DEBENTURES AND BONDS UNDER ETHIOPIAN LAW

Workneh Alemnew Alula[å]

Abstract

The need to develop domestic security markets has increasingly attracted the attention of national and international policymakers following the recent international financial crises. The issue of debt management is intrinsically linked to security market development. The Ethiopian law recognizes debentures and bonds as debt instruments. Even though the Commercial Code of Ethiopia provides fairly advanced rules governing debentures, private companies have never issued debentures in Ethiopia. Bank- based financing of investments, which leads to a greater degree of control over the private sector by a relatively small group of agents, is still prevalent. So, there is a need for developing a security market as an alternative. There is no a comprehensive and vibrant law that regulates government bonds other than the proclamations (Government Bonds Proclamation No 172/1961, Negarit Gazeta, Year 20, No. 11 and Government Bonds Proclamation No 262/1969, Negarit Gazeta, Year 28, No. 12,) enacted during the Imperial Government. So far there is no law that repeals the 1969 Government Bonds proclamation. Some of the provisions of the proclamation do not, however, correspond with the present practical reality. As per the guidelines of the Grand Renaissance Dam Bond, the present FDRE government sets no maximum ceiling price for the bonds. This article is, therefore, designed to shed light on the legal aspects of debentures and bonds in the context of stock market development as envisaged under the Ethiopian law. It's methodology is qualitative and it is conducted through: Analysis and assessment of the existing Ethiopian policies, laws and practices; Review of the studies available in Ethiopia: Literature study and consultation of the laws and regulatory practices of countries and Comparison of the Ethiopian policies, laws and practices with the policies, laws, practices and recommendations in the international experience.

Key words: Bond, debenture, grand renaissance dam bond

[å]LL.B, LL.M in Business Law: former High Court Judge at regional High Court; currently lecturer in law at Gondar University, School of Law. For comments, he can be contacted via e-mail at: worknehalemnew@gmail.com.

1. INTRODUCTION

A number of studies prove that local securities markets play a vital role in a country's financial system.[1] The creation of securities market in Ethiopia can be justified by many functions: such as: providing long term finance which the banks are not doing; meeting the growing need for domestic resource to finance investment; providing market place and thereby enhancing the transferability, liquidity and proprietary value of existing securities; curing the excess reserve and liquidity positions of the banks.[2] However, many less developed economies are not successful in their efforts to put in place a sound security market and the capital markets in these economies remain relatively unproductive and small.[3] Ethiopia had a securities market in the 1960s and 70s until it was closed because of change of government policy in 1974. Currently, the country does not have formal securities market and the Bank-based financing of investments is still prevalent.[4]

Even though the Commercial Code of Ethiopia does not define the term "debenture", it has provisions that deal with debentures under its second book, sixth title, and fifth chapter. One can infer from the provisions of the Commercial Code of Ethiopia that a

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[1] Robert B. Ahdieh, "Making Markets: Network Effects and the Role of Law in the Creation of Strong Securities Markets," *Southern California Law Review*, Vol. (2003).

[2] Solomon Abay, Financial Market Development, Policy and Regulation: The International Experience and Ethiopia's Need for Further Reform 134, (2011) (unpublished manuscript).

[3] Robert B, supra note 1.

[4] Solomon, supra note 2.

Debenture is a contract between the holder and the issuer company.[5] Unfortunately, the provisions have never been still put in to practice half a century after the coming into force of the commercial code. The distinction between a Bond and a Debenture, as a result of whether the debt is evidenced by the certificate in question is secured or not, does not work in Ethiopia since a debenture is a secured instrument like bond under Ethiopian law.[6] As far as Government Bond is concerned, however, the Imperial government attempted to issue bonds as per the 1961 and 1969 Proclamations that were enacted to provide and regulate the issuance of government bonds.[7] The FDRE government has also issued bonds for the construction of Grand Renaissance dam of Ethiopia.

This article is therefore designed to shed light on the legal aspects of debentures and bonds as envisaged under the Commercial Code and other laws of Ethiopia. The article has four parts. The first part deals with the interests for and against development of stock market in Ethiopia. The second part discusses general remarks on debentures/bonds. It focuses on the basic concepts of debentures/bonds. The third part deals with Debentures under Ethiopian law. It provides the mechanisms of the issuance, operations and payment of debentures. It also deals with the characteristics of debentures. Part four is devoted to deal with Bonds under Ethiopian law. The last part discusses the current practices on

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5 Commercial Code of Ethiopian Proclamation, NEG. GAZETTA EXTRAORDINARY, Art. 430 (No.166/1960)

6 Solomon, supra note 2.

7 See Government Bonds Proclamation No 172/1961, Negarit Gazeta, Year 20, No. 11 and Government Bonds Proclamation No 262/1969, Negarit Gazeta, Year 28, No. 12,)

bonds and debentures in Ethiopia and analyzes the policy concerns and the recommendable regulatory legal and institutional frameworks for the development of debenture and bond markets in Ethiopia.

2. THE DEBATE ON STOCK MARKET DEVELOPMENT IN ETHIOPIA

A stock market is an organized market place in which stocks, shares, debentures, bonds and other securities are traded by members of the exchange, acting as both agents (brokers) and principals (dealers or traders).[8] It is, therefore, a market place for the purpose of centralized trading in securities.[9] It is a legal person the exclusive activities of which include the organization of trading in securities carried out as per existing legislation and consistent with regulations established by the exchange.[10] Ethiopia had securities market in the 1960s and 70s until it was closed because of change of government policy in 1974.[11] Currently, the country does not have formal securities market and the Bank-based financing of investments is still prevalent.

The academia, the business community, the National Bank of Ethiopia (NBE), and other stake holders saw the importance of having stock market in Ethiopia as early as

8 Abera Bayisasahu, Can Ethiopian Companies Meet the Listing Requirements of African Stock Exchanges? Addis Ababa University Faculty of Business & Public Administration, Department of Accounting & Finance 11, (2011) (unpublished manuscript)

9 ENCYCLOPEDIA OF BANKING AND FINANCE, STOCK EXCHANGE 3 (9th ed. 1993).

10 Securities Market Proclamation, KAZAKHSTANSKAIA PRAVDA, Art. 2 (No. 32/1997).

11 Solomon, supra note 2.

1994.[12] The Justice and Legal System Research Institute (JLSRI) of Ethiopia drafted a Securities and Exchange Proclamation in 2001 and invited the stakeholders in the country to make comments on the draft proclamation in 2002.[13] Then, the Institute redrafted the proclamation by incorporating the comments and submitted the final draft to the Council of Ministers of the Government in 2003.[14]

However, the Federal Democratic Republic of Ethiopia (FDRE) government has refused to enact "the draft proclamation" and suspended the moves for creation of the securities market for the reasons that the infrastructure and regulatory conditions for creation of the market are not ripe.[15]

Some scholars argue that the country's economy may be overheated due to inflow of capital and sudden repatriation in the aftermath of creation of the security market."[16] The government has shown belief that the creation of corporate bond market should come first before the institutionalization of securities market.[17]

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12 Ibid.

13 Justice and Legal System Research Institute of Ethiopia (JLSRI), the first, second and third drafts of the Securities and Exchange Proclamation (2001) (unpublished manuscript).

14 Solomon, supra note 2, at 134.

15 Id. at 135.

16 Id. at 136.

17 Abera, supra note 8.

Others argue that bank-based financing of investments may lead to a greater degree of control over the private sector by a relatively small group of agents.[18] This could be avoided by putting more reliance on market- based financing. To avail capital to the most productive enterprises, there seem to be strong arguments for developing an equity market in Ethiopia as an alternative to debt financing. Unlike banks, equity investors will share in the benefits and costs of risky projects and their return is not limited to a fixed interest rate but will rise with the profitability of an enterprise.

Hence, the creation of securities market in Ethiopia is justified by many functions: such as:[19] providing long term finance which the banks are not doing; meeting the growing need for domestic resource to finance investment; providing market place and thereby enhancing the transferability, liquidity and proprietary value of existing securities; curing the excess reserve and liquidity positions of the banks; enabling the NBE to enforce monetary and financial policy objectives through indirect and open market instruments. Ethiopia faces several challenges including:[20] short track record of the companies in the country to attract buyers for their securities; the reluctance of some companies in the country to go to the public and freely float their securities; the practice of most of the public companies, including the banking and insurance companies that can take the lead in the issuance and trading of securities, being limited only to the issuance of ordinary shares; and, the level of income and saving capacity of most individuals and households is reportedly low to establish dependable demand for securities. However,

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18 Asrat Tessema, Prospects and Challenges for Developing Securities Markets in Ethiopia: An Analytical Review Addis Ababa University, Faculty of Business and Economics (1997/98) (unpublished manuscript), p.2.

19 Solomon, supra note 2, at 137.

20 Id. at 146.

these challenges do not justify the retreat from creation of the securities market as many of them are results of either the absence of the securities market or government policy.[21]

3. GENERAL REMARKS ON DEBENTURES AND BONDS

3.1. The Conceptual Background: Debentures and Bonds

3.1.1. Debentures

The term "debenture" originated from the Latin word "debenture" and it was first employed to refer to a form of acknowledgment of indebtedness used by the kings of England in the old days to pay the wages of their servants.[22] In fact, the same was given to soldiers to charge the government of England to pay a soldier-creditor a sum due upon computing the account of his arrears.[23] Today, in a different form and character, the essence of the original debenture, i.e., admission of indebtedness exists embodying a promise and the obligation to pay, then after this being the point of departure, these days there are a huge variety of debentures issued with the aim of financing companies.[24]

21 Id. at 147.

22 L.C.B GOWER, THE PRINCIPLE OF MODERN COMPANY LAW 323,(1st ed. STEVENS AND SONS LTD. LONDON 1957).

23 Id. at 324.

24 Tewodros Mehret, The Nature of Preferred Shares and Debentures under the 1960 Commercial Code of Ethiopia 9 (LL.M thesis, Addis Ababa University, Law Faculty 2005).

A debenture may be defined as *"a document evidencing indebtedness entitling its holder to a fixed rate of interest until the payment of the principal."*[25] It is a type of transferable security that represents claims against the company and its holder is a creditor who does not have ownership interest in the company.[26] Hence, it is freely transferable. Debentures may be issued in connection with a unit of an entire borrowing when a company borrows a great sum of money at a time or it may be given to an individual lender.[27] As an instrument of financing companies, debentures have a lot of advantages, for instance, debentures distribute risk among creditors, thereby enabling the company to secure the amount of funds necessary to finance its operation. Secondly, debentures confer no voting right upon their holders as to management and control of the company.[28] The original shareholders do not lose their power of control as a result of the issue of debentures.

3.1.2.Bonds

The term "bond" has several meanings and applications. The Black's Law Dictionary defines it as a *"certificate or evidence of debt on which the issuing company or governmental body promises to pay the bond holders a specified amount of interest for a specified length of time, and to pay the loan on expiration date."*[29] A bond, like debenture:, is a document evidencing indebtedness which entitles to the holder to a

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25Public Enterprises Proclamation, FED.NEG.GAZETTA, art. 2 (No. 25/2000).

26 Tewodros, supra note 24.

27Id. at 10.

28Id. at 11.

29 L.C.B GOWER, supra note 22.

certain amount of interest and repayment of principal upon maturity.[30] Bonds are used by corporations and the federal, state, and local governments to raise funds.[31] Most bonds are negotiable, or can be readily traded prior to their maturity date.[32] The price of bonds depends on the original amount borrowed, the interest rate the bond pays and the comparable interest rates and the returns on other investments in the economy.[33]

3.2. DEBENTURES UNDER ETHIOPIAN LAW

3.2.1. Characteristics of Debentures

The Ethiopian law recognizes Debentures as debt instruments.[34] A debenture is a binding agreement between the holder and the issuer.[35] It is a negotiable instrument one has to possess it so as to exercise the right it embodies so that it becomes property of the holder.[36] In many legal systems, the basis of difference between a debenture and a bond

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30 Tilahun Teshome , Module on Financial Markets Development and Regulation, Addis Ababa University, School of Law 2 (2013) (unpublished manuscript).

31 Ibid

32 Ibid

33 Tewodros, supra note 24.

34Tilahun, supra note 30.

35 Ibid

36 Tewodros, supra note 24.

is whether security is attached to the investment.[37] Accordingly, a bond issued by a company is secured debt while debenture is unsecured one and some describe debenture as unsecured bond.[38] Some say, more importance is given to bonds as they provide a right of priority to their holders over other creditors.[39]

The Commercial Code of Ethiopia consistently has employed the word "debentures" but not for the term "bond" under Article 432 of the Code which substituted the former. For both, the Amharic version uses the same designation. It is not clear why a different term is used in one provision of the Commercial Code. Article 433(b) indicates that a debenture is secured. Thus, the distinction between a bond and debenture as a result of whether the debt is evidenced by the certificate in question is secured or not may not work under Ethiopian law.[40] The Ethiopian Grand Renaissance Dam Bond guideline, which is issued by the FDRE government, defines that a Bond is a debt instrument like promissory note and Treasury bill. The only difference between Bond and Treasury bill is that a bond serves for much more period than Treasury bill does. The type of the Bond may be either Coupon bond with interest or without interest.[41]

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37 Id. at 10.

38 Id. at 11.

39 Ibid

40 Solomon, supra note 2.

41 National Bank of Ethiopia, THE ETHIOPIAN GRAND RENAISSANCE DAM BOND GUIDELINES issued by FDRE Ministry of Finance and Economy Development and provided by the Development Bank of Ethiopia, 5 (2011 E.C), (May 1, 2013), http:// www.nbe.et.com.pdf

3.2.2. Debenture as a Contract

The Ethiopian law defines a contract as "*an agreement whereby two or more persons as between themselves create, vary or extinguish obligations of a proprietary nature.*"[42] The issuance of debenture creates "obligation of a proprietary nature" since the issuer company has an obligation to pay interest at fixed interval of time and the principal at the time when it matures.[43] It involves two persons: the debtor company that issues the instrument and the creditor who is the debenture holder. Therefore, the formality requirements for a valid contract provided under the Ethiopian Civil Code shall be applicable for the contract between the issuer and holder of the debenture. However, a debenture is not an ordinary and simple contract since the effect of debenture is not strictly limited as between the contracting parties and the right of the creditor is negotiable.[44]

3.2.3. Debenture as a Property

A debenture is a document which incorporates a right against the debtor company. So, one has to use the document so as to establish his property right. Pursuant to Article 1128 of the Ethiopian Civil Code, rights and claims embodied in debentures to bearer are deemed to be corporeal chattels unless provided otherwise. A Debenture can be furnished as a pledge in order to guarantee the performance of an obligation irrespective of their

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42 Civil Code of Ethiopian Proclamation, NEG. GAZETTA, Art. 1675 (No.165/1960)

43 Tewodros, supra note 24.

44 Id. at 14.

form.[45] It may be jointly owned in which case no co-owner may claim part of the debt as debentures are indivisible.[46] So, Debenture can be sold, bought, bequeathed or pledged like any other property.

3.2.4. Debenture as a Negotiable Instrument

A Debenture is one of the types of transferable securities.[47] Article 715 of the Ethiopian Commercial Code defines a negotiable instrument as "*any document incorporating a right to an entitlement in such manner that it is not possible to enforce or transfer the right separately from the instrument.*" But, some argue that there might be non-negotiable debentures as can be inferred from the wording of Article 429 of the Ethiopian Commercial Code.[48] The provision provides that *"no negotiable debentures shall be issued by: individuals; companies whose capital is not fully paid; and companies which have not issued a balance sheet in respect of their first financial year."* This implies that there is a possibility to issue non-negotiable debentures. However, in most cases, the term 'debenture' shall be used in connection with a transferable long term debt security issued by a company.[49]

45 Civil Code of Ethiopian Proclamation, NEG. GAZETTA, Art. 1675 (No.165/1960)

46 Tewodros, supra note 24.

47 Tilahun, supra note 30.

48 Tewodros, supra note 24.

49 Id. at 20

3.2.5. Debenture as a Secured Debt

Articles 433(f) and 443 (1) of the Ethiopian Commercial Code indicate that a Debenture represents a secured debt and its holder is a secured creditor. Accordingly, the special guarantees attached to the debenture and the dates of the deed setting up the guarantees are required to be stated in the certificate given to the creditor.[50] The security that might be given to guarantee the performance of the obligation is either real or personal as per the wordings of Articles 433, 436 and 443 of the Ethiopian Commercial code. A surety-ship is envisaged as one of the securities that may be given to guarantee the performance of the obligation of the debenture issuer under Ethiopian law.[51] As per article 443(1) of the commercial code pledge may be given as a security, in which case, the agent of the debenture holder, if any, is required to receive and preserve the pledge. Mortgage can also serve as a real security to the debenture. Article 430 of the commercial code provides that one of the instances a company may issue debentures exceeding the amount of paid up capital is when the company's property is mortgaged.

3.3.Issuance of Debentures

Debentures are closely tied to share companies in the Ethiopian legal system. Article 429 (1) of the commercial code prohibits the issuance of negotiable debentures by individuals. Joint ventures and private limited companies are not also allowed to issue

50 Id. at 21

51 Commercial Code of Ethiopian Proclamation, NEG. GAZETTA EXTRAORDINARY, Art. 436 (4)(No.166/1960)

negotiable debentures in Ethiopia.[52] However, there are no similar provisions that prohibit the three types of partnerships from issuing negotiable debentures. Partnerships cannot issue negotiable debentures since private limited companies are not allowed to issue negotiable debentures. Debentures to be issued by share companies; Article 429 of the Commercial Code provides that *"companies whose subscribed capital is fully paid and which have made public their balance sheet for the first year of their operation may issue such instruments."*

In addition, a "debentures issued by a company may not exceed the amount of paid up capital shown in the last adopted balance sheet."[53] This amount, however, may be exceeded*: "(a) where the company's immovable property is mortgaged and the debentures issued do not exceed two thirds of the value of the mortgage; or (b) where the excess over the paid-up capital is guaranteed: by registered securities or securities issued or guaranteed by the State and the date of redemption is not earlier than that of the debentures; or by government or public authorities annuities."*[54] Article 432 of the commercial code provides that *"bonds or debentures may be issued at a price greater than their par value, but, they may not be issued at a price lower than their par value except in accordance with special laws."*[55]

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[52] Id. at Art. 274 and 510 (3)

[53] Id. at art 430 (1)

54 Ibid.

55The prohibition is the same as to shares as provided under Commercial Code of Ethiopian Proclamation, NEG. GAZETTA EXTRAORDINARY, Art. 326 (1) (No.166/1960)

Debentures are issued in accordance with the borrowing power of a company. As per Article 419 (2) of the commercial code, the issuance of debentures and guarantees attached thereto requires the approval of an ordinary general meeting. Therefore, the decisions passed by the board of directors shall secure the approval of an ordinary general meeting. However, the convertibility of debentures to be issued shifts the approval required to that of an extraordinary general meeting.[56] As per Article 474 of the commercial code the *"issue of convertible debentures is subject to the prior approval of an extraordinary general meeting"* since conversion of debentures in to shares results in increase in the capital which involves the amendment of memorandum of association.

3.4.Kinds of Debentures

This topic deals with different types debentures with their peculiar characteristics and reveals which among the different types of debentures are recognized under Ethiopian commercial code.

A Convertible debenture is one of the kinds of debt security that gives its holder the option to convert it to a common or preference share at a stated time and rate of exchange.[57] The two main reasons as to why companies issue convertible securities are the desire of companies to raise common capital and to improve the market acceptance of debentures.[58] The Ethiopian company law permits the issue of convertible debentures

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56 Tewodros, supra note 24.

57 Id . at 28.

58RALF J.BAKER AND W.L CARRY, CASES AND MATERIALS ON CORPORATIONS, 1000 (3rd ed. STEVENS AND SONS LTD. LONDON 1958).

with the approval of an extraordinary general meeting.[59] Such approval requires express renunciation by the shareholders of the preferred right of subscription of the shares to be issued under such conversion, for the benefit of the holders of the convertible Debentures.[60] Here, a conversion clause is one of the items to be specified in a Debenture certificate in cases where the debenture is convertible.[61] The Ethiopian Commercial Code also requires the certificate of a convertible Debenture to set out the period of time within which the Debenture holder may convert his/her Debenture in to shares.[62] The phrase "where appropriate" in Article 433 (h) of the Commercial Code shows that a Debenture may be convertible in an exceptional manner. Therefore, one can argue that a Debenture issued in Ethiopia may be convertible at the option of the holder.[63]

A perpetual debenture has no fixed date for its redemption. So, it is to be redeemable on the happening of a remote contingency.[64] It is redeemable solely upon winding up or when the company fails to discharge its obligation, for example, if the company fails to pay interest due. Article 433 (e) and (f) of the commercial code provide that *"debenture certificates shall be issued from a counterfoil register and shall show:*

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59 Commercial Code of Ethiopian Proclamation, NEG. GAZETTA EXTRAORDINARY, Art. 474 (No.166/1960)

60 Ibid.

61 Tewodros, supra note 24.

62 Commercial code, supra note 59, art 433 (h).

63 Tewodros, supra note 24.

64 C.D THOMAS, COMPANY LAW FOR ACCOUNTANTS 304. (1st ed. OXFORD UNIVERSITY PRESS 1985)

the serial number and nominal value of the certificate, the rate and date of interest payments and the terms for redemption; the amount of the issue and the special guarantees attaching to the debentures and the date of the deed setting up such guarantees.” Therefore, we can conclude that a company cannot issue a perpetual debenture in Ethiopia since Article 433 is a mandatory provision.

A redeemable debenture is payable on a fixed date or before a fixed day that is certain unlike perpetual debentures.[65] This implies that the principal will always be paid at the time when the debt matures unless there is prepayment for one reason or another.[66] Consistently, article 433 (e) of the Ethiopian commercial code mandatorily makes the term of redemption of debenture one of the essential contents to be stated in the debenture certificate. Therefore, debentures are always redeemable under Ethiopian law.

A secured debenture is a debenture that is secured by collaterals such as mortgages and pledges.[67] The Ethiopian commercial code contains several provisions assuming that debentures are better to be secured. Here, the query to be raised is whether security is intrinsically attached to any issue of debenture. Yet, Articles 419 (2), 433(f) and 443 (1) of the commercial code may be taken to understand that debentures are always secured in the Ethiopian legal system. Specifically, Article 433 (f) provides that debenture certificates must be issued from a counterfoil register and shall show the

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65 Tewodros, supra note 24.

66 Id. at 27.

67 Ibid.

amount of the issue and the special guarantees attaching to the debentures and the date of the deed setting up such guarantees.

Unsecured debentures, also known as naked debentures, have neither personal nor real guarantees attached to them in order to assure the performance of the obligation of the company under the contract.[68] Unsecured debenture is a mere acknowledgement of indebtedness and its holder has no better right than an ordinary creditor.[69] Article 433 of the commercial code of Ethiopia does not warrant the possibility of issuing unsecured debentures in Ethiopia.

A debenture is said to be registered when the holder's name is entered in the register kept at the issuing company.[70] It seems to be simple and meets the requirements of capital market because the identity and the title of the holder are known with whom the company is able to easily communicate.[71] Therefore, it enables the company to pay an identifiable credit whose receipt is a sufficient discharge.[72] If the issue of bearer debentures is forbidden by the law or memorandum or article of association, all debentures shall be registered and in the absence of such prohibition the holder of one form of debenture may convert it to the other form.[73] Article 341 of the commercial code

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68Tewodros, supra note 24.

69 Id. at 28.

70 C.D THOMAS, supra note 64.

71 Id. at 304.

72 Tewodros, supra note 24.

73 Commercial Code of Ethiopian Proclamation, NEG. GAZETTA EXTRAORDINARY, Art. 720 (No.166/1960).

of Ethiopia provides that *"ownership of registered shares shall be established by the relevant entry in the register kept at the head office and no transfer is complete until recorded in this register."*

A debenture is said to be Bearer where no debenture holder's name is entered as the owner of the instrument.[74] Art. 719 of the commercial code of Ethiopia states that *"according to the forms provided for their transfer, negotiable instruments may be to bearer, in a specified name or to order."* In addition, as per article 340 of the commercial code of Ethiopia, *"bearer shares are assigned by delivery, without any other requirement and; unless the country is proved, such shares shall be deemed to be the property of the holder for the purpose of payment of dividends, redemption and right of participation in general meetings."* Therefore, we can conclude that the Ethiopian law recognizes both registered and bearer shares. And, both forms of debentures are declared to be negotiable instruments.

3.5.Operations and Payment of Debentures

A company that wants to issue a debenture offers to the public for subscription by a prospectus and whoso ever wants to subscribe makes an application on the form provided and deposited in the place of application stated in the prospectus.[75] A debenture, which is the property of the owner, is subject to transactions, such as, sale and pledge. The first holder of the debenture certificate becomes the owner thereof by

74 Tewodros, supra note 16.

75 Commercial Code of Ethiopian Proclamation, NEG. GAZETTA EXTRAORDINARY, Art. 319 (No.166/1960).

issuance and can transfer his right embodied in the debenture certificate by transferring the instrument.[76]

Bearer debentures are transferred by mere delivery and their assignment is not subject to any requirement other than delivery.[77] Whereas, in the case of registered debentures the instrument is in a specified name so that a mere delivery does not transfer possession. That is why the Ethiopian law provides that "ownership of registered shares shall be established by the relevant entry in the register kept at the head office and no transfer is complete until recorded in this register."[78]

Furthermore, Article 723 of the Commercial Code provides 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 he transferred by delivery of a new instrument in the name of the new holder." "Such delivery shall be entered in the register." Once a person becomes the lawful owner of the debenture "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."[79]

As to payment, a debenture is "a document that incorporates the right its holder has and evidences indebtedness of the company which promises to pay interest and

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76 Tewodros, supra note 16.

77Commercial Code of Ethiopia, supra note 67, Art 340.

78 Id. at art. 341.

79 Id. at Art. 718.

principal at the agreed time.[80] The principal obligation of the issuer company is payment of the face value of the instrument to its debenture holder and the obligation is extinguished where it is executed as per the terms of the contract.[81] Therefore, the contractual relationship between the debenture holder (creditor) and the issuer company (the debtor) comes in to an end when the debtor company redeems the debenture held by the creditor.[82] The Ethiopian commercial code fails to provide the mechanisms as to how a debenture may be redeemed.[83] It rather requires a debenture certificate to contain a provision concerning the terms of its redemption.[84] So, the issuer company may redeem its debentures before the maturity date by any means stipulated in the certificate.[85]

The redemption right given to the issuer company is crucial since it enables the company to refund when interest rates of the debenture decline.[86] Normally, a debenture is payable at the time of its maturity unless the company is entitled a redemption right.[87]

80 Edward Manson, supra note 40, at 420.

81 Tewodros, supra note 24, at 32.

82 Ibid.

83 Ibid.

84 Commercial Code of Ethiopian Proclamation, NEG. GAZETTA EXTRAORDINARY, Art. 433 (e) (No.166/1960).

85 Tewodros, supra note 24, at 33

86 Id. at 34.

87 Id. at 35.

There are, however, situations where redemption occurs before the maturity date of the debenture. For instance, Article 438 of the Ethiopian commercial code provides that when the issuer company enforces a proposal relating to modifications in the structure of the company; amalgamation with another company or issue of debentures having priority over existing debenture, the company shall redeem within three months from such proposals having become effective the debentures of the creditors as may so request without securing the approval of the debenture holders' meeting.

3.6.The Current Practice in Ethiopia

Even though the Commercial code of Ethiopia provides fairly advanced rules governing debentures, companies have never issued debentures in Ethiopia. Professor Escarra, who is the drafter of the commercial code of Ethiopia, said that "perhaps they [the provisions of the commercial code dealing with debentures] are too advanced for the present needs of the Ethiopian Economy."[88] There are no subsequent legal frameworks issued taking the advantage of the provisions of the commercial code.[89] Therefore, we can conclude that the chapter of the commercial code dealing with debentures is a typical case in point where the law does not correspond with the practical reality.[90]

88 P. Winshop, Back ground Documents of the Ethiopian Commercial Code of 1960, Addis Ababa University 68 (1972) (unpublished manuscript).

89 Tweodros, supra note 16, at 35.

90 Id. at 37.

4. BONDS UNDER ETHIOPIAN LAW

4.1. Bond Laws during the Imperial and Military Governments

4.1.1. Bond Laws during the Imperial Government

To begin with the historical background, "*the imperial government enacted laws on government bonds for the first time in Ethiopia in 1961 and 1969 to facilitate the financing of development projects of the government and stimulate the development of the securities market of the time.*"[91] The preamble of the 1961 Proclamation to provide the issuance of Government Bonds provides that *"the development of capital market within the Empire (Ethiopia) justifies the taking of action to facilitate the issuance of government bonds in which savings and capital may be invested with full security."* It also states that *"the issuance and sale of government bonds would provide the government with funds required for the financing of further development of the country."* The 1969 Proclamation to provide the issuance of Government Bonds, which amends the 1961 proclamation, repeats the wording of the preamble of the 1961 proclamation. The 1961 proclamation defines that "government bonds are written obligations to pay a fixed sum of money (the face value), at a fixed time in the future (maturity date) issued

91 Solomon, supra note 4, at 128.

simultaneously as a series."[92] It also states that "the minister of finance is authorized to issue government bonds in an amount not to exceed thirty million (30,000,000) Birr."[93]

The proclamation provides that government bonds issued shall in no event bear a date of maturity more than 10 years from the date of the issue and the bonds shall be bearer bonds; that is, they shall be negotiated by simple transfer.[94] It also states that the bonds shall in no event bear a rate of interest of more than six and one half percent per annum or if said bonds shall carry the right to participate in premium drawings, and the total amount payable as interest and/or premium shall in no event exceed six and one half percent per annum of the face value of all of the bonds then outstanding of the particular series involved.[95]

The proclamation deals with the characteristics of bonds and provides that government bonds issued may have all or some of the following characteristics, as may be decided by the Ministry of Finance.[96] (a) Said bonds may be issued in separate series, having different dates of issue and different characteristics. (b) They may carry a fixed rate of interest, payable periodically, and/or the right to participate in periodic public

92 Proclamation to provide the Issuance of Government Bonds in Ethiopia. NEG. GAZETTA, art. 2 (No. 2/ 1961)

93 Ibid.

94 Id. at Art. 3.

95 Ibid

96 Id. at Art. 4.

drawings for the determination of those bonds with respect to which premiums shall be paid. (c) Bonds of a given series may all bear the same date of maturity or they may mature in installments in accordance with a fixed plan of redemption subject to the limitations set forth in Article 3.

It also states that government bonds shall be legal investments for all purposes, including without limitations, insurance, pension and trust funds, all shall be accepted for deposit as guarantees by any governmental or other public authority upon conditions prescribed by the Ministry of Finance.[97] The exemption clause[98] of the proclamation provides that interest or premiums received by the holder of any government bond issued hereunder shall be exempt from income tax. And, interest, premiums and principal not collected within 10 years from the date upon which payment thereof falls due shall be deemed forfeited to the state.[99] The then Ministry of Finance was authorized to issue regulations for the implementation of the proclamation.[100] Accordingly, the "Premium Bonds Regulations" of 1963 and 1968, and Saving Bonds Regulation of 1963, 1964 and 1968 were issued pursuant to the Government Bonds Proclamation of 1961.

After 8 years, however, the 1961 proclamation was amended by the 1969 proclamation to provide the issuance of government bonds. The concepts provided by the two proclamations are similar except the following minor differences.

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97 Id. at Art. 5.

98 Id. at Art. 6.

99 Id. at Art.7.

100 Id. at Art. 8.

(1). The 1961 proclamation[101] included 9 Articles, whereas, the 1969 Proclamation includes 10 articles as Article 2 of the former proclamation is spitted to two Articles under the latter.

(2). It authorized the minister of finance to issue Government Bonds in an amount not to exceed thirty million (30,000,000) Ethiopian dollars. On the other hand, the 1969 Proclamation authorizes the minister of finance to issue government bonds in an amount not to exceed One hundred million (100,000,000) Ethiopian dollars. This indicates that the amount of money that the minister is authorized to issue was reconsidered.

(3). The 1961 Proclamation provided that the Government Bonds issued shall in no event bear a rate of interest of more than six and one half percent per annum or if said bonds shall carry the right to participate in premium drawings, the total amount payable as interest and/or premium shall in no event exceed six and one half percent per annum of the face value of all of the bonds outstanding of the particular series involved. Whereas, the 1969 Proclamation provides that the Government Bonds issued shall in no event bear a rate of interest of more than seven and one half percent per annum or if said bonds shall carry the right to participate in premium drawings, the total amount payable as interest and/or premium shall in no event exceed seven and one half percent per annum of the face value of all of the bonds outstanding of the particular series involved. This implies that the change introduced by the amendment is to increase the amount and interest rate of the bonds. Some of the provisions of the proclamations, such as, the amount of government bond to be issued by the ministry of finance, does not correspond with the

101 Proclamation to provide the Issuance of Government Bonds in Ethiopia. NEG. GAZETTA, (No. 5/ 1969)

practical reality. As per the guidelines of the Grand Renaissance dam Bond, the present FDRE government sets no maximum ceiling price for the bonds.[102]

4.1.2. Bond Laws during the Military Government

The Military Government, known as Derg, also halted the issuance and circulation of treasury bills and government bonds in favour of direct bank borrowing.[103] Accordingly, it issued ten years savings bonds on the 10th of March 1975 and amended the Imperial bond law on the 11th of same month.[104] It then diverted its attention from the issuance of bonds and treasury bills to direct advance by the National Bank of Ethiopia and introduced special bonds only as late as 1988 to curb the constraints it faced to finance the war that concluded its life in 1991.[105]

4.2. The Current Bond Laws in Ethiopia: The Grand Renaissance Dam (GRD) Bond Guidelines

The introductory part of the GRD Bond Guidelines provides that the cost of construction of the dam is very high so that the government intends to collect the finance from the general public. The government issues the GRD Bond in order to collect the money from the people. The Guideline defines that "*Bond is a debt instrument like*

102 National Bank of Ethiopia, supra note 37, at 2-6.

103Solomon, supra note 2, at 128.

104 Id. at 129.

105 Id. at 130.

promissory note and treasury bills." The only difference between Bond and Treasury bills is that bond serves for much more period than Treasury bills.[106] It also provides that the bond can be transferred to third parties. The type of the Bond is either Coupon bond with interest or coupon bond without interest.[107]

The bond issuer is the FDRE ministry of finance and economy development and the Bond provider is the development bank of Ethiopia.[108] The commercial bank of Ethiopia in Ethiopia and Ethiopian embassies and offices outside Ethiopia are agents to sell the bond.[109] The minimum price of the bond is 50 birr in Ethiopia and 500 birr outside Ethiopia.[110] However, there is no maximum ceiling price of the bond. The Payment time is 1-5 years and above 5 years and the interest rates are 5.5% for 1-5 years bonds and 6% for above 5 years bonds. The interest is to be calculated starting from date on which the bond is purchased.[111] The bond buyer is entitled a coupon that shows the amount of the bond. [112] The guideline also provides the possibility that bond holders may return the bond before the maturity date but after 1 year if the bond is of 1-5 years and

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106 National Bank of Ethiopia, supra note 37.

107 Ibid

108 Ibid.

109 Ibid.

110 Ibid.

111 Solomon, supra note 2, at 130.

112 Id, at 131.

after 3 years if the bond is of above 5 years.[113] As per the guideline, the benefits of the GRD Bond for Ethiopia are: promoting saving and investment; increasing foreign exchange; creating job opportunities as the number of investment increases; and promoting monetary and financial markets in Ethiopia.

The Guideline also provides the significances of the GRD Bond for Bond holders. It states that the bond enables the holders to increase their wealth through saving. The bond is trustworthy since it is guaranteed by the government.[114] The interest obtained from the bond is free from income tax. It is transferrable to legal heirs of the bond holder or to other persons through succession and donation and it can be sold to a third party at the secondary market. It also serves as a pledge to borrow money from Ethiopian Banks but the guideline does not answer the question "from which bank and exactly how much to borrow".

4. 3. Benefits of Developing a Bond Market in Ethiopia

The major benefits of having a vibrant and working bond markets are;[115] at the macroeconomic policy level, a government securities market provides an avenue for domestic funding of budget deficits other than that provided by the central banks.

113 Id, at 132.

114 Ibid

115 The Working Group on Capital Flows, Developing a government bond, an overview, in the proceeding of the Financial Stability Forum (FSF) 4, (2000) .

- A government securities market can also strengthen the transmission and implementation of monetary policy, including the achievement of monetary targets or inflation objectives, and can enable the use of market-based indirect monetary policy instruments.
- They help governments to reduce their exposure to interest rate, currency, and other financial risks.
- Finally, a shift toward market-oriented funding of government budget deficits will reduce debt-service costs over the medium to long term through development of a deep and liquid market for government securities.[116]

At the microeconomic level**,** development of a domestic securities market can increase overall financial stability and improve financial intermediation through greater competition and development of related financial infrastructure, products, and services.[117]

- Development of a bond market can help change the financial system from a primarily bank-oriented to a multilayered system, where capital markets can complement bank financing.
- The development of securities and credit markets and a related benchmark yield curve enables the introduction of new financial products, including repurchase agreements (repos), money market instruments, structured finance, and derivatives, which can improve risk management and financial stability.
- Finally, development of a securities market entails creation of an extensive informational, legal, and institutional infrastructure that has benefits for the entire financial system.[118]

116 Ibid.

117 Ibid.

4.4. The Need for Legal and Regulatory Framework for Developing Bond Markets in Ethiopia

The legal, regulatory, and supervisory framework is one of the major prerequisite for sound government securities market development.[119] Therefore, Ethiopia should enact a comprehensive bond law in addition to the GRD Bond guideline which is designed to a specific project. The basic parts of the legal framework helping an efficient domestic government securities market usually include an explicit empowerment of the government to borrow, budgetary rules for the issuance of government securities, rules for the organization of the primary market, role of central bank as agent for the government, the debt management framework, rules governing issuance of government securities, and rules pertaining to the secondary market.[120] A balance must be struck among the needs for proper risk control, market integrity, and market development so that the legal framework defines incentives for all market participants, the issuing government, the central bank, regulatory agencies, market intermediaries, end investors, and other stake holders.[121]

118 Id. at 2.

119 See Ruediger Ruecker; Market potential Assessment and Road map Development for the Establishment of Capital Market in Ethiopia, in the proceeding of forum organized by Addis Ababa chamber of Commerce on stock market , 27 (2011).

120 Id. at 28.

121 Id. at 32.

The legal framework must also define the rights and obligations of parties to debt contracts in the primary and secondary markets for issuers, investors, and intermediaries.[122] This definition should include (i) minimum guidelines for disclosure of material information, and (ii) liability for entities involved in distributing securities and for entities handling third party investment accounts.[123] Investment regulations need to permit sufficient flexibility for investors, yet create adequate safeguards for prudent operations and for the safeguarding of fiduciary obligations, as in the case of pensions.[124]

4. CONCLUSION AND RECOMMENDATIONS

This paper examined various concepts as to the legal aspects of Debentures and Bonds under Ethiopian law. The Commercial Code of Ethiopia does not define the term “debenture” despite fairly advanced provisions are enshrined therein. Articles 430- 444 of the code provide detailed rules about debentures. We can infer from the provisions of the commercial code that a debenture is a document evidencing indebtedness entitling its holder to a fixed rate of interest until the payment of the principal. As per Article 429 of the Commercial Code only companies whose subscribed capital is fully paid and which have made public their balance sheet for the first year of their operation may issue debentures since such instruments are to be issued by share companies. Even though the Commercial code provides fairly advanced rules governing debentures, the private companies have never issued debentures in Ethiopia. Consequently, the chapter of the commercial code dealing with debentures has never been put in to practice even half a

122 Solomon, supra note 2, at 133.

123 Ibid.

124 Ibid.

century after the coming into force of the commercial code. There are no also subsequent legal frameworks issued taking the advantage of the provisions of the commercial code. Even recently, the situation does not seem to change since there is no initiation on the part of government to put them into practice. Therefore, we can conclude that the chapter of the commercial code dealing with debentures is a typical case in point where the law does not correspond with the practical reality.

The Ethiopian laws provide for the possibility of issuance of Government bonds and treasury bills although the hitherto utilization of the laws on bonds leaves much to be questioned. During the Imperial government era, the 1961 proclamation was amended by the Government Bond Proc. No. 262/1969 that provided higher amount of bonds with higher interest rate than the former proclamation. The FDRE government also issues the Grand Renaissance Dam bond in order to collect money for the construction of the dam from the general public. Some of the provisions of the 1969 proclamation such as, the amount of government bond to be issued by the ministry of finance, does not correspond with the present practical reality since the Guideline of the GRD Bond has no maximum ceiling price.

The major benefits of having a vibrant and working debenture/bond markets include; at the macro level, a debt securities market provides an avenue for domestic funding of budget deficits other than that provided by banks. Debenture and bond market can also strengthen the transmission and implementation of monetary policy, including the achievement of monetary targets or inflation objectives, and can enable the use of market-based indirect monetary policy instruments. Whilst at the micro level**,** development of a domestic debenture/bond market can increase overall financial stability and improve financial intermediation through greater competition and development of related financial infrastructure, products, and services.

Therefore, this paper provides the following recommendations for the development of debenture/bond markets in Ethiopia. The paper finds that the Commercial code of Ethiopia fails to deal with some aspects of transferrable securities. Even though there are some indications that debentures may be non- negotiable, it is not clear under what conditions that debentures might be non- negotiable. Hence, the code shall be amended to fill such gaps.

It is prohibited to issue debentures at discount under Ethiopian laws except in pursuance of special laws. The issuance of debentures at discount is almost a universally accepted rule. It is not evident what interest is to be protected by the prohibition under Ethiopian law. One of the advantages of debentures when compared with shares is that debentures can be issued at a lower price than their par value. Hence, debentures have lost this quality under Ethiopian law. Therefore, companies should be permitted to issue debentures at discount.

The legal, regulatory, and supervisory framework is one of the major prerequisite for sound securities market development**.** In Ethiopia, however, there is no a comprehensive and vibrant law that regulates the issue of government bond other than the proclamations enacted during the imperial government. Even the Imperial proclamation No.262/1969 has not been enforced in the present situation. Therefore, the government shall enact a comprehensive law that regulates the present and the future conditions of bond markets in Ethiopia. There should also be an organ entrusted with the task of regulating the capital markets in general and the debenture and bond markets in particular so as to have an effective and efficient control in the whole process of issuing and transferring debt securities.

The basic parts of the legal framework helping an efficient domestic securities market usually include an explicit empowerment of the government and companies to borrow, budgetary rules for the issuance of debt securities, rules for the organization of the primary market, role of central bank as agent for the government, the debt management framework, rules governing issuance of government and company securities, and rules pertaining to the secondary market. A balance must be struck among the needs for proper risk control, market integrity, and market development so that the legal framework defines incentives for all market participants, i.e. the issuing government or company, the central bank, regulatory agencies and other stake holders.

In general, the legal framework in Ethiopia must define the rights and obligations of parties to debt contracts in the primary and secondary markets for issuers, investors, and intermediaries. This definition should include (i) minimum guidelines for disclosure of material information, and (ii) liability for entities involved in distributing securities and for entities handling third party investment accounts,. Investment regulations need to permit sufficient flexibility for investors, and create adequate safeguards for prudent operations and for the safeguarding of fiduciary obligations.