Liability and Defense in NI

1. Liability of parties in NI

Article 790 of the comm'l code deals with parties liable for payment of a bill.

Art.790. -Joint and several guarantees of persons bound by bill.

1) All drawers, acceptor, endorsers or acceptors for honor of a bill of exchange shall be jointly and severally liable to the holder.

2) The holder may claim against all these persons individually or collectively without being required to observe the order in which they have become liable.

3) Any person signing the bill who has taken it up and paid it has the same right.

4) Proceedings against one of the parties liable shall not bar proceedings against the others, even though they may be subsequent to the party first proceeded against.

The acceptor of a BE is the party who is primarily liable to the holder of the instrument. The liability of the other parties including the drawer, endorser and acceptor for honor arise in case when the drawee of the instrument refuses to accept the instrument.

The liability of parties who are secondary liable may also arise when the drawee who accept the instrument failed to effect payment when the holder present the instrument for payment.

As indicated above, endorsers and acceptor for honor are secondarily liable for the payment because their liability arises if the drawee who accepts ***does not*** pay upon presentment for payment.

The holder can sue them all together with the acceptor, or s/he can sue only one or some of them from whom s/he thinks can get payment. The fact that holder ***did not*** include the remaining some people who could be sued together would ***not*** *set* them free. S/He can still institute a legal proceeding against the remaining some if the suit against the former is unsuccessful.

It is the right of any party who would be liable under the bill to make payment. The bill may be fully dishonored or partially paid and partially dishonored. In payment to the holder the party will have the right to demand from the holder that the bill and the protest be surrendered to him, with a receipt.

Accordingly, the party who pays can ask the party liable to him, the drawer and the endorsers, before him/her. The endorsers subsequent or after him/her are not liable to him/her as it is him/her who gave the bill as consideration for fulfillment of his/her obligations towards them. Thus, they are creditors not debtors of him/her. The extent of the right of this paying party against others liable to him is to the extent of the sum he paid with legal interest.

Assume, the drawer is Abebe and Belay, Chala and Debebe are endorsers of the bill respectively where Eskedar is the last endorsee and Fikadu is the drawee, and the bill has been accepted, but dishonored for payment by Fikadu.

IF Chala pays the bills amount, say Br. 35,000, to the holder or last endorsee Eskedar, Chala's right against the holder, Eskedar, is requiring the delivery of the bill with the Protest and receipt. Chala then can institute legal recourse against Abebe, Belay and Fikadu, the drawer, an endorser before him and the drawee, but not against Debebe as this is a subsequent endorser Chala ***cannot*** hold liable. The extent of Chala's right is the amount he paid, the 35,000 Birr and legal interest 9% per annum and calculated from the day Chala paid the sum to Eskedar up to he is paid back and other expenses if any.

❑Parties Liable to a Dishonored Check

Art. 872, states how the holder may exercise his right against the party liable under the check.

Art.872-Joint guarantee of persons bound by a check

1) All the persons liable on a check shall be jointly and severally liable to the holder.

2) The holder may sue all these persons individually or collectively without being compelled to observe the order in which they have become bound.

3) Any person signing the check who has taken it up and paid it has the same right.

4) Proceedings against one of the parties liable shall be no bar to proceedings against the others, notwithstanding that such other parties may be subsequent to the party first proceeded against.

It is impossible to know the parties who are liable to the holder from the reading of the provision. The provision simply says all the parties liable to check are jointly and severally liable. Who are these parties who are liable on check?

To address the above question let us reconsider who the parties to a check are. The original parties to a check are the person who draws the check (the drawer), the person on whom the check is drawn or who is required to pay the check (the drawee) and the

One of such parties is the endorser and endorsee who transfer a check by signing on it and to whom the check is transferred by endorsement respectively. The other person who is a party to a check is the acceptor for honor.

In other words, in order for a party to a check to be held liable on it, the basic requisite of liability has to be fulfilled. That is the party that is sought to be liable on the check by the holder is one who have assented to be bound. His assent is signified by his signing on the check as drawer, endorser or acceptor for honor. If his/her signature ***is not*** contained in the check or an allonge affixed there to s/he ***will not*** be held liable.

Thus, the drawer, endorser and acceptor for honor are legally obliged to guarantee that a check will be paid upon presentment for payment. In the event of the dishonoring of the check the holder can exercise his right or recourse against them.

As you well know, the drawee of check is always the bank. The bank has an obligation to pay to the holder of a check when it is presented to it. The bank will not be liable to the holder unless it accept check. The bank is also liable if it certify the check.

When a bank dishonors a check it is liable only to wards the drawer but not to wards the payee or holder as there is ***no*** privity of contract between the holder and bank. A binding contractual agreement between the drawee and the payee or holder ***does not*** exist to the effect that the drawee will honor a check presented for payment by the holder. Moreover, as it is only a person who signs on a check that will be held liable on the check and the drawee does not sign the check, it ***will not*** be held liable on the check for failing to pay the amount to the holder.

However, when a bank, at the request of the holder, certifies a check, the bank guarantees that the money to meet the check is available for payment when the check is presented. In other word, the certifying bank is guarantees payment of a certified check up to the expiration of the six months from the date on which the check was drawn. As Article 832(2) provides the "The cover in respect of a certified check shall remain blocked in a separated account for the benefit of the holder until the expiry of the period of time for presentment provided in Art 855." In short, the certification of a check operates to make the drawee that certified the check liable towards the holder and allow the holder to exercise his/her right or recourse against the drawee.

❑Liability in case of Alteration of a Check

Articles 879 and 880 provide what the consequences of alteration of a check. Article 879 deals with the effect of the alteration of the text of a check while Article 880 specifically deals with the alteration of a crossing on check.

Art.879:- Extent of the obligations of signatories

In case of alteration of the text of a check, parties who have signed subsequent to the alteration shall be bound according to the terms of the altered text; parties who have signed before the alteration shall be bound according to the terms of the original text.

Art.880:- Alteration of crossed check.

1) In the case of a crossed check, any alteration of the crossing made without authorizations shall invalidate the check except as regards any person who has him self made or consented to the alteration, and towards later endorsers.

2) *Where the alteration is not apparent, the lawful holder may rely on the check as if it had not been altered and require payment as originally provided*

The important factor to be considered in Art 879 is the time when a signature was placed on the check relative to the occurring of the alteration. Thus parties who have signed subsequent to the alteration will be bound according to the terms of the altered text while parties who have signed prior to the alteration are bound according to the terms of the original text.

For instance, X draws a check for birr 100,000 before endorsing it to Y who endorses it to Z, in turn Z endorses it to L, and L altered and endorses it to K. If K sues all the endorsers on the check, L will be held liable to wards K for birr 110,000 as he have signed on the check after it was endorsed by X and Y while X and Y will be liable to wards K for birr 100,000 since they signed on the check before it was altered.

With respect to a crossed check Art 880 (1) provides that any alteration of the crossing made without authorization ***will invalidate the check*** as regards any person who has himself made or consented to the alteration and to wards subsequent endorsers.

2. Defense in NI

Certain defenses can bar the right of holders to demand payment from persons who would otherwise be primarily or secondarily liable on the instrument. The governing law which is relevant to the above issue is Article 717 of the Comm'l Code of Ethiopia.

Article 717

1. The debtor may only set up against the holder of the instrument defenses based on their personal relations defenses of form, and those based on the text of the instrument.

2. He may set up defenses based on 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 set up against the holder of the instrument defense based on his personal relations with preceding holders unless the holder in acquiring the instrument has knowingly acted to the detriment of hr debtor.*

Article 717 of the comm'l code mentions all the available defenses the debtor may raise. These defenses are:-

- Defenses based on the personal relations between the debtor and the holder;
- Defenses of form and those based on the text of the instrument;
- Defenses based on falsification of signature;
- Defenses based on lack of capacity;
- Defenses based on lack of representation at the time of issue of the instrument; and
- Defenses based on the absence of the necessary conditions for bringing the proceedings.

Depending on whether a holder who makes the demand for payment is HDC or ordinary holder, the defenses are divided in to two general categories i.e. ***Universal defense*** and ***Personal defenses***.

1. Universal defense

Universal defenses, which are also known as real defenses, are defenses which are valid against all holders and include defense of form and those based on text of the instrument, defense based on falsification of signature, defense based on lack of capacity and authority to represent, and those based on absence of necessary conditions for bringing the proceeding.

❖Defenses based on form and text of the instrument:

These are defenses, which the debtor can raise in relation to the formality requirement of NI. We may look at article 735, 823/24, and 827/28 of the Comm'l Code as examples. If these requirements ***are not*** fulfilled the debtor may raise defenses based on non fulfillment of such requirements. Again defenses based on text of instruments refer to situation where the contents of the instrument are altered or cancelled etc. In this case, the debtor may raise the alteration or cancellation as a defense. ***For example*** The holder of the instrument which is payable to bearer altered the amount of money fixed in a BE from 2000 to 20,000 by adding one zero and delivered it to a holder in due course. In this case the drawer of the instrument have a valid defense against the payment of extra 18,000 thousand birr.

❖**Falsification of signature:**

Signature of the parties involved in a NI is a necessary requirement to hold them liable under the instrument. It may happen that the signature of the debtor who is required to pay is falsified or forged. In such a case, the debtor has a right to raise defense based on such ground and refuse payment.

❖**Lack of representation (authority)**

Where a person signs on a NI on behalf of another person without having authority, the person on whose behalf the instruments signed can not be held liable for the obligations incorporated in the instrument. For instance, Ms. “A”, who is the secretary of Mr. “B”, signed on B’s check representing B without actually having proper authority and gave it to Mr. C. Mr. C later on transferred the check to Mr. D. Mr. D, claimed payment of the check from Mr. B, the employer of Ms. A. Mr. B can raise defense based on absence or lack of representation against D, or C.

❖ **Lack of capacity**

Incapacity is also among the ground of defenses that bar the right of holders to demand payment from the parties who are otherwise liable to payment. Incapacity may relate with the age or mental state of a person. If one of the parties liable to the holder signed the instrument while s/he was bellow eighteen years old or while he was adjudicated mentally incompetent by court proceeding, he or those people who represent him can defend payment on the ground of his age or mental problem.

2. Personal defense

Personal defenses are used to avoid payment to an ordinary holder of a NI. Such defense ***can not*** be raised against HDC. The term personal relation between the debtor and the holder is so broad that it almost includes every prior relation the two persons have had. It may, for example, refer to contractual relations between the debtor and the holder including the one based on which the NI is issued or transferred to the holder. When the there is a breach of the underlying contract for which the NI was issued the maker of a note can refuse to pay it or the drawer of a check stop payment.

Ato Lema and Ato Daba entered in to contract for the sale of two laptop computers. According to the contract, Ato Daba agreed to deliver the computers two months after Ato Lema pay the price of the lap top. Though Ato Lema paid the total price of the laptop immediately after the contract, Ato Daba did not deliver the laptops until two weeks after the expiry of the two months period. Eighteen days after the expiry of the two months period, Ato Daba present the BE for payment. In such case Ato Lema can raise personal defense against Ato Daba on the ground of breach of contract.

In the above case what would happen had Ato Daba transferred the instrument to Ato Duga who acquired the instrument in good faith with out knowing the defense available against Ato Daba?

In such case Ato Lema ***can not*** raise against Ato Duga, the HDC, the defense he could have raised against Ato Daba; since personal defenses are defenses that can only be raised against ordinary holders not against HDC.