loss may emanate from escaping the time requirement or the fraudulent behaviour of the insured. Since it is the duty of the insured to observe

utmost good faith in his/her dealing with the insurer throughout, the claim which he/she puts forward must be honestly made, and if it is fraudulent, he/she will forfeit all the benefits under the policy whether there is a condition to that effect or not. The insured must make a full disclosure of the circumstance of the case, for example under Article 668 of the commercial code. There is usually an express condition in the policy to the effect that if the claim is in any respect fraudulent, or if any fraudulent means or devices are used by the insured, or any one acting on his/her behalf, to obtain any benefit under the policy, all benefits under it is to be forfeited. It is immaterial, therefore, whether the fraud affects the whole or only part of the claim though at the same time it must have some relation to the claim itself.

4.6.2. The Settlement of the Claim

When the insurer accepted liability for the claim put forward by the insured, or has been forced to do so as a result of a legal action brought against it or as a result of an arbitration award in favorer of the injured, it is under a duty to pay. The insured is, however, not entitled to payment until such time as the amount recoverable has, or ought to have, been ascertained. The policy usually contains an express condition that no claim shall be payable until all requisite particulars have been furnished. With this regard, the commercial code provided certain prerequisites that require consideration before the insurer is urged to pay the sum which the insured is legally entitled to get coverage. Article 685 provided that the insurer who insured a liability for damages shall not pay compensation until a claim is made against the insured person with a view to amicable or judicial settlements. It is a precondition that the third party injured should approach the insured and require compensation for the damage.

The action of the third party might be for a settlement by agreement or bringing the matter before the attention of a court of law. The provision seems to stay the insurer far from the matter until the third party takes action against the insured. What about the right of the insured to joint the insurer, for example, as a defendant as recognized under Article 43 of the 1965 Civil Procedure Code? What if the insured paid the required inevitable compensation to the third party voluntarily without the latter claiming it circulating the damage? Has it the consequence of forfeiture of demanding compensation for such loss from the insurer? The provision seems to create some practical problem and it should be applied in such a manner that enables the third party get recovered from the injury and involving the insurer in court litigation consistent with the dictation of the civil procedure code in a manner that assists the attainment of justice.

The other precondition in setting claim between the insured and the insurer in instance of liability for damages is the requirement that the insured person should make the damage good to the third party insured so the he/she can require coverage from the insurer under Article 688 of the commercial code. It reads,

"1. No insured person shall receive compensation until the third party injured has been paid to the extent of the amount insured.
2. Any stipulation contrary to the provision of this Article shall be of no effect."

This is a very important provision that the purpose of insurance of liability for damages is to cover the insurance of liability for damage is to cover the insured from the loss which he/she might have suffered from paying compensation to a third party injured. Unless the insured

makes the damages of the third party, he/she involves in no loss. It is only if the injured proves that there is a material loss his/her part that the insurer covers. The risk insured is the liability. It may be argued that it is not sufficient that an incident materialized giving rise to liability of the insured to the third party concerned. The injured should at the same time show that he/she involved in loss because of a kind of advance he/she made in material terms reinstituting the third party to the possible position he/she was before the injury. The principal concern of the insurance policy is not to see whether the third party is compensated or not. Such third party may indirectly obtain from the insurer, the benefit of immediate payment from the insured who has a subsequent back up from the particular insurer.

However, one critical question may be raised to the point of view of the capacity of the insured to pay compensation to the third party. What if the insured has no means to make the damage of the third party good? can not he/she require the insurer directly pay to the third party? Does not it avoid circular claims of compensation from the insured to the third party and from the insured to the insured? Is that not a settlement to the third party incidentally? What is the problem if the insurer pays directly by the claim of the insured proving the liability? Does not it fit the purpose for which the policy is necessitated? Does not it serve a social purpose by reinstating the third party to the position expected timely? The provision should be seen in light of answering such questions. The issue is whether the purpose of the insurance policy is insurance of liability for damages is to ultimately insurance of liability for damages is to ultimately relieve the insured from a kind of loss out of a liability to third parties or not? If the answer is in the affirmative whether the third party is compensated by the insurer or directly by the insured has not change in the liability of the insurer the insured to the extent agreed in the

policy. It would be purposeful (if the) provision is seen in light of such utility. Still the parties should be given the right to create such arrangement in the policy practically, insurers pay directly to the third party within the limit of the amount of coverage agreed in the policy.

The problem attached to Article 688 is not an issue is compulsory vehicle insurance of liability for third [arty damages for Article 6(2) of proclamation 559/2008 implied that the insurer could possibly pay compensation for damage directly to the third party injured. It reads,

> *"Nothing in this sub-Article (1) of this Article shall be deemed to render void any provision is any such policy requiring the person insured to repay to the insurer any sum which the latter may have become liable to pay under the policy, and which have applied to the satisfaction of the claims of third parties."*

Still the requirement of involving the insurer in proceedings between the insured and the third party is provided under Article 650 of the commercial code making admissions of liability or compromise by the insured without the consent of the insurer will not imply liability against the latter. This strengthens the above argument in favour of direct coverage of compensation by the insured to the third party. The insurer and the insured can agree a term that the former get opportunity to involve in direction of civil case originating from a claim brought by the party injured under Article 687(1).

Having passed through such possible purposeful considerations, the risk should be coved by the insurer in such a manner that attains the purpose of keeping the insured to the economic position before the occurrence of the risk of liability to a third party within the limits of

the terms of the policy for insurance of liability for damages. That is to say, the extent of compensation to the injured by the insurer should be equal to the liability he/she involved in or less than that based on the limit in the policy. However such extent of liability of the injured in compulsory insurance of vehicles for liability to third parties is limited to a certain coverage as articulated under Article 16 of the proclamation. It states,

"1. The amount of compensation due to damage caused by an insured vehicle shall not exceed.
    a. Birr 40,000 in case of death
    b. Birr 15,000 incase of bodily injury
    c. Birr 100,000 in case of damage to property
2. Any person who alleges to be entitled to compensation above the limit provided for under Sub-Article (1) of this Article shall have the right to claim the same from the insured person in accordance with the relevant laws."

The mode of compensation in liability insurance often takes the form of cash reimbursement for the law requires making the damage good with equal amount of the loss which the third party suffered from either the injury against the person either bodily injury or death or the property.

4.7. Subrogation in Insurance of Liability for Damages

Dear distance learner, do you think the principle of subrogation applicable to insurance of liability for damages, in what cases? The principle of subrogation is a known concept that apply to insurance contract and there is no exception to insurance of liability for damages provided that the circumstance permits. One might think the application of the principle in the area typically for third party

liabilities which arise from the answerability of the insured to other persons specifically employees as the case of the application of Article 2921 of the civil code which shoulders liability upon employers to compensate damage to third parties for the injury which is caused by employees and agents. Insurance policy of liability for damages, includes such answerability covering such risk of liability to third parties of the insured. The question is whether the insurer replaces the footing of the insured once after it covered the compensation with view to claim payment from the person who caused the injury to the third party posing obligation upon the insured. The civil code provided a rule that the employer who is answerable to a damage for an injury introduced by an employer or agent in discharge of a function under Article 2131(1) can latter on claim from the employer or the agent the recovery of the payment it made to the third party by the application of Articles 2128 and 2126(2). This is the right which the insured can exercise and the insured after making the compensation true to the insured can take the footing of the latter and require the person causing the damage to cover the payment it made in the form of compensation. It is to say that the insurer can subrogate the insured and exercise the right enshrined under Article 2128 and 2126(2) of the civil code against the employer of the agent to whom the insured is answerable with a view to recover the amount of money it paid in the form of compensation. The issue of what if the insured made the situations of subrogation impossible may obtain response by way of analogical interpretation of the law that apply to insurance of objects for there is no specific provision to this effect in the commercial code. If we take such a position and apply Article 683, we might say the injurer relieves itself of liability in case where the insured made things inconvenient disabling the insurer to substitute itself for the beneficiary for the purpose of recovery from the person who is responsible for the damage to the third party in the transaction.

4.8. Unit Summary

Dear distance learner, insurance of liability for damages is discussed as a kind of insurance which concerns covering a risk of the insured's liability for third party damages of either bodily injury or death or property it may be classified into different categories depending some backgrounds either the source of liability either contractual, extra-contractual or compulsory requirement of the law, or based on the subject of damage either person or property or depending on the kind of damage the third party sustained either material or moral. Hence, the insurable interest in insurance of liability for damages is the loss which the insured possibly involves in due to payment of compensation to the injured third party. Accordingly, the policy aspires to bring the insured into the previous position by way of compensating the payment he/she made or to make to the third party injured. As part of insurance of liability for damages, a recent Proclamation No 559/2008 is provided with a view to compel vehicle owners to enter into contract of insurance to cover damages of vehicle accidents of third parties. Under this law, all vehicle owners are under duty insure themselves against a risk of vehicle accidents harming third parties. It provided different systems of backing the matter for example, establishing "Fund" system to enable the injured obtain emergency medication in any health institution, among others. In case where the risk materializes, the insured should give notice and provide proof of loss enabling the insurer discharge its duties duly in light of the policy. Once the insurer accomplished its duties to the insured can substitute for the better with a view to require the person causing the loss pay the damage. This is termed as adherence to the principle of subrogation, one of the guidelines in insurance business.

4.9. Check Question

1. How do you describe insurance of liability for damages?
2. What is insurable interest in insurance of liability for damages?
3. Classify insurance of liability for damages on different bases.
4. What do you think is the objective of Proclamation 559/2008?
5. Explain the preconditions to enforce insurance of liability for damages.
6. Liability to third parties due to the fault of the insured is a risk to be covered in insurance of liability for damages. Evaluate the legality of the statement.
7. Discuss subrogation to the view point of insurance of liability for damages.
8. Why do you think is the reason for exclusion of criminal liability as a risk to be covered under the regime of liability for damages insurance?
9. Distinguish between contractual and extra contractual liability insurance coverage?

Unit Five

Insurance of Persons

5.1 Unit Introduction

Dear distance leaner, now you are in the last part of this body of the module. It deals with insurance of persons that regards coverage of material injury up on the occurrence specified risk. Though life is not calculable in material terms, such nature doesn't preclude it form the realm of insurance for a certain risk against for example, the body or the life of a person may result in material injury up on the person him/her self or his/her dependants in case where the effect of the injury is death. Consequently, insurance of persons involves its own meaning scope and nature which is given the first coverage in the present unit. A brief discussion is made bout the main distinguishing points of insurance of persons with other forms of insurance like insurance of objects and insurance of liability of damage. Insurance of persons also involves in certain categories depending of the kind of risk covered in the insurance policy. That classification is given consideration as the distance learner go through the details of their material. What constitutes insurable interest is also given place telling the students about the nature of protection desirable in the area of the subject matter. The issue of who is the beneficiary of life insurance policy with the problems in practically applying the relevant law is addressed. A critical insight of the learners is required in this area, particularly, about the application of Article 701 of the commercial code. Claim related matters are also covered with the question of whether the principle of subrogation is operative in insurance of persons. Final remark in a summary statement with the subsequent self check questions drive the students back to the total deliberation of the unit. Possible in- text questions and activities are

provided as well in the due course of addressing point in the area. The main reference is Chapter Four of Title III of the commercial code that includes Articles 689 -712

At the end of the unit, the distance learner will be able to:-

- Define insurance of persons,
- Identify the nature and determine the scope of it nature,
- Explain some categories of insurance of persons,
- Distinguish between of the insurances and insurance of persons,
- Explain insurable interest in insurance of persons,
- Decide on the beneficiary of insurance of persons,
- Answer questions that refer to claim of enforcement of polices,
- Give practical solutions to arisen cases in connection with the subject matters, among others,

5.2 Meaning, Nature and Scope of Insurance of Persons

Dear distance learner, what do you think it constitutes by insurance of persons? Insurance of persons is a kind of insurance engagement confined on the welfare of a person him/her self. It may matter during life coverage or there after the person dies. The policy depends on the life or death of the person or a kind of injury against the body due to risk stated in the policy. It regards neither the property interest not a kind of liability he /she owes to a third party. But the subject matters is the insured person him/her self the personal welfare. It is not possible that personal welfare is calculable in money terms. But legally devised enabling an insurer and the insured to fix an amount payable to the beneficiary upon the occurrence of the particular risk

envisaged in the policy. As the body of insurance of persons, life insurance is substance defined by decision or statute as contract, whereby one for a stipulated of consideration, called premium, agrees to pay a certain sum of money upon the happening of a given contingency which is death of the insured under the ordinary contract and is the termination of specified period under a contract in which the endowment feature is incorporated. It is in other cases, said

> “ A life insurance policy may be defined as a mutual contract whereby the insure in consideration of the payment to it by the inured (or by some owe in his behalf) of a certain premium or premiums conditioned as to amount by the life expectancy of the insured as measured by mortality tables and as usually conditioned by the insured’s state of health as revealed by medical examination assumed an immediate hazard to loss to itself and creates for a third party beneficiary an immediate estate in a fixed amount by agreeing to pay a given sum, which may be greatly in excess of the premium actually paid, upon the happening of a particular event, i.e. death which in turn is contingent up on the duration of the life of the insured”

A life insurance policy is not a contract for indemnity in the strict sense, and in the case of fire, burglary, flood, etc insurance, but a contract to pay a sum of money in the event of the specified risk such as death against the person’s the person it is generally considered as a evolved policy but not as a property subject of assessment in money terms. Article 689 of the commercial code typically addresses the nature of insurance of persons stating it” A contract for the insurance of persons shall not be deemed to be a contract for compensation. The amount insured may be freely fixed

and shall be due regardless of the damage suffered by the insured person”

This is because of the nature of the interest to be protected as one can also see form the readings of Articles 691 and 711 of the same as inclusive of the life or death or bodily injury due to accident or illness of the person inured Article 691 defined life insurance as

> “A life insurance is a contract whereby the insurer undertakes against the payment of one or more premiums to pay to the subscribe or the beneficiary a specified sum on certain conditions dependent up on the life or death of the subscriber or third party insured.”

The policy refers the particular risk to recovered in the insurance policy regards the death of the person or a peril during the life time of the person the occurrence of which entitles a specified beneficiary in the policy a sum of money freely fixed irrespective of the extent of damage suffered by the insured person. The other provision that regards insurance of persons is Article 711 which defines insurance of accidents and illness stating,

> “An insurance policy against accident is contract whereby the insurer undertakes to pay a specified sum of the insured person where the injured person is the victim of an accident during the period specified in the policy or to the beneficiary named in the policy, where the insured person dies. It includes insurance against illness”

This another manifestation that the risk to be covered in the insurance policy is a particular peril that may result in a hazardous effect upon the insured which may bring a particular injury to the insured him/her self or a specified third party. The commercial code adopted a broader definition.

It is to show that insurance of persons refers the person as the subject matter of policy which operates dependent on the life, death, illness or bodily injury of the insured. The undertaking is not of a nature that implies compensation but coverage of a certain damage fixing agreed amount money which is to be determined flexibly. Hence, the subject matter is a human person's welfare, the nature is contractual but not of indemnity and the scope is the kind of risk on the life either death, illness or injury of the person to be covered with payment of sum amount of money in the form of back up to the damage by the insured him/herself or a third party beneficiary who might be dependent of the insured.

Hence, insurance of persons is distinguished from other natures of insurance such 'a' property insurance which is indemnity of a property damage due to the occurrence of specified risk like fire compensating the insured with some amount of money fixed in the policy which usually is equal to the material loss but sometimes it may be less than that as determined in the policy (b) insurance of liability for damages which regards making refund by the insurer to the insured for the payment he/she made in the form of compensation to the third party injured . These two forms are measurable in terms of money and have equal value which is not true in insurance of persons. Subrogation is possible in these forms of insurance policies as discussed in the previous units whereas it is not possible in insurance of persons under Article 690 of the commercial code. There is a subject matter difference coupled with nature of risk coverage. Other detailed differences could be identified in the due deliberation of the matter in subsequent discussions.

5.3 Classification Insurance of Persons

As stated earlier, insurance of personas may be categorized in to different classes based on the nature of the risk covered.

A. life insurance: - this policy depends on the a risk on the life or depend on the contingency that the insured is alive on a specified date as can be seen from the reading of Article 692 (1) of the commercial code which articulated that insurer who enters in to life insurance undertakes to pay a specified capital or life interest provided the insured person is alive at the date fixed in the policy. This is a clear indication to establish life insurance policy that it is not necessary that the risk covered should only be death. Life insurance may depend on the death of the person as can be understood from (2) of the same provision which reads that the insurer who enters in to an insurance of the event of death undertakes to pay, on the death of insured person a specified capital or life interest to those having rights from the insured person or the beneficiary named in the policy. A combined is policy also possible under sub (3) of Article 692 (3)

B. insurance against accidents and illness: - This depends on an undertaking that regards payment of sum of money fixed flexibly dependent on accident or illness that caused injury the insured. It is an insurance policy contingent on the life of the person, not any other think. The risk may be accident, death, illness and the like. The occurrence of such contingency results in payment of the sum fixed by the insured to the beneficiary as an undertaking of the insurer.

5.4 Insurable Interests in Insurance of Persons

It is stated earlier that insurance of persons is not an insurance of indemnity and the subject matter is the inured him/her self. Then,

dear distance learner, what constitutes insurable interest in the area of consideration? Human life is about so many things. The welfare of one depends on the welfare of another like the case of children upon a parent. There might be accident against the person which introduces resultant entailing limitation on the proper working capacity of the person that may be accident with the effect of permanent or temporary disability. A person may also involve in a risk of illness which requires cost. These all and other related factors may have drastic economic implication upon the insured or his/her dependents either spouse, ascendants or descendants based on the circumstance of the person. It is such a material loss that gives rise to insurance of persons. That is to say, behind the welfare of a person insured, there exists a certain contingency that imply economic consequences up on the insured him/herself or some other person who might have interest on the welfare of such a productive person for example.

It is referring that material interest the subject matter revolves around given shield to the concerned persons behind the particular risk which may result in the specified loss. Insurable interest in insurance of persons rests on such contingency. The kind of peril feared to probably occur may be death or something else against the referred person in the concerned insurance policy. It is an important insurance business and there is no exception to insurance of persons for there is a referred risk and probable material damage to person. But there are exclusionary rules on certain risks like the death of the insured due to suicide as articulated under article 699 of the commercial code. Save in such and other related exceptions, there is a need in insurance of persons to show the existence of insurable interest in the subject matter. For example, a public servant of 30 years of age with

average salary has insurable interest to be covered in a policy of life insurance for his death due to his tow minor children with respective age of 3 and 5. The life of such person has material benefit to the proper upbringing of his children and his death involves a negative consequence. He can enter in to an insurance policy to safeguard such interest to his minors incase of the peril called death, a risk insurable the occurrence of which matures the policy concerned.

By the same token in insurance of illness, the insured has insurable interest which can be calculated in money term in case where the risk covered is occurred. The subject matter in such insurance of is the health of the insured. Health might be affected by a particular peril referred in the policy. The insured needs to get recovered from the peril by way of medication which required coverage in material terms, i.e. the medical treatment requires cost. Such cost is the insurable interest which the particular insurer undertakes to cover. The same is to all other risks in insurance of person resulting in coverage in material terms.

The law typically addresses the nature of coverage but not in the form of compensation. It is doesn’t prohibit addressing the problem in money terms.

5.5 Conditions in Life Insurance Policy

Any insurance policy should detail the particulars specified under article 658 of the commercial code an exhaustive discussion is made about the matter in unit two of this part of the module. Life insurance policy, in addition to these particulars, should contain statement that show.

a. the name, surname and the date of birth of the insured person,

b. the name and surname of the beneficiary if specifically referred,

c. the occurrence on which the payment of the agreed amount depends

d. the manner of calculating any reduction in the value of the policy or the redemption value, as particularly required

Under article 695 it is very important that insurance policy of life must particularly refer the person insured for without the specification of such person either the contract is made between him/her and the insurer or between a third person and the insurer as stated under Article 693 is very important in the sense that insurance policy operates depending on the particular reference of the subject matter since it is the person him/her self to be referred as object of the policy, Such particular specification should be seen in the policy so that the risk to be covered in the undertaking can be determined that its occurrence protects the interest at stake. In addition to this, in case where the beneficiary indicated, his/her identification should be stated in the policy. This is to enable to insurer make the courage possible in the event of the risk, to the relevant person. But, the distance learner should remember that the beneficiary may not be stated in light of the application of Article 662.Further, the nature of risk sought to be covered in the policy is required to be stated in the policy. This is a very important element that the duty of the insurer can surely be known only if its obligation (the object of the contract) is clearly indicated referring the particular peril that may give rise to the claim of enforcement of the policy.

The third requirement in the particulars of life insurance policy refers the need to address the nature of the risk which the insurance policy covers. Life insurance policy, except for death of the inured, can be subject to redeem at any time after three annual premiums have been paid for a value to be determined by the policy by virtue of Article 710.It is about recollecting the policy form the injured by the insured. This is one of the reflections that insurance policy of life is considered to be a property incorporating real rights exercisable.

An insurance policy for life is said to be embracing a property right over an incorporeal thing recognized in article 1128 of the civil code specifically stated under article 697 of the commercial code which reads, “ A life insurance policy may be pledged by annexing a schedule to this effect to the policy or by endorsing a policy to order (as stated in Article 696 of the same) or in accordance with Article 2866 of the civil code.” Pledge is a security device recognized as safeguarding the proper performance of a particular contract by way of subjecting a movable property both corporeal and incorporeal standing guarantee to the concerned creditor. This is another clear manifestation that an insurance policy of life is a movable thing against which a person concerned can exercise right in rem. Recall your property law studies about right in rem. Being a right up on which a particular person can exercise, insurance policy can be assigned, pledged or endorsed which life insurance policy requires the written agreement of the insured person in accordance with article 698.

As a condition precedent to the validity of an insurance policy for death a person incapable of involving in juridical acts, i.e. in capable of exercising rights and duties under the civil law is simultaneously

incapable to enter in to insurance contract. The rule that applies to general contracts applies to insurance contract that an undertaking assuming obligations and attaching rights to an insurance policy such person is invalid. Article 694 addressed the matter stating,

> “An insurance policy made for the event of the death of incapable person shall be of an effect not withstanding that the incapable person or his representative agreed to the insurance. The policy may be cancelled by the application of any interested person party and all the premises paid shall be refunded”

One can recall the consistency of this provision with the objective behind the need to protect the4 interest of minors and judicially interdicted persons under the relevant provisions of the civil code and the Revised Family Code, typically the making of wills by such persons is imputable and the tutors have no authority to perform such acts. The same justification applies here for the consumption of entering in to life insurance policy for the death of such person.

Dear distance learner, remember also the discussion on the possibility of the making of insurance contract by unauthorized third party on behalf of the insured whose later acceptance is necessary for enforcement of the policy in case of occurrence of the risk insured and for the purpose of claiming premiums. The same rule applies to life insurance policy but with additional requirement of the need to obtain the simultaneous consent of the spouse of the person insured. The latter requirement is necessitated so as to prevent the possible negative effects of compromising the interest of the concerned spouse in formulating the insurance policy entailing a consequence with regard to

payment of the premium and designation of the beneficiary of the policy who can collect the economic utilities behind the insurance. Once the beneficiary accepted policy it is irrevocable. It can, however, be revoked before such time by virtue of Article 703.

Non– payment of premium has two possible alternative consequences:

1. Stay the policy reducing the capital or life interest in case where at least three annual installments are paid but less than what should be annually covered under sub(3) of Article 709 if full payment is not made despise one month notice or
2. terminate the policy in case where less than three installments are made and still the insured is not in a position to pay though given one month notice by virtue of sub (2) of the same provision.

5.6 The Beneficiary of life Insurance Policy on the Death of the Insured

Dear distance learner read Article 701 of the commercial code give particular emphasis to sub (1) and (2) and determines the beneficiary. The issue revolves around whether the spouse and children of the insured should be beneficiaries despite there is no specification as such in the policy ? What is the need of sub 1, how the provision operates consistent with Article 827 of the civil code? The issue divided jurists and courts and there is exhaustive deliberation of one scholar on the area as published in Journal of Ethiopia Law Volume XVI, on pages 67-80, November 1993. The full text is provided as follows. First you read the decisions and then the excerpt later on.

The High Court of Addis Ababa

First Civil Division

Civil case No, 6022/73

Designation of beneficiaries in a life insurance policy for the event of death - Rights of heirs- and the surviving spouse - Assignment or pledge of proceeds of a life insurance policy-Persons having rights from the insured- Application of the rule “stare decisis" -Consideration of the best interests of minors-indispensable parties " mandatory joinder of parties-Suits by paupers. Comm. C. Arts. (692(2), 698, 701, 706, 707 Civ. Prov. C. Arts. 40(2), 467.

Action by a designated beneficiary to be entitled to the whole proceeds of a life insurance policy.

Held: Action dismissed

The fact that the spouse and children of an insured person have been· expressly included in the Commercial Code of Ethiopia as beneficiaries of a life insurance policy shows that they are equally entitled to the proceeds together with the designated beneficiary.

Tikemt 25, 1976

Ato Tilaye Tegegn

Judge:

Plaintiff:

Defendant:

Interveners:

Wro. Tisgercda Wolde Selassie

The Ethiopian Insurance Corporation

1. Wrt. Sara Tekle Haimanot

2. Wrt. Mehret Tekle Haimant et. al.

The court renders the following judgment after examining the case at hand.

Judgment

In her statement of claim dated Tahssas 27, 1973, plaintiff pleaded that:

On the basis of the request contained in a letter dated Yekatit 21, 1973, a life insurance policy No. 30480 was signed between her late husband Ato Tekle Haimanot Wolde Gabriel and the Defendant on Megabit 14,1973;

The insured designated her as the beneficiary of the policy under item 15 in accordance with Art. 660(1) of the Commercial Code of Ethiopia The defendant refused to pay the agreed sum in the policy, i.e., Birr 20,000 (twenty thousand) when she claimed it after the deceased passed away on Yekatit 10, 1974; and prayed that the defendant be ordered to effect payment of the sum in the policy as per Art. 706 (1) of the Commercial Code.

When summon was served on the defendant, it presented a statement of defence dated Yekatit 21, 1973 and admitted its liability on the policy under consideration.

The defendant, however, argued:

While plaintiff claims the whole sum on the basis, of the policy and Art, 701(1) of the Commercial Code, the heir, of the deceased. Who

have produced a duly probated certificate of heir ship from the Addis Ababa Awraja Court, contend that they should benefit from the proceeds of the policy according to Art. 701(2) (11) of the Code:

In a similar case the High Court affirmed the payment the Corporation made to the heirs of another insured under Civil Case No.1133/69 while the Supreme Court quashed the judgment under Civil Appeal Case No., 749/70 and ordered it to pay the sum stated ,in that policy for the second time to the designated beneficiaries,

Accordingly, defendant pealed that the heirs of the deceased he joined in this proceeding as indispensable parties under Art. 40(2) of the Civil Procedure Code, as it is confused as to whom it should pay. It further expressed its willingness to deposit the sum in the policy with this court so that payment he effected when the beneficiaries are ascertained.

After the plaintiff gave her reply to this argument, this court ruled, on Sene 9, 1973, that the heirs of the deceased he parties to the' proceeding. The amended statement of claim, which was no different in substance from the initial one, was served on 'the interveners.

Four of them namely Mehret Tekle Haimanot, Amanuel Tekle Haimanot, Meaza Tekle Haimanot and Nebiyu Tekle Haimanot submitted a reply on Tir 9, 1974, In this reply written by their attorney they disclosed that they do not claim the sum under litigation because they have now learned the Proceeds of the insurance policy does not constitute part of the estate of their father.

The other heirs, Sarra Tekle Haimanot, however, brought a different argument in a statement written by her pleader on Tikemt 8, 1974. She stated that Art. 701(1) of the Commercial Code does not entitle the plaintiff to be the sole beneficiary because the subscriber's heirs

are equally entitled under sub article 3.

The plaintiff, who claims full payment, presented extensive legal arguments, including:

1. It is not possible to specify any beneficiary in addition to the ones designated in the policy without the consent of the subscriber, Ato Tekle Haimanot Wolde Garbriel, and this is stated under Art. 698 of the Commercial Code.
2. The word "or" in Art. 692(2) of the Commercial Code implies that if there are designated beneficiaries, payment should only be effected to them - otherwise. the word "or" should have been "and".
3. The statement that says the sum to be paid to a specified beneficiary shall not form part of the insured person's estate under Art. 706(2) of “the commercial Code and further the other statement that reads the sum to be paid to the subscriber's spouse is to be regarded as the personal property of the spouse" in Art. 706(3), show that the benefit from a life insurance policy must be given to the spouse or children in accordance with Art. 701 (2). Provided no beneficiary is designated in the policy as per Art. 701 (2).

Through her lawyer, Sarra Tekle Haimanot, on her .part, responded to this argument in t he following manner.

1. What Art. 698 of the Commercial Code provides is that only the insured himself or one who obtains his consent may assign or pledge the insurance policy which is treated as money. Also, with the exception of NebiYu, as no other beneficiary was added

than those stated under item 15 of the policy in line with Art. 701 of the Code, the plaintiff is wrong in citing Art. 698.

2. The plaintiff has presented an argument that would defeat her claim by citing Art. 692(2) of the Commercial Code. This is because the provision provides that when the insured dies the insurer should pay a specified capital or life interest to those having rights from the insured or in the event of their non-appearance to the beneficiary named in the policy.

The true spirit and purpose of the law, in this respect, is not to derogate from, and contradict the other provisions of the law, but rather, to enable the person designated as the main beneficiary to share the precedes of the policy equally with those envisaged by Art. 701(2), notwithstanding that they are not mentioned in the policy.

The Insurance Corporation also produced copy of a decision rendered by the First Division of the Supreme Court in which it was held that the Corporation pay proceeds of an insurance policy to a designated beneficiary under Civil Appeal Case No. 749/70.

In light of these facts, legal arguments and the evidence presented, this Court shall now examine the case as follows:

Art.698 of the commercial code

In this provision, it is stated that an assignment or endorsement of an insurance policy or changing the beneficiary named in the policy is of no effect unless the insured person agrees in writing. The provision makes clear that it is not possible to replace or change the person specified as the beneficiary without the consent of the insured.

In the case at hand, since the claimant does not demand that Wro.

Tsigereda, the specified beneficiary of the insurance policy; be changed or replaced by another person, and since the request of the interveners is to get their share in accordance with the law, we have not found this provision to have a direct relevance to the case.

Art.692 (2)

This provision states that if the insurer has entered into a contract for the event of death of the insured, the insurer shall pay the specified money to those that have rights from the insured person or to the beneficiary named in the insurance policy.

The plaintiff argued that the term "or" does not imply that the persons mentioned in Art. 701(1) and (2) would jointly receive the money but it rather gives the option to make payment to one of them. If it is decided to interpret the law based on such argument, it would be the heirs that would be the primary beneficiaries and not the plaintiff. Therefore, this argument presented by the plaintiff by invoking. Art 692(2) of the Commercial Code is not tenable and is thus rejected, because it would not make the plaintiff the sale beneficiary.

Articles 706 and 707

Art 706(2) States that the money to be paid to the beneficiary shall not form part of the insured person's estate. Since the issue in this case is who the beneficiary of the life insurance policy is and not whether the insurance money constitutes part of the estate, and, furthermore, since Art. 707 provides that the money to be paid to the beneficiary cannot be refunded to the estate and cannot he deducted from his share, the court, holds that these provisions have no relevance to the case and on this point we have thus rejected the plaintiffs claim. Even if the Supreme Court has held that the insurance money should only be paid to the designated beneficiary, this court cannot be bound by such decision as the Ethiopian legal system does

not follow the system of precedence. Accordingly, it renders its own decision by interpreting the law.

The provision that is directly relevant to the case at hand is Art. 701 of the Commercial Code. The Article, captioned as "beneficiary of insurance policy", enumerates who such beneficiaries are in sub-articles 1 and 2.

In the civil and Commercial Code of Ethiopia some sub-articles are alternatively listed under an article by using the word "or". Others are cumulatively listed using the word "and". If the provisions are listed alternatively, it is only in default of the creditor or debtor in sub-article 1 that the person mentioned in sub article 2 will take the place of a creditor or debtor; while in provisions that are listed cumulatively, persons mentioned in both sub-articles shall jointly be creditors or debtors.

But the sub-articles of Art. 701 of the Commercial Code have not been listed in the alternative or; cumulative as mentioned above. The words "and" or "or" have not been used. Therefore, various courts have interpreted this provision either in the alternative or in the cumulative.

1. The heading of Art. 701 is "beneficiary of insurance" and it describes the beneficiaries in its three subsequent sub-articles·;
2. The fact that sub-article 10f this article provides that the insurance policy in the event of death may be made for the benefit of a specified beneficiary does not make it a mandatory requirement that there should always be a specified beneficiary, and even when there is a specified beneficiary, the provision does not clearly state that such person shall be the sale beneficiary of the insurance policy; and
3. The phrase "notwithstanding that they are not mentioned by

name" in sub-art.2 cum sub-article 1, shows that the spouse and children are made beneficiaries by law.

In the opinion of this court, the purpose of Art. 701 (I) is to give a right to the insured person to add other beneficiaries he wants, in addition to those who are beneficiaries by law; it does not exclude those beneficiaries mentioned in sub-article 2 from sharing the proceeds. This interpretation is further strengthened by the phrase, "notwithstanding that they are not mentioned name."

On the other hand, even if proceeds of an insurance policy does not form part of the inheritance claim, the fact that the spouse and children arc made beneficiaries by virtue of sub-article 2 helps us to determine that the law wants close relatives of a deceased person and those who are mentioned by him in the -policy to he beneficiaries of such a policy. According to the Civil Code other descendants and ascendants could be heirs. But the, fact that the spouse and children have been expressly Included as beneficiaries of the life insurance shows that these persons shall be deemed to be beneficiaries together with the person that is specified in the policy.

Therefore, in this case, we hold that the life insurance of the deceased, Ato Teklenaymanot Walde Gebriel, shall be paid to the person whose name is specified in the policy in accordance with Art. 701 (1) and to those persons specified in Art. 701(2).

The file shows that Wrt. Mihret Tekle Haymanot et.al. Do not want to share proceeds of this insurance policy. From the oral litigation and the contents of the file of this case, we have come to realize that they have given such response in order to support their mother who, as a beneficiary specified in the policy, was litigating against Sara T/Haymanot who is born from a different mother. However, we do not think that they intend to renounce their right. Since the reply was prepared for them by some one else for they are minors:

1. it is evident that such argument lacks good faith ; and

2. Because of this argument an unwanted consequence could have resulted whereby the children might have lost the benefit of the insurance; therefore the court wishes to caution those who prepared the reply to refrain from such conduct in the future.

Another point that makes this case unique is the issue of how much the deceased'swife, Woizero Tsigered a Woldeselassie, will get considering that she is the specified beneficiary in accordance with sub-article 1 of Art. 701 of the Commercial Code. and she is also a beneficiary under sub-article 2 of same Article.

As stated above, since sub-article 1 allows the insured person to specify any person-he wishes. And Woizero Tsigereda W /Selassie has been specified under this provision, this makes her a beneficiary; furthermore, by virtue of sub-article 2,she is also made a beneficiary.

One of the children of the deceased, Nebiyou T jHaimant, was not born at the time the insurance policy was signed. Thus in pursuance of Art. 701(2) (b) of the Commercial Code. he is not deemed to be a beneficiary.

Therefore, we hold that the 20,000 Birr that is payable under the insurance policy shall be divided among the six beneficiaries as follows:

1. Woizero Tsigereda W /Selassie, pursuant

to Art. 701(1) Birr3,333.03

2. Again W /0 Tsigered W /Selassie,

pursuant to Art. 701(2) (a) Birr3, 333.03

3.Woizerit Sara T /Haymanot Birr3,333.03

4.Woizerit Mihret T/Haymanot Birr3,333.03

5.Amanuel T/Haymanot Birr3,333.03

6. Meaza T /Haymanot Birr3, 333.03

As the beneficiaries listed from number 3-6 have not paid court fees, they should pay it before an execution order is given. Let this be communicated to the High Court's Registrar. .

All costs of the proceedings shall be paid by each party. Let this file be returned to the archives.

The Supreme court of Ethiopia

Civil Appeal Case No.749/70

Designation of a beneficiary in a life insurance policy - rights of the heirs and the surviving spouse in the event of death of an insured person-obligation of an insurer-good faith required in the performance of a life insurance contract-joining third parties as persons liable for contribution or indemnity to the defendant-intervention Comm. C Arts. 691, 701, 705, 706 Civ. Pro. C. Arts. 41, 43.

On appeal from a judgment of the High Court denying claim of the designated beneficiary to be entitled to the proceeds of a life insurance policy where such payment was earlier made to the heirs of the insured upon order of the Addis Ababa Awraja Court.

Held: Judgment reversed

1. Payment of the proceeds of a life insurance policy to the designated beneficiary is an obligation the insurer must assume.

2. Order of a lower court this regard can not be invoked for relief from subsequent payment to be made to the designated beneficiary.

Tir 25,1971

Justices: Ato Teshome Haile Mariam

" Abebe Workie

" Getachew Afrassa

Appellant: Woiz.Yeshimebet Jemaneh

Respondent: The Ethiopian insurance corporation

After examining the arguments of both parties, we have rendered the decision as follows:

Decision

This is an appeal from the judgment of the High Court rendered on Tir 26, 1970 under file No. 1133/69.

The present appellant who initiated this proceeding alleged that

1. her brother the late Ato Engida Jemaneh had designated her as the beneficiary of his life insurance policy the proceeds of which is Birr 30,000;
2. upon the death of her brother she claimed payment of the said amount, but the respondent requested her to produce a dully probated court order in which her status is established;
3. when she fulfilled the request, the respondent once again failed to pay her the money on the ground that it had already effected the payment to the children of the deceased who are also his heirs;
4. pursuant to Art. 705 and 706 of the Commercial Code, money due from this policy does not form part of the estate of the insured person;

And pleaded that the Insurance Corporation pay her the proceeds of the policy, i.e. Birr 30,000.

The Ethiopian Insurance Corporation affirmed that when the appellant claimed the proceeds of the policy, she was told to have her status as an heiress established. Before she had complied with the request, the respondent contended, the spouse and children of the deceased produced a dully probated certificate of heir ship from the Awraja Court on Tir 29, 1968 under file No. 2450/67. As it was further instructed to effect payment of the proceeds of the policy to these heirs by the said court, the Corporation stated, it had complied with the order and paid the sum to them. Respondent went on further and stated that the heirs have undertaken to intervene in any litigation that may ensue regarding this payment and prayed that these heirs be joined in the proceeding in accordance with Art. 41 of the Civil Procedure Code.

When the High Court ordered that the heirs of the deceased be joined in the proceeding, they submitted a reply dated 20/4/70 in which they stated the non existence of any ground justifying their intervention. The present appellant, on her part, argued that if the respondent had paid the proceeds of the policy to ineligible persons without there being any suit against it, it may claim restitution. But cannot in any way be relieved of its liability .under the policy.

In its judgment, the High Court stated that Woiz. Yeshimebet is a designated beneficiary of the life insurance policy. On the other hand, the heirs are also entitled to the proceeds of the policy pursuant to Art. 701 of the Commercial Code. But as the Corporation paid the disputed sum not of its own will but in pursuance of the order made by the Addis Ababa Awraja Court dated Tir 29, 1968 and Yekatit 4,1968 under file No. 2450/67, it should not be held liable for second payment.

The appellant brought an appeal from this judgment of the High Court on Ginbot 29, 1970 alleging that the Insurance Corporation was aware of the fact that the deceased had named her as a specified beneficiary of the policy and that she was in possession of the policy. She was

furthermore informed by the Insurance Corporation that payment would be made to her when she established at court that she is the sister of the deceased. She argued that since the respondent is aware of all these~ -it is unlawfully litigating against her by invoking a legal provision that governs situations in which the beneficiary is not specified in the policy. As regards the contention that payment was made pursuant to the order of the Awraja Court, the appellant argued that since the respondent was aware of the beneficiary specified in the policy, it cannot avoid the obligation on this ground.

The appellant also objected to the judgment of the High Court which had reasoned that the decision of the Awraja Court ordering payment to the heirs was improper, but had nonetheless ruled that appellant should sue the heirs and not the Insurance Corporation.

Counsel for the respondent, in its reply dated Hamle I, 1970 admitted that it had promised to pay the proceeds of the insurance policy, when the heirs establish their right to the inheritance. It argued that although the appellant is a specified beneficiary of the policy, the law also provides that the subscribers spouse and children are deemed to be specified beneficiaries. The ·spouse and children of the deceased 'had established their status as heirs before the appellant did so.

The respondent further argued that the appellant was also the representative of a child of the deceased named Tarnirat Engida, but that the Awraja Court had rejected the claims of the appellant in its decision of Tir 5, 1965 (File No. 4311/67). The Awraja Court had also ordered on Tir 29/1967 (File No. 2450/67) that, since the right of the legal heirs of the deceased to the inheritance should not be prejudiced by reason of the loss or non-production of the policy, payment should be made to the legal heirs who are the children of the deceased. Furthermore in the explanation to this decision made on Yekatit 4, 1968 the Awraja Court had ruled that "the Ethiopian Insurance Corporation

should effect the payment of the proceeds of the insurance policy in accordance with the earlier decision of the Court" and that this decision should be transmitted to the Corporation, thereby ordering the Corporation to pay the proceeds to the legal heirs. The Corporation therefore alleged that it had paid the proceeds of the policy to the heirs accordingly and that the legal heirs had undertaken to intervene in and litigate any dispute concerning the payment. The respondent therefore argued that even if the appellant were to be deemed as a beneficiary of the policy, she would have a claim only against the heirs, and the judgment of the High Court should be confirmed.

This Court has examined the arguments presented by both parties. That the appellant is a specified beneficiary of the deceased's life insurance policy is not contested. The respondent's argument is based on Art. 701 of the Commercial Code and the order given to it by the Awraja Court. A life insurance policy is a contract between the insurer and the subscriber. The insurer has the duty to perform its obligation in accordance with. The policy the beneficiary a specified in the policy. Article 691 of the Commercial Code provides that the proceeds of the policy has to be paid to such specified person. Article 706 of the Commercial Code further rules that the beneficiary may claim directly from the insurer. The appellant's claim is based on these provisions.

The fact that the respondent had requested the Awraja Court to whom it should pay the proceeds of the insurance policy instead of discharging its obligation as set out in the contract shows its lack of good faith in performing the contract. It is established that the appellant has requested payment to be made to her in accordance with the policy. The respondent had also asked her to comply with necessary formalities. Accordingly, the appellant had duly established her status at court. The respondent contended that it had paid the proceeds to the legal heirs in conformity with the order of a court. However, the respondent cannot

benefit from an order it had confusingly led the court to make and avoid its responsibility since in a life insurance policy payment is to be made to the beneficiary. The beneficiary in this case is the present appellant, W/o. Yeshimebet Jemaneh.

The Insurance Corporation had to discharge its duties conscientiously, but had failed to do so in this case, even though it was aware of all relevant facts, believing that a court order will relieve it of its obligation. We have therefore reversed the judgment of the High" Court which was made without due cognizance to all these factors, and order that respondent should pay the proceeds of the life insurance policy to the appellant.

Designation of the Beneficiary of a Life Insurance in the Event of Death

Girma Woldeselassie

A person who takes out an insurance policy on his own life obviously intends that, upon his death, some one should benefit from the proceeds. But the question that has long been debated among jurists is whether societal interests should be imposed upon the policy-holder, so that at least his spouse and children are made beneficiaries by virtue of the law, or whether he should be given maximum freedom in designating a beneficiary of his own choice.

Ethiopian courts are today divided over this same issue. In a number of cases presented to the courts, the policy-holders designated persons other than members of the immediate family as beneficiaries of an insurance policy in the event of death. Upon the death of the insured person not only the designated party but also the spouse and children of the deceased claimed payment, the latter two on the basis of Art 101 (2)

of the Ethiopian Commercial Code. The issue before the courts was whether tile said provision entitled the spouse and children of the insured to benefit from the proceeds in spite of the fact that they were not mentioned in the policy, and despite the filet that a third party was expressly designated as the sole beneficiary.

A division of the High Court grants that, pursuant to the first sub-article of the named provision, the insured person can designate his own beneficiary, including persons other that the spouse and children.

But in reading this provision jointly with the second sub-article, it arrived at the conclusion that even if they are not designated by the insured, his spouse and children are at all times presumed to be beneficiaries of any life insurance policy in the event of death. Thus, according to this court, if the insured names his. mother as the only beneficiary, the lady will have to share the proceeds with the spouse and children of the deceased (and other "heirs", according to the French version), in spite of the fact that they are not designated.

Quite clearly, this Interpretation of the law follows the school of thought that rejects granting unlimited authority to the policy-holder in determining who the beneficiary should be. There are strong arguments to support this position.

To begin with, the policy-holder, more often than not, is the sole breadwinner.

For that reason, it is his duty to provide for the sustenance of the family in the event of his death. Even if there is property to be inherited, the liquidation process is commonly such a protracted affair that its proceeds might not be available for the immediate needs of the household. On the other hand, insurance payments are supposed to be relatively easy to obtain in the form of cash.

Another argument involves the need to protect the common property.

Since the proceeds of life insurance do not form part of the insured's estate and, hence, are not subject to the rules of succession, a life insurance policy destined to benefit persons other than the spouse or children can be used as a means of excluding substantial assets from the estate.

Designating a third party beneficiary can be particularly injurious to the surviving spouse, who would otherwise be entitled to half of the benefit had it formed part of the estate. One should also note that, most commonly, the insured pays the premiums out of his income, which, in turn, is a common property.

Consequently, it makes good sense to safeguard such vested interests of the spouse and children of the insured by making them beneficiaries to life insurance by virtue of the law; even when they are not so designated. In the opinion of the said division ·of the High Court, therefore, the Ethiopian law of life insurance in the event of death is motivated by these very concerns.

A division of the supreme Court is not persuaded by these arguments. Where there is a beneficiary expressly designated by the insured pursuant to the authority vested in him by the first sub-article of Art 701, the latter court reasoned, such a beneficiary is entitled to the entire proceeds of the policy.

Turning to the interpretation of Art. 701 (2), the Supreme Court ruled that the spouse and children of the insured would be entitled to the benefits only where no one is expressly designated by the policy-holder.

In sum, therefore, the two courts are at complete loggerheads. According to the first decision, sub-articles 1 and 2 of Art. 701 are complementary. A third party can be designated as beneficiary, but he will have to at all times share the benefit with the spouse and children of the insured even

where these are not mentioned as beneficiaries.

According to the second decision, however, the will of the policy-holder is supreme and, as such, whoever is designated by him gets all the benefits that accrue from the policy. It is only where the policy-holder dies with out designating a beneficiary that his spouse and children would be able to claim the proceeds.

These divergent decisions by the two courts have, if anything, thrown both policy-holders and insurers into total confusion, which is compounded by the absence of the principle of stare decisis our legal system.

That is one reason why the above is not a simple case of High Court decision being reversed by the Supreme Court. If it were, the issue would have been much less significant. It is rather a situation where a lower court avowedly rejects a prior decision of a superior court. The High Court did acknowledge that a decision of the Supreme Court covering a similar fact situation had been brought to its attention; but the lower court declared that it did not agree with the interpretation by the Supreme Court of Art 701 of the Commercial Code, and that the lower court was not at any rate bound to conform to the judgment of the superior court. It therefore consciously arrived at a contrary conclusion. Quite evidently, these cases point up a timely question as to what position our legal system should adopt regarding' precedence. That, however, is not the immediate concern of this paper.

Here we are concerned with the fact that the two decisions mentioned above follow different schools of thought that entertain totally opposed approaches regarding the question of designating a beneficiary in a life insurance policy. The two perspectives, in turn, reflect different levels of social and economic development. Hence, the question that deserves to be pondered at this juncture in the development of the legal system is as to which approach best serves the needs of present-day Ethiopia.

A very useful way of getting a fuller understanding of a particular provision of any law is to study its historical ,evolution. Thus, original drafts, subsequent changes, minutes of the Codification Commission, and parliamentary debates are vital tools. What is at present readily available to us as regards the Ethiopian Commercial Code is only the avant-project, which one finds reasonably helpful.

Even so, Professor Jauffret's comments are woefully scanty when it comes to Art 701 of the Commercial Code. But in one interesting sentence he does give us a possible clue as to what that provision was intended to mean. "I have included," he wrote, "the most liberal solutions for the determination of the beneficiaries of the insurance in the case of death". Unfortunately, he tells us no more, not even what he meant by "most liberal", One has therefore to look further to determine what a "liberal" policy would be regarding the determination of an insurance beneficiary in the case of death.

In the same avant-project, Jauffret uses the term "liberal" on several other occasions. Making reference to the laws of some countries, for example, he notes that the validity of the life insurance contract in the event of death is not affected by the fact of the insured committing suicide. He then characterizes such a position as "too liberal", and himself adopts the opposite course in his draft of the Ethiopian law those other countries choose to continue to give effect to the will of the insured in spite of the act of Suicide, Jauffret's use of the term "liberal" to describe that position leads one to conclude that he must also have employed the same term to impart the same idea regarding Art. 701, i.e., giving supremacy to the will of the insured.

This line of reasoning can be further supported by reference to the sense in which other countries employ the term "liberal", The French law of life insurance is of particular relevance because it has had considerable influence on its Ethiopian counterpart.

Another reason why we should seek the meaning of liberality in the French law is because it is known to be one of the most liberal as regards the designation of a beneficiary of life insurance in the event of death. According to one commentator.

Thus, what is commonly understood as a liberal position regarding the designation of a life insurance beneficiary, at least among French legal scholars, is one that gives the policy-holder the least restricted freedom. Hence, one can reasonably conclude that, when Jauffret, a French legal scholar, declares that he chose the "most liberal solution", his intention was to give the policy-holder the maximum liberty in the choice of the beneficiary of his policy. This goal was accomplished under sub article 1, where it is unambiguously provided "An insurance policy for the event of death may be made to the benefit of a specified beneficiary."

Having thus established the policy underlying Art. 701 by our reference to the draftsman's avant-project as well as to the European conception of a liberal policy regarding the designation of a beneficiary, what remains is the task of reconciling the second sub-article to the first.

To begin with, it has been argued that the first sub-article is totally consistent with the declared goal of the draftsman. It is the provision through which the draftsmen intended to realize his goal of resolving the issue relating to beneficiary designation In the "most liberal" fashion. The term "most liberal" IS, In turn, understood to mean a policy that places the least restriction on the right of the policy-holder to choose his own beneficiary.

Turning to the second sub article, it would be contrary to principles of legal drafting to assume that the draftsman included two contradictory provisions in the same article. In other words, sub-article 2 can not be so interpreted as to defeat the declared objective accomplished by one Sub-article earlier.

It should, however, be conceded that such an anomaly can occur in an legislation, especially if the original draft has been altered by people other than the draftsman. Such alterations may be carried out with less insight as to their effect on other provisions or even on the policy on which the entire law is structured. In view of that possibility, one may wonder if sub-article 20f Art. 701, assuming for the moment that it contradicts the first sub-article, is a later addition or modification by either the Codification Commission or Parliament.

But there is almost conclusive evidence that this was not the case. Jauffret's draft of the section of the Commercial Code on insurance was accepted by the Codification Commission without any alteration. The hand-written remark addressed to Jauffret, on the first page of the draft, believed to have been written by a member of the Codification Commission, states that the draft was "wholly accepted".

That the present content of Art 701 is exactly the same as the one in the original draft is further evidence that neither the Codification Commission nor Parliament introduced any change in Jauffret's draft.

The meaning of sub-art, 2 of Art 701

An effort has been made to establish the legislative policy underlying the Ethiopian law of life insurance as regards the designation of a beneficiary. It has also been submitted that the original draft designed to reflect the said objective has not been altered at any time during the legislative process. Finally, it is clear that sub-art. 1 of At 701 fully accords with the declared legislative policy, since it gives the policy-holder a free hand in determining the person to whom the benefit should go.

Hence, interpreting sub-art 2 of Art 701 - as did one of the courts - to mean that the spouse and children of the insured are at all times beneficiaries of a life insurance policy in the event of death, even where

a third party has been expressly designated as the sole beneficiary, would contradict the basic policy underlying the whole provision and defeat a goal attained in the preceding sub-article. For that ~ reason alone, the said interpretation should be rejected.

Other arguments can, however, be marshalled in support of the foregoing, conclusion. Consistently with its declared "liberality", the law empowers the insured to evoke the allocation of the benefit to a specified beneficiary so long as the latter has not accepted the benefit (Art. 703 (2)). If, on the other hand, the spouse and children are deemed to be beneficiaries, by virtue of the law and independent of the will of the insured, there would be no point in authorizing the insured to change his mind as to his earlier allocation of the benefit. Once again, an interpretation of sub article -2 of Art 70 which would lead to such an anomaly cannot be allowed.

Furthermore, the said interpretation would render worthless the use of life ' insurance policy as a modern tool for a business transaction. Nowadays, it has become common practice in many developed countries for a person to take out life insurance in favour of his creditor, by way of guaranteeing the performance of a certain obligation.

It has also been quite some time since this practice arrived in Ethiopia. Take, for example, the case of the thousands of people who have borrowed money from the Mortgage Bank to build homes. As a condition for obtaining the loan, each one of them had to take out a life insurance policy designating the bank as the sole beneficiary.

The Ethiopian insurance law, as a modern piece of legislation, recognizes such' use of a life insurance policy. Article @1 (2), for instance, envisages a situation where the insurer may undertake to pay upon the death of the insured a specified capital "to those having rights from the insured person ...”

Article 697 further clarifies this point by expressly permitting the pledging of

a life insurance policy.

Interpreting Art 710(2) in a manner that would limit the free will of the insured would not only be contrary to the spirit of the above cited two provisions but would also produce a ludicrous result. In the case when: the Mortgage Bank is the sale beneficiary, for instance, the proceeds would have to be shared by the spouse and children of the insured, there by defeating the whole purpose of the transaction and rendering totally ineffective the use of life insurance as a pledge.

On the basis of the above arguments, it is submitted that the interpretation of sub-art. 2 of Art. 701 to the effect that the spouse and children of the insured should get some portion of the benefit, even where the insured dies having designated someone else as the sole beneficiary, should be rejected as contrary to the policy underlying the law as well as to several of its basic provisions.

Having said that, one has to examine the alternative interpretation given to the provision in question by the-second court. Here, the court recognizes that, under Art 701 (1), the insured is at liberty to designate a beneficiary other than his spouse or children, and that, where he does so, the designated beneficiary gets the entire proceeds of the policy. .

With regard to the second sub-article, the court took the position that, even where the insured fails to designate them, his spouse and children become, by virtue of the law, beneficiaries of a life insurance policy in the event of death.

Then the court had to reconcile these two contradictory positions, which task it achieved by concluding that the un-designated spouse and children would be able to collect the benefit only where situation

envisaged under the first sub-article does not come into the picture, i.e., where the insured fails to designate a specific person.

Thus, consistently with the above noted legislative policy, the court upheld the supremacy of the insured. And to that extent, its decision is correct.

This writer, however, wishes to take issue with the court's interpretation of the' second sub-article of the provision. According to this court, the effect of the said sub article is to make the spouse and children of the insured beneficiaries where he dies without indicating who the benefit should go to.

Nevertheless, the law is absolutely clear as to what the destiny of the proceeds of a life insurance policy should be where the insured dies without designating a beneficiary. Both the Civil Code (Art 827) and the Commercial Code (Art 705) provided that it "shall be paid into the subscriber's estate", thereby forming part of the inheritance. The unanimity of the two codes on this point, and the absence of ambiguity in the languages of the two provisions, leave no room for interpretation. Hence, no construction of Art 701 (2) of the Commercial Code, which contradicts the above cited provisions, as does that of the above named court, can be allowed to stand.

What should the interpretation of Art. 701 (2) be and what purpose was it designed to serve? To answer those questions, one needs to look more closely at the wordings of sub-articles 1 and 2 of Art. 701.

Under the first sub-article, the subscriber is authorized to make his life insurance policy to the benefit of a "specified" person. What does "specified" mean? In other words, how specific should the subscriber be? The question is all the more significant because very many subscribers do not want to commit themselves irrevocably, in view of the unpredictability of their future relationship with the beneficiary. As a

matter of fact, in some countries "only exceptionally will a particular person be designated as beneficiary by name". (p. 18, Stockholm).

Under Danish law, for example, "If the policy-holder wants his spouse to receive the insurance proceeds entirely, he can obtain this result by designating as beneficiary "spouse", and he, therefore, need not mention the spouse by name. If the policy-holder wants his children to take the insurance proceeds, he can use as beneficiary designation the expression "children", (without having to mention each child by name)." (p. 17, Stockholm).

That being the case, no insurance law would be complete without a provision that regulates the usage of generic terms in designating beneficiaries. It is submitted that Art. 701 (2) is designed to serve that very purpose in the Ethiopian law of life insurance.

To substantiate this proposition, let us further examine the content of Art 701 (1), which authorizes the subscriber to make his life insurance policy benefit a "specified" person or "specified" persons. The question has been raised as to how

specific he should be. One can find the answer, albeit indirectly, in the second sub article. Under that provision, a certain category of people are "deemed to be specified beneficiaries notwithstanding they are not mentioned by name" (emphasis added). Hence, the word "specified" under the first sub-article should mean mentioning the beneficiary by name, failing which the requirements of that provision would not be satisfied.

Such a condition, obviously, has many advantages. It serves the interests of subscribers who are absolutely certain as to the person(s) to whom the benefit should go. Secondly, if names are mentioned, the wishes of the subscriber become so categorical that the possibility of disputes arising over who the beneficiary should be is almost nil.

On the other hand, requiring that degree of specificity of all subscribers would not be a practical proposition. As noted earlier, in very many countries, only a minority of life insurance subscribers wish to identify by name a particular beneficiary in the event of death.

Unsure of what the future may have in store, many subscribers refuse to commit themselves irrevocably. Under Ethiopian law, for instance, ''The allocation of the benefit of a policy to a specified beneficiary may not be revoked after the beneficiary has agreed to the policy" (Art 703 (1)) of the Commercial Code; (see also

Art 1961 (1) of the Civil Code).The consequence of such an arrangement can be fully grasped if one considers a person who, desirous of providing financial security for his family, takes out a life insurance policy for the event of his death. Suppose he designates "Tamima", his wife at the time, beneficially. Tamima readily accepts the policy. Sometime later, the two are divorced, and each gets married to another person. Assume also that the subscriber has a number of children from his new wife and none from the previous one. All the same, the proceeds would go to Tamima, thereby defeating the whole purpose behind the policy.

It is to guard against such eventualities that many a subscriber prefers to use a generic term such as "my spouse" or "my wife" in designating a beneficiary.

Consider also the case of a subscriber who wants his children to benefit from the policy. If he mentions by name those that were already born at the time of subscription, those might be the only beneficiaries. But that would be contrary to the intention of a subscriber who wants all his children, including those born after he took out the policy, to benefit. That consideration explains why many people prefer to use "children", "offspring", or similar generic terms, to mentioning individuals by name.

Another word commonly employed by subscribers in "heirs" (which word,

as noted earlier, is found in the French version of Art 701 (2) of the Commercial Code but does not appear in either the Amharic or English versions). If the subscriber mentions by name his heirs as beneficiaries, the same question as arose in relation to children might arise.

What Art 701 (2) does, therefore, is to recognize and give sanction to the use of generic terms in designating a beneficiary .In other words, if the subscriber prefers to use words such as "my wife", "my children" or "my heirs", persons who fit those characterizations "shall be deemed to be specified beneficiaries notwithstanding that they are not mentioned by name".

Art. 701 (2) also addresses other issues that often arise in relation to the use of generic terms in designating beneficiaries. In the case where the word "wife" or "spouse" is used, the question often is which one? The spouse subscriber was married to at the time of subscription, or his legal wife at the time of his death? Where the subscriber was not married at the time of subscription but got married later on, Art 701 (2) is unambiguous. Such a wife is the proper beneficiary.

But if the subscriber was married to X at the time of subscription, divorced her and was married to Y at the time of his death, the language of the law is not sufficiently clear. Even so, it seems to recognize the marriage that was concluded "after the policy was entered into". That position can also be supported by invoking the raison d'etre for such a policy, which, more often than not, is to provide for the sustenance of the immediate family after one's death.

Conclusion

There were times when it was almost universally believed that the primary purpose of a life insurance policy in the event of death was to protect the members of the immediate family of the insured against sudden deprivation. The then prevailing social and economic conditions

justified this attitude. Of particular significance was the fact that the man was, more often than not, the sole breadwinner, so that his death almost inevitably meant a serious economic crisis for his dependents. Most frequently, therefore, it was to forestall such a, crisis that men took out life insurance. Hence the identification of a life insurance policy with the interests of the immediate family of the insured. This state of affairs was, in turn, reflected in the old laws of many European countries.

With increased modernization, however, things changed radically. To begin with, at least in the modem sector of most economies, the man is no longer the only member of a family who earns an income. Secondly, many countries have developed a variety of social security schemes so that the, death of the head of a family no longer portends extreme economic difficulty for its members. Thus, providing for" the sustenance of family ceased to be' the primary objective of a life insurance policy in countries where these changes occurred.

In the meantime, the business world found new uses of a life insurance policy.

It was discovered, for instance, that it is one of the best ways of securing someone's obligation.

Then, the law had to catch up, even if belatedly, with the changed circumstances. In most countries of the developed world, this meant placing greater emphasis on the free will of the policy holder.

As noted by Jauffret, it was this liberal position that Ethiopia adopted with regard to the designation of beneficiary of a life Insurance policy.

One can, of course, question the wisdom of adopting such a stand in a country where social and economic conditions are fundamentally different from those of Europe. Ethiopian policy makers were not unaware of this fact. Yet, they were convinced that modern laws could be used to force Ethiopia onwards to the current stage of the modern world.

Besides, a modern insurance law would help attract foreign capital - the mainstay of the then developmental policy of the country.

On the other hand, the policy makers must have accepted the inevitability of a period of tension between local conditions and the super imposed alien law. The decisions of the two courts discussed above are, in a way, reflections of the said tension. In this regard, one of numerous questions judges will have to address is how to protect the interests of the spouse within the context of a law that upholds the supremacy of the will of the insured.

Most countries that have liberal life insurance laws - including the U.S.A., France and the former West Germany - have recognized the need for such protection if the interests of the surviving spouse so require. On several occasions, their courts have set aside the will of the insured, despite the fact that their laws do not expressly authorize interference with the freedom of the policy holder in determining a beneficiary.

The most common case in many western countries is where a married man designates his mistress as beneficiary. Courts have consistently held such designations control bonus mores and gave the benefit to the wife, even though she was riot expressly designated as beneficiary.

Thus, it appears that this is a better compromise approach to bridge the gap between those who believe that life insurance should exclusively benefit the immediate family, and those who stress the supremacy of the will of the insured. While recognizing and giving full effect to the will of the insured who designates a third party as a beneficiary for perfectly legitimate reasons, it leaves room for the invalidation of the designation when it is contrary to morality or good faith.

It is, however, submitted that such an option is not available to Ethiopian courts confronted with a situation where a policy-holder may abuse his right to name a third party in a manner offensive to our sense of

mortality, or where the court is persuaded of the existence of fraudulent conduct. It is true that, as a special contract, life insurance law is governed by the general principles embodied in Title XII of the Civil Code. The court can, therefore, invalidate the insurance contract on grounds of immorality if such exists. But the consequence of invalidation under Ethiopian law does not lead to the same solution as the one that flows from the equity-based decisions of the United States or European courts - which is, for instance, substituting a beneficiary not designated by the policy-holder in the place of the one designated.

The result of invalidation under Ethiopian law is the reinstatement of the contracting parties, i.e., the policy-holder and the insurance company, to positions they had held before they entered into the contract. This in effect means two things:

First, the insured gets back whatever he paid in premiums and possibly plus interest, and not the proceeds stipulated in the contract. Quite obviously, there can be a substantial difference between the two amounts.

Secondly, since the insured is dead by the time these issues are raised, the proceeds of the reinstatement go into the estate of tile deceased, and not to a particular person who, by equity or moral considerations, should have been the beneficiary.

Thus, by invalidating, the court would in effect destroy the essence of the contract without attaining its objective of doing justice to the insured party.

The course which may possibly lead to the desired goal would be to vary the contract, that being what substituting a designated beneficiary by one who is not so designated may amount to. Yet the Ethiopian law of contracts, strongly grounded on "Freedom of Contract", emphatically exhorts that "courts may not vary a contract or alter its terms on the

ground of equity except in such cases as are expressly provided by law" (Article 1763). The narrowly circumscribed exceptions (Arts 1766-1770) do not at all permit the degree of variation that would be necessary to replace one beneficiary by another. In light of this fact, Jaffrey's assertion that he chose the "most liberal solution" makes complete sense.

Dear distance learner, do you agree with the conclusion? Which position might you think best serves the nature and propose of the protection and goes consistent with the particular nature of the transaction? May you device some other suggestion compromising the matter?

5.7 Settlements of Claims in Life Insurance

5.7.1 Conditions Precedent to Make the Claim

Dear distance leaner, it is always necessary that the duty to notify the occurrence of the risk to the insurer should be respected by the beneficiary of an insurance policy under Article 670 of the commercial code. The same applies to life insurance that the beneficiary to the policy has the duty to inform the insurer that the risk covered in the contract is materialized. The duty to notify the risk as materialized is coupled with the duty to supply a proof that shows it is occurred consistent with the terms of the cover in the insurance policy. In life insurance policy for life of the person, for example it is very important that the insured person should be proved to live at the date fixed in the policy. This operates, for instance, in a policy that operate upon the retirement of the insured that he/she is terminated of employment on attainment of that age being the ground to the same effect. The life of the insured is the proof for immediate enforcement of the policy as stated under Article 692 (1) and Article 702.

The proof of occurrence of the risk needs special consideration in a life insurance for the death of the insured suicide by the insured and murder of the insured by the beneficiary have the effect of excluding the beneficiary from claiming the enforcement of the terms of the policy. Insurance policy is there serving the injury behind fortuitous events. There is a principle that requires utmost good faith to prevail in insurance legal chains. In insurance policy of life for the death of the insured, the peril sought to be covered is the inevitable occurrence of death beyond the control of the insured .i.e. its accidental occurrence. Deliberate suicide of the insured poses a presumption that he/she anticipated the fortuitous event covered in the policy and such deliberate action is assumed to stand contrary to the requirement of utmost good faith. What is important is the suicide should be deliberate so as to constitute such a position. Hence; article 699 of the commercial code addressed the matter as a conduct denied of protection. It reads:

> *"1. Not withstanding any provision to the contrary, an insurance policy of the event of the death shall be of no effect where the insured person knowingly commits suicide. The insurer shall establish that suicide was committed knowingly.*
>
> *2. The policy shall be effective where the beneficiary can show that suicide was not committed knowingly"*

The reading of the provision shows that death is presumed to be occurred fortuitously, but the insurer can prove that it is suicide, a deliberate one.

Not only suicide but also murder by the beneficiary of the insured excludes the claim for enforcement of policy. As it can be seen for the provision of Article 700 that mere allegation of murder is not sufficient that the beneficiary should be proved to kill the insured intentionally and convicted by a criminal court

showing that he /she is guilty of the offence. The prohibition behind the conduct is due to the public policy that a person should be the beneficiary of his/her criminal conduct. That is to say, a person should not consume the economic yield of his/her criminal conduct. Had the policy been enforced to the benefit such beneficiary, the law would stood contrary to the objective of the criminal law that operate so as to achieve ultimate and everlasting peace, order and security of the general public and the state as articulated under article 1 of the, 2004 FDRE Criminal Code.

The proof that the beneficiary should be alive at the time of maturity of the policy is not only required for an insurance policy of life that operate attaching a life benefit to the insured but it is also applied to a policy of life for the death of the insured that the beneficiary should be alive at the time when the insured person dies in the absence of otherwise agreement. This is to fit the purpose for which the policy is made. The intention of insured person is presumed to destine the policy for the injury to the beneficiary because of his/her death and that should be respected in the sense that it should be achieved provided that the beneficiary is alive with the consequence of joining the value in the policy to the estate of the insured in case where the beneficiary dies by the cumulative application of the provisions of the civil code that govern succession.

5.7.2 Extent of payment to the Beneficiary.

Dear distance learner, it is briefly stated earlier that insurance of persons is not a policy for compensation for it is impossible to calculate the person of a human being in money values, but the materiel damage which a person might involve in behind the life or death or injury of the person. Because this reason, the parties are at liberty to flexibly determine the value due to the concerned

beneficiary upon the occurrence of the specified risk covered in the insurance policy regardless of the damage which the insured person suffers as articulated under article 689. The law accepted the practical impossibility of valuating human life and devised open door for free determination of the benefit payable in terms of money. The extent of coverage of the particular damage insured may be greater or lesser. It is not important that the cover is lesser or greater or equal to the loss. What matters is the occurrence of the risk consistent with the terms of the policy.

Hence, a proof that the risk is materialized in harmony with the terms of the insurance terms poses a duty on the insurer to pay the agreed amount to the beneficiary which often involves cash money. The insurer will not go to assess the extent of the loss. It simply pays the agreed amount either in the form of lump sum or annuity consistent with the provisions of the insurance policy. The beneficiary can claim the payment directly from the insured and the paid amount does not form part of the estate in case of death of the insured which poses a presumption that a spouse involves in taking personal property if the latter gets benefit in the policy being beneficiary designed by virtue of the application of Article 706. Once payment is made to the beneficiary, he/she cannot be required to refund an amount to the inheritance in pursuant to the subsequent provision.

In the absence of specification by the insured of the beneficiary under Article 662 or in case where the policy is revoked under article 703(2) or the beneficiary is not alive contrary to the requirement under 702, the capital to be paid by the insurer shall be joined into the estate of the insured to be administered under the law that regulates succession.

5.7.3 Third Party Claims over the Insurance Due

Third parties have no any right to enforce their rights against the beneficiary of a life insurance policy by way of requiring the attachment of the capitals of the policy for example. This operates, simultaneously to a claim under bankruptcy proceeding. Article 708 addressed the matter stating that

1. The creditors of the insured person have no right on the sums to be paid to the beneficiary.
2. The provision of Article 1029(a) of the commercial code shall not apply where the insured person is declared bankrupted.

The justification behind is the assumption of designation of the sums in the policy for utility of day to day survival of the beneficiary satisfying the basic human needs as recognized in the 1965 Civil Procedure Code.

5.8 Subrogation in Insurance of Persons

Dear distance learner, subrogation is one of the principles that apply to insurance business as it is discussed earlier. The principle operates to the exception of insurance of persons. This is also reflected in the commercial code under Article 690 that states:

> *"Not withstanding any provision to the contrary, the insurer who has paid the agreed amount may not substitute himself for the subscriber or beneficiary for the purpose of claiming against third parties who caused the damage."*

The reason traces the nature of the policy which is destined not for compensation. Insurance of persons does not hold indemnity in mind. It is designed for sustaining the life of the beneficiary by way of filling the gap between the harm to the person insured and the economic

benefit to the beneficiary. It is annuity that should be covered by transfer of the risk in to social burden by way cumulative contribution of persons involving in cover of the same risk under the umbrella of insurers.

5.9 Unit Summery

Dear distance learner, a kind of exhaustive deliberation is made about insurance of person involving cover of risk of death, illness, injury or some related consequences upon the insured or some other person due to such occurrence to be specified in the respective insurance policy. It may generally constitute two forms being either insurance of life of the person or insurance against accident or illness of the person. Insurance of persons is distinguished from other forms of policies which are sought to attain compensations to the insured person. Insurance of persons is not a policy for indemnity but to flexibility determine the amount of coverage in case where the stated risk materializes. The amount to be fixed is not to compensate the injury, but to abridge economic gaps by way of availing life annuity to the concerned beneficiary. Hence, insurable interest in insurance of persons revolves around such area of consideration. Deciding the beneficiary of life insurance for the death of the insured constituted a practical problem due to drafting problem of article 701 of the commercial code. Life insurance requires the fulfillment of certain preconditions including those specification of the insured and the beneficiary, life the beneficiary at times when the policy matures, like and the like. Claim of enforcement of the policy requires notice to the insurer and proof of occurrence of the particular risk covered to the exclusion of suicide and murder of the insured. Accordingly, the insurer should pay the agreed amount irrespective of the lesser or greater extent of the damage proved to occur.

The insurer who paid the sum cannot substitute itself to the position of the beneficiary with a view to cover the paid amount from the third party who caused the damage. This emanates from the nature of the policy embracing welfare purpose.

5.10 Self-check questions

1. Give a brief description of the nature and scope of insurance of persons

2. Classify insurance of persons

3. Distinguish between insurance of persons and insurance of property.

4. What is insurable interest in insurance of persons?

5. Explain the conditions of insurance of persons.

6. To what extent insurance of persons can be determined under what legal authority?

7. Insurance of persons is not for indemnity. Give explanation for the statement.

8. What is the status of subrogation in insurance of persons as compared with some other policies?

9. Explain the preconditions of claiming enforcement of insurance of policy of persons.

10. Murder by the beneficiary of the insured denies the beneficiary the claim to enforce the policy. Why do you think is the reason?

Module III

Law of Negotiable Instruments

INTRODUCTION

Dear students, welcome to the course on the Law of Negotiable Instruments. In the business world of today it is becoming more and more acceptable to make use of negotiable instruments in commercial activities. They are very important documents of rights that the rights and duties of those who deal with them need to be governed with such well- set and sophisticated rules. The bill of exchange which is one of the typical commercial negotiable instruments and which has been used as a means of exchange between European merchants in the early days is now still playing a very important role in the business world. In Ethiopia, the bill, specifically the foreign bill of exchange plays an important role in conducting international trade.

The rules in relation to the transfer of bills of exchange are special rules, as this transfer is a process which can affect the rights of the different persons in to whose hand the bill passes and since it can give rise to various courses of actions.

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. There are many types of negotiable instruments recognized in the world and by the 1960 Ethiopian Commercial Code as well. The Code recognizes three types of documents as negotiable instruments, i.e., commercial instruments/ bills of exchange, Promissory notes, checks, traveler's checks/, securities/ shares or stocks, bonds/ and documents of title to goods/ bills of lading and other types of rail way bills, warehouse good's deposit certificates./

All these instruments play a very vital role in facilitating trade and commerce. If we take, for example, commercial instruments they are of paramount importance to modern commercial transactions. Commercial papers, which were creation of centuries ago, are ways of paying for property and services without having to carry large sums of money.

This material consists of five units. In the first unit we will see the general notion of negotiable instruments, the characteristics they posses, the different types of them and what is meant by negotiability.

The second unit looks in to the definition, formal requirements, nature and purposes of bills of exchange. In the third unit we will see the different modes of negotiation that can be used in transferring bills. It also deals with types and forms, elements and effects of endorsement which is one of the ways of negotiating bills. We will further see establishment of title to bills. An attempt will be made to see the rights of the various parties in relation to the way they establish their title to the bill.

In the fourth unit, we will discuss the issue of promissory notes and their similarity with respect to bills of exchange. Lastly in the fifth chapter we will discuss different types of cheques including their unique characteristics and application.

At the end of each unit, different types of review questions will be given and students are advised to do well all these questions. If a student fails to understand these questions and becomes unable to provide appropriate answers, the writer advises the student to go back to the specific chapter for better comprehension.

Unit One

Negotiable Instruments and Negotiability

1.1 Negotiable Instruments in General

Negotiable instruments play an important role in the business world. The business world of today accepts these instruments as a substitute for cash in consummating business transactions, occupying a certain place in the finance industry and commerce. This is due to the fact that there is insufficient cash available to satisfy the needs of the business community, and these instruments may serve as evidence of payment and performance of a contract. Besides, these instruments have certain unique characteristics that enable business activities to be facilitated easily and smoothly. Therefore in this chapter, we will see what these instruments are, and what characteristics they possess.

Objectives:

After completing this chapter, students will be able to

- Define what negotiable instrument is,
- Describe the features or characteristics of negotiable instruments,
- Explain the different types of negotiable instruments,
- Analyze the concept of negotiability of instruments; and

acquire the basic knowledge of commercial instruments

1.2 Definition of Negotiable Instruments

Dear distance learners, have you ever heard about the expression ‘’Negotiable instruments’’? What does it refers to? You have already studied about the concept of banking and insurance. In this topic, we will see about negotiable instruments.

Negotiable instruments are documents of a certain type, used in commercial transactions and monetary dealings. In this case, “negotiable” means transferable by delivery and “instrument” means a written document by which a right is created in favor of some person. The term negotiable instrument, literary means “a document transferable by delivery’.

In English Mercantile law, the term is used in wider sense. Thus, a negotiable instrument is one in which “the true owner could transfer, the contract or engagement contained there in by simple delivery of the instrument.’’

In Indian law, the term negotiable instrument is used in a restricted sense. Based on this, the Indian Law recognizes three kinds of

instruments as a negotiable instrument and these are promissory notes, bills of exchange and cheques.

Dear distance learners, have you got some hint about the term negotiable instruments? I hope that you have. What is negotiable instrument as per to the 1960 Ethiopian Commercial Code ?

The term' Negotiable' means legally capable of being transferred by endorsement or delivery and the term ' Instrument' means a formal or legal document in writing. Thus, the term negotiable instrument applies to written instruments which are transferred by endorsement or delivery.

A negotiable instrument is a choses in action, the full and legal title to which is transferable by mere delivery of the instrument (possibly with the transferor's endorsement) with the result that complete ownership of the instrument and all the property it represents passes to the transferee free from equities, if the latter takes the instrument in good faith and for value. In this case, by chose in action we mean that the property does not exist in a material form but is a right. So, the document itself as representative of the right is referred to as chose in action.

Art 715(1) of the 1960 Ethiopian Commercial Code 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.

According to Art 715(1) of the Code, we can identify certain elements;

a. It is a document- negotiable instrument is a contract in writing. There is no such thing as an oral instrument; and an oral promise to give or pay falls outside the concept of negotiable instruments
b. It must embody a right to entitlement. Any document to be referred as negotiable instrument must contain a right to entitlement, which other words means that it should contain a promise to give something as to ‘’pay money’’
c. Right and obligations are negotiable. This is the most important nature of documents containing a right to entitlement. The right can be freely negotiated or transferred like any other property.

Hence, negotiable instruments being entitlements of rights are documents which are evidences of rights or of debts. And since the rights embodied in these instruments are intangible personal property, negotiable instruments fall under one of the classes of chose in action, and the basic rules of property law apply in determining the rights and liabilities of the parties to the transfer of such instruments.

Thus, negotiable instruments are chooses in action that may be freely transferred by mere delivery, or by endorsement and delivery from on person to the other so as to pass a complete title to a transferee who takes *bona fide* (in good faith) and for value free of the equities and with the right in the transferee to sue in his own name all parties to the instrument.

Negotiable instruments are one form of control, and the fundamental rules governing contracts are applicable to the determination of the legal questions which are arising from such instruments. But there are points of departure from contract law in negotiable instruments law, and for it not to be a mere contract but a negotiable instrument,

it has to fulfill certain requirements, otherwise provisions& law of contract will apply. An instrument which does not meet the requirements lad down to qualify an instrument as a negotiable one or an instrument which in its inception was negotiable but has lost its quality of negotiability is referred as a non – negotiable instrument.

1.2.1. Main Characteristics 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 can not be perceived by the senses. A right of action under contract is a class of property known as “chooses in action” and can be distinguished from a corporeal movable property “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 copy right holder, rights of a trader in respect of his trademark, trade name and good will 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 contract, 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 in to juridical acts, i.e. minors and judicially interdicted persons may not create a valid contract through negotiable instruments

Art. 733

"Any person having contractual capacity may bind himself by commercial instruments"

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)

"Declarations made by commercial instrument shall bear the signature of the person making them"

Generally, we can sum up the essential features of negotiable instruments as follows;

1. Writing and signature

Negotiable instruments must be written and signed by the parties according to the rules relating to promissory notes, bills of exchange and cheques.

2. Money

Negotiable instruments are payable by legal tender money of the country/Ethiopia. The liabilities of the parties of negotiable instruments are filed and determined in terms of legal tender money.

3. Negotiability

Negotiable instruments can be transferred from one person to another by a simple process. In the case of bearer instruments, delivery of the transferee is sufficient. In the case of order instruments, two things are required for a valid transfer: endorsement (i.e., signature of the holder) and delivery. An instrument may be made non-transferable by using suitable words. E.g. “pay to X only”.

4. Title

The transferee of a negotiable instrument, when he fulfils certain conditions, is called the holder in due course. The holder in due course gets a good title to the instruments even in cases where the title of the transferor is defective.

Dear students, we will see what a holder in due course in the future.

5. Notice.

It is not necessary to give notice of transfer of a negotiable instrument to the party liable to pay. The transferee can sue in his own name.

6. Presumptions

Certain presumptions apply to all negotiable instruments. For instance, it is presumed that, there is consideration. It is not necessary to write in a promissory not the words “for value received” or similar expressions because the payment of consideration is presumed. The words are usually included to create additional evidence of consideration.

7. Popularity

Negotiable instruments are popular in commercial transactions because of their easy negotiability and quick remedies

8. Evidence.

A document which fails to qualify as a negotiable instrumental nevertheless be used as evidence of the fact of indebtedness.

Example:-
Alemu writes to Abebe “I owe you birr 2000” This is not promissory note but the document can be used as evidence to show that Alemu is indebted to Abebe for birr 2000.

1.2.2. Types of Negotiable Instruments

Depending on the countries legislation, there are different types of negotiable instruments. For example, according to the 1881 Negotiable Instruments Act of India, three kinds of instruments are recognized as a negotiable instrument. These are promissory notes ,bill of exchange or cheque payable either to order or to bearers.

According to Art 715 (2) of the 1960 Commercial Code of Ethiopia, three kinds of negotiable instruments are recognized.

Art 715 (2)
“The law recognizes in particular as negotiable instruments commercial instruments, transferable securities, documents of title to goods”.

Based on that, the code recognizes these three instruments

1. Commercial instruments
2. Transferable securities
3. Documents of title to goods

1. Commercial Instruments

Concerning commercial instruments, there is no need to say much here, as they will take the whole of chapter two. Generally, they include;

- Bills of exchange
- Promissory notes
- Cheques
- Traveler's cheques and
- Warehouse goods deposit certificate.

These instruments are negotiable instruments incorporating rights for payment of a specified a mount 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.

2. Transferable securities.

Transferable securities are those negotiable instruments which contain intangible rights. The sources of such rights may be investments made in companies or loan providers 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 inverts in a company is entitled to share in the profits of the company if any, i,e. he has the right to receive dividend and to

shore in the assets of the company where the company is discovered (Art 345)

On the other hand, the person who has purchased a government bond or a treasury bill or a company bond, also called debenture, acquires the right to receive repayment of the money he has given on loan plus interest. (Art 433)

However, all securities are not negotiable instruments. What makes securities negotiable instruments is their transferability according to rules of negotiation. Therefore, if it can not be negotiated, it is difficult to circulate as money. Bonds stocks and transferable shores are instances of securities which are negotiable instrument considered.

3. 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. These kinds of negotiable instruments embody rights to entitlement, which in other words means that they embody ownership right to goods and indebtedness. Some examples of documents of title to goods are:-

- Bill of lading (evidence of ownership to goods shipped).
- Air way bill
- Rail way bill and others

Dear students, we should perhaps pause here and note that although the Commercial Code recognizes the above instruments as negotiable, it mainly governs the first type of negotiable instruments, i,e,

commercial instruments. The other types of instruments, i.e, transferable securities and documents of title to goods have been dealt in connection with other area of law. They are dealt with only generally from Art.715-731 together with other instruments.

1. 3. Negotiability of Instruments

Negotiability is the most important and distinctive characteristics of negotiable instruments that distinguished it from a simple contract. It is of such importance that instruments that lack this attribute will be governed by provisions of general contracts instead of instruments law.

Negotiability has its own different attributes. Besides enabling the instruments to be transferable freely, it gives the holder of the negotiable instrument the benefit of a number of presumptions, such as presumptions of valuable consideration, which he would not have as a claimant in an ordinary contract action. Also, this concept of negotiability enables the transferee to acquire greater rights than his transferor had, where he purchases the instrument in good faith.
‘

The central concept of ‘’Negotiability’’ is the status of a holder in due course, i.e., negotiability may become effective through a holder in due course but negotiability exists distinct from and prior to the existence of a holder in due course.

When we look its definition, negotiation is the transfer of an instrument in such form that the transferee becomes a holder. Whether a holder actually takes free of existing equities and defenses depends up on the further fact of his status as a holder in due course

or a taker through such holder. The transfer of negotiable instruments takes different forms. And according to the forms provided for their transfer, negotiable instruments may be to bearer, in a specified name or to order. Students, please discuss with your friends about these different types of instrument?. Before reading my notes please try to provide your own.

Bearer instruments are those that are transferred by the mere delivery of the instruments, and a holder of such instrument establishes his right to the entitlement by the mere fact of presentment of the instrument. Hence for the purpose of establishing his right over a bearer instrument, since he can exercise his right up on it by the mere fact of its presentment.

When we see instruments in a specified name, the only way that a person can establish his right to the entitlement in the instrument is by the fact of being of designated a beneficiary there in and in the register held by the person issuing the said instrument. And the form of negotiation of such instruments is either by an entry of the name of the transferee both in the instrument and in the register held by the person issuing the said instrument or by delivery of a new instrument in the name of the new holder with such delivery to be entered in the register. It is really doubtful to consider instruments in specified name as negotiable, for the mode of their transfer does not follow attributes of easily negotiability.

Instruments to order are negotiated by endorsement followed by the delivery of the instrument to the beneficiary under the transfer. And the establishment of right by holder requires there to be an uninterrupted series of endorsement; which is to mean that every transfer should be accompanied with an endorsement.

The transferee, the person to whom the instrument is negotiated, may be a holder or a holder in due course. A holder a negotiable instrument is any person entitled to the possession of the instrument in his own name, and to receive or recover the amount due there on from the parties negotiable there to. In order to be accorded the special position of a holder in due course,' a person must first be a "holder" and a "holder" to qualify as a "holder in due course" he must take the instrument.

1. For value
2. In good faith and
3. Without notice that it is overdue or has been dishonored or of any defense against or claim to it by any person.

Dear students, is negotiation distinguished from the ordinary assignment? What is ordinary assignment? Please try to discuss with your friends before reading my notes.

Well, negotiation is distinguished from ordinary assignment. While both refer to transfer, negotiation is limited to the special class of contracts known as negotiable instruments, while ordinary assignment applies to contractual rights and chose in action in general, whether negotiable or non-negotiable. In contrast, to this similarity of assignment and negotiation in that both refer to a transfer, there is an important difference between the two. The assignee receives the same rights under a contract as those possessed by the assignor, no more no less; while in a negotiation the transferee may receive greater rights than those enjoyed by the original transferor. If the transferee of the negotiable instrument is a holder in due course he holds the instrument free from personal defenses

available to the original parties, but he does not hold the instrument free from real defenses, that is, defenses which go to the validity of the instrument in its inception. So, it could be said that the main attribute and advantage of the concept of negotiability is the protection it through around the holder in due course.

Dear students, do you think that the process of negotiability requires certain requirements? I guess you said yes. Great: The process of negotiability is expected to full fill certain requirement. Among these requirements, the first one is form. An instrument must satisfy certain formal requirements if it is to be negotiable. The negotiability of any instrument is determined by the presence or absence of the legal elements of its negotiability or non-negotiability. If an instrument fails to meet one or more of its requirements, it will be considered valid but non-negotiable whose transfer is accomplished by an assignment rather than negotiation and the transferee becomes a holder with the rights of an assignee instead of a holder in due course.

The formal requirements of the different types of negotiable instruments differ slightly, which is due to the difference in the purpose they serve. Nevertheless there are some common requirements that all of them should fulfill. And these are:

- They should be in writing
- Assigned by a maker
- They should contain words of negotiability (I,e, to order,) or to bearer).

1.4. Commercial Instruments

Definition

Commercial instruments are negotiable instruments incorporating rights for payment of 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.

Dear students, let me produce the provision in the Commercial Code that deals with the case of commerce instruments.

Art. 732- Definition.

1. Commercial instruments are negotiable instruments setting out an entitlement consisting in the payment a sum of money.
2. Bills of exchange, promissory notes, cheques, travelers' cheques and warehouse goods deposit certificates shall be deemed to be commercial instruments under this code.
3. The provisions of Art. 2813-2824 of the civil code shall apply to warehouse goods deposit certificates

Art. 732(1) of the commercial code of Ethiopia defines commercial instruments as negotiable instruments setting out an entitlement consisting in the payment of a sum of money. Sub-Article (2) of the same article provides that bills of exclude promissory notes, checks, travelers cheques and where house 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.

Dear students, we will see each commercial instrument one by one in the coming chapters.

Review questions

1. What are the essential features of a negotiable instrument?
2. What do you understand by the term ‘’ negotiability’’ of a Negotiable Instrument?
3. Examine the different modes of discharging of liability of parties to a negotiable instrument
4. What will happen if a negotiable instrument
   a). is lost ?
   b). obtained illegally?
   c). obtained by fraud?
   d). is forged?
5. What are the cases when a negotiable instrument need not be presented for payment? When a negotiable instrument is said to be dishonored?
6. Define what negotiable instrument is.
7. Pin point the nature and purpose of negotiable instruments.
8. Clearly show the role of negotiable instruments.
9. Discuss commercial negotiable instruments, transferable securities, and documents of title to goods.
10. Discuss what a holder in due course means in the Ethiopian Commercial Code.
11. What distinguishes negotiable instruments from other documents?
12. A holder claiming a right on negotiable instrument shall prove that he is a lawful possessor. Explain how the holder may prove this.
13. What are the major elements constituted in the definition of negotiable instruments?

14. Discuss the nature of free transferability of negotiable instruments as an exception to the general rule of transfer of other properties?

Unit Two

Bills of Exchange

Objectives:

After completing your readings of chapter two of this material you will be able to

- Define the concepts what bills of exchange is,
- Identify the parties in bills of exchange,
- Describe the formal requirements of bills of exchange, and
- Explain the purpose and nature of bills of exchange

2.1 Definition

Dear students, what is bill of exchange? What purpose does bill of exchange serve?

According to section 5 of the Negotiable Instrument Act of India, bill of Exchange is defined as "……. An instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument"

According to the above definition, the maker of a bill of exchange is called the Drawer. The person who is directed to pay is called the Drawee. The person who will receive the money is called the payee .When the payee has custody of the bill, he is called the Holder. It is the holder's duty to present the bill to the drawee for his acceptance. The drawee signifies his acceptance by signing on the bill. After such signature the drawee becomes the acceptor.

In a bill of exchange some times the name of another person is mentioned as the person who will accept the bill if the original drawee does not accept it. Such a person is called the Drawee in case of need.

When we come to the case of Ethiopia, the concept of bills of exchange is provided under Art. 735 of the Commercial Code. Students, for your convenience, I have reproduced the provision under.

Art 735- Requirements

A bill of exchange shall contain:

a. the term “bill of exchange” inserted in the body of the instrument and expressed the language employed in drawing up the instrument;
b. an unconditional order to pay a sum certain in money
c. the name of the person who it to pay (drawee)
d. the time of payment;
e. the place of payment;
f. the name of the person to whom or to whose order payment is to be made or an indication that it shall be payable to bearer;
g. the date when and the place where the bill is issued
h. the signature of the person who issues the bill (drawer)

The Ethiopian Commercial Code prefers to provide the content of bills of exchange rather than its meaning under Art.753. But when we see the overall essence of the Article, bills of exchange is an instrument by which payment maybe effected without the use of cash, or payment post paid by the granting of credit. They are used for both domestic transactions and international trade.

As per to this Article, a relationship in a bill of exchange is established where a person wishes to pay money not by cash but by means of an instrument called bill of exchange. For example, X is indebted to Y for Bir. 10,000, “X” has money in the hand of “Z” now as “X” does not have cash, he may pay his debtor by issuing bill of exchange, which is a piece of paper containing an order of payment. Then, “X” issues a bill of exchange and orders “Z” who holds X’s money, in the bill to give br.10,000 to Y. Y then will take the bill, at its maturity to “Z” and gets payment . It is in this way that a bill of exchange may be issued.

According to Art 735 of the commercial code, a bill of exchange involves three persons. That is to say, in a bill of exchange there are at least three parties, Viz:

- the drawer (issuer) the person who issues a bill of exchange (In the above example ‘X’)
- the payee, to whose favor the bill is issued (In the above example “Y”); and
- the drawee, on whom the order to pay is made (In the above example “Z”

Students, are you clear with the above concept? Well, if you are not clear with the concept, please read it once again.

2.2 Parties to a bill of Exchange

Initially there are three parties to a bill of exchange. The person who gives the order is called the drawer, the person to whom the order is given is called the drawee and when he signs the bill, that is he accepts it, he is called the acceptor; and finally the person to whom the bill is payable is called the payee.

Art. 737 of the Commercial Code provides that, a bill of exchange may be drawn to the drawer's order, or to the drawer himself, or for account of a third person. It is not necessary, hence, that separate persons should answer to the description of the drawer and payee. One person may feel any two of these positions. Thus, one may become "drawer and payee" when the bill is drawn "pay to me or my order" or "drawer and drawee" when one draws a bill up on himself. This does not affect the instrument's being treated as a bill of exchange. What is required is that the three parties drawer, drawee and payee must be pointed out in the bill with certainty. It is only when the bill is drawn for account of a third person that the existences of three separate persons occur.

A person to be liable on a bill of exchange, he has to sign on it as a drawer, acceptor or endorser under the general rule relative to the liability of a party on a formal contract; no one can be held liable whose name does not appear on the contract. A party to a bill may be either primarily or secondarily liable as to its payment; and the person primarily liable on a bill is the person who, by the terms of the bill, is absolutely required to pay it. Students, who is this party that is absolutely required to pay it? Please try to provide your own answer.

Art. 743. Liability of Drawer

The drawer guarantees both acceptance and payment. He may release himself from guaranties acceptance. Any provision by which he release himself from the guarantee of payment shall be of no effect.

From the provision we can say that the drawer, since he can not release himself from guarantying payment, at all the times he guarantees the payment of the bill, and hence is absolutely liable for its payment.

Art. 764 of the commercial code on the other hand provides as effects of acceptance that, *"by acceptance, the drawee undertakes to pay the bill of exchange at its maturity, and that where there is default of payment, the holder, not withstanding that he is the drawer, may claim under the bill against the acceptor for all that can be demanded in accordance with articles 791 and 794".* And according to Art 791*, "The holder may recover from the person against when he exercise his right of recourse (in this case the acceptor) the amount of the unpaid bill…"*

One can say by reading these provisions thus, that where he has accepted, the drawee becomes the primary party liable to pay the bill, as once the holder has got his bill accepted by the drawee he pays the sum, and under Art.792 that if any other party than the acceptor paid the bill, he will have the right to recover from him. Hence, it could be said that the acceptor is a party that is primarily liable on a bill. But, what about the drawee who has not accepted? Will he not be liable? The drawee is as we have seen above under Art.735(C) the person who is to pay the bill. So we cannot say he will not be liable. But what differentiates the liabilities assumed by the drawee and the acceptor?

The drawee, if we resort to the definition we gave to a bill of exchange, is a person who owes the drawer a sum equal to the payment of the bill. It is because of the drawer's relationship with the payee which incurred a debt equal to that with the drawee, that the drawer pays the payee and discharges his debt with the drawer. And acceptance brings about a legal relationship between the drawee and the payee; and by acceptance the drawee undertakes an independent obligation to pay the payee.

This means that, he can not raise any objection as to the payment of the bill. So, although the drawee is liable for the payment of the bill, the payee can bring a legal action up on him only if he accepts the bill. So when we see it from the point of view of the holder, he will have as the party absolutely liable for the payment of the acceptor. The drawee, even though he is liable on the bill, if he refuses payment to the holder, where the drawer has released himself from guaranteeing acceptance, the holder can go to the drawer for the payment of the bill, as the drawer guarantees payment, and he can recover the payment from the drawee by virtue of Art 792. But had the drawee accepted the bill the holder would have had the right to sue him.

Hence, the holder has the two parties primarily liable on the payment of the bill the drawer and the acceptor. The drawee, although he is liable to pay since when he refuses to pay the drawer can pay the payee and hence payment of the bill effected becomes secondarily liable, or the drawer will finally come to him for the recovery of the payment. The other party that may be of secondary liability on bill is the payee who has endorsed the bill i.e, the endorser. Art 750 sets out as guaranty of the endorser that “he guarantees both acceptance and payment, in the absence of any provision to the contrary. So, since he can release himself from guaranteeing payment by inserting a provision stating so, he seems to fall under the category of secondary liability.

2.3 Formal requirements of a bill of exchange

As we have seen before, the Commercial Code of Ethiopian 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 consider this as the basic requirement. To be a valid bill of exchange, an instrument must comply with the

formal requirements laid down under art.735. The form of the instrument serves in determining whether the law of negotiable commercial paper or a general contracts law will apply in determining the rights and liabilities of the parties. No particular technical terms need to be used in drafting an instrument which is to be negotiable.

Art. 735. Requirements.

A bill of exchange shall contain:

a. the term “bill of exchange’ inserted in the body of the instrument and expressed in the language employed in drawing up the instrument
b. an unconditional order to pay a sum certain in money;
c. the name of the person who is to pay (drawee);
d. the time of payment
e. the place payment
f. the name of the person to whom or to whose order payment is to be made or an “indication that it shall be payable to bearer.
g. The date when and place where the bill is issued
h. The signature of the person who issues the bill (drawer)

A bill of exchange may be any type of paper or piece of paper. But, to qualify as a bill of exchange there are certain requirements this paper should fulfill. Students, eet me provide one sample of bill of exchange for you, that contains the elements that are mentioned under Art.735 (a)-(h)

Bill of exchange

Br, 10,000 Date: Dec,10,2019

Bahir Dar

Pay to Abebe Molla or to his order on Dec.20,2009 at his office. The sum of Br 10,000 with interest at the rate of 9% from date until paid

To Yonas Biruk Abera Molla

Model of Bill of Exchange

A bill of exchange that does not contain any one of the element mentioned under Art.73(a(valid and the drawer or any other party to the instrument can raise defect of form

Under Art.735(1), the paper should contain the word “bill of exchange”, Here, according to the provision, unless the bill of exchange contains this word, it will lack one of the element and it will be invalid and this position is mentioned under Art 736 of the Commercial Code.

When we come to Art 735 (b), the law requires that the drawer of a bill of exchange should make an order to the drawee (who is supposed to pay). Recognition of debt is not an order. For example if the drawer says in the bill as, “I acknowledge Br, 20,000 as my debt” is not on order. It only recognition of debt and it may serve as an evidence for the future court litigation. But “pay to ‘A’ Br. 20,000 is an order, which is acceptable.

Again, the order given by the drawer should not be attached to any condition. It should not depend on the happening or not happening of a certain future event. For example, if the drawer says in the bill “pay to ‘A’ Br 10,000 if stand first in the competition, or if he gets married” etc, this is a conditional order, which is not valid because the instrument is payable only on the happening of the contingencies In other words, it becomes payable only if “A” stands first or gets married. If he never stands first or he never marries, the bill will not

be paid. Therefore, for a bill of exchange to be valid, it should contain unconditional order.

The other issue in sub (b) is that the order should be to pay a “sum certain in money”. An instrument is payable in money if it gives the payee the right to have payment in the currency of any domestic of foreign money: Birr, dollar, Euro, etc. So an instrument payable in wheat or corn can not be commercial instrument. Again, the amount of money the drawer orders should be “certain”. If the sum is certain, the transferee can determine quickly how much the drawer owes, and therefore how much the transferee should pay for the instrument.

The sum is certain if the payee can determine at the time set for payment, from the instrument itself with our reference to any outside source the amount then payable.

When we come to the issue with regard to time of payment, a bill of exchange that 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 payment, shall be deemed to be payable at the domicile or at the addresses of the drawee, and a bill which does not provide place of issue, is deemed to have been drawn at the place mentioned besides the name of the drawer.

In addition, the bill should contain the name of the payee or language such as to “order” or “bearer”. To be negotiable, an instrument must contain language expressing the issuer’s (drawer’s) intention that the instrument circulates freely. This language of negotiability can be either “order” language or “bearer” language, depending on the wishes of the parties. The presence of “bearer or “order” language assures any transferee (person who receives the instrument from the

payee or other holder) that the drawer is willing to pay even a stranger. Dear students, here it is appropriate to raise one question. Is there any mechanism to protect the bill from unauthorized or inappropriate person, i.e., a thief? Do you think that it may even encourage the transaction if mechanism is inserted? Please discuss with your friends.

The signature of the drawer is required for the obvious reason that payees and other holders must be able to prove whose legal commitment the instrument represents. The signature may be hand written or may be affixed by any mechanical process such as a stamp or thumb print. The signature of the drawer may appear in the body of the instrument. However, it normally appears at the end of the document.

Dear students, what will be the effect if the requirements that are mentioned under Art 735(a)-(h) are not fulfilled?. Please make a discussion with your friends. The effect of the non-fulfillment of the requirements mentioned from (a-h) differs depending up on the requirements, which are not fulfilled. Where the requirements mentioned below are not met, the instrument shall not be valid as a bill of exchange. There requirements are:

- those mentioned in item a,b,c,f & h of Art.735;
- the date on which the bill is issued.

On the other hand, where the following elements are not fulfilled, the instrument is still valid as a bill of exchange, but the law will take some presumptions and fill the gap. These elements are:

- those mentioned in item ‘d’ and ‘e’ of Art. 735 and
- When the place where the instrument is issued is not specified.

Students, what will be the effect if there is discrepancy in the sum payable?. As solution, we have art 740 of the Commercial Code. For your convenience, I have also reproduced it here in below.

Art 740 – Discrepancy in t he sum payable.

(1) Where the sum payable by a bill of exchange is expressed Loath in words and figures and there is discrepancy, the sum expressed in words shall prevail.
(2) Where the sum payable by a bill of exchange is expressed more than one in word or more than are in figures and there is discrepancy, the smaller sum shall prevail.

Student, have you read the above provision? Well; sometimes due to an error for other reasons the amount of money specified in the bill of exchange may be ambiguous. This ambiguity may arise when the sum payable is expressed both in figure and words. If, for example, the bill of exchange reads pay “A Birr 2000 (twenty thousand).

In this case, the law under Art 740 says that the bill of exchange will not be invalid by reason of this discrepancy. The instrument is still a valid bill of exchange and the law solves the problem by taking the amount written in words. The sum expressed in words shall prevail; i.e in the above example, the drawer shall pay birr – ten thousand.

Student, we have also another situation that creates discrepancy. This, a situation where the amount in the bill of exchange is expressed more than once in words & figures. In this case, the law says that the bill of exchange is valid and the amount that prevails is the smaller sum.

Student, what will be the consequence, if the bill has the signature of incapable person that cannot bind him/her self?. Here, to solve this problem, we have article 741 of the commercial code.

Art 741 – signature of persons incapable of binding themselves

> In a bill of exchange bears signature of person incapable of binding themselves by a bill of exchange, forged signature, signatures of factious persons or signature, which for any other reason cannot bind the person who winged the bill of exchange or on whose behalf it was signed, the obligations of the other person who have signed it shall be valid.

Student, the above question leads us back to Art 717 of the Commercial Code. **Art, 714** of the code tells us defense, available to debtors when they are preceded against in negotiable instruments. Based on that, incapacity, falsification of signature and lack of authority are defenses available to debtors in negotiable instruments.

For example w/t Helen, the secretary of Ato Yaregal, falsifies or forges the signature of her employer, prepares a bill of exchange payable for herself, puts the forged signature of her employer and transfers the bill of exchange to Muluken , who does not know anything about Helen's act, Muluken intern endorses the bill of exchange and transfers it to Helga. Then at is its maturity, Nega taken the instrument to the drawee to get payment. But the drawee refuses of institutes an action against Helen, Yargal and Muluken. Now question may arise as to whether the instrument is valid bill of exchange, as to where there each party is liable and what defense a available to each party. Students, is the instrument valid? Please have a discussion with your friends before reading my notes and write tour answer in the space provided.

The answer to the question is given in Art 717 and 741of the commercial code. The instrument is definitely a valid bill of exchange provided that all the elements mentioned in Art. 735 are met. Concerning the liability of Helen, Yaregal and Muluken, from Ato Yaregal, the employer, whose signature is forged he is not liable in the bill of exchange, because he did not sign on the instrument, He can raise the defense based on falsification of signature stated in Art 717(1). However, Helen and Muluken are liable in the bill of exchange to Nega pursuant to **Art 741** the Commercial Code. It says if the bill of exchange bears signature of person incapable of binding themselves by a bill of exchange, forged signature, signature of fictions person who signed the bill of exchange or on whose behalf it was signed, the obligations of the other persons who have signed it shall be valid.

The whole idea behind **Art 741** is that a bill of exchange shall not be is valid because of the fact that the signature of one of the debtor's is falsified, or he is incapable or he does not give authority. The bill of exchange still binds other and w ho gave proper a authority.

Student, in addition to the above issue, let me raise similar cases. What will be the effect, if a bill is signed by a person without having the power to act? Do you think that the bill of exchange is valid? Please have a discussion before reading my notes.

Art 742. Signature without power to act.

Whosoever signs a bill of exchange on behalf of person for whom he had no power to act shall be bound himself as a party to the bill and, of he pays, shall have the same rights as the person for whom he purported to act. The some rule shall apply to an agent who exceeded his power.

Students, the above article has something to do with the law of agency. It is to be recalled that in the law of agency that acts performed by a person who does not have authority shall not bind the person on whose behalf the acts are performed. In addition, even if the person has authority to perform certain acts, he should not exceed his authority and perform acts, which are not the subject of the agency.

When we read **Art 2205** (2) of the Civil Code, we find the issue, which is of particular interest. In this sub article, it has been stated that signing bill of exchange needs special authority. An agent who has only general authority may not sign a bill of exchange. If he does so, he exceeds his authority and the effect is provided in Art 741 of the Commercial Code. **Art 742** indicates a situation where a person signs a bill of exchange on behalf of another person without having authority at all or in excess of his authority.

Let us assume that, Silesh issues a bill of exchange on excess of his authority and delivers to Mengesha. Mengesha then transfers to Wubetu. Who is then liable? According to Article 742, the Principal is not responsible for the bill of exchange, as he did not give authority to Silesh to sign on his behalf. And yet the bill of exchange is valid and

binds Silesh. Silesh who signs on the bill of exchange without authority shall bind himself as a part to the bill and, if he pays to Wubetu, shall have the same rights the person for whom he purported to act could have.

The other issue with regard to bill of exchange is, when there is incompleteness in the instrument. Student, what will be the effect if the instrument is incomplete? Please read the following provision of the Commercial Code.

> **Art. 744** – Bill of Exchange in Blank.
> If a bill of exchange, which was incomplete when issued, has been completed otherwise than in accordance with the agreements entered I to, the non-observance of such agreement may not be set up against the holder unless he has acquired the bill of exchange in bad faith or, in acquiring it, he committed fault.

Normally, a bill of exchange is completed by the person issuing it. The drawer is supposed to comply with the bill as to its time of payment, amount money and other derails. But, for some reasons the drawer may deliver an incomplete bill to the payee and agree with the later that bill should be completed in a certain way. The payee is then expected to complete the incomplete bill in exactly the same way agreed up on between the drawer and himself. However, the payee disregarding the agreement completes the bill in away otherwise than agreed up on by the drawer. A question may arise here as to whether the payee may enforce the bill against the drawer. The answer is no when the payee tries to enforce the bill, the drawer will definitely raise the argument they reached as a defense based on personal relation between the two.

A real problem arises, however, if the payee instead of trying to enforce the bill endorses it and transfers it to another person, say to Ato Abebe. Abebe is now holder of a bill of exchange, which is completed by the payee otherwise that agreed up on by the drawer.

Can Abebe enforce the bill which is completed? Otherwise, is the drawer liable for the bill which is completed otherwise than he wanted it to be completed? Student, the answer for this question is given under Art, 744 of the Commercial Code. According to this Article, Ato Abebe is entitled to the rights in the bill if he acquires it in good faith and without committing a fault. In this case, Abebe is a holder-in-due course and hence the drawer cane not raise the agreement entered in to with the payee as a defense against Abebe. Student, we will see what a holder-in-due course is in the later chapter. On the other hand, if Abebe acquires the bill of exchange in bad faith, i.e knowing what the payee did, knowing the agreement between the drawer and the payee, he cannot get the right incorporated in the bill. The drawer can successfully raise the defense based on personal relation.

Students, is the above issue clear? Have you understood it appropriately? Well, in order to catch up the idea, please read again and again. Now, I am going to raise the issue of ante or post dated bill of exchange. Before explaining the concepts, let me reproduce the provision.

Art 745 – Ante or post dated bill of exchange,

(1) A bill of exchange shall not be Null and voile for the sole reason that is no frond or illegality.

(2) A person to whom an instrument so dated is delivered is deemed to have acquired it at the date of delivery.

Antedated bill is a bill, which bears a date earlier than the date of issue. For example, the drawer prepares a bill of exchange on sep. 20/ 2009 and delivers it to the payee on the same day. However, the date he writes on the bill is not Sep 20/2009, it is rather August 20/2009, which is earlier than the date of issue or delivery. On the other hand, a post dated bill of exchange is a bill, which bears date later than the date of issue. It is just the opposite of antedated bill. For instance, the drawer prepares a bill on Sep 20/ 2009, and delivers it to the payee on the same day. But the date written on the bill is not Sep 20/2009, rather October 25/2009. As we have seen above unless the purpose post-dating or antedating is to commit fraud or illegal acts, the bill of exchange so dated is valid.

Now, I am going to raise some issues in relation to the liability of the drawer of bill of exchange.

Art 743 – Liability Drawer

The drawer guarantees both acceptance and payment. He may release himself from guaranteeing acceptance. Any provision by which he releases himself from the guarantee of payment shall be of no effect.

Students, in our previous discussion we have seen that the drawer is a person who issues a bill of exchange. As soon as he places a signature on the bill and delivers it to the payee, a contract is automatically made promising the payee that the drawer will pay in the event the drawer (the person who is ordered in the bill to pay the face value of

the bill to the holder) does not pay. There is also what we call acceptance concerning bill of exchange. So, signing on a bill of exchange as a drawer results in an implied contract that the drawer promises to pay it when it matures.
When we look at Art 743, the drawer's liability is to guarantee that the drawee will accept and pay the bill of exchange when it is due. This implies that his liability is not primary. In other words, his liability matures only when the drawer refuse, to accept it or to pay it. The holder of the bill cannot proceed against the drawer unless and until he presents the bill to drawee for acceptance and payment.

On the other, the maker of a promissory note and acceptor of a bill of exchange are primary parties. Primary liability is unconditional, i. e, primary party is liable to the holder of the instrument for the face amount, and can be sued for it immediate when the instrument becomes due, without the need for any further action by the holder, Consequently, when sued, a primary party cannot delay the lawsuit on the grounds of the holders failure to make presentment (demand) for payment.

Dear students, have you understood well all the issue that I have raised with regard to formalities of bill of exchange?. I think so! Now, I am going to raise some special cases with regard bill of exchange in the following sections.

2.4 Purpose and nature of Bills of Exchange

Bills of exchange are instruments, by means of which a series of debts may be discharged without the use of cash, or payment postponed by the granting of credit. It serves as a debt collector, as transferor of cash or as financing a transaction.

In settling a debt, the debtor would like to have a proof that the person that comes to collect the debt is entitled to it and by getting hold of the bill would have a proof of discharge of his liability. As the rule says that, “the debtor shall only pay against delivery of the instrument”. Students, have you understood what discharge mean?. Great; Let us see now an illustration, to make clear what is meant by discharging a series of debts without the use of cash. Let us suppose that ‘A’ owes birr 1000 to ‘B’ who in his turn owes birr 1000 to ‘C’. ‘B’ can order ‘A’ to pay ‘C’, and when ‘A’ does this, both debts will be extinguished.

A bill is said to be used as a transferor of cash when it is negotiated either through endorsement or delivery. In its use as financing a transaction the bill is used in its credit-granting aspect. An instance of such use would be where for instance a retail merchant buys birr 5000 worth of goods from a wholesale firm and, by granting a bill payable in three months, gets time to sell his stock before meeting the price. The creditor, on the other hand, in taking the bill from his customer, has obtained a most useful document of debt. He has his debtor fixed down to a definite date of payment, and he can if it is inconvenient for him to be without the money, get the bill discounted by a banker, (Art.941(1)) thus obtains a sum equivalent to the debt before the amount of the bill is due. As the bill passes around thus, it collects credits, and the more the bill circulates the more credit it builds up.

The popularity and usefulness of a bill of exchange is largely due to the exceptional privileges which it enjoys. The special benefits of using bills of exchange are that a bill being a doubly secured instrument, if dishonored by the acceptor, the holder or the payee

may look to the drawer for payment. In case of immediate need of money the possibility that a bill can be discounted with a bank by the payee and the fact that it is possible to discharge two separate debts by the same bill of exchange, are the other benefits of using a bill of exchange.

Bills of exchange can be used for both domestic transactions and international trade, and according to this they are classified in to two; inland and foreign bills. A bill of exchange is either a foreign or domestic bill depending up on the place where it is drawn and made payable. One drawn and made payable within the same country is a domestic or inland bill; and one drawn in one country and payable in a different country is a foreign bill.

The form of a bill of exchange used for general business transaction is called a draft, if the drawee is a bank, it is a cheque, and if the drawer also is the same bank it is a crasher's cheque.; and if is a different bank it is bank draft. A trade acceptance is a bill of exchange drawn by the seller, on the purchaser of the goods sold, and accepted by such purchaser. So far we have seen the definition, characteristics and nature of the bill. Now we will proceed to deal with the manner by which a bill of exchange is transferred from one person to another in the coming chapter.

Review question

1. What is bills of exchange and what are its elements?.
2. ''Please let the bearer have ten birr and oblige''. Is it a bill of exchange? What is your reason, if your answer is no?
3. ''We here by authorize you to pay on our account to the order of A, birr 7000.'' Does it fulfill the requirements of bills of exchange?

4. Discuss the legal elements that should be fulfilled for an instrument to be called commercial instrument.
5. Verify what a bill of exchange, promissory notes, and checks are.
6. Discuss what generally and specially crossed checks are.
7. Discuss what certification of checks is.
8. Discuss the legal orientation of interest in relation to commercial negotiable instruments.
9. Discuss what opposition, payment, and discharge are.

UNIT THREE

Negotiation of Bills of Exchange

Objectives:

After completing your readings of chapter three of this material you will be able to

- Define the concepts negotiation of bills of exchange ,
- Explain what delivery and endorsement of bills of exchange is
- discuss the different types of bills of exchange,
- describe the purpose of endorsement as a means of negotiating bills and

Acquire the basic knowledge of establishment of title.

3.1 In general

Negotiation of bills of exchange means the act by which a bill of exchange is put in to circulation:

1. originally by the drawer delivering it to the payee, and

2. by being passed on the original payee to another. But a distinction must be made between the first transfer from the first drawer to the first holder, and subsequent transfers. The first transfer of the bill to the payee is called the “issue” of the bill, and subsequent transfers are called negotiation. Hence, which the first holder of an instrument acquires title by issuance, the second ad successive holders acquire it by negotiation.

The delivery of an instrument by the drawer with the intention of granting rights in it, is technically referred to as its “issue”, although the term “drawing” is also used. The first delivery, that is issuance, is essential to complete the contract, but the first transferee, though a holder, can not be a holder in due courses, except where the bill is drawn in favor of the drawer, in which case his endorsee is the first transferee. This is because, as we have seen above in order to be a holder in due course, one of the requirements is for the person to get the bill for value. And in the case of issuance drawing the payee does not get it for value i.e by paying to get it, but because the drawer with whom he had personal relations owes him a debt.

He is merely the person designated as payee in the bill and hence is a mere holder. A holder is the person who receives possession of the instrument from the drawer or from an endorser.

After its issuance, a bill may be transferred. Depending on whether the bill is negotiable or not its mode of transfer will acquire different forms. A negotiable bill of exchange is transferred by way of negotiation as well as by assignments. To negotiate a bill is to transfer it, so as to make the person to whom it is transferred, the holder; and a holder may always transfer unless he is specially prohibited from doing so by words contained in the bill. Hence as it is the rule, where

the transfer of a negotiable instrument is accomplished by a negotiation and the transferee meets the requirements “for a holder in due course the holder takes the instrument free from most defenses; that is the transferee can acquire better rights in the instrument than the transferor had.

A bill can be negotiated until payment is effected or satisfaction there of by the drawer, drawee or acceptor after maturity, but not after such payment or satisfaction. This to mean that negotiability of an instrument stops only when the party ultimately liable there on pays it at or after maturity. This indicates that a bill can be negotiated even at or after maturity if it has not been paid or satisfied. In this case the acceptor or drawer who receives the instrument at payment but before maturity may resistive it”.

As we have seen above ,a bill of exchange which is one of the types of negotiable instruments falling under one of the classes of chooses in action has the basic rules of property applied in determining the rules of its transfer, the right and duties of the parties to the transfer of such an instrument.

In relation to the transfer of personal property, our Civil Code under article 1143 says that, any transfer of possession made by virtue of a contract shall be effective at the time when the thing is delivered. So According to this article delivery is the determinant factor for the transfer of personal property by virtue of a contract.

When we come to our Commercial Code, there are different provisions that deal with the rule for the transfer of instruments. In general provisions for negotiable instruments are given:

Art. 721 (1) An instrument to bearer shall be transferred by delivery of the instrument.

Art. 723 (1) Instruments in a specified name may be transferred by the entry of the name of the transferee in the instrument and in the register held by the person issuing the instrument.

Art. 724 (1) Instruments to order may be transferred by endorsement, followed by delivery of the instrument to the beneficiary under the transfer.

When we go to the special provisions given for bills of exchange, concerning its transfer these rules are provided in a single article.

Art. 746. Negotiability

1. A bill of exchange to bearer may be transferred by simple delivery of the instrument.
2. Any other bill of exchange, even if not expressly drawn to order, may be transferred by endorsement. When the drawer has inserted in a bill of exchange the words “ not to order” or similar words, the instrument can only be transferred according to the form and with the effects of an ordinary assignment.

Hence, we can see that the main rule for the transfer of a bill is by delivery only if it is payable to bearer, by endorsement followed by delivery if it is payable to order, and according to the form and with the effects of an ordinary assignment if it is, payable to a named payee only.

So, since the modes of negotiation of a bill are basically effected through delivery and endorsement, we will see now in brief what is meant by delivery and endorsement.

3.1.1 Delivery

It should be noted that whatever the form of negotiation is, delivery made voluntarily with the intention of transferring the ownership of the instrument to the transferee is essential. Delivery is a voluntary manual transfer of possession, actual or constructive, from one person to another, with the right of action passing to the holder. It is the final step necessary to complete the existence of any written contract, and it is a prerequisite to the validity and enforceability of a negotiable instrument. In order to constitute a complete negotiation the delivery should be made with the intention of passing the property, as delivery not made voluntarily and without an intention is not valid. Thus, a person delivering an instrument to another for safe custody will not be negotiating the instrument even if the instrument is a bearer one. Hence, delivery though simple, is an important formality for without it no possessor is constituted as a holder of an instrument.

Delivery may be actual or constructive. A delivery is actual when the instrument is physically handed over by the transferor to the transferee or to some one on his behalf. And a delivery is constructive when it is effected with out any change of actual possession. It implies a delivery in the eyes of the law.

Delivery is an essential ingredient of every written contract in that every written contract must be delivered by the party obligating himself to some one who has a right to control it, since delivery is evidence of the assent of the general rule, a negotiable instrument like any other written instrument, has no legal inception or valid existence until it has been delivered in accordance with the purpose and intention of the parties.

Let’s see in the following example the effect and importance of delivery.

‘A’ draws a bill in favor of “B” or order. “B” endorses it in blank, thereby converting it into a bearer bill. A thief steals it from “B” and negotiates the bill to “H”, a holder in due course. ‘H’ can sue all prior parties because in his favor a delivery from ‘B’ to the thief is conclusively presumed and he has acquired the bill in the rightful manner bearer bills are negotiated, that is through delivery.

3.1.2 Endorsement

The word endorsement has been defined as writing of one’s name on an instrument with intent to incur the liability of a party who warrants payment of the instrument, provided it is duly presented to the principal at maturity, not paid by him, and such fact is duly notified to the endorsee.

An endorsement of a bill of exchange is made by the writing of the holder’s name by him or his behalf. It is customarily written on the back of the instrument, although it may appear anywhere on the instrument; or on a paper called an “allonge”, attached so firmly thereto as to become a part thereof, when the back of the instrument is full of endorsements and there is no place. Thus, an endorsement consists of the signature of the holder usually made on the back of the bill or on an “allonge” with the object of transferring the instrument.

The person making the endorsement is called an “endorser” and the person to whom the instrument is endorsed is called an “endorsee”. And as to the party that is entitled to endorse an instrument, it is the payee of the instrument that is the rightful person to make the first

endorsement. Thereafter, the instrument may be endorsed by any party who has become the holder of the instrument. Ordinarily, the drawer of a bill of exchange can not endorse; but if he has become the holder in his own right, he may endorse the bill. (art. 737(1) of the commercial code)

In effect, an endorsement is an implied contract by the endorser to pay the endorsee if the drawee does not. It is a conditional contract, which distinguishes it from the contract of the drawer, in that the endorser is liable to pay only on the condition that the drawee does not (art. 750 (1) of the commercial code).

An endorsement, to be valid and in order to operate as a means of negotiation, must comply with certain requirements.

An endorsement is required to negotiate only certain types of bills: order bills. Let us see now the different types of bills in relation with their modes of transfer.

3.2 Bearer bills

Article 746(1) of our Commercial Code states concerning bills of exchange payable to bearer that a bill of exchange drawn to bearer may be transferred by simple delivery of the instrument. A part from this provision that deals with the transfer of a bearer bill, we don’t find any other provision that gives its meaning and nature. When we refer to the general provisions for negotiable instruments (title one of book IV) the situation is more or less the same. We have article 719 that states that according to the forms provided for their transfer, negotiable instruments may be to bearer, in a specified name or to

order. We can see from this provision that an instrument can be drawn depending up on its form of transfer. There is also article 721 providing that an instrument to bearer shall be transferred by delivery, and that the holder of an instrument to hearer establishes his right to the entitlement as expressed in the instrument by the sole fact of presentment of the said instrument.

As we have seen above, the only requirement for a bearer bill of exchange to be negotiated is a mere delivery; and the person who acquires a bearer instrument through delivery will be considered as the lawful possessor of the bill.

But what is a bearer bill of exchange and what are its attributes that distinguish it from the other forms of bills? The fact that the answer for these questions is not provided in our code forces us to go back and examine the background of book IV of our commercial code to see based on which law the rules relating to a commercial instrument to bearer are adopted.

Professor Escara, the drafter of the Commercial Code, states as follows concerning the adoption of the rule of a commercial instrument to bearer.

> *“ One of the differences frequently found between the Anglo – saxon system and that of the uniform law is that the first allows the creation of a commercial instrument to bearer while the latter does not. But while the uniform law does not permit the creation of a commercial instrument to bearer it does permit an endorsement to bearer and consequently from the document when the instrument is endorsed to bearer it*

circulates exactly as if it had originally been drawn to bearer. Under those circumstances the difference between the two systems is hardly logical. I have introduced in to the Ethiopian law the rule that the bill of exchange can be drawn directly to bearer."

Hence, since the draft has introduced the possibility of drawing a bill to bearer from the rule of the Anglo-saxon system, I think it would be right to consider the definition and nature of a bill payable to bearer as is provided in the Anglo-Saxon laws.

Article 9 of the Uniform Negotiable Instruments Act.27 describes an instrument payable to bearer as follows.
"An instrument is payable to bearer

1. When it is expressed to be so payable; or
2. When it is payable to a person named therein as bearer; or
3. When it is payable to the order of a fictitious or non- existing person, and such fact is known to the person making it so payable; or
4. When the name of the payee does not purport to be the name of any person; or
5. When the only or last endorsement is an endorsement in blank.

Thus a bill in the form, "pay bearer" or 'pay to bearer" is payable to bearer. But a bill payable to the order of the bearer" is not payable to bearer within the meaning of the uniform Act, so as to be negotiable by mere delivery. Like wise, an instrument payable to "bearer" followed by the name of a person, as in "pay to bearer A " has been held non-negotiable, since it is held in legal effect the same as if the word "bearer had been omitted.

The other conditions which enable a bill to be payable to bearer are that when it is payable to the order of a fictitious or non-existing person with this fact being known to the person making it to payable, and when the name of the payee does not purport to be the name of any person. But what is meant by a fictious, non-existing and an inexistent name of a person?

The fictitious payee doctrine operates to make paper ostensibly drawn to order or to bearer. This is to mean that it helps to distinguish a paper whether it is a bearer one or not; and whether a valid endorsement of an instrument is necessary for its transfer and, hence, who is to bear the loss as between the drawer, drawee and holder in certain situations.

A payee may be fictitious without regard to whether he is existent or non-existent, the test being the intent and knowledge of the maker of the fictitious character of the payee, and hence the rule may be said to be that a negotiable instrument or endorsement made to a fictitious person can’t be treated as payable to bearer and negotiated without endorsement unless the person making it known and actually intends to make the instrument payable to a fictitious person. Thus a fictitious person may be defined as a fictitious person who, through named in the bill, has no right to it or to its proceeds, because it depends on the knowledge or intention of the party against whom it is attempted to assent the rule and not upon the actual existence a non-existence of a payee of the same name as that appearing in the instruments, so that a real person may be a fictitious payee and a non existing person may be real with in the rule.

A bill that has as the name of the payee a name that doesn’t purport to be the name of any person is to mean bills that are made out as “

pay to the order of cash" or "pay to the order of wages" or "pay to the order of office". Bills written out in such forms are deemed as negotiable without endorsement and thus bearer bills.

In general the basic concept of a bearer bill is that it is a bill which the issuer intends to be negotiable but doesn't name a payee who can endorse and negotiate it. Thus it will be negotiable since the drawer or endorser has not made any limitation to the negotiability of the bill, by a simple delivery, since the issuer's negotiation has not named the payee who can endorse it.

A bill originally expressed to be payable to bearer cannot be endorsed as payable to order, and, not withstanding such an endorsement, it would continue to be payable to bearer. If for instance a bill is payable to bearer on its face originally expressed to be payable to bearer ,it would remain a bearer bill even if A endorses it in the form " pay to the order of B" and delivered it to B''. B could negotiate the bill (bearing A' s special endorsement) to C by a mere delivery without endorsement and A would not be liable to C, as the latter could not make title through A's endorsement, because the acquisition of ownership by c is only through the delivery made by B of a bearer paper.

Let's see now this situation in an illustration. Supposing A draws a bill in favor of B or order upon A. B indorses it in blank and hands it to C who transfers it for value to D who transfers it for value to E, a holder in due course. Neither C nor D endorses the bill which on presentation at A's bank is dishonored. E can sue A (art 743 comm. Code of Eth) and he can also sue B on his endorsement (art. 750 comm. Code of Eth). He cannot sue C because C has not signed the bill and because he is not immediate transferee. And he cannot sue D

unless he can prove that D knew at the time of the transfer that the bill was valueless. But there is no provision in our code that makes the transferor by delivery liable to his immediate transferee that is a holder in due course, where he is aware of any fact which renders the bill valueless, at the time of transfer. Article 721(2) of the commercial code provides that, “the holder of an instrument to bearer establishes his right to the entitlement as expressed in the instrument by the sole fact of presentment of the said instrument”. If this is so, then does it mean that when the holder in due course presents the bill to the drawee and the bill is dishonored he will have no recourse even if the immediate transferor has transferred it knowing that the bill was valueless.?.

Students, please try to provide your own answer before reading my notes. In the opinion of the writer of this material, our law should have provided for a condition by which the holder in due course of a bearer instrument could bring a legal action against his immediate transferor where he has acted maliciously. And hence in our illustration above E should be allowed to be able to sue D if he can prove that D knew at the time of the transfer that the bill was valueless, as E is an acquirer through good faith and honesty that is protected by the law, he should not be the party bearing the loss.

3.3. Non-negotiable bills

A bill is said to be non-negotiable when it contains words prohibiting transfer or an intention that it should not be transferable. Such an instrument will be valid as between the parties thereto, but it is not negotiable.

Article 746 (2) provides that; “… when the drawer has inserted in a bill of exchange the words “not to order” or similar words, the instrument can only be transferred according to the form and with the effects of an ordinary assignment.

Hence, a bill made out as a “pay X only” and a bill that says “pay X” and crossed “non negotiable” will be deemed to be non negotiable bills, since these words have the effect of prohibiting negotiation.

Article 723(1) provides dealing with the transfer of instruments in a specified name that;

Instruments in a specified name may be transferred by the entry of the name of the transferee in the instrument and in the register held by the person issuing the said instrument. They may also be transferred by delivery of a new instrument in the name of the new holder with such delivery entered in the register.

The form of bills in a specified name takes to be transferred is such a special procedure which is completely different from the form “negotiable instruments take. And as we have seen in article 746(2) the transferee of the non-negotiable bill will have the status of an ordinary assignee. So it has to be noted that although a non-negotiable instrument doesn’t possess the quality of negotiability which gives a holder in due course a good title irrespective of the title of the transferor ,yet it can be assigned as a chooses in action. The reason for this is that as we have seen above, 48 The reason for this is that as we have seen above, negotiable instruments are governed by property law since they are one of the classes of chooses in action. Hence in this special case of the transfer of non- negotiable instruments the appropriate property law has to apply.

Let us see in the following instance, what could happen in a condition where a non-negotiable bill is transferred as a negotiable one. D drew a bill on G payable three months after date, “to the order of H only” and crossed it” non-negotiable.” The bill was accepted by G and Endorsed for value by D to H. Here H could not sue G for the amount of the bill, because it was not transferable. So H could not be a holder in due course, but a mere assignee of the bill, taking it subject to the equities or the original parties. Hence a non-negotiable bill could be said to have every quality except that of negotiability .Students, are you clear with this concept? Great.

To sum up, for bills in order to be negotiated in the sense negotiable instruments are transferred, it has to be made out either to bearer or to order. Bearer bills have the attribute of being negotiated easily since all that is required is the delivery of the bill while order bills requires both endorsement and delivery to be negotiated. Any other bill in a form other than the above two bill are not be considered as a negotiable bill; and thus will not bill are not be considered as a negotiable bill; and thus will not be transferred by a negotiation. Bills made out to a specified person hence, are not in the orthodox sense of the word negotiable.

3.4 Endorsement as a means of negotiating bills

Endorsement, as we have seen in the previous topic, is a means by which bills payable to order are negotiated. It is of crucial importance to these bills in that without an endorsement an order bill transferred in any other way will have the effect of a mere assignment instead of

negotiation. Let us see now the elements, forms types and the effect of endorsements.

3.4.1 Forms and elements of endorsements

The Commercial code sets out the form and elements of endorsements as follows.

Art. 725. Forms of endorsements

1. *An endorsement shall be written on the instrument and signed by the endorser.*
2. *An endorsement not containing the name of the endorsee shall be valid.*
3. *An endorsement "to bearer" shall be equivalent to an endorsement in blank.*
4. *An endorsement in shall be unconditional. Any condition to which it is made subject shall be of no effect.*
5. *A partial endorsement shall be rule and void.*

Art. 748 forms of endorsement.

1. *An endorsement shall be written on the bill of exchange or on a slip affixed there to (allonge). It shall be signed by the endorser.*
2. *The endorsement may leave the beneficiary unspecified or may consist simply of the signature of the endorser (endorsement in blank). In the latter case, the endorsement to be valid shall be written on the back of the bill of exchange or the slip affixed there to allonge.)*

Art. 747. Elements of endorsement

1. *An endorsement shall be unconditional. condition to which it is made subject shall be of no effect.*
2. *A partial endorsement shall be will and void*
3. *An endorsement "to bearer" is equivalent to an endorsement in blank.*

Hence, an endorsement has to be in the form of the above listed rules in order to be valid. And what these rules require of a valid endorsement in short is that the endorsement must be written on the bill itself or on an allonge and must be signed by the endorser. There are conditions where the simple signature of the endorser on the bill, without additional words is sufficient and in such cases where the endorsement is made by a simple signature, it will be said that the instrument is endorsed in blank; and the bill will be considered as endorsed to bearer. The other form which an endorsement must fulfill in order to be valid is to be unconditional. Any condition to which it is made subject shall be of no effect. Although we have said in the previous chapter, that an endorsement by its very nature is a conditional contract since it is a promise by the endorser to pay on condition that the drawee refuses to pay, here when the code says unconditional it doesn't seem to be in that sense, what is wanted to be said here seems that notwithstanding the fact that an endorsement by its very nature is conditional on the fact of refusal of payment by the drawee, it couldn't be conditional on any other things. The last requirement set out by our code of a valid endorsement is that it must be an endorsement of the entire bill. A partial endorsement, that is to say, an endorsement which purports to transfer to the endorsee a part only of the amount payable, or which purports to transfer the bill to two or more endorsee serially, does not operate as a negotiation of the bill. The endorsement in such a case would be deemed not to have

been made, and if the bill is transferred to someone with such an endorsement, it will have the mere effect of an assignment (art.730 commercial Code.) For instance, if a bill is payable for 100 Birr, it is not possible to endorse it as to 25 Birr to X and as to 75 Birr to Y.

Generally what our code sets out as the forms and elements that valid endorsement should have one stated above. The bills of Exchange Act of 1882 in its section 32 also requires of a bill to fulfill these requirements. But in addition to these, these section 32 of the Act sets out as requirements also that “where a bill is payable to the order of two or more payees or endorsees who are not partners all must endorse unless the one endorsing has authority to endorse for other; where, in a bill payable to order, the payee or endorsee is wrongly designated, or his name is misspell, he may endorse the bill as therein described, adding if he things fit, his proper signature; and where there are two or more endorsements on a bill, each endorsement is deemed to have been made in the order in which it appears on the bill, until the contrary is proved.”

So, while on the other points the Commercial Code and the Act are the same, they come to a point where they differ for the only reason that the Act has these three additional requirements. But the absence of these requirements from our commercial code according to the writer of this paper is not such a big has in that when valued from a relative significance point, the ones, our code lists are the more important ones, as their absence can have the effect of making the endorsement ineffective, and thus our code is at a stand that could be referred to as adequate. In the provision of these rules.

Having seen what a valid endorsement should fulfill, now let’s pass to the different types of endorsements.

3.4.2 Types of Endorsements

Our Code doesn't deal with the different types of endorsement in a specified form. Generally there are five different types of endorsements. These are: (1) special endorsement ;(2) endorsement in blank; (3) restrictive endorsement; (4) qualified endorsement; (5) conditional endorsement. Either of the first two kinds of endorsements may be combined with the other three. Let us see now these different types of endorsements individually.

A. Special Endorsement

A special endorsement is an endorsement which specifies the person to whom, or to whose order, the instrument is to be payable; and the endorsement of such endorsee is necessary to the further negotiation of the instrument. The person to whom or to whose order the bill is to be payable has to be specific. The usual forms of a special endorsement are "pay D" or "pay to the order of D" or "pay D or order". It is still regarded and treated as a special endorsement, despite the fact that the words "to order" are missing. So this type of endorsement is the generally accepted and presumed one since when we defined the form an order bill takes when drawn, in the previous discussion, we have used a similar form.

The importance of a special endorsement is that the endorsee cannot negotiate the bill without in turn endorsing it, and so becoming liable up on it, although he can transfer it for value without endorsing it, and his transferee is in the position of an assignee under an intimated assignation. The specified person's endorsement is absolutely

significant to the bill's further negotiation since otherwise it sill simply be assigned.

Let's see the instance where A draws a bill in the form of "B or order". B negotiates it to C writing on the back "pay to the order of C" and signed" .B This is a special endorsement and the bill is still an order bill is still an order bill in the hands of C. Now, if C negotiates it to D by simply signing on the back "C" i.e., by endorsing it in blank, the bill will be a bearer bill, negotiable by delivery. Although in both the above instances the bill has been properly and effectively negotiated, the bill has remained an order bill in the former endorsement (special endorsement) while in the latter endorsement (endorsement in blank) it has changed into a bearer bill. So, in order for an order bill to remain an order one throughout its circulation, it has to be endorsed specially. And, in our instance, if B or C had delivered the bill without signing it wouldn't have been a negotiation, but a simple assignment.

B. Endorsement in blank

Article 748(2) of the Commercial code provides that "the endorsement may leave the beneficiary unspecified or may consist simply of the signature of the endorser (endorsement in blank). In the latter case, the endorsement to be valid shall be written on the back of the bill of exchange or on the slip affixed there to (allonge). This is the exact contrast of special endorsement since it doesn't specify the endorsee. This endorsement is made by the mere signature of the endorser on the bill, usually and properly on the back of the bill or on an allonge.

A bill endorsed in blank will acquire the status of a bearer bill, and thus will be negotiable by delivery alone. Hence, for example if C signs his name on the back of an order bill and delivers it to D, the

latter acquires one ownership of the bill and holds it as a bearer bill. Because it is a bearer bill he can negotiate it to E, merely by delivery it to him. The importance of this, as we have seen in our discussion of a bearer bill, is that although, if E has given value for the bill, D as a transferor by delivery merely wants that the bill is what it purports to be, that he has a right to transfer it, and that at the time he is not aware of any fact which renders it valueless as he has not signed the bill, he is not liable upon it as such to any one, not even to E. The reason is that he has merely sold the bill as a species of moveable property and unless otherwise varied the terms first mentioned are the terms of the sale. E sues D upon a contract of sale, not upon a contract upon and arising out of the bill. If in our instance, B is the drawee and A the drawer who issued the bill, and if B refuses to accept the bill, and in the mean time A and C became insolvent so that the bill is in fact worthless, E has no remedy against D. The only obligation that D under takes is that what he has transferred to E is a bill and that at the time of the transfer he was not aware of any defect that makes the bill worthless.

An endorsement in blank is risky. If A, the payee of an order bill, endorses it in blank and delivers it to B, a thief who steals it from B can pass a good title by delivery to a holder in due course. A is then liable to all subsequent endorsees in case of default in payment, since as we have seen in the previous chapter, in a case of transfer by delivery of a bearer instrument the payment of the bill is guaranteed either by the drawee, acceptor or the endorser of the blank endorsement.

So, since a bill endorsed in blank is equivalent to an endorsement “to bearer” and hence is transferred by a mere delivery, and since the holder of an instrument to bearer establishes his right to the

entitlement as expressed in the instrument by the sole fact of presentment of the said instrument,[17] the plaintiff will have a valid little upon the bill, as his entitlement of right to the bill has been in accordance with the form provided under our law.

Hence, the decision that would be reached, according to the writer, would be the same as that of the court's even when the facts are seen in light of our Commercial Code.

C. Restrictive Endorsement

An endorsement is restrictive where it prohibits the further negotiation of the instrument, or which expresses that it is a mere authority to deal with the instrument in a certain specified way, and not a transfer of its ownership. Examples of such an endorsement would be "pay A… only," pay D for the account of X", or "pay D or order for collection." In other words a restrictive endorsement is an endorsement that prohibits the further negotiation of the instrument, since it is an endorsement to a payee that limits the payee's right to a further negotiation. A bill which is negotiable in its origin continues to be negotiable united it has been restrictively endorsed.

A restrictive endorsement gives the endorsee the right to receive payment of the instrument and to sue anybody his endorser could have sued, but gives him no power to transfer his rights to other and hence the object of a restrictive endorsement is to prevent money received on the instrument from being applied to the use of any person other than the person specified.

Section 35 sub 3 of the bills of exchange Act of 1882 states what a restrictive endorsement is and the right it gives to the endorsee, that

“ where a restrictive endorsement authorizes further transfer, all subsequent endorsees take the bill with the same rights and subject to the same liabilities as the first endorsee under the restrictive endorsement.”

When we see the provisions of the commercial code in relation to endorsement of bills of exchange, it is provided in the following Articles as follows.

Art. 753 Endorsement by attorney

1. *Where an endorsement contains the words “value in collection,” “for collection,” “by attorney” or any other similar words implying agency, the holder may exercise all the rights arising out of the bill of exchange, but he can only endorse it in his capacity as agent.*
2. *The parties liable can only set up against the agent defenses which could be set up against the principal.*

Art 754. Endorsement in pledge.

Where an endorsement contains the words “value in security”, “value in pledge” or any other similar words implying a pledge, the holder may exercise all the rights arising out of the bill of exchange, but an endorsement by him has the effects only of an endorsement by an agent.

In both situations the holders of the bill can exercise all the right arising out of the bill. Their limit is only concerning the negotiation of the instrument.

Under article 753, it is a relationship of principal and an agent. But this agent is an agent holder. He can exercise any right of a holder (such as presenting it for payment, for acceptance). But if he wanted to transfer it to another by endorsing the instrument, he shall do so as an agent. And if he endorses the bill otherwise, the principal or the original endorser can invoke civil code's provision, acting beyond power, "under article 2190(1).

Under article 754, we can see that an endorsement could be for the purposes of security. Here also the pledge endorsee is under the same situation, his endorsement will be in his capacity as an agent.

But what will the subsequent endorsees be faced with? Our commercial code doesn't deal with such a situation, but as we have seen above section 35(3) of the bills of exchange act of 1882 provides that, "all the subsequent endorsees take the bill with the same rights and subject to the same liabilities as the first endorsee under the restrictive endorsement." This is what seems the logical and connect conclusion, also from the reading of our commercial code provisions, in that when it says, he endorses in his capacity as agent, it seems to mean that the endorsee of such an endorsement will be having the principal of the endorser an his principal also, otherwise if these endorsees get full entitlement to the bill, what will the endorsement in the capacity of an agent restrict? .If we conclude this then could it be argued that a restrictive endorsement has an effect of an ordinary, as the endorse merely stands in the shoes of the endorser? The position that is held by our law seems as though it has such effect.

Generally a restrictive endorsement enables the endorser who may wish to curtail the general liability which he takes upon himself by endorsing and delivering an order bill, for example, although willing

to transfer ownership he may desire to restrict further negotiation, or he may not want to transfer ownership but intend that his endorsee act as his collecting agent or if he transfers ownership, to impress a trust upon it in the hands of the endorsee.

D. Conditional endorsement

Our Commercial Code provides clearly in article 725 (4) that an endorsement should be unconditional in order to be valid. So under Ethiopian law conditional endorsements are not allowed. If there exist endorsements that are conditional, this same article provides that the condition to which it is made subject shall be of no effect; this is to mean that if on the instrument there appear words that show the conditionality of the endorsement they will not be considered as effective and the endorsement as a normal one.

But what is a conditional endorsement? Section 33 of the Bills of exchange Act of 1882 defines a conditional endorsement as follows*:*

"A conditional endorsement is an endorsement where a condition is attached to the signature, which has the effect of negating his personal liability on the bill. When a bill is so endorsed, the condition may be disregarded by the payer and payment to the endorsee is valid whether the condition has been fulfilled or not."

Endorsements that read, "pay B or order on his marriage", "Pay B on the arrival of the ship", are examples.

So, where an instrument is endorsed conditionally, that is making payment up on the happening of a specified event, although the condition may be disregarded by the drawee, payment to the endorsee

is valid whether the condition has been fulfilled or not; as between the endorser and endorsee the condition is binding, and if the endorsee is paid, the endorser can recover it from his if the condition is not fulfilled.

If A endorses a bill, “pay B, if he hands over the title deed document”, the payer may disregard the condition; and payment to the endorsee will be valid whether the condition is fulfilled or not, or alternatively the payer may refuse payment until the condition is satisfied. In the former case where, endorsee is paid without fulfillment of the condition, since it still exists as between A and B, A will have the capacity to recover the payment.

E. Qualified Endorsement

Section 38 states about qualified endorsement as follows

> *“A qualified endorsement constitutes the endorser a mere assignor of the title to the instrument. It may be made by adding to the endorser’s signature the words “without recourse,” or any words of similar import. Such an endorsement does not impair the negotiable character of the instrument.*

This is a situation where any endorser can negate or limit his liability to subsequent holders: and where a bill is payable to order, since endorsement is compulsory to negotiation. If he wishes to transfer without making his self liable for payment in cases of default, he can endorse in the following way: without recourse, X.”; or “pay D or order without recourse to me.” other words than “without recourse”

should clearly be similar import. For instance, “pay D or order at his own wish” will do.

Subject to the qualification of warranties a qualified endorsement transfers every thing that would be transferred by a blank endorsement; and the qualification “without recourse” or its equivalent, is limited to the immediate endorsement to which it applies. The subsequent endorsees will not be affected by the qualification because their right will be subject to the way they acquire the bill. If the endorsee of the qualified endorsement endorses the bill in the normal way (without qualification) “pay X or order”, it can be deduced that he will be liable as to the subsequent endorsees.

3.4.3 Effects of Endorsement

Dear students, in the previous topic we have seen all about the case of types of endorsement. Now we are also going to discuss about effects of endorsement. The effect of an endorsement on the further negotiation of the instrument will depend in part on whether it is an order instrument or a bearer instrument and in part on the type of the endorsement. But it, should be remembered that the type of an endorsement can have no effect on the negotiable character of the instrument. If an instrument is a negotiable instrument when issued, it continues to be a negotiable instrument irrespective of the type of endorsement on the instrument.

The type of the endorsement becomes of importance, in determining the right of the holder to negotiate the instrument and in determining what the holder must do to negotiate the instrument.

A negotiable instrument may be endorsed for two distinct reasons: it may be endorsed because the endorsement is necessary to the negotiation of the instrument, or it may be endorsed for the purpose of adding the obligations of the endorser to those of the party primarily liable.

The Commercial Code provides the following as effects of endorsement.

Art 749. Effects of endorsement.

1. *An endorsement transfers all the rights arising out of a bill of exchange.*
2. *If the instrument is in blank, the holder may:*
    a. *fill up the blank either with his own name or with the name of some other person;*
    b. *re-endorse the bill in blank or to the other person;*
    c. *transfer the bill to a third person without filling up the blank and without endorsing it.*

According to this Article, an endorsement should not be for a part of the amount appearing to be due on the instrument. Hence an endorsement for partial payment according to this article is not acceptable as a valid endorsement under our law. But concerning this question of partial endorsement the law in this same code seems to contradict itself when on the other hand it provides under Articles 941(2) and 943(2) concerning the discount of instrument. Under Article 941(2) it gives the banker the right to the further endorsement of the instruments that come to his hand by a reason of discount. And Article 943(2) states that," instrument accepted for discount for a partial amount only shall be reimbursed up to that amount." From the readings of these provisions, one can't strictly conclude that an

instrument can be endorsed for only a partial amount as article 725(5) orders mandatory that an instrument endorsed for its partial amount shall be null and void. So, one can reconcile these two contradictory conditions, in the opinion of the writer, by assuming that the bank is a trustee for the part of the face value of the bill and on behalf of the holder.

When we take a bill endorsed in blank as we have seen above, it consists merely of the signature of the endorser. In this case the endorsee is provided with three alternatives.

The first alternative is that he may fill up the blank either with his own name or with the name of some other person, and by so doing, in effect, he is converting a blank endorsement into a special endorsement. Originally the only form of the unqualified endorsement which also sought to transfer the full title to the endorsee was the special endorsement, and when the name of the special endorsee was omitted from the endorsement, it was regarded as a special endorsement, blank as to the endorsee’s name, just as an instrument could be issued blank as to the payee’s name. The holder of the bill endorsed in blank could convert the endorsement in to a special one without signing his name, by writing above the endorser’s signature a direction to pay to any other person as endorsee or to himself. And since holder does not sign himself on the instrument he does not there by incur the responsibility of an endorser. From this one can imply that it is the endorser in blank that would incur the liability of an endorser in a case of conversion of the bill endorsed in blank to a special one. The holder of the bill endorsed in blank, when he fills in the blank with a name of some other person and negotiates it, he simply becomes a transferor by delivery.

The conversion of an endorsement in blank in to a special one is useful in that it could be a remedy to the risk which a bill endorsed in blank is exposed to. As we have seen above, a bill endorsed in blank may be stolen and the might pass a good title to a holder in due course.

The second alternative that an endorsee of a bill endorsed in blank may do is to re-endorse the bill in blank or to some other person. Here the holder may negotiate the bill with or without mentioning the payee to whom the bill is endorsed. When he negotiates the bill by not mentioning the name of the endorsee by simply signing, he is endorsing the bill in blank and the bill will have the same effects as the ones we are discussing now. But in both cases the endorser will be liable on the bill since he has singed up on it.

The third alternative that the holder is entitled to do is to transfer the bill to a third person without filling up the blank and without endorsing it. As we have seen in the previous chapter, the effect of a blank endorsement by the payee of an order instrument, or by a special endorsee of an instrument payable to order on its face is, to make the instrument negotiable by delivery: which means that such an instrument is then payable to bearer. Hence in this case what the holder of the bill endorsed in blank can do is to simply deliver the bill to a third person.

3.4.4 Endorsement after maturity or protest

We have said in our previous discussion that a bill can be negotiated even after maturity until it is paid or gets discharged. But how does and to what effect could a matured order bill be endorsed?

Students, what is meant by “after maturity or over due “and “protest”? A bill payable on demand is deemed to be overdue when it appears on the face of it to have been in circulation for an unreasonable length of time. The question of unreasonableness being one fact. Other bills are overdue when the due date for payment has passed.

Protest is a default of acceptance or of payment which shall be evidenced and formally declared by a deed drawn up by a public officer.

The Commercial Code provides concerning endorsements after maturity or other protest as follows.

Art 755, Endorsement after maturity of after protest

***1**. An endorsement after maturity shall have the same effect as an endorsement before maturity. An endorsement after protest for non-payment, or after the expiration of the limit of time fixed for drawing up the protest, shall operate as an ordinary assignment.*

2. Unless the contrary is proved, an endorsement without & date shall be deemed to have been written on the bill before the expiration of the limit of time fixed for drawing up the protest.

3. Where a refusal to pay has been endorsed by a declaration of the drawee in accordance with article 781(2), an endorsement without date shall be deemed to have been made before the protest.” According to this provision an endorsement made whether before or after the bill’s maturity will have the same effect. The bill’s state, that it is its being overdue or not does not affect the endorsement and hence the made of transfer of the instrument.

While this is how our law deals with the endorsement of overdue bills, the rule in the common law countries is entirely different from ours. There has been in the common law system a question as to how to describe an overdue paper: does it lose its negotiable character at maturity and become a mere chose in action; does it become a chattel, that is personal property like a deed house or; does it remain " negotiable" at least in certain particulars, though not in other. There is a more or less accepted opinion that since instruments are made to be paid at maturity, after maturity they are disgraced, and their period of free circulation is an end, and although the policy of other countries may be to accord matured paper certain of the attributes of content paper the Anglo-American law has definitely set its face against it. Hence according to the Anglo- American law when a bill is endorsed when overdue it is, as regards such endorser or endorsee deemed a bill payable on demand; and an overdue bill can only be negotiated subject to any defect of title affecting it at its maturity; and therefore, no person who takes it can acquire or give a better title than had the person from whom he took it. In other words the holder or endorsee will not be a holder in due course. The reason for this a holder in due course is a holder who takes the instrument for value; in good faith; and without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person. So, since the fact of a bill's not being overdue is one of the requirements that should be fulfilled in order for one to be a holder in due course, an endorsee of an overdue bill could not be one.

The writer of this module thinks that this reasoning of the Anglo-American law is a logical one. In our law the appropriate provision doesn't give anything concerning the endorsee of an overdue bill acquiring a lesser right. It simply says that it will have the same

effect, which could mean that an endorsee of such bill may as a result become a holder in due course. But when we analyze the holder in due course's status (as the one we have seen above) and when we ask the question that instantly arises, why is it still in circulation, why is it not paid?, since it is likely for there to be something wrong, this situation needs to be dealt with more carefully. But our code doesn't seem to deal with this situation appropriately, and an assertion that an endorsee of an overdue bill may become a holder in due course is wrong, as it goes contrary to the requirements a holder in due course should fulfill.

In our law as we have seen above under Article 755, it is an endorsement that is made after protest has been drawn up, that is affected. An endorsement made in such a condition, i.e. after protest has been drawn up, will not operate as a negotiation at all, but merely as an ordinary assignment.

Sub-Articles (2) and (3) of Article 755 try to protect the endorsee of such bill and try to mitigate the harsh effects of sub (1).Under Sub-Article (2) when there is a situation where there is an endorsement without date, it will be presumed as though this endorsement is written on the bill before the expiration of the time limit fixed for drawing up the protest. And under sub(3) when a refusal to pay has been evidenced by a declaration of the drawee in accordance with the rules provided for the conditions and periods of protest, then an endorsement without date shall be deemed to have been made before protest.

3.4.5. Liability of Endorsers

Every prior party, namely, the maker or drawer, the acceptors, and all intervening endorsers to a bill is liable there on to a holder in due course until the bill is duly satisfied by payment or otherwise gets discharged. No person is liable on a bill unless he has signed it. Accordingly, the liability of prior parties to a holder in due course is joint and several; and he may hold any or all the prior parties liable for the amount of the dishonored bill.

As we have seen in the previous discussion the liabilities of these parties, according to the obligation they have are classified into primary and secondary, and all endorsers are secondarily liable since their liability is conditional upon the dishonor debtor's failure to pay of the bill and since an endorsement is an implied contract to pay if the drawee does not.

The transferor, by his act of endorsing the bill, warrants to his immediate transferee and to pay subsequent holder, that when the bill left his hands he had a good title to it, that it was a genuine one in every particular at the time of the endorsement, and that any endorsement on it previous to his own were genuine endorsements. When a person endorses a bill he there by makes contractual promises to the endorsee and, with some exception to subsequent holders of the bill.

Unless the endorsement otherwise specified ,every endorser engages that upon dishonor and any necessary notice of dishonor and protest, he will pay the bill according to its tenor at the time of his endorsement to the holder or to any subsequent endorse who takes it up, even though the endorser who takes it up was not obligated to do so. An unqualified endorser in addition to his liability on the contract of endorsement gives certain warranties to subsequent holders. Even the one who qualifies his endorsement or one who negotiates a bill by

delivery alone without endorsement, should also make some warranties, such as that the bill is genuine and in all respects what it purports to be, that he has a good little to it. When we see this condition under our commercial code it is provided as follow regarding the liability of endorsers.

Art.750 Guarantee

1. *In the absence of any provision to the contrary, the endorser guarantees both acceptance and payment*
2. *He may prohibit any further endorsement; in this case he gives no guarantee to the persons to whom the bill is subsequently endorsed.*

What is referred to as *" provision to the contrary"* in sub (1) is to mean if the endorser has qualified the endorsement to relieve himself from the contractual liability as a guarantor of the instrument as an endorser who endorses "without recourse" or other qualifying language of similar import is not liable to the holder or endorsees for nonpayment of the bill by the party primarily liable. No other person concerning the endorser's guaranteeing the above conditions is provided. Thus if the endorser releases himself from guaranteeing payment and acceptance according to 750(2), then it seems that he will not guarantee anything. In all other cases the endorser shall have the liability of guaranteeing both acceptance and payment. The second sub-article gives the endorser a means by which he could avoid liability: which is by endorsing the bill restrictively, that is by prohibiting the further endorsement of the bill.

Endorsers are liable in the order in which their names appear on the instrument unless they have otherwise agreed.[45] For example, if a bill

is endorsed, A, B, C, D, and E each would be liable to all subsequent endorsers but not liable to prior endorsers. A is liable to B, C, D, and E, but E is liable only to the holder of the instrument.

Generally an endorsement plays a very significant role in the negotiation of bills. It is the preferred way of negotiating because it gives the endorsee a secured right as the signature of the endorser on the bill makes him liable on it, except when he has qualified his endorsement. And the endorsee of an endorsed bill will have the endorser an a party to whom to resort to, in case the bill is dishonored as the endorser guarantees payment according to article 750 of the commercial code.

3.5. Establishment of Title

We have seen until now in the various topics of this material how a holder could establish a title over a bill. By a mere possession in case of a bearer bill and by a series of uninterrupted endorsements in case of an order bill. We have also seen that the way a party acquires a title over a bill and the sort of title he acquires is such a determinant factor that his rights and duties in relation to the bill will be affected. So, it would be a subject worthy of discussion. And in this topic we will see the establishment of title by the parties of a negotiable instrument and the rights that accrue to such parties in relation to it.

Article 716 of our commercial code provides that;

1. *The possessor of a negotiable instrument has a right to the entitlement as expressed in the instrument against presentment of the said instrument to the debtor? On condition that he establishes that he is a lawful possessor in the manner provided by law.*

2. *The debtor shall only pay against delivery of the instrument.*
3. *Except in cases of fraud or gross negligence on his part the debtor shall be released by payment at maturity to the person to whom the instrument gives the capacity of creditors not withstanding that the said person is not the holder of the right.*

According to these provisions, in order for one to have a right to the entitlement as expressed in the instrument he has to establish that he is a lawful possessor in the manner provided by law. But what is meant by a lawful possessor and what are the requirements for one to be so?

Let us first see the debtor- creditor relationship and how it fits the parties to a bill of exchange. The debtor since it is the paying party has to be the drawer or acceptor of the bill and the creditor, the person in lawful possession of the bill. And sub-Article (2) provides that for the debtor to pay, the creditor has to deliver to him the bill. The possessor can exercise his right only through the presentment and surrender or the instrument which incorporates the right. (Art. 716 Commercial Code).

Sub-Article (3) provides the conditions under which the debtor is released from his obligations, which is by payment at maturity to the person entitled to the right through the instrument on condition that the said person is the holder of the instrument. The debtor may not be released if he paid in case of fraud or deceitful practices according to sub-art (3) and a fraud or gross negligence on the part of the debtor could be when he and the holder get into some kind of agreement as against the drawer.

Now let us see the persons that can be considered as the lawful possessors of the bill.

3.5.1 Holder

The ‘holder’ of a negotiable instruments means any person entitled to the possession of the instrument, and to receive or recover the amount due there on from the party liable thereto. There are two elements in this definition: 1) that he must be entitled to the possession of the instrument and, 2) that he must be entitled to receive or recover the amount due thereon from the party liable thereto.

What the first element tries to tell us is that the person in whose hands the instrument is, should have acquired through the appropriate modes of transfer, so as to have an entitlement to their right. Hence he must get an order instrument by way of an endorsement followed by delivery with his name stated specifically therein, and he must be the bearer thereof (or an endorsee of a blank endorsement) of a bearer instrument. Hence, a thief or an endorsee under a forged endorsement, although may be having the possession of the instrument, made out, “to order” he cannot be called its holder because he didn’t not acquire legal title thereto and hence is not entitled in his own name to the possession thereof.

Under the second element, it is required that the person should have the right to receive or recover the amount of the instrument and give a valid discharge to the payer. An example of this would be where one may be the bearer or the drawee or endorsee of an instrument but he may not be called a holder if he is prohibited by a court order from receiving the amount due on the instrument.

Hence, according to the above definition, i.e the fulfillment of both the above elements, the understanding is that the holder is classified as lawful holder to whom the instrument is payable, and an unlawful holder such as the finder of a bill endorsed in blank who can nevertheless give a valid title to a holder in due course.

How about under our law? Does the phrase “lawful possession” purport the same meaning as the above? Let’s see first what is prescribed under our law for one to be a lawful possessor.

Art. 721(2) The holder of an instrument to bearer establishes his right to the entitlement as expressed in the instrument by the sole fact of presentment of the said instrument.

Art. 722 The holder of an instrument in a specified name establishes his right to the entitlement as expressed in the instrument by the fact of his designation as beneficiary therein and in the register held by the person issuing the said instrument.

Art. 724. The holder of an instrument to order establishes his right to the entitlement as expressed in the instrument by an uninterrupted series of endorsements.

So the requirements, for a bearer bill to be in possession of it and for an order bill to show “an uninterrupted series of endorsements” (i.e., that every transfer should be accompanied by an endorsement) need to be fulfilled for one to be in lawful possession. Professor Escara the drafter of the commercial code of Ethiopia stated the following in relation to the concept of lawful possessor:

> *"In the uniform law, the lawful holder is defined as a person who establishes his title to the bill through an uninterrupted series of endorsements. It is fairly simply of course, to establish this and one cannot see exactly how the position of the holder will be clearly superior because he does not have to prove this and will be presumed by law to be a holder in good faith. In any case, seeing that it was impressible to reconcile the two systems (uniform and Anglo-Saxon) I have though it better to conserve intact the system of the uniform law"*

Even though this position of our law is drafter on the basis of the uniform law, since the contradiction between the two systems is concerning the proving or not of the series of signature by the holder in due course, (as the Anglo-Saxon law requires the holder in due course to prove the genuineness of the signatures) and since concerning the other issue are almost similar, we will make references to the uniform commercial code in our dealings with this topic.

And according to the Uniform Commercial Code (UCC), being a holder is one' of the requirements of being a holder in due course, and to be a holder one must meet the two conditions set out in the code's section 1-201 (2) which are; i) he must have possession, ii) of an instrument "drawn, endorsed to him or to his order or to bearer on in a blank".

This provision doesn't classify possession into lawful and unlawful: but we find within the second element, the conditions we have seen to far as requirements of being a holder.

If an instrument is payable to bearer, ether because it was issued that way and conditioned its life as a bearer instrument, or because it was endorsed in blank by a holder, the possessor of the instrument will be a holder; even though the instrument may have passed through the hands of a thief, since the holder in due course may derive a good faith from a chain of titles that includes a thief in its links. But this same rule does not apply to a stolen order instrument since in order to pass a stolen order instrument, a thief must forge the endorsements of the party to whose order it is drawn; and for the reason thief's transferee is not a holder. section 3-202 (2) of the UCC doesn't include a thief's signature as constituting an endorsement; so no party can be a holder of an order .Instrument stolen prior to endorsement by the owner of the instrument

So the rule is that, for one to be a lawful holder, he will either have to be a possessor of an instrument made out to bearer or acquire an order instrument through a genuine endorsement i.e through an endorsement mad by the lawfully entitled endorser. This same principle being reflected under our law, the person referred to as the lawful possessor' under article 716 is the person who is either the person designated as payee in the instrument, or the possessor of a bearer instrument, or an endorsee of a valid endorsement of an order instrument.

As we have seen in the first chapter under the characteristics of negotiable instruments; the person deemed as the lawful possessor is entitled to sue on the instrument in his own name, to negotiate it and to give a valid discharge for it. He will have all the rights that his transferor had up on such instrument. And he will take possession of the instrument subject to:

- all defenses of any party which would be available in an action on a simple contract; and
- the defenses of want or failure of consideration, non performance of any condition precedent, non-delivery or delivery for a special purpose.
- the defense that he or a person through whom he holds the instrument acquired it by theft, or that payment a satisfaction to such holder would be inconsistent with the terms of a restrictive endorsement; and the claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action of such party."[11] In short all sorts of defenses that may be raised on the transferor may be raised on the holder, i.e he merely stands in the shoes of the transferor. Thus, the holder is no different from an ordinary assignee. In order for a holder to avoid this i.e, to take the instrument free from previous personal defenses and to have a better title than his transferor had, he has to qualify as a holder in due course.

Let us see now what the holder should fulfill in order to be a holder in due course.

3.5.2 Holder in due course

Our commercial code provides in relation to a holder in due course under article 718 that no claim for recovery may be made against a person who has acquired a negotiable instrument in due course, in accordance with the rules applying to negotiation. But who is a holder in due course and what is meant by, 'acquiring an

instrument in due' course in accordance with the rules applying to negotiation?

We will see now who the holder in due course is and precisely why his position might be important.

Section 3-302 of the uniform commercial code defines a holder in good faith as follows:

1. A holder in due course is holder who takes the instrument,
a. for value; and
b. in good faith; and
c.** without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person**.

So in order for one to be a holder in due course of an instrument he must meet the following conditions:

He must be
i) a holder of a negotiable instrument who took it
ii) for value;
iii) in good faith;
iv) without notice that it was overdue or had been dishonored or of any defense against or claim to it on the part of any person.

Most litigations under the heading holder in due course' are likely to arise not with the rights of a holder in due course, but with whether the party qualifies as a holder in due course or not and once a party so qualifies, the legal consequence of his status is relatively clear. One fails to be a holder in due course if he fails to satisfy the conditions listed above. So, since one's being a holder in due course or not is

such a critical issue, it will be necessary to examine each of the conditions listed above individually and thoroughly.

i) Holder: As we have seen above who a holder of an instrument is, we will proceed to the following conditions.

ii) For value: when is a holder said to have taken an instrument for value? Section 3-303 of the UCC provides that a holder takes the instrument for value;

a. to the extent that the agree consideration has been performed or that he acquires a security interest in or a lien on the instrument otherwise than by legal process; or
b. when he takes the instrument in payment or as security for an antecedent claim against any person whether or not the claim is due; or
c. When he gives a negotiable instrument with an irrevocable commitment to a third person.

Hence a bank or any person who discounts an instrument in the regular course of trade has given value for it; likewise if a loan is made and an instrument is pledged as a security for the payment of the loan, the secured party has given value for the instrument to the extent of the amount of the loan. If an instrument is given in payment of a pre-existing debt, it is taken for value first as if it were given in payment for goods purchased concurrently with its negotiation. Hence, if X owes Y a past –due debt and he endorse and delivers, to Y an instrument issued to him in payment of the debt or as security for its payment, Y will be said to have given value for the instrument.

Suppose B and C enter in to a contract when C obligates himself to deliver an automobile C is said in this case to have given value for the instrument.

While it is necessary in order to qualify as a holder in due course, that one must have parted with value, it is not necessary that the value given shall equal the face amount of the instrument since 3-303(a) of the UCC provides, ‘as the agreed consideration’. It is only where the discount is unreasonably large; and thus the value given very small, that a question of bad faith could be raised.

iii) In good faith. Good faith is a question of fact?. If rules were established announcing the requirements for good faith and compliance therewith obtained, it would, nevertheless be impossible to measure whether a person was actually taking an instrument in good faith or not. And it has been held that the test for whether a person has taken an instrument in “good faith” so that he qualifies as a holder in due course, depends upon whether there is honesty free transaction and not whether the taken has been diligent in investigating or negligent in not investigating, the origin or transfers of the paper which is offered to him. Good faith involving a question of fact; it has been held that the fact that a person takes an instrument under suspicious circumstances is not sufficient to prove bad faith. However, if a person acquires an instrument under circumstances which should have created an inevitable inference that an infirmity existed in the instrument the person could not have taken such instrument in good faith.

Our civil code provides the definition of good faith in relation to the good faith possessor as follows:

Art. 1162 (1) Definition;
Whosever acquires a corporeal chattel shall be deemed to be in good faith where he believes that he is contacting with a person entitled to transfer the thing to him.

Hence, what is stated as the transferee's being in good faith of is, his believing the transferor's having a valid title over the corporeal chattel. The civil code basically seems to follow this 'white heart' subjective test of good faith. The uniform commercial code also seems to examine the good faith of the transferee on the 'subjective test' basis. It does however list some suspicious circumstances which might prevent a person from becoming a holder in due course, regardless of actual state of mind at the time he acquired the instrument. These suspicious circumstances are listed under section 3-302(3) of the code.

If the person's being in good faith is one of the conditions for being a holder in due course, in relation to what then should the person be of good faith?

iv) the holder should be in good faith that he had no notice that the instrument was overdue or had been dishonored or of any defense against a claim to it on the part of any person. And this is the last requirement of being a holder in due course.

Notice means actual notice, though it need not be formal. But to constitute notice, there must be knowledge of the facts, or a suspicious of some thing wrong combined with a willful disregard of the means of knowledge.[18]

A person can acquire notice of a defense in various ways. He can observe that the instrument is crudely altered; he can see that its date for payment has already passed; he can notice it has been stamped 'paid' or he may even have actual knowledge of a contract defense of the drawer. In all such cases a would – be holder in due course does not deserve to take free of such defenses for he could have refused the instrument.

Under the provision of the uniform commercial code 1-202 (2) a person has notice of a fact when:

a. he has actual knowledge of it; or
b. he has received a notice or notification of it; or
c. from all the facts and circumstance known to him at the time in question he has reason to know that it exists.

Also if the person knew that the drawers had asserted good defenses to their liability against a given payee in 50 out of the last 100 instrument made payable to that payee, then he might fail to be a holder in due course because he lacked good faith as to that instrument, even though he did not know of a specific defense on any given instrument.

What is stated under 1-201(25)-c, " from all the facts and circumstances known to him…" is likely to raise an objective-

subjective test controversy. Could it be tested on the basis of the reasonable man standard? It seems as the only way out.

A person can also be said to acquire notice by way of direct information from the transferor, or by documents transferred to him signifying for example mortgage, or by the information written on the face of the instrument.

The holder is again said to be on notice of a claim or defense when the instrument that he takes is so incomplete as to call in to question its terms of validity

However, in such a condition where the holder is on notice that the bill is not regular and complete on its face, he may take the instrument as a holder in due course with knowledge that it has been completed before his purchase, provided he is without notice that such completion was improper. Similarly a purchaser has notice that a demand instrument is over due if he has reason to know that he is taking it for more than a reasonable length of time after its issue.

Generally a holder to acquire the special status of a holder in due course has to take the instrument complete and regular on its face and without notice that here is some defect with its entitlement. And, a would be holder in due course is said to have taken as instruments complete and regular on the face of it under the following conditions:

1. that he became holder before it was overdue, and without notice that it had previously been dishonored if such was the fact;
2. that at the time it was negotiated to him, he had no notice of any defect in the title of the person who negotiated it to him. Can a payee be a holder in due course? UCC section 3-302(2)

> lays to rest this question as follows; ‘A’ payee may be a holder in due course”. But one may ask what the significance of the fact that a payee can be a holder in due course is, since section 3-305 of the UCC permits a party to take free of the defenses only of a “ party to the instrument with whom the holder has not dealt.” And most payees will not take free of the drawer’s defenses even when these payees are holders in due course, for they will have dealt with the drawer. In most cases therefore a payee holder in due course will not enjoy the most significant advantage normally accorded one in his shoes.

This is what the uniform commercial code says. Our code does not mention of a payee’s being a holder in due course. But, according to the opinion of the writer of this paper, as our code is silent concerning the payee’s ability to be a holder in due course, the possibility of being so is hardly logical. We have said before that the payee acquires a bill by way of issuance and that issuance, is the first delivery of the bill to a person for some kind of debt the drawer owes him, and the bill is in the first place issued to settle that debt, with the premise of the creditor to pay on certain date person all to the payee, unless he wants to further negotiate the bill to some other person. But a holder in due course acquires a bill through negotiation. A negotiation that should be effected for value, in good faith and without notice that the bill is defected. These prerequisites which are mandatory to the holder in due course can not be required of the payee because the payee, since he has personal relationship with the drawer, he will not be required to be examined that he is not under deceitful practices concerning the acquisition of the bill. But a holder in due course must fulfill all of these conditions. Because, in order to have the protection a holder in due course gets he should be a person who has acquired the bill without any malpractice. The holder in due course acquires

the bill or value, in exchange for something. For his purpose, the bill is merely a cash and it serves him as a means of exchange. For instance he can get it in lieu of money for some thing he sold to the negotiation.

For this reason and for the reason that we have seen above that the fact of granting the status of the holder in due course to the payee is pointless since he had personal relations with the drawer, it is better to the rule which specifies that a payee cannot be a holder in due course.

The holder in due course, takes the instrument free of all claim to it on the part of any person even though certain so called real defenses may be asserted against him.

A holder of an instrument even though he may have failed to meet one or more of the requirements to be a holder in due course, in certain circumstances, he may take the instrument from a holder in due course, thereby obtaining the rights of such holder.[28] But if the person taking the instrument cannot establish holder in due course status or rights of a holder in due course, he takes not only subject to the defenses mentioned above (real defenses), but to all valid claims to it on the part of any person.[29] This could be where the owner of a stolen instrument asserting claim to it against such holder and where this person’s inability to establish holder in due course status may stem from the fact that he had notice that the instrument was overdue or had some defect when he acquired it. Otherwise as we have seen in the previous chapter, a stolen instrument (a bearer one can in the course of its circulation get into the hands of a holder in due course.

Again our Civil Code provides in relation to possession in good faith as follows:

Art. 1161(1)

Whosoever in good faith enters for consideration in to a contract to acquire the ownership of a corporeal chattel shall become the owner by virtue of his good faith when he takes possession of such chattel.

2) His rights shall not be affected by the fact the person with whom he contracted had no Valid title

Art. 1163 Time when good faith must exist.

1. *Good faith must exist at the time of the entry in to Possession.*
2. *Discovery by the possessor that he acquired the thing from a person who was not entitled to transfer the ownership there of shall be of no effect whose such discovery occurs after he entered in to possession.*

These provisions set out that depending on the state of mind of the transferee, that is provided he was of good faith at the time of entry in to a contract of acquisition ownership and entry into possession, he will have a valid title over the corporeal chattel even though the person with whom he contract (the transferor) had no valid title. So the main elements according to the civil code for a transferee to have

possession in good faith is that he be of good faith at the time of the conclusion of the contract, and at the time of entry in to possession, of the transferor's entitlement of the right to transfer it to him. (art 1162 civil code).

What article 718 of the commercial code provides for the holder in due course is of similar nature with that of the civil code. It says that no claim for recovery may be made against a person who has acquired a negotiable instrument in due course. So in effect; in our law once a person has acquired an instrument in accordance with the condition that make person a holder in due course, then that person has a valid title over it, and no claim for recovery may be made against him (by the former owner; for instance in case of a stolen bearer instrument. But as we have seen above the so called real defenses are defenses that are invoked against even a holder in due course. Therefore, although no action for recovery can be made against the holder in due course, he is subject to real defense.

To sum up, the rights of a holder in due course, once he has acquired the status, are

1. Valid delivery by all prior parties is conclusively presumed so as to make them liable to him.
2. He holds free from any defect in the title of prior parties, and from mere personal defenses available to prior parties among themselves and can enforce payment against all parties liable on the bill. In other words he gets a better title than his transferor had. The only defenses that may be set up against a holder in due course are real defenses. What are so called real defenses? And to what extent do they affect the holder in due course's rights and what do they give rise to? We will deal with these

defenses later on. But before that, you are advised to think over it again and again.

3.5.3 Negotiation by unauthorized parties

We will now discuss about the negotiation of lost or stolen instruments and instruments obtained by unlawful means (for e.g. by theft or fraud) or for lawful consideration. Our commercial code doesn’t deal with such conditions since article 731 provides that the procedure to be followed in the case of negotiable instruments damaged, destroyed, lost or stolen shall be prescribed.

Let us see these conditions and their effects in accordance with the uniform commercial code.

As we have seen above, a completed bearer bill that is lost a stolen before a after delivery “can get into the hands of a holder in due course. For example if M draws a bill payable to bearer on N and gives it to L, and L loses it X, a finder may give the bill to Y, a good faith purchaser who can collect payment from B. It has, therefore become a settled rule that thief or any other person having possession of a bearer paper complete upon its face can give a holder in due course a good title to it against all the parties there to as well as the true owner. Hence it may be taken to be the well settled rule of law that the transfer of stolen negotiable instrument, negotiable by delivery, to a *bonafide* purchaser for value, without notice and before maturity, vests him with a good title against the world.

But in a case where the stolen instrument is an order instrument (that is one drawn, “pay to the order of X’, the thief will have to forge the endorsement of the payee and endorse in order to pass it along to an innocent party. In such a case the party that has paid money to another for the instrument but has not received payment on it will be the initial loss bearer, and this party will inevitably look for a potential defendant on whom to trust the lose. Where a signature on an instrument is forged, this results a confusing conflict of the rights and the collecting bank (the bank which discounts or takes the instruments for deposit).

Let us see now what could take place in the following hypothetical instance.

A issues a bill payable to the order of B. A thief steals the bill and forges ‘B’s endorsement. The thief then chases the bill at a depositary bank which passes it to a collecting bank which ultimately receives payment from drawee bank. The drawee wrongfully charges the bill to A’s account the principle proceeding that might possibly arise from this case are as follows:

1.)Payee V drawer on a stolen instrument.

Under section 3-804 of the UCC the payee may sue the drawer on a stolen instrument, provided he indemnifies the drawer against the possibility of a second claim on the stolen bill, to issue another bill for him.

2) Drawer V. drawee.

The drawer is likely to sue the drawee on the argument that the drawee should pay only on a genuine order (endorsement), and hence he be reaccredited to his account.

3) Payee V. drawer or depositary bank.

Hence payee sues as the owner of the bill on the theory that those who have dealt with the bill after the thief are guilty of conversion under section 3-419 of the UCC. According to this provision an instrument is said to be converted when; a drawee to whom it is delivered for acceptance refuses to return it on demeaned; or any person to whom it sis delivered for payment uses on demand either to pay or to return it; or it is paid on a forged endorsement.

4) Drawee V. depositary bank or other bank.

If the drawee had decided or has been forced to re-credit the drawer's account the drawee might then sue back up the strum for breach of the warranty of title under section 4-207(1) (a) of the UCC.

The drawer in such cases will be subjected to double liability where the drawee has not yet debited his account, since his liability still persists even after the bill is stolen and the payee under section 3-804 is demanding him to issue a second one. But on his liability on the stolen bill, where the drawee has paid it, he can insist that the drawee recredit his account; as no subsequent possessor of that bill can be a holder in due course since a thief of an order bill nor a transferee

there of has power to endorse it . If the drawee recognized the forgery and did not pay, even a holder in due courses, failing to recover when the instrument was presented to the drawee for payment, could not recover from the person whose signature was forged.

But how is the drawee supposed to know if a signature is a forgery or not? Under the Geneva Convention, the drawee is required to verify only the regularity of the chain of endorsements, and is not responsible for the validity of the endorsements themselves.

The principle that is held under the uniform commercial code is different from this. In situation when the forged signature is that of the drawer's, the drawee cannot charge the amount of the item to the drawer's account unless the drawer's negligence substantially contributed to the forgery of his signature as a drawer. (Section 3-406); neither can the drawee recovery the payment from the presenter who presents in good faith because even under warranty section 3-417(1) (b) all that he warrants is that he has no knowledge that the signature of the drawer is forged, not that it is not forged, so the basic idea is that a drawee who accepts or pays should be able to recognize the genuineness of the drawers signature and to take the risk where it is forged and he has not known. From this it could be said that under the uniform code that even where the forged signature is that of an endorser that the drawee has to make certain, sides seeing there are a series of endorsements, that they are genuine endorsements.

So in general what happens where a forged instrument is paid by a drawee, after discovery of the forgery, the drawer who must still issue another instrument to the payee, demands that the drawee re-credit his account. And this fact becomes a controversy between the drawee

and the person whose signature was forged. Since admission by one of them will result in bearing the loss, both will try to defend themselves. Drawee, that there was no fault with him since he has checked and believed in good faith that the signature was genuine and will try to invoke negligence on the other party; while the other party will try to prove that drawee had recognized forgery and that he was negligent.

This is when we see the condition according to the uniform commercial code. When we come to our code, professor Escarra in his manual of the background documents of the commercial code, has stated referring “lawful possessor”, that having found it impossible to reconcile the two systems (uniform and Anglo-Saxon, his thought is better to conserve intact the rules of the uniform law.

And according to the uniform law (the Geneva convention) as we have seen above the drawee is required to verify only the regularity of the chain of endorsements, and is not wanted to check the validity (genuineness) of the signatures. And if this is the principle followed under our law, who then is going to be responsible for the loss? Could it be the holder of the instrument?

As we have seen earlier article 751 of the commercial code provides for the establishment of title by the holder.

And according to sub-art (1) of this provision and from what we have seen at the beginning of this chapter, a holder of a bill made out to order can establish a lawful possession over it if he acquires it through an uninterrupted series of endorsements. Sub art.(2) of this provision states that unless the holder acquires the bill in bad faith or

unless in acquiring it he has committed a fault, he can't be dispossessed of it.

Here, let me raise some questions. Whose responsibility would it be where a forged bill is paid?. What if the holder has acquired it in the belief that all signatures on the bill were genuine, i.e what if he is a holder who has acquired the bill in good faith, for value and without notice that it has a defect in its entitlement? As we have seen before, art.718 commercial code provides that no action for recovery can be made against a holder in due course; and according to the Geneva convention it is not required of the good faith purchaser to make sure that the endorsements on the bill are genuine, but only that there are a series of uninterrupted of them and that he should be in good faith. Which means according to this law and according to what we have seen earlier in our introductory chapter, the holder in due course can acquire a valid and protected right over a bill that is stolen or last (whether it is a bearer or an order bill) and over a bill in which one of the signatures is forged.

If this is so then, i.e if the drawee is required to see only if there are a series of endorsements, and if the holder in due course is also required to see in good faith if there are a series of endorsements only, then on whom would the liability lie where a bill that has a forged endorsement up on it is paid. The parties left unprotected in this case are the drawer and the payee of endorsers. Can we then to say that they are the liable parties? Can we then also to conclude that forged endorsements are operative according to the UCC and thus our law? .The answer to the latter seems to be, from what we have seen so far is, in the affirmative. But wouldn't this be against public policy and isn't forging an endorsement something that would make the whole purpose and the relationships of the parties on the bill we have

been seeing so far ineffective? Forgery is an act, according to the opinion of the writer of this paper and according to the common law principle, that goes against the valid existence of the bill and thus a real defense that should be good even to a holder in due course.

Hence, it is in the opinion of the writer of this paper that the uniform law's and our code's stand concerning the holder in due course's ability to acquire a good faith out of a forged endorsement is not right, and concerning such matters of liability of loss in case of forged bills the position the common law (the uniform commercial code) held is a much preferable rule. Since within the latte,r the position of every party seems to be appropriately dealt with, and situations are provided for each party to bring actions on the others and also for each party to make an appropriate defense.

Bearing this in mind, let us examine now the possible defenses that could be raised by the different parties, in relation to a negotiable instrument.

3.5.4 Defenses

A defense is a reason offered by a party sought to be charged drawer, accepter, endorser) for avoiding liability for the payment of the instrument. A defense is something different from a party's liability since both, the drawer or acceptor, who has primary liability as well as the endorser and drawee that have secondary liability, may offer forgery of their signature as a defense against payment of an instrument. We have said earlier that a person could be liable on an instrument, only if his name is signed on the instrument. But this doesn't mean that all the persons whose name is signed on the

instrument are liable. And, even though under the applicable rule of law, a party is not liable. He may still not liable even to a holder in due course. It would be convenient to refer to all situations of fact in which the party, whose name is signed on the instrument, may successfully defend an action against him, brought by a holder in due course, as real defense; and to refer to all situation of fact where the signatory will be held liable to the holder in due course and not liable to the holder not in due course, as personal defenses. So defenses are of two types of personal defenses: that may be raised against all holders except holders in due course, and real defenses that may be charged against anyone including a holder in due course. In relation to defenses of negotiable instruments, Article 717 of our commercial code provides as follows:

Defenses

1. *The debtor may only set up against the holder of the instrument defenses based on the personal relations, defenses of form and those based on the text of the instrument.*
2. *He may set up defenses based of falsification of signature, lack of capacity or power of representation at the time of issue of the instrument, or on the absence of the necessary conditions for bringing the proceedings.*
3. *The debtor may not set up against the holder of the instrument defenses based on his personal relations with proceeding holders, unless the holder, in acquiring the instrument, has knowingly acted to the detriment of the debtor.*

This article sets out the different defenses the debtor can case against the holder of the instrument. As defenses that could be raised by the debtor are: defenses based on falsification of signature; defenses

based on lack of capacity or power of representation at the time of issuance of the instrument; or those based on the absence of the necessary conditions necessary for bringing the proceedings.

When it is said, "defenses based on their personal relations", it is to mean such defenses which constitute, for example those founded on contractual or extra –contractual relations of the debtor with the holder. There is usually an underlying contract for the performance of which a negotiable instrument may be issued or endorsed and such contractual relation constitutes a personal relation between the parties to the contract. The defenses that could arise from the contractual relation according to article 717(1) may be set up against the holder by the debtor. But the debtor can not raise against the holder, defenses founded on the debtor's personal relations with preceding holders, unless the holder has acted to the determinant of the debtor knowingly.

The defense of form is also an available defense for the debtor. Because we have said previously that a bill of exchange in order to have a valid existence must fulfill certain formal requirements. And, by defenses based on the text of the instrument, it is meant defenses that include material alternation, and defenses which can be detected from the reading of the text.

As to the defenses that are provided by 717(2) ,one of the defenses that a debtor can raise is the defence of falsification of signature which seems to mean forged and unauthorized signatures; whose rational seems that such signature does not represent the debtor's consent to be bound by the instrument, and hence he cannot be legally liable on the instrument. The debtor can also raise against the holder such defenses as are based on the lack of capacity. The basis

for such defenses is that incapable persons, since they cannot give consent sustainable at law because of lack of understanding of the consequences of their act, their signature on a negotiable instrument does not represent their consent to be bound thereby. Also the defenses of lack of power of representation is an available defenses to the debtor .According to article 2206(2) of the civil code, a person who signs in the name and on behalf of another person without the necessary power of authorization or in excess of power of authorization, the person on whose behalf the act is done will not be bounded by the instrument unless he ratifies the act.

By the defence of, “absence of necessary conditions for bringing the proceedings” under article 717(2) it is meant the absence of certain proceedings without which the performance of the dead becomes impossible as, for instance, non presentment for payment of a bill .

Let us see now which defenses could be raised against who based on the classification we have seen above.

A. Personal defenses

Personal defenses are those defenses that are based on the personal relations of the parties; and the phrase, ‘’personal relation” includes the underlying obligation to the creation of a negotiable instrument. A bill of exchange may be issued to discharge a debt. It is the contract, i.e the personal relationship between the original parties, that under lies the issuance of the bill.

Personal defenses include contractual defenses, non delivery of the instrument, fraud, previous payment, counter-claim, unauthorized completion and theft.

A debtor can invoke the defense of previous payment when he has discharged the instrument by payment and failed to cancel the document and the instrument is further negotiated to a holder in due course, or a holder through a holder in due course, and he (the debtor) becomes liable for a second payment. Counter claim is a claim that part payment has been made on the instrument and such proof of payment can only be enforced against those parties who know the part payment. And, an unauthorized completion is said to be there when a holder who normally has the right to complete an instrument according to the express or implied instructors of the drawer, completes the instrument otherwise than in accordance with the instruction.

All these defenses have one common thing. Which is, that the debtor can not invoke these defenses against the holder in due course? Assuming that there is an action on a bill, so long as the relations between the original parties to the contract exist, defenses are available for the drawer to deny the endorsement of payment of the bill to the payee. But this does not mean that the defenses are available against a holder in duecoruse to whom the payee has transferred the bill. For example, a finder or a thief of a bearer instrument may pass a negotiable bearer paper by delivery alone and thus deprives the true owner, of his claim to the instrument since a holder in duecourse take free of the ownership rights of any person and provide a defence of theft on a bearer instrument can not be raised against him. The keystone of the law of negotiable instruments is the rule that a holder in due course of a negotiable instrument

takes it free from “personal defenses” or claims which may exist between the original parties to the instrument. And this is provided for under sub (3) of article 717, “… that he may not set up against the holder defenses based on his personal relations with proceeding holders unless the holder has acted knowingly to the detriment of the debtor”. So against a holder that has acquired the instrument in good faith, by which it seems to mean holder in due course, defenses of personal nature cannot be raised.

B. Real defenses

From the stand point of public policy there are certain defenses which do so to the validity of the instrument and which are good against a holder in due course of a negotiable instrument. These are the so called “real defenses” which we referred to previously as exceptions to the right of the holder in due course to take the instrument free from all claims to it on the part of any person.

These are defenses other than those that relate to the personal relations of the previous parties. Thus, based on which is provided under article 717, defenses of form and those based on the text of the instruments, on falsification of signature, lack of capacity or power of representation at the time of issuance of the instrument or on the absence of the necessary conditions for bringing the proceedings, are real defenses. The essence of these defenses is that they are based on the intrinsic nullity of the instrument that the good faith or otherwise of the holder is irrelevant.

Defenses of forgery and form, those defenses based on the text of the instrument are real defenses to be even invoked against a holder in due course, since as we have seen above the drawee is entitled to

refuse payment on a bill that consists a forged signature and a bill that is not in accordance with the formal requirements of the bill of exchange is not or a valid existence at all. Hence the reason why the defenses of incapacity and of illegality, which make the instrument void, are available against even a holder in due course is that it is the policy of the law to override protection even to the holder in due course where greater protection is seemingly desirable for and where public policy in discouraging illegal transactions is furthered by permitting the defence of statutory illegality.

Hence, the establishment of title of negotiable instruments is effected through delivery alone in case of bearer instrument and through delivery and endorsement in case of instruments made out to order. And the lawful possessors of the instrument, i.e., the person who acquired the instrument through either of the above ways, are further classified in to two: holders and holders in due course. Holders are the persons who possess the instrument lawfully and who may bring an action upon it. But who stand in the shoe of the transferor, with all the personal defenses of previous parties subject against them. Holders in due course are holders who, besides possessing the instrument lawfully and bringing action upon it, are not subject to the personal defenses of previous holders. They acquire a better title than their transferor had. This is because they get possession of the instrument in a more special way then the holder which is; in good faith, for value and without notice that the instrument had defects. The only defenses that may be raised against a holder in duecourse are real defenses, and this is for the reason of public policy and because the defects go to the validity of the instrument.

Dear students, in this chapter we have seen issues in relation to bills of exchange exhaustively. Now we have completed the chapter. Here

under review questions are provided to you. Before proceeding to the coming chapter, you are advised to answer all the review questions. To answer all the questions very well as well, you are advised to read again and again the chapter.

3.4Review questions

1. Discuss the concepts what opposition, payment, and discharge mean.
2. Discuss what does negotiation of negotiable instruments means.
3. State clearly state what we mean by maturity of commercial instruments.
4. Discuss what does acceptance of commercial instruments means.
5. Discuss in brief what acceptance for honor is.
6. What is the due date of the following instruments?

    a. A bill of exchange dated 30 October 2009 payable two months after date
    b. A bill of exchange dated 31 December 2009 payable 90 days after sight
    c. A promissory not falling due for payment on Sunday the 14th March 2009.

Unit Four

Promissory Notes.

Dear students, well come to the fourth chapter which is all about the concept of promissory notes. In this chapter, we will not have a deep discussion like that of the previous chapter. Because most of the provisions that can serve for bills of exchange can also serve at the same time for promissory notes and you are advised to go back in the second and third chapter and to compare such similarity which are common to these commercial instruments.

Objectives:

After completing your readings of chapter four of this material you will be able to

- explain the concepts what promissory note is,
- describe the formal requirements for a valid promissory notes
- analyze the appropriate provisions of bills of exchange that serve for promissory notes, and
- evaluate the extent of liability of the makers of promissory notes

4.1 Definition

A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money only to, or to order of a certain person, or to the bearer of the instrument. The person who makes the promise to pay is called the maker. He is the debtor and must sign the instrument. The person who will get the money (the creditor) is called the payee.

Dear learners, as we can see from the above definition, it is apparent that the following essential requirements must be fulfilled by the instrument intended to be a promissory note.

- The instrument must be in writing

A promissory note has to be in writing. An oral promise to pay cannot be considered as a promissory note. The writing may be on any paper. It may be in pencil or in ink and include printing or typing. No particular form of words is necessary, even a promise contained' should be used in a letter will suffice, provided the other requirements are complied with. Of course the words used must import a clear undertaking to pay, but it is not necessary that the word 'promise should be used. Dear learners, now let me provide you with a model of promissory note.

Birr.10,000 Bahir Dar, 25 Nove,2009

Sixty days after date I promise to pay to Ato Nega Elias or order the sum of birr ten thousand only with interest thereon at 10% per annum for value received.

Stamp

Tebabal Hulgize

- The instrument must be signed by the maker of it

A signature in pen or by a rubber stamp of facsimile is more preferable.

An illiterate person may use a mark or cross instead of writing out his name, the signature or mark may be placed any where on the

instrument, not necessarily at the bottom. It may be at the top or at the back of the instrument.

- The instrument must contain a promise to pay. The promise to pay must be express. It cannot be implied or inferred. A mere acknowledgment of indebtedness is not enough.

For example:-

"Ato Alemu I owe you Bir, 10, 000," This is only an admission of indebtedness. There is no promise to pay and therefore what is stated in the instrument is not a promise to pay and therefore the instrument is not a promissory note.

- The promise to pay must be unconditional. Hence if the promise to pay is accompanied with a condition, it is not a promissory not.

Example:-

(i) *"I promise to pay Alex Birr. 3000 on Maru's death provided Maru leaves me enough to pay his sum"*

(ii) *"I promise to pay Alex Birr. 4000, seven days after Maru's Marriage*".

These instruments are not promissory notes, because the promise to pay is accompanied with a condition "I promise to pay Alex Birr. 4000 on demand" is not with on unconditional promise.

But, stipulations of the following type are not regarded as conditions. Promise to pay at a specified time or at a specified place or after the

occurrence of an event which is certain to occur, or payment after calculating interest at certain rate.

Example:-

"I promise to pay Alex Birr. 2000 on 1st April, 2010"

- The makers of the instrument must be certain and definite
- The sum of money to be paid must be certain

4.2. Formal Requirements

When we come to the provisions of the commercial code, similar to the case of bills of exchange, the commercial code of Ethiopia does not provide the definition of promissory note, which is identical with the definition provided above. But, the code contains essential element for the instrument to be considered as promissory note.

Art 823 – Requirements

A promissory note shall contain:-

(a) The term "promissory note" inserted in the body & the instrument and expressed in the language employed in drawing up the instrument.

(b) An unconditional promise to pay a sum certain in money.

(c) The time of payment

(d) The place of payment

(e) The name of the person to whom or to whose order payment is to be mode or a statement that the note is payable to bearer.

(f) The date when and place where the note is issued

(g) The signature of the person who issues the instrument (maker)

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 absence of time of payment, place of which 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 not which fails to indicate the place of payment is presumed payable at the address of maker of the promise and not which does not indicate the place of issuance deemed to have been drawn of the place indicated beside the name of the maker.

Dear student, in the previous discussion I have discussed in detail the concept of bill of exchange and promissory notes and I hope you have understood it well. Now let me raise issues related with the difference between bills of exchange and promissory notes. Dear students, can you see any difference between these commercial instruments? Please try to provide your own answer before reading my notes.

The difference between bills of exchange and promissory notes is mentioned here in under;

A. Number of parties

In a promissory note there are two particles the maker and the payee. But, in a bill of exchange there are three parties the drawer, the drawee and the payee.

B. Promise and order

In a promissory note there is a promise to pay a certain sum of money. But, in a bill of exchange there is an order to pay a sum of money.

C. Acceptance

A promissory notes is signed by the person liable to pay it the, no acceptance is necessary. A bill of exchange except in certain cases requires to be accepted by the drawer before it is binding up on him.

D. Liability

The maker of promissory note is primarily liable on the instrument. The drawer of a bill is liable only when the drawer does not accept the instrument or pay the money due.

E. Relationship

In a promissory note the maker stands in an immediate relationship to the payee. In a bill of exchange a drawee stands in immediate relationship with the acceptor and not to the payee.

F. Notice.

In case of non-payment or not-acceptance of bill, notice must be given to all persons liable to pay. This is called the notice of dishonor. In the case of a promissory note, notice of dishonor to the maker is not necessary.

4.3. Reference to Provisions Relating to Bills of Exchange

Dear students, have you noticed the above differences between the two commercial instruments? Well! But, even though there is certain deference between promissory notes and bill of exchange, almost the provisions that apply for the bill of exchange are applicable ***mutatis mutandis*** to promissory notes. The provisions which are equally applicable to promissory notes are:-

(i) Endorsement (art 746 – 756)
(ii) Time of payment (art 769 – 773)
(iii) Recourse in case of non-payment (art 780 – 793), 795 – 793)
(iv) Protests (art 781-791)
(v) Alteration (816)
(vi) Limitation of Action (art 817 & 818)
(vii) Stipulations of Interest (art 739)
(viii) Discrepancies as regards the sum payable (art 740)
(ix) The consequences of signature by a person who acts without authority who exceeds his authority (art 742)
(x) The provisions regarding bill of exchange in blank (art 744).
(xi) Provisions relating to acceptance for honor (art 766 – 768)

4.3 Review questions

1. Define the term *promissory note.*

2. List and discuss the similarities and differences between a bill of exchange and a promissory note.

3. What is the significance of Art 825 of the Commercial Code?

Unit Five

Cheques

Students, how was your reading in the previous chapters? I think you have enjoyed over it. Now we are in the last chapter of this material which deals with the concept of cheque. Like that of the previous chapters you are recommended to red attentively all the issues that I am going to raise. Wish you good reading.

Objectives:

At the end of this chapter, you will be able to

- Define what constitutes cheque and explain the nature of drawing a cheque ,
- Explain the concept of presentment and payment of cheque
- Identify the limitation of actions in case of cheque, and
- Discuss the effects of limitations of actions in case of cheque.

5.1. Definition and Drawing of a Cheque

5.1.1. Definition

According to the English Bills of Exchange Act 1882, a cheque may be defined as an unconditional order in writing addressed by one person to another, who must be a banker, signed by the person giving it, requiring the banker to pay_on demand a sum certain in money to or to the order of a specified person or to bearer. Under the 1931 Geneva convention on the uniform law of cheques, a cheque is defined as and instrument drawn on a banker.

Although no statutory definition is provided for the term ‘‘cheque’’ under the Ethiopian commercial code, there are mandatory requirements of form that it must fulfill and, failure to comply with any one of which will destroy the validity of the paper as a cheque. These requirements, some of which are incorporated in the above definition, will be discussed below

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A. Parties to a cheque

There are three parties to a cheque, namely; (1) the party by whom or by whose authority the cheque is signed, called the drawer; (2) the party authorized to pay out the money, that is, the banker; called the drawer; (3) the party to whom or to whose order the money is to be paid called the payee.

B. Requirements of a cheque

According to the Geneva uniform law, cheques are formal, the validity of which depends primarily on its form. The Ethiopian commercial code also provides formality requirements pertaining to a cheque and these are as follows:

I .Unconditional order to pay a sum certain in money.

This means that it is mandatory that it carries on the face of the cheque an unconditional order to pay a sum certain in money. The requirement that the sum must be certain that a definite, unalterable amount must be stated. So, this requirement is a typical characteristic of a commercial negotiable instrument.

II. The name of the person who is to pay (drawee)

This means that the name of the banker on whom the cheque is drawn or the order is addressed should be indicated on the face of the cheque so as to avoid any mistake regarding the bank or institution from which the payment of the cheque is to be demanded.

III. The place of payment_

It is usual to state in a cheque while it is to be paid however, article 828 of the commercial code give a remedy if in case the place of payment is not stated. So, unlike the other requirements which a cheque should meet, this one is permissive. As envisaged in article 835,"a cheque may be payable at the domicile of a third party in the locality where the drawee has his domicile or in another locality provided that such third party is a banker."

IV. The data when and the place where the cheque is drawn.

That is, details of the place and date of drawing are both essential requirements that must be shown on the face of the cheque. Where a cheque is draw in one place and is payable in another having a deferent calendar, the date of issue shall be construed as being the equivalent day of the calendar of the place of payment.''

V The signature of the person who draws the cheque(drawer).

The drawer's signature is an essential requirement because it is a representation to all holders of the cheque that the drawer has

funds to meet the cheque and it is also important from the point of view of the drawer without which it shall not honor the order give by the drawer. Thus, in order to make the instrument a valid cheque, it must be signed by the drawer himself or by some person duly authorized by him. In line with this concept, articles 838 and 839 of the commercial code provide:

> *Where a cheque bears signatures of persons in capable of binding themselves by a cheque, forged signatures or signatures of factious persons who signed, the cheque or on whose be-half it was signed, the obligations of the other persons who have signed it shall be valid. Whosoever signs a cheque on behalf of a person for whom he has no power to act shall bind himself as a party to the cheque and the person for whom be purported to act. The same rule shall apply to an agent who has exceeded his powers.*

In order that an instrument becomes a valid cheque, it should be made payable to or to the order of a certain person or to bearers. But we do not see this element in article 827 and the missing of such elements, not given remedy in article 828, a cheque which does not specify the payee is deemed to be a cheque to bearer. And this seems to be the reason for it not to be a requirement.

C. Requirements absent and their remedy_

The above discussed requirements are necessary conditions that must be fulfilled so as to consider the instrument as a valid cheque. Nevertheless, there could be some features absent from the formal requirements and certain solution may be given as a legal remedy by

the law itself. To this effect, if the elements stated in articles 827(c) happens to be missing, article 828 provides that:

(a) Unless otherwise expressly provided the place mentioned under the some of the drawer shall be deemed to be, the place of payment. If several place are mentioned under the name of the drawer, the cheque shall be payable at the first place mentioned;
(b) In the absence of these statements, and of any other indication, the cheque shall be payable at the place were the drawer has his principal establishment,

Thus, a cheque is not invalid by reason that it does not specify the place where it is payable. For the place mentioned under the name of the drawer shall be taken as a place of payment, it seems also that a cheque may state an alternative place of payment in which case, the first-named it to be taken as the place of payment. And in the absence of these statements, the cheque is still valid and is payable at the principal place of business of the drwee.

D. Prerequisite for drawing (previous cover)

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The most important obligation of the drawer is to hold with the drawer sufficient funds that is, the essential characteristics of a cheque is the existence of a prior disposable found at the time of issuance of the cheque in the hands of the drawee. And for one to have this disposable fund ie, previous cover; it is necessary that he has an account operated by cheque (a current account) with the bank. A similar notion is envisaged under Article 830 of the commercial code which imposes an obligation on the part of the drawer to hold sufficient funds with the drawer at the time of issuance of the cheque

and it is after doing this that the drawer can be able to dispose of his by sending a cheque. But in citumstances where the drawer has written a cheque on insufficient funds that is, without adequate fund to meet the face value of the cheque, the drawer bank returns the cheque paid upon presentment for payment. And as provided under 657_of the Ethiopian penal code, which reads:

(1) Whosoever intentionally draws a cheque without cover or knows that there will not be full cover at the time of presentment for payment, is punishable for fraudulent misrepresentation.

(2) Where the offender acted negligently, he is punishable with a fine not exceeding five hundred Ethiopian dollars.

So, criminal sanctions would be held against such drawer as a previous cover is needed for one to be able to draw a cheque.

5.1.2 Drawing of a cheque

A cheque may only be drawn on a banker or an institution or establishment by law as a banker. So, the drawer of a cheque should always be a banker. In Ethiopian, commercial bank, Agriculture and Development bank and National bank seems to be the appropriate institutions on which a cheque could be drawn.

A cheque may be made payable to or to the order of a certain person or the bearer. This can be inferred from reading article 833 of the commercial code. Sub article 1(a) of the same article provides that a cheque may be made payable to a specified person with or without the express clause “to order”. So, a cheque may be drawn payable to a specified person or his order using words such as “pay to **Y** or order” and such kind of a cheque is known as an order cheque. A cheque may

also be made payable to a specified person without the express clause to order, that is, payable to the payee named on the cheque.

Article 833(1)(b) provides that a cheque may be made payable to a specified person with a clause ‘’not to order” or any similar clause.

And according to article 833(1)(c) a cheque may be made payable to bearer. That is, it may be drawn using words such as “pay bearer”. Thus, a cheque drawn the cheqeu using words such as “pay barer” is known as a barer cheque. Sub 2 and 3 of the same article provides that a cheqeu made payable to a specified person with the word “or to bearer” or any similar words: or a cheque which does not specify the payee shall be deemed to be a cheque to bearer.

5.2. Presentment and payment of a cheque

An essential characteristic of a cheque is that it is payable on demand. Article 854 of the commercial code proved that a cheqeu is payable at sight. This means that a cheqeu is payable immediately upon presentation. Therefore, as to the date of its maturity, a cheque shall be deemed to be mature from the time of its drawing.

We have seen that a cheque which is a demand instrument entitle the holder to immediate payment when presented. In order to effect such payment Article 855 of the Commercial Code provides the time within which it should be presented. It reads as follows:

“A cheque shall be presented for payment within six months of the date thereof, regardless of when the cheqeu was issued.” The term’ issue’ arising out of this definition requires consideration. ‘Issue’

means the first delivery of a cheqeu to a person who takes it as a holder. Thus, in light of Article 855 of the Commercial Code, the period for presentment begins to run from the date specified on the face of the cheque and not of he date of delivery, i.e, the date of delivery is of no relevance in calculating the time limit for presentiment. And until the elapse of the six months period after its date. A cheque is not deemed to be over due.

In relation to this provision, the question of post-dated and ante-dated cheques could be raised. That is, when a cheque is dated, it can be ante –dated or post-dated. An ante-dated cheque is one that bears a date before the date of issue and a post-dated cheqeu is one dated later than the date of issue.

Dear students are you clear with the above concept? For further understanding ,let me illustrate this, if we take for instance that A gives B a cheque dated December 10,2007 (Tahesas1, 1999 E.C), for payment of a debt, B has to present the cheque for payment within six months starting from such date that appear on the cheque till June 10,2007 (sene1, 1999). But A, instead of putting the date of delivery which is December 10, 2007 (Tahsas 1, 1999 E.C), may put on the cheque September 11,2007 (Meskerme 1, 1999 E.C) which means an ante-dated cheqeu or he may put March 10, 2008 (Megabit 1, 1999 E.C) making it a post-dated .The cheque is in effect only a representation by the drawer that he expects to have funds in the bank with which to pay the cheqeu on the date named there in and is generally held to be payable at sight or upon presentment there of the bank, at any time on or after the day of its date. Though there is no express provision dealing with such kind of cheque in the Ethiopian commercial code, the 1931 Geneva convention on a uniform law of cheques come from, provides in its article 28 that a cheque is payable

at sight and that a cheque presented for payment before the date stated as the date of issue is payable on the day of presentment. In addition, although a post-dated chqeue is one of the reasons in which a bank dishonors cheques, when articles 854 and 855 of the Commercial Code are read together, a cheque is payable at sigh provided that it is presented for payment within six months of the date thereof regardless of when the cheque was issued. So, one can argue that a post-dated cheque though it does not mature until the day of its date, it should be payable on demand on and after its date specified on the instrument.

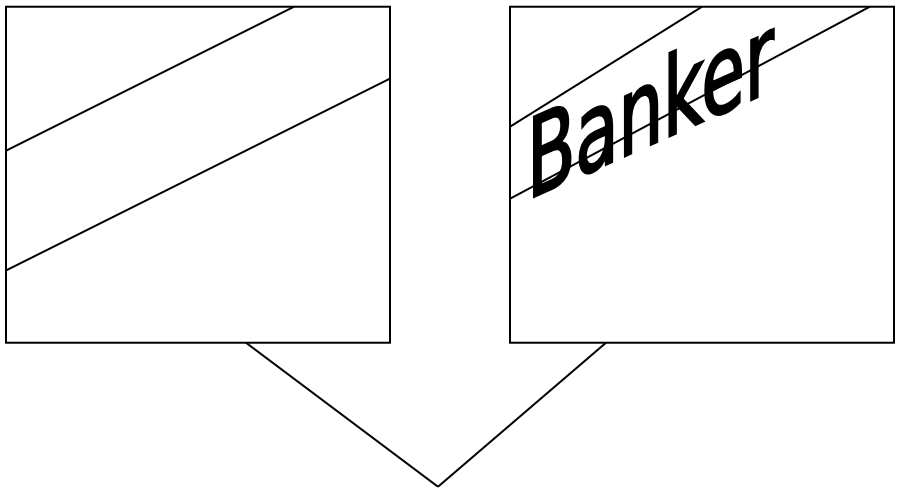
Thus, going back to our previous example, the banker should have no obligation to honor it merely on the ground of its being originally post-dated and therefore should pay the cheque if presented for payment starting from March 2008 (Megabit 1, 1999 E.C) (the specified date on the cheque) till September 10, 2008 (Meskerem 1, 2000). And also as to the ante-dated cheqeue dated cheque dated September 11, 2007 (Meskerem , 1999 E.C), it can be brought for payment starting from such date till March 11, 2008 (Megabit 1,199 E.C.) without taking in to consideration the date of delivery which was December 10, 2007 (Tahisas 1, 1999 E.C.)

In the following chapter we are going to discuss limitation of actions on a cheque in which case the time limit for presentment plays an important role in calculating the time within which one can exercise his right of recourse.

5.3. Crossed Cheques and Cheques Payable into Account

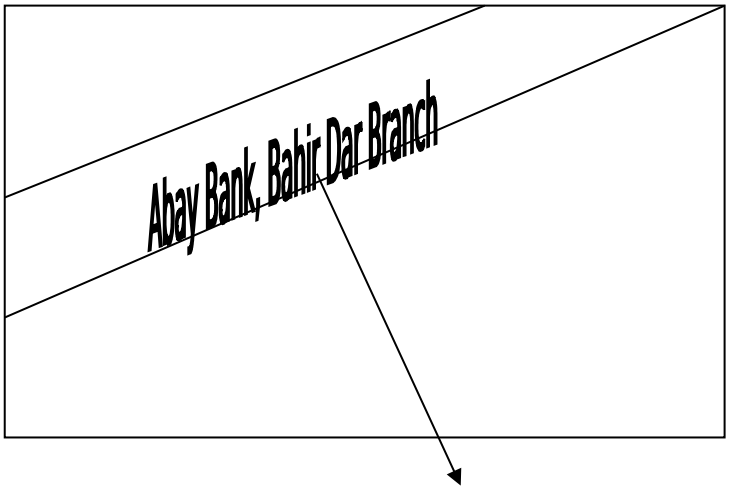
A crossed cheque is a cheque containing two parallel lines drawn across its face by the drawer or holder. Crossing are of two types, general and special crossing.

A cheque is crossed generally where it bears the two parallel lines only or where the word “bank’ or ‘banker’ is inserted between the lines. In between the lines, certain additional words like ‘banker’ or some equivalent term may be written or it may be left without additional word.



Sample of General Crossing

We have also another kind of crossing what we call it special crossing. The crossing shall be special where the name of a specific bank is inserted between the lines.



Sample of Special Crossing

A cheque 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 cheque may be paid to a person who is the customer of the drawee. However, a bank may not collect crossed cheque 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 cheque is paid to the intended person by preventing payment to other persons into whose hands the cheque might fall. It also helps to avoid or at least minimize risks associated with loss or theft of cheques i.e. to trace and identify the person who actually received payment for the purpose of recovery. Because crossed cheques are paid to either

banks or customer of banks whose addresses are known and traceable.

However, the fact that a cheque is crossed does not mean that it cannot be negotiated as open cheques. Negotiation of crossed cheques shall have the same effect as the negotiation of open checks and the person to whom such cheque 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 cheque. A person to whom a crossed cheque 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 cheque.

A bank, which violates the provisions of Art 864 and pays the cheque 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 cheque. /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 cheque, where it is shown that the customer on whose behalf it collected the crossed cheque has no right to the instrument or that his rights is defective and subject to personal defenses.

Where the drawer or holder of a cheque writes transversally across the face of the cheque words such as ‘payable in account’ or any similar expression, the drawee may not pay the cheque in cash to a person who is not its customer. Such cheque 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 cheque in cash at the counter shall have the liability to pay damages provided under Art 866.

5.4. Action of reIcourse by the holder

Actions of recourse by the holder against the endorsers, the drawer and the other parties liable shall be barred after six month from the expiration of the limit of time for presentment.

As we can see from this article, there are certain necessary conditions that the holder must fulfill in order to exercise his right of recourse against such parties to a cheque. Therefore conditions which need consideration and therefore, will be discussed below.

Presentment in due time

The holder has to present the cheque for payment within six moths from the date that is specified on the cheque and failure to do so will bring loss of right of recourses against parties liable for the payment of the cheque. This is because presentment for payment is necessary in order to establish the liability of the parties who are secondarily liable. These parties are those that become liable only when the primary party (the person who by the terms of the instrument is

required to pay the same) fails to pay and the holder performs certain conditions precedent, namely presentment, notice, and dishonor. These parties include the endorsers and drawer of a cheque. But the law provides that the drawer guarantees payment and any provision by which he releases himself from this guarantee shall be of no effect. So, it could be said that the primary responsibility rests with the drawer. However, when the bank certifies a cheque at the request of the drawer, the primary responsibility could be transferred to such drawer because certification of a cheque is a security to holders of a cheque to be honored as presented.

Though the cheque is presented within such period, there are various instances in which it is dishonored by the payee bank, that is, payment may be refused or cannot be obtained.

If we take for instance, the commercial bank of Ethiopia, it has enumerated the various reasons for dishonor. These are when:-

1.Endorsement Missing
2. payee’s endorsement required
3. payee’s endorsement irregular
4. Drawer’s signature differ
5. Alteration in drawer’s full signature
6. cheque is post-dated
7. cheque is out dated
8. Amount in words and figures differ
9. payment stopped by the drawer
10. Deposit items not cleared
11. cheque is mutilated
12. Drawer’s signature missing
13. Additional signature required

14. Account closed on
15. A/C transferred to Branch
16. Insufficient funds

Hence, if the cheque is dishonored for any one of the above reasons, a protest must be drawn which is the next necessary condition that a holder must fulfill in order to exercise his right of recourse.

Protest

Protest is a formal declaration of the fact of non-payment usually executed by a notary in order to avail only of one's right of recourse against the drawer and the endorsers. That is, it serves as an evidence of dishonor for the holder who desires to recover against the prior party on the cheque.

So, in light of article 868 of the commercial code, the holder may exercise his right of recourse against the endorsers, the drawer and the other parties liable where the cheque on presentment in due time is not paid and the refusal to pay is evidenced:

(a) by a formal instrument (protest): or
(b) by a declaration of the drawer dated and written on the cheque and specifying the day of presentment; or
(c) by a dated declaration made by a financial institution approved by the government stating that the cheque has been due time and has not been paid.

As regards conditions of protest the relevant Commercial Code provision (article 781(1) relating to bills of exchange provides that default of payment shall be evidenced by a deed drawn up by a public

officer (protest for non-payment). A dated declaration written on the cheque itself may replace this deed, except were the drawee's, in the text of the cheque itself, stipulates for a protest by deed drawn up by a public officer.

But could a protest be evidenced by a deed of a public officer in Ethiopia? There is no Civil status register, no public officer in Ethiopian to draw out such protest. Hence, the question of drawing of a deed by a public officer is out of question and the only simple way out is the dated declaration written, signed and sealed by the drawee which is sufficient prove for the holder to sue the parties involved on the cheque.

Dear students, now I am going to pose one question .When can a protest be drawn? Please discuss this question with your friends before reading my note.

In light of Article 869 sub 1 of the Commercial Code, the protest or equivalent declaration shall be made before the expiration of the limit of time for presentment. That is, it must be made within the time prescribed for presentation for payment which is six months starting from the date specified on the cheque.

In case when the cheque is presented on the last day of the time limit, the protest may be drawn up or the equivalent declaration made the drawer and the other parties liable if a protest or its equivalent declaration is not made.

In addition, the holder is also required to give notice as to the non-payment of the cheque to the prices concerned.

Notice of dishonor

If a cheque is dishonored after presentment, notice of such dishonor must be given to those parties that are secondarily liable.

So, in the event of dishonor of a cheque by reason of non-payment the law prescribes a time limit that the holder shall give notice of dishonor within the four business days following the date of protest or the equivalent declaration is made or, in the case of a provision “ret our sans fraise,” the day of presentment to his immediate predecessor and the drawer. This immediate predecessor, if an endorser, then has himself two further business days in which likewise to notify his predecessor and so on similarly back along the chain of endorsers each having two business days from the date upon which be receives notification.

Where in accordance with this sub article notice is give to a person who has signed a cheque, the same notice shall be given within the same limit of time to his acceptor for honor. It is sufficient if notice is give to the endorser preceding him, in the case of endorser whose address is not give or is unreadable.

Unlike the above two requirements (presentment and protest) which makes the holder to lose his right of recourse if not fulfilled, the person failing to give notice of dishonor within the prescribed time is subject of damaged caused by his failure, not to exceed the amount of the cheque: and he does not forfeit his right in the instrument. This same principle is incorporated in Article 870(8) of the Ethiopian commercial code.

If for instance where the chain of endorsement has been from A to B to C to D to E. The last named being the holder at the time of dishonor, E will need only to notify the drawer and D in order to preserve his right of recourse against A, B, and C also. Suppose then that having done this D fails to notify his predecessor (and that E demands payment from C who, being un notified, has for that reason no ready money with which to pay E, who therefore brings an action against C. In such an event C will be required to pay E but may require D to reimburse him with all the costs and damages for which he has been penalized because of failure to serve notice on him.

"The drawer, an endorser or an acceptor for honor, may, by the stipulation ***"retour sans frais," "sans protect"*** or any other equivalent expression written on the instrument and signed, release the holder from having a protest drawn up or an equivalent declaration made in order to exercise his right of recourse". The same principle is provided under article 871 sub 1 of the commercial code. But, these words shall not release the holder from presenting the cheque within the prescribed limit of time or from giving the requisite notices and the burden of proving the non-observance of the limit of time lies on the person who seeks to set it up against the holder.

So, waiver of protest does not include a waiver of presentment "where these words are written by the drawer, they shall be effective against all persons who have signed the cheque; where they are written by an endorser or acceptor for honor, they shall be effective against such endorser or acceptor for honor. Where inspire of the word written by the drawer, the holder has the protest drawn up or equivalent declaration made shall bear the expenses thereof". This means that it remains open to any party ,other than the drawer, to dispense with protest against the drawer so as to avoid the changes

that would necessarily be incurred, provided that party is willing to pay the cheque. So, there is no need for the holder to protest the cheque to preserve his right of recourse against anybody liable on the cheque; indeed, he will be liable to pay the protest if he does so. But where the words are written by an endorser or acceptor for honor, the caste of the protest or equivalent declaration may be recovered from all the persons who have signed the cheque. So, he may make his protest if he mashes to safe guard his right of recourse against the other endorsers and in such a case, he will recover the cost thereof from them.

Force Majeure

As an exception to the above discussed conditions, however, where there are circumstances which make the holder unable to present or draw up the protest or the equivalent declaration within the prescribed time the limits of time shall be extended.

These circumstances occur when they are absolutely prevented by force majored (legal prohibition by any state or other cases of force majeure). In such kind of situation, the holder shall give notice without delay of the case of force major to his endorsers and make a dated and signed declaration of this notice on the chque or on a slip affixed there to dealing with notice or dishonor shall apply. And were force majeure has terminated, the holder shall without delay present the cheque for payment and where necessary, have a protest drawn up or an equivalent declaration made. It means that when the cause for delay is removed, presentment must be at the earliest possible moment. Likewise, if it is necessary to draw up a protest or make an equivalent declaration, they must be done at the earliest possible time when the cause of delay ceases to operate. But if force majeure

continues to operate beyond fifteen days after the date on which the holder even before the expiration of the time limit for presentment has given notice of force majeure to his endorses, recourse may be exercised and neither presentment nor a protest declaration shall be made. So, in such an instance, this sub-article give right of recourse without presentment or drawing up of or protest.

The law also provides that facts which are purely personal to the holder or to the person entrusted with the presentment of the cheque or the drawing up of the protest or the making of an equivalent of the cheque or the drawing up of the protest or the making of an equivalent declaration shall not be deemed to constitute cases of force majeure. But what is meant by “facts that are purely persona which are purely personal may be where for example the holder has absolutely unable to present the cheque on time, say he was on a vacation and hence, there must be an external cause absolutely preventing the holder form presenting the cheque or draw up the protest or make the equivalent declaration.

Coming back to our previous discussion, if the holder has fulfilled the above conditions namely of presenting the cheque in due time and drawing up the protest or the equivalent declaration, save in cases of force majeure, he can exercise his right of recourse against the endorser, the drawer and the other parties liable provided that the periods of time provided for bringing an action on a cheque are observed.

It is also provided that actions by the holder of the cheque against the drawer are barred by the law after three years from the expiry of the time limit for presentment, that is, after three years and six months of the date specified on the cheque. Consequently, the drawer

may raise the defense of limitation of action against the holder were the letter fails to observe such period of time

In order to illustrate article 881 sub 1 of the Commercial Code, I will take as an example one instance of dishonor that would enable the holder to sue different parties liable for the payment of the cheque.

What I want to make clear to the students is that, I will nether go in to details to discuss the conditions as to when and how such actions could be brought by the holder nor the extent of the liability of the parties because the sole aim of this topic is just to show the limit of time within which the holder and the other parties liable for the payment of the cheque have in order to exercise their right of recourse against other parties, provided the above discussed conditions are fulfilled.

There could be different types of actions which the holder can bring against such parties since there are lots of reasons for dishonor by the drawer bank.

Let’s assume that A drew a cheque on Abay Bank in favor of B who endorsed it to E who again endorsed it to C and there may be a third party D, who puts his signature to guarantee as to the payment of the cheque. In such a case, if upon presentment the latter dishonored the cheque for ‘insufficient fund’ in the account of the drawer. C (who got it by way of endorsement from E can have a right of recourse against E or B because the endorsers liability is similar to that of the drawer because C, being the second endorsee, both the endorsers namely E and B are liable to him pursuant to article 846(1) of the commercial code,it is provided that endorses guarantees payment. But endorsers may stipulate to release themselves from liability to future endorsee

i.e, B may for instance prohibit any further endorsement, and in this case, C cannot have a right of recourse against B. C can still have a right of recourse against A, the drawer of the cheque, because where he has no funds with the drawer bank, he become absolutely liable in a suit on the cheque in which case by the very fact of drawing the cheque, he guarantees payment. And any provision by which he releases himself from his guarantee shall be of no effect.

As provided under article 881 (1) of the Commercial Code, the holder is not only entitled to exercise his right of recourse against the endorsers and the drawer, but also against other parties liable for the payment of the cheque. Such parties refer to acceptors for honor who could be a third part or a person who has signed as a party to the cheque. So, in light of our example, the holder can also exercise his right of recourse against D who has signed the cheque guaranteeing as to its payment, D may for instance state that he has give this guarantee for the benefit of E (the endorser). Thus, since he grantees the due performance by E for whom he intervenes of his obligations under the cheque, he is liable pursuant to article 872(1) and therefore, actions of recourse could be exercised against him.

The holder can also exercise his right of recourse against the dawee like in case of wrongful dishonor. This is because the bank owes a duty to the depositor to honor his cheque so long as he has a sufficient balance to cover them. So, as provided under Article 832 of the Commercial Code, if there is sufficient cover in the account of the drawer, and the drawee has certified the cheque in favor of the holder, by putting his signature on the face of the cheque, one can say they the bank is duty-bound to honor such cheque, So, the holder can exercise against such bank (drawee) if it has dishonored his cheque wrongfully.

The holder can exercise his right of recourse against person liable on a cheque jointly and severally. These are those mentioned in sub (1) of Article 881 namely the endorsers, drawer and the other parties liable for the payment of the cheque like third parties who guarantee as to the payment of the cheque. This also includes the drawee mentioned under Article 881(3) of the Commercial code.

But what does jointly and severally liable mean? Does the holder have the right to sue all of them at once?

The principle of joint and several liabilities as provided under article 1897 of the civil code states that the creditor may require all the debtors or one of them to discharge the obligation in whole or in part and each debtor shall be liable until the obligation is fully discharged. So, if the cheque be dishonored, the holder may enforce payment from the drawee or an endorser, or the acceptor for honor or the drawee or all of them at his option. In other words, the holder may join all parties liable on the cheque in one suit or may claim against this entire person individually for they are jointly and severally liable to him.

The holder can claim from all these persons individually or collectively without being compelled to observe the order in which they have become bond. Consequently, he may seek recovery from the last endorses or from the first endorser, or from intermediate endorsers or he may join all the endorsers in one action. And proceedings against one of the parties liable shall be no bar to proceedings against the others, not withstanding that such other parties may be subsequent to the party first proceeded against

So, in such instances, the holder should first know as to when and within what limit of time he could exercise his right of recourse against such parties and this is when the application of the statute of limitations come in to picture.

As against parties secondarily liable no right of action arises to the holder until there has been a presentment for payment, and hence as against the drawer or endorser of a cheque time will run only from the time when the cause of action against him is completed. In other words, the holder's right of action does not accrue until he has presented the cheque for payment in due time, save in case of force majeure, and the necessary proceedings on dishonor taken, that is , he has give notice of dishonor, and where the refusal to make payment is evidenced by a protest or by the equivalent declaration, after which, under the provision of Article 881(1) an immediate right of recourse against the endorsers, the drawer and the other parties liable such as acceptor for honor accrues to the holder.

But is there a time limit within which actions of recourse may be exercised by the holder to enforce such partied liability on a cheque?

As provided under article 881(1) of the commercial code, actions of recourse by the holder against the endorsers, the drawer and the other parties liable shall be barred after six months from the expiration of the limit of time for presentment. Thus, since such actions of recourse are barred after six month from the limit of time for presentment, that is, after one year of the date specified on the cheque, no action can be maintained by such cheque holder against any party mentioned in the provision after the expiry of one year.

Thus, if in our previous example, A gives B a cheque dated September 12, 2008 (Meskerem 1, 1999 E.C) for payment of a debt and B endorses the cheque to E who again endorses it to C, C has to present the cheque for payment to the drawee bank (Abay) within six months starting from such date that appears on the cheque until March 12, 2009 (Megabit 1, 2001 E.C) and if his cheque is dishonored by the payer bank for some reasons and returned to him, after taking the necessary proceedings on dishonor, he could exercise his right of recourse against the parties liable until September 12, 2009 (Meskerem) 1, 2002 E.C) that is, after the expiration of March 12, 2008 (Megabit 1, 2000 E.C), he is in addition given six months to exercise his right of recourse.

In light of our discussion, it is worthwhile to consider a case of Gezahengn Areda Vs Desalegn Dibaba (Civil case No. 139/83 E.C., High court, A.A.) involving a defense of limitation of action. The facts of the case involve that the defendant (Desalegn Dibaba) had given the plaintiff (Gezahegn Areda) cheque dated Tir 30, 1982 E.C. in the amount of Ethn.birr 17,200, but upon presentment on Megabit 26, 1982 E.C. it was returned unpaid by the drawee bank due to 'insufficient funds' in the account of the defendant. Then, the plaintif institute a suit on Msekerm 1, 1983 E.C. and asked the court to order the defendant to pay the sum written on the cheque.

The defendant responded that the action is barred by the statue of limitation because the action should have been commenced within six months from Tir 30, 1982 E.C.

The issue framed by the court is whether in this case, action of recourse is barred as a result of lapse of period of limitation. The court felt it necessary to examine the issues of limitation of actions.

Accordingly, as provided under article 855 of the code, a cheque shall be presented for payment within six months of the date there of, regardless of when the cheque was issued and under article 881 (1) it is provided that actions of recourse by the holder against the endorsers, the drawer and the other parties liable shall be barred after six month from the expiration of the limit of time for presentment. Hence, the court holds that as the plaintiff has presented the cheque within six month of is date and that since Articles 855 and 881 (1) are taken cumulatively the plaintiff has twelve months to institute an action before his right is barred as a result of laps of periods of limitation and the cheque in question was signed on Tir 30,1982 E.C., and the action was brought on Meskerem 1, 1983 E.C., the one year limitation, which is Tir 30,1983 E.C. has not expired. Thus, the court rejected the defendant's defense that according to article 881(1), the plaintiffs action of recourse are barred.

Therefore, the court ordered the defendant to pay the plaintiff the amount of Ethn. birr 17,200, together legal interest amounting to 9% from the date on which the action was brought until the time the defendant pays such amount, as well as court fees according to the receipt given. Defendant is also ordered to pay Ethn. Birr. 350 to the plaintiff the costs and advocates fees incurred by the latter by reason of the present action.

The writer of this material is of the same opinion as that of the court because according to the facts of the case, the plaintiff has duly presented the cheque for payment and has brought his action before the one year limitation has expired, so, the governing provision should be Article 881(1) of the Commercial Code and the defendant's

mistaken interpretation to Article 881(1) by taking the time limit to be the same as 855 of the code should be rejected.

As regards the certifying bank's liability on a certified cheque the statute provided under Article 881(3) of the commercial code did not begin to run until a demand was made by the holder.

Article 881(3) of the commercial code provides that: actions by the holder of the cheque against the drawer shall be barred after three years from the expiry of the time limit for presentment. So, just as he is required to observe against the parties mentioned under article 881(1), he is also obliged to observe the period fixed under this article in order to exercise his right of recourse against the drawee. That is, his right to bring and sustain a suit against the drawer is barred after three years from the expiry of the time limit for presentment.

Thus, in as much as his right against the drawee is concerned, C (the holder mentioned in the above example) to whom a cheque dated September 12, 2008 (Meskerem 1, 2001 E.C.) was given, should bring his action until March 12,2011 (Megabit 1,2003 E.C.) which means three years more in addition to the limit of time fixed for presentment (March 12,2007) (Megabit 1,1999 E.C.)

We have seen that there is a time fixed for the holder to exercise his right of recourse against parties liable on a cheque but what about the right of the parties liable for the payment of the cheque against other such parties? What does the commercial code says about this?

II. Action of a party liable against other liable parties

Actions of recourse by the different parties liable for the payment of a cheque against other parties liable shall be barred after six months from the day on which the party liable has paid the cheque or the day on which he was sued thereon.

As we have seen earlier, the parties liable for the payment of the cheque are those mentioned under Article 881(1) and sub(3) of the Commercial Code, namely the endorsers, the drawer, acceptor for honor and the drawee. So, different actions could be brought by these parties against each other like for instance the drawer against the drawer, the endorser against the drawer and the endorsers against each other.

If for instance we take actions of recourse by endorser against the drawer or endorsers against each other, since the holder, as said earlier, is entitled to sue anyone of the parties liable for the payment of the cheque, he might have selected out one of the endorsers, say B, and sued him to pay the amount specified on the cheque. In such a case, B who has been compelled to pay the cheque may recover from the drawer (A) because the drawer guarantees payment and cannot release himself from such guarantee. Or the holder might have sued E (another endorser) to pay the amount of the cheque. Consequently, E who has been compelled to pay the cheque may recover from B (the prior endorser) because B, who guarantees as to the payment of the cheque. Should compensate the subsequent endorse (E) who has been compelled to pay it.

Now the question is when can such parties bring actions of recourse against such other parties?

If for instance we take actions of recourse by endorsers against each other, then, when can E sue B in the above example?

The statute of limitation begins to run in favors of an endorser of a cheque when the cause of action against him occurs, as were the endorsee has paid the holds. Hence, the statue does not start running in favor of B until payment is made by E which in turn means E has no right to bring action against B until he has paid the amount of the cheque to the holder or as provided under Article 881(2) he has been sued by such holder.

But is there a limit of time within which he can exercise his right of recourse?

As regards actions of recourse between the different parties liable on a cheque, the law proceeds that actions are barred after six months from the day on which the parity liable has paid the cheque or the day on which he was sued thereon.

Hence, if E failed to bring an action against B within the six months period of time starting from the day he has aped the amount of the cheque to C, his right will be barred due to the expiry of time; or if after being sued by such holder be failed to pay the amount of the cheque, he can sue B within six months starting from the day he was sued by C (the holder)

Thus, if E pays the holder on January 13, 2007 (Tir 4, 2000 E.C.) he can exercise his right of recourse against B till July 13, 2007 (Hamle 4, 2000 E.C.) starting from the date of payment; or if being sued by the amount of the cheque, he can exercise his right of recourse

against B till May 12, 2007 (Ginbot 2, 2000 E.C.) starting from the day he was sued by such holder.

So, failure to exercise his right within such period will bar his right to bring proceedings against such other party liable. Students, till now that we have seen the limit of time fixed for parties to a cheque to enforce their right of recourse, let us then see the application of the period of limitation in other cases as provided in the following sub-articles of this same article (881).

III. Limitation in case of legal proceedings

In as much as legal proceedings are concerned, limitation shall run from the date of the conclusion of the last proceedings.

Where a person is prevented from exercising his legal remedy the tendency of legal proceeding, the time during which he is thus prevented should not be counted against him in determining whether limitation has barred his right. Thus, during the tendency of litigation provoked by defendant's own acts, limitations do not run against plaintiff. If for instance, a counterclaim has been lodged by one of the patties in a suit brought by the cheque-holder for the payment of the cheque, and if that counter – claim as is brought into the suit has the effect of suspending the running of the statute of limitation, in such a case, it is after the conclusion of this counter – claim proceeding that the statute continues to run against such holder. And this means that the holder's right is preserved as it existed at the commencement of such proceedings. If this provision is not interpreted in right of this, it will be in contradiction with the last part of Article 881(2) which provides that the statute of limitation shall run from the day the party liable for the payment of the cheque was sued by the holder, i.e. it

would render one of these sub-articles meaningless. The problem with these provisions could be the fact that they have come from different sources in that sub 2 of article 881 from the 1931 Geneva Convention on a uniform law of cheque from which most of the Ethiopian provisions dealing with cheques have come from and sub of article 881 from another source.

IV. Situations in which limitation does not apply

Unlike sub four of article 881 of the code which deals with the running of the statue of limitations, the next sub article dales with situation that take a case out of the statue of limitations. This sub article states that limitation shall not apply where judgment has been pronounced or the debt has been acknowledged by separate act. But when judgment is said to be pronounced? .Pursuant to Article 180 of the Ethiopian Civil procedure code., “after a suit has been heard, the court shall pronounce judgment”, and an acknowledgement in order to take the case out of the statute, must be in writing signed by the party chargeable to the person who is the claimant. And this act of the debtor indicating that he considers himself bound by the debt will constitute recognition of the debt.

So, where judgments has been pronounced; or although judgment has not been pronounced, if the debt has been acknowledged by separate act to someone who was entitled to receive payment of the debt, the law excludes the application of the statue of limitations, Thus, what is left is simply a matter of execution. That is, pursuant to article 384 of the Civil Procedure Code, the person in favor of whom judgment has been procedure can exercise his right for the years and also by invoking Article 1852(2) of the Civil Code, the creditor to whom debt has been admitted in writing can exercise his right within ten years.

5.4.1. Interruption

Interruption is an act or preceding that defeats a claim based on limitation by stopping the running of the period of time required for the perfection of the title or claim and starting it running as a new.

Dear tudents, when do you think that this limitation of time is interrupted?

As provided under Article 882(1) of the commercial code, the period of limitation shall be interrupted by the brining of an action, by notice being given of third party action or by lodging a claim in bankruptcy. So, the period of limitation may be interrupted by the action of the cheque-holder for the enforcement of his right in court against the parties liable for the payment of the cheque or by notice being given of third party action. A court action interrupts the period of limitation if and only if the debtor receives notice of it. In addition, limitations as to a suit are also interrupted while plaintiff is delayed by the tendency of bankruptcy proceedings. If for instance in a suit by the drawer bank a cheque – holder commence proceedings for the drawer's bankruptcy, such proceeding will stop the running of the period of limitation.

Once we have seen the different instances that interrupt the period of limitation, but up on whom is such interruption effective? Students,

please discuss this issue with your friends before go through with my note.

The law provides that the interruption of the period of limitation shall be effective against the person in respect of whom the act interrupting such period is performed. This means that if for instance we take a claim in bankruptcy the tendency of such proceeding by the cheque holder against the drawer in a suit brought by the latter one, has the effect of interrupting the period of limitation against the drawer because he is the one against whom such proceeding is lodged. Hence, as the law so provides, the effectiveness of the interruption remains only on the drawee.

But the issue here is that, what is the effect of such interruption?

As regards the effect of interruption sub 3 of article 882 provides that where the period of limitation is interrupted, a further period of the same duration shall begin to run. This means that the time already run does not count; it is list for the calculation of limitation, but it recommence to run immediately and neither its nature nor its duration is changed; it is the same limitation which befits again, with a new point of departure. As we've seen earlier, since any act interrupting the period of limitation as regards the holder is defective against him, the same period of limitation as provided under Article 881(1) and sub(3) of the Commercial Code will recommence to run for him to exercise his right. Likewise, an act interrupting the period to limitation as regards parties liable for the payment of a cheque is defective against such parties and hence the same period of limitation starts to run anew as provided under article 881 sub 2 of the code for them to exercise their right.

Generally speaking, the one in respect of whom the act interrupting the period of limitation was performed is there by existed in a more advantageous position because he is given a chance to have a longer period to perfect his claim for the time already run does not count against him. Thus unlike sub 4 of Article 881 in which the creditors rights are being preserved as they existed at the commencement of the legal proceedings and the statute of limitation continues to run against such creditor from the date of the occlusion of such proceeding, under article 882, the limitation period starts to run a fresh and the time already run does not count i.e., is lost for the calculation of limitation. Article 882 is also different from sub 5 of article 881. In that case, under this sub article the application of the statute of limitation is taken away where judgment has been pronounced or the debt has been acknowledged by separate act i.e., unlike article 882, it is not an interruption but limitation does not apply.

5.4.2. Time limit

As regards time limit, the law provides that the presentment or protest of a cheque may only take place on a working day and where the last day of the time limit prescribed by law for performing any act relating to a cheque, and particularly for performing any act relating to a cheque, and particularly for presentiment or for the drawing up of a protest of the making of an equivalent declaration, is a public holiday, the time limit shall be extended until the first working day which follows the expiration of that time.

But what if the holidays occur during the period of limitation? In such a case, they shall be included in calculating the limits of time. Days on

which, under the provisions of the laws in force, no payment can be required or protest drawn up, shall be deemed to be public holidays.

In as much as calculation of times is concerned, legal or contractual limits of time shall not include the day on which the period begins to run. It seems that the law gives authority to the contracting parties to fix limitation periods which differ from the time fixed by the statutes of limitation. But according to the writer of this material, the permission of the law should be the generally accepted rule. Because the contracting parties may fix a period which is unreasonable like for instance unreasonably short, and therefore, the legal or statutory limitation period should be the binding one on such parties.

Thus, as provided in the law, the day on which the period begins to run is not included in calculating the time limit. This means that if for instance an endorser after having been sued by the cheque – holder pays to such holder on January 13, 2007, he should bring his action against his prior endorser till July 13, 2007. Here, the day on which the period of limitation of action begins to run which is January 13, 2007 will not be included in calculating the time limit. However, hid action shall be barred where July 13, 2007 is lapsed without being used.

5.4.3. Days of grace

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Dear students, what do we mean by days of grace? Please make a discussion with your friends before reading my notes.

Days of grace, are certain number of days allowed for the payment of a negotiable instrument after the expiration of the time expressed in the instrument. But since a cheque is payable on demand that is,

immediately on presentment, it is not entitled to grace. Therefore, as the law so provides in article 885, no days of grace are granted.

Students, in the next topic we are going to see the effects of limitation of actions of a cheque.

5.5. Effects of limitation of action on a cheque

Dear students, let me ask you a question before proceeding to the point. Students, what right does this limitation bars?.

In construing provisions and effect of statutes of limitation, a distinction is drawn between those which operate merely to bar enforcement of right, there by destroying remedy only, and those which operate not only to bar remedy but also take away the right. “statutes have sometimes been said to be founded in part, at least on the general experience of mankind that claims which are valid are not usually allowed to remain neglected” That is as a general rule at least with respect to debts or money demands a statute of limitation is not regarded as discharging the debt, or even impairing, the obligation, either in law or in fact, and there is left available to the creditor every other lawful means of realizing on the debt or obligation.

Accordingly, thought the limit of time within which the cheque- holder should have exercised his right if recourse has expired, pursuant to Article 799 of the Ethiopian commercial code, such holder is allowed to bring proceedings for unlawful enrichment for his debt is not discharged by the parties liable for the payment of the cheque.

Thus, thought limitation of action on cheque under Ethiopian law is substantive in their nature for there is a provisions that bars such cheque holder from exercising his right due to lapse of time limit. It could be argued that such limitation of the legislature should be the guide in determining whether a statute extinguishes a debt or not, it is shown by necessary implication of the law, that the holder of the cheque can bring proceedings for unlawful enrichment which means that such right reviews the debt. That is, despite the fact that such cheque holder is barred from enforcing his right based on t he cheque I.e., claiming remedy that he could have sought on the cheque, his right to claim as to the payment of his cheque is not taken away by the statute of limitation.

Thus, if his right is not impaired to realize his debt, let us then see the lawful means left available to such holder to demand the payment of his debt owed by the parties who have not discharged their obligations.

What is the proceeding in case of unlawful enrichment?

Unlawful enrichment is a doctrine or principle which is that one shall not be allowed to profit or enrich himself at the expense of another contrary to equity. Unjust enrichment of a person occurs when he has and retains money or benefits which in justice and equity belongs to another, and there must be some specific legal principle or situation which equity has established or recognized to bring a case within the scope of the doctrine.

Students, before discussing the right of the holder to claim his debt on the basis of unlawful enrichment, let us see other possible proceeding which could be first sought because an action of unlawful enrichment

may be brought only in the event where there in no other remedy to the party at loss. That is, no other action should be available in the sense that the plaintiff, must not have any other possible action arising from contract or quasi-contract.

Article 799 of the commercial code, which allows the cheque holder to bring proceedings for unlawful enrichment though he has failed to perfect his right on the instrument, has provided in its sub article four that there proceedings (proceedings for unlawful enrichment) may not be brought unless the holder cannot bring causal proceedings.

So, what does a causal proceeding mean? According to the meaning that could be inferred form Article 800 sub 1, it is the proceedings arising out of the legal relations on which the issue or transfer of the cheque is based.

In this article, professor Escafra, the drafter of the commercial code of Ethiopia, has inserted in to the Ethiopian law solutions which are generally accepted in German law. “Hence, such solution should be taken as the basis of our discussion since there are no relevant provisions dealing will the concept of causal proceedings apart from article 800 of the Commercial Code.

As we have seen in chapter one of this material, a negotiable instrument is one form of a contract as between the immediate parties. In the same token, the situation in case of a cheque, which is one of the typical negotiable instrument, begin with the debtor’s giving his creditor a cheque in “payment” to the debt and complications are introduced when the holder fails to perfect his rights on the cheque, and yet, naturally enough, wishes to collect his debt.

Even though the creditor has taken the cheque, the original debt still exists and under some circumstances the creditor may resort to such specific debt. And it may mean that even if the statute of limitations has barred actions on the cheque, the holder may still sue on the underlying obligation on which the insurance of the cheque is based.

So, a question arise as to whether the holder has, after taking the cheque, two rights against his debtor, one on the cheque and another on the underlying obligation, or whether he has only one right on a claim which is a merger of rights on t he debt and on the instrument?

According to German law, of which its solutions are accepted by Ethiopian law, the cheque holder had tow causes of action against the debtor, one on the instrument and one on the original debt. Thus, it is settled that the holder of such cheque, may still sue the debtor-drawer of the instrument used in "payment" on the underlying obligation even if because of his cases he has lost his right to sue on the instrument. In such a case, if any injury was caused the debtor-drawer by the larches, his sole remedy is by a counterclaim for damages suffered.

Our law provides that such holder can bring action on the underlying obligation subject to requirements. That is, as provided under sub one of article 800, the proceedings arising out of the legal relations on whom the issue or transfer of the cheque is based shall subsist, unless it is proved that there has been notation.

So, if there has been notation, I.e., an agreement to pay the debt, then causal proceedings does not subsist. This is because the effect of novation is to release the original debtor or discharge the original

contract for it is a substitution of a new contract for the old one. Hence, if the debtor drawer assumes and agrees to pay the amount of the cheque to the holder which is past due, then the original contract i.e., the legal relation between the drawer and the holder of the cheque on which the issue or transfer of the cheque is based is discharged and so is the drawer released. Consequently, the holder's right to wiring his case based on their legal relations does not continue to exits.

Under sub two of Article 800 it is provided that such proceedings can only be brought if non-payment has been evidenced by a protest. Thus, a holder whose cheque has dishonored for some reason after presentment, and who has drawn up a protest but failed to exercise his right of recourse within the prescribed limit time, can sue the debtor- drawer on the underlying obligation for which the cheque was give. The holder may not bring causal proceedings unless he offers to restore to the debtor the cheque, at the same time depositing it with the court registrar, after satisfying the necessary formalities for preserving to the debater such proceedings by way of recourse which the latter may be entitled to bring.

According to the writer of this material, it seems logical that causal proceeding should be brought on the cheque itself. This is because the holder may power his claim merely by introducing the cheque which instead of being used as a means of payment remains to be an ordinary document evidencing the underlying obligation for which the cheque was given by the drawer to the holder so as to allow the latter to sue on it.

Generally speaking it could be said that such right to bring causal proceedings was given because it would be unfair to bar the holder

form access to his money because of his failure to exercise his right in due time.

But what if such cheque holder cannot bring causal proceedings? What other right is left for him to collect his money?

In such situation, a proceeding for unlawful enrichment comes in to picture.

Art. 799(1) deals with the action of unlawful enrichment by the holder against the drawer and the acceptor where the obligations of such persons on which the cheque was founded are terminated by reason of limitation of actions. Such proceedings may also be brought against the drawee, the third party at whose domicile the cheque is payable and the person or business organization on whose behalf the cheque is drawn. But, endorsers whose obligations have terminated cannot be subject of these proceedings.

Before discussing about the drawer's and the drawee's enrichment,, and the extent of their liability, let us first see as to when can such holder seek recovery from them upon the unjust enrichment action.

The holder to whom an uncertified cheque has been endorsed and whose rights has expired due to his negligence may in no case sue a debtor- endorser on the underlying obligation. The reason is that it may lead into great practical difficulties, as when there are many endorsements, and the debtor is the last endorser, it forces the creditor endorsee (holder) to fall back on this debtor endorser and the latter on his debtor and so forth until the parties ultimately liable (either the drawer or the drawee) are reached, and to avoid this the

creditor should be denied any right or recourse for unjust enrichment against an endorser.

Thus, instead, the holder is allowed to exercise his right of action against the drawer (not the debtor – endorser) if the drawer would be unjustly enriched by a discharge from liability on the cheque. This unjust enrichment action, based on the instrument, is subsidiary in character, and allowed only if the holder has no other means of satisfying his claim.

On the other hand, if the debtor draws or endorses a cheque which is certified, the holder, even if he has lost his right of recourse against the debtor – endorser on the instrument and on his original claim, will have a right on the instrument against the certifier drawee who remain liable despite his state cheque. That is, claims for the debt which can no benefit be made on the state cheque representing it falls under claim for unjust enrichment.

Thus, in such kind of instances, the holder can resort to the provision of unlawful enrichment and bring action against the drawer and the drawee.

In as much as their liability is concerned, article 799 sub 1 provides that they shall be liable to the holder up to the amount of the sum by which they have unlawfully enriched themselves at his expense.

Dear students, here it is advisable to raise some issues to elaborate the above concept. What do we mean when we say that they have enriched themselves unlawfully? What does at the expense of the holder mean? And if they are enriched, then what is the extent of their liability?

As there is no general provision dealing with the concept of unlawful enrichment in the commercial code. I will resort to the Ethiopian civil code provision that deals with such concept.

The general principle of unlawful enrichment is provided for under Title XIII of Book IV of the Commercial Code under article 216. It reads as follows:

> ***Whosoever has derived a gain from the work or property of another without just cause shall indemnify the person at whose expense he has enriched himself to the extent to which he has benefited from his work or property.***

In order to get a proper understanding of such principle, we should also see the 'definition' given by professor krzeczunowich for an action for unjust enrichment. It says:

> ***The (unjustifiable) Enrichment action lies if there be enrichment derived from an impoverishment; a non-remote connection between the enrichment and the impoverishment.***

In light of Article 2162 of the Civil Code, a person is said to be enrichment if the derived or received a gain. Basically, when one observe this article; one may see that the enrichment must be derived from "property" or "work" of the impoverished. However, one may add by way of interpreting the "abstract" principle embodied in this very Article that, the enrichment should also govern cases of intangible property. This is because, since a cheque is a kind of an

intangible property, it could fall under the term; property that no remedy either contractual or extra-contractual is available to the cheque – holder, it would be appropriate to categorize such type of enrichment under an enrichment derived from one's work or property.

The enrichment may take the form of a material addition to another's primary, avoidance of certain expenditure or of moral advantage.

Therefore, since the drawer of a cheque who has collected the amount of the holder's cheque from or has a claim against the drawee is deemed to hold such money that belongs to the use of the holder, an unjust enrichment action should lie against him. And also since the certifier drawee who has held the money that belongs to the holder adds to his advantage, as action for unjust enrichment should lie against him too. That is, the drawee is spared form expenses that ought to have been paid to the holder had it not been for the failure of the latter to exercise his right in due time.

Enrichment by itself is not sufficient ground for an action of unlawful enrichment and there must also be an impoverishment on the part of the plaintiff, failing which no action will lie.

So, since there is a failure on the part of the holder to acquire asset or money, there is a loss or impoverishment on his part which correspond to the gain or enrichment acquired by the drawer or the drawee. And this is what the law tries to explain saying "at the expense of the holder". Since, it would be necessary to improve the holder's position by bringing an action based on unjust enrichment.

There is also one condition that must be fulfilled in order to bring the unlawful action. It is the absence of legal justification for the

enrichment. But it is said that no theory of cause can cover all cases, and by abandoning the idea of cause one can require that enrichment be immoral or unjust. So, the fact that they have gained money that belong to the holder as to which he is entitled is against the fundamental principle of justice that no one ought to unjustly enrich himself at the expense of another.

It is also true that the quantum of enrichment must be certain. Hence, as provided under Article 799 sub 1 of the code, the extent of their liability is up to the amount of the sum by which they have unlawfully enriched themselves. This means that the amount that could be recovered can only be to the extent of the defendant's enrichment, so, such holder may demand to be indemnified to the extent of his impoverishment which is enough amount to make up it, by the action of unlawful enrichment.

If for instance, where the chain of endorsement has been from A to B, and from B to C and if the original value of the cheque was birr 1000, and the amount of the cheque that C holds is birr 800, then despite the fact that the free value of the cheque is birr 1000, C (the holder) can claim from A (the drawer) only birr 800 for it is the amount of the sum by which the latter has unlawfully enriched himself.

Still now, we have seen the right of a cheque holder who can bring action by invoking the provision of unlawful enrichment when he couldn't bring his action on his instrument itself, then a question arises as to what right can a holder have to claim his debt if he failed to present the cheque within the six months period specified under the law.

According to the writer of this material, he should at least be given a right to bring proceedings for unlawful enrichment for it is the only available means to which he could resort to collect his, money i.e., he has no other possibilities of an action except basing his claim on unjust enrichment against the drawer and the drawee.

Hence, as were discussed earlier, since the drawer who has a claim against the drawee for the amount of the holder's cheque is deemed to hold such money that belongs to the use of the holder. And also since the drawee adds value or money to his patrimony that ought to have been paid, had it not been for the holder's failure to exercise his right in due time, a proceeding for unlawful enrichment should be raised agents such parties.

In addition, though absences of cause justifying the enrichment are one of the requirements of the action for unjustifiable enrichment. As we have seen earlier, it is enough if the enrichment is immoral or unjust. Hence, even if there is a fault on the part of the holder to present his cheque for payment within the six months period, there is no just cause to release the drawer and the drawee without discharging the holder's debt.

Thus, as provided in Article 799(1), the extent of the drawer's and the drawee's liability should be up to the amount of the sum by which they have unlawfully enriched themselves at his expense.

Besides, as the moral duty not to enrich oneself at the expense of another is the basis of the doctrine of unjust enrichment, one can argue that such holder should also be allowed to bring his claim based on the provision of article 799 of the commercial code.

But is there any time limit specified within which a cheque holder whose right has been barred due to lapse of period of limitation can bring his action by invoking the provision of unlawful enrichment?

Under Book IV, Title XII of dealing with contracts in General, Article 1677(1) state that the relevant provisions of this Title shall apply to obligations not withstanding that they do not arise out of a contract. So, by virtue of this article, we can apply Article 1845 of the Civil Code to impose a time limit for such holder to bring his case based on the provisions of unjust enrichment i.e., his right shall be bared if not brought within ten years.

However, although this mandatory provision (1845) sets down a imitation on the time of instituting an action for performance of an obligation, it does not preclude such parties from making payment to the holder in satisfaction of the claim of such an obligation.

Review questions

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1. Discuss what generally and specially crossed cheques are.
2. Discuss what certification of checks is.
3. State the various ways in which the cheque can be crossed
4. Who is entitled to cross a cheque?
5. What is the effect of crossing a cheque with the words-not negotiable, or Account payee only?
6. Ato Bahiru issued a cheque to Ato Ayele in payment of his debt. Bahiru endorsed the cheque and transferred it to Molla. Molla presented the cheque to the drawee bank and learned that the fund available in to Ato Bahiru's account is half the amount specified in the cheque.Molla requested the drawee bank to pay the fund available in to Bahiru's account the bank refused by

stating that the cheque did not have a sufficient cover . Do you think the bank’s refusal to pay the cheque is legally acceptable? Why and why not?

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