

**St Mary's University College**  
**Faculty of Law**

**The legal and practical problems surrounding the  
dishonoring of cheque due to insufficient fund**

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**St Mary's University College**  
**Faculty of Law**

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**By: Aksumite Tesfaye**  
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## Introduction

Society solved the problem of the discomfort of the physical transfer of money, and the possibility of its thievery while being transferred, by putting the money in the hands of a bank and then issuing a check for the money to be transferred to various people.

In principle, a check is a written unconditional order addressed to a bank, to pay on demand a sum certain in money. A check is a negotiable instrument transferable by delivery and with endorsement where it is not payable to the bearer.

A check can be a two or a three party instrument. A check is written is an order by one person (the drawer) to another (the drawee), directing the latter to pay money to a third person (the payee).

The most common situation involving check arises when someone deposits money in a checking account and then writes checks addressed to the bank, ordering it to pay out of the account money to those nominated. In this situation the bank's customer is the drawer, the bank is the drawee, and the nominee is the payee.

Cheque, being one of the negotiable instruments can be transferred, and can be dishonored after presentment for payment when they are drawn against insufficient fund in the customer's account.

Dishonor is the refusal of the bank to pay to the payee because the customer does not have sufficient fund in his account. Whenever, a check is dishonored for insufficiency of funds, the dishonoring bank must, at the holder's request issue to him a certificate of non-payment, permitting a simplified execution against the overdrawing customer.

The paper aims at exploring the legal and practical problems surrounding the dishonoring of checks due to insufficient fund.

# Chapter 1

## Research proposal

### **Title of the research paper**

The legal and practical problems surrounding check dishonored due to insufficient fund in Ethiopia.

### **Statement of the problem**

One of the practical problems related to the check dishonored due to insufficient fund in Ethiopia occurs due to the bad practice and lack of competence in the judiciary, the courts do not entertain the said cases or suits speedily in accordance with the relevant provision of the civil procedure code and the commercial code. The lengthy trial suits on check created lack of confidence on people who frequently use checks in business transaction.

The other problem related to check without cover is that where courts fail to adjudicate a suit or a case involving a check without sufficient cover in accordance with the relevant law then the national bank of Ethiopia issued a directive to stop the practice of drawing a check without having sufficient cover and to protect the payee under the check. The issuance of the directive resulted in other undesired consequences, that is, the national bank of Ethiopia has put in the directive it issued penalties for persons who draw a check without having sufficient cover which makes the wrongdoers or persons that draw a check without sufficient cover subject to the directive, the commercial code and the penal code. And the directive could not be effective due to some issues that are not included in the directive.

The Ethiopian commercial code does not include the measure of damages for wrongful dishonor. When a wrongful dishonor occurs due to some error of the bank and the drawer incurs damage because of it then the payor bank must be responsible for it. The law should include this to protect the drawer.

## **Significance of the study**

It is necessary to write the research to show the magnitude of the practical as well as the legal problems surrounding cheque dishonored due to insufficient fund and proposes corrective measures to be taken.

1. The research would help to show the legal issues related to dishonoring of a cheque
2. The study will propose some amendments to the commercial law as well as the directive issued by the Ethiopian national bank.
3. The need to identify existing practical problem relating to the dishonoring of cheque due to insufficient fund.

## **Objective of the study**

Considering the legal and practical problems and the impact on the drawer of a cheque and payee under the cheque, the study has the objective of fully explaining the dishonoring of cheques due to insufficient fund and fully explaining the legal and practical problems related to dishonoring of cheques due to insufficient fund.

The study has the objective of analyzing the national bank directive on check drawn without sufficient cover and the commercial code and the problems related to the practice of the courts.

The study will propose an amendment of the provision of the commercial code and also NBE directive with the view of avoiding the legal and the practical problems surrounding cheque dishonored due to insufficient fund.

## **Literature Review**

There are foreign literatures on the dishonoring of checks due to insufficient fund. However, we do not have adequate literature in the Ethiopian context concerned with the legal as well as the practical problems surrounding cheque dishonored due to insufficient fund.



## **Delimitation of the study**

My research will only deal with the problems pertaining to cheques issued without sufficient fund against the provision of the commercial code and the directive of the national bank of Ethiopia. It does not include the dishonoring of a cheque for any other reason except due to insufficient fund.

## **Limitation of the study**

The limitations of this paper are lack of related literatures and the availability of the court cases and the willingness of the employee of the court registrar to give the cases.

## **Research Methodology**

The research methods used to get adequate information about the research paper is reading and going through the different laws (that is, the commercial code, civil procedure code, NBE directive etc.) the research method also includes reading and going through books and other materials related to the use of checks and dishonoring of checks and also going through the different internet websites.

In addition, the research depends on interviews with banking professionals and to assess the practical problems, court cases and judgments are used.

# Chapter 2 Cheque

## 2.1. Definition of a cheque

Different scholars and different commercial laws define cheque in different ways. I will try to show some of the definitions given by scholars.

A cheque (check-USA) is a negotiable instrument instructing a financial institution to pay a specific amount of a specific currency from a specified demand account held in the drawer or depositor's name with that institution. Both the drawer and payee may be natural person or legal entities.<sup>1</sup>

Mr. P.P.S Gogna has defined the term cheque as a bill of exchange, which is drawn upon a banker and is always payable on demand.<sup>2</sup>

Mr. P.C Tulsian defines a cheque as a bill of exchange, which is (a) drawn on a banker (b) payable on demand<sup>3</sup>

Mr. M.C Kuchhal defines a cheque as:

A bill of exchange with two distinctive features namely:

- i. It is always drawn on a banker, and
- ii. It is always payable on demand<sup>4</sup>

P. N Varshney defines cheque as a cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.<sup>5</sup>

I believe writing a lot of definitions is not important because definitions given by scholars are similar. In most literatures, cheque is defined to be a member of a bill of exchange with two additional essential characteristic i.e. being always drawn on a banker and being payable on demand.

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<sup>1</sup> [http:// en.wikipedia.org/wiki/cheque](http://en.wikipedia.org/wiki/cheque)

<sup>2</sup> P.P.S Gogna, a textbook of mercantile law, 3rd edition,, S.G & company, p.439

<sup>3</sup> Tulsian P.C, business law, 2<sup>nd</sup> edition, Tata McGraw-hill publishing, p 17.17

<sup>4</sup> Kuchhal M.C, mercantile law, 5<sup>th</sup> edition, vikas publishing, p357

<sup>5</sup> Varshney P.N, banking law and practice, 3<sup>rd</sup> edition, chand and sons publishers, p...

We have seen above some of the definitions given by scholars and we will see some of the legal definitions given by different commercial laws from where most countries of the world derive their negotiable instruments law from.

Cheque is defined in section 10 of the common wealth cheques Act of 1986 as

An unconditional order in writing that

- (a) Is addressed by a person to another person being a financial institution; and
- (b) Is signed by the person giving it, and
- (c) Requires the financial institution to pay on demand a sum certain in money<sup>6</sup>

The legal definition of the term “cheque” is contained in section 6 of the negotiable instruments act, which reads under:

‘A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.’<sup>7</sup>

The detailed legal definition of a cheque comes from section 73 of the bills of exchange act 1882 as

“A cheque is an unconditional order in writing, addressed by one person to a banker; signed by the person giving it, requiring the banker to pay on demand, or at a fixed or determinable future date, a sum certain in money, to a specified person or to the order of a specified person or bearer.”<sup>8</sup>

The Ethiopian commercial code does not actually provide a clear definition of a cheque but instead the code provides in its article 827 requirements that every cheque should contain to be considered legal cheque under the Ethiopian commercial code.<sup>9</sup>

Despite the legal and highly technical definitions of a cheque given to cheque, I believe, in reality that it is a document of payment, signed by the account holder payable on an individual or organization that are recorded on the cheque.

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<sup>6</sup> Commonwealth cheques act (1986), section 10

<sup>7</sup> Negotiable instruments act (1881), section 6

<sup>8</sup> Bills of exchange act (1882), section 73

<sup>9</sup> Commercial code of Ethiopia (1960), article 827

## 2.2 Nature of a cheque in general

There is not of course, enough money to go around and what money is available is frequently too physically awkward to be moved easily. Human civilization has been able to create additional sources of money in the form of transferable contractual debt.

Society solved the problem of the awkwardness of the physical transfer of money and the concomitant possibility of its theft while in transit, by putting the money in the hands of a guarded depository (typically a bank) and then issuing written orders (cheque) for the money to be transferred to other people.<sup>10</sup>

A withdrawal out of a bank deposit may be made by the customer or under the customer's authority, either in cash or in the form of a cashless payment, either for the customer himself or in the form of payment to a third party. And cheque is one of those methods where withdrawal out of a bank deposit can be made in the form of a cashless payment in the form of payment to a third party.<sup>11</sup>

When a person or organization opens a checking account, the depositor receives a checkbook containing blank checks that the depositor issues a check with.<sup>12</sup> The cheque that is drawn against funds deposited in your personal checking account is called a personal cheque.<sup>13</sup>

Cheque is widely used because they are safer and more convenient than cash. A person who has a checking account does not have to carry large sums of money, which could be lost or stolen.<sup>14</sup>

Even though cheque developed much later than the bill of exchange, the function of cheque has remained basically unaltered over the last 250 years.<sup>15</sup>

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<sup>10</sup> J. Whaley Douglas, problems and materials on commercial law, 4<sup>th</sup> edition, p 305

<sup>11</sup> Geva Benjamin, bank collection and payment transaction, 1st edition, oxford university press, p 107

<sup>12</sup> World book of encyclopedia (2001), p 390

<sup>13</sup> Microsoft Encarta (2007)

<sup>14</sup> Ibid at 12

<sup>15</sup> K. Zweigert, international encyclopedia of comparative law, Martinus Nishoff publisher, p 22

When we see the etymology of the word ‘cheque’, the most common spellings of the word (in all its senses) were check, cheque and checque from the 1600’s through 19000’s. Since 1800’s, the spelling cheque has become standard for the financial sense of the word in British English (across the common wealth countries while only check is retained in its other senses, thus distinguishing the two definitions in writing). On the other hand, check remains in use for financial sense in American English. <sup>16</sup>The spelling cheque is used in under the Ethiopian commercial code.<sup>17</sup>

A cheque is transferable from one holder to another by negotiation. According to article 842 of the Ethiopian commercial code, a bearer cheque or a cheque made payable to a specified person in which the words ‘not to bearer’ or any similar word have been inserted can be negotiated by simple assignment. <sup>18</sup> An order cheque or a cheque made payable to a specified person is negotiated by the endorsement of the holder. <sup>19</sup> Though a cheque can be transferred through negotiation, cheque is primarily a payment form, and is by its nature intended to be presented for payment immediately, and not negotiated to a third party.

A cheque can be a two or three party instrument. The person who draws the cheque is called the drawer. The banker on whom the cheque is drawn is called the drawee; it is also referred to as the paying bank.<sup>20</sup> And the person on whom the cheque is drawn payable is called the payee.

A cheque becomes a two party instrument when according to art 834 sub article 1, the drawer draws the cheque to the drawer’s own order.<sup>21</sup> And becomes a three party instrument when the drawer draws the cheque for account of a third party.<sup>22</sup>

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<sup>16</sup> <http://en.wikipedia.org/wiki/cheque>

<sup>17</sup> Ethiopian commercial code (1960), article 827-

<sup>18</sup> Ibid, article 842 sub article 1

<sup>19</sup> ibid sub article 2

<sup>20</sup> Abott Keith, business law, 7<sup>th</sup> edition, 2002, Biddle ltd, p 301

<sup>21</sup> Ibid at 17, article 834 sub article 1

<sup>22</sup> Ibid, sub article 2

Other persons come to be a party if it is endorsed. Then the endorsee will become a party to a cheque according to article 842 of the Ethiopian commercial code.

A cheque that is only drawn on a banker<sup>23</sup> can be drawn to bearer or to order of a third person.<sup>24</sup> According to the Ethiopian commercial code a cheque can be drawn to the drawer's own order<sup>25</sup> or it can be drawn for account of a third person<sup>26</sup>. A banker can also draw it on itself and it is called a cashiers cheque.<sup>27</sup>

The steps a cheque undergoes helps to get a better understanding of how a cheque works. The steps go as under:

Step 1 – drawer of the check had deposited money with the bank, which becomes his debtor.

Step 2 – the drawer needs some cash, or to pay someone else (his creditor)

Step 3 the drawer writes of (draws) a check on the bank

Step 4 the creditor of the drawer goes to the bank with the check

Step 5 the bank pays the creditor of the drawer when duly required or with the time limit given by the law.<sup>28</sup>

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<sup>23</sup> Ethiopian commercial code (1960), article 829

<sup>24</sup> Ibid article 834

<sup>25</sup> Ibid sub article 1

<sup>26</sup> Ibid sub article 2

<sup>27</sup> Ibid sub article 3

<sup>28</sup> Geoffrey Lipscombe and Keith Pond, an introduction to the modern financial services industry, 4<sup>th</sup> edition, financial world publishing, p...

## 2.3 Historical background of cheque

The ancient Romans are believed to have used an early form of cheque known as praescriptiones in the first century BC. During the 3<sup>rd</sup> century AD, banks in Persia and other territories in the Persian Empire under the Sassanid Empire issued letters of credit known as Sakks.

Between 1118 and 1307, it is believed the Knights templar introduced a cheque system for pilgrims traveling to the holy land or across Europe. The pilgrims would deposit funds at one chapter house, and then withdraw it from another chapter at their destination by showing a draft of their claim. These drafts would be written in a very complicated code only the templars could decipher. The knights adopted it most likely from the Muslims who are known to have used the cheque or Sakk system since the times of Harun alrashid (9<sup>th</sup> century).<sup>29</sup>

In the 9<sup>th</sup> century, a Muslim businessman could cash an early form of the cheque in China drawn on sources in Baghdad, a tradition that was significantly strengthened in the 13<sup>th</sup> and 14<sup>th</sup> centuries, during the Mongol Empire. Indeed, fragments found in the Cairo Geniza indicate that in the 12<sup>th</sup> century cheques remarkably similar to our own were in use, only smaller to save costs on the paper. They contain a sum to be paid and then the order “may so and so pay the bearer such and such amount”. The date and name of the issuer are also apparent.<sup>30</sup>

The cheque had its origins in the ancient banking system, in which bankers would issue orders at the request of their customers, to pay money to identified payees. Such an order was referred to as a bill of exchange. The use of bills of exchange facilitated trade by eliminating the need for merchants to carry large quantities of currency (e.g. gold) to purchase goods and services.<sup>31</sup>

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<sup>29</sup> [http:// en. Wikipedia.org/wiki/cheque](http://en.Wikipedia.org/wiki/cheque)

<sup>30</sup> Ibid

<sup>31</sup> Ibid

Mr. R. K Gupta explain the origin of cheque as the practice of cheque started before the outbreak of civil war of 1642 when merchants used to leave their money with goldsmiths. The merchants used to address short letter to request to their goldsmiths authorizing the payment of the sum due to their creditor. The creditors was taking this letter of authority to the goldsmith's shop and receive the payment from the goldsmith. The merchants were using goldsmiths as their bankers and their accounts were known as running cashes and became popular. By 1678, the number of goldsmiths increased and in London there were fifty- eight goldsmiths who kept running cashes of various merchants. The copy of one of the instruments issued in favor of goldsmiths is given below:

Mr. Thomas Feweles

I desire you to pay unto Mr. Samueta, Howard or order upon receipt hereof the sum of nine pounds, thirteen shillings and six pence and place it to the account of

14<sup>th</sup> august, 1675 your servant

9: 13: 6

Edmund Warcupp or

Mr. Thomas Feweles Goldsmith at his shop between two temples gates ffleetstreete.<sup>32</sup>

## 2.4Essentials of a cheque

Since the Ethiopian commercial code does not provide the definition of cheque, in order to clarify definition of a cheque under the Ethiopian commercial code, the following essentials of a cheque should be analyzed.

1. The cheque should contain an unconditional order to a banker. If a cheque is payable out of a particular fund or payable on contingency, it cannot be a cheque under the Ethiopian commercial code.

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<sup>32</sup> R.K. Gupta, banking law and practice, 1<sup>st</sup> edition, modern law publisher, p 483



2. A cheque must be signed by the drawer to be a valid cheque under the Ethiopian commercial code. Signature can be either personally or by someone authorized to sign on his behalf.
3. The cheque must be for the payment of a certain sum of money only. The sum must be expressed in words and figures.
4. The cheque should also contain the name of the person who is to pay. So the name of the banker who is to pay should be stated in the cheque to be considered a valid cheque under the Ethiopian commercial code.
5. According to the Ethiopian commercial code the place of the payment of the cheque payment should be contained in the cheque.
6. The cheque should also indicate when and the place where the cheque is drawn.<sup>33</sup>

Under the Ethiopian commercial code, if a negotiable instrument does not have the essential characteristics provided under article 827 then it does not meet the legal definition of a cheque.

## **2.5 Distinction between a cheque and a bill of exchange**

Even if most scholars say and also the historical background show that a cheque is a bill of exchange, one can see the differences below.

- A cheque is always drawn on a banker or the drawee in case of a cheque is always a banker while a bill of exchange is usually drawn on some person as well as a banker.<sup>34</sup>

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<sup>33</sup> Ethiopian commercial code (1960), article 827

<sup>34</sup> Ibid, article 829

- A cheque does not require any acceptance. Cheque is presented for payment and not for acceptance. But a bill of exchange generally requires acceptance before payment can be demanded from the drawee.<sup>35</sup>
- In the case of cheque, the payment can be countermanded i.e. on drawer's request; the banker can stop the payment of a cheque. But in bill of exchange, the payment of a bill of exchange cannot be countermanded i.e. the drawer of a bill of exchange cannot stop the parties from making payment.<sup>36</sup>
- Crossings apply only to cheque and unlike cheques; a bill of exchange cannot be crossed.<sup>37</sup>

## **2.6 Cheque legislations in common law and Civil law**

### **2.6.1 Cheque legislation under the common law Jurisdiction**

In the United Kingdom, cheques are governed by the bill of exchange Act, as supplemented by the cheque act. As a rule, statutes in common law countries, and hence, their laws of cheques, are modeled on the bill of exchange Act.<sup>38</sup>

In common law jurisdictions, the applicable statute effectively defines a cheque to be unconditional order in writing, addressed (or drawn) by one person (the drawer) payable on demand, in sum certain in money, to the order of a specified person or to the bearer.<sup>39</sup>

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<sup>35</sup> supra at 34

<sup>36</sup> Ibid, article

<sup>37</sup> Ibid article

<sup>38</sup> Geva Benjamin, Bank collection and payment transactions, 1<sup>st</sup> edition, oxford university press, p 140

<sup>39</sup> Ibid p 141

The British Bills of exchange Act 1882 furnished the model for the law of negotiable instruments of most members of the common wealth and of some other countries which, at one time or another came under the influence of English law.<sup>40</sup>

Moreover, it had a strong influence on the uniform negotiable instruments law of 1896 of the united state of America. This law, in turn, influenced the draftsmen of the uniform commercial code. Article 3 and 4 of the uniform commercial code, although these two articles – which have modernized the law of negotiable instruments in the united states – depart in many instances from the earlier American act and, as a result, from the British Bills of exchange act 1882. The American law in part remains similar to the law developed in England.<sup>41</sup>

In common the model statute of the English bill of exchange Act of 1882 has influenced law jurisdictions including jurisdictions that have been under strong British influence.<sup>42</sup>

## **2.6.2 Cheque legislations under the civil law jurisdiction**

In civil law countries, cheques are governed by statutes modeled on 1931, Geneva uniform law of cheques. The various national statutes are nonetheless non identical.<sup>43</sup>

The negotiable instruments law of Ethiopian commercial code is derived from the uniform law of cheque and uniform law of bills of exchange.<sup>44</sup>

In civilian world, the codification of negotiable has a considerably longer history than in common law countries.

At present – in the wake of unification efforts of the Hague conventions of 1910 and 1912 and Geneva conventions, most of the civil law countries have introduced laws either adopting or showing the influence of the uniform law of bill of exchange and uniform law of cheque.<sup>45</sup>

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<sup>40</sup> Ibid p 140

<sup>41</sup> K. Zweigert, international encyclopedia of comparative law, Martinus Nishoff publishers, p18

<sup>42</sup> Geva Benjamin, Bank collection and payment transactions, 1<sup>st</sup> edition, oxford university press, p 141

<sup>43</sup> Ibid p 100

<sup>44</sup> Personal interview with W/O Kibre Moges

<sup>45</sup> K. Zweigert, international encyclopedia of comparative law, Martinus Nishoff publishers, p18

Many countries in different parts of the world, which have preferred to draft their own law, have in effect based them to a very considerable extent on the Uniform law of bill of exchange and uniform law of cheque.<sup>46</sup>

## 2.7 Presentment and dishonor of a cheque

Presentment of a cheque is defined as the production of an instrument to the drawee for payment in black's law dictionary.<sup>47</sup> Presentment is also best defined as the demand for payment made upon the drawee or other payer by the holder or on behalf of the holder.<sup>48</sup>

Though the primary relationship between a banker and his customer is that of a debtor and creditor, the relationship imposes the obligation on the bank to honor its customer's cheque. The drawee of a cheque having sufficient fund of the drawer, properly applicable to the payment of such cheque must pay the cheque when the cheque is presented within the time limit provided by the law.<sup>49</sup>

According to the Ethiopian commercial code, a cheque must be presented before the bank within the time limit given in article 855 of the commercial code. According to the Ethiopian commercial code, a period of six month is considered sufficient time within which a cheque must be presented for payment.<sup>50</sup>

A cheque may only be issued if the drawer has funds with the drawee. The existence of a previous cover or sufficient fund before drawing a cheque is mandatory under article 830 of the Ethiopian commercial code. Even if the non-existence of a previous cover does not affect the validity of the cheque.<sup>51</sup>

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<sup>46</sup> K. Zweigert, international encyclopedia of comparative law, Martinus Nishoff publishers, p19

<sup>47</sup> Byran. A. Garner, black's law dictionary, 8<sup>th</sup> edition., west publishing, p1222

<sup>48</sup> J. Whaley Douglas, problems and materials on commercial law, 4<sup>th</sup> edition, p 447

<sup>49</sup> Interview with W/O Kibre Moges [head of law department of national bank of Ethiopia], Addis Ababa, march 2008

<sup>50</sup> Ethiopian commercial code (1960), article 855

<sup>51</sup> Ibid, article 830

Though drawing a cheque without having sufficient previous cover does not make the cheque invalid under the Ethiopian commercial code; it justifies the banker in dishonoring the cheque.<sup>52</sup> Where the payee presents the cheque for encashment or payment by exhibiting the cheque and the bank refuses to pay the cheque then we say the cheque is dishonored. Dishonoring is the refusal of the drawee to pay the payee.<sup>53</sup>

A cheque that is not honored because it contains insufficient fund is called insufficient cheque. It is also called dry cheque, bounced cheque, worthless cheque etc.

A dishonored cheque can be a problem for an individual or any size company. There are both civil and criminal penalties to this unlawful act of drawing a cheque without having previous sufficient cover, which goes against article 830 of the Ethiopian commercial code. Dishonoring and drawing cheque without sufficient fund and directive issued to avoid this unlawful act will be discussed in chapter 3.

## **2.8 Existing problem of the commercial code relating the Measure of damages for wrongful dishonor**

A bank is responsible to its customer for damages caused by the wrongful dishonor caused by some errors created by the bank. Other laws like the uniform commercial code include a provision that deals with the measure of damages for wrongful dishonor.

Liabilities of the bank can be limited to actual damages proved and it can also include damages for an arrest or other consequential damages.

The Ethiopian commercial code should include a provision that deals with wrongful dishonor in order to protect drawers that are accused or drawing a cheque without sufficient fund erroneously. As much and much people rely on cheque in Ethiopia even with the advent of electronic payment like ATM, the addition of this provision in the commercial code will contribute to the smooth working of the system of cheque.

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<sup>52</sup> Ibid, sub article 1

<sup>53</sup> J. Whaley Douglas, problems and materials on commercial law, 4<sup>th</sup> edition, p 447

## **Chapter 3**

# **Drawing cheque without sufficient fund and dishonoring of cheque under the Ethiopian law**

### **3.1 reasons banks dishonor a cheque**

To facilitate the use of cheques in settlement of liabilities, it is necessary that the cheques are honored and not bounced. But when a cheque does not meet the requirement under the commercial law then the bank refuse payment and dishonor the cheque. Here are some of the reasons for dishonoring a cheque:

1. When the funds in the customer's account is insufficient to meet the cheque.
2. When the cheque is presented at the branch other than the branch where customer has issued the cheque has his current account.
3. When the cheque is presented before the date on which it is written to be payable or it is a post-dated cheque.
4. When the banker receives a notice of the death of his customer.
5. When the drawer gives the bank a stop payment order.
6. When the account of the drawer is closed.
7. When the cheque is not presented within the time limit given by law.
8. When the signature of the drawer is not available on the cheque<sup>54</sup>

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<sup>54</sup> Interview with W/O Kibre Moges [head of law department of national bank of Ethiopia], Addis Ababa, march 2008

### **3. 2 requirements for a cheque to be honored under the Ethiopian commercial code**

**The banker is bound to honor the customers cheque provided the conditions are fulfilled.**

The requirements under the Ethiopian commercial code are:

- Another requirement is under article 830 of the commercial code that clearly put that a cheque may only be issued if the drawer has funds with the drawee and in accordance with an express or implied agreement under which the drawer has the right to dispose of the funds by cheque. The existence of cover prior to issuing a cheque is an important requirement as it entails the dishonoring of the cheque unless the requirement is fulfilled.

It should be noted that the fact that the drawer does not have sufficient fund does not affect the validity of the cheque according to article 830 but justifies the banker in refusing payment of the cheque. So it is essential that the account on which a cheque is drawn must have sufficient fund.<sup>55</sup>

- The other requirement for a cheque to be honored by a banker is the presentment within the proper time limit given by law found under art 855 of the Ethiopian commercial code. Thus A cheque that is drawn and payable within Ethiopia require to be presented with a reasonable time of six months according to article 855 of the Ethiopian commercial code. The banker is bound to honor a cheque only when it's duly required to pay. According to the Ethiopian commercial law, a period of 6 month is considered sufficient time within which a cheque must be presented for payment.<sup>56</sup>

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<sup>55</sup> Ethiopian commercial code (1960), article 830

<sup>56</sup> Ibid article 855

### **3.3 Drawing cheque without sufficient fund and the dishonoring of a cheque**

The deposits accepted by a banker are its liabilities repayable on demand so it is under a statutory obligation to honor its customer's cheque. The drawee bank will not be discharged unless it pays the cheque to the one entitled to obtain payment, as determined under the law.

The paying bank owes a duty to its customer to honor his cheques if properly drawn upon an in credit or within an agreed overdraft facility and duly presented by the holder.

The paying bank is obliged to honor his customer's cheque if the customer has sufficient funds in his account to meet the cheque.<sup>57</sup> If the customer does not have sufficient fund in his account to meet the cheque, the banker may refuse the payment on cheque.<sup>58</sup> So the bank does not have a legal obligation by reason of its contract with the customer to honor the customer's cheque when they are drawn against insufficient fund in his account.

Cheques are being used in commercial transactions in a big way in Ethiopia. And smooth working of the system of cheque depend upon the honesty and integrity of the parties but when the cheque is presented by the banker for payment and the banker finds that the cheque can not be paid due to various reasons, it has to dishonor the cheque. But cheque fraud has been used by many by drawing a cheque without having sufficient fund in one's account.

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<sup>57</sup> R.K. Gupta, banking law and practice, 1<sup>st</sup> edition, modern law publisher, p 513

<sup>58</sup> Ibid, p 514



Cheque fraud is among the oldest and most common forms of financial crime. Even with the emerging of electronic payments, cheques still are used for millions of payments each year, making them a prime target for criminals. Drawing cheque without sufficient have been one of the cheque fraud used by coffee exporters when they used to purchase coffee from coffee producers on a credit basis by writing a post dated cheque subsequently dishonored by banks when presented for payment due to insufficient fund.<sup>59</sup>

The coffee exporters neither paid the price of the coffee prior to the date of cheque nor deposit sufficient fund in their current account at which they draw the cheque even after selling the coffee to coffee importers abroad and collecting price of the coffee.

The coffee exporters who bought the coffee on credit basis without paying at the time they were buying still did not pay the sellers even after they export the coffee and collected what is due to them from the coffee importers at their current account with the bank and did not deposit what is collected from the coffee at their current account with the bank on which they draw the cheque.

When the coffee producers file a suit because the coffee exporters deceive them, the court took a long time to give judgments so the national bank has to issue a directive, as it is a regulatory body in connection to the use of cheque to safeguard the coffee producers. As the farmers or coffee producers had to suffer and also incur a lot of cost to get judgment due to the lengthy trial Cheque is also regulated by the directive of the National Bank of Ethiopia, directive No. SBB/31/2002.<sup>60</sup>

The directive is issued to stop the dishonoring of cheque due to only insufficient fund and to stop the practice of drawers who draw cheque on their banker without having sufficient fund in their account.<sup>61</sup>

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<sup>59</sup> personal interview with Ato wondemeneh [ head, supervision department of the national bank of Ethiopia], march 2008

<sup>60</sup> Ibid

<sup>61</sup> Proclamation No. SBB/31/2002, preamble

The directive was issued to end the crisis in the use of cheque and suffering of the coffee producers and also to regulate the drawing of cheque without cover.

### **3.3 Existing problems with regard to directive No. SBB/ 31/2002**

Even if directive No. SBB/31/2002 was issued to insure the proper use of current account and cheque and to stop the cheque fraud used by many. I strongly believe it should be criticized on the following points:

1. It should be noted that directive No SBB/31/2002 is only issued to govern the dishonoring of cheque due to insufficient fund according to art 1.5 of the directive that clearly states that the directive govern dishonoring of cheque only on the ground that there is no sufficient cover.

The directive is not applicable to other reasons such as stop payment order. So customers who do not have sufficient fund in their current account will draw a cheque and order the bank to stop payment. Because according to art 857 of the commercial code<sup>62</sup>, the stop payment order given by the drawer to the bank gives sufficient authority for the bank to dishonor the cheque or Refuse payment so a drawer of a cheque can draw a cheque and give stop payment order to the bank.

I am of the opinion that if directive is issued for the proper use of current account and function of cheque then it should not be dishonoring only on the ground of insufficient cover because it creates a way to cheat as customers can draw a cheque to a drawer and give the bank a stop payment order by which the drawers will escape liability as the cheque is not dishonored. In the long run, customers who do not have sufficient fund in their account will develop a habit of stop payment order before their cheque is dishonored for insufficient fund because the directive does not govern stop payment.

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<sup>62</sup> Ethiopian commercial code, article 857

2. There were laws governing the dishonoring of cheque prior to the issuance of the directive. There were also institutions to enforce these laws such as courts before the national bank of Ethiopia issued the directive. This is clearly admitted by the directive itself under its preamble that reads “whereas cheque as a negotiable instrument is recognized and given legal protection under Ethiopian law.

According to the directive if a drawer’s cheque is dishonored due to insufficient fund, the banks will levy on the drawer a fine of 5% of the amount appearing on the dishonored cheque and also close the drawer’s current account at all their branches.

The drawer whose cheque is dishonored due to insufficient fund shall be subjected to the commercial code and the penal code. He may defend civil suit at courts of civil divisions in accordance with the commercial code and civil procedure code. The drawer may also stand criminal charges and be tried by penal code and criminal procedure code and also is penalized by the directive.

Subjecting citizens to such confused directive particularly imposing penalties has negative effects to citizens who use cheque in their business transaction and as most merchants in Ethiopia use cheque even with the coming of the electronic payment.

Due to my interview with Ato Wondemeneh, head of supervision department of the national bank of Ethiopia, the national bank currently believes the directive is effective, as the number of persons who draw a cheque without having sufficient fund in their current account has reduced considerably.<sup>63</sup> I am of the opinion that the national bank of Ethiopia should not be misled by the reduction of the number of the drawers without cover due to the effectiveness of the directive.

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<sup>63</sup> Personal interview with Ato wondemeneh [ head, supervision department of the national bank of Ethiopia], march 2008

Because the drawer and the holder of the cheque negotiate among themselves or are mediated by the drawee bank so that the drawer will not suffer the penalty stated in the directive. So the national bank of Ethiopia should not be misled to thinking that people have stopped drawing without having sufficient cover.

Drawers will continue to cheat creditors and escape liability by simply abandoning their business or opening a new account with a different identity card and name by getting a new identity card with another name from another kebele as the Ethiopian government does not have the registration system India or the United States have, by which the government can keep track of every individual from the particular registration number that every individual is registered with. In the United States, each individual in the United States is required to register with US government by law.

Since individuals need the registration number for any official paper work like to open a bank account, to buy saving bonds, getting medical insurance etc. since we the Ethiopian government the registration system it is easy for people to commit a cheque fraud and escape without the penalty as it is easy to open a new bank account by getting a new identity card from a new kebele and with a new name.

3. In order to regain the current account services and to have deleted the name from the delinquent list, the conditions in art 6 must be fulfilled:

- The person must be suspended from use of current account for a minimum of 18 months from the date of the closure of the account.
- The person must present satisfactory evidence to the NBE with respect to full settlement of all dishonored cheques and penalty charges related to the earlier closure of current account; and

- Files with the NBE a written application, with the copy to the federal police commission, indicating his/her intention and commitment to operate current account honestly and carefully in the future.

The closing of a current account for more than one time, the directive imposes 10% fine of the amount stated in the cheque dishonored due to insufficient fund for a second time. If the drawer pays this 10% fine and fulfill all the condition stated under art 6 of the directive (conditions to regains current account services). The drawer would be allowed even where his account is closed for a second time due to a cheque drawn without cover.

It should also be noted that the drawer whose account is closed for more than 3 times can regain current account service fulfilling those conditions. However, the fine to be imposed where an account is closed 3 times or more than 3 times is not provided in the directive.

A person might do this unlawful act of drawing cheque without sufficient cover more than three times but the directive does not provide the fine to be imposed. And also the penalty, for those who enter the delinquent list for the first time and for those who reenter should not be the same if the directive needs to be effective.

### **3.5 Civil remedies for the unlawful act of drawing cheque without sufficient cover**

There are civil and criminal penalties for the unlawful act of drawing cheque without insufficient cover. According to article 872 of the Ethiopian commercial code, a holder can sue all persons liable on a cheque individually or collectively without being compelled to observe the order in which they have become bound.

Under article 873 of the Ethiopian commercial code, the code has stated what can be claimed from those sued in article 872. The person can claim

- The unpaid amount of the cheque
- Interest at the legal rate as from the date of presentment

- The expenses of the protest or equivalent declaration, and of the notices given and any other expenses
- A commission not exceeding one third percent

Cases involving a cheque is entertained by a summary procedure according to article 284 of the civil procedure code. When we analyze article 284 of the civil procedure code, it tells us that all suits where the plaintiff seeks to recover a debt or liquidated demand in money payable by the defendant with or without interest arising from a contract, expressed or implied such as a cheque may at the choice of the plaintiff, be instituted upon payment of the given court fee by presenting a statement of claim endorsed “summary procedure” and together with an affidavit made by the plaintiff or by any other person who can swear to the facts found in the statement of claim.

According to article 285 of the civil procedure code, upon filing of a suit according to article 284, the court, after the defendant is summoned in the form prescribed by law and the court passes a judgment and the defendant does not appear and defend the suit except upon applying for and obtaining leave to defend from the court. In sub article 2 of the article 285, the in default of such application by the defendant within the period fixed by the summons served upon him, then the court passes the decree according to the words or the claim of the plaintiff.

### **3.5.1 Existing problem regarding the practice of the courts in entertaining cases involving a cheque dishonored due to insufficient fund**

In Ethiopia, a suit involving a dishonored cheque with or without interest is entertained by a summary procedure when the plaintiff opts for a summary procedure. The plaintiff when instituting the suit should include in the statement of claim that he prefers a summary procedure.

Where the plaintiff submit his statement of claim with an affidavit and the defendant is summoned in the form prescribed by the law and the defendant does not apply for leave to defend, then the court passes a decree as per the statement of claim.

The practical problem is thus as to the defendant being given a chance to defend though he does apply for it. That is, when the defendant does not apply for a leave to defend, the court orders that the defendant appears and defend the case. This is contrary to the law that states in article 285 of the Ethiopian civil procedure code, which states that the court passes judgment based on the statement of claim when the defendant does not apply leave and it is granted.

Although cases involving a cheque must be disposed off speedily and without full scale trial according to article 284 of the civil procedure code, takes a longer time to pass judgment. Because the courts do not pass a decree as per the statement of claim of the plaintiff but instead order or grant a leave to defend to defendant even when they do not apply for it. It should be noted that in Ethiopia, where there is still heavy reliance on cheques, a time-consuming court judgment would affect the smooth working of the system of cheque.

### **3.5.2 Holdings of the court**

The first case, a case litigated between united insurance and Ato Fekadu Elfigid, where Ato Elfigid drew a cheque worth a 1000.00 birr on 30/10/98 but when the cheque is presented for payment or united bank, it refused payment or dishonored the cheque stating that there is no sufficient fund in the account of the drawer.

The plaintiff presented the statement of claim to the court with an affidavit made by the lawyer of the plaintiff according to article 284 of the civil procedure code and the case to be seen by a summary procedure. But the court granted the defendant a leave to defend twice.<sup>64</sup>

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<sup>64</sup> United insurance v. At Fikadu Elfigid [1999] case No 82269, first instance court

The second case, which is litigated between w/o woynished Bekele and W/o Mestawt Belachew and Ato legesse sahale, where the two defendants (Mestawt Belachew and Legesse sahale) drew a cheque to Woynishet Bekele but when the plaintiff presented the cheque to Wogagen bank, the bank dishonored the cheque stating the reason that there is no sufficient fund in the account of the drawer. When the second defendant (Ato Legesse Sahale) told that he was not summoned properly, the court decided that the first judgment be cancelled and ordered that he should be summoned properly and ordered for him to appear and defend the suit.<sup>65</sup>

In both cases, the courts decided to grant leave to defend and making the case take a longer time.

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<sup>65</sup> Woynishet Bekele V. Mestawt Belachew and Legesse Sahalu



## **Chapter 4**

### **Conclusion and recommendation**

#### **4.1 Conclusion**

A cheque is one of the means money is transferred in a cashless payment and also means money is protected from being stolen while being transferred. But still cheque fraud is among the most widespread and common crimes.

A cheque is not actually defined under the Ethiopian commercial code instead provides lists of requirements that a certain negotiable instrument should fulfill in order to be considered a legal cheque under the Ethiopian law which is found in its article 827.

A cheque can be a two or a three party instrument. The person who draws the cheque or the drawer when drawing a cheque on the drawee, it is necessary according to the Ethiopian law that there is sufficient fund in the hands of the drawee or the account or the account of the holder.

The Ethiopian commercial law also in its article 830 states the necessity of having sufficient previous cover before drawing a cheque. A cheque is presented for encashment within a period allowed by the law. When a cheque is presented and there is not sufficient fund in the account of the drawer, then the bank refuses payment, we say the cheque is dishonored. Insufficiency of funds is one of the reasons banks dishonor a cheque. Sometimes a wrongful dishonor might occur due to some error created by the bank.

In addition to the commercial code, there is a directive issued by the national bank of Ethiopia by which the dishonoring of cheque is governed.

A case involving a dishonored cheque is heard by a summary procedure at the option of the plaintiff according to article 284 of the civil procedure code.

## **4.2 Recommendations**

Since Ethiopia still relies heavily on cheque, it is important that cheques are used with honesty and without fraud. The smooth working of the system of cheque depends upon the honesty and integrity of the people using the cheque, judiciary that can interpret the laws properly and laws that can contribute to the smooth working of the system of cheque.

1. The commercial code should include the measure of damages for wrongful dishonor in order to protect a drawer whose cheque is erroneously dishonored by a bank.
2. The directive No SBB/31/2001 should include issues such as stop payment order, the penalty for those who enter the delinquent list for the third time or more, and reduce the harsh punishment as the drawers of a dishonored cheque are subject to penalty are subject to other laws (the criminal and civil law). Because it will affect the people that use cheque in their business transactions.
3. The government should adopt the registration system in order to keep track of the people that draw a cheque without sufficient fund and escape liability by getting a new identity card and by which the directive can be effective.
4. The government should assign qualified judges that can interpret the law properly in order to make the practice of the courts effective in dealing with cases that involve a cheque.



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