

ADDIS ABABA UNIVERSITY
SCHOOL OF LAW

**Warehouse Receipt System in Ethiopia: Its Legal and
Practical Significance with Emphasis on Its Role in Securing
Transactions**

By: Bisrat Mulugeta

Advisor:

Associate Professor Zekarias Keneaa
(LL.B., LL.M.)



**Submitted in partial fulfillment for the Requirements for the Degree of
Masters of Laws (LL.M.) at the School of Law**

December 2011



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By: Bisrat Mulugeta

Board of Examiners:

1. Zekarias Keneaa (Associate Professor)

Signature

Date

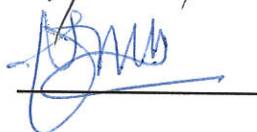


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2. Tilahun Teshome (Professor)



3. Tewdros Mihret (Ato)



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Abstract

Agriculture constitutes the backbone of the Ethiopian economy; not only it attracts 90% of the Country's export earnings but it also employs 85% of the Country's labor force. In spite of its promising potential, the agricultural marketing system is underdeveloped and it is still in its traditional rudimentary order. Lack of rural access to finance is the fundamental problem hampering production, productivity and income of rural farm household. Financial institutions consider lending to small farmers risky (due to farmers' lack of adequate collaterals) and costly (due to high transaction costs). In this Thesis, WHR system is suggested as an innovative mechanism that can rectify the marketing and financial problems of the agricultural sector by facilitating the conversion of inventories of agriculture into a readily tradable Device, commonly known as WHRs. The receipts can be used either as collateral to access credit or as channel for dealing with the underlying commodities. Generally, a well functioning system of WHRs provides higher prices, accurate weights and measures and credit to agricultural producers including smallholder farmers. It is also advantageous for lending institutions as it provides them secure & easily liquidated form of collateral.

Despite its half a century old legal rules governing the system, Ethiopia has never been able to establish an effective WHR system and reap its benefits. Among the various legal and institutional bottlenecks capping the implementation of the system in Ethiopia, lack of active supervisory/regulatory body, absence of secondary legislation supplementing the WHR System Proclamation and the National Bank of Ethiopia's Bills Market Directives (which has influenced banks to divert to long term loans) are the major ones. There are also challenges associated with the legal framework of the ECX warehousing business. In this Thesis, it is argued that besides creating conducive policy environment to the expansion of the warehousing industry, building a uniform legal framework of WHRs system that is enforced by a national regulatory body is crucial to tackle the existing challenges. Moreover, the core activities that should be performed by the government, lending institutions and other stakeholders towards realizing the implementation of effective WHR system are outlined.

Finally to highlight on the structure of the Thesis: the first chapter focuses on methodology and the second chapter provides general background of WHR system in the world and in Ethiopia. In the third Chapter the legal framework of Ethiopian WHR system is closely analyzed. The forth chapter is devoted to legal and practical aspects of collateralization of WHRs. Finally, concluding remarks of the writer are presented together with some recommendations.

Abbreviations and Acronyms

CBE – Commercial Bank of Ethiopia

CFC - Common Fund for Commodities

EBRD - European Bank for Reconstruction and Development

ECX – Ethiopian Commodity Exchange

EDI - Electronic Data Interchange

EGTE – Ethiopian Grain Trade Enterprise

eWHR(s) - Electronic Warehouse Receipt(s)

IFPRI - International Food Policy Research Institute

MoARD - the former Ministry of Agriculture and Rural Development

NBE - National Bank of Ethiopia

PLCs - Private Limited Companies

UNCTAD - United Nations Conference on Trade and Development

USAID - US Agency for International Development

WHR(s) – Warehouse Receipt(s)

Chapter one

Introduction

1.1. Background of the Study

Traditional and innovative collateral securitization mechanisms have kept on developing so as to finance the expanding global trade in agricultural commodities.¹ However, it is pretty clear that developing and transitional economies have not benefited as much from the increase in agricultural trade flows and alternative financing mechanisms as developed countries.² In Africa lack of rural access to credit has remained to be severe constraint for many farmers. Particularly the scant pre-harvest finance adversely affects the whole output of agricultural activities and ultimately push smallholder farmers into worse poverty.³ Although 73% of the population lives in the rural areas of the continent where there is high incidence of poverty, countries are not yet able to move forward in improving access to rural finance with the required pace.⁴

This is no exception for Ethiopia which is one of the developing African countries having predominantly an agrarian economy. In Ethiopia not only Small-holder farmers but also the whole agricultural market is suffering from very limited, if not at all nil, access for credit. Studies affirmed that lack of finance is one of the fundamental problems hampering production, productivity and income of rural farm households in the country.⁵ As agriculture is the back bone of the country's economy supporting about 80% of the total population,⁶ the problem of rural financing appears to be all touching. Another study has further revealed that formal financial institutions in Ethiopia don't consider the smallholder farmers constituting the large part of population as creditworthy for the reason that they can't afford the required collateral.⁷

Thus, realizing efficient, sustainable and widely accessible rural financial scheme has kept on being major obstacle of economic development for many countries in the continent including Ethiopia.⁸ Even the liberalization of the financial sector, which was hoped to make a difference

¹ The World Bank Agriculture And Rural Development Department, Rural Finance Innovations Topics and Case Studies, Report No. 32726-GLB, April 2005, pp. 6 - 7

² Ibid, p. 7

³ Gideon E. Onumah (2003), Agribusiness: Vendor Financing in Input Markets: Improving Access to Rural Finance through Regulated Warehouse Receipt Systems in Africa, Case Study, Natural Resources Institute (NRI), pp. 1 – 15

⁴ Ibid,

⁵ Sisay Yehuala (2008), Determinants of Smallholder Farmers Access to Formal Credit: The Case of Metema Woreda, North Gondar, Ethiopia, M.Sc. Thesis, Haramaya University, pp.1 -3

⁶ Federal Democratic Republic of Ethiopia Ministry of Finance and Economics Development in Conjunction with Ministry of Agriculture and Rural Development, Global Agriculture and Food Security Program - request for Funding Public Sector Window Agricultural Growth Program (GAFSP GAP FINANCING), Draft, 29th September, 2010 p. iii

⁷ Adera, A. (1995) Instituting effective linkages between formal and informal financial sector in Africa: A proposal, *Savings and Development*, pp. 5 – 22

⁸ Onumah, Improving Access to Rural Finance, Op. Cit., pp. 1- 5

in the supply of rural finance, brought virtually no change. This is mainly because formal financial institutions have become more risk averse and reduced their exposure to agriculture and the rural economy which are thought to be riskier. Among the major setbacks increasing FFIs' risk in the rural economy, lack of suitable collateral is reported to be in the forefront.⁹ In Ethiopia farmers and the agribusinesses sector in general lack traditional collateral such as physical assets and have tenuous title to the land.¹⁰ Because of this, they are not able to meet the strict requirements of banks to secure loans. The principal asset that most farmers and agribusinesses do have is their production. Hence, rectifying the problem of agricultural finance presupposes the innovation of a mechanism that can make use of the farmers' agricultural products as reliable collateral to finance farmers and the agriculture sector in general.

Warehouse receipt (WHR) system is widely accepted as the right mechanism fulfilling the required criterion. This system helps to solve the financial problem in agricultural sector by providing an alternative to traditional lending requirements of financial institutions. Properly functioning system of WHRs enables farmers to access credit against their agricultural commodity stored in licensed warehouses.¹¹

WHR system is normally part of a package of innovations designed to modernize the agricultural marketing systems. It is a scheme that is chiefly applicable to agricultural products which are subject to fluctuating price within the harvest and lean seasons. The System is an important and effective tool for creating liquidity and easing access to credit. It also offers additional benefits such as smoothing the supply and prices in the market, improving smallholder farmers' incomes, and reducing food losses.¹² WHR system can play dominant role in the development of the overall agricultural sector, by permitting smallholder farmers to hold food back to the lean season, allowing them to access markets on more equitable terms, and enhancing the efficiency of the entire commodity chain.¹³ The system is especially relevant for emerging economies¹⁴

In this complex and expeditious economic world where millions of transactions involving large amount of commodities takes place in every minute, it is too costly, inconvenient and risky to

⁹ Onumah, *Improving Access to Rural Finance*, Op. Cit., pp. 1- 5

¹⁰ See Article 3048(2) and (3) of the Ethiopian Civil Code (Civil Code of the Empire of Ethiopia, Proclamation No. 165 OF 1960) which states that a person may not offer an immovable as a security unless he is entitled to dispose of it and Article 40(3) of the Ethiopian Federal Constitution (Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia 1st year No 1, 1995) which clearly declares that the ownership of rural land is exclusively vested in the state and in the peoples of Ethiopia. Cumulative reading of the two legal provisions uncovers that farmers in Ethiopia can't collateralize their land as they have no title on to dispose it.

¹¹ The World Bank Agriculture And Rural Development Department, *Rural Finance Innovations Topics and Case Studies*, Report No. 32726-GLB, April 2005, p. 7

¹² Daniele Giovannucci, Panos Varangis, Don Larson, *Warehouse Receipts: Facilitating Credit and Commodity Markets, A Guide to Developing Agricultural Markets and Agro-enterprises*, available at: <http://ssrn.com/abstract=952596>, as retrieved on June 19, 2011, pp. 1 - 3

¹³ UNCTAD, *Review of Warehouse Receipt System and Inventory Credit Initiatives in Eastern & Southern Africa*, Final draft report commissioned by UNCTAD under the All ACP Agricultural Commodities Program (AAACP), September 2009, p. 1

¹⁴ The World Bank(2005), op cit., p. 7

undertake physical delivery of commodities at every transaction. WHR system rectifies such inconveniences by facilitating the representation of the commodity subject to transaction by a single paper. To state briefly how the system operates - the commodity intended to be transacted will be stored in an accredited warehouse and a document ascertaining the availability of the commodity be issued by the warehouseman. This document which indicates the type, grade and weight of the stored commodity is often known as Warehouse Receipt. Depending on the law of the jurisdiction, title to the underlying commodity can be transferred to a third party simply by endorsement and transfer of the receipt without the need to have any physical contact with the stored commodity. The owner of the commodity who is provided with the receipt can go to the market and deal with the commodity merely using the receipt.

As noted above, on top of its significance in making the transaction easy, WHR system is also well known for its vital role in raising money so as to meet the various exigencies of the business world in agriculture sector. In developing countries like Ethiopia low liquidity compels farmers to sell commodities right after harvest when prices are low so as to cover their working capital needs. However when there is effective WHR system, the holder of the receipt may offer the receipt as a security to get loan from financial institutions and extend the sale of commodities beyond harvest season. Put differently, WHR system enables producers, processors or traders to borrow against grain stored in licensed warehouses. It is much more convenient form of collateral than pledging the commodity itself. The lender institution merely by taking possession of the document starts to exercise pledge right on the commodity and when the situation so justifies may claim delivery of the commodity in the warehouse and dispose them towards settling the debt. WHR system can also be described as a new business for financial institutions as it provides them a new type of collateral with high liquidity and low cost. WHRs are in general basis for collateralized commodity transactions¹⁵.

In summarizing the importance of WHR system for the agricultural sector Lacroix and Panos put that:¹⁶

“The overall efficiency of markets is greatly enhanced when producers and commercial entities can convert inventories of agricultural raw materials or intermediary or finished products into a readily tradable device. Since warehouse receipts are negotiable instruments, they can be traded, sold, swapped, used as collateral to support borrowing, or accepted for delivery against a derivative instrument such as a futures contract”

Nowadays WHRs have become integral part of the marketing and financial systems of most industrial countries.¹⁷ Many developed countries across the world, including some finger counted

¹⁵ the World bank(April 2005) op. cit., pp. 8

¹⁶ Richard Lacroix and Panos (2006), Finance & Development VARANGIS, *Using Warehouse Receipts in Developing and Transition Economies*, p. 1

¹⁷ UNCTAD (2009), op. cit., pp. 49 - 52

developing and transitional economies, have been reaping manifold advantages of WHR system for long time by creating suitable environment for it.

However, the case is different for most of developing and least developed economies. In these countries, despite the fact that the system has potentially a very high socioeconomic payoff, various constraints have significantly capped the progress of the system.¹⁸

A country can enjoy the aforementioned multifarious advantages of WHR system when it is able to create, inter alia, conducive legal and regulatory environment for the proper functioning of the system.¹⁹ Without adequate legal protection it is a bit difficult to find parties willing to take part in the system. Major participators such as depositors, banks and other dealers would become reluctant to rely on the receipt representing the stored goods unless they can make sure that the receipt has strong legal protection. Hence, a robust legal environment is by and large a *sin qua non* element of effective WHR system. In addition to this, a country needs to fulfill some basic operational requirements, including but not limited to, suitable storage facility, national grading system and consistent inspection.²⁰

In Ethiopia the concept of warehousing business has been officially given legal recognition since 1960 when the modern Civil and Commercial Codes were enacted. The Civil Code designates Warehouse receipt as 'Receipts and Vouchers' whereas the Commercial Code refers it as 'Warehouse Goods Deposit Certificate'.²¹ In both of the Codes there are provisions dedicated to matters of warehousing business and WHRs, though not complete.²² Further steps were taken to fill the visible gaps in the existing Codes by enacting another new law, i.e. the WHR system Proclamation No. 372/2003, which came into force in 2003.²³ Following the enactment of 2003 WHR system proclamation an attempt was made by the government of Ethiopia to embark on pilot implementation project of national WHR system which frozen after two years.²⁴ Since 2007 ECX, a state-owned institution serving as market center for a few selected types of grain, has embarked on the operation of WHR System. Currently ECX is using eWHR for its trading activities. The Exchange is also working towards facilitating loan access to depositors taking the receipt as a security. But yet the receipt system is not as such well developed in the country In

¹⁸ Ibid

¹⁹ The World Bank (April 2005) op. cit., p. VIII

²⁰ Ibid

²¹ See Articles 2813 and 732 of the Civil Code and the Commercial Code respectively

²² Tilahun Teshome (2002), *Legal Aspects of Development of Warehouse Receipt system in Ethiopia*, *Recht in Africa*, p. 221 – 222 (This is the only journal Article written on the legal aspect of Ethiopian WHR system before the enactment of the 2003 warehousing legislation. To the best of the writer's knowledge, there is no an article written on Ethiopian WHR system after the 2003 warehousing legislation came into force.)

²³ The proclamation to provide for a warehouse receipt System No 372/2003, 10th year No. 2, Addis Ababa, 14th October, 2003.

²⁴ Interview with Ato Teshome Lema, Director of information and Control of Agricultural Marketing Directorate, at Ministry of Trade

Ethiopia where agriculture is the backbone of the economy WHR system is expected to play predominant role in the overall economic development of the country; however, the reality witnesses the contrary. Why this happened? This question leads us to the problems intended to be addressed in this research.

1.2. Statement of the Problem

Despite the efforts being exerted by ECX the WHRs system has not yet able to achieve its desired goal of benefiting farmers from the marketing and financial functions of WHRs. Agricultural commodities which are widely produced and distributed across the nation are still within the traditional frame of transaction. Farmers' access to finance has not witnessed significant improvement. The legal framework within which the Exchange is carrying on warehousing business and facilitating the use of its electronic receipts as collateral lacks clarity. The fluctuating market price of agricultural products is not regulated by market mechanisms rather by wider government intervention which is again traditional. These interventions tend to send confusing signals to farmers and the traders, discouraging intensification and investment in the warehousing business and throughout the agricultural value chain.²⁵ Lending Institutions, except Commercial Bank of Ethiopia, have not yet begun providing loans holding WHR as collateral.

The fact that the nation's economy is agriculture led, coupled with its political economy which is claimed to promote free market economic system make the aforementioned problems more pressing. This research attempts to explore the legal and practical perspectives of the problems and come up with possible solutions that foster wider use and expansion of WHR system in the country. To be more specific, the research is aimed at addressing, inter alia, the following major research questions:

- What are the legal and practical significance of WHR system in Ethiopian economy?
- What are the legal and institutional bottlenecks capping the implementation and expansion of WHR system in Ethiopia?
- What are the key requirements for implementation of viable WHR financing system in Ethiopia?
- What is the legal base for the warehousing activities of ECX? Is it authorized by law to launch WHR financing scheme using its receipts?
- Are the financial institutions of Ethiopia comfortable with the concept of WHR financing system?
- Do the financial institutions of Ethiopia start providing loan taking WHRs as reliable collateral? If not? Why not?

²⁵ UNCTAD (2009), op. cit., pp. 49 - 52

1.3. Objectives of the study

The research is generally aimed at illuminating on the legal and practical aspects of the Ethiopian WHR system by focusing on its role as a mechanism of securing transaction. It also explores the legal and practical significance of realizing wider use of the System in Ethiopia.

Accordingly, the following specific objectives are intended to be achieved in this research

- exploring legal and practical significance of warehouse receipt system in Ethiopia;
- uncovering recent developments in the WHR system and its incorporation into the modern market system;
- portraying the strong integration of WHR system with the modern commodity exchange system introduced by ECX;
- closely analyzing the legal provisions regulating the WHR system in Ethiopia and make a comparison with the current changes in the world when necessary;
- shedding light on the importance of WHR financing system to the agriculture sector with emphasis on its implication on smallholder farmers;
- identifying the key requirements for the implementation of viable WHR financing system in Ethiopia;
- examining the legal basis for the current application of WHR Financing system under the umbrella of ECX;
- identifying principal stakeholders of the WHR system along with their role in building effective receipt system;
- examining the willingness of Ethiopian lending institutions to recognize WHRs as secure collateral; and finally
- putting forward major steps that should be taken by the government of Ethiopia and other stakeholders so as to realized the implementation an integrated national WHR system.

1.4. Significance of the study

The study enables to make out the current status of the application of Warehouse Receipt system in the agricultural sector of Ethiopia and its role to the economic development. The benefit of the system to smallholder farmers, constituting the majority of the country's population, will also be portrayed. It further depicts the existing opportunities to foster wide use of the system across the nation and actual challenges that may impede the expansion of the system with their possible solution.

The findings of the research besides their academic significance are hoped to give some lesson to the concerned government authorities and other stakeholders on how to enhance the economic benefits of WHR system in Ethiopia and scale up its role in the nation's economic development. To the best of the writer's knowledge, there is no comprehensive research work done on Ethiopian WHR system after the 2003 warehousing legislation came into force. Because of this, most of the legal and practical issues pertaining to the WHR system of Ethiopia have remained to be uncharted. This work is believed to contribute some in rectifying the serious dearth of materials on the area. It may also serve as an important stepping stone to further studies.

1.5. Research Design

The research is done by employing Qualitative research method. This method is selected because of the explorative nature of the statements of the problem and the overall subject matter of the study.

1.5.1. Subjects and participants of the study

The core subjects of the study have been the legal provisions regulating warehousing business and WHRs in Ethiopia, The WHR financing scheme designed under the umbrella of ECX, the Ministry of Trade, the Ministry of Agriculture, Ethiopia commodity Exchange Authority, banks and nonbank lending institutions and Ethiopian Grain Trade Enterprise (EGTE). The participants of the study have been representatives from legal experts on the area, the individual farmers, private and public banks and micro financing institutions.

1.5.2. Sampling size and Sampling technique

A minimum of two representatives have been selected from each subject and participant based on purposive sampling technique. The selection has been undertaken primarily taking into account the experience, position, expertise and other attributes of the individuals the study demands.

1.5.3. Data gathering instruments and techniques of Analysis

The following instruments have been employed to gather the qualitative and quantitative information used in the thesis:

- Two rounds Structured and in-depth Interviews;
- Observation of selected warehouses and
- Content analysis of relevant domestic laws, Reports of National Bank of Ethiopia and other international organizations, and foreign literatures

The data collected via the aforementioned instruments are analyzed qualitatively. While analyzing the data the writer has also consulted the experience of some countries which are selected purposefully. Among the countries selected, Uganda, Ghana and South Africa were taken for their relatively similar agricultural environment with Ethiopia. Other developed countries' experiences such USA, Canada and other European countries were consulted to draw lesson from their best practices in implementing and utilizing effective WHR system and come up with better way outs for the problems in our system.

1.6. Scope and Limitations of the Study

The scope of the study is limited to legal and practical aspects of WHR system in agricultural sector of Ethiopia. Stated otherwise, detail economic analysis of the system is entirely beyond reach of the study. Domestic and foreign Laws governing the matter and literatures as well are analyzed to see the compatibility of Ethiopian Laws with the recent changes in the world. The opportunities and challenges in fostering wider use of WHRs in Ethiopia are also issues endeavored to be addressed in the study.

The most serious limitation of the study was indeed lack of adequate literatures on the area. Particularly at the domestic level it is only one journal article which has been at the disposal of the writer.²⁶ In view of tackling the serious challenge of dearth of materials, the writer has used workshop papers presented in Ethiopia and neighboring countries which are on the same battle for implementation effective WHR system. In addition, the fact that the system is at its nascent stage couldn't enable the writer to cite practical cases while elaborating the legal provisions. Particularly no practical case was found on negotiation of WHRs. Thus, the only option left for the writer was to focus on discussing the legal provisions by comparing with other legal jurisdictions and suggest necessary amendments.

²⁶ See Teshome (2002), *op. cit.*

Chapter Two

General Background of WHR System and Its Development in Ethiopia

2.1. Definition, Nature and Function

2.1.1. Definition and Nature

Warehouse Receipt (WHR) is a piece of paper or electronic document issued by an accredited warehouse upon taking delivery of commodities to be deposited in its own storage facility or, in the premises of the depositor but kept under the warehouseman's direct control²⁷. It is also defined as a certification of legal ownership of the warehoused commodity.²⁸ The receipt can be understood as a document that state the ownership of a specified quantity of commodities with specific characteristics and stored in a specific warehouse.²⁹ By virtue of the receipt the warehouse operator affirms that he has held commodities which belong to the depositor whose name appeared in the receipt.

Coulter and Onumah defined WHRs as “documents issued by warehouse operator as evidence that specified commodities of stated quantity, quality and grade, have been deposited at particular locations by named depositors”³⁰ According to Coulter and Onumah, while issuing the receipt the warehouse operator has to incorporate, *inter alia*, the major specifications enabling to identify the deposited commodity, the place where it is deposited and the identity of the depositor. In fact the basic elements not to be missed in WHRs vary in different jurisdictions. However, as the WHR is commonly taken as a contract of bailment between the owner of the commodity and the warehouse operator, it should at least incorporate the major rights and obligations of the contracting parties therein. Accordingly, not only must the receipt incorporate the quality, quantity and grade of the commodity the warehouse operator owes to the depositor, one may also suggest that the receipt should incorporate the rate of storage fees and service charges due to the warehouse operator. Whatever the content may be it is worth capitalizing that the receipt primarily evidences the fact that the commodities are delivered to the warehouseman who issued the receipt.

²⁷ The warehouse operator may not necessarily use its own storage facility to deposit the commodities. For example in filed warehousing the warehousing company uses the premises of the depositors as a warehouse and exercise direct physical control over the commodities stored.

²⁸ Rick Andrews, Rob Munro, and Mike Filed (2007), Building a Warehouse Receipt Program That Works for All Stakeholders, Notes from the Field No. 1, available at [www. BusinessGrowthInitiative.org](http://www.BusinessGrowthInitiative.org), retrieved on 13th June, 2011, p. 1

²⁹ Giovannucci, Varangis, and Larson, Warehouse Receipts, p. 1

³⁰ J. Coulter and G. Onumah (2002), The Role of Warehouse Receipt Systems in Enhanced Commodity Marketing and Rural Livelihoods in Africa, Natural Resources Institute, Food Policy, Vol. 27 p. 323

In Ethiopia, a legal framework for WHRs was designed five decades ago when the Civil and Commercial Codes were enacted. Different terms have been employed by the Codes to refer to WHRs. The Commercial Code refers WHRs as “Warehouse goods deposit certificates”³¹ while the Civil Code used the words “Receipts and Vouchers”. Per Article 2813 of the Civil Code, a WHR constitutes two documents known as Receipt and Voucher. A person is entitled to full ownership over the underlying deposited commodities when he holds both documents. The Commercial Code under its Article 732(2) and 715(2) recognizes the receipts as negotiable commercial instruments. Despite setting forth such general remarks on the nature of WHRs none of the Codes provide a distinct definition for WHR.

A clear legally binding definition has been provided to WHRs only under the WHRs System Proclamation that came into force in October 2003.³² Article 2(20) of the Proclamation defines WHRs as:

“a written acknowledgment drawn in accordance with this Proclamation [i.e. Proclamation No 372/2003] and issued by a warehouseman purporting receipt of goods belonging to another for storage and includes electronic warehouse receipts”

The definition underscores that the receipt is an evidence for delivery of the goods to the warehouseman. Unlike the provisions of the Civil Code, the Proclamation requires for the issuance of a single document (WHR) which entitles the holder with full ownership right over the underlying commodities. Put differently, the WHR serves as a document of title. The definition under the Proclamation goes further to recognize electronic WHRs too, in line with the demand of electronic commerce (e-commerce) which is becoming integral part of the modern economy. Inevitably, the receipt needs to be issued in accordance with the Proclamation so as to apply the above definition. The details related to the content and issuance of the receipt will be dealt with in chapter three of this paper.

2.1.2. Functions of WHR system

Nowadays, WHR system is widely accepted as a very important tool for the development of agricultural sector across the globe.³³ Well functioning system of WHRs leads to an increase in the availability of credit, reduce its cost, and mobilize external financial resources for the agricultural sector.³⁴ It helps to reduce the strong price fluctuations prevalent throughout the year by injecting more planning into the marketing system. WHRs system also has pivotal role in the

³¹ Article 732(3) of The Commercial Code of Ethiopia

³² The WHR System Proclamation Op. Cit.,

³³ Höllinger, F., Rutten, L. and Kiriakov, K. (2009) *The Use of Warehouse Receipt Finance in Agriculture in ECA Countries*. Technical background paper for the World Grain Forum 2009, St. Petersburg, Russian Federation, Supported by FAO/World Bank and FAO/EBRD Cooperative Programs pp. 14 - 15; see also Si Matthies and Kiriakov (2009), Op. Cit. pp.8 - 13

³⁴ Richard Lacroix and Panos Varangis (1996), *Using Warehouse Receipts in Developing and Transition Economies*, Finance and Development, pp.36 -37

creation of modern commodity markets which enhance competition, market information and international trade.³⁵ Moreover, the receipts lay the foundation for more sophisticated products, such as derivatives and hedging contracts.³⁶ By so doing WHR system can facilitate the transformation of agricultural market into modern trading system and accelerate economic growth. The system can also provide a way to gradually reduce the role of government in agricultural market and improve food security.³⁷

The system of WHR typically involves three parties: the depositor, the warehouse operator and lending institutions (typically Banks and Microfinance Institutions).³⁸ Producers/Farmers participate in the system seeking for higher prices, accurate weights and measures and credit. Lending institutions, on the other hand, involve in the system seeking for secure & easily liquidated collateral. In an effective WHR system, producers/depositors deposit a finished good or agricultural product in an accredited warehouse and receive a receipt certifying the deposit of goods of a particular quantity, quality, and grade.

The depositor can use the receipt as a form of portable collateral to request a loan from a lending institution. By so doing, the farmers having WHRs in their hands can immediately ease their cash constraint without the need to dispose their products. Alternatively, the producer may also use the warehouse as a channel for selling the goods. In this case the goods in the warehouse are released to the buyer, the loan and fees are deducted from the selling price, and finally any remaining profits go to the depositor's pocket. Alternatively, the depositor is also at liberty to regain control over his produce on the condition that he repaid the bank for the loan (principal plus interest), if any, and the warehouse operator for any storage fees.³⁹

³⁵ Daniele Giovannucci, Panos Varangis, and Don Larson, Warehouse Receipts: Facilitating Credit and Commodity Markets, A Guide to Developing Agricultural Markets and Agro-enterprises, available at: <http://ssrn.com/abstract=952596>, as retrieved on June 19, 2011, 1 - 3

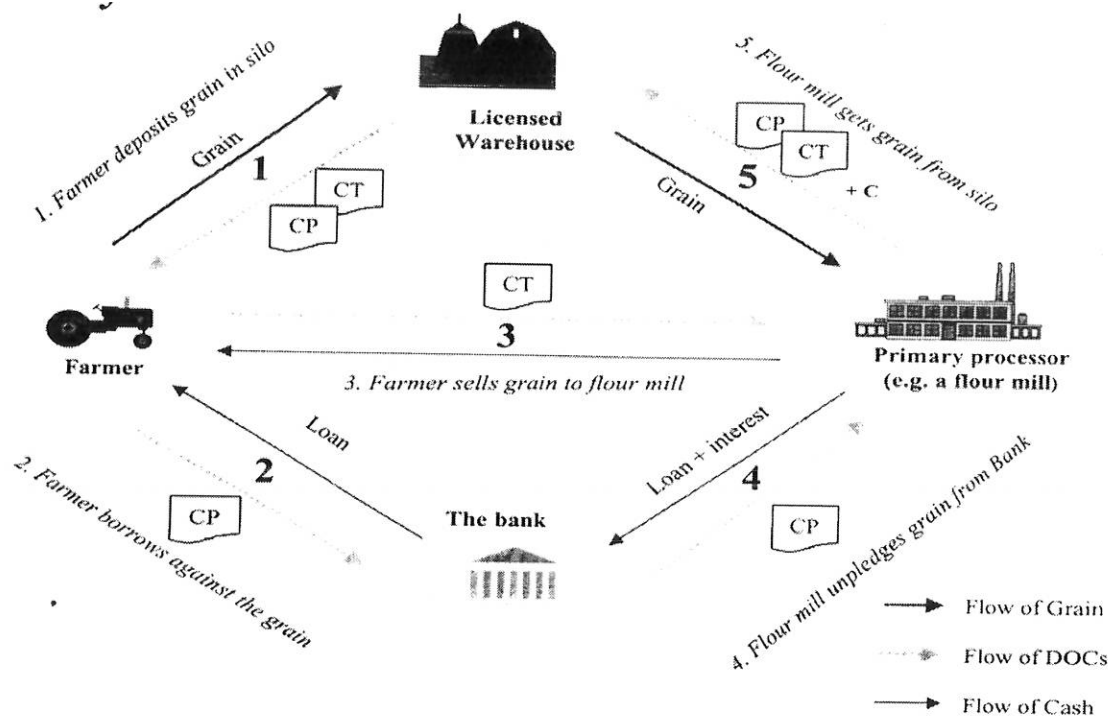
³⁶ The World Bank Agriculture And Rural Development Department, Rural Finance Innovations Topics and Case Studies, Report No. 32726-GLB, April 2005, pp. 11 -12

³⁷ Giovannucci, Varangis, and Larson , Warehouse Receipts, op. cit.

³⁸ The depositor may be a producer, farmer group, trader, exporter, processor or any other individual or body corporate.

³⁹ Bryde, Peter, and Eusebio Martin (1999), "Grain Receipts in Economies in Transition: An Introduction to Financing Warehouse Receipts," In Agricultural Finance and Credit Infrastructure in Transition Economies: Proceedings of OECD Expert Meeting, Moscow, February 1999, Paris and Washington, DC: Organization for Economic Co-operation and Development (OECD)

The following figure depicts how the system of WHR operates



Source: Bryde and Martin (1999)⁴⁰

In many jurisdictions WHRs have been serving two core functions. The first one is that they can be used to deal with the underlying stored commodity, i.e. marketing function. Secondly, they may also be offered as collateral by the depositor/holder to secure different transactions. Everberg described the function of WHRs stressing on the former as follows:⁴¹

“A receipt evidences the existence of the goods; it describes, identifies and locates them. The warehouseman can as conveniently deliver them to one person as another. What easier way could parties devise for the transferring of title to goods with great facility and certainty than by a transfer of the receipt in such a way that the warehouseman must hold the goods for the transferee? Without the moving of a barrel or a bale, without the lifting of a pound of material, but by the mere scratch of a pen, an owner of goods is able to pass title to another to thousands of tons of goods occupying enormous areas in tremendous warehouses, some of which may be located in the most distant sections of the country.”

⁴⁰ Bryde, Peter, and Eusebio Martin (1999), op. cit. pp.

⁴¹ C. E. Everberg (1949), The Warehouse Receipt – Credit Security and Financing Device, 54 Com. L. I., p. 51

The quotation above uncovers the manifold advantages of WHRs particularly related to the commodity market. However, it should be noted that the use of WHRs either as a pledge or as a device of transferring title to the stored goods was not free of challenges. There were debatable legal issues pertaining to the validity and extent of the rights conferred by the receipt. In English Common Law Legal System, different cases relating to the function of the receipts were presented to the courts and disposed in a manner that acknowledges equivalent status of WHRs with that of the stored goods they represent.

The *Zwinger V. Samuda*⁴² Case was among the prominent cases in which the courts clearly addressed the question whether the property rights in the stored goods can be transferred by the receipt or not. In the said case the litigation was between a purchaser of stored goods who is in possession of the WHR representing the goods and a pledgee of same goods who relinquished his possession of the receipt. Both parties demanded delivery of the stored goods and finally the dispute was brought to a court. The court decided in favor of the possessor of the receipt, i.e. the purchaser, reasoning that the use of these documents to sell or pledge goods was prevalent and was not an inconvenient practice.

In another similar case of *Lucas v. Dorrien*⁴³, the depositor of goods in a warehouse went bankrupt after pledging the dock warrant for a loan. The trustee of the bankruptcy proceeding sought to recover the goods deposited in the name of the bankrupt but pledged for a loan. In resolving the dispute between the pledgee and the trustee the court reasoned that transfer of the receipt to the pledgee marks that the possession of the stored goods was taken away from the bankrupt; hence, the claim of the trustee has no valid ground. Here one can understand that possession is an important incident to prove pledge in common law tradition. The court further stated in its reasoning that⁴⁴

“All special juries cry out with one voice, that the practice is, that the produce lodged in the docks is transferred by endorsing over the certificates and dock warrants, and therefore there is no reputed owner, if he doesn't produce his certificate”

The two common law cases, which were disposed in the early 19th century, corroborated pivotal role of WHRs in commodity market serving as a document of title since the old days. In Ethiopia also the receipts are now being used in the modern commodity exchange market system that has been put in place by ECX.⁴⁵

⁴² As cited by Michael J. Vaughn (1968), Warehousing Security Transactions: Progeny of Twyne's Case, Baylor Law Review, Vol. XX, No 1, p. 9

⁴³ Vaughn (1968), op. cit., p. 8

⁴⁴ Ibid, p 9

⁴⁵ Proclamation No 550/2007, A Proclamation to Provide For The Establishment of The Ethiopian Commodity Exchange, Federal Negarit Gazeta 13th year No 61, 14th September, 2007, See Article 6(5)

As hinted above, WHR also plays an important role as a security device. In this regard, Rudd noted the following some fifty years back:⁴⁶

“The warehouse receipt ... is a convenient form of security which the holder or owner may transfer to a lending institution to secure the repayment of a loan needed to finance his commercial operations; it is a form of pledge much more convenient than a pledge of the goods themselves.”

In the modern economy too, WHRs have remained to be highly preferable form of security devices, particularly in the agriculture sector which usually suffers from lack of convenient form of collateral. WHRs allow agricultural producers, processors and traders to obtain flexible working capital by offering their farm products stored in licensed warehouses as security. In this respect, WHRs are mentioned as an innovative mechanism that enable small scale famers escape the cheap price of the harvest season and simultaneously access fund by using their stored agricultural product as loan collateral.⁴⁷ To put it plainly, WHR system permits farmers to extend the sales period of modestly perishable products well beyond the harvesting season. It also creates price transparency which enables farmers to make informed sales decision rather than merely handing over their products to “farmgate” buyers/intermediaries who often offer below-market prices.⁴⁸

WHR system plays a crucial role in upgrading the standards and transparency of the storage industry. The warehouses operating in the system will be made subject to regulatory regime by which their day to day activities can be inspected. The expansion of the storage facility is also believed to provide the agribusiness with efficient crop collection points at which large volumes of crops may be handled in the most cost effective manner. Furthermore the use of WHRs in the agriculture sector lowers transaction costs by guaranteeing quantity and quality of stored goods. It also encourages the development of national quality measurement standards for agricultural products.⁴⁹

The advantages of WHR system are not limited to farmers/depositors. Other parties involved in the system also share the benefits out of it. Obviously the warehouse operator enjoys the new warehousing business opportunity created by the system. Lending institutions like Banks can minimize their risk as the system provides them collateral that can retain a high commercial value and be liquidated quickly. The operation of WHR system in some African countries, such as Ghana and South Africa, has benefited both financial institutions and farmers.⁵⁰ Not only lending institutions benefited from high loan repayment rate, but also farmers reaped higher

⁴⁶ IM. H. Rudd (1962), Analyses of Article 7 of the Uniform Commercial Code Texas Legislative Council, Austin, Texas (As cited by Vaughn (1968), op. cit., p. 2)

⁴⁷ Vaughn (1968), op. cit., p. 8

⁴⁸ Ibid

⁴⁹ Giovannucci, Varangis, and Larson , Warehouse Receipts, op. cit.

⁵⁰ Innovations in Microfinance (2000), Op. Cit., p.5

profits by increasing their possible selling prices by as high as 230 percent.⁵¹ WHRs have clear advantages for both farmers and lending institutions of the rural regions across Africa. First the producers can gain access to standard storage facilities and get rid of post harvest losses due to backward storage facilities. Secondly they can maximize their profits as never before by using the WHR as collateral to access finance. The use of the receipt as collateral for loan minimizes the risk for lending institutions and opens up a new client segment that the institutions hardly reached before.⁵²

The Ethiopian WHR system, as outlined in the preamble of the 2003 Warehousing Proclamation, is intended to achieve certain objectives. To begin with, it is aimed at easing farmers' access to credit by offering the inventories as collaterals to lending institutions.⁵³ Secondly, it promotes the transfer of title to the stored goods by simple delivery of the WHR representing the goods. It is further aimed at maintaining the supply and demand balance of agricultural products in the market and protecting producers from price shocks. Finally, the significant role of WHR system in promoting financial activities is not overlooked under the proclamation.⁵⁴ In a nutshell, though the WHR system of Ethiopia is not designed to the exclusive benefit of the agricultural sector, from the reading of the preamble and Article 4 of the Proclamation one can effortlessly comprehend that promoting and improving such sector is the central role the system is intended to play in the country. And, the fact that Ethiopia's economy is predominantly agrarian seems to justify such policy direction.

2.2. Different Approaches to Warehousing Business

It is apparent that developing a system of WHR presupposes modern, well equipped and large size Warehouses. The warehouses may employ various approaches to operate the business. The warehousing businesses can be classified based on their approach. Each type of warehouse provides its customers with a different range of security and services. The major types are briefly described below.

1. Public warehouses

The term public in this context never connotes public ownership; it rather implies that such warehouses are open to anyone on a non-qualifying basis.⁵⁵ Put differently, whosoever wishes to bring in agricultural commodities may store them in a public warehouse. Public is used here to refer to the fact that the warehousing company stores goods on behalf of the public in general.

⁵¹ Ibid

⁵² Ibid pp. 8-9

⁵³ The WHR System Proclamation, Op. Cit., paragraph three

⁵⁴ The WHR System Proclamation, Op. Cit., paragraphs one, two and four

⁵⁵ This is to mean that such type of warehouses provides their storage service to the public at large and they aren't allowed to make discrimination among depositors. But it doesn't mean that the warehouse operators cannot put uniformly applicable criteria as to matters such as type and minimum weight of the commodity they receive for storage. (See footnote 30)

Though public warehousing service is open to deposits by all-comers, including traders, millers, public agencies and others, farmers are often the leading users of the service.⁵⁶ Four alternative approaches may be utilized for operating public warehouses. These are Unregulated independent 'elevators'⁵⁷; Warehouses regulated by the State; Warehouse regulated by a trade body⁵⁸, and; Bulking by private trade intermediaries^{59, 60}.

In principle, only public warehouses can provide WHRs of use for international trade.⁶¹ Banks usually prefer receipts issued by public warehouses.⁶² That is because these warehouses are believed to be independent storage facility providers where the owners act only as custodian of the stored goods and has no interest on the goods except service charge. This has enabled the warehouses to engender confidence, ensure fair treatment of the parties, and enhance integrity of the system.⁶³

2. Private warehouses

Among the various alternative approaches of expanding warehousing services one may be developing it along the 'private' lines, where it primarily serves as a means by which private traders and processors raise finance and potentially turn their own stocks into tradable instruments.⁶⁴ Private warehouses are storage service providers that don't accept deposits from whosoever wishes to deposit. In private warehousing, there is a close relation between the warehouse and the owner of the stored commodities and it is somehow difficult to prove actual subsistence of the bailment relation expected to exist between the owner and the warehouse operator.⁶⁵ This type of warehousing service is provided by collateral management companies, such as international and local inspection companies, freight forwarders and others holding stock

⁵⁶ UNCTAD (2009), Review of Warehouse Receipt System and Inventory Credit Initiatives in Eastern & Southern Africa, Final draft report commissioned by UNCTAD under the All ACP Agricultural Commodities Program (AAACP), p. iv

⁵⁶ Ibid p. 2

⁵⁷ The difficult policy environment caused by politically sensitive nature food crops sometimes trigger few large trading companies to make an attempt towards providing their own warehousing services on an unregulated basis. See UNCTAD (2009), op. cit., p. 1 - 3

⁵⁸ The Eastern African Grain Council (EAGC) is can be typical example of Systems regulated by trade bodies. To date, EAGC's certified warehouses are confined to Kenya only. Nonetheless, given the broad base of membership of the organization, it is believed to have best prospects for success in evolving into a uniform system covering a large part of Africa. See UNCTAD (2009), op. cit., p. 2 - 5

⁵⁹ This approach is applicable in a situation where there is no policy framework that favors the establishment of a regulatory framework for warehouses. In such scenario, the development of bulking by private trade intermediaries provides an opportunity for farmers to store their products, and eventually it may evolve into a regulated system. Currently, there are initiatives in Malawi to develop a warehouse system of such approach.

⁶⁰ UNCTAD (2009), op. cit., pp. 1- 6

⁶¹ Ibid, pp. 30 - 33

⁶² J.O. Fabunmi (2002), op. cit., pp. 1 - 5

⁶³ Ibid, p. 11

⁶⁴ UNCTAD (2009), op. cit., pp. 100 -101

⁶⁵ UNCTAD (1996), op. cit., pp. 30 - 33



for third parties. Currently, most of the warehousing activities in Africa fall within this category of warehouses.

3. Farmers-focused warehouses

These are warehouses providing storage and financing services almost exclusively to agricultural commodities deposited by farmers. Unlike public and private warehouses, farmer-focused approach is not basically intended to commercial purpose. The objectives of this type of storage facilities are often either supplying local food needs in rural areas or bulking products prior to taking to market. Farmers-focused approach can be put into operation in three different approaches namely, Cooperative approach, supported by bank lending; Microfinance-linked approach, where the rural storage is financed by local microfinance institutions, and; Technological improvements in rural storage. Among the three, Microfinance-linked approach has been pragmatically proved to work well in the experience of Madagascar.⁶⁶ The approach turned out to be highly successful in Madagascar mainly because it is integrated into a structured microfinance network which can provide necessary management and financial support.⁶⁷ It is also recommended that countries of East and Southern African countries, including Ethiopia, should work on assessing on how they can adapt Malagasy approaches to rural microfinance and inventory credit to their own circumstances.⁶⁸

4. Field Warehousing

As the name implies, Filed warehousing is a storage facility rendered by setting up a warehouse 'in the field' – that is in the owners premises, other than using the warehouses already existing the warehouseman's premises. The system of Field warehousing is mentioned for serving as best type of collateral that filled the gap created after the great Economic Depression when survived manufacturers found themselves in difficulty to furnish the usual security to access new credit or capital.⁶⁹ Manufacturers who were not in a position to provide satisfactory security, but have a large stock of raw materials awaiting manufacture, got the opportunity of accessing loan by offering as collateral portion of their premises containing the materials to a warehouse company. And, this is what is called Field Warehousing. Once a WHR is issued by Filed warehousing companies Banks didn't show any reluctance to finance the receipt apparently because the system protected them. The pledge of the WHRs was just as effective as would be a pledge of the goods themselves.⁷⁰

Yet the concept of Field Warehousing has come into prominence in the late 19th century when the goods to be stored got larger and more difficult to move to warehouses.⁷¹ As stated above, in

⁶⁶ UNCTAD (2009), op. cit., pp. 1 - 4

⁶⁷ Ibid

⁶⁸ Ibid, pp. 5 - 6

⁶⁹ Daniel M. Friedman (1942), Field Warehousing, Columbia Law Review, Vol. 42, No. 6 Columbia Law Review Association, Inc., pp. 991-1013

⁷⁰ Friedman (1942), op. cit., pp. 991-1013

⁷¹ Vaughn (1968), op. cit., pp. 20 – 26

a field warehousing, the goods need not be moved to the warehouse but the warehouse operator itself goes to the place where the goods are situated.⁷² Field Warehousing can be described as a storage service provided in the clients' premises, normally to enable the client to obtain financing against stock held there. The warehouse operator leases the premises for a nominal fee and is responsible for control of the commodities used as collateral.⁷³ Though there is no removal of the goods from the owner's premise, separation is inevitable. The warehousing Company is also required to segregate the premise containing the goods warehoused from the reminder and post numerous signs indicating its possession to the public. The company further places placards on the warehoused materials and put a custodian in charge of the goods.⁷⁴

In contrast to other types of warehousing, field warehousing is aimed at finance not storage.⁷⁵ It has developed in many jurisdictions as a security device which enables the borrower to deliver to the lender legally valid documents of title and to grant a possessory pledge of goods stored in the borrower's own plant, mill, refinery or warehouse. Here the operator manages a warehouse on the premises of another business. This usually occurs in industries such as milling or cotton spinning where the industry finances the acquisition of raw materials, while someone else, i.e. collateral managers, controls the stock for the bank. In France, Belgium, and many Latin American countries, field warehousing continues to be widely accepted as a practical and safe security device⁷⁶

5. Trading warehouses

Warehouse operator under this category of warehousing service trades the stored commodity on behalf of the depositor. This perhaps creates a conflict of interest for the warehouse operator; however such approach of warehousing has operated successfully in North America for many years.⁷⁷ In contrast to the North American experience, in the Latin American countries, which adopted the civil law countries' approach of developing WHR system, licensed warehouses are not normally allowed to trade in stored commodities as this is deemed to create unacceptable conflict of interest.⁷⁸

Among the various categories of warehousing businesses portrayed above, Ethiopia has adopted the public warehousing type which is regulated by the state.⁷⁹ This approach is mainly built on the experience of North America and proved to work effectively in the countries like South

⁷² Forestier, *et al.* (2004), Special Study, op. cit., p. 1

⁷³ UNCTAD (2009), op. cit., p. 1

⁷⁴ Friedman (1942), op. cit., pp. 991 - 1013

⁷⁵ *Ibid*, pp. 1012 -1013

⁷⁶ Forestier, *et al.* (2004), Special Study, op. cit., Appendix - I

⁷⁷ *Ibid* p. 2

⁷⁸ UNCTAD (2009), op. cit., pp. 13 - 14

⁷⁹ In addition to the various provisions of the WHR System Proclamation which clearly depicts that the system is state-regulated, Article 32(1) of the same proclamation, which provides that elevators having free space shall always be willing to receive all suitable goods for which they are licensed to warehouse, can be mentioned as another concrete evidence showing Ethiopian receipt system is designed based on 'public warehousing approach'.

Africa, Philippine, Bulgaria, Kazakhstan and North American countries.⁸⁰ Of course, selecting the one that best fits to the context of Ethiopia obviously requires further multidisciplinary studies on the area. Generally it is agreeable that all types of the warehousing services are desirable since they can cause value chains⁸¹ to operate more efficiently. But yet, as said before, foreign experiences depict that public warehousing is more open system favoring a large number of suppliers. Licensed public warehousing is also preferred by Public sector buyers like World Food Program (WFP) and national parastatals for it enables them to require delivery simply in the form of WHRs issued by such warehouses.⁸² Based on this, one may validly contend that Ethiopia has rightly chosen the warehousing approach that lays down the foundation for the development effective and viable system of WHR. At the same time, it is the view of the writer that conducting researches on the applicability of the rest in Ethiopia also deserves accentuation.

2.3. Genesis and Development of WHR System

2.3.1. Historical Origin

The genesis of grain WHRs traces as far back to the Mesopotamian civilization of 2004 B.C when they were used for the first time.⁸³ Apart from this, the evolution of WHRs in the common law legal system partly based itself on the usage of bill of lading. Since old days difficult to determine precisely there was a custom of issuing bill of lading for goods on carriage.⁸⁴ Dealing with such bill in place of the goods was also a common practice. Shippers and merchants used to validly transfer and pledge the underlying goods just by using the bill of lading. This custom of the shipping industry was to some extent incorporated into the body of Common Law by judicial decision. But yet since the practice was not well established by usage and custom it would be safer to state only that the transfer and pledge of the bills was long stayed practice among the parties involving in the shipping industry other than concluding it was truly integral part of the Common Law.⁸⁵ And, there was evident inclination on the part of both the judiciary and parties involved towards dragging same status and usage of bill of lading to that of WHRs.

Despite these closely similar usages, it is a widely held view that WHR system emerged as part of the modern business transaction in the western world in the 19th century. In 1803, one of the oldest British dock company, known as West India Dock Company, was founded and started operating warehousing business extensively. The company provided storage facility to goods awaiting shipment and large quantities of imports. The dock company is among the oldest

⁸⁰ UNCTAD (2009), op. cit., p. 37

⁸¹ Kaplinsky et al. defined this concept as follows: a value chain “describes the full range of activities which are required to bring a product or service from conception through the different phases of production (...), delivery to final consumers and final disposal after use” See Kaplinsky, Raphael, and Morris, Mike (2001), A Handbook for Value Chain Research, Report Prepared for IDRC (as cited by Dorothee Löttscher (2010), Essay in Development Policy: Inventory Credit in Value Chain Development – Access to liquidity for rural poor, NADEL MAS cycle 2008-2010, p. 5

⁸² UNCTAD (2009), op. cit., pp. 100 -101

⁸³ Vaughn (1968), op. cit., pp. 1 - 6

⁸⁴ Ibid

⁸⁵ Ibid

warehousing companies known for introducing and supporting WHR system. The company used to issue dock warrant to the goods in its storage and when such warrant is transferred to another person the company wasn't hesitating to deliver the goods to the transferee. Though the validity of transfer and pledge effectuated by using the warrant had been subject to legal controversies it is undeniable fact that the company took considerable steps in facilitating the use of WHR to transfer the title to the underlying goods.⁸⁶ Eventually the transfer and pledge of goods merely using the receipt representing them had been established by Case Laws in England though challenged again by judicial decisions rendered later on.⁸⁷ However, in response to the call of pragmatism, the English parliament enacted laws formally institutionalizing the WHR system in the early 1990s. The laws also recognized WHR, thought to a limited scope, as a document of title.⁸⁸

In the US, warehousing business emerged in its modern pattern when Chicago was changed from a fur trading village to a commodity-trading metropolis in the mid 19th century.⁸⁹ It was around this period the development of the steam navigation and railways, coupled with invention of the telegraph greatly stimulated a massive flow of grain from American Mid-West to the East Coast and eventually to Europe.⁹⁰ Following this, large scale of steam-powered 'elevators' and multi-storey buildings were built to store in bulk the grains brought by farmers and other suppliers, prior to sale and onward shipment. The storage service providers also used to issue tradable WHRs against the stock.⁹¹

The receipt system facilitated futures trading and ultimately oiled the wheels of the market chain to great extent. In the late 1860s, the elevators' acts of over grading, and issuing receipts for stocks they did not hold, *inter alia*, called for regulator's attention to the sector in the US.⁹² In early 20th century, the US Warehousing Act of 1916 together with related State Acts created a regulatory regime for the whole system, covering agricultural warehousing, grades and standards, and commodity exchanges. The regulated system of WHR kept on growing rapidly not only in USA but also in the rest of the world. In 1998, the number of warehouse operators in USA had drastically increased to almost 12,000 with a fixed storage capacity of 230 million tons. From these warehouses about one third was owned by cooperatives.⁹³

⁸⁶Cases of *Lucas v. Dorrien*, *Zwinger V. Samuda*, *Keyser V. Suse*, *Spear V. Travers*. In deciding these cases judges of the common law courts attempted to treat WHR just like bill of Lading. (as cited by Vaughn (1968), op. cit., pp. 1 - 6)

⁸⁷Vaughn (1968), op. cit., pp. 6 - 11

⁸⁸The Factors Act of 1889 and the 1893 Sale of Goods Act (as cited by Vaughn (1968), op. cit., pp. 13 - 15)

⁸⁹Cronon, W. (1992), *Nature's Metropolis: Chicago and the Great West*. Norton: New York and London (as cited by UNCTAD (2009), op. cit., pp. 17 - 18)

⁹⁰Ibid

⁹¹Ibid

⁹²During this period, the State of Illinois, one of the member states of US Federation located in the North Central part of the country, was enacting laws to regulate the expanding service of elevators or warehouse operators.

⁹³UNCTAD (2009), op. cit., pp. 12 - 13)

2.3.2. Expansion of WHR system: A general survey

At present WHRs are an integral part of the marketing and financial systems of most developed countries. The overall efficiency of markets in the agribusiness sector is greatly improved when producers and commercial entities can convert inventories of agricultural products into a readily tradable device. As WHRs are often negotiable instruments, they can be traded, sold, swapped, used as collateral to support borrowing, or accepted for delivery against a derivative instrument such as a futures contract.⁹⁴ That's why they have become a fairly mainstream in the developed world.

However, it is unfortunate that the system has not yet been widely used in many developing and transition economies. This happened to be true mainly because of institutional and structural shortcomings. Lack of incentive to development of private warehouses; government intervention in the market; lack of apt legal, regulatory and institutional environment for the system; and very little or total absence of awareness about the merits of the system are among the major obstacles which should never be left unmentioned in this connection.⁹⁵

Yet, there are considerable number countries from among the developing and transitional economies which are able to develop the system of WHR and reap the multiple advantages out of it. Latin American countries, including but not limited to, Argentina, Brazil and Colombia, have introduced the system in the 19th century. These countries followed the typical approach of Civil Law countries by passing General Warehousing Acts regulated by Ministries of Trade or banking authorities. Warehouse operators in the said countries issue depositors with WHR, in two parts, one a title document, confirming depositor's title on the commodity and another a pledge certificate which the depositor can offer as a collateral to get loan.⁹⁶ Here it is worth noting that such trend of continental legal system was also put in place in Ethiopia prior to the enactment of the 2003 warehousing proclamation.⁹⁷

From 1980s onwards around twelve countries of Eastern Europe and the Former Soviet Union have embarked upon the development of WHR system with a substantial outside support from donors such as United States Agency for International Development (USAID), the European Bank for Reconstruction and Development (EBRD) and the World Bank and Common Fund for Commodities (CFC).⁹⁸ Nevertheless, the efforts brought the desired outcome of obtaining fully developed system only in three of the countries.⁹⁹ These are Hungary, Bulgaria and Kazakhstan.¹⁰⁰ The failure seems to be attributable, at least partly, to the inappropriate approach

⁹⁴ *Mor and Fernandes*, Op. cit., pp. 42 -43

⁹⁵ *Richard and Panos*, Op. cit., pp.36 -37

⁹⁶ UNCTAD (2009), op. cit., pp. 8 - 14

⁹⁷ The Civil Code of the Empire of Ethiopia, *Negarit Gazeta Extraordinary Issue*, 19th year, No. 2, Article 2813 et seq.

⁹⁸ Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op Cit., p. 14 and p.42; see also UNCTAD (2009), op. cit., pp. 14 - 15

⁹⁹ UNCTAD (2009), op. cit., pp. 14 - 15

¹⁰⁰ Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op Cit., p. 37; see also UNCTAD (2009), op. cit., pp. 14 - 15

of donors focusing on changes at the central level rather than working with local banks and develop the system bottom-up.¹⁰¹ It is further emphasized that effective WHR system can be realized only when due care is taken to avoid blueprints and allow for sufficient time for adjustments and consensus building among the various stakeholders anticipated to involve in the system.¹⁰²

Like countries in Eastern Europe and Former Soviet Union, donors had leading role in the efforts towards building effective WHR system in Africa. Public warehousing is already introduced in many countries of Africa such as Ghana, Niger, Malawi, Tanzania, Uganda, Ethiopia, Zambia, Kenya though the degree of progress varies in each country. Ghana and Niger deserve mentioning for their success story in introducing and implementing the system. In both countries WHR system has brought considerable improvement particularly in increasing the farmers' profit.¹⁰³ Another African country having well developed system of WHR system is South Africa. Its WHR system is different from the system introduced in other African countries for it emerged without specific enabling legislation.¹⁰⁴ By and large, with regard to the expansion of WHR system in Africa, one can safely conclude that so far many of the developing countries in the continent have not succeeded in building the most effective WHR system that can significantly change the rural life and accelerate the whole economic growth.

2.3.3. Recent Developments in the WHR System and its Incorporation into the Modern Economy

Effective WHR system is conceived as one of essential elements constituting the framework of 'Modern market institutions'. It enables to develop more efficient and effective agricultural markets that benefit both consumers and producers. The system bridges smallholder farmers with the downstream buyers. Farmers who were marginalized in the market system can start to play central role and eventually become "price setters" rather than "price takers". The system also allows farmers to get efficient service of weighing, grading and storage services which they could hardly access previously. In the system of WHRs, farmers can use their stored commodities as a security to get loan and ultimately be able to hold crops for better price or for their own local consumption in the lean season. Since such collateral is secure and easily liquidated it has secured wider acceptance from financiers too. Furthermore the development of functioning WHR system plays pivotal role in transforming the agriculture market into modern business transaction by facilitating transfer of title on the underlying commodity by mere delivery of the receipt without any physical contact with the commodity.¹⁰⁵ All this qualities of

¹⁰¹ Ibid

¹⁰² Ibid

¹⁰³ Richard and Panos, Op. cit., pp.36 -37

¹⁰⁴ Gideon E. Onumah, Ana Marr, Alan Marter and Daniel Day-Robinson (2003), Mid-Term Evaluation Report On Warehouse Receipts Projects in East and Southern Africa Financed by Common Fund for Commodities (CFC), Natural Resource Institute p. 7

¹⁰⁵ UNCTAD (2009), op. cit., pp. 8 - 9

WHRs have made them part and parcel of the modern economy especially in the agribusiness sector.

For many decades WHR system was functioning with paper receipt or paper document of titles.¹⁰⁶ Economic actors had been showing reluctance to change this too old paper based system.¹⁰⁷ In fact Paper document of titles do have their own attractive legal characteristics. They can serve as objects capable of being taken into physical possession. They can be issued either as non-negotiable or negotiable receipts; and when they are issued in the latter form, they can be duly negotiated. Despite these merits of paper based WHRs the fact that the modern economy is transforming to electronic commerce (e-commerce) has made inevitable the need for the replacement of paper based receipts with that of electronic WHR (eWHR). Stated otherwise, as the industry moves to a paperless environment, the use of paper WHRs should be transitioned to electronic forms. Furthermore recent studies in the area have concluded that the paper based WHRs system is cumbersome, costly and inefficient as compared to eWHR.¹⁰⁸

eWHRs are merely computer records of all of the information which is required to appear on a paper WHR.¹⁰⁹ They are now recognized as a key innovation capable of radically reducing cost, increasing security, facilitating transactions and providing useful information to players. Especially the eWHR system is noticeable for being available 'off the shelf'.¹¹⁰ One may further contend that eWHR has also its own contribution in reducing environmental pollution as it trims down the papers thrown away after use. By using eWHR in place of the paper receipts a country can reap, *inter alia*, the following key benefits:¹¹¹

- It eliminates the need to store, file, safeguard and track used and unused paper WHR;
- It does away with the costs of overnight delivery of WHRs. Obviously transfer or negotiation of paper WHRs requires delivery of the document, which may be done overnight or two days later by expensive courier. The use of eWHR can speed transactions and supply the ultimate holder with the electronic receipt within minutes rather than hours and days;
- It can achieve centralizing of the purchasing, issuance, and monitoring of WHRs issued from all warehouses of same company;
- Warehousing companies can easily issue multiple, identical WHRs without repeated data entry; and

¹⁰⁶ Donald B. Pedersen (1995), Electronic Data Interchange as Documents of Title for Fungible Agricultural Commodities, 31 Idaho L. Rev. 719, Idaho Law Review, Westlaw, pp. 1 - 12

¹⁰⁷ Ibid 30

¹⁰⁸ eGrain, Inc., Electronic Warehouse Receipt, Fact Sheet available at, www.egrain.com, retrieved on 12th June 2011

¹⁰⁹ Ibid

¹¹⁰ UNCTAD (2009), op. cit., p. 18

¹¹¹ eGrain, Inc., Electronic Warehouse Receipt, Fact Sheet available at, www.egrain.com, retrieved on 12th June 2011; See also UNCTAD (2009), op. cit., pp. 1 -18

- On the part of depositors, the eWHR is pivotal for it allows them to have instant control of all of their eWHRs and avoids the concern of loss of the receipts.

In the US, eWHR system was put in place for the first time by Cotton warehouses, backed by Federal regulations that came into force in 1995.¹¹² By now, the electronic system has already secured wider acceptance from both lending institutions and regulatory bodies at both Federal and state levels of US.¹¹³ From Africa, South Africa is mentioned for its best experience in developing electronic system of WHRs.¹¹⁴ In South Africa the initiative to develop a system of electronic silo certificates or eWHRs was taken by two leading silo operators which commissioned a software company to develop the system. The system is internet based and accessible only for those having the required password. Holders of electronic silos certificate can use the system either to transfer or pledge their receipts being anywhere. The electronic system first won the support of lending institutions in South Africa which saw that it would greatly reduce costs of using paper receipts, increase security, speed up handling, and create a clear audit trail of transactions. Banks developed interest on the system particularly because it allowed them to do business faster and lend out their money more quickly. However suspicion on the confidentiality of the data had been causing reluctance on the part of trading community to accept the system. This problem was rectified by outsourcing the management of the system to a neutral private company and by strengthening the regulatory framework to make the system watertight. Another African country that is following the footsteps of South Africa is Uganda. It has embarked up on introducing regulated electronic WHRs system and so far the system has been well received by farmers, and even more so by bankers.¹¹⁵ Similarly in Ethiopia, eWHR system has been introduced for the first time by Ethiopian Commodity Exchange (ECX). ECX has made some internal rules governing the electronic system.

2.4. Antecedents to WHR System in Ethiopia

Warehousing business and WHRs are not as such new phenomena in Ethiopia. The country introduced the notion of WHRs system into its legal system during the Imperial regime while enacting two of the modern Codes of the country i.e. the Civil and Commercial Codes. In fact, one may not be able to find the term 'Warehouse Receipt' as it is in any of the Codes due to the reason that the Codes employed different expressions to refer to the same thing - WHR.¹¹⁶ However, the legal rules remained on the paper. No significant efforts were put up in order to translate the legal rules into practice. Although a multitude of reasons might have impeded the implementation of the system in Ethiopia, chief among them could be the command economic system in which the country was put for almost two decades. During this period the socialist

¹¹² UNCTAD (2009), op. cit., p. 13

¹¹³ Ibid

¹¹⁴ Ibid, p. 50

¹¹⁵ Ibid, op. cit., pp. 1 - 2

¹¹⁶ WHR is referred as "Receipts and Vouchers" and "Warehouse goods deposit certificates" in the Civil and Commercial Codes, respectively. See above section 1 of this chapter

government used to tightly control the trade, through cooperatives and its parastatal agency known as Agricultural Marketing Corporation (AMC). The government had policies of fixed territorial grain prices, restricted private inter-regional grain movements, limited private sector participation, and a producer grain quota.¹¹⁷ Such tight situation had been blocking the expansion of warehousing business not only in Ethiopia but also in many other African countries. Researches revealed that past government interventions/control in commodity markets¹¹⁸ has been among the major impeding factors reducing the economic returns to warehousing business in many developing countries.¹¹⁹ ¹²⁰ The bigger the manipulation of market prices, the less incentive there is to store and, thus, to finance the stored commodities (inventories).¹²¹

Even after 1991, when the country has embarked upon economic reforms towards liberalizing its market, the warehousing business did not witness flourishing forthwith. This is partly because, as confirmed by different studies, the market reform did not bring the expected impact on agricultural growth¹²² - which is essential for the expansion of warehousing industry. Needless to say, the market reform in Ethiopia brought the desired results in the significant re-engagement of the private sector in grain trade, the improvement of market integration, and the reduction of marketing margins.¹²³ Nevertheless, the agriculture sector has benefited much less out of all these.¹²⁴ In connection to this various institutional and infrastructure related constraints of agricultural market performance are mentioned. These includes lack of sufficient market coordination between buyers and sellers; the lack of market information; the lack of trust among

¹¹⁷ Eleni Z. Gabre-Madhin and Ian Goggin (2005), Does Ethiopia Need a Commodity Exchange? An Integrated Approach to Market Development, EDRI-ESSP Policy Working Paper No. 4, pp. 2 - 4

¹¹⁸ In India, sophisticated agricultural markets, including thriving futures markets, once flourished. More recently, however, government interventions in setting and maintaining domestic prices have displaced the economic viability of many storage schemes and limited the demand for inventory-based credit. Similarly in Mali, credit systems partly established based on inventory receipts were rendered ineffective, inter alia, due to a number of government-imposed conditions and delays. It is apparent that Brazil's legislation dates back to 1903 but its systems have deteriorated because of political intervention, and bureaucratic entanglement. (See Giovannucci, Varangis, and Larson, Warehouse Receipts, op. cit.)

¹¹⁹ Giovannucci, Varangis, and Larson, Warehouse Receipts, pp. 1 - 6

¹²⁰ "During the 1990s, there were two pilot inventory credit initiatives in Ghana, one of them involving small farmer co-operatives, and the other involving relatively larger traders storing in state-owned storage facilities. In 1997, both projects were adversely affected by an ad hoc Government decision to grant selected businesses exemption of import duties on white maize in reaction to crop forecast suggesting there would be a major food shortage. The forecast turned out to be incorrect, and the maize import seriously depressed market prices for two years, causing losses to those storing the domestic crop with inventory credit" [See: Coulter J. and Onumah G.E. (2001) "The impact of government policy and regulation on the effectiveness of warehouse receipt systems: the case of Africa", Paper presented at Workshop on Warehouse Receipt Financing: making the difficult deals easier and more profitable, Amsterdam, July 9-11, 2001 (as cited by E. Onumah (2003), Improving Access to Rural Finance, Op. Cit., pp. 11)]. Similarly in Zimbabwe a WHR system project launched by The Zimbabwe Agricultural Commodity Exchange (ZIMACE) collapsed due to heavy government intervention in the grain market in 2002. (See Onumah, Ana Marr, Marter and Daniel (2003), Mid-Term Evaluation Report op. cit., p. 7)

¹²¹ Forestier, et al. (2004), Special Study, op. cit., p. 8 - 9

¹²² Eleni Z. Gabre-Madhin and Ian Goggin (2005), Does Ethiopia Need a Commodity Exchange? Op. cit., pp. 2 - 4

¹²³ Ibid

¹²⁴ Ibid



market actors; the lack of contract enforcement; the lack of grades and standards; limited road, telecommunications and storages; and high transportation cost.¹²⁵

Persistence of these market constraints ultimately convinced the government of Ethiopia that it should take further steps towards developing appropriate market institutions and building the required infrastructure. Particularly the 2002-2003 food crisis is mentioned as important manifestation of these market constraints that attracted government's attention. The food crisis was a result of surplus crop production and price collapse in 2002 which were followed by drought threatening about 14 million people in the coming year. Less reward of farmers in the first year caused the production in the next year to be far less than the amount needed even to feed the population.¹²⁶ As observed by the CEO of ECX, this incident has remarkably influenced the government to think of a mechanism enabling producers to store their surplus products for the bad times.¹²⁷ As part of the efforts to correct the market constraints a federal legislation that provides for WHR system was enacted in 2003. And, in the next two years, the government arranged all institutions¹²⁸ necessary for the system and embarked on pilot implementation within the period 2005-2007.¹²⁹ Nevertheless, when the concept of modern commodity exchange came to the government's attention it completely disregarded the pilot implementation and focused on establishment of commodity exchange.¹³⁰

In 2007 the government launched the new marketing institution, the Ethiopian Commodity Exchange (ECX), which has been designed being integrated with WHR system.¹³¹ As there has been a preexisting WHR System Proclamation which came into force some five years before, the ECX hasn't faced as such noticeable legislation related challenges in integrating its exchange system with WHR system. Shortly, in the last eight years some efforts, including enactment of new legislation, have been exerted towards realizing the establishment of a functioning WHR system in the country and some encouraging results have already been achieved particularly by ECX.¹³²

¹²⁵ Eleni Z. Gabre-Madhin and Ian Goggin (2005), Does Ethiopia Need a Commodity Exchange? Op. cit., pp. 2 - 4

¹²⁶ Ethiopian Commodity Exchange to Develop Agriculture, (<http://www.ecx.com.et>) last visited on 5th of February 2009 (as quoted by Fikru Dagne (2009), The Legal Framework of the Ethiopian Commodity Exchange, Challenges and Possible Remedies, Addis Ababa University, Faculty of Law, unpublished, pp. 45 - 46)

¹²⁷ Ibid

¹²⁸ As disclosed by Ato Teshome, A regulatory office was opened under MoARD and EGTE and Commercial Bank of Ethiopia were assigned to take the roles of warehouse operator and lender, respectively.

¹²⁹ Interview with Ato Teshome Lema, Director of information and Control of Agricultural Marketing Directorate, at Ministry of Trade

¹³⁰ Interview with Ato Teshome Lema (From Ministry of Trade) and Ato H/ Selassie (from EGTE). The interviewees explained that eight sites were selected for the pilot implementation and in Bure, which was one of the selected sites; farmers were depositing their products upon receiving WHRs issued by EGTE.

¹³¹ See Proclamation No 550/2007, Op. Cit.,

¹³² Rabobank International Advisory Service (RIAS) (2010), Warehouse Receipt (WHR) Financing, Guide Book For Bankers- Ethiopia, p. 8

Before stepping right into the next section it appears worthwhile to say few words on the provisions of the Civil and Commercial Codes which were regulating warehousing business and WHRs in Ethiopia before the new legislation was enacted. The Civil Code under its Book V, dealing with special contracts, devotes one distinct chapter to warehousing. Obviously the base for warehousing business is the agreement of the person intending to deposit his goods and the warehouse operator. In view of this, the first article of the chapter provides a definition for the contract of warehousing. The definition incorporates some of the salient features of the modern WHR system. Among these, it spells out that the warehouseman needs to secure a license so as to engage in warehousing business in Ethiopia. Besides this, article 5(3) of the Commercial Code states that warehousing activities are among the acts regarded as trade activities provided that they are carried out professionally and for gain. Thus, a person who is running warehousing activity professionally and for gain shall, in addition to securing license from the concerned public authority, be registered as a trader.

The second important point worth noting from the definition tendered by the Civil Code is that the inclusion of the two core functions (i.e. marketing and financial functions) of WHRs which are now at the heart of the modern receipt systems in many countries. The definition clearly sets out that the warehouse operator may not necessarily hold or store the goods on behalf of the depositor only. Regardless of the fact that the contract of warehousing has been made with the depositor, either a Purchaser or a pledgee of the stored goods may become a party on whose behalf the warehouse operator has stored the goods. This implies that the Civil Code has given legal recognition for both transfer of the title to the stored goods and pledging of the same, merely using the documents representing the stored goods.

These documents which are purported to represent the stored goods are named as "Receipt and Voucher" under Article 2813 of the Civil Code. The warehouse operator, upon the request of the bailor, may issue him the two documents having same content. As described under the relevant provisions of the Code the documents given to the bailor splits the rights a holder may exercise over the stored goods. Holder of the voucher alone shall exercise pledge right on the stored goods whereas the holder of the receipt is given only the right of inspecting the goods in the warehouse. In fact, Article 2820(2) tips another entitlement to the holder of the receipt. The due holder can demand delivery of the stored goods after depositing the sum due to the holder of the voucher/the pledgee at maturity.

The "receipt and voucher", or "Warehouse goods deposit certificates" in the wordings of the Commercial Code, is also recognized as a negotiable commercial instrument.¹³³ A reputed Ethiopian researcher while shedding light on the implication of this noted that:¹³⁴

¹³³ The Commercial Code, op. cit., cumulative reading of Articles 732(2) and 715(2)

¹³⁴ Teshome (2002), op. cit., p. 194

“As negotiable instruments that incorporate a right to an entitlement, the relevant provisions of the Commercial Code on negotiability, on form and manner of transfer, on holder in due course, and on endorsement may be applied on WHRs as well.”

In general, some of the major components/concepts of the modern WHR system such as marketing and financial functions and negotiability of the receipt were incorporated in Ethiopia even in the 1960's Codes. However, it doesn't mean that the Codes had provided for robust legal regime for the realization of effective system of WHR system in the country. As figured out by Professor Tilahun Teshome, the provisions in the Codes were needed to be revised particularly for the following reasons:¹³⁵

- ✓ To provide for definition of important terms such as warehouse, WHR, warehouse operator and so on;
- ✓ To determine the persons eligible to operate warehousing business and the requirement thereon;
- ✓ To clearly spell out rights and obligations of all parties involving in the system
- ✓ To clarify the extent of negotiability of WHR;
- ✓ To establish reliable scheme of insurance and bonding for the proper performance of the obligations of the warehouseman; and
- ✓ To provide for conducive legal environment to the transformation of the paper receipts into the efficient electronic system of WHR.

2.5. The Integration of WHR System with Commodity Exchange market in Ethiopia: The Case of ECX

2.5.1. Role of WHRs in Commodity Exchange Market

As addressed above, one of the major functions of WHR system is transforming the agricultural market into modern and efficient system. In developing countries like Ethiopia it won't be far from the truth to say that there is no fair market system for agricultural commodities. Smallholder farmers have little bargaining power in their business relation with big and influential buyers who collects agricultural products knocking every farmer's door. The farmers have no considerable say on the weight and particularly the quality of the agricultural commodity they are supposed to sell. The buyers who are deemed to have wider access to big markets in the city often abuse their position and misinform famers about the market value of the agricultural commodities. They may also cheat weight and grade of the commodities. Farmers usually have no other market choice than merely submitting themselves to terms offered by the buyers.¹³⁶

However, in an effective WHR system the situation is different; neither the farmers nor the buyer have the chance to determine the weight and quality of the products. Even the warehouse operator has no say on weight and grade of the product to be stored. The grade and weight of the

¹³⁵ Ibid, op. cit., pp. 221 - 222

¹³⁶ J. Coulter and G. Onumah (2002), Op. Cit., p. 322

products are determined by independent professionals licensed as graders and weighers. This helps to make the weighing and grading process fair and impartial. Every licensed warehouseman operating within a rigor regulatory regime is required by law to issue a receipt indicating, *inter alia*, the accurate weight and grade of the commodity to be deposited as per the national standard whilst taking delivery of the commodity. It means that when farmers take their products to the licensed warehouses rather than directly disposing them, they can get a safe storage space which provides independent and accurate evidence of the value of the products stored as well as, in most cases, transferable documents which establish title to the goods.¹³⁷ The WHR system has also key role in rectifying the problem of information asymmetry in agricultural market. It builds up a transparent system which increases farmers' bargaining powers by enabling them obtain accurate market information. As a natural outcome of its role in building transparent market system, the system also creates more competitive environment in the agribusiness sector and form the basis for trading the commodities.¹³⁸

The other market function of WHR system is improving the quality of agricultural products in the market. One of the contributing factors in degrading quality of agricultural products in Ethiopia is the traditional and low level storage facility.¹³⁹ The fact that domestic agricultural products are low quality often forces factories of the country using agricultural products as raw materials to import them from outside.¹⁴⁰ The system of WHR rectifies these quality related problem by putting in place scientific and well organized storage facility enabling agricultural products reach the desired customers/industries with all their qualities. The system also helps the products maintain their quality by avoiding unnecessary physical deliveries at every transaction. It facilitates dealings on the stored products to be undertaken merely using the receipt representing the commodities, without the need to have physical contact with the stored commodities. It's only the final buyer who wants to use/consume the product that demands physical delivery.¹⁴¹ Such paper based market system modernizes the whole agribusiness sector. Particularly, the introduction of electronic receipts makes the agricultural market system more advanced and secured.

Moreover, WHR system trims down transaction cost by making transactions on the stored goods quite speedier than they formerly were. It also fosters impersonal trade by description, which involves much lower transaction costs than the trade by sampling, which is common in most

¹³⁷ Forestier, et al. (2004), Special Study, op. cit., p. 8 - 9

¹³⁸ Richard and Panos, Op. cit., pp.36 - 37

¹³⁹ In interview with Ato Teshome, Director of Information and Control of Agricultural Marketing Directorate at Ministry of Trade, he underscored that post harvest loss of agricultural products is among the major problems Ethiopian farmers are still facing.

¹⁴⁰ Ibid

¹⁴¹ Onumah (2003), Improving Access to Rural Finance, Op. Cit., pp. 1- 5

African countries.¹⁴² Interestingly, the system enables to get rid of transportation and physical delivery costs that were required at every transaction.¹⁴³

WHR system is also beneficial for it lays the foundation for futures markets by providing a reliable delivery point and negotiable title documents. An agricultural market integrated with WHR system promotes certainty and predictability of contracts. The system ensures certainty and predictability in terms of both the quality and quantity of the commodity and the ability of the seller to deliver on schedule. Functioning WHR system assists in developing modern commodity exchange which are useful to price discovery and selling commodities, and, in some cases, to mitigation of price risks. As observed by scholars, most of commodity exchanges established in Africa end up merely as intermediaries with little or no active trading, mainly because they lack a system that guarantees proper performance of contract. It is recommended that the exchanges can have better chance of success if integrated with effective system of WHR.¹⁴⁴

WHR system has pivotal role in reducing government interventions in the agricultural market, eventually. Government interventions are often justified by the needs for supporting prices, by purchasing directly from producers, and providing guarantee for a measure of food security. In a functioning WHR system, when prices drop below a support floor the government can simply accept WHRs rather than taking delivery of physical inventories. This way of government involvement is at least less interventionist than that exercised earlier. By holding WHRs government may help to stabilize the lowering price by limiting the excess supply in the market. Since WHRs guarantee the existence of stocks, governments can also achieve their food security objectives by merely holding the receipts. In WHR system, the private sector is responsible for purchasing, storing, and disposing of the physical stocks. Through time, the system itself will start to protect market participants against price fluctuations and significantly reduce, though not eliminate, the role to be played (ad hoc intervention) by government.¹⁴⁵

2.5.2. The Legal Basis for the Integration WHR system with Commodity Exchange in Ethiopia: The case of ECX

WHR system and functioning commodity exchange are interrelated for one contributes for the feasibility and success of the other. As observed by Dr. Eleni and Goggin,¹⁴⁶ they particularly complement each other in the following perspectives: Grades and standards set for the warehouse operations will also be used for exchange with standardized contracts; the price transparency achieved through indication of the specific grade on receipts also generates price information that can be used on the exchange; Speculative risk, which may lead the scheme of

¹⁴² Ibid

¹⁴³ Ibid

¹⁴⁴ Ibid, Op. Cit., pp. 5 - 7

¹⁴⁵ Richard and Panos, Op. cit., pp. 36 -37

¹⁴⁶ Eleni Z. Gabre-Madhin and Ian Goggin (2005), Does Ethiopia Need a Commodity Exchange? Op. cit., p. 11

WHR to demise, is transferred by selling receipts on the exchange; and finally, the robust legal regime required for enforcement of quality and of the transferability of the receipt are equally important for both the WHR system and the functioning of the exchange. In recognition of this, Ethiopia has attempted to integrate its commodity exchange with the already existing legal regime of WHRs.¹⁴⁷ In this section the legal basis of integration will be briefly discussed subsequent to shedding light on the general objective and structure of the Ethiopia Commodity Exchange (ECX).

ECX was established in September 2007 as a state-owned market institution having its own legal personality.¹⁴⁸ It serves as marketplace where buyers and sellers come together to trade, and are assured of grade, weight, delivery and payment.¹⁴⁹ The primary objective of the Exchange is realizing efficient, orderly and unified marketing system for agricultural commodities in a manner that ensures participation of smallholder agricultural producers.¹⁵⁰ Several economically important agricultural commodities including coffee and sesame are being traded through the ECX. From 2009 onwards it has been compulsory to sell all coffee through the ECX.¹⁵¹ Unlike other government institutions, ECX is governed by a board of directors comprising eleven members drawn from both the public and private sectors. Six member of the board including the chairperson are appointed by the Ministry of Trade, which has supervisory authority over the Exchange.¹⁵² The remaining five directors of the board are elected by members of the Exchange.¹⁵³ Because of this the exchange is usually referred as a public-private enterprise.

Finally let's have a glimpse on the legal basis for the integration of the WHR system with the commodity exchange. (The ECX entered into operation being integrated with one of the most important related institutions, WHR system. The establishing Proclamation of ECX under its article 6(5) states guaranteed WHRs are the basis to conduct trading on the Exchange. This legal provision, coupled with Article 20(2) of the same Proclamation make up the major point integration between the Exchange and warehousing system. One can trade his commodity on the Exchange only if he is due holder of a receipt representing the stored commodities. This is further reinforced by Article 20(2) of the Proclamation which unambiguously spells out that

¹⁴⁷ Ibid, pp. 18 - 21

¹⁴⁸ See Proclamation No 550/2007, op. cit. Article 3(1)

¹⁴⁹ Jennie van der Mheen-Sluijer (2010), Ethiopian commodity exchange and contract farming arrangements: Complementing institutions, Development Cooperation Netherlands Ministry of Foreign Affairs, pp. 6 – 16

¹⁵⁰ See preamble of Proclamation No 550/2007, op. cit.

¹⁵¹ See Council of Ministers Regulation on Coffee Quality Control and Transaction, No. 161/2009, Negarit Gazeta 19th year, No.3, 2009, Addis Ababa; See also Jennie van der Mheen-Sluijer (2010), op. cit. pp.6 -16

¹⁵² Cumulative reading of Articles 11(1) and Article 2(13) of Proclamation No 550/2007 vests supervisory authority on the former MoARD. However Article 21(2) of Proclamation No. 691/2010 has given all powers and duties of MoARD on matters relating to Agricultural marketing to the newly established Ministry of Trade. Accordingly, the supervisory authority over ECX, which is a power directly related to agricultural marketing, has been given to Ministry of Trade. (See also the discussion below on Registration, licensing and publicity under Section 3.4.3)

¹⁵³ Proclamation No 550/2007, op. cit., See Articles 3, 4 and 11

trading a commodity on the exchange without the issuance of WHR is illegal. Moreover, besides its primary goal of serving as forum for commodity exchange, ECX may also engage in warehousing business to carry out weighing and inventory management of agricultural commodities, as per article 24 of the proclamation. As a warehouse operator, the Exchange also issues WHRs for the commodities it received for storage. Such receipt will be used to trade the stored commodities on the exchange floor.) From the above discussion, one can effortlessly understand the firm legal and practical integration of the WHR system and the Exchange.

Perhaps, another important issue to be raised at this juncture would be the legal framework within which the Exchange carries on its warehousing business. Actually, the law lacks clarity on this issue. Article 2(4) of Proclamation No.550/2007 provides that the Exchange shall be governed by *other relevant laws*, in addition to the Exchange Proclamation and the Ethiopia Commodity exchange Authority Proclamation No. 551/2007. Since the Exchange Proclamation does not contain provisions dealing with detail matters of warehousing business and WHRs, the WHR System Proclamation can be considered as one of the relevant laws and hence it can be deduced that the Exchange shall carry on its warehousing activity in accordance with the provision of the WHR system Proclamation.

On the other hand, Article 24(1) of Proclamation No.550/2007 authorizes the Exchange to operate warehousing business and issue WHRs without prejudice to Article 26 of the WHR System Proclamation which provides the requirement of registration and other operational requirements. This provision tends to exempt the Exchange from all requirements provided under the WHR System Proclamation except Article 26 of the same. Hence, Article 24(1) may lead to a conclusion that the warehousing activities of the Exchange including its WHRs are not necessarily governed by the WHR system proclamation.

The reality on the ground tends to be closer to the second line of interpretation. This can be inferred from the way the Exchange is carrying on its warehousing activities. (ECX is operating warehousing activities and issuing WHRs without being registered and licensed by the competent authority. Its warehousing activities are also being regulated not by the regulatory body of authorized by the WHR System Proclamation but by the Ethiopia Commodity Exchange Authority which claims to have full supervisory power over the Exchange pursuant to Proclamation No. 551/2007.) Furthermore, other detail matters of the Exchange's warehousing activities are being governed not by secondary legislations issued in accordance with the WHR System Proclamation but by the internal Rules of the Exchange that are issued pursuant to Article 12(10) of the Exchange Proclamation No. 550/2007. Taking into account all these facts, it won't be untrue to state that there is another distinct legal regime of warehousing business in Ethiopia that is exclusively reserved to EXC.

In view of the writer such separated legal regime of ECX adversely affects the uniformity of the WHR system in Ethiopia. It may also unnecessarily increase the cost of building robust legal regime for the receipt system. Hence, it is suggested that alike any other warehouse operator

ECX should start operating its warehousing activities within the national legal framework of WHR system provided under Proclamation No. 372/2003. To this end, all legal and institutional conditions required for the national WHR system should be put in place. 1

Chapter Three

Analysis of the Legal Framework of WHR system in Ethiopia

3.1. The Significance of Conducive Legal Regime: An Overview

It is widely held view that a robust legal framework is the most crucial requirement for the establishment of effective WHR system for it engenders confidence among depositors and financiers.¹⁵⁴ In jurisdictions where warehousing legislation is either non-existent or inadequate, the underlying task has usually been promoting this instrument and striving to move legal transition forward through policy dialogue and technical assistance.¹⁵⁵ Undoubtedly, formulating efficient and effective legal framework for WHR system is important. Yet one has to reasonably question that - is it really the most crucial prerequisite without which the desired goal of building successful WHR system can never be achieved? Empirical observations of different countries' experience tend to answer this question negatively.¹⁵⁶ A robust legal regime alone may not achieve the desired goal. As will be portrayed below, at times, over emphasis on legislation may even turn out to be an encumbrance lagging behind the introduction and development of the system in a given country.¹⁵⁷

In projects designed to improve agricultural market in Tanzania, Uganda and Zimbabwe through Promotion of privately run warehousing systems and the establishment of collateralized WHR systems priority was given to promulgation of supportive warehouse legislation.¹⁵⁸ This approach is criticized for disregarding practical experience of countries like South Africa who are known for their success story in building functional WHR system without specific enabling legislation. In fact South Africa had a warehouse law enacted in 1930 though rescinded during the Apartheid era. Since then the country had no distinct warehouse act and its Silos Certificate System has emerged in the absence a WHR specific law.¹⁵⁹ The silos certificate system in South Africa is normally regulated by Law of contract. In similar fashion, Zambia is developing the receipt system by giving priority for other measures assuring parties to the receipt about the security of their interest in the receipt. Supportive legislation is sought only after the system is built up.¹⁶⁰

¹⁵⁴ Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op Cit., p. 8

¹⁵⁵ Paul-Henri Forestier, Peter Bryde, Ilir Fani, and Nick Papandreou (2004), Special Study, Warehouse Receipt Program/Agricultural Commodity Financing Program, OPER No: PE04-271S, p. 1

¹⁵⁶ P. 24

¹⁵⁷ Gideon E. Onumah, Ana Marr, Alan Marter and Daniel Day-Robinson, Op. cit., pp. 1 - 4

¹⁵⁸ Onumah, Ana Marr, Marter and Daniel (2003), Mid-Term Evaluation Report op. cit., p. 7

¹⁵⁹ UNCTAD (2009), op. cit., pp. 15 - 17

¹⁶⁰ Ibid

On the contrary, there are countries having more than a century old warehouse laws but not yet able to come up with effective WHR system. Brazil can be mentioned as an example in this regard. Though the warehouse laws of Brazil dates back more than 100 years the country still lacks a functional receipt system because of disabling elements in the policy environment.¹⁶¹ Moreover over emphasis on warehouse legislation is also blamed for diverting attention from the more fundamental task of implementing a viable receipt system.¹⁶² For example in Zimbabwe, the warehousing project which focused on supportive legislation delayed piloting a modified version of a receipt system for grains, which was successfully introduced in the country by its Exchange (ZIMACE) earlier.¹⁶³

In fact it should be made pretty clear that all the above facts about warehouse legislation never lead to a conclusion totally undermining its significance. But they, at least, uncover the presence of other more important elements that should be considered either together with or more preferably before the promulgation of the law. Legislation by itself can't build a system on the ground it rather enables already established system to operate. Hence, the significance of enabling legislation becomes undisputable once after all other necessary components to the system are put in place. As mentioned above warehousing legislation is needed mainly to engender confidence among parties to the receipt. Particularly the treatment of the receipt as secure collateral presupposes the presence of conducive legal environment.

The warehousing legislation achieves this target only when it can, inter alia, ensure the enforceability of the security timely, clearly define the rights and duties of each party in the receipt system, and foresees the transferability of the receipt by delivery and/or endorsement.¹⁶⁴ The security is required to be enforceable few days after default without the need to judicial intervention.¹⁶⁵ The legislation should give the receipt a status functionally equivalent to the commodities stored. It should also establish a mechanism to register the financing secured by the receipts so that the creditor will be in a position to claim his right on the collateral unequivocally.¹⁶⁶ Looking at international practice, the most comprehensive regulatory regimes fulfilling the aforementioned basic elements can be found in USA, Canada, Philippines and India.¹⁶⁷ From Africa, Tanzania, Zimbabwe and Uganda have prepared their draft legislations

¹⁶¹ Onumah, Ana Marr, Marter and Daniel (2003), Mid-Term Evaluation Report op. cit., p. 7

¹⁶² Ibid

¹⁶³ Ibid

¹⁶⁴ The World Bank (April 2005), op. cit., p. 13

¹⁶⁵ Forestier, et al. (2004), Special Study, op. cit., p. 7 – 8

¹⁶⁶ Ibid

¹⁶⁷ J.O. Fabunmi (2002), op. cit., pp. 1 – 5; See also Onumah (2003), Improving Access to Rural Finance, Op. Cit., pp. 5 - 8

substantially based on the US model. The 2003 Ethiopian warehousing Proclamation is also made after the US model.¹⁶⁸

3.2. The 2003 Ethiopian WHR System Proclamation

With the opening of markets and the liberalization of trade, such instruments as WHRs have become important in the transition to markets for they reduce uncertainty and enhance efficiency.¹⁶⁹ Ethiopia has embarked upon market reforms since the early 1990s. Alike other countries in transition, the potential benefits of WHR system to the country have become more evident particularly after the government started taking measures towards liberalizing the agricultural market. Obviously for a WHR system to work well, there are some basic requirements that should be fulfilled. In 2003, International Fund for Agricultural Development (IFPRI) observed credible warehouse regulation and legal enforcement among the major issues that must be resolved for the proper functioning of the system in Ethiopia.¹⁷⁰ Hence the need to revisit the provisions of the Civil and Commercial Codes pertaining to warehousing business and WHRs was found to be inevitable.

There is a debate as to whether the appropriate legal environment can be achieved by the promulgation of a specific WHR legislation, or as an amendment of sections of the relevant Codes. Evidence to date suggests that the first approach is more convenient.¹⁷¹ In line with this, Ethiopia has rightly resorted to the first approach and created a separate federal legislation regulating the matter in 2003. Another worth raising issue in this connection is determination of the government having legislative power over the matter. Articles 51(12) and 55(2) (b) of the Federal Constitution states that inter-state and foreign commercial activities are within the jurisdiction of the Federal Government. The constitution further puts enactment of the Commercial Code under the exclusive jurisdiction of the Federal Government. Based on this, it has been validly contended that the Federal Government is vested with the power of regulating warehousing business and the 2003 Federal Proclamation of WHR system has enough constitutional basis.

Of course, this trend is a bit different from that of the US experience where both the Federal and State governments can make warehousing legislation. In the US, it is up to the warehouse operator to choose either to be licensed at federal or state level. The federally licensed warehouses are regulated under the United States Warehouse Act (USWA), which is administered by the United States Department of Agriculture (USDA), and the state licensed warehouse under the state warehouse statute.¹⁷² The purpose of the federal Warehouse Act is to

¹⁶⁸ Compare the 2003 WHR System Proclamation with the 1916 US Warehouse Receipt Act (USWA) and its subsequent amendments

¹⁶⁹ Giovannucci, Varangis, and Larson, Warehouse Receipts, pp. 5 - 6

¹⁷⁰ IFAD (International Fund for Agricultural Development), Federal Democratic Republic of Ethiopia Country Program Evaluation, Report No. 2045-ET, May 2009, pp.75 - 76

¹⁷¹ The World Bank (2005), op.cit., p. 13

¹⁷² B. Pedersen (1995), op. cit., pp. 1 - 12

uniformly regulate storage facilities which house agricultural produce and support elevators' efforts to secure financing.¹⁷³ According to the late 1990s' statistics, from the total of about ten thousand elevators operating in the US, only 1828 warehouses were licensed under the USDA.¹⁷⁴ This shows that warehouse operators are more comfortable with the regulatory framework at the state level. On the part of the regulators, the legal framework at a state level is preferable for it minimizes administrative costs related to inspection and monitoring. The state warehousing legislation can also better address area-specific matters pertaining to the warehousing business. However, in Ethiopia it seems too early to recommend decentralization of warehousing legislation to states level. In view of the writer of this paper, the system should first grow up and start functioning effectively and efficiently within the uniform legal framework designed at the federal level. Once functioning system is built centrally it won't be a difficult task to decentralize the system and optimize the benefits out of it.

The 2003 federal legislation of WHR system is well structured legal document that has filled the major gaps left in the Civil and Commercial Codes.¹⁷⁵ The Proclamation has incorporated best practices of the world at the time it was promulgated. It has particularly paved the way for the implementation of WHR system in conjunction with commodity exchange under the umbrella of ECX.¹⁷⁶ As can be read from the preamble, the Proclamation aims at promoting both financial and marketing functions of WHRs. It contains detail provisions regulating warehousing business and WHRs. It is the aim of this chapter to have a critical look at important parts of the proclamation.

3.3. Bodies Eligible to operate Warehousing Business

Warehousing is normally a commercial activity.¹⁷⁷ As a rule, in Ethiopia, a person can engage in any activity of commercial nature either individually or in the various forms of business organization by joining hands with other business partners. But some legislation including the warehousing legislation provides exception to this rule. The 2003 WHR System Proclamation doesn't make warehousing business open for all. It rather provides that only Cooperative Societies¹⁷⁸, Private Limited Companies, Share Companies and Public Enterprises can operate the business.¹⁷⁹ Put differently, sole proprietors and other business organizations like joint venture and partnerships can't engage in business of warehousing in Ethiopia. The major rationale behind such restriction, as pointed out by Professor Tilahun Teshome, the drafter of the

¹⁷³ D. Love (1982), Westlaw, Op. cit., P.117 - 118

¹⁷⁴ B. Pedersen (1995), op. cit., pp. 1 - 12

¹⁷⁵ Si Matthies and Krassimir D. Kiriakov (2009), Development of a Warehouse Receipt System in Ethiopia: assessment Report, VOCA Consult pp. 6 - 7

¹⁷⁶ Rabobank International Advisory Service (RIAS) (2010), Warehouse Receipt, p.8

¹⁷⁷ See the discussion above under section 2.4 of this Thesis.

¹⁷⁸ The Proclamation does not spell out the criteria Cooperative Societies shall meet to operate warehousing business in Ethiopia. (See The WHR system proclamation, Op. Cit., Article 26 (1) and (3)) Because of this, it is hardly possible to say Cooperative Societies are practically permitted to engage in warehousing business.

¹⁷⁹ The WHR system proclamation, Op. Cit., Articles 5 and 26

WHR system proclamation, is ensuring integrity and reliability of the system by allowing only trustworthy warehouse operators to conduct the business.¹⁸⁰ The Professor also added that allowing all businesspersons and business entities to conduct the warehousing activity would make difficult the regulator's task of monitoring and supervising the regime. In his view, well organized structure of companies makes them easier for effective regulation. Such restriction on the form of business is not unique for warehousing business. The banking sector of Ethiopia, which has similar nature with the warehousing industry, is reserved only to share companies.¹⁸¹ This is mainly because share companies do have more accountable organizational structure, and thus easier to regulate.¹⁸²

Assuming that the restriction based on the form of the business organizations employed by the Proclamation is convincing, one may still cast a reasonable doubt on the eligibility of Private Limited Companies (PLCs) to operate warehousing business. Currently it is practically observed that the PLCs in Ethiopia are commonly formed among family members and are usually blamed for going bankrupt intentionally.¹⁸³ The owners of the companies attempt to use the legal personality of the company as a shield to escape from liability.¹⁸⁴ Hence, even if it is accepted that form (form of business organizations) based restriction on warehousing business sector is appropriate, in the current situation of Private Limited Companies in Ethiopia it won't be convincing to allow them operate warehousing business. Based on this, the supporters of form-based requirement suggest that Private Limited Companies shouldn't be allowed to operate warehousing business in Ethiopia. And, accordingly, they recommend the amendment of Articles 5 and 26 of the WHR System Proclamation which allow PLCs to engage in warehousing business.

On the other extreme end of the spectrum, despite the clear provisions in the WHR System Proclamation one may contend criticizing the form based criterion employed by the WHR System Proclamation on the ground that form of the business entity per se cannot assure

¹⁸⁰ It is widely held belief that the success of WHR system depends on the credibility and competence of warehouse operators. (See ZACA, what are the main Requisites for A successful WHR system? available at http://www.zaca.com.zm/zaca_pre_requisite.html retrieved on 10/30/2001)

¹⁸¹ As described by Professor Tilahun, warehousing business and the banking business are closely similar business sectors demanding rigorous regulatory regime. The difference between the two is that while the former deposits money the latter deposits commodities belonging to others. An interview with Professor Tilahun Teshome on 22nd October, 2011

¹⁸² Interview with Professor Tilahun Teshome on 22nd October, 2011

¹⁸³ In Ethiopia Private Limited Companies are surrounded by Problems related with formation (fully paid up capital), share transfer restrictions (transfer of share outside the company), organization of the company (company governance and management) and limited liability of members (no clear provision as to the liability of the company). (See: Nigusie Tadesse (2009), Major problems associated with private limited companies in Ethiopia: The law and the practice, Addis Ababa University, Faculty of Law, Unpublished, p. 82 - 86)

¹⁸⁴ In fact the doctrine of 'piercing the Veil' may be invoked to make the individuals behind the company personally liable. But it is still cumbersome and unattractive for the creditors to satisfy their claims going through all these process.

trustworthiness of the warehouse operator. Perhaps form based restriction may not be appropriate for it may contribute very little towards achieving the desired goal of ensuring the system's integrity. It is rather suggested that one can assure that all elevators are in a position to discharge their legal obligations properly by simply setting out objective requirements for operating the business. The requirements should, inter alia, include minimum capital and bond and insurance for the stored commodities. Once these requirements are set, any form of business entity fulfilling the criteria should be given the opportunity to carry out the warehousing business.

Both lines of argument stated above do have their own merits and it is indeed a policy issue to decide either to rely on the first or the second. In the view of the writer, it would be more effective to rely on the bonding scheme of the WHR system rather than the forms of the businesses operating warehousing activities. Particularly in Ethiopia where the warehousing industry is not yet able to attract the private sector, putting form-based restrictions may cause a lag in the expansion of the sector. Therefore, whether the business is a sole proprietor or a business organization what matters most has to be the fact that it complies with the legal requirements to operate the business not the form of the business. All concerns pertaining to security and reliability of the system can more safely be addressed using effective bonding and insurance schemes. It can be further argued that the involvement of business entities with unlimited liability (like partnerships and sole proprietors) strengthens the reliability of the system by broadening the protection of creditors of the warehouse operators. Regarding the inconveniences claimed to arise in relation to regulation of the system (when all forms of business are permitted to operate warehousing business), I don't think this could be a big concern to Ethiopia at this level where there is no large number of warehouse operators difficult to control. May be after some years when the number of warehousing businesses scale up it would be appropriate to consider such form-based restrictions so as to ensure effective regulatory regime. But now the warehousing industry should be left open to any interested applicants fulfilling the legal requirements. At the same time the government shall put in place a competent regulatory body functioning in accordance with the provisions of the WHR system Proclamation.

3.4. Legal Requirements to launch the Business

As portrayed above one way of maintaining the integrity of WHR system is setting out requirements for operating the business. The warehousing legislation of Ethiopia provides for important requirements which help to ensure that every elevator in the system is capable enough to discharge all its legal obligations emanating from the warehousing contract. However the requirements which Cooperative Societies shall meet to launch the business are left to be determined by a directive and such directive has not yet come into existence.¹⁸⁵ Unless such directives put in place it would be hardly possible for the regulatory organ to license Cooperative Societies.

¹⁸⁵ An interview with Ato Teshome Lema, Director of Information and Control of Agricultural Marketing Directorate at Ministry of Trade

The key requirements to be met and maintained by Share Companies, Private Limited Companies or Public Enterprises which intend to launch warehousing business in Ethiopia are set forth below in three categories.

3.4.1. Capital, Premises and Personnel

A person intending to operate warehousing business has to first show that it is financially sound with a minimum capital of one million birr.¹⁸⁶ Assuming that the amount of the threshold capital was determined taking into account economic and other related conditions prevalent at the time of making of the law, one may validly suggest the reconsideration of such amount. Especially, the sharp decline witnessed in the value of 'birr' within the last eight years strengthens the recommendation for increment of the minimum capital. In view of assuring stored commodities' safety, Article 2(b) of the Proclamation requires prospective warehouse operators to have a business premises convenient for warehousing industry.¹⁸⁷ Of course the person need not necessarily be owner of the storage facility. Alternatively, one can comply with the requirement of premises by producing evidence that shows he has leased the premise for duration of 12 months with a possible extension for another twelve months.¹⁸⁸ The law also requires the prospective warehouse operators to employ qualified personnel capable of making use of the physical facilities in the storage to handle, grade and properly store commodities delivered to them. More specifically, the personnel should be acquainted with the expertise required to handle the commodities for which warehousing license is sought.¹⁸⁹

3.4.2. Insurance and Bonding

Insurance coverage and Bonding are the other essential conditions required by law to engage in warehousing business.¹⁹⁰ These schemes, on one side, enable depositors feel guaranteed that they can regain control over their stored property at any time; on the other side, they also enable financier of the receipts to feel confident that they will be reimbursed in case where the warehouse operator defaults. In short, the schemes strengthen reliability of the system by warranting that the underlying property or the stored good is always available.

To begin with Insurance coverage, Article 31(2) of the Proclamation states that a warehouse operator shall insure all the goods represented by WHRs. However it fails to describe the specific risks against which insurance policies shall be bought. Obviously, the insurance coverage is expected to extend to all legal liabilities of the warehouseman in relation to the stored goods.

¹⁸⁶ The The WHR system proclamation, Op. Cit., Articles 26(2)(a)

¹⁸⁷ Article 26(2) (b) of the Proclamation provides that a business premises is considered to be convenient when it has a permanent structure of warehouse which is equipped with all facilities necessary for receiving, grading, storing, cleaning and out loading commodities tendered for storage.

¹⁸⁸ The The WHR system proclamation, Op. Cit., Articles 26(2)(b)

¹⁸⁹ Article 26(2) (c) of the Proclamation doesn't clearly describe what it means by "the required training and experience". But one may come up with a sound argument that the quoted phrase refers to the expertise a warehouse employee is expected to have by usage and custom.

¹⁹⁰ The The WHR system proclamation, Op. Cit., Articles 31(1) and (2)



This coincides with the practice in the US's WHR system.¹⁹¹ To decide the appropriate level of warehouse legal liability insurance coverage, it is important first to determine the value of the goods in storage. In fact it is seldom possible to determine the exact value of the stored goods as it varies depending on changes in market price. Yet, at least, taking estimated value of the goods at the time they are delivered for storage, the warehouseman can price warehouse legal liability insurance coverage.

Here it is worth noting that the existence of insurance coverage for warehouseman's legal liability by itself may not necessarily relieve the warehouse operator from liability.¹⁹² In case where the warehouseman agreed to elevate his commitment¹⁹³ beyond the standard duty of care prescribed under the law,¹⁹⁴ insurers don't give coverage.¹⁹⁵ So the warehouseman will be obliged to redress loss caused by materialization of risks that are beyond the standard duty of care. Damage caused by natural catastrophe such as lightening or earth quake can be ideal examples of loss occurred by causes not covered under the law.

On the other hand, it is advisable for depositors to be well aware of the fact that all risks and liabilities associated with their stored products cannot be outsourced. Damage occurred due to causes not related with warehouseman's negligence won't be covered by warehouse legal liability insurance policies. Nor can it be made good by the warehouseman himself. That means such loss is supposed to be borne by the depositor himself. Because of this, it appears important for the depositor to obtain adequate insurance coverage against risks such as Acts of God and any other casualty for the stored product.

On top of the insurance coverage, warehouse operators are also obliged to keep with the concerned ministerial office a surety bond or an undertaking sufficient to secure performance of his legal obligations emanating from the warehousing transaction.¹⁹⁶ The bond is principally aimed at protecting depositors against risks, like fraud and gross negligence, not otherwise coverable in the insurance market.¹⁹⁷ The bond can also be used to repay depositors who do not recover all their deposited commodities in the event of a bankruptcy. To the extent that the commodity on hand and the bond is not sufficient to compensate all WHRs holders in full, they will typically receive pro rata portions of the bond and available commodity.¹⁹⁸ The type and amount of the bond or undertaking is left to be determined in a directive issued by the concerned ministerial office or it's designate. However, as told by Ato Teshome, no directive regulating

¹⁹¹ International Warehouse Logistics Association (IWLA), Insurance and the Warehouse Industry, pp. 1 – 3

¹⁹² Ibid, p. 3

¹⁹³ The The WHR system proclamation, Op. Cit., Articles 6 (3)

¹⁹⁴ The The WHR system proclamation, Op. Cit., Articles 31(1) and (2)

¹⁹⁵ International Warehouse Logistics Association (IWLA), Insurance and the Warehouse Industry, pp. 1 – 3

¹⁹⁶ The The WHR system proclamation, Op. Cit., Articles 31 (1)

¹⁹⁷ Forestier, et al. (2004), Special Study, op. cit., p. 25

¹⁹⁸ D. Love (1982), Westlaw, Op. cit., P.117 - 118

such matter has been issued to date.¹⁹⁹ In the absence of such directive it would be totally impossible to license warehouse operators since the surety bond they shall keep in the ministry is not yet known.

In the US Warehouse Act where similar requirement of bonding is imposed on warehouses, the amount is determined based on the nature, value, and likely quantities of commodities to be stored. Warehouses providing storage service for grain are required to provide a bond of twenty cents per bushel²⁰⁰ for the first one million bushels of storage capacity in the warehouse, fifteen cents for the next one million bushels of storage capacity, and ten cents for all storage capacity over two million bushels. The Secretary of Agriculture exercises broad discretion in the determination of the bonding amount.²⁰¹ Generally the amount of bond required in US ranges from a maximum of \$500,000 to the minimum is \$20,000. In the states warehouse statute the minimum requirement goes down up to \$5000.²⁰² Based on this experience the directive to be issued by the concerned ministerial office shall provide not only the type of bond or undertaking but also the objective criteria or formula employed to determine the amount of bond every warehouse operator is required to keep.

In some jurisdictions, bonds are substituted by Indemnity Fund set up by contribution collected from all participating warehouses who charge a fee to their customers.²⁰³ Similar to bond, an Indemnity Fund is intended to cover non-insurable fraud risk.²⁰⁴ As the indemnity fund will only be funded over a period of time by fees collected from the depositors, in jurisdictions where a new WHR system is being built up the use of public funds is needed to provide a minimum initial capital.²⁰⁵ However obtaining the initial contribution to capitalize such funds adequately from host governments is a big challenge particularly in the developing countries.²⁰⁶ For this reason Indemnity Funds are proven difficult to set up. In this regard, the inclination of the Ethiopian WHR system legislation towards bond rather than setting up indemnity fund is correctly chosen policy direction.

3.4.3. Registration, Licensing and publicity

Like other traders carrying on commercial activities, warehouse operators are required to get registered and be licensed before launching their business. All eligible persons, except Cooperative Societies, complying with the aforementioned criteria shall be registered in the

¹⁹⁹ An interview with Ato Teshome, Director of Information and Control of Agricultural Marketing Directorate at Ministry of Trade

²⁰⁰ A unit of measure in the US Customary system used for measuring dry goods (Encarta dictionary 2009)

²⁰¹ D. Love (1982), Westlaw, Op. cit., P.117 - 118

²⁰² Ibid

²⁰³ The World Bank (2005), op. cit., pp.7 -8

²⁰⁴ Forestier, et al. (2004), Special Study, op. cit., p. 2

²⁰⁵ Ibid, p. 7 - 8

²⁰⁶ Ibid

commercial register, at the place where the head office of their business is situated.²⁰⁷ It shall also apply to the concerned ministry to get warehousing business license. In the 2003 WHR system Proclamation, the Ministry of Trade and Industry is empowered to license warehouse operators.²⁰⁸ However, Article 5(2) of Proclamation No. 380/2004²⁰⁹ gave the Powers vested on the Ministry of Trade and Industry under the WHR System Proclamation to the Ministry of Agriculture and Rural Development (MoARD).²¹⁰ Again, another Proclamation enacted in 2010 gave all powers and duties vested on MoARD with respect to matters relating to 'agricultural marketing' to the newly established Ministry of Trade.²¹¹ As stated by Ato Teshome, Director of Information and Control of Agricultural Marketing Directorate at Ministry of Trade, warehouse receipt system is one of the principal activities that fall within the domain of 'Agricultural marketing' and hence the powers and duties of the MoARD on WHR system are given to Ministry of Trade by virtue of Proclamation No. 691/2010. Accordingly, including his directorate, all departments under the MoARD which were working on agricultural marketing have been moved to the Ministry of Trade. Therefore, by now it is the Ministry of trade that is legally empowered to issue warehousing business license.

While issuing license the Ministry or its designate classifies each warehouse in terms of its capacity or specific service for which it is going to be licensed. Such classification helps depositors to decide easily to which warehouse they should take their commodities. In addition to the warehouse operator, persons engaged in activities related to warehousing service such as inspection, classifying, grading, and weighing or sampling of agricultural products are obliged to get licensed from the Ministry of Trade or its designate. Here professional competence of the applicant is the only requirement to be observed while issuing such license. However, if the licensee is going to be engaged in grading of agricultural products he/she shall in addition obtain delegation from the only government agency empowered to approve and declare Ethiopian standard i.e. Ethiopian Quality and Standard Authority.²¹²

²⁰⁷ Proclamation No. 686/2010, Commercial Registration and Business Licensing Proclamation, 16th Year No. 42, ADDIS ABABA, 24th July, 2010, Article 6(2)

²⁰⁸ The WHR system proclamation, Op. Cit., Articles 2(14) and 27

²⁰⁹ Proclamation No. 380/2004, Reorganization of the Executive Organs of the Federal Democratic Republic of Ethiopia (Amendment), 10th Year No. 15, Addis Ababa, 13th January 2004

²¹⁰ Cumulative reading of Article 5(2) of Proclamation No. 380/2004 and Article 27 of the The WHR system proclamation, Op. Cit., reveals that warehouse business licensing power is given to the Ministry of Agriculture and Rural Development. See also 30(1) (k) of Proclamation No. 686/2010 which provides exception to warehouse business licensing.

²¹¹ Proclamation No. 691/2010, Definition of Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia, 17th Year No.1, Addis Ababa 27th October, 2010, Article 21(2). This article reads as follows Article 21(2)

:The powers and duties given to the Ministry of Trade and Industry by the provisions of other laws, currently in force, with respect to matters relating to trade and to the Ministry of Agriculture, with respect to *agricultural marketing* [emphasis added], are hereby given to the Ministry of Trade."

²¹² Quality and Standards Authority of Ethiopia Establishment Proclamation No. 102/1998, 4th Year No. 26, Addis Ababa, 3rd March, 1998, Article 6(1)

If a person is found carrying out warehousing business without being registered and licensed, besides the administrative measures to be taken in accordance with the relevant laws, such person will also be subject to serious punishment prescribed under the commercial Registration and Business Licensing Proclamation.²¹³ An interesting issue deserving further discussion in this connection is the legal effect of failure to comply with the requirement of registration. Apparently, if the person is not registered, it is recognized neither as a juridical person nor as a warehouse operator. However, the issue becomes a bit complicated when such denial prejudices the interest of third parties or used by the person to reduce or avoid his legal liabilities. The classical argument in this regard is that though the warehouse operator is not legally registered and licensed if it is proved that third parties have contracted with it believing that it is licensed and that it was actually doing the business of warehousing then it shall be treated as a '*de facto warehouse operator*' to the extent the interest of third parties so requires. This argument has been accepted by the US courts. In the USA, despite the fact that the company is not formally registered and licensed for warehousing business the courts try to check whether the actual business of the company falls within the definition of warehouse operation, for the purpose of determining legal liability. For instance a marina in Florida was held as warehouse operation after its business was examined by the court.²¹⁴ On the other hand, certified air freight forwarders and lessors of an underground cave used for storage of records have escaped from being considered as warehouse operators.²¹⁵

At the other extreme end, one may contend that the requirements of registration and publication are incorporated under the law to protect the interest of third parties. Hence it is up to the third parties to check in the concerned registering office that the person with whom they are going to transact is actually a licensed warehouse operator.) Any person who rushed to the transaction without checking this shall be the sole bearer of the risk. So the second argument rests on a conclusion that if a warehouse is not legally registered and licensed there is no any legal ground to compromise the mandatory requirements of registration and licensing and consider it as '*a de facto warehouse operator*'. In the view of the writer, such conclusion seems a bit inflated. I favor the former argument mainly because it blocks the possibility for a person operating the warehousing business in the wrong track to abuse the situation and attempt to benefit from his illegal acts.

²¹³ If the person fails to comply with the requirement of registration the punishment is fine from thirty thousands to sixty thousands birr and a rigorous imprisonment from three to five years. In case where the person violated the provisions pertaining to warehousing business license then he shall be punished with fine from one hundred fifty thousand to three hundred thousand birr and with rigorous imprisonment from seven to fifteen years. Besides this any property which was being used for the business shall be confiscated by the government. (See: Commercial Registration and Business Licensing Proclamation No. 686/2010, Article 60 (3))

²¹⁴ Richwagen v. Lilienthal, So. 2d 247 (1980), Dist. Ct. App. FL 4th Cir

²¹⁵ See International Business Machines Corporation V. Universal Transcontinental Corporation, 595 N.Y.S. 2d 106 (Sup. Ct. App. Div. 2d Dept.) and Butler Manufacturing Company Inc. v. Americold Corporation, et al, 841 F. Supp. 1107 (US Dist. Ct. D. KS) 1993

In Ethiopia once the warehouse operator has gone through the process of registration and licensing, the last requirement it shall comply with is publication.²¹⁶ The warehouseman whose name has already entered the commercial register shall cause to be published in a newspaper of national circulation within thirty days from the date of its registration. The publication is required to include the location of its head office and each warehouse under its control, the type of commodities it's licensed to warehouse, and its financial standing. On top of this, every licensed warehouseman is obliged by law to display a statement at conspicuous places in all warehouses under his control declaring that it is licensed in accordance with the 2003 WHR system proclamation.²¹⁷ Such disclosure may keep depositors and other parties contracting with the warehouse operator on the safer side for it can be invoked to prove that they have transacted with the warehouseman believing that it is duly licensed to operate the business. In case where the warehouseman displayed the statement without actually having a license, its relation with depositors and others may fall beyond the scope of the warehousing legislation. However the depositors may contend in the court of law that their relation with the warehouse operator shall be governed by the warehousing legislation against the interest of the warehouse operator. The ground for such argument is the fact that they were misled by the wrong statement the person (warehouseman) displayed. Of course this argument could be validly contested by the mandatory requirements of registration and licensing. (See the discussion in the previous paragraph)

Finally, a bit controversial point worth capitalizing in connection with licensing and registration of warehouse operators is the case of ECX. Since its establishment ECX has been operating warehousing business and issuing eWHRs. But the Exchange embarked on the warehousing activities without complying with the aforementioned requirements of registration and licensing.²¹⁸ In fact, Article 24(1) of Proclamation No. 550/2007 seems to require ECX to comply with the requirement of registration only; and it indirectly tends to exempt the Exchange from the licensing requirement. Article 24(1) of Proclamation No. 550/2007 reads as follows:

“Without prejudice to Article 26 of the Warehouse Receipt System Proclamation No. 372/2003, the Exchange may operate warehouses to carry out weighing and inventory management of agricultural commodities and issues Exchange warehouse receipts for the purpose of the Exchange trading”

In an interview with Ato Yohannes, former manager of ECX Compliance Division, he indicated that an attempt was made by ECX to approach the concerned body, i.e. MoARD, so as to fulfill the formality requirements set out under the law. However, because the Ministry had no a system put in place for such purpose the Exchange's effort couldn't be fruitful. Even today the Ministry of Trade, which has taken over the licensing and registering power from the MoARD, has not

²¹⁶ The The WHR system proclamation, Op. Cit., Articles 28(1) and (2)

²¹⁷ The The WHR system proclamation, Op. Cit., Articles 28 (2)

²¹⁸ An interview with senior legal experts of the ECX Compliance Division; See also Article 24(1) of Proclamation No. 550/2007

made any preparation to discharge its duties and responsibilities emanating from the law.²¹⁹ Hence, even if somebody applies to get warehousing business license he/she can't find an office in the Ministry tasked with activities pertaining to warehousing business. As described by one senior official in the Ministry, this is mainly because the government's attention, as far as agricultural marketing is concerned, is totally diverted to ECX. The government seems to conceive that all activities pertaining to agricultural marketing, including the implementation of WHR system, can effectively be undertaken under the umbrella of ECX. This obviously puts the agricultural marketing system of the country under the monopoly of a single market institution. Nonetheless, lessons drawn from the experience of many other countries depict that there should be conducive environment encouraging the flourishing of multiple of warehouse operators, and even Exchanges.²²⁰ To this end, the Ministry shall start properly performing its functions laid down under the WHR system proclamation.²²¹

It is also argued that the Exchange should be treated just like other warehouse operator so long as its warehousing business is concerned. Hence, not only being registered, the Exchange should also be licensed to continue carrying on its warehousing business. The writer of this Thesis couldn't come up with any concrete reason justifying exemption of ECX from the licensing requirement.²²² Principally, as its name implies, ECX is intended to be a trading platform not a warehouse operator. But if it is found necessary for the Exchange to operate warehousing activities so as to achieve its target of facilitating trade, it shall do so upon complying with all the legal requirements enshrined under the WHR system proclamation. Put differently, Article 24(1) of Proclamation No. 550/2007 seems unsound and it should be amended in a manner that puts all warehousing activities of ECX within the legal framework provided by the WHR System Proclamation.

3.5. Issuance of WHR and its Legal Effect

In Ethiopia the sole bona fide issuer of a valid WHR is a duly licensed warehouse operator.²²³ The warehouses are bound to issue receipt to every interested depositor immediately after receiving the commodities to be stored.²²⁴ As noted earlier, according to the provisions of the Civil Code the warehouse operators in Ethiopia might be required to draw up two documents

²¹⁹ An interview with Ato Teshome, Director of Information and Control of Agricultural Marketing Directorate at Ministry of Trade

²²⁰ Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op. Cit., p. 7

²²¹ See Article 26 et seq. of the WHR System Proclamation

²²² All the interviewees including those drawn from ECX didn't mention any convincing reason for exempting the Exchange for the requirement of Licensing. In addition Professor Tilahun Teshome, drafter of the WHR System Proclamation and professor of law at Addis Ababa University, contends that the Exchange shall be subject to the WHR System Proclamation regarding all matters of its warehousing business. (an interview with Professor Tilahun Teshome on 21st October 2011)

²²³ As discussed earlier, exceptionally ECX is issuing WHRs without being licensed.

²²⁴ The WHR system proclamation, Op. Cit., Articles 6(1)

(Voucher and receipt) representing the same commodity deposited in their store. This is a trend in the continental law countries such as Spain and most of Europe.²²⁵ In contrast to this, the 2003 WHR System Proclamation has introduced a 'single receipt system' which is borrowed from Anglo-Saxon legal system^{226 227}. The basic difference between the two lies in the fact that in the former case ownership to the stored commodities is perfected by holding the two documents (i.e. the Voucher and Receipt) simultaneously whereas in the latter ownership is perfected merely by holding a single receipt representing the stored commodity.²²⁸ Hence, currently the warehouse operators in Ethiopia may issue only a single document representing the specific amount of commodity in storage. And this document is named as 'warehouse receipt' (WHR) under the law.²²⁹

3.5.1. Formality Requirements of WHR and Effect of Non compliance

WHRs commonly serve as the strongest evidence for the existence of bailment relationship.²³⁰ The same holds true for Ethiopia where there is a specific legal provision providing that a duly drawn up receipt delivered to depositor constitutes a valid contract.²³¹ It means that the receipt itself is a bailment contract and once the receipt is delivered to the depositor the parties need not, at least they are not required by law, to make another separate written storage agreement for their transaction. From this, it can be inferred that the receipt is usually very important document in defining the relationship between the parties to the transaction. Unless the terms in the receipt clearly define the parties' rights and obligations arising from the warehousing contract it is hardly possible to maintain smooth business relationship between the parties. In view of this, warehouse laws set out some basic elements which shall be incorporated in the receipt.²³² In Ethiopia the following particulars are prescribed by the law as mandatory elements that must appear in every receipt:²³³

- a statement that the WHR is issued in accordance with the provisions of the WHR system proclamation;
- the name, address and registration number of the warehouse operator;
- the location of the warehouse or other places where the goods are stored;
- the date of issue of the WHR;

²²⁵ UNCTAD Secretariat (1996), Op. Cit., pp. 18 – 20

²²⁶ One-part receipt or 'single receipt system' is used in common law countries such as USA and Britain. In these countries the receipt is named as warrant and it conveys title to the stored commodity.

²²⁷ Giovannucci, Varangis, and Larson, Warehouse Receipts, pp. 1 - 3

²²⁸ Ibid

²²⁹ The WHR system proclamation, Op. Cit., Articles 2(20)

²³⁰ B. Pedersen (1995), op. cit., pp. 1 - 12

²³¹ The WHR system proclamation, Op. Cit., Articles 7(1)

²³² See for example Section 7-202 of the Uniform Commercial Code which governs content and form of WHR

²³³ The WHR system proclamation, Op. Cit., Articles 6(2)

- the consecutive number of the WHR;
- the name and address of the person by whom or on whose behalf the goods are stored;
- the rate of storage charges;
- the kind, quality and quantity of the goods represented by the WHR;
- the cost of the goods at the time when it is stored at the warehouse;
- the time limit until when the goods are to be stored;
- a statement of the amount of any advance made and of any liability incurred for which the warehouse operator claims a lien or has a security interest;
- an undertaking by the warehouse operator to deliver the goods on demand; and
- the signature of the warehouse operator.

The above list is not exhaustive. Parties are at liberty to insert additional terms on the receipt that better defines their relationship provided that they maintain the warehouse operator's obligations as provided under the WHR system proclamation. The other possible restriction on the parties' liberty in deciding the content of the receipt is perhaps Article 41 of the WHR System Proclamation which provides that the concerned ministerial office or its designate may draw up model WHR to be employed by warehouse operators. The English version of the said article tends to be a mandatory provision, dictating all warehouses to use the model receipt, whereas the Amharic version is permissive.²³⁴ In the view of the writer, the significance of Article 41 in terms of ensuring uniformity of WHRs across the country shouldn't be undermined. Nevertheless the provision shall simultaneously be taken as a permissive provision (in line with the spirit of the Amharic version) leaving space for the parties to better define their relation within the given legal framework. In support of such recommendation one may also come up with a sound argument that the application of Article 41 is subject to article 6.²³⁵ That is to say even if Article 41 is mandatory provision its application can't go to the extent of denying parties the right to better define their relationship that is explicitly given by sub article 3 of Article 6.

As to the effect of noncompliance, despite the fact that the aforementioned particulars are mandatory elements of every receipt omission of any of them will never render the receipt useless. Stated otherwise, the receipt won't lose its legal status because of the missing of any of the particulars prescribed by the law. However, if it is proved that somebody has sustained damage due to such omission; the issuer (warehouseman) who failed to comply with the legal requirements shall take full responsibility for the damage.²³⁶

²³⁴ The phrase "to be employed" in the English version seems to be mandatory expression. But in the Amharic version the phrase "ተግባራዊ ሊሆኑ ይችላሉ" or "can be employed" (translation my own) appears to be optional. Hence, according the Amharic version, which prevails over the English in case of discrepancy, the decision whether to use the model or not is left to the discretion of the warehouses.

²³⁵ It is explicitly indicated under article 41 that its application shall not prejudice what is provided by Article 6.

²³⁶ The WHR system proclamation, Op. Cit., Articles 6 (3) and (4)

3.5.2. Legal Effects of the Receipt on Bona Fide Issuers and Holders

WHRs require a recognized foundation in law ensuring that the ownership established by the receipts is not challenged.²³⁷ In some countries like the USA and India, the law explicitly recognizes them as title documents; but in other countries, they are legally considered merely as proof of deposit or evidence of possession by the warehouseman on behalf of the depositor.^{238 239} In Ethiopia, WHRs are given a legal status functionally equivalent to that of the stored commodities. In fact, we don't find a provision in the WHR System Proclamation which directly declares WHRs as a document of title to the underlying goods. Article 7 of the Proclamation which deals with legal status of the receipt merely states that the proper issuance and delivery of the receipt to the bailor constitutes a contract between the parties. Here nothing has been said on the legal effect of the receipt as 'document of title'.

However, from the reading of the different parts of the Proclamation, one can easily deduce that WHR is legally treated as a document of title to the goods stored. For example, the Proclamation under its preamble, states that one of the legislation's objectives is to enable farmers store their products upon receiving a document of title²⁴⁰ to the products. This document of title is what has been referred as WHR under the law.²⁴¹ In addition to this, Article 8(2) of the Proclamation while dealing with over issuance provides that "*The holder of the original receipt or his transferees shall retain title to the goods*". This also implies that the receipt is recognized as sufficient evidence that the person to whom it is issued (or any other holder in due course) has

²³⁷ Mor and Fernandes, Op. cit., pp. 46 - 47

²³⁸ In jurisdictions where the receipts convey title documents, their transfer to a bank or a purchaser automatically enables the transferees to exercise indirect control over the commodities warehoused. For example if the transferor borrowed money offering the receipt as pledge to a bank and defaulted to pay off his debt, the bank can present the receipt to the warehouse operator to obtain the commodities, and liquidate them. Of course for this to happen, the receipt needs to be a negotiable document of title. But in case where the receipt is recognized as mere proof of deposit it loses its quality of being secure and reliable collateral. This is because if the receipt is not a title document, then the warehouseman won't be duty bound to deliver the stored commodities to new possessors unless he received notice of the transfer of the receipt from the original depositor/transferor. Hence neither the pledgee nor the purchaser of the receipt can claim delivery of the commodities. This restricts the financial and marketing functions of the receipt. Indeed, some countries try to resolve the problem by setting up a tripartite arrangement (known as an "attornment" arrangement) between the lender, the borrower, and the warehouseman, in which the warehouseman explicitly acknowledges to the lender that he is holding the commodities on the lender's behalf. Such an arrangement may partly tackle the problem for the time being but never avoids the need for a legislation which recognizes WHRs as a legal document of title. (See: UNCTAD Secretariat (1996), Op. Cit., pp. 18 - 20)

²³⁹ See Forestier, et al. (2004), Special Study, op. cit., p. 7 - 8 and UNCTAD Secretariat (1996), Op. Cit., pp. 18 - 20

²⁴⁰ See also J.O. Fabunmi (2002), op. cit., , Pp. 10 - 11

²⁴¹ "Document of title to goods" is defined under Article 2(7) of the WHR System Proclamation as "a written description; identification or declaration of goods which, in the regular course of business or financing, is treated as evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers"

²⁴¹ The WHR system proclamation, Op. Cit., Articles 6 (1)

title to the property described therein.²⁴² Yet, for more clarity it would be better to include a statement in Article 7 of the Proclamation that plainly declares the legal status of the receipt as a valid document of title to the underlying goods. In this regard the Uniform Commercial Code can be mentioned as a model. The UCC under its Section 1-201 (15) explicitly recognizes WHRs as a document of title.

It is evident that the legal effect of duly issued WHRs extends to the parties involving in the transaction at different levels. Primarily, issuance of the receipt marks the creation of a 'contract of warehousing'²⁴³ between the depositor and custodian of the stored goods (i.e. the warehouseman). Where parties haven't made a separate storage agreement, delivery of the commodities to the warehouseman marks an offer and the issuance of a WHR covering the stored commodities may signify acceptance of the offer by the warehouseman and the formation of the warehousing contract. The warehousing contract is closely similar with bailment²⁴⁴. Nonetheless, as observed by Professor Tilahun Teshome, it has, at least, two major peculiar features that make it different from the latter. First the warehouseman, in contrast to a bailee, can issue a transferable document of title to his customers. Secondly, unlike the bailee, the warehouseman shall always be a licensed trader.²⁴⁵ In this section I endeavor to shed light on the major rights, liabilities, and duties of each party to the receipt excluding pledgees who will be discussed in the next chapter.

3.5.2.1. Issuers' rights and obligations

It is the legal obligation of all warehouse operators to issue a WHR to the depositor when the latter so requires. But the issuer shall take care not to over issue (draw up more than one) receipts for the same commodity in his storage.²⁴⁶ If a warehouse operator issues receipts in respect of the same commodities already represented by an outstanding WHR he shall be held liable for the damage caused to holders of the receipt issued for the second time. The problem of over issuance of receipts (issuance of a receipt for commodities already covered by another receipt) may occur in any type of warehousing system including the regulated public warehousing type adopted by Ethiopia, but it has been witnessed to be more common in private warehousing system where the warehouse operator issues receipts to itself.²⁴⁷

²⁴² See also Article 9(1) and 20(6) of the WHR System Proclamation

²⁴³ Contract of warehousing is understood by the law as "a contract whereby one party, the warehouseman, being duly licensed by the appropriate organ, undertakes to receive and store goods on behalf of either of the bailor or of the purchaser of the goods or of a person who receives it in pledge. (See The WHR system proclamation, Op. Cit., Articles 2(4))

²⁴⁴ The term bailment is derived from the French term "*bailleur*" which means "to place in the hands of" Bailment refers to the situation where possession of property is temporarily transferred from one person (bailor) to another (bailee) for a specific purpose.

²⁴⁵ Teshome (2002), op. cit., pp. 197 - 198

²⁴⁶ It should be noted that the prohibition of over issuance doesn't extend to issuance of a receipt in accordance with the WHR System Proclamation in substitution to lost, stolen or destroyed receipts. Nor it does include the replacement of receipts of greater denomination with the smaller one or vice versa.

²⁴⁷ B. Pedersen (1995), op. cit., pp. 1 - 12

The other obligation of the warehouseman pertains to preservation of the goods in the storage. Apparently, while issuing the receipt in accordance with the law the warehouseman undertakes to store the goods safely. Based on this, Article 14(1) of the WHR System Proclamation imposes a duty of care, diligence and preservation on the warehouseman. Sir William Blackstone, in his *Commentaries on the Law*, describes the obligation of such person as follows:²⁴⁸

“... if he undertakes specially to keep the goods safely he is bound to take care of them, as a prudent man would take care of his own.”

Like Blackstone the Ethiopian warehousing legislation has relied on the doctrine of ‘Reasonable Man’ standard to determine the warehouseman’s obligations.²⁴⁹ This Doctrine is widely accepted as a nucleus of the law of warehousing contract governing all aspects of warehouseman’s liability for products placed under his custody.²⁵⁰ The doctrine requires a warehouseman to act towards the goods in his storage in a manner a reasonably careful man would act under similar circumstances. The warehouseman is held liable only for the loss caused by his failure to comply with this duty either intentionally or negligently.²⁵¹

Warehouse operators may attempt to exonerate themselves from legal liability for injury associated with the stored products by using different means like incorporating a disclaimer statement in the contract/receipt. However, so long as it is established by a court of law that the custodian of the goods falls within the meaning of ‘warehouse operator’ under the relevant law, the statements in the contract or other related measures hardly relieve him from liability.²⁵²

For instance, in USA a Company named as ABC was engaged in the business of warehousing property of others for charge. The company, intending to make itself clear from liability, stipulated a wording of disclaimer in the WHR against all liabilities and required property owners to maintain broad property insurance coverage against any possible loss. Nevertheless all the protective statements couldn’t rescue the company from liability. A court in the US held the company liable for the loss of a property in its warehouse due to flood. The court after making sure that the company’s business falls within the definition warehousing business invoked the relevant provision of the Uniform Commercial Code which makes responsible a warehouse operator for damage caused by its failure to exercise care with regard to property of others under its custody or control. Alike the Ethiopian law, the UCC doesn’t relieve a warehouse operator from his legal liability even if there is clear agreement of the parties to that effect. Of course, in the case at hand, the company was held liable not because Acts of God, like flood, gives rise to

²⁴⁸ International Warehouse Logistics Association (IWLA), Insurance and the Warehouse Industry, p. 1

²⁴⁹ The WHR system proclamation, Op. Cit., Articles 14 (2)

²⁵⁰ Article 13(5) is another provision of the warehousing Proclamation which has adopted closely related general standard (i.e. good faith and compliance with standard commercial practice) that shall, in addition to the explicit provisions of the proclamation, be used to determine the liability of the warehouseman.

²⁵¹ Section 7- 204(1) of the Uniform Commercial Code

²⁵² Donald S. Malecki, Three Misconceptions About Warehouse Operators Liability, Colemont Insurance Brokers, accessed at www.colemont.com pp. 1 - 3

liability. But, it was because the court believed that the company's immunity for the loss resulted from acts of God is vanished due to its failure to take reasonable step to reduce the chance of damage caused by impending flood.²⁵³

The warehouseman is also expected to redeliver the preserved good to the right claimant when demanded. Particularly, he is duty bound to redeliver to the holder in due course of negotiable WHR the goods exactly conforming to the quality and quantity indicated on the receipt. This holds true regardless of the fact that the warehouseman didn't actually receive the goods in part or in whole or the goods or their quality or quantity do not correspond with the description in the receipt.²⁵⁴ A warehouseman who fails/refuses to redeliver shall be held accountable unless he can establish the existence of lawful and justifiable reasons provided under the law that hinders redelivery.²⁵⁵ The existence of conflicting claims to the title or redelivery of the goods is one of the lawful grounds of excuse for refusal. In this case, the warehouseman is allowed to take reasonable time before effecting redelivery to ascertain the validity of the adverse claims by taking such actions as instituting a proceeding of interpleader in the court of law.²⁵⁶ The warehouseman is also excused from his duty of redelivery when he receives a written notice from the holder of the negotiable²⁵⁷ WHR that the receipt is lost, stolen or destroyed. In this case the warehouseman shall not discharge his obligation of redelivery without court order. If he does it without getting court order then he will be liable for any person injured thereby.²⁵⁸

The most important right of a warehouseman arising out of the warehousing contract is Right of Lien. The claim of the warehouseman through lien shall relate to due charges and fees for the storage of the commodities.²⁵⁹ Similar provision of the UCC further illustrates these charges to include:²⁶⁰

“charges for storage or transportation (including demurrage and terminal charges), insurance, labor, or charges present or future in relation to the goods, and for

²⁵³ Though flooding was not common in the area of the company's warehouse it was at least known to occur. That's why the court condemned the company for lack due care.

(See Malecki, Ibid, pp.1 – 2)

²⁵⁴ The WHR system proclamation, Op. Cit., Articles 15

²⁵⁵ Article 13(4) of the WHR System Proclamation states the following as lawful and justifiable excuses for refusal/failure of redelivery:

1. delivery of the goods to a person whose receipt was rightful as against the claimant;
2. previous sale or other disposition of the goods in lawful enforcement of a line or on a warehouse operator's lawful termination of storage;
3. any other defense deemed to be lawful by a court of law or a duly constituted arbitration tribunal (the existence of conflicting claims as provided under Article 12 of the Proclamation can be one of the instances falling under this sub article)

²⁵⁶ The WHR system proclamation, Op. Cit., Articles 12

²⁵⁷ As will be discussed later if the receipt is non-negotiable redelivery won't be effected to third parties unless the depositor/original holder notified the warehouse operator about the transfer of the receipt to third parties.

²⁵⁸ WHR System Proclamation No. 372/ui2003, Articles 10(1) – (3)

²⁵⁹ The WHR system proclamation, Op. Cit., Articles 19(3)(a)

²⁶⁰ Section 7-209 (1) of the UCC

expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law”

Hence, the warehouseman can't invoke the doctrine of lien right to satisfy its claim against the depositor/the holder in due course which emanates from other transactions undertaken between them. Generally lien cannot be applied to satisfy a claim, arising out of goods represented by one receipt, using goods represented by another receipt but belongs to the same holder/depositor. The right of lien shall rather be exercised only on the goods covered by a particular receipt out of which the right arises.²⁶¹

As set forth under Articles 18(2) and 19(3) (d) of the Proclamation, the right of lien subsists only where the goods are still in possession of the warehouseman and the warehouse operator hasn't failed to redeliver the goods while there is no sufficient ground of excuse. Such type of liens which arises as a matter of law and only exists against presently stored goods is commonly known as special or specific liens. At this juncture, it should not be left unmentioned that specific lien arising out of duly negotiated WHR is limited to charges in an amount or at a rate specified on the negotiable receipt or if no charges are so specified, to a reasonable charge for storage of the goods covered by the negotiable receipt.²⁶² Of course, the warehouse operator can satisfy his claim of extra charge and fee, if any, from the original depositor based on the contractual relationship existed between them.²⁶³ Unlike the Ethiopian warehousing legislation, the UCC gives explicit recognition for additional type of lien right known as General lien. General Lien exists for charges incurred with respect to previously stored goods. According to Section 7-209 (1) of the UCC general lien can be exercised when it is clearly noted on the face of the receipt that general lien can be claimed. Once the existence of such notation is ascertained, the warehouse operator can claim general lien either against the depositor or holder in due course, based on the rate and charges specified in the receipt. However, if the general lien notation doesn't incorporate specific rate or charges then the warehouseman can claim a reasonable amount against the holder in due course and the contractual amounts as against the depositor.²⁶⁴

In the Ethiopian warehousing legislation, apparently there is no explicit provision providing for general lien. But it should also be noted that there no legal provision prohibiting general lien. Parties to a WHR are at liberty to insert additional terms in the receipt that are consistent with the warehouse legislation and better define their relationship as well. Hence, in effect, like the Uniform Commercial Code, the legal regime of Ethiopian WHR system also leaves the parties at liberty to make agreement for creation of general lien by inserting a term in the receipt to that effect. As it is the case in other jurisdictions, the warehousing legislation of Ethiopia requires the

²⁶¹ The WHR system proclamation, Op. Cit., Articles 19(3)(e)

²⁶² This can be inferred from Article 20(6) of the WHR System Proclamation which provides that holder in due course of a negotiable WHR shall enforce his right in the instrument free from all previous claims and defects.

²⁶³ Kersten (1994) op. cit., pp. 8 - 9

²⁶⁴ Ibid

warehouseman to serve due notice on all persons known to claim interest on the goods before foreclosing his lien by selling the goods. Any person claiming interest on the goods can stop the sale upon paying the amount required to satisfy the lien and other reasonably incurred expenses. The warehouseman shall be accountable for any damage caused by his failure to comply with this and other related conditions set forth under the law.²⁶⁵

The other legal right of the warehouseman pertains to measures he is empowered to take when the duration of storage expires or the goods stored are found to be hazardous. The warehouse operator, upon giving due notice to the person known to have interest, can demand payment of due charges and the removal of the stored goods immediately after the period of storage stipulated in the receipt come to an end. In case where the receipt is silent on the period of storage, the law authorizes the warehouseman to invoke his right of demanding payment of charges and removal of the goods a year after the date of deposit.²⁶⁶ The first pertinent issue here is the justification for fixing the one year. It would be somehow unreasonable to oblige the warehouseman to stay for a year in the condition where there is no specific term of agreement binding him. In this regard, the UCC provides better way out which promotes parties' freedom of contract. Section 7-206(1) of the UCC states that if no period of storage is fixed under the receipt, payment and removal can be demanded by the warehouse operator within a stated period not less than 30 days after the notification. In contrast to the Ethiopian law, the UCC compels the warehouseman to keep the goods in his store only for a reasonable period of time within which the concerned person shall effect payment of charges and remove the goods. Secondly, the failure of the law to fix the maximum possible duration of storage may encourage hoarding. Hence, it is recommended that the law shall state a reasonable limit for the duration of storage.

Where the warehouseman has sufficient evidence showing that the goods under storage are about to deteriorate or decline in value to less than the amount of his lien, he can sell the goods upon serving due notice to persons known to have interest on the goods. Sometimes the goods in warehouse can be found hazardous to human or property after being received for storage. In such a case, Article 17(4) of the WHR System Proclamation permits the warehouse operator to sell the goods upon giving proper notice to the concerned persons. When the sale failed despite a reasonable effort on the part of the warehouseman, he is authorized to dispose of them in any lawful manner. Obviously, a warehouseman who successfully sold the stored commodities invoking his legal rights mentioned above shall have a right on the proceeds only to the extent of his lien. If there is any amount in excess of the warehouseman's lien then it shall be held on trust for the benefit of the person entitled.²⁶⁷

²⁶⁵ See the conditions listed under Articles 19(3) and (5) of the WHR System Proclamation

²⁶⁶ The WHR system proclamation, Op. Cit., Articles 17(2) cum (1)

²⁶⁷ See Article 17(1) - (5) of the WHR System Proclamation

3.5.2.2. Holders' rights and obligations

WHRs holders' rights on the receipt and to the underlying goods mainly depend on the type of the receipt they are holding and the way it reached to them. This will be entertained in detail in the next section dealing with negotiable and non-negotiable WHR. In this section, we shall see the general rights and obligations of holders of the receipt arising out of the warehousing contract. Broadly speaking, qualified holders of WHRS are owners of the goods represented by the receipt.²⁶⁸ Thus, they can exercise the bundle of ownership rights on the receipt and the goods represented by the receipt. They commonly exercise their title either by selling or pledging the receipt.²⁶⁹ In exercising their property rights holders in due course can also demand delivery of the stored commodities upon presenting the receipt. The holders who have title on the receipt and the goods also bear the risk of loss or damage apart from those caused by the warehouseman's fault or negligence.²⁷⁰ The status of the warehouseman should be pretty clear. He is nothing more than custodian of the goods on behalf of the right holder of the receipt. Thus, delivery of the goods to the warehouseman doesn't transfer all the risks associated with the goods. The warehouseman's liability is limited only to loss associated with the stored commodities caused by his fault. Other risks that normally follow ownership still remains with the owner of the goods i.e. holder of the receipt.

The principal obligation of holders of WHRs that emanates from the warehousing contract is the obligation to pay charges and fees for the storage and related services rendered by the warehouseman. The storage charges due to the warehouseman are normally calculated based on the rate indicated in the WHR. However if the receipt omitted to fix the rate of charge then we shall obviously resort to reasonable storage charges rate to determine the amount of lien required to be satisfied by the holder of the receipt. All holders of WHRs are legally obliged to give written acknowledgment for the delivery of the goods while taking out the goods from the warehouse. In case where the receipt is negotiable, the holder shall in addition surrender the receipt to the warehouseman so as to obtain the stored commodities represented therein.²⁷¹ But in case where the WHR is the non-negotiable one, the bailor can order the release of the stored commodities without the need to present or surrender the receipt.²⁷²

Coming to the major rights of WHRs holders enshrined under the law, in case where the WHR is lost, stolen or destroyed the holder of the receipt can suspend delivery of the commodities covered by the receipt to any claimant just by informing the warehouseman in writing what happened to the document. In such a case the warehouseman shall preserve the commodities under his custody until he receives order from a court of law.²⁷³ Another important legal right of

²⁶⁸ See the discussion above under section 3.5.2. which portrays the legal status of WHRs as a 'document of title'.

²⁶⁹ See the discussion on marketing and financial functions of WHRs in the second Chapter

²⁷⁰ The WHR system proclamation, Op. Cit., Articles 14(2)

²⁷¹ The WHR System Proclamation, Op. Cit. Article 13(2) (a) – (c)

²⁷² The WHR System Proclamation, Op. Cit. Article 13(3)

²⁷³ The WHR system proclamation, Op. Cit., Articles 10

holders is the possibility of replacing a receipt with greater denomination with a number of receipts with smaller denominations and vice versa. Such right makes the WHR system more flexible and facilitates wider exploitation of the marketing and financial functions of the receipts. The WHR System Proclamation under its Article 11 provides protection for holders of the receipt by exempting warehoused commodities from attachments on account of either debt or insolvency of the warehouseman.

3.6.

3.6. Transferability and Negotiability of WHRs

Negotiability is often used interchangeably with Transferability. However, a report on WHR System, commissioned by UNCTAD, has attempted to uncover the technical point of divergence between the two terms. A transferable WHR can simply be transferred from one person to another just like the commodities it represents.²⁷⁴ But Negotiable WHRs go further and confer upon the transferee a direct interest in the underlying property free of any outstanding claims except those noted on the receipt itself.²⁷⁵ Thus, the difference lies on the rights of the transferees of the two receipts. Transferee of a negotiable WHR is entitled to the goods described under the receipt regardless of any other dealings either the depositor or the warehouseman made with the goods. The transferee of a non-negotiable but transferable receipt, on the other hand, will only have a right equivalent to the rights of the transferor, and can more easily be defeated by other claimants. Yet it should be noted that the difference between the two terms is occasionally a grey area. In some areas transferable WHRs have been perceived to have all the characteristics of a negotiable instrument, but the laws and legal practice in many countries do not treat them as such.²⁷⁶

A WHR can be either negotiable or non-negotiable according to the obligations assumed by the warehouseman or according to the statutory provisions.²⁷⁷ The Ethiopian Warehousing Proclamation gives recognition for negotiability of WHRs. The law distinguishes negotiable receipt from that of the non-negotiable based on the notation of the magic word 'Nonnegotiable' on the receipt. Per Article 20(2) of the Proclamation a receipt is said to be non-negotiable only if it carries the term 'nonnegotiable' on the face of it. It means that the law has taken a general presumption that all WHRs are negotiable unless the contrary is conspicuously indicated on the documents. Stated otherwise any receipt which does not bear the term non-negotiable on its face remains to be a negotiable instrument.

The said legal provision simply requires the presence of the word 'nonnegotiable' so as to prevent negotiability of the receipt. But taking into account the crucial impact of the word in defining the nature of the receipt the writer of this thesis believes that the legal requirement for the presence of the word may not suffice alone. The law shall further dictate conspicuous

²⁷⁴ UNCTAD (2009), op. cit., pp. 7 - 8

²⁷⁵ Ibid

²⁷⁶ Ibid

²⁷⁷ The Yale Law Journal Company, Inc (1913), Liability of a Warehouseman to an Assignee of a Non-Negotiable Warehouse Receipt, The Yale Law Journal, Vol. 22, No. 3 (Jan., 1913), pp. 246-250

notation of the word 'nonnegotiable' on the receipt in order to prevent possible dishonest practices done by putting the term surreptitiously.²⁷⁸ In USA, to make the receipts easily identifiable warehouse operators usually use different colors to negotiable and non-negotiable receipts in addition to conspicuously noting the term non-negotiable on the apt receipts.²⁷⁹ This is also a good practice that helps to avoid deceptions in dealing with the receipts.

3.6.1. Negotiable Receipts

As provided under Article 22 (6) of WHR System Proclamation, a negotiable WHR is a document which is not only transferable but also capable of conferring upon the transferee a direct interest in the receipt and the underlying commodity free of any outstanding claims and defects. It in effect conveys title to the underlying commodities. Thus, a transferee or a holder in due course of a negotiable receipt may demand delivery of the goods covered by the receipt at anytime upon presenting the negotiable receipt to the warehouseman. However, it should be noted that the transferee's rights/interest over the receipt and the stored commodities is not free from the claims of the warehouseman arising out of his lien right. Hence, the transferee can take delivery of the goods only upon satisfying the warehouseman's lien rights. Article 19(1) of the Proclamation sets forth that the warehouseman is entitled to the right of lien that shall be enforced against any person claiming to have interest on the goods under his custody. Similarly, Article 13 of the same requires bailor demanding delivery of goods covered by negotiable receipt to satisfy first the warehouseman's claims arising out of his lien right. Yet this claim of the warehouseman should not be perceived as an inherent claim over the goods. Normally the warehouseman is a mere custodian who has no direct interest in the stored commodities. His claim goes against the stored commodities only when the owner of the commodities defaults to pay the agreed charges and fees for the storage service.

↳ Issuer of a negotiable receipt is bound to deliver commodity complying with all the terms in the receipt to whoever presents the document.²⁸⁰ When the bearer of a duly endorsed receipt surrenders it to the warehouseman, he obtains the commodities stored against this negotiable receipt. If the commodities stored have been properly graded, delivery of a negotiable WHR may replace normal physical delivery.²⁸¹ It can be stated that the receipt has a status equivalent to a lawful currency. Like a lawful currency, negotiable WHR must be carefully guarded, and the holder of properly endorsed and duly negotiated receipt is presumed to be entitled to spend the negotiable receipt.²⁸² Transferee of negotiable WHR, who received the document by due negotiation, cuts off *nearly* all outstanding claims on both the receipt and the underlying

²⁷⁸ In USA, to make the receipts easily identifiable warehouse operators usually use different colors to negotiable and non-negotiable receipts in addition to conspicuously noting the term non-negotiable on the receipts

²⁷⁹ John Hanna (1931), The Protection of A Holder of A Warehouse Receipt, 15 Minnesota Law Review, p. 292

²⁸⁰ D. Love (1982), Westlaw, Op. cit., P.115

²⁸¹ UNCTAD Secretariat (1996), Op. Cit., pp. 14 - 15

²⁸² Drew L. Kershen (1994) Comparing the United States Warehouse Act and U.C.C. Article 7, 27 Creighton L. Rev. 735, Westlaw, pp. 1 -6

commodities represented by the receipt.²⁸³ Consequently the transferee acquires better title than that of the transferor.²⁸⁴ But there is one exceptional situation provided under Article 23 of the Proclamation which is aimed at maintaining the legal protection of bona fide purchaser of the commodities covered by the receipt.²⁸⁵ In case where a person, in good faith and in line with the ordinary course of business, purchases fungibles and takes delivery thereof from a warehouse operator who is also duly licensed to sell such commodities, the purchaser's right over the goods shall not be challenged even by the holder in due course of a negotiable receipt representing the same commodities. It means that holder in due course of a negotiable receipt cannot cut off the claim of a good faith purchaser of the commodities covered by the receipt who complies with the conditions laid down above. Here the right of the holder in due course of negotiable receipt is exceptionally limited to that of the right of his transferor.

Despite the apparent exceptions stated above, Article 20(6) of the Proclamation sets forth that holder in due course of negotiable receipt enforces his rights free from *all previous claims and defects*. It appears inconsistent with the legal provisions providing for the exceptions discussed above. Perhaps one can argue that the said provision lays down the principle and the legal provisions governing lien right of the warehouseman and uncontested title of the bona fide purchaser are the exceptions to the rule, and hence the inconsistency can easily be reconciled by the canon of Interpretation which provides the special shall prevail over the general. Yet, for better clarity it is recommended to indicate under article 20(6) the presence of exceptional claims that may not be successfully contested or cut off by due holder of negotiable receipts. Otherwise the phrase '*...all claims and defects*' used in the provision tends to send the wrong signal to readers.²⁸⁶

Like other jurisdictions, 'due negotiation' is provided by the Ethiopian warehousing legislation as a crucial condition in determining the rights of the transferee of a negotiable WHR.²⁸⁷ All transferees of negotiable receipts are not entitled to the full rights under the law. A transferee of negotiable receipt can exercise his full right over the receipt and the underlying commodities by cutting off previous claims and defects only when he acquires the receipt after due negotiation.²⁸⁸ If the transferee gets the negotiable receipt without due negotiation his rights will be restricted to

²⁸³ J.O. Fabunmi (2002), op. cit., , Pp. 10 - 11

²⁸⁴ One can infer this from the reading of Article 20(6) of the The WHR system proclamation, Op. Cit.,

²⁸⁵ The Civil Code Op. Cit., Articles 1161 et Seq.

²⁸⁶ A similar provision under the Uniform Commercial Code (Section 7502 (1) (d)) explicitly put as an exception those claims arising under the terms of the receipt or under article 7 of the Code. In similar fashion warehousing legislations in many other jurisdictions too clearly provide that holder of WHRs shall enforce his rights arising out of the receipt free of any defense or claim that are not revealed on the face of the receipt. The insertion of such qualification makes the holder of the receipt liable for claims of the warehouseman emanating from his lien right since such lien is usually revealed on the receipt.

²⁸⁷ The WHR system proclamation, Op. Cit., Articles 20(6)

²⁸⁸ Ibid

the title and rights that the transferor had.²⁸⁹ A negotiable receipt is said to be duly negotiated when it is transferred/negotiated in accordance with the rules governing its negotiation or transfer.²⁹⁰ Article 20(4) of the Proclamation provides that a negotiable receipt can be transferred to third parties by endorsement and delivery. Sub article 5 of the same Article further states endorsement can be made either in blank, to the bearer or to a named person. This makes negotiable WHR freely transferable even better than they were before the enactment of the 2003 WHR system proclamation.²⁹¹ A negotiable receipt issued or endorsed to a specified person can be renegotiated by endorsement in blank, to the bearer or to another named person. As provided under the Commercial Code a receipt issued or endorsed to the bearer shall be transferred by mere delivery of the receipt.²⁹² Since endorsements to the bearer and in blank are equivalent the rule for endorsement to the bearer of a receipt also applies to endorsement of a receipt in blank.²⁹³

In addition to the requirement of negotiating the receipt in accordance with the relevant legal rules, in some literatures it has been argued that a person claiming to be a holder in due course has to show that he has taken the receipt for consideration, in good faith and without notice of any prior claim or defense against it.²⁹⁴ In similar fashion, Article 20(6) of the WHR system Proclamation provides that one can enforce his right in a negotiable receipt free from all previous claims and defects when he/she is holder in due course of that receipt. "Holder in due course" is defined under the proclamation as follows:²⁹⁵

"Holder in due course" means a person who is in possession of a negotiable warehouse receipt for consideration, in good faith and without notice of any prior claim or defense against it."

Such definitive meaning of "Holder in due course" is applicable under literally all negotiable instruments laws. In relation to this, Professor Tilahun noted that:²⁹⁶

"In the province of the law of negotiable instruments, a holder in due course is a person who has taken possession of a commercial instrument or a document of title to goods for value, in good faith and without notice of any prior claim or defense against it, (emphasis added) thereby being entitled to enforce his right in the instrument free from all claims and personal defenses."

²⁸⁹ This can be inferred from the reading of Article 730 of the Commercial Code and Article 1966 of the Civil Code.

²⁹⁰ The commercial Code of Ethiopia, Op. Cit., Article 718

²⁹¹ WHRs issued or endorsed 'to the bearer' have become valid only after the coming into force of the 2003 WHR System Proclamation. Before that, though Articles 719 and 721 of the Commercial Code generally recognizes WHR issued to the bearer, Article 2815 of Civil Code clearly restricts the issuance of 'receipt and voucher' or WHR only to the bailor or a third party designated by him.

²⁹² The commercial Code of Ethiopia, Op. Cit., Article 721(1)

²⁹³ The commercial Code of Ethiopia, Op. Cit., Articles 725(3) and 721(1)

²⁹⁴ Teshome (2002), Op. Cit., pp. 206 - 207

²⁹⁵ The WHR system Proclamation, Op. Cit., Article 2(12)

²⁹⁶ Ibid p.206 (emphasis supplied)

In the legal system of Ethiopia, as far as WHRs are concerned, the meaning of holder in due course has got sufficient legal foundation. However, it should be noted that the concept of 'holder in due course' is important not only for WHRs but also for all other negotiable instruments recognized under the Commercial Code. Unfortunately, the Commercial Code does not clearly provide the elements to be fulfilled for claiming the position of "holder in Due course". Article 718 of the Code which is aimed at describing the concept of 'holder in due course' surprisingly uses the same phrase to describe it. The presence of the aforementioned definitive meaning obviously helps to fill the gap in the Code. Yet, it is the view of the writer that the meaning of 'holder in due course' merits to be incorporated in the forthcoming amendment of the Commercial Code.

The other interesting issue to be raised in connection with negotiability pertains to possibility of transferring part of the rights represented by the receipts. For instance can a holder of a receipt representing 100 quintals of wheat transfer only half/some of the amounts indicated on the receipt to third parties. Though the WHR System Proclamation is silent on the issue Article 725(5) of the Commercial Code directly addresses it by stating that a partial endorsement shall be null and void. Hence negotiation is always possible for the whole amount of the commodity represented by the receipt. A holder who wants to transfer some of the amounts covered by the receipt should first request for replacement of the receipt at hand with a number of receipts with smaller denomination in accordance with article 6(6) of the proclamation.

Finally, building public trust on negotiable receipts necessitates making the transferor of the receipt responsible for some major defects affecting the validity of the receipt and that are known to him. Per Article 22 of the WHR System Proclamation, a transferor who negotiated the receipt for consideration shall guarantee: the genuineness of the receipt, that he is not aware of any defect affecting validity and worth of the receipt, and that he has duly and effectively negotiated the receipt. But the transferor's liability shall never extend to damage caused by the default of either the previous transferors or the warehouseman.²⁹⁷

3.6.2. Non-Negotiable Receipts

A non-negotiable WHR, on the other hand, is just what its name connotes--not negotiable. It is a receipt always made out to a specific party (a natural or a juridical person). As the receipt cannot be negotiated warehouses issuing such receipts are contractually bound to deliver the commodities covered by the receipts only to the person to whom it has been issued. In many legal systems, it's only this person that may authorize release of goods in the warehouse. Since the receipt merely represents the commodities covered therein its delivery will have the same effect with delivery of the property itself. It can't be tantamount to transfer of the warehousing

²⁹⁷ The The WHR system proclamation, Op. Cit., Article 21(2)

contract and enable the transferee to maintain an action upon it in his own name. In support of this view, US courts had the following to say:²⁹⁸

“although the assignment of the receipt vested title to the goods in the assignee, it did not transfer the contract: that the warehouseman could not be made bailee to the assignee without notice of the assignment of the contract”

Accordingly, warehouses will be liable for damages should they deliver the warehoused commodities to anyone other than the person named on the receipt without receiving notice.

Coming to Ethiopian laws, the situation appears a bit different. Per Article 20(3) of the WHR System Proclamation, the transfer of the rights and obligations arising out of non-negotiable receipts shall be governed by relevant provisions of the law regulating Sale or ordinary Assignment. Accordingly, when we look at the relevant provisions of the Civil Code governing ordinary assignment we learn that the creditor, in our case the bailor, can assign his rights in the receipt and in the goods covered therein without the need to secure the consent of the debtor i.e. the warehouse.²⁹⁹ This means that so long as the rights in the receipt are properly assigned, the assignee can claim his rights against the warehouseman despite the fact the warehouseman received no notice about such assignment from the assignor. Of course the assignee is advised to notify the assignment to the warehouseman forthwith so as to keep himself in a safe position. Otherwise the assignee may lose his right of taking delivery because of the act of the assignor. This is provided under Article 1967(1) of the Civil Code as follows

“The debtor shall be released where, before the assignment was brought to his knowledge either by the assignor or the assignee, he pays the assignor in good faith”

Since the Ethiopian law has nothing to say on the form of the assignment, the bailee is at liberty to assign his rights in any form convenient to the parties involved. But it appears pragmatically difficult to enforce rights assigned in other forms than writing. As said before, the relevant provisions of the WHR System Proclamation regulating delivery against non-negotiable receipts implies that surrendering the receipt is not necessary to obtain the stored commodities. If that is the case, the assignee while demanding delivery should at least present written evidence showing proper assignment of the rights in the receipt to him.³⁰⁰ As noted above, even in case of negotiation of receipts issued in a specified name or to his order, the law requires the endorsement to be written on the instrument and signed by the endorser.³⁰¹ Hence, we may have stronger reason to contend that assignment of non-negotiable receipts should be prescribed to be

²⁹⁸ The Yale Law Journal Company, Inc, (1913) Liability of a Warehouseman, Op. Cit., pp. 246-250

²⁹⁹ The Civil Code, Op. Cit. Articles 1962 et seq.

³⁰⁰ In legal systems elsewhere a simple order, signed by the party to which the original warehouse receipt was issued, is enough to effect a delivery of the stored commodities out of the warehouse. (See UNCTAD Secretariat (1996), Op. Cit., pp. 14 - 15)

³⁰¹ The Commercial Code, Op. Cit., Article 725(1)

made in written form. However, on the other extreme end of the spectrum, one may contest the imposition of the formal requirement claiming that it would lead to overregulation. It can be argued that there is no justifiable reason for the law to dictate the parties to use a specific form. The law should rather leave the parties at liberty to choose any mode of assignment which they believe pragmatic and convenient. In the view of the writer, the latter appears contemporary. Since the case at hand is a civil matter it should be up to the parties to choose the mode of assignment which promotes their interest.

A person to whom a non-negotiable receipt is transferred will have the same position as if he purchased the property itself.³⁰² This paves the way for the application of the grand principle of sale that states 'no one shall transfer to others what he has not'. In effect, the transferee will be prevented from acquiring better title than his transferor had. Put differently, the transferee occupies no better position than his assignor did as regards the warehouseman. In line with this, Article 1966 of the Civil Code states the following on valid defenses that can be raised by the warehouseman against the assignee:

1. *The debtor may set up against the assignee, as he could have done against the assignor, any defenses which were available to him upon his becoming aware of the assignment.*
2. *Where he had a claim against the assignor which was not yet demandable at the time, he may invoke a set-off, provided his claim does not fall due later than the assigned claim does.*

Alike the case of negotiable receipts the transferor of non-negotiable receipt for consideration is also required to furnish guarantee for the existence of the rights intended to be assigned. However the scope of guarantee required in assigning non-negotiable receipts is far smaller than that of the negotiable. Transferor of non-negotiable receipts for value shall warrant only the existence of the rights at the time of the assignment. And such guarantee doesn't exceed the amount owed by the assignor plus the costs of the assignment and of any unsuccessful proceedings against the debtor.³⁰³

3.7. Accommodation of eWHRs under Ethiopian legal framework

Generally, three models were suggested to be utilized to adapt eWHR system to the already existing legal systems, or vice versa, of different jurisdictions.³⁰⁴ The first model states that law and practice could be structured to make electronic documents of title fit into existing law and into the conceptualizations that we have developed for paper documents of title. In the second model, a new conceptual framework that preserves some, if not all, of the functions of the paper documents is proposed to be created by the law. The third model put forward experimentation

³⁰² It has been already indicated under Article 20(3) of the WHR System Proclamation that transfer of rights and obligations arising from non-negotiable receipts shall be governed by the legal rules governing Sale.

³⁰³ The Civil Code, Op. Cit., Articles 1664 and 1665

³⁰⁴ B. Pedersen (1995), op. cit., pp. 1 - 12

with a mixed system which preserves the old pretty much intact, but allows the use of electronic data transmissions to develop in limited contexts. The last one is quite closer to the recent practice in USA which allows optional use of electronic WHR for a particular non-fungible agricultural product.³⁰⁵ Likewise Ethiopia has also adopted a model similar with that of USA. This can be inferred from the WHR System Proclamation which allows alternative use of the paper and electronic receipts.³⁰⁶

Whatever the model pursued, it seems clear that legislation will be required up front.³⁰⁷ Accordingly, Ethiopia has given explicit recognition for eWHRs under its federal law of WHR system. Article 2(20) of the Proclamation which purports to define WHR gives eWHR the same legal status with that of paper WHR. Accordingly, the provisions of the Proclamation intended to govern paper WHRs are also *mutatis mutandis* be applicable to eWHR. Yet, it would be a bit difficult to apply all the provisions intended to regulate paper WHR to eWHR because of the very nature of the latter. Hence a separate legal instrument regulating some unique matters of eWHR seems to be inevitable. It is advisable to regulate such detail matters pertaining to eWHRs by legal instruments other than proclamation, such as regulations or directives, so that it won't cost much to modify the legal rules in line with the rapid technological changes. Article 40 of the Ethiopian WHR System Proclamation tends to follow this approach. Though the specific body in charge of making the rules is omitted, it is at least indicated under the said article that the procedures for the issuance and transfer of eWHR will be established under some other instrument. Today, eight years after the Proclamation came into force, there is no any legal instrument in Ethiopia that can be nationally applied to all eWHRs.

Indeed the ECX, which is the first to embark upon eWHR system in Ethiopia, has incorporated provisions under its Rules of Exchange that regulate the creation and use electronic receipts.³⁰⁸ But the application of this body of rules is restricted to the electronic receipts issued by the Exchange itself. If another private company wants to invest on the area (electronic warehousing business) it may need to make its own rules or wait for the making of the rules by the concerned government body. To make the area attractive for investors, a detailed body of legislation regulating the issuance and use of all eWHRs has to be put in place either by the concerned Ministerial office or the Council of Ministers as soon as possible. Such uniformly applicable legislation contributes to the expansion of the use of eWHR in the country by rectifying stakeholders' suspicion and mistrust on the electronic system.

³⁰⁵ Ibid

³⁰⁶ Per Article 2(20) of the WHR System Proclamation cited above, 'Warehouse Receipt' in the context of the Proclamation refers to both the paper and electronic receipts. It means that the legal status given to the paper receipt is also conferred on the electronic receipt and it is possible to use the two alternatively.

³⁰⁷ B. Pedersen (1995), Westlaw, op. cit., pp. 1 - 12

³⁰⁸ Revised Rules of the Ethiopia Commodity Exchange No. 5/2010, July 2010, Addis Ababa - The Exchange issued the Rules in exercise of the power vested on it as per article 12(10) of the Ethiopia Commodity Exchange Proclamation No. 550/2007.

Coming specifically to the provisions under the Exchange Rules and other relevant laws that are purported to regulate eWHRs in Ethiopia, though the provisions touch upon important issues in the electronic system they still lack comprehensiveness. Some important issues are left unregulated and this gap may eventually cause problems that may adversely affect the overall performance the system.

Normally, a legal framework for electronic WHRs should clearly establish what is required in terms of computer data to create an electronic document of title.³⁰⁹ However the ECX rules have jumped over such terms and simply began with laying down the procedure to be followed for the creation of eWHRs.³¹⁰ Per the Rules, a depositor who delivered his commodities to a warehouseman receives a document known as 'Goods Received Note',³¹¹³¹² It is worth mentioning that such a Note doesn't represent a legal title to the deposited goods. Nor can it be transferred or negotiated. It is merely a precondition for the creation of eWHR by the Central Depository, which is the only entity of the Exchange authorized to issue eWHR.³¹³ The Central Depository issues the electronic receipts only when it receives the 'Goods Received Note' (GRN) electronically transferred from the concerned warehouse.³¹⁴ Article 9(2) (5) of the Exchange Rules further provides that the electronic receipt may upon request be materialized into a paper receipt, according to the procedures of the Exchange Central Depository. However, in practice the Exchange is not willing to materialize electronic receipt into paper receipts on the ground of preventing forgery.³¹⁵

If a WHR is to exist only in the electronic impulses of the computer, it is virtually impossible to contend that it is a written and signed document in the traditional sense. However the current Ethiopian WHR System Proclamation sets out signature of the warehouseman as one of the particulars to be incorporated into a WHR³¹⁶,³¹⁷ One may think that though signature is made a requirement, there is no explicit statement under the law dictating the signature to be handwritten. Moreover, the normal function of signature is perceived to be authenticating the document. If such long-established function of signatures can attract a consensus, then their role can easily be taken over by assurances of authority and authenticity that only computers can provide.³¹⁸ However, a problem arises when the existing laws sticks on traditional way of

³⁰⁹ B. Pedersen (1995), op. cit., pp. 1 - 12

³¹⁰ Revised Rules of the Exchange (2010), Op. Cit., Article 9.1, 9.2 and 9.4

³¹¹ 'Electronic Goods Received Note' is defined under 2.1.20 of the Exchange Rule as "A document that is issued at the warehouse by the warehouse manager purporting receipt of commodities".

³¹² The Rules of Exchange, op. cit., Article 9.1

³¹³ Ibid, Article 9.2 - 9.3

³¹⁴ Ibid, Article 9.1.6

³¹⁵ An interview with Ato Daniel Yilekal, Manager of ECX Central Depository

³¹⁶ WHR System Proclamation, op. cit., Article 6(2)(m)

³¹⁷ Article 15 of the WHR System Proclamation also explicitly put signature of the warehouse operator or his agent or employee as a requisite to claim delivery of goods exactly conforming to the quality and quantity indicated under the WHR by a person who is holder in due course of a negotiable WHR.

³¹⁸ B. Pedersen (1995), op. cit., pp. 1 - 12

affixing signature. Here comes the case of Ethiopia. Though the current warehousing Proclamation doesn't contain a provision directly dictating handwritten signature, Article 1728(1) of the Ethiopian Civil Code which is authorized to complement³¹⁹ the WHR System Proclamation clearly spells out that when signature is required by law it shall be made handwritten. The Ethiopian Commercial Code under its Article 734(2) provides a mechanical process like stamp as an alternative way of affixing signature. However, there is no a legal provision in any of the Codes that gives recognition to electronic signature.

Hence, the need for amendment of the existing legislation appears to be inescapable. One may, of course, argue that handwritten signature is inconsistent with eWHR and at the same time Article 46(2) of the warehousing Proclamation explicitly repeals any law inconsistent with provisions of the proclamation. Thus it would be possible to draw a conclusion that as far as WHR system is concerned Article 1728 of the Civil Code is no more applicable as it contradicts with Article 40 of the Proclamation which recognizes eWHR. In the view of the writer of this thesis, this way of argument may serve as a way out for the time being but doesn't totally avoid the controversies surrounding the issue. Hence the enactment of a law giving explicit recognition to electronic signature or providing for broader meaning for 'signature' appears to be apt.

In this regard, the definition of signature in UCC can be taken as ideal example. Under the UCC, signature is given broader meaning encompassing any symbol adopted by a party and intended to authenticate a written document. This way of defining 'signed' provides space for adaptation of eWHRs.³²⁰ In fact, there is also emerging developments in the electronic technology that is coming with solution for complications of eWHRs pertaining to the requirement of signature. This technology allows capturing and verifying signatures (autographs) with pen computers.³²¹

In case where the warehouse operator whose signature is required to appear in the WHR is physically unable to affix his signature on the receipt using one of the alternatives provided by the law, his consent shall be evidenced by an authentic declaration on the instrument.³²² If the warehouse operator is visually impaired or illiterate his signature or thumb-mark on the receipt won't have legal effect unless authenticated by a notary.³²³

It is apparent that one of the most important qualities of WHRs is their negotiability. Hence it is crucial to maintain same quality of the receipt in the new world of Electronic Data Interchange (EDI) too.³²⁴ In view of this, the Exchange Rules spell out that the eWHR issued by the Central Depository of ECX represents a legal title to the deposited commodity and it can be either transferred or negotiated. Put differently, all eWHRs of the ECX are negotiable by virtue of

³¹⁹ WHR System Proclamation, op. cit., Article 4(2)

³²⁰ U.C.C. section 1- 201(39)

³²¹ B. Pedersen (1995), op. cit., pp. 1 - 12

³²² The Commercial Code, Op. Cit., Article 734(3)

³²³ The Civil Code, Op. Cit., Article 1728 (2) and (3)

³²⁴ Ibid, pp. 8 - 9

Article 9.2.3 of the Exchange Rules. The Proclamation, on the other hand, states that a WHR³²⁵ is said to be negotiable only if it doesn't bear the term 'nonnegotiable' on its face.³²⁶ Here the Rules of the Exchange tend to contradict with the WHR system proclamation. while the proclamation provides the notation 'nonnegotiable' as a requirement to identify non-negotiable receipts form that of the negotiable, the Exchange attempts to make all receipts negotiable by virtue of its Rules. The contradiction practically occurs if the Exchange issues a receipt having the term non-negotiable on its face. As per the Rules of the Exchange, such a receipt should remain negotiable but if the proclamation is to be applied the receipt turns out to be nonnegotiable.

Normally in case of paper WHRs the negotiable document of title can be issued either in the form of 'to order of the named person' or 'to the bearer'. But when the receipts are electronic 'to the order of the named person' is suggested to be more preferable type of negotiable eWHRs.³²⁷ The other possible type of negotiable receipt, i.e. to the bearer electronic receipts, is not as such advisable as it may lessen the security of the receipt. Hence, to avoid confusion, the law governing the eWHR regime shall go further beyond requiring the inclusion of the terms 'Negotiable' or 'Non-negotiable' in the receipt and clearly indicate whether to the bearer electronic receipts are given recognition or not.³²⁸ In our case neither the Proclamation nor the ECX Rules clearly exclude the issuance of 'to the bearer' electronic receipts. Therefore, the conclusion would be that to the bearer electronic receipt is permitted in the Ethiopian system. As stated above such type of receipt erodes the security of the electronic system hence this can be another point seeking legislative measure.

The other gap witnessed in ECX Rules is absence of provisions providing for the detail process and elements of due negotiation via electronic data interchange (EDI). Obviously the rules of negotiation applicable to paper receipts can't be directly enforced on electronic receipts.³²⁹ The Exchange Rules simply state that the Central Depository is authorized to transfer legal title. How a holder of a receipt can request for negotiating his receipt and how the transferee can check that the receipt is duly negotiated to him – are questions to be addressed under the Exchange Rules. Unless these are prescribed clearly, simply because the receipts are declared negotiable, we cannot recognize them as negotiable since they can't be practically negotiated. In practice the ECX receipts are serving as negotiable document of title only for the purpose of trading on the Exchange floor.³³⁰ Other than this, the system in ECX doesn't allow holders to negotiate their electronic receipts online or merely by giving instruction to the Central Depository.³³¹ Let alone

³²⁵ This includes eWHR also as per article 2(20) of WHR system proclamation

³²⁶ WHR system proclamation, op cit., Article 20(2)

³²⁷ B. Pedersen (1995), op. cit., pp. 1 - 12

³²⁸ Ibid, pp. 8 - 9

³²⁹ See the discussion on negotiability of paper based WHRs in the previous section

³³⁰ An interview with Ato Daniel Yilekal, Manger of ECX Central Depository

³³¹ Ibid

negotiating the receipts currently it is not possible for holders even to check audit trail of their receipt online. In fact, the Manger of the ECX Central Depository, Ato Daniel, has disclosed that every holder can get from the Central Depository a report on the status of his receipts twice a day.³³²

The other point a legislation of eWHR should address is the criterion to be employed to determine the right holder of eWHR.³³³ Unfortunately this is left almost untouched in Exchange Rules. In the paper based WHRs the holder or person in possession of the document of title is pretty clear. The one exercising physical control over the receipt is deemed to be holder of the title document/WHR. But when it comes to eWHR the question who is the holder tends to be somehow difficult since there is no physical object to be possessed. Some legislation simply provide that the one who receives an electronic data interchange (EDI) message transmitting all interest in a WHR is a "holder". Such legation seems a bit chancy.³³⁴

It should be noted that a person can be considered as a 'holder' when he is able to achieve a certain level of control over the document that can be accepted as legally equivalent to physical possession. In a paper based WHR system lending institutions providing credit against a negotiable WHR are vitally concerned about taking possession of the receipt. That is because physical possession of a negotiable WHR (document of title) is thought to tantamount to possessing the underlying commodity. Financers consider possession of the receipt as the best means of protection against its misuse. But once the system is transformed into electronic receipt there won't be a paper document to rely on to get one's right protected. It is rather exercising control over electronic transmissions that enables to ensure that the receipt is not misused.³³⁵ Thus, it is recommended that elements appropriate in eWHR system for an equivalent level of "control" be identified and incorporated into the law.³³⁶

Another issue to be taken up in this connection is the neutrality of the system provider. System provider is defined in the WHR System Proclamation as "a person wherever domiciled who provides services to a licensed warehouse operator in matters pertaining to management, to the provisions of electronic records, and to the setting up and maintenance of computer based systems to manage and record transactions in respect of electronic receipts."³³⁷ In the existing eWHR system of Ethiopia ECX is often playing with double positions both as warehouse operator and system provider. In fact it's not unique to Ethiopia; the same holds true in countries like Uganda.³³⁸ Yet the South Africa's system of electronic silo certificates which is reported to be the best experience in Africa have showed that contracting out the management of the

³³² Ibid

³³³ B. Pedersen (1995), op. cit., pp. 1 - 12

³³⁴ Ibid

³³⁵ Ibid, pp. 8 - 9

³³⁶ Ibid 8 - 9

³³⁷ WHR System Proclamation, op. cit., Article 2(17)

³³⁸ UNCTAD (2009), op. cit., p. 50



electronic system to an independent third party, system provider, enables to address the concern of the trading community about the confidentiality of the data.³³⁹ Where all documents are held on an electronic system with a single reliable electronic registry the risk of forgery can also be overcome.³⁴⁰ The system provider/registry can either be a governmental or private company duly authorized to undertake the management of the system.

Finally, very interesting lesson to be drawn from experience of South Africa is the establishment of an Administration Centre which includes a telephone trading desk so as to help farmers who are computer-illiterate use the electronic system. The center enables farmers having problem in using computer just to phone to the desk and give instructions.³⁴¹ In Ethiopia where majority of farmers are not computer-literate such administration center will have pivotal role in making the electronic system reachable to vast majority the potential depositors.

3.8. Insolvency of the Warehouse Operator

Depositors primarily rely on financial standing of the warehouse operator while warehousing their products. Because of this, solvency of warehouseman is considered to be among the most important issues calling for due accentuation in developing effective WHR system. In fact, it should be noted that insolvency is natural outcome of competitive market and hence its occurrence at a reasonable rate may not necessarily imply problems in the warehousing industry or in the whole economic environment at large. In this case, what is expected from the government is just to make sure that a bankruptcy regime striking balance between the interests of creditors and that of the bankrupt is in place. But, when the rate goes up it is needless to say that the core reasons leading companies to financial failure shall be checked out and apt legislative and administrative measures be taken to address the problems in the bankruptcy regime.

In countries which have well developed and widely expanded system of WHRs, insolvency/bankruptcy of warehouse operators has been witnessed among the major challenges adversely affecting producers and others. For instance, in the USA, 177 warehouses were reported for running bankrupt only within six years from 1975 to 1981.³⁴² Following such financial failure farmers have lost more than fourteen million dollars. It means that every farmer who deposited in the bankrupt warehouses has lost on average \$ 4,292. This shows unbearable damage sustained by farmers due to financial failure in the warehousing industry. Most

³³⁹ Ibid, pp. 15 - 17

³⁴⁰ Ibid, p. 50

³⁴¹ Ibid, pp. 15 - 17

³⁴² Such inflated rate of bankruptcy in US warehousing industry was mainly attributed to reasons like mismanagement, volatility of grain prices, and losses due to speculation in grain futures. In addition, a committee appointed by the government to investigate the cause of the financial problem in the warehousing industry identified that unfavorable state of the economy and high interest rates were key factors aggravating the financial failure of grain elevators. Countries like Ethiopia which are embarking on WHR system may draw lesson from US experience on the various causes aggravating financial problem in the warehousing industry.

significantly, such insolvencies deny farmers access to what is often their sole income producing asset, i.e. the grain they produced. Obviously, farmers are not the only victims of the financial failure in the warehousing industry, lending institutions, commodity markets and other stakeholder also lose much.³⁴³ Hence the need for sufficient legal provisions governing bankruptcy of warehouse operators is inevitable. After all, it's noteworthy that the ultimate goal of warehousing legislations is properly regulating warehouse operators in order to keep them solvent.³⁴⁴

In Ethiopia, the WHR System Proclamation doesn't contain provisions governing bankruptcy proceeding of the warehouse operators. Hence the relevant provisions of the Commercial Code regulating bankruptcy proceeding shall complement the warehousing legislation pursuant to Article 4(2) of the same. According to the general³⁴⁵ bankruptcy regime provided under the Code, the pecuniary effects of bankruptcy shall be limited only to those properties belonging to the bankrupt, and other assets in possession of the bankrupt but owned by a third-party shall be excluded from the bankruptcy proceeding.³⁴⁶ Coming to the right of the warehouse operator on the stored commodities, as already established earlier, the warehouseman is nothing more than a custodian of the stored commodities on behalf of the legitimate holder of the WHRs covering the commodities. He has no any interest on the stored commodities except storage charges and fees. Thus, it follows that commodities under the possession of a bankrupt warehouse operator but belonging to third-parties (such as the right holders of WHRs covering the stored commodities) are completely excluded from the bankrupt estate. Similarly, the only provision of the WHR System Proclamation dealing with bankruptcy (i.e. Article 11) repeats the same rule by providing that stored commodities for which WHRs are issued in the name of third-parties shall not be liable to attachment on account of bankruptcy. Since this can be easily inferred from the already existing provisions of the Commercial Code, the relevance of the replication in the Proclamation is totally unclear. In any case, the most important point to be emphasized here is that the legitimate holders of WHRs can claim delivery of the commodities in the warehouse upon paying due charges and fees to the trustee even after the warehouseman is declared bankrupt. But this holds true only when the commodities covered by the receipt are still available in the warehouse.

However, in the situation where the warehouse operator went bankrupt, it would be unlikely that all commodities for which receipts are issued will be available in the warehouse. When the commodities are not available for various reasons then the holders of the receipts may have no

³⁴³ Michael D. Love (1982), A Survey of Current Issues and Legislation Concerning Grain Elevator Insolvencies, 8 J. Corp. L. 111, Journal of Corporation Law Fall, Westlaw, pp.111 - 113

³⁴⁴ D. Love (1982), Westlaw, Op. cit., P.115 - 118

³⁴⁵ The word general is inserted here to inform readers that Ethiopia has introduced a special bankruptcy regime for banking sector by virtue of Proclamation 592/2008.

³⁴⁶ The Commercial Code, Op. Cit., Article 1009(1), See also Taddese Lencho (2011), Ethiopian Bankruptcy Law: Commentary (Part II), Journal of Ethiopian Law, Vol.24 , No. 2, pp.2- 89

option than joining the Universality of Creditors in the bankruptcy proceeding. Of course, at this juncture, the surety bond which is exclusively used to satisfy the claims of WHRs holders should not be left unmentioned. The holders of the receipt may join the Universality of Creditors only if the surety bond is found insufficient to satisfy the full amount of their claims arising out of the receipt. Hence, legitimate holders of WHRs may not sometimes escape from experiencing the pain arising out of the weak sides of the old aged bankruptcy regime provided under the Commercial Code.³⁴⁷ Though there may not be the need to create a special bankruptcy regime for warehousing industry the amendment of the provisions in the existing regime is important. Moreover, depending on the existing situation in the warehousing industry, legislative and administrative measures enabling to prevent the financial failure of warehouses shall be taken timely. This may include increasing the amount of the surety bonds that warehouses are required to keep, requiring financial statements attesting to the elevator's financial condition (some require a Certified Public Accountants statement also), stiffen licensing requirements, and provide tougher penalties for violation of regulations.³⁴⁸

³⁴⁷ The various reasons triggering the amendment of the provisions of the existing bankruptcy regime are discussed in detail by Taddese Lencho in his two parts Commentaries published in Journal of Ethiopian Law. See Taddese Lencho (2008), Ethiopian Bankruptcy Law: Commentary (Part I), Journal of Ethiopian Law, Vol.22 , No. 2, pp. 63 - 95; see also Taddese Lencho (2011), Ethiopian Bankruptcy Law: Commentary (Part II), Journal of Ethiopian Law, Vol.24 , No. 2, pp.2- 89

³⁴⁸ D. Love (1982), Westlaw, Op. cit., P.115 - 118

Chapter Four

WHRs as Instrument of Security: Their legal and practical Significance in Ethiopia

4.1. Introduction

Though WHRs can be used as a security for any transaction, they are usually offered as collaterals for loans.³⁴⁹ Producers, processors and traders are used to access credit by offering the receipts as a security.³⁵⁰ Providing fund/loan against the receipt is commonly referred to as WHRs Financing or Inventory Credit. In other words, WHR financing is the use of securely stored goods as loan collaterals.³⁵¹ Financing of WHRs is not at all a recent phenomenon in the business world. It has been undertaken in different forms since time immemorial.³⁵² In this regard, Vaughn noted that “*the evolution of warehousing as a base on which to borrow money can claim beginnings as old as the concept of property ownership*”.³⁵³ It is further argued that the emergence of WHRs financing system could be the extension of ‘Barter’ method of the primitive society and the pledge employed there.³⁵⁴

Three major types of WHRs financing arrangement were identified by Vaughn.³⁵⁵ The simplest and commonly used type is an arrangement in which the owner of the goods deposits them in a warehouse and gets loan from the warehouseman himself by offering the stored goods as a pledge. The other most prevalent arrangement refers to the situation where the owner stores the goods in a public warehouse and receives a WHR.³⁵⁶ Then the owner can pledge the receipt to secure any transaction including a contract of loan. It is this type of arrangement that has been introduced in Ethiopia by the 2003 warehousing legislation. The third arrangement is known as field warehousing. In this case the goods need not be taken to the warehouse but the warehouse itself moves to the premises where the goods are situated.³⁵⁷ Though the goods intended to be under the possession of the warehouseman may not be removed from the owner’s premise they shall be clearly separated from the reminders, if any. The field warehousing company after

³⁴⁹ Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op. Cit., p. 7, p. 20 and pp. 50 – 52

³⁵⁰ Ibid pp. 50 – 52

³⁵¹ Innovations in Microfinance (2000), Warehouse Receipts: Financing Agricultural Producers, Technical Note No 5, p.1

³⁵² Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op Cit., p. 14

³⁵³ Vaughn (1968), Op. Cit., p. 4

³⁵⁴ Ibid

³⁵⁵ Ibid, pp. 7 - 9

³⁵⁶ Public warehouses are widely used in the WHRs financing schemes of United States, Western Europe and other countries such as Singapore and South Africa. (See Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op Cit., p. 19)

³⁵⁷ Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op Cit., p. 8 and p. 19

taking delivery of the goods (exercising full control over the goods) issue a receipt that can be used by the depositor/holder like the receipts issued by public warehouses.³⁵⁸

Recently, WHRs financing has captured the attention of researchers and international organizations engaged in activities targeting the improvement of the agribusiness sector in general.³⁵⁹ Research findings in the agriculture sector have asserted that limited or total absence of access to rural finance is one of the major bottlenecks for the development of countries with agrarian economy.³⁶⁰ And, it is suggested that such financial shortage can be best rectified through the implementation of WHR financing scheme.³⁶¹

Similarly, a study done in Ethiopia in 2008 has laid emphasis on negative impact of financial shortage on agricultural sector. The study stated the following as its concluding remarks:³⁶²

“In Ethiopia, among other things, lack of finance is one of the fundamental problems hampering production, productivity and income of rural farm households. Since access to institutional finance is very limited, the majority of the poor are forced to search financial services through informal channels.”

The quotation indicates improving accessibility of rural financial services is one of the most important engines of economic development in Ethiopia. To this end, besides encouraging the establishment and expansions of financial institutions, it is also equally important to make sure that borrowers have appropriate assets that can be offered as collaterals. In countries like Ethiopia, where the land policy doesn't allow farmers to offer it as a security,³⁶³ lack of assets to be collateralized appears to be a serious setback. Formal financial institutions in Ethiopia don't consider smallholder farmers as creditworthy because of the fact that they can't furnish the required collaterals.³⁶⁴ WHR financing system fills the gap between the agriculture sector and formal financial institutions by facilitating conversion of agricultural inventories into a receipt that can be offered as collateral. By so doing WHRs play dominant role in rectifying the serious financial constraint prevalent in the rural areas. Since the loan to be given against WHRs is often flexible, it can be used either to overcome immediate liquidity requirements or to finance future crop/investments on farm equipment or alternative businesses.³⁶⁵ WHRs are identified as more apposite mechanisms for accessing short-term working capital loans because they do not tie-up

³⁵⁸ Ibid,

³⁵⁹ Onumah (2003), Improving Access to Rural Finance, Op. Cit., pp. 1 - 12

³⁶⁰ Ibid, p. 12

³⁶¹ Ibid

³⁶² Yehuala (2008), Op. Cit., pp.1 -3

³⁶³ Proclamation of the Constitution of the Federal Democratic Republic of Ethiopia , Proclamation No. 1/1995, 1st Year No.1, Addis Ababa – 21st August, 1995, Article 40(3)

³⁶⁴ Adera A., (1995), Op. Cit., pp. 5 – 22

³⁶⁵ Mr. Nachiket Mor and Dr. Kshama Fernandes (2009), Warehouse Receipt Finance for Farmers – A Glimpse, Commodity Insight, MCX AND PRICEWATERHOUSECOOPERS, year book, pp. 42 -43

fixed assets(if any), which are more appropriate security devices for accessing long-term credit for capital expenditures.³⁶⁶

WHR financing system is also suggested as a means of rectifying the financial constraint in import and export market of commodities.³⁶⁷ Developing countries and countries in transition cover close to half of world exports and imports of commodities.³⁶⁸ Producers, processors, traders, exporters and importers from these countries are confronted with a need for credit, even more than that of their counterparts in developed countries who normally have more equity.³⁶⁹ This financial constraint can be rectified or at least abated by introducing effective WHR financing scheme. Particularly in Ethiopia where agricultural commodities make up significant part of the country's export trade³⁷⁰ WHRs financing scheme creates better access of credit to exporters. For example, An Ethiopian trader who wants to build up a sufficiently large volume of Coffee for an export transaction may find himself in need of fund. But if there is a well functioning WHR system in place, the trader can simply take the coffee in his possession to a licensed warehouse and get a WHR covering the coffee. Then he can easily secure the needed fund from banks by offering the receipt as a collateral and buy additional stocks of coffee for the export market. When an export contract is signed, the importer pays directly to the bank, which on receiving the payment (or letter of credit) authorizes the warehouse to release the coffee to the buyer. The bank keeps what is necessary for reimbursement of its loans and pays to the trader the remaining funds.³⁷¹ By so doing, the scheme not only finances the export trade but it also makes all the parties involved there beneficiaries.³⁷²

4.2. The Role of WHRs Financing System in an Agrarian Economy: Ethiopian smallholder farmers in focus

Agriculture is the backbone of economies of virtually all developing and least developed (LCDs) countries. Particularly in most of the Eastern and Southern countries of Africa, including Ethiopia,³⁷³ national economies remain highly dependent on agriculture, both as regards exports

³⁶⁶ Marisa Baldwin, Erin Bryla, and Anja Langenbacher, 2006, Expanding Post-Harvest Finance Through Warehouse Receipts And Related Instruments, Agricultural and Rural Development Notes, ISSUE 8, p.1

³⁶⁷ Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op Cit., p. 7 and p. 33

³⁶⁸ UNCTAD Secretariat (1996), Op. Cit., pp. 1 - 3

³⁶⁹ Ibid

³⁷⁰ See: <http://www.state.gov/r/pa/ei/bgn/2859.htm#>, last visited on 29th July, 2011

³⁷¹ UNCTAD Secretariat (2003), Op. cit., pp. 12 – 16

³⁷² The exporter earns profit from the export transaction, the warehouse operator benefits from the storage fee and the bank collects interest from the money it lent.

▪ ³⁷³ Ethiopia is a landlocked country of about 80 million people and abundant agricultural land. The country has predominantly agrarian economy. In Ethiopia the agricultural activity is essentially rain-fed; plus to this, it is plagued by periodic drought and soil degradation. Poor storage facility and transport infrastructure has made it difficult and expensive to get to the market agricultural products harvested through all these stumbling blocks. On top, Farmers suffer from very limited access to finance. Despite all these setbacks agriculture has remained to be most promising resource and back

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³⁶⁷ Höllinger, F., Rutten, L. and Kiriakov, K. (2009), Op Cit., p. 7 and p. 33

³⁶⁸ UNCTAD Secretariat (1996), Op. Cit., pp. 1 - 3

³⁶⁹ Ibid

³⁷⁰ See: <http://www.state.gov/r/pa/ei/bgn/2859.htm#>, last visited on 29th July, 2011

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and as a source of employment and income.³⁷⁴ In these countries, the number of small-scale farmers covers the largest population.³⁷⁵ These farmers often run to the market carrying their products and sell them off immediately after harvests. They do so, not necessarily because of lack of awareness about the fact that the price and the potential for profit reach their apex in lean season. Almost all the farmers in agrarian economies, including Ethiopia, know pretty well that prices fall to their lowest during harvest, due to the simple demand and supply equation, and will gradually go up during lean season. They also understand that the profit that should have come to their pocket is being unreasonably snatched away by intermediaries such as brokers and local traders. I don't think it requires going too far to justify this truth. The fact that farmers are often found to be among buyers in the lean season is quite enough to portray that they are not only sentient of the situation but also victims of the high price in lean seasons. It is common that crops oversold in the postharvest and shipped out to urban centers will be shipped back to the rural belt as either grain or meal, at much higher prices in lean seasons. If this is the scenario, what would be the actual reason that drives smallholder farmers to dispose their products at depressed postharvest prices?

Small-scale farmers consciously surrender their benefits principally because of their dire need of liquidity. The harvest season is high time to the farmers to discharge debts owed for agricultural inputs such as fertilizers.³⁷⁶ Lenders need them to repay debts in this season when farmers are thought to make the maximum possible money. It is during this period the farmers need to obtain cash for School fees, for purchasing different products that they don't produce³⁷⁷ and for

bone of country's economy supporting more than 80% of the total population living in the rural belt. The major agricultural export crop is coffee, providing approximately 35% of the country's foreign exchange earnings. It contributes 45% to GDP and more than 90% of export trade. It is also noted that Ethiopia has strong Potential for self-sufficiency in grains and for export development in livestock, flowers, grains, oilseeds, sugar, vegetables, and fruits. Other traditional major agricultural exports are leather, hides and skins, pulses, oilseeds, and "chat". (See: <http://www.state.gov/r/pa/ei/bgn/2859.htm#> as retrieved on 29th July, 2011; see also Federal Democratic Republic of Ethiopia Ministry of Finance and Economics Development in Conjunction with Ministry of Agriculture and Rural Development, Global Agriculture and Food Security Program - Request for Funding Public Sector Window Agricultural Growth Program (GAFSP GAP FINANCING), Draft, 29th September, 2010, p. iii)

³⁷⁴International Co-operative Alliance Regional Office for Africa (ICA AFRICA), "Exploring Rural Finance Best Practices along Value Chains: Cases from East and Southern Africa, IFAD-SCC-ICA Rural Finance Workshop, 21-24 September 2010, Lusaka (Zambia), available at www.icaafrica.coop, as retrieved on 12th June, 2011.

³⁷⁵For Example in Ethiopia agriculture accounts for 85% of employment and smallholder agriculture is identified as the most important sector of Ethiopia's economy (See Federal Democratic Republic of Ethiopia Ministry of Finance and Economics Development in Conjunction with Ministry of Agriculture and Rural Development, Global Agriculture and Food Security Program - Request for Funding Public Sector Window Agricultural Growth Program (GAFSP GAP FINANCING), Draft, 29th September, 2010, p.iii)

³⁷⁶Interview with small holder farmers residing in the Northern part of Ethiopia

³⁷⁷It is virtually impossible for a man to be self-contend, and thus we all are interdependent. Though farmers may produce surplus crops and other agricultural products, they are dependent of others for the rest of their needs and

preparation of different social ceremonies.³⁷⁸ In addition to the liquidity need of farmers, improper preservation or drying techniques and inadequate storage facilities are also mentioned as factors hindering farmers not to pass through the harvest season retaining their produce. At this juncture, two conflicting interests appear to be apparent. On one hand, there is the farmers' need for liquidity in the harvest season, and on the other hand, the cheap market price and less profit in the same season. WHR financing system is an innovative mechanism that enables to address simultaneously both of these conflicting interests of the smallholder farmers.

Using WHRs small-scale farmers can easily obtain cash in the harvest season without the need to sell their produces. They will also be able to reap the highest profits by postponing the sale of their produces to lean season when market price reaches its apex. The WHR system empowers farmers by providing them with up-to-date information on prices throughout the seasons. It also increases farmers' awareness on quality issues, encourages creation of standards for weights and measures, moderates seasonal price variability, and paves the way for the development of futures and derivative markets for managing price risks.³⁷⁹ Eventually, farmers gain adequate knowledge about market value and current prices of their produces and become "price setters" rather than "price takers". Farmers may also realize savings by "buying back" their produce from the warehouse for home consumption during lean seasons when food prices are high.³⁸⁰ In a nutshell, besides its long term economic benefits, WHR financing system is practically proved to have immediate positive effect on the small and marginal farmers.³⁸¹

Nevertheless, it doesn't mean that WHR system is free of any peril. The WHR financing is, in essence, a speculative activity. Depositors need to be smart enough to bring out the stored commodity to the market at the right time when the price reasonably goes up. Sometimes an attempt to gain the highest profits by waiting until the market has reached its perceived peak may lead to a loss. While the depositor is preserving bulk of the harvest expecting for more increment of price it may start going down. So it is up to the depositors/farmers to be alert enough and take action in time. WHRs financing scheme may also foster inflation and hoarding. As the system

wants which they can't produce. That is why they should take their surplus to the market and exchange with the products that they can't produce but necessary for their lives. For example edible oil, salt, and clothing are among the major products Ethiopian Farmers need to purchase from the market. Most farmers in Ethiopia can't afford to purchase enough amounts of edible oil and other related things for consumption in the whole year. So when the harvest season comes they are either running out of these necessities or left with very few. Because of this they try to get money by selling off their produces immediately after harvesting and purchase things they are in need of. This ultimately causes a glut in the agricultural market chain.

³⁷⁸ This is normally the season when different religious and social celebrations are held in most Ethiopian rural areas. For example in many parts of Ethiopia including the urban centers the harvest season is marked as a typical Wedding season.

³⁷⁹ TechnoServe, Investments In Rural Finance For Agriculture, Agriculture Investment Sourcebook, A Report on a project of Using Warehouse Receipts Systems for Inventory Credit in Ghana, pp. 342 – 343

³⁸⁰ Ibid p.3

³⁸¹ Lacroix, Richard, and Varangis, Panos (1996), "Using warehouse receipts in developing and transition economies", Finance & Development; See also The world Bank (2005), op.cit., pp. 58 – 62

involves holding commodities until the market offers higher price, it may contribute to increase in price and scarcity of commodities in the market. Particularly, in Ethiopia where hording is a major problem, the maximum possible duration of storage has to be strictly regulated. In this regard, Article 17 of the WHR System Proclamation which left the maximum possible duration of storage undefined should be amended. Since WHRs are mainly intended to enable agricultural producers to hold their products back to the lean season and, at the same time, offer it as collateral for short term loan, the maximum duration of storage shouldn't be made too long. In the current situation, it would be fair to prescribe one year as a maximum possible storage.

Moreover, WHR System needs to be backed by reliable drying and preservation technologies. Scarcity or expensiveness of such technologies put the stored product at risk for spoilage, loss from pests, and deterioration in quality. The other possible challenge would be cost of transporting goods to the warehouse. High transportation cost adds farmers' expense and it may sometimes discourage farmers not to store their products.

In addition, it should be made clear that WHR system cannot be feasible everywhere as lack of rural financing is identified as a setback. Those countries which are major producers of agricultural commodities, such as grain, sugar or sunflower seeds, or net exporters of these commodities are believed to have the greatest potential for agricultural commodity lending.³⁸² Hence, specifically coming to Ethiopia, a pertinent question to be posed from the outset would be does Ethiopia has such a potential? In spite of the complicated bottlenecks capping the improvement of agricultural productivity and market access in the country, it won't be far from the truth if the question is addressed affirmatively. It is indisputable that Ethiopia has huge potential in agricultural sector.³⁸³ Therefore the implementation of WHR system will have pivotal role in the overall economic growth of the country. Particularly, the system is hoped to contribute much in improving rural life which applies to close to 85% percent of the total population.

4.3. Legal Aspects of pledging WHRs in Ethiopia

Pledge is one of the legal mechanisms by which a lender can be provided with security interest on a certain thing having pecuniary value.³⁸⁴ Pledge of WHRs is a transaction composed of two elements: a bailment of the commodities with the warehouseman, and then a pledge of the WHRs by the bailor with the lender. As established earlier, the use of WHRs as secure collateral requires strong legislative underpinnings. This section is aimed at illuminating the legal aspects of WHR financing.

³⁸² Forestier, Bryde, Fani, and Papandreou (2004), Special Study, op. cit., p. 2 - 5

³⁸³ Yehuala (2008), op. cit., pp.1 - 8

³⁸⁴ The Ethiopia Civil Code provides more technical definition for pledge under its Article 2825, Art. 2825. - *Definition*

A contract of pledge is a contract whereby a debtor undertakes to deliver a thing, called the pledge, to his creditor as security for the performance of an obligation.

4.3.1. Laws Governing Collateralization of WHRs

In Ethiopia both negotiable and non-negotiable receipts can be offered as collateral. However, the legal regimes governing the manner and effect of collateralization of each type of receipt are entirely different. Negotiable receipts are pledged in accordance with the rules set out under Article 24 of the WHR system proclamation, but collateralization of non-negotiable receipts is regulated by another set of legal provisions laid down in the Civil Code to govern ordinary contract of pledge.³⁸⁵ However, in case where the lender whose claim is secured by non-negotiable receipts is a licensed bank, in addition to the relevant provisions of the Civil Code, the Proclamation on property pledged and mortgaged with banks³⁸⁶ will also apply to regulate the procedure for the sale of the pledge. Besides the above mentioned laws, detail rules of ECX on pledge of receipts are also applied for WHRs issued by the Exchange.³⁸⁷ Under this section we will take a glimpse at the legal requirements for the formation of a valid pledge contract collateralizing each type of WHRs.³⁸⁸ The remaining issues pertaining to the effect of the contracts will be discussed later on.

To start with negotiable WHRs, the holder of such type of receipt can easily offer it as collateral to access loan from lending institutions by handing over the document to the pledgee. No formal requirement is prescribed by the law to be observed when making such contract of pledge. Hence, a valid pledge agreement followed by due possession of the receipt by the pledgee gives rise to security interest of the pledgee. A lender who possessed the receipt as collateral exercises indirect control over the underlying commodity for the simple reason that nobody can order/request release of the commodities from the warehouse without surrendering the receipt.³⁸⁹

Since rights arising out of non-negotiable receipts are not easily transferable their collateralization is assimilated to ordinary pledges. The relevant provision of the Civil Code on ordinary pledge, while defining contract of pledge, provides that the debtor/pledgor shall undertake to deliver the thing to be pledged.³⁹⁰ In the case at hand, the actual thing intended to be offered as a pledge is the commodity under storage. But here, the pledgor may not necessarily effect physical delivery of the warehoused commodities in order to comply with the legal

³⁸⁵ The WHR system Proclamation, Op. Cit., Article 24(6)

³⁸⁶ Proclamation No. 97/1998, Property Mortgaged or Pledged with, Banks Proclamation, 4th Year No. 16', ADDIS ABABA – 19th Feb., 1998

³⁸⁷ The Exchange Rules(2010), Op. cit., Article 9.5.1 – 9.5.2

³⁸⁸ Article 24(6) of the WHR System Proclamation simply refers to 'rules on *ordinary* pledge'. As far as banks are concerned the rules regulating the sale of ordinary pledge are those incorporated under Proclamation no 97/1998. Here it should be underlined that lenders who are entitled to benefit from the foreclosure right enshrined in the Proclamation are only creditor banks, as clearly indicated in the Proclamation itself. Hence, other lending institutions like microfinance institutions cannot invoke the provisions of the Proclamation to sell properties pledged or mortgaged with them.

³⁸⁹ The WHR System Proclamation Article 13(2)(b)

³⁹⁰ The Civil Code, Op. Cit., Article 2825 – one of the elements incorporated in the definition of contract of pledge is the obligation of the pledgor to undertake delivery.

requirement of transferring possession. The pledgor may rather undertake delivery of the commodities by facilitating that the warehouse operator possesses the commodities covered by the receipt on behalf of the pledgee or a third party designated by the parties for such purpose.³⁹¹ Unlike negotiable WHRs, a contract of pledge collateralizing non-negotiable receipts shall always contain the specified amount of debt guaranteed therein; and in addition where such amount of debt is found to exceed five hundred birr the contract must be made in written form. Per Article 1727 of the Civil Code, the contract of pledge prescribed to be made in writing shall be signed by both contracting parties and be attested by a minimum of two witnesses. The fulfillment of all these legal requirements alone may not give rise to a valid pledge contract. A valid contract of pledge comes to existence only from the date when the document of the contract acquires undisputed date.³⁹² Though there can be other possible ways, undisputed date may safely be established by getting the contract registered with a notary.

From the discussion above one can effortlessly appreciate negotiable receipts are far more preferable collaterals than the non-negotiable ones. In case of negotiable receipts parties' freedom of contract as to form is well protected and hence the parties can easily form the pledge contract in any form that is convenient to them. In contrast, a number of legal requirements provided for collateralizing non-negotiable receipts may cause parties to incur considerable compliance cost (or transaction cost) and as a result the receipt may turn out to be inefficient and unattractive for both lenders and borrowers.

4.3.2. Determining the Face Value of a WHR for the purpose of a Pledge Contract

There exist competing interests between the pledgor and pledgee in determining the face value of a WHR intended to be offered as collateral. Lenders would usually seek over collateralization to cover price fluctuation or market risk. Particularly in Ethiopia, banks and microfinance institutions tend to require collaterals having a value that is twice of the amount of the loan.³⁹³ Borrowers, on the other hand, seek reasonable, if not high, estimation of the value of the collateral so as to raise the amount of loan they can obtain. In case of WHRs, the face value of the receipt may be determined based on the market price of the underlying commodities covered by receipt. In fact market price of the commodities is among the essential elements that shall be incorporated in the WHR. But it would not be safe for lenders to simply rely on the price indicated on the receipt for the simple reason that it was written at the time the commodities were stored, not necessarily at the time the receipt is offered as collateral. Thus, lenders may need to make their own observations in the market in order to come up with the right value of the receipt. Practically the quality of evaluation by the lending institutions of Ethiopia is considered

³⁹¹ This way of transfer of possession is usually referred to as "attornment". It is one mode of constructive delivery.

³⁹² The Civil Code, Article 2828(1) & (2)

³⁹³ Booz, Allen, and Hamilton (2007), Ethiopian Commercial Law and Institutional Reform and Trade Diagnostic, United States Agency For International Development (USAID), pp. 43 - 44

inadequate.³⁹⁴ This is mainly attributed to the evaluators' lack of understanding of market and income production values.³⁹⁵ One of the major challenges in determining the face value of WHRs would be market information asymmetry. This can be best rectified when the WHR financing system is built being integrated with modern Commodity Exchanges. The current system in Ethiopia is ideal example in this regard. Lenders willing to finance commodities that are being traded on Ethiopian Commodity Exchange can get market information with virtually zero cost from the website of ECX.

Since lenders do not give the borrower full value of the commodities covered by the WHR discovering the value of the receipt by itself is not an end. The lender should go further to calculate all possible costs the receipt may involve and determine how many percent of the value of the receipt should be advanced to the pledgor/borrower as a loan. The major potential costs to be taken into account relate to claims of the warehouseman arising out of his lien right, the costs the lender may incur when selling the commodity in case of a loan default, and the potential decrease in value of the stored good caused by price volatility in the respective commodity market.³⁹⁶ For instance in Malagasy's rice inventory program the loan amount is computed by multiplying the quantity of rice stored by a percentage factor, usually 75%, of the local rice price at the time of the harvest.³⁹⁷ In Ethiopia, lenders becoming involved in WHRs financing system designed under ECX have reached an agreement with the Exchange to finance 70% of the value of the receipt.³⁹⁸

4.3.3. The Right to Re-pledge

Let's assume a WHR covering huge quantity of commodity that has high market value has been pledged for very small amount of loan in the first transaction. But later on, the holder of the receipt wanted to pledge the same receipt again so as to access additional loan from other lenders. Obviously the value of the receipt is quite sufficient to secure proper performance of additional obligations/debts. But the issue is - would the subsequent pledge get recognition from the law? In jurisdictions like Kazakhstan, validity of subsequent pledge exclusively depends on the terms of agreement of the parties contained in the preceding contract of pledge. If there is a clear term denying the pledgor's right of re-pledging the same asset then any subsequent pledge won't have legal effect. Coming to the legal system of Ethiopia, the WHR System Proclamation which is purported to regulate the pledge of negotiable WHRs has nothing to say on the possibility of re-pledging negotiable receipts. However, Article 2834(2) of the Civil Code which

³⁹⁴ Ibid

³⁹⁵ Ibid

³⁹⁶ Baldwin, Bryla, and Langenbucher (2006), Op. cit., pp.1 - 3

³⁹⁷ Bouquet Emmanuelle Bouquet, Betty Wampfler, and Eliane Ralison (2009), Rice inventory credit in Madagascar conditions of access and diversity of rationales around an hybrid financial and marketing service, Rural Microfinance and Employment Project, Working Paper 2009-2, p. 6 pp. 4 - 6

³⁹⁸ Interview with Ato Yared, Credit Advisor at CBE, Ato Habib Mohamed, Deputy Manger of Credit Department at Nib International Bank, and Ato Behailu Neguse, Manager of ECX Clearing House

is normally applied for pledging of non-negotiable receipts clearly recognizes the pledgor's right to re-pledge a receipt which has been already pledged.³⁹⁹

Therefore, as far as non-negotiable receipts are concerned the law is pretty clear that they can be offered as collateral for more than one transaction to different pledgees. Regarding negotiable receipts too, one may interestingly extend the application of Article 2834 of the Civil Code on the ground that the WHR System Proclamation is silent on the issue and at the same time it is provided under the same Proclamation that it shall be complemented by the relevant provisions of the Civil Code. On top of this, from the general principle that 'anything not explicitly prohibited by law is assumed permitted' one can validly infer re-pledging right of holders of negotiable receipts. But yet, it is the view of the writer that the Ethiopian law leaves the parties to the contract of pledge at liberty to insert a term in their contract that takes away the pledgor's right of re-pledging the same receipt.

Nevertheless, in ECX WHR financing system, a single receipt cannot be pledged for more than one loan account.⁴⁰⁰ It means that, regardless of its high value, a WHR which has already been pledged can never be re-pledged to secure another transaction. Obviously such prohibition on re-pledging right adversely affect the ultimate objective of WHR system by limiting access to credit. At this juncture, what should be taken into account is not the number of obligations/loan accounts secured by a single WHR rather the equivalence of the value of the receipt with the amount of debts to be secured. Normally, the prospective pledgees before accepting the receipt as pledge have to check whether the value in the receipt is actually sufficient to secure their claims or not. Therefore, the prohibition on the right of re-pledging is unnecessary and recommended to be crossed out.

Another interesting point to be raised in this connection takes us to possession of the pledge. Apparently the pledgor shall be dispossessed of the receipt at the moment the pledge contract comes into existence.⁴⁰¹ But the question demanding further dwelling is - who shall take possession of the receipt or to whom the receipt shall be delivered? This issue becomes more critical in case where the receipt is negotiable. Surprisingly, let alone the Proclamation which did say nothing on the issue of re-pledging even the Civil Code that has a provision providing explicit recognition to right of re-pledging has not attempted to address the issue at hand. Generally two possible way outs can be suggested. The first one is that the parties to the pledge contract can agree to keep the pledge under the possession of one of the pledgees. Otherwise, they can also designate by mutual consent a third party who shall take possession of the

³⁹⁹ See also Article 2860 which provides that a pledge (in our case non-negotiable WHRs) can be encumbered with several rights of pledge.

⁴⁰⁰ Rabobank International Advisory Service (RIAS) (2010), Op. Cit., pp.10 - 12 (interviewees from both lending institution and ECX have confirmed that their credit procedures are directly adapted from the document prepared by Rabobank)

⁴⁰¹ Exceptionally contract of pledge may validly be formed without dispossession of the debtor in such cases only as are expressly provided by law (See Article 2832 of the Civil Code)

pledge.⁴⁰² The latter seems the safest since the relationship between the parties to the pledge contract and the third party designated to hold the pledge will be governed by the legal provisions relating to bailment of goods or warehousing.⁴⁰³ It is recommended that in both cases the creditors' security interest on the receipt should be registered.

4.3.4. The Need for Registration

Once we are done with the discussion on creation of enforceable security interests on a WHR what follows is perfection of such interest. Particularly when more than one encumbrance is created on the same object, in our case inventories of agricultural products represented by WHRs, perfection can be employed as indisputable mechanism of settling issues pertaining to priority claims.⁴⁰⁴ Perfection of a security interest provides a lender better protection by making his interest/right effective against third parties. It is an Anglo-American concept, which can be broadly understood as the notice of the security interest given to third parties. More precisely, perfection is another way of saying 'notice to third parties' and it is indeed claimed to be the foundation for effective collateral lending.⁴⁰⁵ Perfection normally involves performance of some acts, which puts third parties on notice of the security interest the creditor has on the pledge.

In different jurisdictions, there are alternative ways used to perfect security interests. The first and commonly used way is having actual possession of the item pledged.⁴⁰⁶ The pledge may be kept under the possession of either the pledgee or another third party designated by the parties. When the pledge is dispossessed from the pledgor/owner, other potential lenders should at least suspect that the commodities are already pledged as collateral for a loan. But yet, it should be noted that there may be the risk of earlier pledging of the commodities by the borrower.⁴⁰⁷ A point worth capitalizing here is that transfer of possession would be convenient for lenders only when the pledge is things like precious metals. However when the pledge is objects like stored commodities, it obviously becomes difficult to manage. In such a case, the pledgee may resort to the second way of perfecting rights - that is constructive possession.⁴⁰⁸

The lender can constructively possess the pledge by making sure that the actual possessor of the pledged commodity is acting on his behalf.⁴⁰⁹ The actual possessor of the commodities i.e. the warehouse operator is assumed to hold the commodities on the pledgee's behalf when the pledged receipt is duly negotiated to the pledgor.⁴¹⁰ In deed, this holds true for negotiable

⁴⁰² Article 2831(1) of the Civil Code provide that parties to the pledge contract can make an agreement to deliver the pledge to a third party

⁴⁰³ The Civil Code, Op Cit. Article 2831(2)

⁴⁰⁴ Booz, Allen, and Hamilon, (2007), Op. Cit., p. 42

⁴⁰⁵ Ibid

⁴⁰⁶ The Civil Code, Op Cit., See: Articles 2825 and 2832

⁴⁰⁷ UNCTAD Secretariat (1996), Op. cit., pp. 19 – 20

⁴⁰⁸ The Civil Code, Op. Cit., Article 2831; see also Article 1145(1) of the Code.

⁴⁰⁹ UNCTAD Secretariat (1996), Op. cit., pp 18 – 19

⁴¹⁰ The WHR system proclamation, Op. Cit., Article 20(6)

receipts. When the receipt is negotiable due holder of the receipt can demand delivery at any time upon presentment of the receipt. Moreover, no one including the original depositor can order the release of the stock without surrendering the receipt. Thus, at the moment the receipt is duly negotiated and delivered to the lender, the warehouse operator starts to act on the lender's behalf. But, in case of non-negotiable receipts, the assignment of the rights in the receipt and its delivery to the assignee alone don't suffice. In addition to proper assignment of the rights, the warehouseman shall also be duly notified about the assignment either by the assignor or the assignee. Unless the warehouseman is informed about the assignment he may release the commodities in the warehouse to the assignor without requesting the presentment of the receipt. Thus, it is hardly possible to say that the warehouseman is holding the commodities on behalf of the assignee until the moment the he is notified about the assignment.⁴¹¹

Another mechanism of perfecting security interest on WHRs is Registration.⁴¹² Lenders can safely secure their interests in the receipt by filing of a registration form naming these instruments or documents as secured property. Registration of security interests gives priority for the secured creditor. The registry system also discloses the number of security interests created in respect of each WHR, and this being public document will constitute notice to the whole world. Thus, it is up to every prospective recipient or financier of a WHR to determine, before acceptance, if there is a competing claim on the collateral underlying the receipt by checking the public document made accessible for all.⁴¹³ By facilitating this, registration resolves the issue of priority claims in the collateralized receipt.⁴¹⁴ Countries like Poland are now making legislations that support the creation of a central pledge registry in order to facilitate resolution of disputes owing to competing claims before the lending or acceptance of WHRs takes place.⁴¹⁵

Registration of security interest on WHRs considerably widens the protection of secured creditor/lender by extending their claim to the proceeds of the sale of commodities.⁴¹⁶ One may also validly contend that registration is important to non-negotiable receipts for the reason that contract for pledge of non-negotiable receipts usually comes into force from the time it acquires undisputable date and the acquisition of undisputable date is best achieved by getting the

⁴¹¹ Please see the discussion on negotiability and transferability of WHRs in chapter three

⁴¹² Of course registration can perfect the security interests in jurisdictions where the WHRs convey title to the underlying stock (See: Richard and Panos, op. cit., pp. 36 -37)

⁴¹³ Richard and Panos, op. cit., pp. 36 -37

⁴¹⁴ Fabunmi (2002), op. cit., pp. 10 - 12

⁴¹⁵ Innovations in Microfinance (2000), Op. cit., p

⁴¹⁶ Even if the pledged property has been sold and become difficult to be identified, the security interest shall be attached to the proceeds of the sale. However, it is still widely held fact that though registration is accepted as one way of perfecting security interests, it usually does not provide the lender equal protection to actually possessing the commodity. This is because if the commodity is in possession of a warehouse operator, he may invoke his lien right against the secured lender. (See : UNCTAD Secretariat (1996), Op. cit., pp. 19 - 20; See also Fabunmi (2002), op. cit., pp. 10 - 12;

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document registered.⁴¹⁷ Hence, registration alone may not make the contract enforceable against third parties.

Beside its role in securing interest, the introduction of reliable registry system can also facilitate sales of existing and future raw materials and commodities.⁴¹⁸ This would open new markets and sources of financing. In this regard we can mention the experience of countries like Brazil, Costa Rica and Colombia which are trying to sell their coffee futures. In these countries efforts are under way to create a network of electronic registries and provide buyers of these futures reliable electronic negotiable WHRs so as to realize worldwide trade of the futures and fetch the best prices and terms.⁴¹⁹ Moreover, the creation of electronic network provides wider and easier access to vital information in the registries not only to potential buyer but also other creditors. A central, widely accessible registry for registering security interests is also recommended to ensure that the financing system is not abused.⁴²⁰ Generally, reliable registry system plays pivotal role in improving access to credit. In countries (including those belonging to CIS⁴²¹) where there is no centralized system for the registration of collateral, secured lending has turn out to be difficult.⁴²²

In Ethiopia, neither the Civil and Commercial Codes nor the 2003 WHR System Proclamation specifically provides registration as a way of perfecting security interests on the WHRs. However, the internal rules of ECX governing the pledge of electronic receipts issued by the Exchange make registration of security interest an integral part in the pledging transaction.⁴²³ According to the Exchange's procedure, immediately after all other formality requirements are met and the receipt is pledged, the ECX Central Depository must put a mark of pledge on the specific eWHR collateralized.⁴²⁴ Stated otherwise, the pledge contract becomes effective and the security interest on the receipt is perfected when it enters into the electronic record of ECX Central Depository. Once a receipt received such mark of pledge⁴²⁵ the commodity covered by it will no longer be available for trade and withdrawal. In this regard, the Exchange undertakes to provide full guarantee for the preservation of all electronic receipts marked pledged.⁴²⁶ In fact,

⁴¹⁷ The Civil Code, Op. Cit., Article 2828

⁴¹⁸ Arizona Board of Regents (2001), op. cit., p. 30

⁴¹⁹ Ibid

⁴²⁰ UNCTAD Secretariat (1996), Op. cit., pp. 17 - 20

⁴²¹ CIS (Commonwealth of Independent State) is "a regional organization composed of countries of the former Soviet Republics, formed during the breakup of the Soviet Union"
(See:http://en.wikipedia.org/wiki/Commonwealth_of_Independent_States#Membership_status_of_CIS_countries)

⁴²² UNCTAD Secretariat (1996), Op. cit., pp 34 - 35

⁴²³ Revised Rules of the Exchange (2010), Op. Cit., Article 9.5.2.1(d)

⁴²⁴ Ibid; See also Rabobank International Advisory Service (RIAS) (2010), Op. Cit., pp.10 - 12

⁴²⁵ If the above recommendation for permission of re-pledging WHR won the support of ECX management the mark to be put on pledged receipt shouldn't continue being merely 'pledged' or 'no sale status'. Together with such mark the specific amount of the secured debts should also be shown there. So that prospective lender can easily check whether the remaining value of the receipt is sufficient to secure the new loan.

⁴²⁶ Rabobank International Advisory Service (RIAS) (2010), Op. Cit., pp.10 - 12

here one may comment that registration is made an integral part of the pledging procedure in ECX scheme partly because the system is entirely electronic. Unless the WHR to be pledged is a paper based receipt it is hardly possible to enforce the security interest in the receipt without notifying the creation of the pledge to the system manager (i.e. the ECX Central Depository).

Unlike the whole system of collateral registration in the country, which is criticized for being fractured and inadequate,⁴²⁷ the electronic registry system implemented by ECX Central Depository is centralized and well organized.⁴²⁸ Consequently, it is believed to reduce the chance of fraud and misunderstanding by creating easy access to relevant information.⁴²⁹ Particularly, Lending institutions before deciding to finance an eWHR offered to them as collateral can easily access reliable information from the Central Depository as to the validity of the receipt and as to whether there are other prior encumbrances such as liens, attachments, or adverse claims and interests on the receipt.⁴³⁰ Of course, under the ECX WHRs financing scheme a single receipt cannot be pledged for more than one loan account.⁴³¹ Thus the issue of priority claim is perhaps uncommon problem. Because of this, the ECX scheme is not benefiting from the conventional role of registration in settling priority issues.

To wind up, it should be underscored that ECX has gone considerable steps forward in developing a central registry system that enables to perfect security interests as well as facilitates easy access to correct information. However, from other countries experience one may convincingly suggest such central registry system should gradually be taken out of ECX's⁴³² control and be managed by a neutral third party (system provider).⁴³³ Such system provider or registry need not necessarily be a government body. It may also be a private company duly authorized to undertake the management of the system. If the registry is established independently it turns out to be a national system rendering registration service not only to pledge of receipts issued by ECX warehouses but also to pledge of other receipts issued by newly emerging warehouse operators which are duly licensed to operate the business. Furthermore, the registry system currently put in place by ECX is applicable only to eWHRs. But it is strongly recommended that the financing secured by both the electronic or paper receipts should be recorded in registry in the same way.⁴³⁴ Hence, the new system provider should design the registry in a manner that accommodates registration of pledge of paper receipts too. By so doing we can ensure the priority right of lenders financing WHRs.

⁴²⁷ Booz, Allen, and Hamilton, (2007), Op. Cit., pp. 42 - 43

⁴²⁸ See: Revised Rules of the Exchange (2010), Op. Cit., Article 9.3.1 – 9.3.9 and 9.6.1 – 9.6.2

⁴²⁹ Booz, Allen, and Hamilton, (2007), Op. Cit., pp. 42 - 43

⁴³⁰ Revised Rules of the Exchange (2010), Op. Cit., Article 9.5.2.1(b); See also Rabobank International Advisory Service (RIAS) (2010), Op. Cit., pp.10 - 12

⁴³¹ Interview with Ato Behailu Neguse ECX Clearing House Manger and Ato Daniel, ECX Central Depository Manager; See also Ibid

⁴³² As ECX is currently operating warehousing business it is hardly possible to consider it as neutral body.

⁴³³ UNCTAD (2009), op. cit., pp. 15 - 17

⁴³⁴ Forestier, et al. (2004), Special Study, op. cit., p. 8 - 9

4.3.5. The Rights and Duties of the Pledgee

Needless to say, a pledgee whose claim is secured by WHRs is entitled to satisfy his claims against the commodities covered by the pledged receipt. However there are also some basic conditions the pledgee shall observe while exercising his contractual rights. The pledge, before taking any action on the receipt or the underlying commodities, shall make sure that the debt has matured and simultaneously the debtor defaulted on payment. Next, default notice has to be served on the debtor.⁴³⁵

If the pledge is negotiable receipt then in accordance with the 2003 WHR System Proclamation, the pledgee can sell the pledged commodities or transfer the receipt to third parties after fifteen days from the date of payment specified in the default notice.⁴³⁶ Though the law provided default notice as an essential condition, it has remained silent on the form and the duration of time to be fixed in the notice for payment. Yet, bearing in mind the provisions of the Civil Code may complement the Proclamation; one may suggest that the notice should be served either in written form or by any other act denoting the pledgee's intention to get payment.⁴³⁷ In similar fashion, one may also contend that the period of time fixed in the notice for payment should be reasonable having regard to the nature and circumstances of the case.⁴³⁸ The other worth noting point left untouched by the law is the situation where notice is necessary. The Proclamation seems to make notice necessary in all situations.⁴³⁹ In fact, it is appropriate to make notice necessary as a rule.⁴⁴⁰ But in some cases it would be totally unsound to require the pledgee to give notice. For example, in case where the debtor has declared that he wouldn't effect payment the pledgee should be allowed to rush to the next step without the need to serve notice. To this end, the Proclamation has to borrow Article 1775 of the Civil Code which list down the situation where notice is avoidable.

In case where the pledge is non-negotiable receipt the manner and legal effect of the pledge shall be governed by the provisions of ordinary pledge laid down under the Civil Code.⁴⁴¹ However, though the receipt may be nonnegotiable, if the pledgee is a licensed bank, the contract of pledge shall be subjected to the foreclosure law.⁴⁴² Accordingly, the bank, after making sure that the debt is due, will serve a minimum of thirty days notice on the pledgor.⁴⁴³ And after the thirty days indicated in the default notice elapsed, the bank can validly transfer the receipt or the

⁴³⁵ The WHR system proclamation, Op Cit., Article 24(2) and (3)

⁴³⁶ The WHR system proclamation, Op Cit., Article 24(2)

⁴³⁷ See: Article 1773 (1) of the Civil Code; See also: Tilahun Teshome (1996), Basic Principles of Ethiopian Contract Law, Research and Publication Department of Federal Supreme Court, Addis Ababa, pp. 104 - 107

⁴³⁸ See: Article 1774 (2) of the Civil Code

⁴³⁹ This can be inferred from close reading of Article 24(3) of the WHR system proclamation

⁴⁴⁰ See Article 1772 of The Civil Code

⁴⁴¹ The WHR system proclamation, Op. Cit., Article 24(6);

⁴⁴² Property Mortgaged or Pledged with, Banks Proclamation No. 97/1998, Op Cit. Article 3

⁴⁴³ Property Mortgaged or Pledged with, Banks Proclamation No. 97/1998, Op Cit., Article 3

underlying commodity to third parties by auction⁴⁴⁴ and satisfy its claims against the proceeds thereof. Similarly here, the law merely states the need to give thirty days notice. It has, however, nothing to say on the form of the notice and the situation where notice may be unnecessary. The relevant provisions of the Civil Code that complement the WHR System Proclamation may also be recommended to be applied here to fill the gaps in the foreclosure law.⁴⁴⁵ In fact in this case, the Civil Code, particularly the provisions of Contract in General, are recommended to be applied on the ground that 'pledge' itself is defined as a special contract.⁴⁴⁶

When it is established that the debtor has failed to effect payment within the period of time provided by the law, the pledgee, in exercise of his contractual rights, may sell the pledged commodities in accordance with the relevant laws and satisfies his outstanding claims including expenses of the sale. The pledgee shall hold the balance of the proceeds on trust for the pledgor.⁴⁴⁷ The pledgee can safely reap the benefits out of the pledge contract only if it took each step in compliance with the relevant provisions of the law governing pledge of each type of the receipts. The pledgee shall be held liable for damage sustained by any one due to the his non-observance of the law.⁴⁴⁸

4.4. Pre-conditions for the Success of the System in Ethiopia

As defined earlier, WHR is a document representing commodities in storage. Normally, when lending institutions give loans against WHRs they have no guarantee for the existence of the actual products intended to be pledged. Nor they will be able to gain physical control over the commodity covered by the receipt. For that matter, the commodities may be nonexistent at the time when loan is requested and released. They can also be disposed or exposed to damage after the loan is released.⁴⁴⁹ Because of these risks, lenders may accept WHRs as pledge instruments of secure collaterals and finance them only if they trust the whole system in place. Not only lenders but also other actors in the system of WHR need to build strong trust to participate in the system. The desired trust is engendered, among other things, by creating effective and reliable WHR system which is backed by suitable/enabling legal regime. In addition to this, the creation of reliable system of WHR equally demands the fulfillment of some basic operational and institutional requirements that will be discussed herein after.

⁴⁴⁴ The auction shall be undertaken in accordance with the Article 394 -449 of the Ethiopian Civil Procedure Code (See Article 6 of Proclamation No. 97/1998, Op. Cit.)

⁴⁴⁵ The foreclosure law can be complemented by Article 1773 (1) of the Civil Code as to the situation where notice is unnecessary and by Article 1775 of the Civil Code as to the form of the notice.

⁴⁴⁶ See: Article 2825 of the Civil Code

⁴⁴⁷ See: Article 24(4) of the WHR System Proclamation and Article 2859(2) of the Civil Code

⁴⁴⁸ WHR system proclamation, Op Cit., Article 5

⁴⁴⁹ These problems have been practically observed eliminating one of the primary benefits of warehousing access to credit (See: The World Bank (2005), op.cit., pp. 58 -59)

4.4.1. Availability of Reliable Warehousing Service

Suitable and easily accessible storage facilities are among the key operational requirements for successful establishment of WHR system.⁴⁵⁰ The credibility of the whole system depends on the presence of competent warehouse operators that comply with the minimum standard set by the law. Warehouses should always strive to further modernize their services by using more secured new technological innovations and highly qualified staff. For instance in Tanzania first class warehouses are required to fulfill the following conditions:⁴⁵¹

- Maintain good record-keeping systems
- Have weighing facilities, such as weighbridge, platform and pneumatic scales
- Maintain good security systems and communication facilities
- Have competent, trained personnel and storekeepers
- Have moisture meters, which they use in carrying out quality analysis, grading and sorting. They shall also have dedicated sample rooms.

Though it has been close to a decade since the new warehousing legislation came into force in Ethiopia, there is no significant progress in the quality and number of warehouses operating in the country. Currently, the two major warehousing service providers are ECX and Ethiopian Grain trade Enterprise (EGTE). As a matter fact, none of them is licensed to operate warehousing business in accordance with the WHR System Proclamation.⁴⁵² Yet, ECX has practically embarked on warehousing business on the ground that its establishing Proclamation allows it to operate such business.⁴⁵³ However, strictly sticking to the law, the Exchange is allowed to operate warehousing business 'for the purposes of Exchange trading' not for other purposes like WHRs financing scheme.⁴⁵⁴ Thus, the legal basis for the WHR financing system currently launched by the Exchange is unclear. In the writer's view either the Exchange shall have to be licensed to operate warehousing business or the Proclamation shall have to be amended to give explicit authorization to the Exchange to operate warehousing business for WHR financing purposes.

⁴⁵⁰ ZACA, what are the main Requisites for A successful WHR system? available at http://www.zaca.com.zm/zaca_pre_requisite.html retrieved on 10/30/2001

⁴⁵¹ Gideon E. Onumah, Ana Marr, Alan Marter and Daniel Day-Robinson, Op. cit., p. 21

⁴⁵² An interview with legal experts at ECX compliance division and Ato H/ Selassie G/ Georgis, Senior officer of property Administration at EGTE

⁴⁵³ The Ethiopia Commodity Exchange Proclamation No. 550/2007, Article 24(1)

⁴⁵⁴ That is to say the Exchange is not authorized to issue receipts that can be used as collateral for loan. It is rather authorized by law to issue receipts that are used for its trading activities only. Therefore, ECX has no legal ground to facilitate the use its receipts as collateral.

Despite the legal debate above, ECX has launched WHR financing system in Ethiopia. It has sixteen warehouses situated in the major surplus regions of the country.⁴⁵⁵ Given the size of the country and the people engaged in agricultural activities such number is very small. However just to embark on the system may suffice. Almost all the warehouses under ECX render better quality services complying with the minimum legal standard.⁴⁵⁶

The other major warehousing service provider, EGTE, is a public enterprise recently re-established by Council of Ministers Regulations No. 58/1999.⁴⁵⁷ According to Ato H/Selassie G/Georgis senior officer of property Administration at EGTE, the Enterprise owns close to 250 warehouses, each having a storage capacity of 50,000 to 100,000 tons of grain. The warehouses are well distributed throughout the country. As stated by the officer, moving from Addis Ababa in the four directions (East, West, North and South) one can find the Enterprise's warehouses approximately on every hundred kilometers. It is also disclosed that the enterprise has qualified experts on agricultural products in each of its branch offices situated across the nation. These show the huge potential of the Enterprise to participate in WHRs financing system as a warehouse operator. But so far there are no mentionable efforts exerted in this respect. The Enterprise has been using all these resources for the purposes of purchasing grain from farmers and selling in local and mainly in export markets.⁴⁵⁸ This is apparently traditional way of stabilizing market by direct intervention.

Though the purposes of the Enterprise laid down under the Regulation didn't explicitly mention WHR system as one component, Article 5 of the same allows the enterprise to engage in other related activities enabling to the attain its purposes.⁴⁵⁹ Obviously, facilitating the implementation of viable WHR financing system by taking the role of a warehouse operator can be one of these activities. Hence, if there is willingness on the part of the government, by virtue of the said provision, the Enterprise can embark on warehousing business after getting license from the appropriate organ.

It is pretty clear that the WHR financing system of Ethiopia cannot go far with the limited number of warehouses operated by ECX. At Present, Persons owning large size warehousing facilities in Ethiopia prefer to rent it rather than engaging in the warehousing business themselves.⁴⁶⁰ And, this is traditional way of earning limited income from huge resources.

⁴⁵⁵ The Sixteen warehouses of ECX are situated at Addis Ababa, Dire Dawa, Nathret(Adama), Bure, Nekemet, Humera, Hawassa, Jimma, Bedle, Dilla, Gimbi, Gonder Metema, Asosa, Sodo, and Bonga available at <http://www.ecx.com.et/Operations.aspx#WH>, retrieved on 15th September, 2011

⁴⁵⁶ Interview with Ato Bayou Mekonnen, Investigator, at Ethiopian Commodity Exchange Authority

⁴⁵⁷, Ethiopian Grain Trade Enterprise Re-establishment Council of Ministers Regulation, 6th Year No.2, ADDIS ABABA – 22nd October, 1999

⁴⁵⁸ An interview with legal experts at ECX compliance division and Ato H/ Selassie G/ Georgis, Senior officer of property Administration at EGTE

⁴⁵⁹ Council of Ministers Regulations No. 58/1999, Article 5(3)

⁴⁶⁰ Interview with Ato Teshome from Ministry of Trade and Professor Tllahun Teshome, drafter of the WHR System Proclamation and a researcher who wrote a journal article on the area

Hence, the government besides facilitating for the involvement of EGTE in the warehousing business, it should also highly encourage the private sector to invest in the warehousing Industry. Once the government accepted WHR financing as a strategy towards achieving its development goals in the agriculture sector, it should provide more attractive incentives to capture as many private warehousing businesses as possible. On top of this, lifting of the legal restriction on the form of businesses allowed to involve in the warehousing industry may also contribute to increase the number of warehouse operators.

4.4.2. Effective Regulatory Regime

Legislation achieves its targeted goal when backed by strong enforcement mechanism. Otherwise, it remains to be toothless and paper-tiger. In view of this, effective regulatory regime is believed to be at the heart of viable WHR system. There has to be a regulatory organ tasked with ensuring that the licensed warehouses and other related professionals in the sector meet certain basic standards of the law and are properly inspected on a regular basis. This would ultimately enable to establish and preserve the integrity of WHRs and the warehousing system as a whole.⁴⁶¹ Warehouse operators are commonly private businesses running their activities on a commercial basis with the primary objective of maximizing profit. Hence, it's important to make them subject to an independent monitoring system which oversees that the minimum financial, technical and administrative standards of the warehouses are not compromised in striving to win the market competition. If these standards are accepted and transparent to all participants in the system, WHRs issued by licensed warehouses can be treated as cash equivalent.⁴⁶² The existence of the regulatory system gives comfort to the financing banks, and lowers their transaction costs in dealing with WHRs.⁴⁶³ Moreover, the receipts can secure wider acceptance in the business world as reliable instruments on the basis of which ownership of deposits can be preserved and transferred.⁴⁶⁴

The regulator can be either a public or private organ. If a country opts for direct public sector regulation, it is generally recommended that it should vest authority in the body which is least susceptible to political interference.⁴⁶⁵ But as much as possible it is advisable to pursue the option of regulation by private body such as private company designated by the government, a reputed trade association, or an Exchange.⁴⁶⁶ In the view of the writer of this thesis, among the various reasons demanding the neutrality or independence of the regulatory body one may be the fact that the regulator is expected to oversee not only the private actors participating in the system but also unnecessary government interventions that may adversely affect the warehousing

⁴⁶¹ Forestier, et al. (2004), Special Study, op. cit., p. 8 - 9

⁴⁶² Richard and Panos, Op. cit., pp.38 - 39

⁴⁶³ UNCTAD (2009), op. cit., p. 49

⁴⁶⁴ The World Bank (2005), op.cit., pp. 58 -59

⁴⁶⁵ UNCTAD (2009), op. cit., p. 49

⁴⁶⁵ Onumah (2003), Improving Access to Rural Op. Cit., pp. 7 - 8

⁴⁶⁶ Giovannucci, Varangis, and Larson, Warehouse Receipts, pp. 1 - 3

industry. Warehousing business has direct nexus with the politically sensitive part of the economy i.e. Agriculture. As observed by Coulter and Onumah, governments usually resort to ad hoc interventions, which can potentially undermine the whole system of WHRs, on the ground of food-security.⁴⁶⁷ The manipulation of market price by the state directly impacts the incentives of storing and financing the storage.⁴⁶⁸ In Ghana, for example, two schemes of WHR were reported to be shackled merely because of ad hoc state interventions.⁴⁶⁹ Hence, the regulator, acting as an independent organ, shall take a critical role of building stakeholders consensus and policy coherence so as to create conducive environment for the proper functioning of the warehousing industry. Of course, in any case, this happens to be true when there is genuine commitment on the part of the government to establish a well functioning WHR system.⁴⁷⁰

In Ethiopia, the regulatory power is vested on a ministerial office which appears susceptible to political interference. Previously Ministry of Trade and Industry and MoARD were empowered to regulate the warehousing industry at different times.⁴⁷¹ But currently such regulatory power is vested on the recently re-established Ministry of Trade.⁴⁷² The Ministry is allowed either to discharge its regulatory powers and duties by itself or delegate some other body to fulfill the role of the regulator.⁴⁷³ From this one may infer that though the legislation vested the regulatory power in a government body it still leaves a space for private regulation of the sector. That is to say the Ministry can delegate its regulatory power to the private sector which is believed to be more effective and reliable.⁴⁷⁴ In fact, right this time, it may not be tenable to delegate the regulatory power to the private sector. However, through time when the private sector in the country gets stronger the Ministry may consider delegating its regulatory power to the private sector.

The Ministry is empowered to inspect the manner of receiving, storing, handling, classifying, weighing and grading of agricultural products in every warehouse. In other jurisdictions, Warehouses are made subject to unannounced visits by “examiners”.⁴⁷⁵ In Ethiopia there is no explicit legal provision which authorizes the conducting of unannounced inspection. But it

⁴⁶⁷ Onumah (2003), *Improving Access to Rural Finance*, Op. Cit., pp. 11

⁴⁶⁸ Forestier, et al. (2004), *Special Study*, op. cit., p. 8

⁴⁶⁹ Onumah (2003), *Improving Access to Rural Finance*, Op. Cit., pp. 11

⁴⁷⁰ Forestier, et al. (2004), *Special Study*, op. cit., p. 8

⁴⁷¹ See Article 27 and Article 5(2) of Reorganization of the Executive Organs Proclamation (Amendment) No. 380/2004

⁴⁷² Article 21(2) of Definition of Powers and Duties of the Executive Organs Proclamation No. 691/2010

⁴⁷³ See Article 26 and the following provisions of the The WHR system proclamation, Op. Cit.,

⁴⁷⁴ Private regulators are believed to be more reliable and effective mainly because they work to maintain their reputation and acceptance in the business world. The public regulators on the other side are often susceptible to wrong behaviors such as bribery. (See: UNCTAD Secretariat (2003), *A Primer on New Techniques used by the Sophisticated Financial Fraudster with Special Reference to Commodity Market Instruments*, UNCTAD/DITC/COM/39, pp. 12 – 16)

⁴⁷⁵ Report of the Working Group on Warehouse Receipts & Commodity Futures, Department of Banking Operations and Development Reserve Bank of India, Mumbai, April 2005, p. 29; Onumah (2003), *Improving Access to Rural Finance*, Op. Cit., p. 7; J. Coulter and G. Onumah (2002), *The Role of Warehouse Receipt Systems* Op. Cit., p. 325

should also be noted that neither there is a law requiring the inspector to give prior notice to the concerned warehouse before going for inspection. Thus, the conclusion is clear - like many other jurisdictions, Ethiopian warehouse operators have no legal grounds to refuse unannounced visit by regulators/inspectors. This makes the warehousing industry more accountable and always up to the standard. The regulatory office is also bound to check that all warehouses are properly keeping records of commodities deposited and withdrawn every day. In addition, it may also examine all books of accounts, records and papers of each warehouse.⁴⁷⁶ The regulator may charge fee only when the inspection or examination is conducted by the request of the warehouse.⁴⁷⁷ In countries where there is well developed warehousing industry, for example the USA, the oversight system is funded mainly by user fees.⁴⁷⁸ Similarly, in Ethiopia, in order to ensure the sustainability of the regulatory regime, a mechanism enabling the regulator to cover most of its annual budget/expenditure should eventually be designed. To this end, one way may be to charge reasonable fee for, at least, two or three times annual inspections or examinations being conducted on regular basis. The inclusion of such regular inspections, in addition to funding the regulator, will also fill the gap of the Proclamation in setting the minimum number of times every warehouse shall be inspected or examined in a year.⁴⁷⁹ Unless such minima is set it would be difficult to make sure that all warehouses are properly covered by the regulatory regime. Besides the warehouse operator, licensed inspectors and other staffs of the warehouse licensed as classifiers, graders, weighers or samplers of agricultural products are also subject to investigation of the regulator at any time.⁴⁸⁰

The regulator should further follows up that the warehouses publish their storage tariff in a news paper of national circulation within thirty days from the commencement of ever Ethiopian fiscal year. Storage tariff is also required to be permanently displayed on conspicuous places at each warehouse.⁴⁸¹ When the situation so justifies, the warehouse may publish new tariff which will be applicable to commodities deposited after the publication of the new tariff.⁴⁸² The publication of tariff, on the one hand, ensures transparency of the system; and on the other, it encourages price competition among warehouses. Moreover, the regulatory body, in collaboration with relevant government offices, such as Authority of Quality and standard Assurance, is empowered to establish standards for agricultural products being stored in licensed warehouses.⁴⁸³

⁴⁷⁶ The WHR system proclamation, Op. Cit., article 34(1) and (2)

⁴⁷⁷ The WHR system proclamation, Op. Cit., article 35(2)

⁴⁷⁸ Onumah (2003), *Improving Access to Rural Finance*, Op. Cit., pp. 6 – 8; J. Coulter and G. Onumah (2002), *The Role of Warehouse Receipt Systems* Op. Cit., p. 325

⁴⁷⁹ In USA, every federally licensed warehouse is examined by federal inspectors at least four times annually (See: Hanna (1931), *The Protection of A Holder*, Op. Cit., p.295)

⁴⁸⁰ The WHR system proclamation, Op. Cit., Article 34 (3)

⁴⁸¹ The WHR system proclamation, Op. Cit., Article 30 (1) and (2)

⁴⁸² The WHR system proclamation, Op. Cit., Article 30 (3)

⁴⁸³ The WHR system proclamation, Op. Cit., Article 33(1)

The regulatory organ of the Ethiopian WHR system which is responsible for enforcing the law has an authority literally extending to suspending license of a warehouse or other related professionals overnight.⁴⁸⁴ It may also permanently revoke the license upon notifying the specific charges in writing and hearing the responses of the alleged violator within a reasonable time. The regulator takes such actions against a warehouse operator when it's proved that the warehouse failed to comply with any of the conditions set out in the WHR System Proclamation.⁴⁸⁵ Particularly, failure to maintain the minimum capital, incompetence or incapacity, losing control over the whole or some part of the business premises are among the specific grounds provided under the law for suspension or revocation of a warehouse license.⁴⁸⁶

A warehouse operator against whom such measures are taken shall forthwith give up all his warehouses along with the stored commodities to the regulator. The receiver undertakes only managerial activities as defined under the Civil Code.⁴⁸⁷ Apparently this is done to protect those having claim or interest in the warehouse. In the same way, the regulatory organ may suspend or revoke licenses of inspector, classifier, grader, weigher or sampler of agricultural products where it is shown that such person violated professional standards or has become incompetent or incapacitated. Final decision of the regulator for revocation of a license shall always be notified to the public through the mass media.⁴⁸⁸

The provisions of the Proclamation dealing with administrative measures to be taken by the regulator seem to be too general and inadequate. To begin with, the grounds for revocation and suspension of license are not stated separately. This ultimately broadens the discretion of the regulator and opens the door for abuse of power. Secondly, the maximum duration of suspension of license is not indicated. Because of this, suspension may sometimes have the same practical effect with that of revocation. Thirdly, nothing has been said on the appeal right of the person whose license is either suspended or revoked. This obviously denies the person's constitutional right of access to justice.⁴⁸⁹ Lastly, the law is also silent on the controlling mechanisms the regulator has to employ on inspectors, samplers, and others. At least, there has to be annual reporting system by which the regulator can oversee the activities of such professionals.

⁴⁸⁴ The WHR system proclamation, Op. Cit., Article 38(1)

⁴⁸⁵ In fact it is provided under the law that failure to comply with conditions set out under the regulation to be issued by in accordance with the warehousing Proclamation will also make the warehouse subject to suspension or revocation of license. However so far no regulation is has come to existence.

⁴⁸⁶ The WHR system proclamation, Op. Cit., Article 38(1)(a) – (e)

⁴⁸⁷ Article 2204 of The Ethiopian Civil Code defines Acts of management as follows:

1. Acts done for the preservation or maintenance of property, leases for terms not exceeding three years, the collection of debts, the investment of income and the discharge of debts shall be deemed to be acts of management.
2. The sale of crops, goods intended to be sold or perishable commodities shall he deemed to be acts of management.

⁴⁸⁸ See: Article 38(3) and (5) of the WHR system proclamation, Op. Cit.

⁴⁸⁹ Proclamation of the Constitution of the Federal Democratic Republic of Ethiopia , Proclamation No. 1/1995, 1st Year No.1, Addis Ababa – 21st August, 1995, Article 37(1)

Therefore, it is the belief of the writer that the Proclamation needs revisiting on the aforementioned issues.

Broadly speaking, the Ethiopian Warehousing Proclamation provides for rigorous regulatory regime to the sector. However the Ministry which is authorized either to exercise its regulatory power by itself or by delegating it to another pertinent organ has taken no significant steps towards discharging its responsibilities. As stated by Ato Tshome Lema, Director of Information and Control of Agricultural Marketing Directorate at Ministry of Trade, there is no department under the ministry which is tasked with regulation of warehousing business. He recalled that a regulatory office named as Warehouse Regulatory Inventory Credit Office was established under MoARD for the pilot implementation of the receipt system which lasted from 2005 to 2007. But later on the office was closed following the freezing of the system.

Bearing in mind that there is no office tasked with regulating warehousing businesses in Ethiopia, pertinent question to be raised here would be - who regulates the ECX operated warehouses? Currently the warehouses of ECX are being regulated by Ethiopian Commodity Exchange Authority. In an interview with Ato Bayou Mekonnen, an investigator at the Authority, he stated that the Authority is empowered to regulate and control all activities related to Commodity Exchange by virtue of Article 5 of the Authority's establishing Proclamation⁴⁹⁰ and hence the warehousing business of the Exchange as part of the activities of the Commodity Exchange are within the regulatory power of the Authority. Normally, the Exchange is authorized to operate warehousing business specifically for the purposes of Exchange trading.⁴⁹¹ And hence it may be agreeable that the Authority has regulatory power over the warehousing activities the Exchange does for its trading purpose. Generally, this situation leads to a conclusion that, at least legally speaking, we have two regulatory bodies for the WHR system of Ethiopia - the Ethiopian Commodity Exchange Authority for ECX operated warehousing business and the regulatory body to be established by the WHR System Proclamation for other warehouse operators. Apparently such dual regulatory regimes will have adverse effect on the uniformity of the regulatory system. In view of the writer, there is no any special reason for assigning a separate regulator for warehousing business conducted by ECX. Therefore, it is recommended that the power to regulate warehouses shall be given back to the regulator indicated under the WHR System Proclamation, i.e. the Ministry of Trade. But to do so, first the Ministry shall start properly exercising the powers and duties assigned to it by the law.

⁴⁹⁰ Ethiopia Commodity Exchange Authority Proclamation No. 551/2007, 13th Year No 62, Addis Ababa, 4th September, 2007

⁴⁹¹ The Exchange Proclamation No. 55o/2007, Op. Cit., Article 24(1)

4.4.3. Efficient Dispute Settlement Mechanisms

One of the remarkable qualities of WHRs is its out-of-court enforceability.⁴⁹² Generally, in case where the borrower defaults on payment the bank whose claim is secured by WHRs can easily liquidate the receipt and satisfy his claim against the proceeds thereof without court intervention.⁴⁹³ The Ethiopian warehousing legislation recognizes such quality specifically for negotiable receipts.⁴⁹⁴ A holder of negotiable receipts is able to secure, release and liquidate the goods covered by the receipt on demand, thereby avoiding any court procedures. However such out-of-court enforcement could be compromised by the inclusion of some procedures aimed at maintaining the reliability of the instrument. Good example here is the requirement for registration of pledge which is widely used in other jurisdictions and also suggested for Ethiopia, at least, in this thesis. If such suggestion get acceptance from the lawmakers it may to some extent limit freedom on the manner of securing/collateralizing WHRs.

Per Article 42 of the WHR System Proclamation, parties to a WHR may agree to resolve all disputes among themselves through arbitration. The law further provides that the parties can also agree to accept the arbitral award as a final decision against which no appeal shall be lodged. But, in case where parties haven't agree to that effect, the court to which they may lodge their petition on appeal against the arbitral award is not indicated under the law. Another lacuna of the law pertaining to appeal right is found under Article 38 of the Proclamation. The said provision sets out the administrative measures that can be taken by the regulatory body against disobedient warehousemen and related professionals. But it is silent on how and where an aggrieved party may appeal against the regulator's decision. In the view of the writer, if the legislator had the intent to preserve the party's appeal right it would have explicitly indicated under the law the court having jurisdiction to hear the appeal against the regulator's decision. However, still there is a room to claim for appeal right, at least on issues of law, since the law doesn't expressly state that the regulator's decision is final. Hence, similar to the above, the aggrieved party may take his appeal to the court having first instance jurisdiction over the matter.⁴⁹⁵ Obviously, in a situation where the regulator's power goes to the extent of revoking licenses permanently it is unconstitutional to deny access to courts for review of the regulators decision. Therefore the writer recommends that legislative measures should be taken towards explicitly stating parties' constitutional rights of appeal.

⁴⁹² Forestier, et al. (2004), Special Study, op. cit., p. 7 – 8

⁴⁹³ One exception here is when the lender is not licensed for banking business and the pledged receipt is nonnegotiable. In such a case the pledgors rights shall be governed by the provisions of the Civil Code running from 2851 to 3060.

⁴⁹⁴ The WHR system proclamation, Op. Cit., Article 24(1) - (5)

⁴⁹⁵ Federal Courts Proclamation, Proclamation No. 25/1996, 2nd Year, No 13 Addis Ababa, 15th February 1996,

4.4.4. Public Awareness on the system

It won't be far from the truth to say that almost all farmers and significant part of the private sector in Ethiopia is not much familiar with the concept of WHR financing system.⁴⁹⁶ In fact, for a society which has long been trading through traditional market system availing of finance against the stored commodities is a new experience. Randomly selected small-producer farmers, who were interviewed for the purpose of this research, were quite surprised to hear about the mechanism of WHRs financing. According to the farmers, they are still compelled to sell off their products in lean seasons. If such a system can be put in place they have unanimously disclosed that they never hesitate to join it.⁴⁹⁷ Hence, it is believed that if the concerned government body, i.e. the Ministry of Trade, makes relentless efforts towards introducing the system to the public at large the system can catch farmers' attention and win their support in a short period. Though it would be difficult to allow smallholder farmers to take part in the system individually for various operational reasons, some mechanisms enabling them to participate without undermining the system should be designed. Many countries realized the participation of small-holder farmers by organizing them in groups, each having 20 - 30 members⁴⁹⁸. Particularly in Ghana⁴⁹⁹ and Tanzania⁵⁰⁰ such method has been fruitful. Using cooperative Unions and Cooperative Societies can also be other alternative options to be considered at the initial stage of the scheme.

The private sector is the other important target group in the awareness raising mission. Besides reserving attractive incentives to the warehousing industry, unreserved efforts should be made towards introducing this potential business sector to investors. In fact, before all, the relevant government offices themselves should get more exposure to the systems through trainings, workshops and experience sharing forums. In this regard, NGOs working in Ethiopia in the area of agriculture may play leading role.

⁴⁹⁶ Informal discussion with officers of MoARD, EGTE, and experts in agriculture sector and members of the private sector

⁴⁹⁷ The writer had the opportunity to meet few smallholder farmers from the Northern and Southern parts of Ethiopia. In addition, in an interview with Ato Birhanu Gezahegn, expert on Agricultural production at Ministry of Agriculture, he stated that most of the farmers in Ethiopia can easily be attracted by WHR system if all the necessary elements of the system are put in place. It should also be recalled that in the 2005-2007 pilot implementation project of national WHR system there were farmers who started depositing their products in the designated warehouses.

⁴⁹⁸ Hicks Frank (1998), *TechnoServe inventory credit program in Ghana*, United Nations Conference on Trade and Development (UNCTAD), (as cited by Mor and Fernandes, Op. cit., p. 47)

⁴⁹⁹ TechnoServe, *A Report on a project of Using Warehouse Receipts Systems for Inventory Credit in Ghana*, Op. cit., pp. 342 – 343 (In Ghana's inventory credit project up to 50 farmers have been organized in a single group)

⁵⁰⁰ Gideon E. Onumah, Ana Marr, Alan Marter and Daniel Day-Robinson, Op. cit., p. 29

4.5. The ECX WHRs Financing System and Involvement of Ethiopian Lending Institutions

4.5.1. Legal Basis for The ECX WHRs Financing System

As already hinted earlier, the first modern market institution of Ethiopia, ECX, is attempting to expand its innovative role in the country's agricultural sector through the implementation of reliable inventory credit scheme. The financing scheme under ECX is aimed at facilitating the utilization of the Exchange's eWHR as a security for short term loan.⁵⁰¹ In fact, at this juncture, it should be made clear that ECX has no express authorization from the law to carry out WHRs financing activities. Neither the Exchange's establishing legislation nor the Authority's Proclamation and Directives contain a provision explicitly permitting ECX to facilitate the use of its receipt as collateral. The Exchange is rather authorized by law to deal with WHRs and warehousing service for purposes of its trading activity, not for financing purpose.⁵⁰² It is only in the Rules of the Exchange that the possible use of the electronic receipt for financing purpose is depicted.⁵⁰³ In an interview with Ato Yohannes Assefa, former Manager of ECX's compliance Division who had leading role in designing the legal framework for the WHRs financing system of ECX, he stated that ECX doesn't necessarily need to have express legal authorization to launch WHRs financing system. In his view, the role of ECX is nothing more than facilitating the financing process. Ato Yohannes further contended that the absence of explicit prohibition by itself can be construed as permission. But the issue here is – isn't there any prohibition under the law?

ECX's right to issue a WHR solely emanates from Article 24(1) of the Exchange establishment Proclamation.⁵⁰⁴ The same Article of the Proclamation which allows the Exchange to issue WHRs also specifies or limits the purposes for which such receipts may be issued - that is '*for the purposes of Exchange trading*'.⁵⁰⁵ Hence, one may validly counter argue that contrary reading of the said article prohibits the use of the Exchange receipts for purposes other than the Exchange's trading activities. Hence, the contention that absence of explicit prohibition can be construed as permission would be open to doubt. Because of this, the Exchange's act of issuing or facilitating the use of the receipts for financing purpose still remains debatable. Perhaps, one possible way to settle such controversy would be amending Article 24 of the Exchange Proclamation in a manner that broadens the use of the Exchange's receipts for financing purposes too.

⁵⁰¹ Si Matthies and Kiriakov (2009), Op. Cit. pp.8 – 13; Interview with Ato Behailu Neguse ECX Clearing House Manger and Ato Daniel, ECX Central Depository Manager

⁵⁰² The Ethiopia Commodity Exchange Proclamation No. 550/2007, Article 24(1) and (2)

⁵⁰³ Revised Rules of the Exchange (2010), Op. Cit., Article 9.2.4; See also Article 9.5 of the Rules which laid down detail procedures to be used for pledging the Exchange's receipts

⁵⁰⁴ As the Exchange is not a warehouse operator licensed and registered in accordance with the WHR System Proclamation its power of issuing receipts never emanates from such proclamation.

⁵⁰⁵ The Ethiopia Commodity Exchange Proclamation No. 550/2007, Article 24(1) and (2)

But, in the view of the writer, this may not be the right way of resolving the controversy. The right solution that clears up not only the issue at hand but also other complications related to licensing and regulation of the warehousing business would be revisiting the whole legal framework of the ECX warehousing business in a manner that authorizes the Exchange to operate its warehousing business in accordance with the WHR system proclamation. From the very beginning, there is no justifiable ground for creating a distinct legal regime for the warehousing business of ECX only. As confirmed by the senior officials of the ECX and International consultants, the WHR System Proclamation basically provides for robust legal regime for warehousing business.⁵⁰⁶ WHRs (either paper or the electronic receipts) issued in accordance with the Proclamation can automatically be used for both marketing and financing purposes.⁵⁰⁷ Even if it is claimed that there are lacunae in the existing warehousing legislation the solution is not creating a separate legal regime but rather working towards filling the gaps.

Of course bringing back ECX to the legal framework of the 2003 warehousing legislation would be a bit challenging task that presupposes the fulfillment of some basic conditions. Primarily the Regulatory body i.e. Ministry of Trade should start discharging its duties with respect to warehousing activities. Secondly, necessary legal instruments (Regulations and Directives) that are sought to come into force subsequent to the Proclamation shall be made sooner with active participation of Experts from ECX and representatives of lending institutions. Once these conditions are fulfilled, not only ECX but also other public enterprises and economic actors from the private sector can be attracted to the warehousing business. This curtails the current tendency of monopolization of the warehousing business by a single institution i.e. ECX and makes the business sector open to anyone complying with the legal requirements.⁵⁰⁸ Such unified approach also facilitates the expansion of viable and integrated system of WHR financing throughout the country. It further enables to rectify the various legal and operational setbacks that may be encountered in the process of building the system through collective efforts of all stakeholders.

As things stand now, the Exchange has pursued WHR financing system based on a tripartite arrangement it made with the banks and borrowers.⁵⁰⁹ It has also taken considerable steps in

⁵⁰⁶ Si Matthies and Kiriakov (2009), Op. Cit. pp. 6 – 7; Rabobank International Advisory Service (RIAS) (2010), Warehouse Receipt, Op. Cit. p. 8

⁵⁰⁷ Currently the ECX WHRs are being used for financial purposes not based on the WHR System Proclamation but in accordance with the tripartite arrangement made by the Exchange.

⁵⁰⁸ What compels us to use the term 'Monopolization' is that on one hand, the necessary conditions for the implementation of the WHR System Proclamation are not yet put in place but on the other hand, ECX is allowed to operate warehousing business under a separate regulatory regime. In this situation it is impossible to find any other warehouse operator except ECX and those warehouses designated by the Exchange. Even the designate warehouses can carry on warehousing business and issue WHR only for the purposes of the Exchange trading.

⁵⁰⁹ One can reach to this conclusion after examining the whole system of WHR financing designed by ECX. First the Exchange makes an agreement with banks willing to finance the Exchange's receipts then holders of the receipts may approach such banks requesting for loan. Such an arrangement is different from the receipt financing system

introducing the concept of WHR financing system in the country.⁵¹⁰ Among the various activities done by the Exchange in collaboration with donors one is preparation of 'Warehouse Receipt Financing Guide Book for Bankers' in Ethiopia.⁵¹¹ The guide book describes in detail the WHR financing model designed by ECX and the whole process of pledging a receipt as well as its legal effect. According to the book, a WHR can always be pledged through the ECX Central Depository. A borrower submits his loan application to the bank based on the information in ECX Member/Client Position Report (MCP) or Goods Received Note (GRN).⁵¹² The bank, after checking from ECX Central Depository the validity of the receipt, accuracy of the information provided on the receipt and that the receipt is free from any other lien, shall send electronically signed ECX pledge request to the Central Depository. Then the Central Depository issues the pledge on the electronic receipt and sends to the bank a 'Pledge Confirmation Report'. Immediately after the receipt is pledged it receives a mark of pledge and no-sale status. ECX undertakes to guarantee the preservation of such receipt until the claim of the bank is satisfied in accordance with the law. Recently the Exchange has incorporated all the aforementioned procedures into its latest Rules revised in July 2010.⁵¹³

4.5.2. The Involvement of Lending Institutions in ECX WHR Financing System

Needless to say lending institutions do have indispensable role in building effective WHRs financing or inventory credit scheme. After all, a WHR financing system can be set into motion only when lenders accept WHRs as secure and reliable form of collateral. Lending institutions, before recognizing the receipt as collateral, need to make sure that the system in place possesses all the key requirements ensuring its integrity.⁵¹⁴ If the system is well designed and reliable, then it obviously carries manifold benefits attracting lenders to participate. Particularly lending institutions of Ethiopia that are interested to become involved in the WHR financing scheme designed under the umbrella of ECX can reap much benefits out of it. To begin with, the system minimizes their risk by providing collateral that can retain a high commercial value and be liquidated quickly.⁵¹⁵ The underlying collateral in the receipt system is usually a soft commodity

intended to be introduced by the WHR system proclamation. According to the proclamation, once a receipt is issued in accordance with law there is no need to make any additional arrangement so as to use the receipt as collateral.

⁵¹⁰ Besides fulfilling the operational requirements to the system ECX has facilitated the preparation of different guide book for bankers and borrowers. It has also been organizing different awareness raising trainings for all stakeholders. (Interview with officials of ECX and banks)

⁵¹¹ Rabobank International Advisory Service (RIAS) (2010), Warehouse Receipt, Op. Cit.

⁵¹² It is a document issued by ECX Central Depository as per 9.3.7. of the ECX Rules(Op. Cit.). The documents contain all necessary information about the eWHR the borrower holds. These include client name and ID, quality, quantity and location of the underlying commodity, and duration or expiry of date. (See: Rabobank International Advisory Service (RIAS) (2010), Warehouse Receipt, p. 10)

⁵¹³ See Revised Rules of the Exchange (2010), Op. Cit., Article 9.5

⁵¹⁴ See the discussions above on legal and operational requirements for the implementation of effective WHR system.

⁵¹⁵ *Mor and Fernandes*, Op. cit., pp. 44 - 46

like grain that is easily tradable on the Exchange. Hence, in case where a borrower defaults on the loan, lenders can immediately sell off this very liquid asset to satisfy all claims secured by the receipt. It is also reported that loans given against WHRs usually enjoy a higher repayment rate as compared to others.⁵¹⁶

WHR system opens up new market opportunities to Banks of Ethiopia (both state owned and private) which were hindered from venturing into the agriculture sector and the rural economy at large mainly due to high risks, limited familiarity with agriculture and absence of appropriate lending vehicles.⁵¹⁷ Another advantage of WHRs gravitating Ethiopian lenders to the system is their low transaction cost. While giving loan against WHRs, the lender need not hold the warehouses' key like the case of 'Merchandise loans'.⁵¹⁸ Nor do they need to employ security guards and controlling staff for the commodities in the warehouses. In the ECX receipt system the Exchange bears full responsibility for the safety of the commodities covered by the receipt. Therefore, the lender without the need to have any physical contact with the commodities can safely process the loan based on the receipt. On top of this, the fact that the all documents are electronic makes the operation less cumbersome.⁵¹⁹

Right at this time, lending institutions operating in Ethiopia are Banks and Microfinance Institutions (MFIs). Since foreigners are not allowed to involve in the sector all lending institutions are owned by Ethiopian state or Ethiopian nationals. This is believed to restrict flow of foreign capital to the sector. According to the first quarter 2009/10 Report of the National Bank of Ethiopia (NBE), the number of banks in the country has reached fourteen and among these three are state-owned. Though the number of state-owned banks appears to be very few, the financial sector is still dominated by them.⁵²⁰ The National Bank's report also revealed that there are 656 bank branches throughout the country. However their rural accessibility is very limited. According to the Report, 37% of the total bank branches are situated in the capital, Addis. Even the remaining are concentrated in regional towns. It is difficult to find bank branches at districts level, let alone at the level of Kebeles. From the point of WHRs system, the presence of lending institutions alone doesn't suffice. The institutions should also have better rural accessibility. However, in this regard, Ethiopian Banks haven't gone far. In addition to this, the banks are not as such willing to involve in small loans due to their high cost. Consequently,

⁵¹⁶ Innovations in Microfinance (2000), Ibid p.5

⁵¹⁷ Adera, A. (1995), Op. Cit., pp. 5 – 22

⁵¹⁸ In an interview with Ato Habib Mohamed, Deputy-General Manager of credit Department at Nib International Bank and Ato Yared, credit advisor at Commercial bank of Ethiopia, they emphasized the role ECX's receipts in rectifying the various challenges faced by Ethiopian banks in relation to the traditional merchandise loan. They described the receipt system as a modern merchandise loan quite favorable to lenders.

⁵¹⁹ Interview with Ato Yared, Credit Advisor at CBE and Ato Habib Mohamed, Deputy General Manger of Credit Department at Nib International bank

⁵²⁰ The three large state-owned banks continue to dominate the market in terms of capital, deposits and assets. (See: Kozo Kiyota, Barbara Peitsch, Robert M Stern (2007), The Case for Financial Sector Liberalization in Ethiopia, Discussion Paper No.565, 2007, p.4)

both Private and state-owned banks are not able to reach the poorest of the poor of the country's population living in rural areas. As correctly observed by writers, especially the private banks have high profit motives and they are used to put many restrictions to permit loans to the poor.⁵²¹

MFIs have come up as a potential device to fill the visible gap between the banks and the needy people.⁵²² Not only for Ethiopia but for the whole of Africa MFIs are accepted as an important institutions in the financial sector that are well positioned to grow and reach the millions of potential clients who currently have no access to mainstream financial services.⁵²³ In Ethiopia, MFIs are contributing their part in the battle against poverty. According to a report revealed by the financial sector regulator, i.e. the NBE, at the close of September 2009 there were twenty-eight MFIs operating in Ethiopia which mobilized deposits amounting to 2.2 billion birr. The five largest MFIs; namely, Amhara, Dedit, Oromia, Omo and Addis Credit and Savings Institutions accounted for 86.4 percent of the total capital.⁵²⁴ Particularly, the MFIs in Amhara and Tigray regions have successfully covered almost all districts (*Woredas*) of their respective regions.⁵²⁵ Thus, despite their legal and operational limitations⁵²⁶ MFIs are proved to be promising tools to rectify the protracted problem of rural access to credit. Given their speedy expansion both in terms of number and rural presence, it would be very wise to facilitate for active involvement of MFIs in Ethiopian WHR financing systems alongside the banks. In this regard, considering Malagasy's best practice in networking its inventory credit system with MFIs may help much.⁵²⁷

To date, as uncovered by Ato Behailu, the ECX WHR financing scheme doesn't allow the involvement of MFIs as lending institutions. Of course, since the system is at its nascent stage⁵²⁸ it would be too early to recommend the integration of the financing system with MFIs. Yet, once

⁵²¹ M. Venkata Ramanaiah1 and C. Mangala Gowri (2011), A review of Ethiopian institutions and their role in poverty reduction: A case study of Amhara Credit and Saving Institution (ACSI), African Journal of Business Management Vol. 5(20), pp. 117-124, (it is also available online at <http://www.academicjournals.org/AJBM>)

⁵²² Ibid, M. Venkata Ramanaiah1 and C. Mangala Gowri (2011),

⁵²³ Anne-Lucie Lafourcade, Jennifer Isern, Patricia Mwangi, and Matthew Brown (2005), Overview of the Outreach and Financial Performance of Microfinance Institutions in Africa, available at http://www.ruralfinancenetwork.org/pubs/MIX%20Africa_Data_Study.pdf, retrieved on 6th October 6, 2011, pp. 9 - 14

⁵²⁴ National Bank Annual Report 2008-2009, available at <http://www.nbe.gov.et/pdf/annualbulletin/Annual%20Report%202008-09/Overview.pdf> as retrieved on October 6, 2011, pp. 31 - 32

⁵²⁵ M. Venkata Ramanaiah1 and C. Mangala Gowri (2011), pp.1 - 8

⁵²⁶ According to a study done on MFIs, the following points are among the major areas that demands reconsideration so as to improve these Institutions: their lending capacity and aptness of their products in terms of adequacy of loan size, their duration relative to the gestation period of the activity financed by the loan, the extent to which repayment cycle/frequency is linked to borrowers' income patterns, flexibility of loan terms and conditions, and their group - based nature of loan.

⁵²⁷ UNCTAD (2009), op. cit., pp. 1 - 6 (See also the discussion on classification of warehousing business in chapter Three)

⁵²⁸ According to Ato Behailu Neguse, it is not more than six months since they embarked on the financing system

the system is effectively implemented with banks the next priority area should be extending it to MFIs; so that the rural community can benefit more out of the financing system.

Broadly speaking, the financing scheme designed by the Exchange is secure and reliable.⁵²⁹ According to Ato Behailu Neguse, General Manager of ECX Clearing House; most of the banks have unequivocally expressed their willingness to join the receipt system in different forums.⁵³⁰ But so far from fourteen banks operating in the country it is only four of them which have signed an agreement with ECX to finance the Exchange receipts. The signatories are Commercial Bank of Ethiopia (CBE), Nib International Bank S.C., United Bank S.C., and Dashen Bank S.C. As described by Ato Behailu, the rest have not joined the system not because they have reservations but mainly because they are not able to meet the technical requirements to operate in the system.⁵³¹ From the four banks which signed the agreement it is only Commercial Bank of Ethiopia which has began financing the receipt.⁵³² So far, the bank has released close to 10,000,000 birr loan holding 26 eWHRs as collateral, as told by Ato Behailu. The remaining three banks have not yet financed a single receipt. Why is that?

The major reason is claimed to be the Bills Market Directives issued by National Bank of Ethiopia (See Annex-2).⁵³³ Ato Habib Mohamed Mohamed, Deputy-Manager of Credit Department at Nib International Bank S.C., underscored that his bank is very interested to give loan holding ECX eWHRs as security. However, the issuance of the Bills Market Directive has become a bottleneck for the bank to pursue financing the receipt. The Bills market Directives, which came into force immediately after the lifting of the Credit Cap, requires all banks except Commercial Bank of Ethiopia (CBE) and Developmental Bank of Ethiopia to purchase 'NBE bills',⁵³⁴ with 27 percent of the amount of new loans and advances they disburse in every month.⁵³⁵ It means that a bank which released 100,000 birr loan in a month shall purchase the volume of bills having the value of 27,000 birr. This bill will be redeemed after five years with 3.0 percent interest to be calculated per annum.⁵³⁶

⁵²⁹ All my interviewees from private and state owned banks have affirmed that they have no reservation on the reliability of the ECX's eWHR financing system.

⁵³⁰ See also Si Matthies and Kiriakov (2009), Op. Cit. pp. 12– 13

⁵³¹ Since the system is electronic the banks are required to have sufficient ICT facility.

⁵³² An interview with Ato Yared Michael credit advisor at CBE and Ato Behailu Neguse, manager of ECX Clearing House

⁵³³ Establishment and Operation of National Bank of Ethiopia Bills Market, Directives No MFA/NBEBILLS/001/2011

⁵³⁴ Article 2(1) of the NBE Bills Market Directives defines 'NBE Bills' as "long-term obligation of the national Bank of Ethiopia having a maturity period of 5 (five) years and sold to all banks."

⁵³⁵ The NBE Bills Market, Directives, Op.Cit., Article 4(2)

⁵³⁶ The NBE Bills Market Directives Article 6 (1)(2)

The most important point to be emphasized here is that the volume of bills to be purchased by every bank is determined “solely depending on the amount of new loans and advances”⁵³⁷ the concerned bank disbursed, regardless of their duration. Whether the loans are long term or short term, so long as the amounts are the same, the term of the loans makes no difference on the volume of bills to be purchased. For example, if a bank lends 100,000 birr for a short-term the amount of interest it earns from such transaction is apparently by far less than that of the same amount lent for a long term. However, the volume of the bills to be purchased remains the same in both cases i.e. 27% of the loans disbursed. In addition, as the number of the short term loan transactions increases the volume of bills the banks are required to buy will also scale up.⁵³⁸ This scenario reasonably induces banks to focus on the long term loan in which case once they buy the bills they can stay longer without the need to buy another. The current system of WHRs financing facilitated by ECX is convenient only for short term (working capital) loans. As stated by Ato Daniel Yilikal, Manager of ECX Central Depository, the maximum storage duration of the commodities covered by the pledged receipts is 90 days. Thus, the duration of the loans provided against WHRs can never exceed three months. In conclusion, the Bills Market Directives, which is discouraging short-term loans as a whole, has ultimately lessened banks impetus to embark on financing WHRs.

As indicated under its preamble, the primary objective of the NBE Bills Market Directives is to ensure participation of all banks in financing of priority sector projects so as to achieve sustainable economic development of the country. However the Directives’ similar treatment of all loans and advances disbursed for long-term and short-term durations has brought probably unintended bottleneck to the implementation of the WHRs financing scheme facilitated by ECX. Hence, in order to promote the expansion of WHRs financing system it is suggested that NBE should at least reconsider the way the volume of the bills shall be calculated. The Directives, rather than determining the volume of the bills to be purchased solely depending on the amount of new loans and advances disbursed by the concerned banks, it should also take into consideration the term of the loans. The volume of bills to be purchased for short-term loans should never be the same with the long-term ones. Otherwise, it would be difficult for majority of the banks in Ethiopia to become involved in WHRs financing scheme and ultimately Commercial Bank of Ethiopia may remain to be the only bank financing ECX WHRs. Also, ECX’s efforts towards accelerating the implementation and expansion of functioning WHRs financing system through active participation all the banks would certainly be futile. According to interviewees drawn from different private banks, currently all banks subject to the directives

⁵³⁷ See Article 3(2) of The NBE Bills Market Directives reproduced hereunder:

“The volume of the bills to be supplied shall depend solely on the amount of the new loans and advances disbursed by banks during the fiscal year and shall be calculated as per Article 4(2) of these Directives.” It implies that all new loans and advances whether disbursed for short-term or long-term duration are treated in the same way.

⁵³⁸ An interview with Ato Habib Mohamed Mohamed, Deputy-General Manager of Credit Department at Nib International Bank S.C.

have submitted their petition to NBE requesting for the total cancellation of the Bill market Directives. So far no response has been given from the NBE.

In fact, the amendment or annulment of the Directives alone won't facilitate the smooth implementation of the receipt financing system. As the receipt is a new product to the Ethiopian lending institutions, every bank need to prepare its own clear internal Credit Policy and detailed Credit-Procedures and disseminate this to all of its loan officers.⁵³⁹ As pointed out by Ato Behailu, the Credit-Procedures for WHR financing should be as short as possible. He justified his argument by raising two concrete reasons. First, since the current ECX WHR system is more secure and reliable there are no as such many facts to be investigated by the bank like in the case of other loan applications. Secondly, the duration of commodity storage in ECX is very short and hence unless banks can process and disburse the requested loan within few days, the feasibility of the loan would be doubtful. In addition to efficient credit policy and procedure, banks shall also put in place effective mechanism of managing the risk of price fluctuations. For this purpose banks are strongly advised to have qualified staff that are acquainted with the idea of Trade and Commodity Finance in general and the ECX WHR procedures, in particular.⁵⁴⁰ In this regard, all the banks including CBE have not yet moved forward.⁵⁴¹

⁵³⁹ Rabobank International Advisory Service (RIAS) (2010), Warehouse Receipt, p.18

⁵⁴⁰ Ibid, p.18

⁵⁴¹ Interview with Ato Yared Michael Credit Advisor at Commercial Bank of Ethiopia and Ato Habib Mohamed, Deputy General Manager of Credit Department at Nib International Bank.



Chapter Five

Conclusions and Recommendations

WHR system is an innovative mechanism chiefly designed to modernize agricultural marketing. The system improves the overall efficiency of markets in the agribusiness sector by facilitating the conversion of inventories of agricultural products into a readily tradable Device, commonly known as WHRs. The receipts serve two core functions: *marketing* and *financial* functions. Well functioning system of WHRs leads to an increase in the availability of credit, reduce its cost, and mobilize external financial resources for the agricultural sector. It helps to reduce the strong price fluctuations by injecting more planning into the marketing system and ultimately enables farmers to access markets on more equitable terms. Using WHRs system, Smallholder farmers can escape the cheap price of the harvest season, hold food back to the lean season and at the same time access short-term loan to ease their cash constraint. The receipt system is also beneficial for lending institutions as it provides them secure & easily liquidated collateral. WHRs have also pivotal role in the creation of modern commodity markets which enhance competition, market information and international trade. Moreover, the receipts lay the foundation for more sophisticated products, such as derivatives and hedging contracts. The system is also important in providing a way to gradually reduce the role of government in agricultural market and improve food security. By so doing, WHR system can facilitate the transformation of agricultural market into modern trading system and accelerate economic development.

The genesis of grain WHRs traces as far back to the Mesopotamian civilization of 2004 B.C. However, the system is claimed to come out as part of the modern business transaction in the Western world in the 19th century. At present WHRs have become integral parts of the marketing and financial systems of many developed countries. The transition of the receipt system from the use of paper WHRs to electronic receipts has fortified its integration with the modern market institutions. The electronic receipt system is widely recognized as a key innovation capable of radically reducing cost, increasing security, facilitating transactions and providing useful information to players. Especially, the electronic receipts are noticeable for being available 'off the shelf'.

Unfortunately the developing world has not yet been able to benefit much from the system of WHRs due to various institutional and structural shortcomings such as lack of incentive to the development of private warehouses; government intervention in the market; lack of apt legal, regulatory and institutional environment for the system; and very little or total absence of awareness about the merits of the system. Since the late 19th century there are ongoing efforts towards introducing WHR system into developing and transitional economies of Latin America, East Europe, Central Asia and Africa. From Africa Ghana, Niger, Malawi, Tanzania, Uganda, Zambia, Kenya, Madagascar and Ethiopia are among the major countries striving for realization of effective WHR system. Ghana and Niger deserve noting for their success story in introducing

and implementing the system. South Africa is also another African country to be mentioned for its well developed system of WHR that emerged without specific enabling legislation. But generally, with regard to the expansion of WHR system in Africa, one can safely conclude that so far many of the developing countries in the continent have not yet succeeded in building the most effective WHR system that can significantly change the rural life and accelerate the whole economic growth.

In Ethiopia, scant rural financial access has been identified as one of the fundamental problems hampering production, productivity and income of rural farm households. WHR system is suggested as a suitable mechanism that enables to rectify such financial constraint in the agricultural sector and further facilitates the development of efficient and modern agricultural market system. More importantly, the receipt system is believed to have immediate positive effect on income of the rural households covering 85% of the total population in the country. Given that Ethiopia is predominantly an agrarian economy, the receipt system will obviously have pivotal role in greasing the wheels of economic growth to a greater extent.

Ethiopia introduced WHRs into its legal system before half a century though the legal rules remained on paper for long period. However, the occurrence of the 2002-2003 food crisis which caused draught threatening 14 million people of the country triggered the government of Ethiopia to think of a mechanism enabling farmers to store their surplus products for the bad times. WHR system was identified as a suitable mechanism for such purpose. Accordingly, the creation of enabling legal regime was given priority and a specific federal law providing for a WHR system was enacted in 2003. The 2003 WHR system Proclamation is a well structured legal document that has filled the major gaps left in the Civil and Commercial Codes. As outlined under the law, the establishment of the system of WHRs is primarily aimed at improving the agricultural marketing system. Among the various approaches to warehousing business the Proclamation has rightly adopted the regulated public warehousing approach. The Proclamation has introduced a 'single receipt system' and given recognition for both negotiable and non-negotiable WHRs that are either paper based or created electronically. It has also laid down legal rules governing the *marketing* and *financial* functions of the receipts. The proclamation further defines the rights and duties of every party involving in the WHR system and also provides for effective regulatory framework to the system.

Though it has been more than eight years since the WHR System Proclamation came into force a national WHR system has not yet been effectively implemented in Ethiopia due to various legal and institutional bottlenecks. To date, there is no a single warehouse operator in the country that is licensed in accordance with the WHR System Proclamation to engage in warehousing business. Since 2007 ECX, the first modern market institution of Ethiopia, has embarked on operating warehousing business and issuing eWHRs. However, the Exchange carries on its warehousing business without being licensed in accordance with the Warehousing legislation. It is claimed that the Exchange is authorized to operate warehousing business and issue WHRs by

its establishment proclamation. The Exchange has also been exerting wholehearted towards expanding the use of its receipts for financing purpose. So far, four banks (three private and one state-owned) have signed an agreement with ECX to become involved in the WHR financing scheme designed under the umbrella of the Exchange. Among the four, it is only CBE which has embarked on financing the Exchange eWHRs. The major reason for the delay of others is mentioned to be the NBE Bills Market Directives which has negative impact on short-term loans. In general, although the ECX has succeeded in launching a trading scheme that is well integrated with a WHR system, the whole system of the warehousing business and the receipts' financing scheme has faced some challenges.

The various legal and institutional challenges which have significantly capped the implementation of national WHR system in Ethiopia are discussed in-depth in the main body of this Thesis. Among these, the major ones are portrayed below together with some recommendations:

- ✦ Though Ministry of Trade is assigned as a national regulatory body vested with the power of licensing and regulating warehousing businesses in Ethiopia, it has not made any preparation so far to start discharging its responsibilities. Neither did it designate another organ for such purpose. Even there is no a department/office to take care of warehousing-related activities in the Ministry. In the absence of a licensing and regulating organ, it is hardly possible to have warehousing businesses. Hence, it is highly recommended that the Ministry should make all the necessary preparations, as soon as possible, and start discharging its duties and responsibilities emanating from the law.
- ✦ Secondary legislations, i.e. Regulation and Directives, which are sought to come into existence following the WHR System Proclamation, have not yet been put in place by the appropriate bodies. The absence of such legal instruments has particularly created wide legal lacunae regarding the requirements for Cooperative Societies to engage in warehousing business, the type of bond or an undertaking required to be executed by the warehouse operators, the procedures for licensing and inspection of warehouses and the procedure for creation and transfer of electronic receipts. These, in turn, have become hindrances for implementation of the receipt system in Ethiopia. Hence, the concerned government bodies should take immediate action towards putting in place such instruments.
- ✦ According to the WHR System Proclamation, Cooperative Societies, Private Limited Companies, Share Companies and Public Enterprises are the only eligible forms of businesses entities allowed to operate warehousing business. However, such criterion, which is merely based on the form of the business, is contested for backing off the private sector. Some argue that such criterion should be further strengthened and similar to the case in the banking sector, Private Limited Companies should also be excluded from the list because their trustworthiness has become doubtful in the current situation in Ethiopia. In this Thesis it

is argued that the integrity of the system would be effectively guaranteed not by relying on the forms of the businesses but by ensuring strict observance of the bonding and insurance requirements and other objective criteria of the receipt system by all business operators engaged in the warehousing activity. Particularly, in Ethiopia, where the system is at its nascent stage, the inclusion of such criterion may not be justifiable. In fact, when the system develops and many warehouse operators join the warehousing industry it would be wise to reconsider such criterion but now the law should be amended to make the warehousing business open to any one complying with the objective legal requirements.

- ✦ To ensure financial capability of warehouse operators the law requires one million birr capital threshold. However such amount of capital which was fixed eight years back is now inadequate because of high inflation rate the country has been experiencing. Thus, it is suggested that such threshold should be increased.
- ✦ In case where the duration of storage has not been fixed, the law requires the warehouseman to stay for a year from the date of deposit so as to invoke his rights of demanding payment of charges and removal. But it is unreasonable to compel the warehouseman to stay for a year in the absence any contractually binding term. Hence, the warehouse operator should be permitted to invoke his rights after giving reasonable notice. In addition, the absence of legal limit for duration of storage may leave room for hoarding and inflation. So it is the view of the writer that the maximum possible duration should be fixed by law.
- ✦ Though the Proclamation obliges the warehouse operators to insure the goods represented by WHRs, the specific risks to be covered by insurance policies are not indicated in the law. Hence the law should clearly specify the risks to be covered by the insurance policy.
- ✦ The law requires the notation of the magic word 'non-negotiable' on the face a non-negotiable receipt to distinguish it from the negotiable ones. But it is suggested that requiring the notation of the word by itself may not suffice alone; the law should further dictate conspicuous notation of the word on the receipt so as to avoid deceptions.
- ✦ In case where the warehouseman goes bankrupt holders of WHRs may satisfy their claim either by taking delivery of the commodities from the trustee or against the surety bond executed by the warehouse operator. However, if there are claims not yet satisfied, the holders may need to join the Universality of creditors and go through the bankruptcy proceeding to satisfy their claims. Thus, the amendment of the age old bankruptcy regime of Ethiopia is also important for better protection of WHR holders.
- ✦ Signature of the warehouse operator is one of the essential elements to be incorporated in every WHR. To make such requirement compatible with the nature of electronic receipts the term "signature" should be defined broadly. In fact the meaning of signature in existing legislations of Ethiopia is broad. Yet, it is recommended that the law gives wider meaning for

term in a manner that clearly recognize electronic signature. In this regard, consulting the approach taken by the UCC may help.

- ✦ It is only Article 2834(2) of the Civil Code which explicitly recognizes pledgor's re-pledging right on non-negotiable receipts. Since the WHR system Proclamation is silent on the issue it can be suggested that the application of the provision of the Civil Code extends to negotiable receipts too. However, in the ECX WHR financing scheme re-pledging is prohibited. Such prohibition is unjustifiable and the law should explicitly recognize re-pledging right so as to increase the financing capacity of WHRs.
- ✦ Generally the absence of centralized system for the registration of collateral makes secured lending difficult. In Ethiopia, except the Rules of the ECX, which make registration an integral part of the pledging process, no law clearly provide registration as a mechanism of perfecting security interests on WHRs. Hence, it is suggested that that law should recognize registration as a mandatory way of perfecting security interest on WHRs. To this end, a central, widely accessible and reliable registry system for both paper and electronic receipts is recommended to be established by law. The current electronic registry system of ECX can serve as a model to establish a national registry system. Registration has multifarious advantages. Among these one is its role in settling priority claims that arise following the re-pledge of receipts.
- ✦ The grounds for suspension and revocation of warehousing business licenses are not stated separately. This unreasonably widens the discretion of the regulator. Thus, it is recommended, the law should put the grounds for each of the administrative measures discretely. It is also suggested that the maximum duration for suspension of the license should be stated by the law.
- ✦ The WHR System Proclamation lacks clarity on the appeal right of parties aggrieved by the administrative decision of the regulatory body. Hence, it is recommended that the law should spell out how, when and where a party may lodge an appeal against the decision of the regulatory body.
- ✦ Currently, banks are perceived as the only lending institutions that may involve in the WHR financing scheme. However, given limited rural accessibility of Ethiopian banks, it is hardly possible to make smallholder farmers beneficiaries from the financing system in which banks are the only lenders. To tackle this limitation, the involvement of Microfinance Institutions is highly recommended. Particularly, in Ethiopia, where there are well-developed regional MFIs, networking the WHR financing system with the MFIs deserves special attention.
- ✦ Though ECX is operating warehousing business and issues WHRs it is neither licensed nor regulated in accordance with the WHR System Proclamation. Furthermore, other detail matters of the Exchange's warehousing activities are being governed not by secondary

legislations issued in accordance with the WHR System Proclamation but by the internal Rules of the Exchange that are issued pursuant to Article 12(10) of the Exchange's establishment Proclamation. This is because it is believed that Exchange is authorized to operate warehousing business and issue WHRs as per Article 24(1) of its establishment Proclamation. Taking into account all these facts, it can be fairly concluded that ECX is operating its warehousing business within a distinct legal framework exclusively reserved to it. However, in this Thesis, it is argued that there is no justifiable ground to exclude ECX from the legal framework of warehousing business provided by WHR System Proclamation. To maintain the uniformity of the legal framework for WHR system the Exchange should start operating its warehousing activities in accordance with the WHR system Proclamation. It is also suggested that due emphasis should be placed on building an integrated national legal regime of WHR system that is enforced by a single regulatory agency and uniformly applied on all persons, including ECX, engaged in warehousing business in Ethiopia. Accordingly, I recommend that Article 24(1) of the Exchange establishment Proclamation should be amended to make ECX subject to the WHR system Proclamation.

- ▼ Currently, the WHR financing scheme designed under the umbrella of ECX is already launched. However the legal basis to use the Exchange's WHRs for financing purpose is doubtful. The establishment Proclamation of the Exchange which authorized it to issue WHRs has also specifically stated the purpose for which the Exchange may issue WHRs – that is for the purposes of the Exchange's trading activity. Hence it can be concluded that ECX has a legal ground neither to issue Rules on pledge of WHRs nor to launch WHR financing scheme. Two alternative solutions can be suggested to rectify the problem i.e. either amending Article 24(1) of the Exchange establishment Proclamation to allow the use of the Exchange receipts as collateral for loan or putting all the warehousing activities of the Exchange within the legal framework of the WHR System Proclamation. The writer favors the latter mainly because it promotes the establishment of uniform legal framework for all warehousing businesses.
- ▼ The other tangible bottleneck of the WHR financing scheme that is raised by banks of Ethiopia is the Bills market Directives issued by NBE immediately after the lifting of the Credit Cap. The Directives is aimed at ensuring participation of all banks in financing of priority sector projects. However, similar treatment of all loans and advances disbursed for long and short term durations has brought probably unintended negative impact on the implementation of the WHRs financing scheme by discouraging short term loans. WHR financing system is normally intended to facilitate access to short term working capital. Particularly in the ECX system the term of the loan can never exceed ninety days. Hence, the Bills Market Directives of NBE directly deters the expansion of WHR financing scheme. Banks very eager to participate in the ECX WHR financing scheme are now retreating back due to the Directives. Therefore, even if it would be impossible to cancel the whole Directives, at least, the way the volume of the bills is calculated should be revisited.

↳ Generally, effective implementation of viable WHR system in Ethiopia demands combined efforts of the government, lending institutions and the private sector. Primarily the government should focus on building an integrated national WHR system uniformly applicable for all warehousing businesses and avoid any exceptions including that of the ECX warehousing activities. It should also properly discharge its responsibility of creating conducive legal and policy environment that attracts the private sector into the warehousing industry and rectify the current inclination of monopolization of the warehousing businesses by ECX.⁷ This primarily includes establishing competent regulatory body, considering the amendment of the existing proclamation of WHR system and putting in place secondary legislations facilitating the implementation of the proclamation. It is also recommended that the government should think of strategies enabling to decentralize the WHR system to regional level. Assuming that the current Directive of NBE will be revisited sooner, lending institutions are expected to prepare clear internal Credit Policy and detailed Credit-Procedures for the new product i.e. WHRs financing. Given the strong legal protection of WHRs and the nature of the receipts financing system, lenders are advised to make their credit procedure as short as possible. They should also have qualified staffs that are acquainted with the idea of Trade and Commodity Finance. Having all these things in place, the remaining important task will be wide range of awareness raising campaign to all stakeholders of the WHR system.

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E. List of Interviewees

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2. Ato Birhanu Gezahegn, Expert on Agricultural production at Ministry of Agriculture
3. Ato Bayou Mekonnen, Investigator, at Ethiopian Commodity Exchange Authority
4. Ato Daniel Yilikal, Manager of ECX Central Depository
5. Ato Habib Mohamed, Deputy General Manager of Credit Department at Nib International
6. Ato H/ Selassie G/ Georgis, Senior officer of property Administration at EGTE
7. Ato Teshome Lema, Director of Information and Control of Agricultural Marketing Directorate, at Ministry of Trade
8. Professor Tilahun Teshome, Professor of Law, School of Law, AAU. He is also the drafter of the 2003 WHR system Proclamation
9. Ato Yared Michael, Credit Advisor at Commercial Bank of Ethiopia Bank
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Annex - I

I. Structured Interview Questions to Ministry of Agriculture

1. Has the government recognized WHR financing system as part of its strategy to improve the agriculture sector?
2. Are there efforts exerted towards implementing the system? If any, please describe!
3. Do you think there is conducive policy environment promoting WHR system in Ethiopia? (government intervention in the agriculture sector)
4. What about the legal regime? Is it enabling?
 - Are all legal instruments such as the regulation and directive expected to be issued following the proclamation put in place?
 - Regulations by the council of Ministers – to facilitate the smooth/proper implementation of the system (per Art. 45 of the proclamation)
 - Directives by the Ministry
 1. to determine the requirement for cooperative societies to carry on warehousing business (Art. 26(3))
 2. to determine the type and amount of bond to be executed by warehouses (Art. 31(1))
5. Has the Ministry set standard for agricultural products? (per Art 33(1) of the proclamation)
 - Had you a say in the standard setting process of ECX as a regulator?
 - After all can ECX set standard?
 - What should be done for the future? Is it not important to set national standards which are uniformly applicable across the nation?
6. Does the ministry have specific department in it which is entrusted with the responsibility of regulating warehousing business? Or has it designated its power to another third party in accordance with the proclamation?
7. is the ministry willing to delegate its regulatory power to private body such as reputed association, Exchange or others
8. Are there persons so far applied to or licensed by the Ministry to operate warehousing business in Ethiopia? If no, what do you think the reason would be?
9. Do you think the government (obviously the ministry is also in it) has discharged its duty of promoting and introducing the warehousing industry to the public in general and the private sector in particular? If yes, what specific activities were done in this regard?
 - Are there any special incentives reserved for inventors willing to work in the Warehousing industry?
10. Have you ever licensed inspectors, classifiers... in accordance with the warehousing legislation? If yes,
 - How do you interpret “proof of competence”
 - Is there a professional standard set by the Ministry as per Art 33(2) of the warehousing legislation?
11. Is there model WHR prepare by the ministry as per Art 41? If any can I get a copy of it?

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12. As a regulator has the ministry licensed ECX to operate warehousing business? If not, what is the legal base for ECX to operate warehousing business?
13. Does it regulate the activity of ECX warehouses?
 - Have you ever visited ECX warehouses and make sure that they are operating in accordance with the warehousing legislation

II. Structured Interview Questions to Ethiopian Commodity Exchange

1. Who are eligible to hold ECX issued WHRs?
2. Can holder of a receipt get hard copy of it or paper receipt? If yes, have you ever issued paper receipt? If no, why not?
 - Article 9.2.1. talks about the Depository's authority of printing copies of the receipt
 - Article 9.2.5. The Electronic Warehouse Receipt may upon request be materialized into a paper warehouse receipt, according to the procedures of the Exchange Central Depository
3. It is provided under the Rules of the Exchange (Article 9.2.3) that your receipts are negotiable. Does it mean the Exchange never issues nonnegotiable receipts even if clients requested? Why or Why not?
4. It is given that your receipts are negotiable; how are they negotiated or transferred from one person to another?
5. Can holders negotiate (deal with) their receipts online?
6. Can holders check audit trail or the status of their receipt online? What about any other interested persons such as potential pledgees? How about the public at large?
7. If it is possible to do that online, do you have a mechanism in place to assist computer-illiterate clients?
8. In the Exchange forum, is it the receipt or the underlying commodity which is actually traded or transferred?
9. What is the difference between exchange actor and Exchange member?
10. Can I get the format of the ECX eWHR in use right now?
11. I think you have embarked on WHRs financing system based on the WHR system proclamation. The said proclamation provides that all warehouse operators shall be licensed to carry on the business. Pursuant to the same proclamation and proclamation No. 380/2004, MoARD is entrusted with regulatory power including issuance of license.
 - Has ECX got warehousing business license from the regulator? If not what is the legal base for its warehousing business?
 - Do you have any business relation with the ministry particularly in relation to the warehousing business and the receipt system?
 - Has the regulator ever visited your warehouses and check that you are operating in accordance with the WHR system proclamation? Why?
12. Is there any provision of law authorizing ECX to carry on WHR financing activities? (Not in its internal Rules)

13. ECX has set standards for agricultural products traded on it.
 - What are the specific products for which standards have been set?
 - Does it done it by itself or how?
 - Article 33 of the WHR system proclamation gives the power of setting standard to the regulator (indeed not alone but in close consultation with relevant public offices).
Is there any legal ground for ECX to set such standard?
14. Is it possible to re-pledge a WHR? Why?
 - If it's not, what is exactly the reason on your part not to allow re-pledging?
15. Can a holder get a receipt with smaller denomination (Art-6(6) of WHR system proclamation)?
16. What is the status of the Guide Book for Bankers (*Rabobank, 2010*)? Is it legally binding document which is in force right now?
17. How many banks have agreed so far to finance ECX issued WHRs? Can I get the name of the banks?
18. Have they started financing? Why?
19. If they financed, how many receipts were pledged so far? Can I get the list of the borrowers and the lenders?
20. Why do you think other banks showed reluctance to sign the agreement for financing WHRs?
21. Do you want to work with MFIs? Can't they participate in the system as a financier? Why?
 - If you are interested, are there efforts exerted to attract them to the system?
22. The Guide Book (mentioned above) states that ECX members & clients, producers' groups & co-operatives union, commercial farms and traders can involve as borrowers.
 - To access finance pledging the receipt the borrower has to be holder of a receipt issued by the Exchange. Can all these groups be holders?
23. How can a pledgor of a receipt sell of the commodities covered by the receipt in case where the borrower defaults?
24. Is there any legal challenge faced by ECX while attempting to implement the WHR financing system?

III. Structured Interview Questions to Banks

1. What are the major forms of collateral your bank accepts to give loan?
2. Do you get registered your contracts of pledge? (is there any legal requirement)
3. Do you accept WHRs as collateral?
4. Does WHR have special advantage for lenders as compared to other collaterals? What is that?
5. Have you ever provided loan against WHRs? If not why? If you have provided:
 - How many receipts have you financed so far?
 - Who are the borrowers (from which group are they)
6. Do you have clear internal credit policy and detail credit procedure which is endorsed by the management and disseminated to the concerned staff (working on credit)?

7. How do you manage risk related to WHRs, for instance price fluctuations
 - Do you have qualified staff with adequate understanding on the ECX system and on the trade and financing of commodities? (such staff is believed important to monitor commodity prices on daily basis and trigger top up clause when necessary)
8. How do you determine the face value of the receipt?
9. How many percent of the value of the receipt is released as a loan?
10. In case of collaterals how many percent of the collateral do you lend?
11. The Ethiopian law (Art. 2834(2) of the Civil Code) allows the pledgor to re-pledge his property again?
 - Have you ever experienced this?
 - What's your stand on the right to re-pledge?
12. What's the possible problem on your part if a receipt you hold as a security is re-pledged to another person?
13. If the right to re-pledge is allowed what would be the best mechanism for settling priority issue?
14. Would registration of pledge be the appropriate mechanism? What are the pros and cons of registration for you?
15. In case where a borrower defaults on loan secured by a WHR the lender can sell off it after fifteen days from the date of payment indicated in the default notice. However, the period of time to be fixed in the notice for payment is not indicated in the proclamation. How do you fill this gap? *Can we use Article 3 of the foreclosure proclamation (97/98) which provides for a minimum of 30 days?*

IV. Structured Interview Questions to Ethiopian Grain Trade Enterprise

1. How many warehouses the Enterprise owns though out the country? How do you explain their distribution?
2. For what purpose does the Enterprise use the warehouses?
3. Does the Enterprise render simple warehousing service or in other words does it store commodities belonging to others?
4. Have you ever thought of or made efforts towards embarking on activities of WHR financing system?
5. Is there a plan for that? Why?
6. Does the Enterprise establishing proclamation allow this?
7. Given the huge number of large size warehouses the Enterprise owns throughout the country, don't you think you the enterprise has huge potential to engage in the activities of WHR system?

Annex-II



NATIONAL BANK OF ETHIOPIA

Directives on the Establishment and Operation of National Bank of Ethiopia Bills Market

Directives No. MFA/NBEBILLS/001/2011

March 2011
Addis Ababa



Establishment and Operation of National Bank of Ethiopia (NBE) Bills

Market Directive No. MFA/NBEBILLS/001/2011

Whereas, fostering monetary, credit and financial conditions conducive to orderly, balanced and sustained economic growth and development is the principal objective of the National Bank of Ethiopia (NBE);

Whereas, all banks should participate in the financing of priority sector projects to bring sustainable economic development;

Whereas, the purchase and sale of NBE bills constitute a key part in achieving the objective;

Now, THEREFORE, in accordance with powers vested on it by articles 5(3,4) and 27(2) of National Bank of Ethiopia Establishment Proclamation No. 591/2008, the National Bank of Ethiopia, (hereafter the NBE), has issued these directives.

Article 1

Short Title

These Directives may be cited as "Establishment and Operation of National Bank of Ethiopia Bills Market Directives No. MFA/NBEBILLS/001/2011".

Article 2

Definitions

For the purpose of these Directives, unless the context provides otherwise:-

"NBE bills" mean long-term obligation of the National Bank of Ethiopia having a maturity period of 5 (five) years and sold to all banks.



2. "Banks" mean all the banks operating in Ethiopia except the Commercial Bank of Ethiopia and Development Bank of Ethiopia.
3. "Allotment" means the determination or the decision as to what amount of bills a bank
4. "Loans and advances" mean any financial assets of a bank as defined by Article 4.6 of NBE Directive No. SBB 43/2008.
5. "Disbursement of loans and advances" means new extension of loans and advances including overdraft facilities during a specified period of time by a bank to all economic sectors except the Federal Government.
6. "Overdraft disbursement" mean average of every Tuesday's overdraft outstanding balance over a given period of time, say a month, a quarter or a year.
7. "Face value" means apparent worth, or the nominal value that appears on the face of a bills.
8. "Maturity date" means period over NBE bills are completed or become due. If maturities fall on weekend and/or holidays NBE bills shall be redeemed on the next working day.
9. "Issue date" means the date on which the bills are issued.
10. "Settlement" means completion of the transaction by delivering the required bills and/or funds.
11. "Settlement date" means the deadline by which a purchaser of the bills must pay for what has been bought and the seller must deliver the certificate for the bills that has been sold.
12. "Fiscal year" means the period from July 1 of a year to June 30 of the following year.
13. "Rollover" means the bills renewal request to be made before maturity date.

Article 3

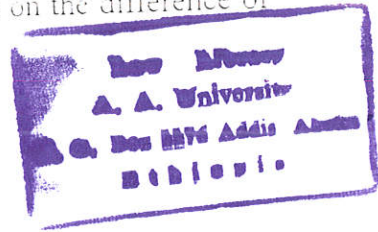
Supply of NBE Bills and Eligibility Criteria

1. Banks shall buy the bills allotted to them as per Article 4 of these Directives.
2. The volume of bills to be supplied shall depend solely on the amount of new loans and advances disbursed by banks during the fiscal year and shall be calculated as per Article 4(2) of these Directives.



In case of overdraft disbursements, the allotment shall be computed on the difference of two consecutive months balances.

The bills shall only be purchased by banks operating in Ethiopia.



4.0 Purchase NBE Bills

Every month each bank shall notify NBE in writing its own respective allotment amount using the report format in Annex 1 of these Directives within 15 days after the end of the reference month.

Each bank shall calculate its own allotment based on monthly plan of loans and advances disbursement. The applicable ratio for the allotment shall be 27 percent of such disbursements. However, the ratio may be revised by the National Bank of Ethiopia when necessary.

The settlement date for the purchase of the bills shall be 3 (three) days after the end of the transaction date. If the settlement date falls on weekends or holidays settlement shall be effected on the next working day.

If the actual disbursement during a month is higher (or lower) than the planned disbursement, the difference in allotment shall be considered in deciding the allotment for the next month.

Banks shall submit a letter of authorization permitting the National Bank of Ethiopia to debit their Payment and Settlement Account for the balance of the purchased bills by them.

5

Notification

The NBE shall notify banks in a predesigned format about its deduction of the allotment amount from their Payment and Settlement Account within 3 (three) days after their account is debited.

NBE shall notify payment of interest rate accrued on the bills and credit their payment and settlement account on annual basis within 5 (five) days after effecting the payment.



e 6

Article 6 Interest of the Bills

The NBE bills shall have a maturity period of 12 months.
The interest rate for each bills shall be 3.0 percent per annum.
The NBE shall pay the interest accrued on the bills on annual basis.

le 7

Article 7 Issuance and Transferability of the Bills

NBE bills shall be issued to banks pursuant to Article 3.2 and Article 4.2 of these Directives.

The bills shall be issued to each bank on monthly basis.

Notwithstanding Article 7(2) NBE bills to be issued for fiscal year 2010/2011 shall retroactively apply on the previous eight months starting July 1, 2010.

A bank may transfer its bills to another bank by endorsement on the back of the bills itself.

A bank may use the bills as collateral for any agreement to be made with domestic banks including NBE.

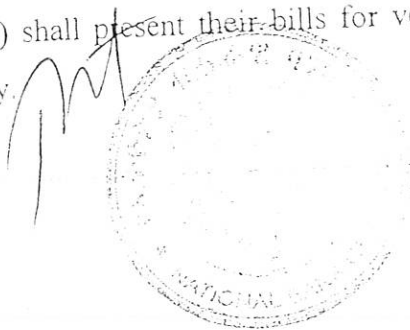
A bank may arrange with NBE to hold the bills in safe custody on its behalf.

Article 8

Redemption

1. On the maturity date as specified on the bills itself, the bills shall be redeemed and credited to the Payment and Settlement account at NBE.
2. The NBE shall verify the bills before redemption.
3. Holders other than those who have previously lodged their bills with the NBE at the time of issue in accordance with Article 7(5) shall present their bills for verification to the NBE two days before the date of maturity.

Page



4. Maturing bills so presented shall be signed with the authorized signature(s) of the last holder and clearly endorsed with the name and other particulars of the Payment and Redemption Agency, which the redemption money, by the

Article 9

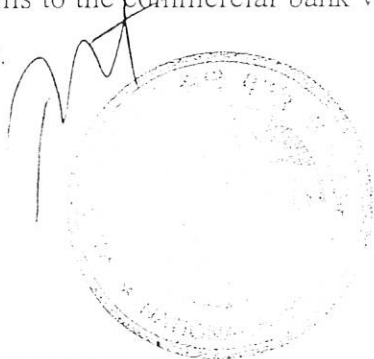
Rollover Instruction

1. Banks may authorize the NBE to rollover their bills at the maturity date.
2. Pursuant to Article 9(1) of these Directives, the NBE may issue new bills within two days upon receiving rollover instruction from banks.
3. The principal amount of the bills shall be paid at the end of the maturity period if no rollover instruction is obtained within 10 (ten) days before the maturity date of the bills.

Article 10

Loss of the Bills

1. In the event of an NBE bills being stolen, lost, mislaid, defaced or damaged, the holder shall inform the NBE in writing with a full statement of the circumstances immediately after the loss is discovered. If theft or malpractice is known or suspected, it shall also inform the police immediately.
2. No duplicate of such NBE bills shall be issued. But where the NBE is satisfied, after due enquiry and (in its sole discretion) the deposit with it of sworn statements and/or a suitable and acceptable form of indemnity against any other person establishing a claim to be the rightful holder of the bills, it may pay (on or after the maturity date) the redemption money due on the bills to the commercial bank whom it considers, after such enquiry, to be the rightful holder.



Article 11

Loans and Advances Facilities by NBE

Loans and advances facilities by banks may be used as collateral for loans and advances from the NBE subject to the policies, rules, terms and conditions laid down for such facilities from time to time by the NBE.

Article 12

Penalty

Any bank engaging in any fraudulent activities when reporting the fresh loan disbursement amount or the allotment amount or in transferring the bills or any other activities against these Directives shall be punishable in accordance with the circumstance of the case in Article 26 of NBE Establishment Proclamation No. 591/2008.

Article 13

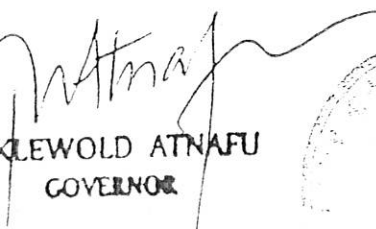
Inapplicable Laws

Any directive which contravenes with these Directives shall have no legal force on matters provided for in these directives.

Article 14

Effective Date

These Directives shall enter into force as of the 4th day of April 2011.


KEWOLD ATNAFU
GOVERNOR



Annex 1: Reporting Format for the NBE Bills Allotment for Banks

Name of the Bank: _____
 Kind of Disbursement: XX to XX, XXXX

Disbursement Plan for the Preceding Month						Actual Disbursement in the Preceding Month		Excess (or Deficits) of Actual Disbursement Over the Plan 1/	Disbursement Plan for the Next Month		Allotment Ratio Applied	Allotment Amount		Remark
A		B		D		C			E			F	G	
Term Loan	Overdraft Loan 3/	Term Loan	Overdraft Loan 3/	Term Loan	Overdraft Loan 3/	Term Loan	Overdraft Loan 3/							

1/ Calculated as actual disbursement during the preceding month (Column B) less the plan for the same month (Column A).
 2/ Calculated as (C+D)XE/100, provided that the two months are in the same fiscal year.
 3/ Overdraft loan to be computed as per Annex 2.

Prepared by: _____
 Signature: _____
 Date: _____

Approved by: _____
 Signature: _____
 Date: _____

Annex 2: Reporting Format for Overdraft Disbursement

Name of the Bank: _____
 Kind of Disbursement: XX to XX, XXXX

Preceding Month Average	Tuesday's Balance					Month Average	Overdraft Disbursement
	Week 1	Week 2	Week 3	Week 4	Week 5		
(1)	(2)	(3)	(4)	(5)	(6)	(7)=(2+3+4+5+(6))/4 (5) 1/	(8)=(7)-(1)

Prepared by: _____
 Signature: _____
 Date: _____

Approved by: _____
 Signature: _____
 Date: _____

(1, 5) refer to the number of Tuesdays during the month under consideration.

