General Introduction

Meaning, basic theories and essential features of law

The meaning of law

The term law has various meanings and there is no a universally recognized and accepted definition of law. For some, "*law is that portion of the established habit and thought of humankind, which has gained distinct and formal recognition in the shape of uniform rules backed by the authority power of the government*."[1] For others, it means "*a rule of external human action enforced by the sovereign political authority*".[2] A certain legal scholar namely, Sir. John Salmond defined law as "*the body of principles recognized and applied by the state in the administration of justice*."[3] Another legal scholar Anson coined the following definition for the term law; i.e. "*the object of law is order, and the result of order is that men are enabled to look a head with some sort of security as to the future. Although human action cannot be reduced to the uniformities of nature, men have yet endeavoured to reproduce by law something approaching to this uniformity*."[4] We can list down dozen of definitions of law given by different lawyers from different angles or views, but as it has been said above, since there is no universally accepted definition of the term, for the purpose of introduction, the above mentioned definitions are enough. Let us now try to have a look at the basic theories of law in a very brief manner.

Basic theories of law

Just like there are various definitions of law, there are different kinds of theories of law, however, we will try to consider only three of them.

The first theory is known as the ***Natural law theory***; this theory tries to insist that law is a set of rules, which are in accordance with nature and reason. The supper natural being that created man has also created law for him/her i.e. for human being. according to this theory, every human law or man made law will be true and perfect so long as it is in line with the law of nature and natural moral principles. Natural law can only be discovered through natural reason. Any human law, which does not conform to the rule of nature and natural justice, cannot be taken as law.

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1. Kuchhal, M.C., ***Mercantile law***, 5th rev. ed., Vicas Pub. PLC. 1999. pp.1
2. Sen, A.K. And Mitra, J.K., ***Commercial law***, 21st rev. ed., the world press PLC, 1994. pp.1
3. *Id*.
4. *Id*.

The second theory of law is called the *positive law theory* and this theory says law is the command of the sovereign. According to the understanding of the supporters of this theory, law has three essential features; namely,

A. its being a type of command

B. its being laid down by a political sovereign (political body i.e. the government)

C. its being enforceable by sanction.

This theory stresses that law is only law if it is effective, and this can only be by being generally obeyed. It does not matter whether it conforms to the rules of nature or objective moral standards and natural justice, if it is applicable and if the violators of such law are punished, that law is the true and perfect law by it self.

The third theory is called the *theory of legal realism*, according to this theory, law is the actual practice of the courts or it is what the judge decides in court. Law is the decision of the courts not the legislation that has been made by the proper law making body i.e. the parliament. These theorists agree with the positivists that law is the expression of the will of the sovereign, but the sovereign is not the law making body but the courts. In other words, for the realists, law is simply what the judge say in court.

Essential features of law

Law has generally three essential characteristic features. These are;

1. Generality is the first essential feature of law; rules of law are general statements on possible human behavior that is rules of law do not expressly deal with particular person. When a certain law is made by the proper law making body, by the parliament in the case of our country, it will concern the nation generally, we can understand this by its wordings which usually begins “who so ever.....” or “any one.....” and such other terms. For example, “Every person has the inviolable and inalienable right to life, the security of person and liberty.”[Article 14 of the 1995 Constitution of the Federal Democratic Republic of Ethiopia] this provision of the constitution is general and doesn’t specify the name of individual persons or behaviors. Another example “A human person is the subject of rights from its birth to death” [Article 1 of the Ethiopian Civil Code of 1960]. This also underscores that rights are conferred to a human race indiscriminately.

2. Normativity is the second essential feature of law in that law is made up of rules of social behavior. The law is not, therefore, interested with every kind of human behavior. It is only the social behavior of man, i.e. human conduct that has materialized itself in some form of social

interaction. In other words, law essentially regulates relations between human beings, as social beings, out side of social relations, there can be no law. The normative features of law is in general classified in to four, these are:

A. *Permissive laws/provisions*: - these kinds of laws/provisions give rights to people either to do or not to do something. Most of the time such laws use phrases like: "have the right to….", "permitted to……", "allowed to….", "may…", and "are free to…." And so on. For instance, "Every person is free to think and to express his idea" [Article 14 of the Ethiopian Civil Code of 1960]. Another example, "a person under arrest may, at any time, apply for bail". [Article 64 of the Ethiopian Criminal Procedure Code of 1961].

B. *Directive laws/provisions*: - these kinds of laws/provisions direct or command a legal duty to do something. Most of the time such laws/provisions use phrases like, "shall", "must", "have the obligation to…" or "is duty bound…" etc. they impose a kind of obligation on persons. For example, "the seller shall guarantee to the buyer that the thing sold conforms to the contract and is not affected by defects." [Article 2287 of the Ethiopian Civil Code of 1960]. This is a clear instance of a directive provision of the law as it imposes an obligation on the seller the violation of which entails a liability to the seller's detriment.

C. *Prohibitive laws/provisions*: - these kinds of laws/provisions give a kind of warning to persons to refrain from doing certain acts. Such laws/provisions use terms like: "shall not…", "must not…", "no one shall…", "no person shall…." And so on. For instance, "No police officer or person in authority shall offer or use or make or cause to be offered, made or used any inducement, threat, promise or any other improper method to any person examined by the police." [Article 31 of the Ethiopian Criminal Procedure Code of 1961]. There fore, this specific legal provision prohibits any offering of inducement by the investigating police to the person under examination.

D. *Rewarding laws/provisions*: - some times, if the law wants a certain norm to develop in the society, it states that those who perform as to its requirements will be awarded. The case related with whistle blowing in cases of corruption is a very nice example in this regard.

3. The third essential feature of law is sanction. rules are not concerned with what happens but they are concerned with what ought to be. They are prescriptive; this means compliance with

rules is an obligation not an option. Members of the society are bound to act and behave in accordance with the law. The law imposes sanctions to force the addressee to follow the prescribed norms.

Functions of law

Under this section, we'll try to see some of the most important functions of law. This clearly answers the question as to why a society needs a law. Law can very important in society's life as it is established to regulate social behavior by way of;

1. maintaining/preserving the peace, order and stability of the nation,
2. settling/resolving disputes/conflicts,
3. securing efficiency, harmony and balance in the function of government machineries,
4. protecting citizens against excessive or unfair government power,
5. being an instrument of social change, and
6. Controlling social values, various behaviors and interests.

The notion of business law and its importance

Having a good background on the concept of law and its basic theories and features, let us now go to the definition of business law. In some legal system, it known by different terms such as commercial law, mercantile law, company law, trade law and others. Though there are these different nomenclatures, all of them imply the same thing i.e. the legal aspect of a business transaction in a certain country. Some tries to define business law as "*that part of law, which regulates the transactions of the mercantile or business community*"[5], while others define business law as that "*branch of law which comprises laws concerning trade, industry and commerce*."[6] As regards to the scope of business law, with the increasing complexities of the modern business world, it has enormously widened. It is generally understood to include the laws relating to concept of contract, companies, negotiable instruments, insurance, banking transactions and personality.

Therefore, the importance of business law is to help students understand the legal aspects of common business activities. not only to students, but also any business person will be benefited from knowing business law in order to appreciate the direct application of it on the day to day business activity and to run his/her business in the proper legal way.

[5]. Sen and Mitra, *cited above*, pp. 5
[6]. Kuchhal, *cited above*, pp.1

Chapter1

Personality

1.1. The notion of personality

What is a person?

Personality means just the state of being a person. We may have one clear understanding about what a person is. However, what we commonly know a person could be is different from that how the law understands the term. Legally, a person is any being that bears or holds rights and duties. In other words, a person is a subject of rights and duties.

1.2. Classification of personality

A Person can be classified in to two,

- Natural (physical) person, and
- Artificial (legal) or fictitious person.

Natural (physical) persons are persons who get their personality from nature i.e. human beings.

Artificial (legal) or fictitious persons are persons not by nature but by the mere operation of the law. These kinds of persons get their personality from the law because without having personality, they may not be allowed to enter in to any kind of legal transaction including business transactions. Example of such are: business organizations, civic associations, trusts, churches and mosques and similar religious organizations, etc...

1.3. The commencement of personality

The term commencement simply refers to as beginning, and when we say the commencement of personality, we are asking the question 'when does personality begin and when does it end?' the beginning of natural personality is different from the beginning of legal personality. Let us consider them separately as follows,

- *The commencement of natural personality*: - according to art. 1 of the Ethiopian civil code, natural personality begins at birth and ends at death. Therefore, the commencement of natural personality is birth and its end is death. However, this being the principle, it has an exception that even a merely conceived child (a child in his/her mothers womb and not yet born) may be considered sometimes as a person provided that some legal requirements are fulfilled. These requirements are clearly indicated under art. 2 of the civil code, i.e.

A. the child should be born alive and viable[7] (Should live at least for 48 hours after he is born), and

B. if his interest so demands.

A child is considered conceived 300 days before of his/her birth.

If that conceived and not yet born child has an interest, which justifies the granting of personality, the law will consider him/her as a person.

Consider the following example:

Mr. X, who was a successful businessperson, died in a car accident leaving behind a wife who is pregnant and left with only two months to give birth. Nevertheless, shortly after his death, the parents of Mr. X came and took over all his property by virtue of the Ethiopian law of succession.[8] After all this, the late Mr. X's wife gave birth to a healthy and cute baby girl. At this time, the mother can reclaim the property of her late husband by representing her daughter pursuant to art. 2 and art. 842(1) of the civil code because the interest of the child justifies so. Bear in mind also that if a child merely conceived already died due to an external factor, even though that unfortunate child could not come to this world alive, he/she would be considered as a person. But, if the child's death in his/her mother's womb results from an internal deficiency, the conceived child is not a person before the eyes of the law. In the above example, if the parents of Mr. X force the mother by any means to abort the child or if they prevent the successful and healthy birth of the child, it will be considered as an external factor which results in the death of the child and as per art. 4(2) and (3) of the Ethiopian civil code.

As natural persons begins to live starting the day of their birth, save some exceptions which we considered, their personality will come to an end on the day of their death. In other words, after death, that human being is not considered as a person, i.e. no more a subject of rights and duties.

- *The commencement of legal personality*: - just like human beings begins to live from the day of their birth, a certain legal entity starts to be a person when three legal requirements are met cumulatively (together). The first one is, *formation*: a certain entity, be it a business organization or a civic association, should be first established, i.e. the founders

[7]. Viability means simply an aptitude or ability to live for a certain period of time.

[8] . Under art. 843 of the Ethiopian civil code(the law of succession), if a person died without any descendants (children), and left no will, his parents will inherit all of his/her property and note that a wife can't succeed her husband and the opposite is also true.

has to prepare the memorandum and articles of association, the number of the members should meet with the minimum requirement of the law, and so on. The second step is *registration*: after the members fulfill all the requirements of formation, they should go to the concerned government organ to have their enterprise registered, if the would be entity is a business organization, they should have it registered in the ministry of trade and industry or in the respective trade and industry Bureaus of regional states as the case may be, and if it is to be a civic association, the members should go to the ministry of justice which is authorized to register such kind of associations. The third and the last step is *publication*: once the entity is formed and registered, it has to be publicized to the society through the official newspaper.

It is after all the above-mentioned procedural requirements of the law are fulfilled that an entity is considered to be a person before the eyes of the law. But again, just like the end of natural personality is death, the end of legal personality is dissolution and winding-up of that entity. If a certain organization, due to some reason, is dissolved, we say that organization is dead that it is no more a legal person before the eyes of law.

1.4. The attributes or importance of legal personality

Previously, we tried to look at there are three cumulative legal steps which a certain entity should go through in order to get personality. But, why does this entity found it very important having a personality? This section tries to answer this question. The attributes or importance of legal personality are,

1. The right to sue (to bring a lawsuit in a court of law against any one) and to be sued (a lawsuit can be instituted in a court of law against that entity) i.e. since entities have their own legal existence distinct from its owners they can sue and be sued in their own name, e.g. a person can claim a certain amount of money which he/she has lent to a share company only from that share company only.

2. The right to own and administer movable or immovable properties in its own name.

3. The right to inherit or succeed estates (properties) if there is a will left in favor of that entity, especially in other legal systems, this is common that wealthy individuals usually make a will that all or part of their property to be given to a certain charity organizations upon their death, therefore, in order to enjoy from such succession, that organization should be a person before the eyes of the law.

4. The right to enter in to contractual transactions and other juridical acts[9] in its own name.

5. The obligation of paying different types of taxes in its own name.

Therefore, it is very important to an entity to have personality in order to accomplish the above-mentioned rights and responsibilities.

Review questions

1) Can you define the term law in your own words?
2) What is business law and the importance of learning it?
3) What is the legal definition of a person?
4) Classify personality and give at least one example for each type of person.
5) When do we say that a child is a person before the law?
6) Ato Abebe and W/ro Abebech were spouses, i.e. husband and wife. They had lots of wealth due to the successful business venture of Ato Abebe. Nevertheless, they were not blessed with offspring for a very long time as a result of which, there was a wide rumor that W/ro Abebech is sterile, i.e. she may not be able to produce children. Thanks to God, after quite some time, W/ro Abebech was told by her private doctor that she will have a child, and after 8 months, she was taken to the hospital where physicians told her that she would give a birth to twins. The first child, a beautiful baby girl, was born immediately upon arrival yet due to the continuous labor, W/ro Abebech collapsed but not died, however, Ato Abebe thought that his wife passed away and as a result, he died due to a serious heart attack that he was suffering for a long time. But thanks to the modern technology, W/ro Abebech was fortunate enough to survive and gave birth to the second child, i.e. a beautiful baby boy. Though W/ /ro Abebech was in a deep sorrow for the unexpected death of her husband, she went back home with her twin babies. Unfortunately, however, upon arrival at home, both of the children died in spite of the fact that there was nothing wrong in their internal body constitution.
    - Ato Abebe's family approached and brought a legal action against W/ro Abebech that since the children died before the attainment of viability age (48 hrs), they have the legal right to take away all the properties belonging to their late son (Ato Abebe). Do you think they will succeed? Why or why not?

[9]. Juridical act means acts of civil life, which have a legal effect.

- Would your answer be different from that you have given in the above question if it was proved that both children died due to a problem attributable to their internal body constitution. If yes why and if no, why not?

7) What are the legal requirements to have a legal personality by an entity?
8) List down the attributes of a legal personality.

Chapter2

Law of Contract

Since human beings have been living in a communal mode of life, accumulation of wealth, property and exchange of goods have become the usual day-to-day activities. For such a reason, the law has attempted to design a mechanism by creating different rules to regulate how these activities should be managed. One of these private legal regimes that deal with such consensual relations among persons is the law of contract. As usual, Let us start by defining what a contract is.

2.1. Definition of contract

What is a contract?

We may define the term contract in so many ways based on our common sense understanding. But the law, under art. 1675 of the civil code, defined the term contract as follows: "*A contract is an agreement between two or more persons as between themselves create, vary or extinguish an obligation of a proprietary nature*." we can identify some elements from the above definition.

- A contract is an agreement that it emanates from the mutual consent or meeting of minds between the contracting parties. This agreement will have a legal effect provided that both parties have the intention to be obliged or bound (*Intentio Obligandi*).
- A contract requires at least two or more person or plurality of parties. In other words, at least in principle, one can't conclude a contract with him/herself. However, this being a

principle, it has an exception that especially in contract of agency, the agent may conclude a contract with him/her self.[10]

- These parties creates a relationship between themselves, in other words, the contracting parties can't create an obligation on third parties that third party may not be obliged or may not be beneficial by virtue of the contractual relationship between the original contracting parties. But again this is the rule (the principle) and we have an exception for this too.
- An obligation is a legal bound by which a person is constrained towards another person to do or not to do some thing. It is a legal bond between two or more persons in virtue of which one of them is bound in favor of the other to do a certain act or to abstain from doing a certain act. An obligation can be classified as legal and contractual obligation based on its source. The source of contractual obligation is the contract between the parties; where as the source of legal obligation is the law itself. This legal obligation may further be classified in to two, namely pure legal obligation and extra (non-contractual) obligation. An example for a pure legal obligation is the obligation to pay tax. Non-contractual (extra-contractual) obligations arise when a person due to his/her fault or even without fault is going to be held liable. For instance, if a driver run over a pedestrian, he/she will be legally liable due to his/her fault. A father or a mother is legally liable for the act that their son/daughter has done. We can also classify an obligation in to three classes, i.e. obligation to do, obligation not to do (obligation of abstinence) and obligation to give. We have two other types of obligations and the basis of this classification is the nature of the obligation it self; these are obligation of diligence and obligation of result. In an obligation of diligence, the person who is under the obligation is not expected to bring about the desired result; rather he/she is only expected to show a due diligence. For instance, a Lawyer (Attorney) is expected to do what ever he/she can do to win the case but he/she can't be sued for not winning the suit. a medical doctor is also required to show a due diligence that he/she has to use all of his/her skill to save the patient, but this doctor cant be brought to court simply because he/she doesn't save the patient. On the other hand, in obligation of result, a determined result is expected from the person under such obligation. For instance, a

[10]. We will consider the notion of contract of agency in Ch. 3 under the title special contracts.

painter is expected to bring about the desired result, i.e. the painting of the whole house as ordered by the owner.

- The contract should be of a proprietary nature. Every contract is an agreement but not every agreement is a contract. For instance, Marriage and Adoption are not considered to be contract because their ultimate objective doesn't have a patrimonial or pecuniary nature. In other words, either Marriage or Adoption is not about money, rather they are status. Their objective is something beyond money. The objective of Marriage is fidelity, supporting each other, tolerance and the intention to form a family which is the basis of a nation and society. But still these statuses are agreements but not contracts. The other type of transaction which may be an agreement but not a contract is social occasions. for instance, one of your friend may invite you to his/her birthday party but unfortunately, you failed to appear, that friend of yours cant take you to court for your failure to come to the party, because in these kinds of agreements, there is no the intention to be bound, it is just a social occasion and relationships.

2.2. Formation of contract

Formation of contract is just the process of establishing or creating or making a contractual relationship with anyone, and in order to form or establish a legally valid contractual relationship, the law requires us to meet or fulfill certain criteria.

2.2.1. Essential elements of formation of a contract

The essential elements of a contract which are the criteria or legal requirements to create or establish a contractual relationship are four in number, these are;

1. *Consent* that each contracting party should show his/her free will to enter in to a binding contract,
2. *Capacity* that both parties in the contract should have the necessary ability to enter in to that contractual transaction,
3. *Object* that the subject matter of the contract should be clearly defined, possible to perform, legal and moral,
4. *Form* that if the law says so that the contract should be made in writing, that legal provision should be respected and observed without any reservation.

The first three legal requirements are mandatory that they can't be set aside and they are also cumulative that all the three should exist at the same time, but the fourth requirement is not

mandatory, rather it is optional. It will be mandatory when the law specifically directs that certain contracts should be concluded in writing, non compliance with this legal provision may entail the voidability of the contract.

Now let us try to look at them one by one in a very brief manner.

1. ***Consent*****:** - it refers to the willingness to enter in to any juridical act. Consent of both parties should be free and conscience. Consent is expressed by an offer and acceptance. **I. An offer** is a proposal to enter in to a legally binding obligation. An offer will be valid if, **A.** *it is definite and certain*, and **B.** *it is communicated to the specific individual offeree.* The offer must be definite and certain, for instance, Ato Abebe said to w/ro Halima "*I will sell my car to you for about more or less 100,000 birr*" do you think this is a valid offer? No it is not, because the phrase "…for about more or less…" creates confusion as to what it means and by this the offer is not definite and clear. Secondly, the offer must be communicated to a specific individual offeree.[11] If for instance, Mr. X said simply "I will sell my car for 100,000 birr", it will not be a valid offer as it is not communicated to a specific individual offeree, or in other words, the specific individual offeree for whom the offer was made is not known. This is not an offer rather it is a mere declaration of intention that Mr. X is expressing or declaring his idea of selling his car at the stated amount of price. let us look at another example, " a certain wealthy man in a certain town declares at a public meeting that he will give 100,000 birr for a charity" at this time, since the declaration is made at a public meeting and is not communicated directly to the specific charity organization, the charity organization can't accept the declaration. So, a mere declaration of intention can't be an offer. Like wise, public place tariffs, price lists in a café or restaurant, catalogues, newspaper advertisements and price tags in a shop or a boutique are not offers since the specific individual offeree is not identified as they are for any body who is interested and can afford them, rather they are declaration of intention and invitations to any one to make an offer. You may see an attractive Italian made fashion shoe in one of the boutiques in the locality of piazza and the price tag which is attached to the shoe says 250birr. This is not an offer rather it is an invitation to you to make an offer, if you like the shoe and if you are sure that

[11] . The person who makes the offer is called "the offeror" and the person who is expected to accept the offer is known as "the offeree ".

you can afford it, you may go inside and starts to make some negotiations as to the price with the shop keeper, at that particular moment, you will be the offeror and the shop keeper will be the offeree. Sale by auction is not an offer and the auctioneer is not considered to be an offeror rather he/she is inviting any one to make an offer by presenting a higher price. If the price or the bid is below the expected amount of bid, the auctioneer is free even to withdraw his auction. But in case of public reward or public promise though it is not considered as a valid offer since it is not communicated to a specific individual offeree, it is considered to be an offer. for instance, if you read a notice on a public board in the near by which says "100 birr for a safe return of my wallet" it will be an offer, or in the news paper or on the radio, if you hear "I will reward any one whoever finds my son or daughter and bring him/her home who disappear from home since this or that day or month or year with the amount of 1,000 birr." this will be an offer. There fore, these kinds of public rewards and promises are considered as offers and they are exceptions to the principle that an offer must communicate to a specific individual offeree. Please bear in mind that for such a promise to be a valid offer under the exception, it must be able to state the exact amount of money to be paid as a reward not just terms like "I'll reward…"Making public rewards and promises an exception to the rule is to facilitate the smooth and peaceful life of the society. **II. An acceptance** is the other element of consent. It refers to agreement to the terms of the offer. In other words, it is a term which shows the agreement of the offeree to be contractually bound. The acceptance should be exactly in conformity with the terms of the offer. This means there will not be an acceptance if the offeree accepted the offer by making some changes or modifications. If the offeree makes such kind of modification in his/her acceptance, it won't be a valid acceptance rather it is a defective one/counter offer and the offeree is going to be presumed as a new offeror. For instance, if X offered to sale his cell phone to Y for 400 birr and Y shows his willingness to buy it but only for 300 birr, this will not be taken as a valid acceptance and Y's words of making the price 300 birr is a counter offer, and in such a situation, the contract is presumed to be formed if X accepts the new offer proposed by Y. An offer and an acceptance may be made orally, in writing, by sign or even by conduct. Auction and a telephone booth and a

Coca Cola machine are clear instances for an offer and acceptance by conduct. If for example A offered to buy 100 quintals of corn from B, whether B sends the said amount of corn or writes to A that he has agreed to send the said amount of corn has no difference as the former is accepting the offer by conduct. But the law gives the right to the offeror to specify a special mode of acceptance by the other party. For example, Mr. A orders some merchandise from Mr. B by stating that there shall be no contract unless the goods are delivered at his residence at a specified time. In this case, the mode of acceptance is the delivery of the goods at a particular time. The other most important point worthy of mentioning here is the case of whether or not silence amounts to acceptance. In principle, *silence doesn't amount to acceptance*. Silence means not answering to an offer made by any form. But this principle may not apply always as there are situations when silence may amount to acceptance. These exceptional situations are, **1.***If there is a duty by the side of the offeree to accept the offer* or **2.***If there is a pre-existing business relationship between the contracting parties*, silence may be taken as an acceptance. Let us consider each of the exceptions. = the first exception is the duty to accept on the part of the offeree. No express acceptance is required where a party is bound by law to enter in to a contract on terms stipulated in advance. Public utility undertakings are clear instances for this. Telecommunication, water and sewerage authority, the light and power supplying authority, postal and public transport service suppliers are not required to officially accept the offer. They are bound by the law to accept such an offer silently, because ***a.*** *the service that they provide is vital for the public*, and ***b.*** *their nature of monopolistic that they are the sole service providers in the country*. = the second exception is pre-existing business relationship between the contracting parties. An offer to continue or vary a prior (previous) contractual relationship or an offer to enter in to a subsidiary contract may be accepted by silence. If the offeree kept silent to the offer for continuation or variation of the already existing contract, or to the offer for entering in to a subsidiary contract[12], it will be presumed that he/she agrees; but to apply this exception, the following requirements should be met cumulatively,

[12] . A subsidiary contract is a contract which is an accessory to the main contract. For instance, a contract of guarantee is a subsidiary contract to a contract of loan.

i. the parties should have a prior contractual relationship,
ii. one of the parties must propose the renewal or modification of the contract,
iii. the proposing party should include a warning clause in his/her offer that if he/she doesn't receive a rejection, the offer will be taken as accepted, and
iv. The offer for modification, variation or continuation of the already existed contract should be made in a special document prepared by the proposing party solely for this particular purpose.

For example, 'A' leased 'B's house since last year for 500 birr per month. Now 'B' has told 'A' that the rent money will increase to 600 birr from next month onwards and 'A' kept silent and continued to live in the house. At the payment time, while 'B' was ready to collect the 600 birr, 'A' refused to pay as the modification/variation of the lease contract made by 'B' has not been made in writing or using the language of the law "the special document"(Article 1684(2) of the Ethiopian Civil code of 1960).

Duration of an offer and an acceptance

The other most important issue related with the notion of consent is the time (duration) of an offer and an acceptance. An offer may be made with or with out time limit. Let us consider first offers made with time limit.

- When the offer is made with a specific time limit, unless the offeree rejects the offer before the lapse of that particular time, the offeror is legally bound by his/her offer until the lapse of the already set time limit. In other words, offers made with time limit are irrevocable.

E.g. Aster, on the 10th of September 2006, made an offer to sell her Toyota carina II to Kalkidan at a price of 100, 000 eth. Birr and Aster stipulated a provision in her offer that the offer will be opened for Kalkidan's reply (acceptance) only until the 10th of October 2006. On the 5th of October 2006, Kalkidan told Aster that she will only buy the car at the price of 75,000 birr. Then, on the 8th of October, Kalkidan changed her mind and calls back Aster and said "all right! I will buy the car at the original price, i.e. at the price of 100,000 birr." but at this time, since Kalkidan made a defective acceptance by modifying the price, it will be presumed that she totally rejected the offer and Aster will no longer be legally bound by the offer even if the time has not yet lapse and Kalkidan changed her mind.

- The second situation is offer made without time limit. If the offer is made with out specifying the time of reply or acceptance, it will be opened for acceptance until the lapse of a reasonable time. But how are we going to determine a lapse of a reasonable time? Or what should be our yardstick or criteria to say this is a reasonable time and that is not. We can't give a clear answer for this as it depends on the circumstances of the transaction. Some transactions upon which an offer is made may be complicated and may require a relatively longer period of time to think about and some may need a fraction of seconds. Therefore, since we can not have an objective test to decide what is reasonable time and what is not, it is left for the discretion of the judge. More over, if the offeror thinks that the acceptance was not made within a reasonable time, the offeror must declare this fact to the offeree, and failure to do so will automatically lead to the presumption that a contract is established or formed between the parties.

Contract between absent parties

Contracts may not always be made between two parties in person as due to various reasons, people may travel from place to place. Thanks to God and the modern technologies made the relationship between two individuals living in different localities possible. One of these technologies is telephone, a contract made through a telephone conversation is considered to be made between two present parties, and the place where the party was called will be taken as the place of the conclusion (place of formation) of the contract. So, acceptance must be made before the parties end their conversation. The other way through which an offer and acceptance may be made between two absent parties is postal service. At this point, there are two internationally accepted theories or approaches as to the issue of the validity of the acceptance made through postal communications and as a result of which the contract is legally formed. These are;

1. *The theory of dispatch*: this theory insists that the contract is deemed to be concluded when the offeree sends (dispatched) the letter of acceptance to the offeror. This means, as soon as the offeree goes to the post office and mailed the letter of acceptance in the mailbox, it will be presumed that the contract is lawfully formed regardless of the fact that the letter had reached to the offeror. For instance, Mr. A, who lives in Addis Ababa, sends an offer to Mr. B, who lives in Gonder and at the time when Mr. B mailed his letter of reply to the mail box, there will be a

contract. It doesn't matter whether or not the reply is received by Mr. A. this approach is followed by Ethiopia, France, England and The U.S.A.

2. *The theory of reception*: this theory, as the name it self indicates, is quite the opposite of the above one as it insists that the contract is deemed to be completed when the letter of reply (acceptance) has reached (received by) the offeror. In the above example, Mr. A should receive the letter of acceptance in order to say that there is a contract concluded. Germany follows this theory.

Defects (vices) of consent

As discussed above, consent on both sides of the contracting parties is very essential and should be clear, undisputable, and communicated to a specific individual offeree. In other words, the consent should be true (genuine), conscience and free. But some times, the consent of one of the parties may be defective or it may be vitiated due to some reasons. These reasons or vices of consent which makes the consent defective are;

A. mistake

B. fraud, and

C. duress.

Let us see how these vices of consent are said to be sufficient grounds to invalidate the contract.

A. *Mistake*: is the first vice of consent which makes the consent defective and leads to the invalidation of the contract. In order to invoke mistake as a ground to invalidate the contract, the mistake should not be any ordinary error, but a *fundamental* and *decisive* mistake. A mistake is said to be decisive when it is proved that the mistaken party would not have entered in to the contract had he/she known that he/she was mistaken. A mistake is said to fundamental when it is related to **1.***the legal nature of the contract*, or **2.** *The individual identity of one of the parties* or **3.** *The identity of the object of the contract*. Now let us see these criterions for the fundamentality of a mistake.

1. The mistake is said to fundamental when it is related to the legal nature of the contract. For instance, Mr. A, due to a sight problem of his eyes, concluded a contract of lease of a house with Mr. B thinking that he was concluding a contract of sale of that particular house, or if Mr. C concludes a contract of guarantee thinking that he was just giving his consent only to be a witness. In both the above examples, A and C has committed a fundamental mistake since it is

related to the legal nature of the contract the rights and obligations emanated from a contract of lease and a contract of sale is different neither is the duty of a guarantor the same as that of a witness.

2. The mistake is said to be fundamental again if it is related to the individual identity or professional integrity of one of the contracting parties. For instance, Mr. A, a company owner, concludes a contract of employment with an accountant with out knowing that the accountant was convicted and imprisoned for the crime of forgery of accounts and breach of trust. If the employer, i.e. Mr. A came to know this fact after the conclusion of the contract, he can invoke mistake to invalidate the contract as the professional and ethical quality of the accountant is very important to his current position that he was going to assume in Mr. A's company. But what if the accountant was convicted for murder in the second degree i.e. negligent homicide; would this also be sufficient ground to invalidate the contract by the side of Mr. A, because it is a fundamental mistake? What about a person sold a commodity to Mr. C but delivers that particular commodity to Mr. D who was the twin brother of Mr. C? Would this be a mistake as to the identity of the person? Discuss!

3. There is also a mistake as to the identity and quality of the object of the contract if for instance Mr. A bought a fertilizer sulphur thinking that he was actually buying pharmacy sulphur. Or, Miss A sold her real gold ring thinking that she was selling the artificial one.

So, if one of the above situations occurs, the party may invoke mistake to bring the contractual relationship to an end (invalidate the contract).

Mistakes related to motives and arithmetical errors

Mistakes which relates to motives or facts motivating the person to enter in to the contract are not sufficient grounds to invalidate the contract as they are neither fundamental nor decisive. For example, Ms. A's father Mr. A concluded a contract with Mr. B for a sale of two Oxen for his beloved daughter's marriage, but unfortunately the marriage ceremony was cancelled but since the marriage ceremony is a mere motive for the conclusion of the sales contract, the contract should be maintained and Mr. A can't invoke mistake as a ground to invalidate the contract.

Arithmetical errors are not sufficient grounds to invalidate the contract as well as they are just mere errors in calculation and since the parties don't have any problem with the content of the contract, these errors can be easily corrected.

The law puts such kind of limitations on the concept of mistake in order to protect the contractual relationship and prevent frequent invalidations of contracts so that the transaction may be carried out peacefully and smoothly.

At this particular juncture, it is proper to raise the question as to who should bear the losses due to the invalidation of the contract by the ground of mistake. It won't be fair to throw all the losses on the shoulder of the person with whom the mistaken party concludes contract. This party must have incurred some expenses thinking that the contract was valid. Therefore, the party who invokes mistake and became successful to invalidate the contract should not go free rather expected to compensate and share the risk with the loosing party. But, the party who is going to be compensated should have a good faith that he/she didn't know or doesn't have any reason to know that the other party was committing a mistake. If it is proved that he/she knew or should have known the facts that the other party was mistaken but kept silent, he/she may not be compensated at all.

B. *Fraud*: is just a deceitful practice, or it is an act of deceiving. In other words, one of the parties is cheating. This act is also known a mistake induced by an intention. In mistake proper, there is no an element of intention to cheat on the side of either parties, but in the case of fraud, one of the parties is intentionally misleading the other party to commit a mistake. This act is the other ground to invalidate the contract if it is only practiced (change to reality); so a mere false statement can't be a ground to invalidate a contract. For instance, if Mr. A obtains a life insurance policy by showing a forged health certificate concealing or hiding the fact that he is seriously ill even near to death. Or a person gets a high position at work by showing false educational documents. All this acts are acts of cheatings and they are practiced, i.e. some body lost something due to the act of cheating.

C. *Duress*: refers to an act of compelling or forcing some one physically or mentally to enter in to a contract. In other words, it is a force full practice. But in order to be a sufficient ground to invalidate the contract, the act of duress should be *serious*, *imminent* and *reasonable*, and the act should be intended to be exercised on the contracting party him/herself, on his/her ascendants (parents) or descendants (children), or on the party's husband/wife as to their life, reputation, or property. The act of the duress need not be real and if it seems real to the threatened party, it will be sufficient. An act of duress by a

third party may also be a ground to invalidate the contract. If for instance, A is forced by B to enter in to a contract with C, C can't prevent the invalidation of the contract by arguing that he didn't exercise the act of duress, but if C can prove that he has no idea whether A was entering in to such contract being threatened by B, C may be entitled to get some amount of compensation. On the other hand, *a threat to exercise a right* is not an act of duress and can't be a ground to invalidate the contract unless it is proved that the threat to exercise a right was intended to obtain an excessive or unlawful advantage. For instance, an individual bought a car from another by paying the full amount of the price but the seller delivered the car and failed to transfer the ownership and deliver the ownership title document, i.e. the "*Libre*", to the buyer and if the buyer said that unless the seller fulfills his side of the obligation, he will bring a legal action in court, this doesn't amount to be an act of duress as the buyer is just using his legal right. But if he said "give me my money back and the documents of the ownership title and change the nature of the contract as if it is a gift (contract of donation)". Now, he is using his right to get an excessive advantage and since this is an act of abuse of a right, it will be a good ground to invalidate the contract. Similarly, *reverential fear* can't be a ground to invalidate the contract. Reverential fear is a fear out of a respect for the wishes of an ascendant or a superior. If for instance, Samuel sold his house by a less price to Johannes as he was told to do so by his father confessor, he can't demand the invalidation of the contract. But if Samuel was told by his father confessor to sell his house to the father confessor himself, reverential fear can be a ground to invalidate the contract. Therefore, what we can understand from this is, if the superior or ascendant took the advantage of his/her superiority, and forced the inferior to do some act for another, that won't be a ground to invalidate the contract as the superior or the ascendant is a third party and neither benefits nor loses from the outcome of the contract, but if the superior him/herself is the contracting party, he/she is getting an unlawful advantages by making use of his/her influence on the victim, so the contract will be invalidated on the ground of reverential fear.

Lesion (unconscionable contract) is the other ground to invalidate the contract. These kinds of contracts are contracts contrary to conscious. If it is proved that one of the parties took an excessive advantage from the want, simplicity of mind, senility or business

inexperience of the other party, the contract will be invalidated. For instance, if a certain country girl with out any knowledge of the market and misinformed by the experienced and shroud gold dealer sold her precious gold necklace 50 birr per gram to him while the actual price per gram is 180 birr, in such a situation, he took advantage of her business inexperience and that will be a good ground to invalidate the contract.

2. ***Capacity***: - it refers to the ability to perform juridical acts. A person is said to be capable if she/he is mentally able to understand the nature and consequence of her/his act. Those who are incapables, in principle, are excluded from performing any kind of juridical act. This group of people lacks the capacity due to age, mental illness or court decision.

Contractual capacity of minors

Minors are human beings who are under the age of 18. Contracts concluded by minors in excess of their power shall be of no effect and can be subject of invalidation by the request of the minor or his/her legal representatives, i.e. guardian or tutor. The law tries to protect the immature and inexperience minors from the complicated transactions and shroud adults. How ever, the minor can enter in to a contract that may be termed as "*acts of every day life*". An act is deemed to be act of every day life when the amount of money involved doesn't exceed 300 eth. Birr and when the permission of the tutor is obtained. For instance if a teen age boy with the age of 16 can buy a nice and fashionable Nike snicker worth 255 birr using his own name provided he has the full permission from his tutor. The minor can also receive his/her income by his/her own as of the age 14 and 15 from his/her work.

Period of minority

In principle, minority ends when the minor attains the age of majority (attains the age of 18) or if he/she is emancipated.

Emancipation refers to an act of freeing a minor from legal restraints. A minor can be emancipated for two reasons. These are;

- if the minor is allowed by the ministry of justice to get married due to a good cause before the age of 18; the situation where the girl-friend of the minor boy becomes pregnant is one instance of such good cause to be granted with permission by the ministry, once he is married, he will be emancipated and he won't be considered as a minor any more. This type of emancipation is known as legal emancipation.

- the other reason is that if the court found out that the child (minor) is smart enough to handle and manage his/her business affairs, the court may give an order of emancipation, and once the minor is emancipated before the age of 18, he/she is not minor any more. This type of emancipation is known as judicial emancipation.

But, if the minor is not emancipated or attained the age of majority, any kind of contract entered in to by him/her will automatically invalidated not by the request of the other contracting party with whom the minor concludes the contract but by the request of the minor or by his/her tutor or guardian.

Contractual capacity of insane persons

An insane person is some one who can't understand the importance of his/her action due to mental illness or mental abnormality. Feeble minded, drunkards, habitually intoxicated persons, prodigals, deaf mute and blinds may also demand the legal protection provided for insane persons. We have two types of insane persons, namely;

- Notorious insane persons and
- Non-notorious insane persons.

Notorious insane persons are persons whose insanity makes him/her to be an inmate in a hospital, institution or a nursing home, or if he/she lives with his/her family or any body who takes care about him/her in a commune of less than 2000 inhabitants and if most inhabitants of the commune considered the individual as insane person due to the care and treatment that he/she gets from his/her parents.

Any person who doesn't fall under the above category is considered to be non-notorious insane person, and mostly lucid intervals are clear instances for this category of non-notorious persons.

Effects of insanity on contracts

The effect of insanity on contract is determined whether the insane person is notorious or non-notorious. If the individual is a notorious insane person, he/she can invalidate the contract after he/she gets his/her mental health or in the alternative, the tutor or guardian or his/her heirs may request the invalidation of the contract.

If the person is a non-notorious one, he/she can't avoid the contract unless he/she proves that his/her consent was not free and true due the mental illness at the time when the contract was formed/concluded. If not, the contract will be maintained as if it is established between two sane persons.

The concept of interdiction

Interdiction is an act of prohibition or withdrawal of a person's capacity from performing juridical acts by a court decision. There are two types of interdictions, namely *judicial interdiction* and *legal interdiction.*

Judicially interdicted persons are minors and insane persons and the court appoints for these persons a guardian to take care of the welfare of these minors or insane persons and a tutor to manage their pecuniary affairs. Legally interdicted persons, on the other hand, are criminally convicted and imprisoned individuals. And the court will appoint only a tutor to take care of the pecuniary affairs of the prisoner.

But what do you think is the reason that the law doesn't appoint a guardian for a prisoner? Discuss!

3. ***Object and form of contract***:

- Object of a contract is the subject matter of the contract or the obligation to be performed.
  - The contracting parties are free to determine the content of the Contract.
  - They can set aside permissive provisions of the law but should observe the mandatory one.[13]
  - The object should be sufficiently defined, legal, moral and possible to perform.
- Form of contract is the other element of a valid contract. The principle is *freedom of form* that parties may opt to make a special form, i.e. if they whish they can make their contract in writing. But this principle of freedom of form, like any other legal principles, has two exceptions that formal requirement may be mandatory. these are;
  - ✓ If the parties agree orally that they will make their contract in the future in writing, they should observe this pre-contractual agreement.
  - ✓ If the law clearly put that certain contracts should be made in writing, this legal stipulation must be strictly followed, and according to arts. 1,723-1,725 and art.

[13] . *Permissive provisions* are provisions of the law which gives us the right to chose to do or not to do a certain act and can be disregarded, where as *mandatory provisions* are quite the opposite and as the term "mandatory" it self indicates, they are obligatory and can't be set aside or disregarded.

2472(1) of the civil code, certain types of contracts are required to be made in writing, these are,

a) Contract relating to immovable properties, i.e. a contract of sale, lease or donation of a house or a land,
b) Administrative contracts, i.e. contracts with public administration or governmental organs,
c) Contract of guarantee,
d) Contract of insurance, and
e) Contract of loan where the amount of money lent exceeds 500 Eth. Birr.

All the above mentioned and other similar types of special contracts must be made in writing, if not, i.e. if the parties orally agree with respect of such kind of special contracts, the law won't consider that there is a contract, therefore, a formal requirement, when it is ordered by law or by the pre-contractual negotiation of the parties, is not only for the purpose of proof but most importantly, it gives validity to the transaction.

So far we have been discussing the four basic or essential legal requirements to establish a legally valid contract and the effect of the non-fulfillment of these requirements is invalidation of the contract that the transaction will be declared null and void.

Invalidation and cancellation of contracts

Both invalidation and cancellation of contracts are the ways by which a contractual relationship may come to an end, in other words, they are both extinction of contracts. But they are different in their cause and effect that the reason or cause to invalidate the contract is the non-fulfillment of one or all of the essential legal requirements of a valid contract. If the consent is vitiated due to a mistake, a fraud or an act of duress; or if one of or both the parties lack capacity; or if the object is not clearly defined, illegal or immoral, or the formal requirement is not observed, the contract will be invalidated. But cancellation of contracts comes when one of the parties especially the debtor failed to perform (to carry out) his/her side of the obligation. In the case of cancellation, there is nothing wrong with the legal validity of the contract as in case of invalidation, but the debtor failed to perform his/her obligation. Therefore, invalidation is caused due to the lack of legal validity of the contract where as cancellation results from the non-performance of the obligation.

Invalidation of contracts may only be demanded by the incapable party or by the party whose consent is vitiated, but if the cause of the invalidation is other than defective consent and incapacity, i.e. if it is due to the object or form, either parties or even other third parties may require the invalidation of the contract.

The effect of invalidation of contracts is restoration of the parties to their previous position had there been no contract, in other words, when the contract is invalidated, the contracting parties will be restored (returned) to the position where they would be had the contract not been made. On the other hand, in the case of cancellation of contract the parties will be restored to the position they would be had the contract been performed.

Period of limitation

If a party wants to bring an action for the invalidation of the contract, he/she has to bring it to court within two years from the ground for invalidation having disappeared. If the contract is to be invalidated due to the incapacity of the individual person, the day of the limitation runs from the day that the incapable party becomes capable. If the minor wants to invalidate the contract for instance, he/she has to bring the legal suit within two years from the day when he/she became major; and if the insane person wants to invalidate the contract, he/she has to bring the suit within two years from the time when he/she becomes mentally normal, and if the party needs to invalidate the contract based on the ground of defective consent, the action for invalidation must be brought before the court within two years after his/her mistake or deceitful practice or act of duress has disappeared.

Assume that A and B concluded a contract in which A offered to sell his gold bracelet that he inherited from his mother to B for 2000 birr believing that the object is a genuine gold bracelet, and B has agreed to pay the said amount of money. Later on, B took the gold to make sure whether or not the bracelet is a 21 karat gold, unfortunately however, he was told by the gold-smith that it was not a gold bracelet at all but a silver. Therefore, the mistaken party; i.e. B can request the invalidation of the contract within two years from the time when he knew that he was mistaken.

Assume that A and B concluded a contract according to which A assumed the obligation of collecting and bringing minor children from rural areas and B assumed the obligation of training them begging. Such an agreement is illegal and may be invalidated at the request of either of the contracting parties or by any interested third party.

Performance of contract

Performance of contract refers to the act of carrying out the obligation imposed upon the parties by the contract. Under this section, we will try to look at the ways and methods of performance of contractual obligations. Who should perform? Who shall receive the performance? Or for whom should performance be made? What should be performed? Time and place of performance and non-performance of contractual obligations and its remedies are going to be briefly discussed.

- *Who shall perform a contract?*

As a rule, the debtor may or may not be expected to perform the obligation him/herself. In other words, the debtor may perform the obligation personally or in the alternative, he/she may authorize another individual to perform the obligation. Further more, performance by third parties may also be authorized by court decision or by the simple operation of the law. The father and mother are, during their marriage, jointly guardians and tutors of their minor children. (Article 204 of the Ethiopian Civil code of 1960), this clearly shows that they are the legal representatives of their minor children and can represent them and perform any obligation on their behalf. The guarantor and the co-debtor can also perform the obligation of the debtor being authorized by law or by court decision.

However, there are situations where the debtor may be required to perform the obligation personally if the creditor shows that the nature of the obligation needs personal performance of the debtor him/herself. For instance, if a certain famous singer in the town concludes a contract with a certain hotel owner in that particular town to entertain the guests and if the singer, due to various reasons, couldn't perform his obligation, do you think he can authorize his daughter or son or a friend to perform his obligation? No, because such kind of obligation, by nature, needs the personal performance of that particular singer. If for instance a famous painter assumes the obligation to paint our house, he/she can't authorize any one as we hired him/her seeing his/her professional skill, experience and efficiency. There fore, such kinds of obligations are special which requires the personal performance of the debtor.

- *Who should receive performance? Or for whom should performance be made?*

Again as a principle, the creditor or any other person authorized by the creditor may receive performance of contractual obligation. But what about if the creditor is not capable to

receive such performance, i.e. the original creditor could be a minor or an insane person or an old aged or a prisoner or a senile. It is obvious that performance made to such kind of incapable persons is not valid before the eyes of the law and the debtor may be required to double performance. But what if the debtor proved that even if he/she made performance to an incapable creditor, the incapable creditor benefited enriched by the performance of the obligation, the debtor may escape from double performance. For instance, if the debtor has returned the money which he had borrowed from Mr. A's, a 16 years old boy, family to the boy as his family passed away, the debtor's performance of the obligation, i.e. repaying the loan to an incapable creditor is not valid, but if he can prove that the minor purchased different clothes and shoes using the money, more or less the minor is benefited so the debtor may be relieved. For instance, A is a minor who received 4000 birr from B who was the debtor of A's deceased parents. Out of the money, A spent 1000 birr for his clothing, 1,200 birr on gambling and 1000 birr for his school fee and the rest for food. At this particular juncture, when the tutor of A claimed the repayment of the money by invoking that the previous payment made to the minor is not valid, B may raise as a defense that the minor has benefited to the extent of 2800 birr by excluding the amount of the money spent on gambling.

In the above hypothetical case, if the minor spent 1000 birr on gambling, 1000 birr for smoking, and another 1000 birr for drinking alcohol and with the remaining amount of money, he bought a play station and obtained 400 birr per month for ten months consecutively by letting others' play the game, would you advise B to raise this fact as a defense against the tutor who has claimed the repayment? Discuss!

- *What should be performed?*

The debtor should perform his/her obligation under the contract exactly. In other words, the performance of the contract by the debtor should be in conformity with what was exactly and clearly promised. If the performance is not in conformity with what was exactly promised, the law entitles the creditor to refuse performance, or to suspend his/her side of obligation or to exercise any other legal remedies of non-performance.

- *Time and place of performance*

The parties are free to agree as to where and when performance should be made. If there is no such stipulation or provision in their contract as to the place of the performance, the place where the debtor had his/her normal residence at the time of the conclusion of the contract will

also be the place of performance of the obligation, in short, the place of the formation of the contract will also be the place of performance. This is due to the existence of the rule of interpretation in favor of the debtor that payment is fetchable by the creditor from the debtor not portable by the debtor to the creditor. But if the object of the contract is some thing like immovable thing or property, the place of the performance of the obligation will be the place where that particular immovable property is located or found, or a particular thing is produced or manufactured. For example, A is the creditor who resides in Addis Ababa and B, the debtor is in Nazareth, and if they have agreed that performance shall be effected at Debrezeit, then, as per their agreement, the place of performance will be the stated place; i.e. Debrezeit. In the absence of such contractual stipulation, the place of performance will be Nazareth where the debtor resides.

As to the time of the performance of the contract, if there is no clear contractual provision in their agreement as to the time of the performance of the obligation, the creditor may require the debtor to perform the obligation at any time provided that the creditor fulfills his/her side of obligation. However, the creditor should give a reasonable time for the debtor to perform the obligation. Some times even, due to the nature of the obligation, performance may be forth with or immediately.

The concept of anticipatory breach

Anticipatory breach simply refers to as an act of suspending the performance of the obligation of one of the parties when the other party shows that he/she will not perform or carry out his/her side of obligation.

The concept of transfer of risk

This concept tries to answer the question as to who should bear the risk to a loss by an unpreventable due to the destruction or deterioration of the object of the contract. The risk is with the person who is in actual control of the thing or the object. So, until delivery, the deliverer will bear the risk and after delivery, the other party will be the risk bearer. But what if the person who is expected to take delivery failed to do so, at this situation, the risk will be transferred to the one who failed to take the delivery of the object.

For instance, A purchased a horse from B for 1000 birr and the time for the delivery of the horse is two weeks after the conclusion of the contract, but if the horse died one week before the date of delivery, the risk shall remain with the seller B and if payment is made, B has to return it

to A, nevertheless, if the horse died after the lapse of time of delivery due to A's failure to take the delivery of the horse on time, though the horse died while under the control of B, A shall bear the risk and if he hasn't made payment, he shall pay in spite of the death of the horse.

Non-performance of a contract

Non-performance of contractual obligation is just a failure on the side of the debtor to carry out his/her contractual obligation.

- *The notion of default notice*

In principle, the creditor should give a default notice to the debtor in order to remind the debtor to carry out his/her obligation in due time. a default notice is a process by which the creditor is demanding the debtor to perform his/her obligation under the contract. In the default notice, the creditor, sets time limit after which he/she will not accept any performance, the time given by the creditor to the debtor should be reasonable. But some times, the creditor need not give a default notice **if**;

a. The obligation is an obligation of abstinence (obligation not to do type), OR
b. The debtor has already declared in writing that he/she will not perform his/her obligation, OR
c. There is a stipulation in their contract which says that if the time has lapsed, there is no need of giving a default notice, OR
d. The obligation that the debtor assumed may only be performed within a fixed period of time and if that particular time has already lapsed.

- *Remedies for non-performance*

If the creditor puts the debtor at default by giving him/her a notice, he/she (the creditor) may seek two alternative remedies. The first one is *specific (forced) performance* with compensation for damage and the second one is *cancellation of the contract as a whole* with compensation for damage.

The creditor may require the debtor to perform the contractual obligation if;

- The creditor has a special interest from the personal performance of the obligation by the debtor, **AND**
- If the performance of the obligation doesn't violate the personal liberty of the debtor.

Assume that A, the famous artist/singer has agreed to perform in the concert arranged by B promotional agency to the public at Exhibition Center, as a result, the promoter has sold

entrance tickets. However, just a day before the concert date, A sadly informed B that he will not be able to perform the concert and provided no reason. Under such a circumstance, do you think specific performance is possible? Please bear in mind that the above two requirements must exist cumulatively (together) in order to apply specific performance as per article 1776 of the Ethiopian civil code of 1960.

Some times, the court may give an order to the creditor himself to perform the obligation of the debtor at the latter's expense or destroy what has been done by the debtor against forbearance at the expense of the debtor. This is called an order of self-help. The debtor may also be ordered by the court to deposit the thing that he has agreed to deliver, when the creditor fails to take delivery, in public warehouse, in a bank or at any place that is convenient. For things perishable and the cost of deposit is expensive, the debtor and the guarantor, if there is any, will be relieved.

In general, due to the non-fulfillment of the above mentioned requirements or for any other reason, specific performance is not possible, the creditor may apply to the court for cancellation of the contract or some times even the individual creditor may be allowed to cancel the contract individually.

We have two types of cancellation, namely;

i. *Judicial cancellation*, which is the rule that the court may give an order of cancellation of the contract only where there is a fundamental breach. There will be a fundamental breach when the non-performance affects the very basis of the contract and the non-performance is total and irreversible. e.g. Mr. A destroyed the latest and modern video camera which he sold it to Mr. B.

ii. *Unilateral cancellation* is the other type of cancellation which gives the right to one of the parties to cancel the contract unilaterally. Unilateral cancellation will be allowed if one of the following conditions is fulfilled. these are;

    1. If the parties have agreed, in other words, if there is a cancellation clause in their contract, OR
    2. When the period of grace or the reasonable time has already lapsed, OR
    3. If the performance of the contract, due to some reasons, becomes impossible, OR
    4. If the other party has already declared in writing that he/she will not perform his/her obligation.

Assume that A ordered an ivory from B's souvenir shop and B agreed to sell each tusk for 5000 birr. The date of delivery is in one moth time from the conclusion of the contract, in the mean time, however, a government regulation has been issued that prohibits hunting of elephants as a result of which performance became impossible and

A can unilaterally cancel the contract without the need of taking it to court.

- *Compensation for damage*

In addition to requiring forced (specific) performance of the contractual obligation or cancellation of the contract as a whole, the creditor may apply for compensation for damage. Damage is a loss or an injury caused by one person to another. The creditor (the plaintiff) will be awarded compensation for damage if two requirements are fulfilled. These are;

- If it is well proved that the creditor (plaintiff) suffered a damage, in other words, it must be proved that the creditor lost something, and;
- It must be also proved that the creditor suffered the damage (incurred the loss) due to the defendant's (debtor's) non-performance of his/her obligation.

The defendant (the debtor), on the other hand, may be relieved from paying compensation for the damage if he/she proved that the reason for the non-performance of the obligation is due to *force majeure*. A *force majeure* is an event which is unforeseeable (something which can't be foreseen or predicted) and insurmountable (something which is beyond our control and unavoidable). The law clearly states that there is such event in times of;

- ✓ Unexpected government prohibition, or
- ✓ The existence of natural catastrophe such as flood, lightening, earth quake, etc… or
- ✓ international or civil war, or
- ✓ The death or unexpected grave accident or illness of the debtor.

If the debtor proved that one of the above mentioned situations occurred and prevented the performance of the obligation, he/she may be free (may not be legally obliged) to pay compensation to the creditor.

Extinction of contractual obligations

Contractual obligations are normally extinguished through performance in accordance with the contract and the law.[14] There are, however, other ways in which a contract and the obligations created by it can come to an end.[15] These reasons, other than cancellation, invalidation and period of limitation that we've discussed above, are Novation, Merger, Set-Off and Termination of the contractual obligation.[16] Let us now address each of them very briefly as follows.

Novation

Novation is defined as the substitution by mutual agreement of one debtor or of one creditor for another where by the old debt is extinguished or the substitution of a new debt or obligation for an existing one, which is thereby extinguished.[17] This is the other method of extinguishing obligations that consists of replacing an old obligation by a new one and the new obligation may differ from the old in its object.[18]

Illustration:

Tewabe owes Tekabe 1,000 birr for some goods the former purchased from the latter; nevertheless, both parties, later on, have agreed in a new contract that Tewabe will keep the 1,000 birr as a loan from Tekabe.

In this simple example, the previous contractual obligation between the two parties; i.e. contract of sale is now extinguished (brought to an end) as it is replaced by a new contractual obligation which is a contract of loan. Therefore, the previous contract is replaced by the new one and according to such; the previous buyer has now become a borrower. For a novation to come to the picture as a ground of extinguishing a contractual obligation, four essential requirements should be fulfilled.[19] These are,

- a previous valid obligation,
- the agreement of all the parties to the new contract,
- the extinguishment of the old contract, and

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[14] . David, Rene, ***Commentary on contracts in Ethiopia***, Translated by Michael Kindred, Faculty of Law, HSIU, Addis Ababa, 1973, pp. 77

[15]. *Id*. pp. 78. See also Art. 1806 and Art. 1807 of the Ethiopian Civil Code.

[16]. See Art. 1807 (a)-(f) of the Ethiopian Civil Code

[17]. Aiyar, P. Ramanatha, ***Concise Law Dictionary***, 3rd ed., (2006), pp. 796

[18]. David, Rene, *Op. Cit*., pp. 84

[19]. Aiyar, P. Ramanatha, *Op. Cit*., pp. 796

- The validity of the new one. [20]

Merger

Merger is the other method of extinguishing a contractual obligation by absorption in another. Merger will come to the picture when one person, with respect to a single debt, becomes both creditor and debtor at the same time.[21] In principle, merger extinguishes the obligation, which has actually become impossible to perform, nevertheless, it doesn't occur to the prejudice of interests that third persons may have in the right.[22]

Illustration:

Almaz, by a contract of loan she had with her father, borrowed 100,000 birr as she was going to purchase a new car and the loan was intended to be returned after a year with no interest. However, her father passed away due to a prostate cancer just two months before the due date of the obligation.

In this instance, since Almaz is going to inherit her father's estate and there is no creditor, the previous obligation that she assumed will be extinguished as both the rights and the duties of her deceased father is merged in her.[23]

Set-Off

Set-Off can be understood as an item or amount, which is or should be balanced against another in the settlement of accounts. In other words, where there are mutual debts between the creditor and the debtor (the plaintiff and the defendant), or if either party sues or be sued by the other, one debt may be set against the other. The right of set-off is the right of a defendant in an action for a fixed and ascertained sum of money, where he (the defendant/the debtor) has himself a liquidated demand against the creditor/the plaintiff.

Under the Ethiopian civil code of 1960, set-off will occur if three conditions are cumulatively fulfilled. These are, the debts, which are going to set against one another, must be in money or similar fungibles, they must be liquidated and they must be due.[24]

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[20] . To have a clear understanding as to how the Ethiopian law addresses novation, please read arts. 1826-1830 of the Ethiopian civil code of 1960.

[21]. David, Rene, *Op. Cit*., pp. 88

[22]. *Id*. pp. 89

[23] . To have a clear understanding as to how the Ethiopian law addresses merger, please read arts. 1842-1844 of the Ethiopian civil code of 1960.

[24]. Look at art. 1832 of the Ethiopian civil code of 1960.

Illustration:

Tihitna borrowed 5,000 birr from Kelemua on 10th of October/2007, which is going to be retuned after 6 months. Just a month before the due date of the loan obligation, Kelemua bought some items worth of 7,000 birr from Tihitina but didn't pay the money. After a while, Kelemua brought a legal action against Tihitna for the 5,000 birr loan, in such a situation, Tihitna can defend her case by raising a counter claim that Kelemua didn't pay the amount of money for the items she had bought from her.

So, the two obligations, hereinabove, will be set against each other and Kelemua will be legally obliged to pay 2,000 birr to Tihitna, where as, however, Tihitna will give nothing to Kelemua as her obligation to return the loan money is extinguished.

Termination of the contractual obligation and Remission of debts

Termination of a contract indicates that the parties, or one of them, have put an end to the contract.[25] It is the opposite of cancellation in that the latter has a retroactive effect, while termination is only effective prospectively.[26] This means all that has already been done in performance of the contract remains effective when the contract is terminated; it simply ceases to be enforceable or to produce new effects in the future.[27] In principle, termination requires the agreement of both parties that both parties must express their consent to bring the contractual relationship to an end. However, some times there are situations where by either party may terminate the relationship without the consent of the other, which is called unilateral termination. Similarly, the court has also the power to terminate the relationship of both parties; this situation is known as judicial termination.[28] Along side with termination, remission of debt is also another ground to extinguish the contractual relationship between the creditor and the debtor. Remission of debt means reduction or total forgiveness of the sentence or debt of the one who has the duty to perform it.[29] Remission of debt is a unilateral action; i.e. it discharges one party from his/her

[25]. David, Rene, *Op. Cit*., pp. 82

[26]. *Id*., pp. 82. See also art. 1815 and art. 1819(3) of the 1960 Ethiopian civil code.

[27]. David, Rene, *Op. Cit*., pp. 82

[28] . With regard to unilateral termination, see arts. 2226 and 2229 of the civil code that talk about the unilateral termination of agency-principal relation ship. The former stipulates the discretionary power of the principal to revoke the power that he/she has given to the agent where as the latter talks about the right of the agent to renounce the power that he/she got from the principal. Regarding judicial termination, refer to art. 1823 and art. 1824 of the civil code that give the power to terminate the contract upon the application of one of the parties in the existence of a special relation between the parties and in cases of gratuitous contract like contract of donation.

[29]. Aiyar, P. Ramanatha, *Op. Cit*., pp. 1005. To remise means to release a claim or to surrender.

obligations without regard to any performance the other party may have provided or still owes.[30] Usually, especially looking at the systems of other countries, before a remission of debt can extinguish an obligation, it must be accepted by the debtor, however, since it is economically advantageous for the debtor, the Ethiopian civil code of 1960 reverses this traditional rule and that if the debtor simply kept silent, that will amount to acceptance of the remission of debt as per art. 1825 of the civil code. But, if the debtor intends to reject the act of remission by the creditor, he/she (The debtor) must inform this immediately to the creditor.

To come to a general conclusion, a contract can be established to create a new obligation, to modify an already existing obligation, or to bring an obligation to an end (to extinguish an obligation). So far, we have been discussion all these situations of creation, variation and extinction of contractual obligations in a very brief manner by giving illustrations. Please bear in mind that the principles and concepts that we've raised so far are general rules applicable in all types of contracts in Ethiopia unless there is a special rule governing some special contractual relationships stipulated in the law it self. Now let us look at in the preceding chapters some of these special contracts and special principles governing them. Before that, however, there are some review questions that you are required to attempt so that you can test yourself as to how you have grasped the ideas mentioned above.

Review questions

1) What is a contract?
2) What are the essential requirements of a valid contract?
3) Ato A sent an offer without time limit to Ato B by mail. Ato B mailed back a letter of acceptance. However, A never received the letter due to the fault of the post office. A argues that there is no contract since he never received the letter where as, B proved that the letter was properly addressed, stamped and mailed. Do you think there is a contract? Why or why not?
4) What kind of mistake may be a ground to invalidate a contract?
5) Solomon is a well known trader in the town of Shashemene engaged in manufacture and sale of leather garments and T-shirts. On February 10/2010, he manufactured 100 T-shirts in his plant. The cost of production for the manufacture was 11,000 birr; however, Solomon miscalculated the cost of production as 7,000 birr only. As a result, Solomon agreed to sell

[30]. David, Rene, *Op. Cit*., pp. 84

all the T-shirts to Zenebe each at a price of 100 birr. In the contract concluded between them, it was agreed that Zenebe should pay 8,000 birr. Later on, Solomon demanded the invalidation of the contract on the following two grounds. State whether each of the grounds amount to sufficient reasons to invalidate the contract or not with explanation.

- Solomon argued that the contract has to be invalidated since the total price of the T-shirts is stated as 8,000 birr when it was supposed to be 10,000 birr.
- Solomon went far and argued that the contract should also be invalidated since he has committed an arithmetical mistake when he calculated his cost of production as 7,000 birr when it was supposed to be 11,000 birr.

6) Ato Maru lent birr 600 hundred to Ato Ali. While paying back the debt, Ato Ali found Maru's twin brother, Tesfaye. Ali, assuming that Tesfaye is Maru as it was impossible to differentiate Maru and Tesfaye and apart from parents, no one could distinguish the two, paid the money to Tesfaye. In such a situation, due to the payment made to Tesfaye is valid? Why or why not?
7) What is a capacity?
8) What is performance of a contract?
9) What is the difference between cancellation and invalidation of contracts?
10) Discuss the situations where by the debtor may not be legally obliged to pay compensation for damage to the creditor.
11) "*Forma dat esse rei*" i.e. form gives existence to the transaction. Explain.

Chapter 3

Special contracts

In our discussion regarding the general legal provisions, which governs contractual relationships of one or more persons, we have tried to see some basic principles and concepts applicable to any type of contract. Under this chapter, we will try to see two kinds of special contracts governed under the Ethiopian civil code, i.e. contract of sale and contract of agency, and bear in mind that the general provisions of contracts we have seen under the previous chapter

are also applicable in special contracts when ever it is necessary. Let us now first consider contract of sale and the legal provisions that governs it.

3.1. *Contract of sales*

3.1.1. Definition of sales contract

As usual we will start by defining what a contract of sale is legally. The law defines a contract of sale under art. 2266 of the Ethiopian civil code *as a contract where by one of the parties, the seller, undertakes to deliver a thing and transfer its ownership to another party, the buyer for a consideration in price expressed in money which the buyer undertakes to pay him(to the seller).*

From the above definition of sales contract, we can easily identify the following main elements of the definition. These are,

a. A sale contract is a contract, there fore, it must fulfill all the requirements of a valid contract, i.e. the parties to this contract must express their full and free consent, they must be capable to enter in to such transaction, the object of the sales contract must be sufficiently defined, moral, legal and possible to perform.
b. There must be at least two parties in sales contract, i.e. the seller on one hand and the buyer on the other.
c. The seller assumes the obligations,
   - First to deliver the thing that he/she has sold to the buyer, and
   - Second, to transfer the ownership title to the buyer.
d. The exchange should be made for a consideration, i.e. for payment, there fore, contract of donation is obviously excluded from being governed by art. 2266 and ff of the civil code.[31] Again, the consideration should be expressed in money; this means that barter contract is not a sale contract as the exchange process in barter is not paper or coin money for a commodity but a commodity for another commodity.[32]
e. The buyer assumes the obligation to pay the agreed price for the thing which he/she has bought.

3.1.2. Object of sales contract

[31] . This doesn't mean that donation is not a contract; donation is a contract and is governed under art. 2427-2470 of the Ethiopian Civil Code of 1960.

[32] . Again, barter is treated as a special contract allied to sale under art. 2408-2426 of the Ethiopian Civil Code of 1960.

The object of sales contract is a corporeal chattel. A corporeal chattel is a thing which has a tangible existence in the world. It relates to material objects the existence of which can be felt by the sense-organs. For instance, a table, a computer, a book, and other things. There fore, incorporeal things which doesn't have material existence such as copy rights, patent rights, industrial design rights, commercial good will and other intellectual property rights are not the subject matter of arts. 2266 and 2267 and the following articles which governs sales contract in the civil code, this doesn't mean that incorporeal properties doesn't have any legal protection, rather they are governed in the different part of the civil code, the commercial code and other subsequent proclamations. Not only being corporeal, but also being a chattel (a movable property) is the other legal requirement to be governed under art. 2266 & 7 and the following articles. What is a movable property? A movable property is any property which can move it self or can be moved by man with out losing its individual character. Based on this definition, obviously land and house which are the only immovable properties are excluded from being subject of sales contract under art. 2266 and ff of the Ethiopian civil code. How ever, these immovable properties, i.e. land and house are governed by another area of the civil law.

3.1.3. Obligation of parties in sales contract

So far, we tried to see the conceptual understanding of a contract of sale and the things which fall under the scope of application of a contract of sale. Let us now consider the respective rights and obligations of the parties in a contract of sale. Let us see first the obligations of the seller.

3.1.3.1 Obligation of the seller

- The first obligation of the seller is the obligation to deliver the thing that he/she had sold to the buyer. As we have tried to see in the definition of sales contract above, the seller assumes this basic obligation when he/she concludes the contract with the other party, i.e. the buyer. So this obligation of the seller is an apparent obligation as it is quite clear from the definition of sales contract. What do we mean by delivery? Delivery means simply the act of handing over of a certain thing to a certain individual. There are three kinds (modes) of delivery, these are, *actual delivery*, *symbolic delivery* and *constructive delivery*. There is an *actual delivery* when the thing or the commodity is physically handed over by one person to another person or to a carrier. If for instance, you go to a certain shop and byes some thing by paying the price there and then, the shop keeper will

give or hand over the commodity to you and you will go with the commodity that you have bought. In the case of *symbolic delivery*, giving of the document like ware house certificate, bill of loading, airway bill or railway bill etc suffices the delivery of the thing to the buyer. On the other hand, when there is no change in the actual possession of the thing delivered and the seller agrees to hold/ to preserve the thing on behalf of the buyer, this type of delivery is known as *constructive delivery*. If for instance, Mr. B purchases a computer from a computer shop but since he doesn't have a settled place for the computer at home, he may agree with the computer shop keeper that the keeper will preserve the computer on behalf of Mr. B until Mr. B arrange a place for the computer. The other related issue with regard to the obligation of the seller to deliver the thing is time and place of delivery. As a principle, the contracting parties have the full right to fix or determine the place of delivery of the thing in their contract. If there is no contractual stipulation in their contract as to the place of the delivery of the thing, the place of business or residence of the seller at the time of the making (conclusion) of the contract will also be the place of delivery.[33] This is due to the reason that the thing sold to the buyer is with the seller. Regarding time of delivery, again if there is an agreement between the parties as to the time of delivery, their agreement shall prevail. But if there is no such agreement, the law tries to fill the gap by stipulating a provision which states that delivery shall be made simultaneously with the payment of the price. In other words, the seller shall deliver the thing as soon as the buyer requires him/her to do so upon payment of the agreed price.[34]

- The other apparent obligation of the seller is the obligation to transfer the ownership title of the thing to the buyer. The seller is expected to transfer the ownership title of the object that he/she had sold to the buyer. This can be done by handing over simply the thing. There are some special corporeal chattels which even require additional formalities for the transfer of ownership. these types of corporeal movables such as motor vehicles, air planes, ships, TV sets and the like registration in addition to the conclusion of the contract delivery of the thing. So the obligation of the seller to transfer the ownership title of such types of special corporeal chattels includes the handing over of the document

[33] . To compare and contrast this issue of place of delivery, please refer to page 32 where we have discussed about the issue of place of performance of a contractual obligation.

[34]. *Id*

which attests the title of ownership in addition to the handing over the actual commodity. One thing which should bear in mind here is that no one can transfer what he/she doesn't own[35], if the owner ship title of the owner is defective, the transferee's title will also be defective. but if the buyer had a strong belief that the seller had a full ownership title to sell the thing, the ownership title of the buyer will not be defective provided that the buyer; paid the full price, has the intention to acquire ownership, has a good faith that he (the buyer) has a strong trust on the title of the seller, and received possession. Good faith on the part of the buyer is always presumed. if the other party is alleging that the buyer didn't have good faith at the time he/she purchased the thing from the seller, this party must prove his/her allegation. This kind of ownership is known as ownership by acquisition. However, ownership by acquisition won't apply in special movables like car, airplanes, ships, TV sets, etc…

- The third type of obligation of the seller which is not apparent from the definition of sales contract is the obligation to give warranty for the commodity that he/she had sold. Before starting our discussion concerning the obligation of the seller to give warranty under Ethiopian law of sales, let us see some theoretical concepts regarding warranty in general. A person who buys goods after having inspected them or had the opportunity to inspect may not complain later of defects that could have been detected by ordinary inspection, this theory in Latin called *Caveat Emptor*, i.e. let the buyer beware, this theory is a very old theory that it was applicable in countries like G. Britain, U.S.A. and other common law countries. According to this theory, if on the part of the seller, no fraud has been committed, the buyer him/herself will be blamed if he/she fails to investigate the defect of the thing, this theory was applicable in ancient times where there were no that much complicated commercial activities and where parties knew each other. The other theory which is applicable in modern commercial transactions is known as *Caveat Venditor*, i.e. *let the seller beware*. In to day's complicated commercial activities, sellers have no much opportunity to directly investigate the goods as it passes in to many hands before it reaches the consumer, and the underlying principle of the obligation of warranty is this principle of Caveat Venditor. This obligation refers to a promise that a proposition of fact is true. The seller should give warranty first, *the object sold is in exact conformity with*

[35] . This principle is based on the Roman law theory *nemo dat qui non habet*, i.e. no one can give what he has not.

the contract, and secondly, *the object is free from defects.* There are two types of warranties, namely *express warranty* and *implied warranty*. **Express warranty** is a warranty stipulated in the sales under which the seller assures the quality, description or the performance of goods. In other words, the buyer bought the goods on a reasonable assumption that the goods are as described by the seller. **Implied warranty** is the other type of warranty imposed on the seller by the operation of the law. The law requires that the seller should provide certain minimum standards of quality and performance even if no explicit promise or representations are made. this warranty may be either *warranty of title* that the seller has the proper title to sell, or *warranty of merchantability* that the goods are merchantable or usable if the buyer wants to resell it after using it, or *a warranty of fitness* for a particular purpose that the good should be reasonably fit for the purpose which is bought, or *a warranty against infringement (encumbrances)* that the seller must assure the buyer that the goods are free from a right full claim of any third party.

For instance, A sold her phone to B for 1000 birr. A should warrant for the peaceful enjoyment of the buyer without the risk of dispossession, and again, A should warrant the normal function of the cell phone to call others and to receive calls from others. If someone bought a racehorse, the horse is expected to have the necessary fitness for the purpose for which it is bought.

3.1.3.2. Obligation of the buyer

- The first and apparent obligation of the buyer is the obligation to pay the price. The price of the item may be ascertained by the contract, but if there is no agreement in the contract as to the determination of the exact amount of price, it will be ascertained by a third party valuer, by weight, by current prices or by the price at which the seller normally sells. The obligation of the buyer to pay the price includes the obligation to take any step provided by the contract or by custom to arrange for or guarantee the payment of the price. The buyer may be compelled to accept a bill of exchange to open a credit account, to provide a bank security or otherwise.
- The second obligation of the buyer is to take delivery of the thing that he/she has bought from the seller. The buyer is required to take such steps as are necessary to enable the

seller to carry out his/her obligation to deliver the thing. If the buyer doesn't appear at the place agreed on time of delivery, that particular buyer will bear the risk of loss or damage to the thing after he/she was duly notified. The buyer will also be liable for the expenses that the seller had incurred for the preservation of the thing on behalf of the buyer.

3.1.3.3. Common obligations of both the seller and the buyer

The common obligations of both the seller and the buyer include expenses, obligations to preserve the thing and transfer of risk.

- ✓ *Expenses*: - there are different types of expenses which are expected to be covered by both the buyer and the seller. The buyer is expected to cover expenses incurred for the conclusion of the contract, expenses of payment and expenses of transport. how ever, the buyer may not be compelled to cover contract expenses of payment if the seller has changed his/her address or place of business after making the contract, in this situation, the seller will bear the risk of covering the expenses of payment. In addition, the seller will assume the obligation to cover expenses of delivery and custom duties.
- ✓ *Obligation to preserve the thing*: - the seller must preserve the thing where the buyer is late in taking delivery. In this situation, the buyer is no without obligation, rather, he/she will be obliged to cover the cost for the preservation of the thing. The buyer has also the obligation to preserve the thing when he/she intends to return the thing to the seller on the ground of non-conformity to the contract or defect in the thing.
- ✓ *Transfer of risk*: - risk of loss may be transferred to the buyer at different times depending on the terms of the contract. The buyer bears the risk of loss or damage to the thing if he/she is late in taking delivery and is put in default. Again when the contract requires the seller to ship the goods to the buyer by a carrier, two possibilities exist; one is if the contract doesn't require that the seller delivers the goods at a particular destination, the risk of loss passes to the buyer when the goods are delivered to the carrier. But on the other hand, if the contract requires the seller to deliver the thing at a particular destination, the risk will pass to the buyer at the particular tender of delivery or upon an offer to deliver.

A brief overview on international sales contract[36]

[36]. Adapted from Mamo Wejaga, ***Text on Business law***, Addis Ababa Commercial College (Unpublished)

Generally, the international sales contract is drafted to accommodate buyers and sellers dealing with each other. The bargaining systems cover items such as market forces affecting prices, risk factors and terms that relate to security of payments. The final agreements relate to the private laws of private transactions. Performance of international sales contract involves greater distance, longer periods before the goods are delivered, and payment is required than in the usual domestic transaction. There are also purely international risks, such as:

- More than one currency
- More than one governments' regulations
- More than one language
- More than one legal system and
- More than one society's norms and culture.

The international sale of goods will commonly involve more than one legal relationship and in addition to the basic sales agreement, there is a shipping and insurance contract. Furthermore, there are myriad of documents such as the bill of loading, invoice, and carriage insurance policy. Moreover, the buyer may have contracted for an independent inspection company to certify as to the nature and quality of goods at the time of shipment. Trade problems associated with international sales contract arise with regard to restrictive trade devices that impede or distort trade. Classic examples of such are tariff, import quotas, import licensing and complicated custom procedures.

Finally, as in the domestic sales contract, the respective rights and duties of the parties to the contract vary according to the arrangement they make with respect to the place, time and mode of delivery of goods and the payment of the agreed price. In spite of the distance, the time factor and the international risks, most of the problems rest on the performance and the placement of risks. Though many different issues are involved in international sales contract, here we are concerned with the arrangement related to security of payment in overseas trade. With this in mind, we'll try to discuss such arrangements under the Ethiopian commercial code under the sixth chapter in a very brief manner.

3.2. *Contract of Agency*

3.2.1. Definition of contract of agency

The term agency can be defined as a relationship based upon an expressed or implied agreement by which one person; the agent agrees to act for another person, the principal in

negotiating and making contracts with third parties. In other legal systems, an agent is defined as a person employed to do any act for another or to represent him in dealings with third persons. The Ethiopian civil code, under article 2199, defined agency as *a contract* where by a person, the agent agrees with another person, the principal *to represent him* and to perform on *his behalf* one or several binding acts. Therefore, agency is contractual relationship and according to this relationship, the agent is duty bound to represent the principal, i.e. to act in the name of the principal on his behalf, i.e. for the exclusive interest of the principal. From this what we can understand, is save some exceptions, in principle what is expected from the agent is to *act in the name of the principal* and *for the exclusive interest of that particular principal*. agency contract has a special feature which differentiate it from any other contracts that it has a trilateral effect, i.e. it has a contractual and legal effect on the principal as it creates a right and an obligation on the principal, it has a contractual and legal effect also on the agent as it also creates a right and an obligation on the agent and it has the same effect on third parties. In agency transaction, we have two contracts, i.e. the contract between the agent and the principal which is the agency contract and the contract between the agent and third parties which is the main contract. The agent is an intermediary that he/she is just a bridge on which the principal and third party/ies may come together. After the formation of the main contract between the agent on behalf of the principal and third party, the respective rights and obligations arising out of that particular main contract will be assumed by the principal and the third party, and the agent, since he/she accomplished his/her mission, will be out of the picture of the transaction. But, this may not be so always that there are some exceptions that the agent may be liable to third parties. One of such exceptions is if the agent acts beyond the scope of his/her power. We have various types of agents, i.e. commission agents, commercial agents, forwarding agents, *Del credere* agents. Among this, later on we will try to consider the concept of commission and commercial agents in a very brief manner.

3.2.2. Sources of agency

Power of agency can be derived from the law, contract or from the court. When the agent is appointed by a written contract or simply by oral agreement by the principal, we say the source of the agency power is contract. But if the individual representative is appointed by the mere operation of the law, the authority is derived from the law. Such kinds of representatives are

tutors, guardians and succession liquidators.[37] The other type of agent whose authority emanates from the law is a curator. This curator is appointed by a court to accomplish some specific acts on behalf of another person upon the application of the relatives of the person or his/her spouse. (*Read arts. 2253 and 2254 of the Ethiopian civil code*).

3.2.3. Scope of agency

The scope of the agency power may be expressly fixed in the contract by the contracting parties. But if it is not fixed in the contract, such scope can be determined based on the nature of the transaction to which it relates. And accordingly, the scope of any agency contract may be either *general* or *special*.

a) *General agency*: - a general agent is authorized to transact all of the principal's business of a particular kind or all of the principal's business at a given place. Agency expressed in general terms shall only confer upon the agent authority to perform acts of management. What are these acts of management? the law clearly defined acts of management as acts done for the preservation and maintenance of property, leases for terms not exceeding three years, the collection of debts, the investment of income and the discharge of debts, the sale of crops, goods intended to be sold or the sale of perishable commodities of the principal. If for instance, the principal appoints the agent using the words "in all my affairs" or "..……is my agent" simply without specifying the authority, it will be taken as a general agency.

b) *Special agency*: - a special agent is appointed to do some specific acts or to transact certain business affairs. Special agency shall be required when the agent is called upon to perform acts other than acts of management. If, for example, A authorized B to sell his house, the authority should be made expressly to the sale of that particular house as the principal has given to the agent the widest right that affect his ownership right. In the same token, an authority to establish a right on an immovable property such as mortgage, servitude, and anticresis require special formality so as in the case of leasing an immovable property exceeding three years. Let us now consider the respective duties of the principal and of the agent.

3.2.4. Duties and liabilities of the principal

[37] . Succession liquidator is a person who is authorized by law to liquidate the estate of the deceased person, how much it is and whether or not free from any kind of debt, and determine the heirs or legatees who are called to take the inheritance. (*Read art. 942 and ff articles and art. 946 and ff articles of the Ethiopian civil code of 1960*).

Since agency is a contractual relationship, it necessarily creates rights and obligations on both parties, i.e. on the principal as well as on the agent. The following are the basic obligations (duties) of the principal.

i. The first duty of the principal towards the agent is contractual remuneration as the principal is duty bound to pay the agreed payment to the agent for the act that the agent accomplished. But if they don't have any agreement as to payment of remuneration, the principal may not be obliged to remunerate the agent. This amounts to that the agent agreed to perform acts on behalf of the principal for free. But, though there is no agreement as to the payment of remuneration, if the agent performs the act within the scope of his/her professional duties or if there is a custom in that particular locality where the contract is formed or where the agent performs the act as to payment of remuneration, the principal will be legally obliged to pay the remuneration to the agent. Again, there is a custom as to the payment of remuneration but if both parties failed to agree as to the amount of the remuneration, the court shall fix the amount based on the customs and usages.

ii. The second duty of the principal towards the agent is reimbursement that the principal has the duty of advancing sums necessary for carrying out the agency activity. Where the principal has not advanced to the agent any money, and due to which the agent incurs expenses, the principal shall reimburse outlays made and expenses incurred by the agent in the proper carrying out of the agency. The principle is there fore, the principal is under a duty to repay (reimburse) the agent for any disbursement and expenses necessary for the proper discharge of assigned duties. The principal may not be, how ever, legally obliged to repay any expenses which the agent incurred due to his/her own negligence or the expenses were incurred for illegal purpose.

iii. The third duty of the principal towards the agent is indemnity that the principal is duty bound to indemnify the agent if the agent sustained any losses or damages while acting on behalf of and for the interest of his/her principal. However, the losses or damages must result directly from the execution of an authority granted.

So long as the agent acts within the scope of the authority given by the principal, the principal is liable to third parties for the performance of any contract made in the name of the principal. But if the act performed by the principal is beyond the scope of the agent's authority,

the principal shall not be obliged unless he/she (the principal) ratified it. Consider the following example

Mr. A authorized Mr. B to lease Mr. A's house only for three years of time and left abroad. When Mr. A came after a stay for ten years he found out that his house is still leased.

In the above example, Mr. A will not be liable for the seven years of rent as the agent acts beyond the scope of his authority. But if Mr. A ratifies or approves the fact that Mr. B leased the house for ten years, he (Mr. A) will be liable to third parties and Mr. B will be presumed as if he acts within the ambit of his power.

Again if the agent performs some acts without being authorized to perform so, the principal may not be liable to third parties unless the principal again ratifies the act of the agent. In the above example, Mr. B sold the house while being authorized only to lease it; he just performed an act which he was not authorized to perform. At this time, the principal will not be liable unless he ratified the act. So, what is the legal consequence of acting beyond one's scope of power? Is the next question. The answer is crystal clear that the principal has two options that he/she may ratify the act done by the agent without authority or repudiate (reject) such act. If the principal doesn't ratify or reject such act, the agent him/herself will bear the liability. In other words, third parties won't have a say towards the principal and they can only hold the agent liable.

Is there a duty on the part of the principal to ratify the act of the agent which he/she performed beyond his/her scope of power or without being authorized to perform that particular act? In principle, the principal doesn't assume any duty to ratify such acts, but as an exception, if the agent performs the act in ***the strictest good faith*** for the exclusive interest of his/her principal. This would be so if it is proved that had the principal knew the fact, he/she would extend the power of the agent. In the above example, Mr. B (the agent) leased the house for ten years thinking that the amount of the rent is very beneficial to the principal or sold the house as he have got a very attractive offer and failing to reject such offer clearly affects the principal, even if he acted beyond the ambit of his authority, the principal may be legally obliged to ratify such acts.

To conclude, the principal in agency transaction is the person who is to be represented by the agent and for whose interest the agent is acting. This principal has the duty to remunerate,

reimburse and indemnify the agent and assumes liabilities towards third parties save some exceptions. Let us now consider the duties of the agent.

3.2.5. Duties and liabilities of the agent

Just like the principal assumes obligations towards the agent, the agent also assumes the following duties towards the principal.

i. The agent shall act with the strictest good faith towards the principal as the agent is authorized to act in the name of the principal in business dealings; greater trust and loyalty are demanded of him/her. Within the scope of his/her authority, the words and acts of the agent are the words and acts of the principal.

All the subsequent duties of the agent more or less are elements of and related to the above basic duty, i.e. the duty to act in good faith. These are,

a. The agent shall act in the exclusive interest of the principal and may not, without the knowledge of the principal, derive any benefit from any transaction in to which he/she enters in pursuance of his/her authority. An agent must not only inform the principal, but also may not personally benefit from the transaction completed in connection with the agency other than receiving the agreed compensation. Any profit that the agent may make in the exercise of his/her duty belongs to the principal. The agent may not also personally buy or sell the things to him/her self unless with out the approval of the principal.[38] More over, an agent may not secretly represent other persons in the transaction being performed for the principal unless both the principal and those other parties are informed and give their free consent.

b. The agent shall keep accounts to the principal for all sums received by him/her and all profits accruing to him/her in the course of his/her employment. An agent must account to the principal for all money and property of the principal that come in to the agent's possession. The agent must promptly notify the principal of the receipt of the money and must make an accounting.

[38] . In chapter 2 of this hand out, we have discussed that in a contract, as a rule, there should be at least two parties, but as an exception, an agent may conclude a contract with him/herself if the principal approves it, i.e. the agent will act both as an agent and also as a third party. (*In this regard, please refer to art. 2188(1) of the Ethiopian civil code*)

c. The agent shall be also diligent that he/she must show a due diligence as *bonus pater familias*[39] in carrying out the agency as long as he/she is entrusted there with. In other words, the agent is required to exercise the degree of care and skill that a reasonably prudent person would use in similar situations.

d. In principle, the agent is duty bound to carry out the agency in person (him/herself) unless he/she is authorized by the principal to appoint a substitute. There is only one exceptional situation where the agent may appoint a substitute. These situations are *if the interests of the principal so justifies or if an unforeseen circumstances occur which prevent the agent from carrying out the agency activity personally and he/she is unable to inform the principal of these circumstances*. The relationship between the principal and the substituted agent shall be as though the substituted agent had received the authority to act as an agent directly from the principal, where the substituted agent had reasons to believe that the agent was authorized by law or by the approval of the principal to appoint a substitute. The agent shall be liable for the acts of any person whom he/she appointed with out authorization as his/her substitute as if the substitute agent was his own.

There fore, what we can understand from the above discussion of respective duties of both the agent and the principal, the rights of the principal are the duties of the agent and the opposite is also true. The agent is personally liable to third parties if he/she acts without authority, in other words, if the agent exceeds the authority given to him/her by the principal or if he acts beyond the scope or ambit of his/her power.

The agent will also be liable for torts, i.e. for committing wrong acts even though he/she acts within the scope of his/her authority. Assume that A, the principal, appointed B, the agent to lease his house only for three years. B has met with a very wealthy man who showed an interest to rent the house for 20,000 birr per month for six years which B has never imagined. B was so delighted and leased the house for six years for the price offered by the rich man. A came to learn such an act of his agent; i.e., leasing the house for six years is beyond his scope of power. Would you please raise the rights of A and possible defense/s of B, if there is/are any?

[39]. *Bonus pater familias* is a Latin word which means " *a good father of a family*"

To give you another example, A needs to buy a very fancy residential house and appointed B for such a purpose; i.e. to buy the said house on behalf of A for a fair price. After some days, B, the agent concluded a contract of sale of a house with C to buy C's house for 800,000 birr and more over, B and C negotiated to inform A that the cost of the house is 900,000 birr in the intention of obtaining extra sum of money for their own personal advantage. A paid the said amount; i.e. 900,000 birr and begun to live in the house. One day, A heard that the actual price/value of the house was not 900,000 birr but 800,000 birr. What kind of right/s do you think A will have?

3.2.5.2. Joint liabilities of the principal and the agent

Both the principal and the agent shall be jointly liable;

a) where the principal informed third parties of the existence of the power of agency but failed to inform these third parties of the partial or total revocation of such power; OR,
b) where the principal failed to ask the agent to return the document evidencing the power of agency or failed to seek a judicial decision to the effect that such document is revoked, OR,
c) Where the principal caused, in any other manner, in particular by his/her statements, behavior or failure to act, a third party to believe that the person with whom he/she was dealing was authorized to act on behalf of the principal.

The notion of unauthorized and undisclosed agency

As we have discussed earlier, agency proper exists where the principal, either expressly or impliedly, authorizes the agent to act on behalf of the principal. Again, as a rule, the agent should use the name of the principal in all his/her dealings with third parties. But some times, the agent may not be expressly or impliedly authorized, a clear instance for such is *the institution of unauthorized agency*. again, some times, the agent may be allowed to use his/her own name in dealings with third parties by representing the principal for various reasons, *the institution of undisclosed agency* is a clear example of such kind of agency power. Let us see these two institutions as follows.

1. *Unauthorized agency* occurs where a person who has no authority to do so undertakes with full knowledge of the facts to manage another person's affair without having been appointed as an agent. The acting person shall manage the affairs he/she has undertaken with the same care as a good father of a family and should bring the management of the

affair to an end and should render accounts to the person on behalf of whom he/she is acting. there is the institution of unauthorized agency where the consent of the person on whose behalf the act is done is non-existent, where the acting person is with the full intention to manage the principals affairs without authority, where the acting person done both juridical and material acts and most importantly, where the act is done for the exclusive interest of the person for whom the act was done. if the above requirements are fulfilled then the person for whom the act was done will assume the duty to ratify the acts done by the acting person in his/her name, indemnify the acting person for all liabilities he/she (the acting person) personally undertook, reimburse the acting person any expenses incurred in his/her (the person for whom the act was done) interest, and compensate the acting person for any damage he/she (the acting person) suffered in connection with the management where such damage sustained due to a fault other than the acting person's. If there is a duty on the part of the person for whom the act was done to ratify the acts of the acting person, the provisions of agency proper will be applied. Consider the following example, Mr. A left for a vacation leaving his ramshackle house behind, and not long after his departure, a strong wind came and destroyed that house and Miss B the neighbor of Mr. A repairs the house by spending some expenses. In this situation, Miss B is an unauthorized agent and upon arrival, Mr. A will be obliged to ratify the acts of Miss B provided that all the above mentioned legal requirements are fulfilled.

2. *Undisclosed agency* occurs when the principal is not known as the agent uses his/her own name but acts for the exclusive interest of the principal. for instance, if the prime minister or the Pope wants to engage themselves in a typical commercial activity, and if they want to appoint an agent, it wouldn't be proper if the agent to use the name of the principal as such involvement of these kind of public figures in a commercial transaction may create unnecessary chaos, so the principal will only use his/her own name while acting in the principal's interest. In these situations, as a rule, third parties may not require the principal to perform his/her side of obligation and their legal and contractual obligation will only be with the agent even if, by chance, they know who the principal is.

to come to a conclusion, as we have discussed in the previous sections of this material, we have said that the agent should be either expressly or impliedly authorized or appointed by the

principal and the agent must not use his/her own name but the name of his/her principal. But as we have seen above the agent may not be always authorized and the agent may be allowed to use his/her own name instead of the principal's if the circumstances so justifies.

3.2.6. Termination of agency

Literally, termination is an act or a process of bringing some thing to an end. Legally, the word refers to the act or a process of bringing contractual relationships of the parties. Since the principal- agency relationship is a mere contractual relationship, it can be terminated either by the act of the parties or by the mere operation of the law. Revocation and renunciation are deemed to be acts of the parties to terminate the relationship, where as termination due to the death, incapacity, declaration of absence or bankruptcy of either of the parties are deemed to be termination by the mere operation of the law. Let us now consider each one of them as follows.

- Revocation by the principal. The principal may, at any time, restrict or revoke the authority that he/she had given to the agent. When the power of the agent is revoked by the principal, the agent must return to the principal documents, if any, evidencing his/her power. And if the revocation causes any loses to the agent, the principal shall indemnify the agent. So, revocation is the first ground of termination of agency-principal relationship.
- Renunciation by the agent. The agent may renounce the agency power that he/she may notify the principal that he/she (the agent) no longer represents the principal. If the renunciation is found to be detrimental to the principal, he/she (the principal) shall be indemnified by the agent who renounced his/her power. There fore, renunciation is the other ground of termination of agency-principal relationship.
- Death, incapacity, declaration of absence or bankruptcy of either of the parties, i.e. the agent or the principal may also bring the principal-agency relationship to an end.

along side with the above mentioned ones, completion of the business of agency, destruction of the subject matter and when both parties, i.e. both the agent and the principal becomes alien enemies are recognized as grounds of termination of agency-principal relationship in other legal systems.

3.2.7. Commission and commercial agents

As I have tried to give you some clue earlier, we have various types of agencies recognized in Ethiopia and in some other legal systems, let us see the two widely known types of agents in Ethiopia, i.e. commission agents and commercial agents.

1. A Commission agent is an agent who undertakes to buy or to sell his/her principals goods, securities or other fungible things *in his own name* but on behalf of the principal. A commission agent is considered as a trader by the commercial code. We have other commission agents such as forwarding agents and Del credere agents.[40]
2. Commercial agent is an agent who represents the principal *permanently in a specified area to deal and make agreements in the principal's name* and for the interest of that principal. This commercial agent is considered as a trader in the commercial code.

Review questions

1. What is a sales contract?
2. What is the object of a sales contract?
3. Teklu sold his wrist watch to Tarik on Wednesday 28th October/2010 in accordance of a contract concluded between them, which imposed the obligation on Tarik to give seven civil codes or an equivalent value in kind in return of the watch at the time of payment agreed in the contract. Do you think this contract is valid? Why or why not?
4. Discuss very briefly the respective obligations of the seller and the buyer in a contract of sale?
5. Abebe sold his car to Shitaye on 1st of April/2010 based on a written contract concluded at the normal residence of Abebe and hand over the "*Libre*" forthwith to her. However, Abebe failed to deliver the jack of the car that is an apparatus for lifting the car off the ground in spite of its importance to the car. When Shitaye noticed such, she immediately approached Abebe and informed him about the fact, though he responded unpleasantly. Shitaye is not sure about her legal rights against the Abebe. What do you advise her?
6. List down and explain in detail the modes of delivery recognized under Ethiopian law.
7. "*Nemo Dat Qui Non Habet*", i.e. he who has not can not give! Discuss.
8. Discuss the legal effects of acting beyond the scope of the agency power.
9. On November 10/2010, Mr. P while having a telephone conversation with Mr. A, gave the latter the authority to buy him a house at Merkato area. Pursuant of this power given to him, A, on November 12/2010, has concluded a contract to buy the house of Mr. T, which was located at the very heart of Merkato, in the name and on behalf of Mr. P for

[40]. In this regard, please read arts. 2234-2252 of the civil code and arts. 60-62 of the commercial code.

half a million birr. Two days later, just before the house was delivered to P (the buyer), T was offered one million birr for the house by Mr. K, and there fore, he wanted to challenge the validity of the contract he had concluded with P through A. is there any possible ground to challenge the validity of the contract? Why or why not?

10. Explain very briefly the concept of unauthorized and undisclosed agency.
11. What are the grounds to terminate an agency-principal relationship?
12. What is a commercial agent?

Chapter 4

Business and the law of Business Organizations

4.1. Definition of business

As usual, Let us start our discussion by defining the term business. Art 124 of the Ethiopian commercial code of 1960 tries to define the notion of business as an incorporeal movable consisting of all movable properties brought together and organized for the purpose of carrying out any of the commercial activities specified under art. 5 of the commercial code. By "*Commercial Activity*", it means what a person is engaged in professionally in an activity with the intention to gain and a person who is engaged in such an activity is called a trader (a business man). More over, companies like PLC (Private Limited Company) and SC (Share Company) by all means are entities engaged in commercial activities. The question paused here is "*Are these commercial activities in the commercial code illustrative or exhaustive*"? It seems exhaustive as it doesn't give a room for other activities to be considered as commercial activities. Nevertheless, in modern times, activities, which were not considered as commercial activities such agriculture, forestry, fishing and handcrafting when they are employed in large scale and harvested mainly for the purpose of maximizing profit, categorized as commercial activities. For instance, floriculture, diary, cash crops and so on… are, now-a-days, a good source of investment and capital accumulation for the trader in particular and for the whole country in general. The fact that agriculture, fishing, forestry and hand crafting had not been taken as commercial activities is due to the reason that they were exploited only for means of subsistence of people's day to day life not for gain. A trader, in general, operates a business and carrying out a business or several businesses as an owner, usufructuary or lessee.

4.2. Elements of Business

A business consists of both corporeal and incorporeal elements. These are:

a. Good will and incorporeal elements/components, and
b. Corporeal elements/components.

a. <u>*Good will and incorporeal components*</u>:-

- Good will: - is one of the main elements of business. "*The good will results from the creation and operation of a business and is a value which may vary according to the probable or possible relations between a trader and third parties customer who may require from him goods and services*."[Emphasis ours] Article 130 of the Ethiopian Commercial code. There are many products in the world market praised for their qualities and create an impression in peoples mind. It is possible to mention good will of products such as carpet of Persia, wine of Paris, whisky of Scotland and the like.

Can you mention some goods in our country that have been remembered for their good will? The source of good will is the capacity of a trader and a trade to retain customers' demand perpetually. Good will includes the kind of product, provision of services, trader's relationship with the employees and economic stability… to build a good will is not an easy task. However, to defame and to discourage it doesn't need that much effort, and this is why unfair competition law is set up to protect the good will of a business. In the normal course of trade, competition is a healthy as it helps the introduction of quality products in the market in sufficient quantity. Nevertheless, some times there might be unhealthy competition in business activity and in such a situation, the law has different remedies either to prevent or cure unfair competition and conflicting of interest between traders, between a trader and his employee and between a trader and other commercial agents. The following acts shall be considered as unfair competition;

- acts likely to mislead customers;
- any false statement made in the course of business with a view to discrediting the undertaking, products and commercial activities of a competitor;

Please give a close look at the following names of commercial activities in our country and give your suggestion whether or not they create confusion.

- Kaldis Coffee vs. Kalvis Coffee,
- Duru dry cells vs. Durata dry cells,
- Sony vs. Sanyo,
- Addidas vs. Addibas, etc…

Remedies for acts of unfair competition

a. *Civil remedies*

- compensation for damages by the unfair competitor to the victim of such act,
- injunction-to stop further unfair competition made by the unfair competitor,
- publication-notice made to the public to remove the effect of misleading by the expense of the unfair competitor,

b. *Criminal sanction*

According to the 1957 of penal code Art. 673 and the current Criminal code of 2004 Art. 719, whoever intentionally commits against another an abuse of economic competition by means of direct or any other process contrary to the rules of good faith in business is punishable, upon complaint, with a fine of not less than 1000 birr or simple imprisonment for not less than 3 months.

c. *Administrative remedies*

The trade practice Proclamation No. 329/2003 sets a trade practice investigation commission entrusted with the duty to prevent and to eliminate anti-competitive and unfair trade practices and avoid any restraint on the efficient supply and distribution of goods and services. The commission may impose the following administrative measures:

- suspend, correct or eliminate the practice in question,
- suspend or cancel business license,
- take appropriate measure that enables the victim's competitive position to be reinstated,
- Impose penalty; i.e. fine 10% of the value of the assets of the violator or 15% of the yearly total gross sales of the violator. Fine may also be imposed from 5000 to 50,000 birr.

The proclamation defines unfair commercial competition as any act or practice in the course of commercial activities that aims at eliminating competitors through different methods. Article 10(1) of procl. # 329/2003. Pursuant to the proclamation, the following acts are, in particular, shall be deemed to be acts of unfair competition,

- any act that causes or is likely to cause, confusion with respect to another enterprise or its activities, in particular, the products/services offered by such enterprise,
- any act that damages, or is likely to damage the good will or reputation of another enterprise falsely,

- any act that misleads or is likely to mislead the public with respect to an enterprise or its activities, in particular, the products/services offered by such enterprise,
- any act of disclosure, acquisition or use of information without the consent of the rightful holder of that information in a manner contrary to honest commercial practice,
- Any false or unjustifiable allegation that discredits or is likely to discredit with respect to an enterprise or its activities, in particular, the products/services offered by such enterprise,
- Any act that directly or indirectly restricts, impedes or weakens the competitive production any distribution of any commercial good or the rendering of any service,
- Any act that restricts or debars the timely or economic means of producing or distributing any good or rendering of any service,
- The importation of any goods from any foreign country into Ethiopia at a price less than the actual market price or whole sale price of such goods in the principal market of the country of their production with the intent to destroy or injure the production of such goods in Ethiopia or to restrict or monopolize any part of the trade in such goods (damping), and
- Trading in any manner in goods imported in to Ethiopia for humanitarian purpose, without authorization by the ministry. (Article 10 (2) /a/-/i/ of procl. # 329/2003).

Please also refer to Articles 132 and 133 of the Ethiopian commercial code of 1960 and Article 2057 of the Ethiopian civil code of 1960 in this regard.

Other incorporeal elements of business

Trade Name: it is the name under which a person operates his/her business and which clearly designates the business. The trade name of the business can be the family name of the trader, trader's own name the assumed name of the same. In all cases, it must not make confusion with other trade names. In such a situation, the court may order damage as a result of possible confusion and in addition may order to include the surname or patronymic in the trade name to obviate confusion.

Trade-Mark: used to distinguish a product from other products. It is a mark of authority and is indicated on products/goods/packages in the form of number, letter, work, drawing, etc. Trade-mark is used to create an impression on customers and it is not allowed to use in the trade mark

the name of the product such as good car, good breed as they are not in any means to distinguish a product from other products.

Service Mark: indicates the service provided by an organization. Transport service mark, insurance service mark, etc. it is not indicated in the product like in the case of trade-mark, it is usually indicated on the correspondence of the organization.

Distinguishing Mark: is the name, designation sign or emblem affixed on the premises where the trade is carried on and which clearly designates the business.

Patents and copyrights: a business may consist patent relating to registered inventions, trade mark designs or models, copyrights or literary and artistic elements and all these are legally protected.

A trader may claim damage when the trade name, trade mark or service mark creates confusion in a manner prejudice to the trader. The other most important point worthy of mentioning here is that the right to lease of the premise of a business. The owner of a premise can lease the premise to another person, and in the same fashion, the lessee of the business can sub-lease the premise for a period his/her contract of lease lasts.

b. *Corporeal Elements*: - are all goods that are the subject of sale in a business premise and equipments. These include the business premise and the land on which the premises have been erected.

Accounts and Entries

An Account is a label used for recording and reporting a quantity of almost anything. Most often it is a record of an amount of money owned by a particular person/entity or allocated to a particular purpose. Account represents the financial and non-financial transactions of a firm to know the total outcome of the investment made by the investor or trader.

Types of Accounts

Basically, we have six types of accounts. These are:

1. *Asset accounts*: these types of accounts represent the different types of economic resources owned by a business such as cash in bank, buildings, account receivables...
2. *Liability accounts*: these represents the different types of economic obligations by a business such as accounts payable, bank loan…
3. *Equity accounts*: these accounts represent residual equity of a business after deducting all liability.

4. *Revenue or income accounts*: such accounts represent the company's or business's gross earning like sales, service and interest income.
5. *Expense accounts*: represent the business's expenditure to enable itself to operate such as electricity, water, rentals, insurance and so on.
6. *Contra accounts*: these types of accounts represent deductions to a relatively permanent asset such as buildings.

The identification of entries in the retail, whole sale, service and manufacturing sectors relies on administrative data received from the actual sale departments. The confidentiality and authorized use of this information is strictly regulated by law. The data received includes source of income including name and address of a client, industry classification, quarterly and annual payroll, number of employees, etc. These data are the basis for construction and maintenance of the business's financial viability, profit or loss margin, income statement and others. In general, the entry contains all known monetary information relating to the business.

Traders and trading (commercial) activities

The term trader may be defined in various ways in different fields of discipline. The Ethiopian commercial code, however, defined it as a person who professionally and for gain carries on any of the commercial activities listed under art. 5 of the same code. For a person (either natural or legal) to be assumed as a trader, these three cumulative defining elements must be fulfilled.

- The person has to operate an activity professionally, which means the activity must not be a one time activity, rather it has to be an activity in which the person involves regularly. If for example, "A" wants to sell his house for he wants to purchase a new one doesn't make him a trader as he is not professionally involved in selling houses, instead the sale of the house is just a one time activity. But, if "A" is involved in the business of selling and buying houses, the scenario will be changed since he is engaged in such a business as a full time activity and there fore, he is a trader.
- The person has to operate the activity for gain. It is crystal clear that the very purpose of any commercial activity is to acquire some king of gain, which is a positive material enrichment. By this, you may understand that moral gains can't be considered as gains *per se* since moral (spiritual/mental) and other similar advantages that one may enjoy are out side the purview of commerce. The purpose of operating commercial activity is to

enjoy economic benefit. There fore, a person to be regarded as a trader should not only be a professional but also has to operate the activity with the intention of having some kind of economic advantage. The person while working for a profit may actually suffer losses but this will not alter the position already acquired, in other words, it is the initial motive of the person that must be taken in to account not the fruits of the business, if a person starts a business with the desire of having profit and by chance incurred loss, this cant bar him/her from being categorized as a trader.

- The activity has to be one of the enumerations of art. 5 of the commercial code. This is the third and equally important element for categorizing a person as a trader is the requirement that the activity must fall under the list of commercial activities pursuant to the said provision of the commercial code. There are some 21 commercial activities listed under art. 5 of the code and any one engaged in one or more such activities provided that the above two requirements are met, will be taken as a trader. These commercial activities are:
    a. Purchasing of movables and immovable with a view to re-selling them either as they are or after alteration or adaptation;
    b. Purchasing of movables with a view to letting them for hire;
    c. Warehousing activities as defined in Art.2806 of the Civil Code;
    d. Exploitation of mines, including prospecting for and working of mineral oils;
    e. Exploitation of quarries not by handicraftsmen;
    f. Exploitation of salt pans;
    g. Conversion and adaptation of chattels, such as foodstuffs, raw materials or semi-finished products not by handicraftsmen;
    h. Building, repairing, maintaining, cleaning, painting or dyeing movables not by handicraftsmen;
    i. Embanking, leveling, trenching or draining carried out for a third party not by handicraftsmen;
    j. Carriage of goods or persons not by handicraftsmen;
    k. Printing and engraving and works connected with photography or cinematography not by handicraftsmen;
    l. Capturing, distributing and supplying water;

m. Producing, distributing and supplying electricity, gas, compressed air including heating and cooling;
n. Operating places of entertainment or radio or television stations;
o. Operating hotels, restaurants, bars, cafes, inns, hair- dressing establishments not operated by handicraftsmen and public baths;
p. Publishing in whatever form, and in particular by means of printing, engraving, photography or recording;
q. Operating news and information services;
r. Operating travel and publicity agencies;
s. Operating business as an agent, broker, stock-broker or commercial agent;
t. Operating a banking and money changing business;
u. Operating an insurance business.

What do you think of this listing of commercial activities under art. 5 of the commercial code? Are these the only activities that must be taken as commercial activities? What about investment in the educational sector (establishment of private educational institutions) and consultancy services. I.e. do you think the list is exhaustive or is it illustrative that others can be added? Discuss!

Obligations of traders

The very purpose of defining the term "Trader" is to distinguish traders from other people that may engage in profit making activities as the law imposes certain legal obligations on traders. The primary obligations of any trader (either as a single one or in a form of business organization) are the following:

1. the obligation to keep books and accounts,
2. the obligation to get registered, and
3. And the obligation to have business license.

The obligation to keep books and accounts

As it is clearly stated under art. 63 0f the Ethiopian commercial code of 1960, traders and commercial business organizations have to keep books and accounts according to the said provision of the code, any person involving in commercial activities has to keep books and accounts. In fact, this requirement may not be absolute as petty traders may be exempted from the obligation to keep books and accounts pursuant to art. 64 of the same code. In addition to the

above legal provision of the commercial code that imposes such an obligation on traders to keep books and accounts, the tax proclamation (Procl. # 286/2002) also states that traders whose capital is more than birr 100,000 shall keep books and accounts for the purpose of computing tax liability. The next question worth asking here is what is the reason for the law in requiring traders to keep books and accounts. The following are some the most important advantages that may be enjoyed by meeting such a requirement.

- *Books and accounts are admissible evidences for activities of a trader*

As stated under art. 71 of the commercial code, books and accounts are admissible evidences for all questions and issues relating to the business or fruits of trade operated by a trader and business organization that maintain the books and accounts. According to art. 2016 of the Ethiopian Civil code of 1960, again, a document written by a given person can't be produced as evidences in favor of the writer. There seems to be an apparent paradox here that the former allows the production of the books and accounts as admissible evidences were as the latter prohibits. In such a situation, we have to understand that the former is a clear exception to the latter and for such a purpose, the commercial code is special law and the civil code is a general one and based on the principle of interpretation of law that special laws will prevail upon the general ones, we may be able to reconcile the conflicts.

- *Books and accounts are useful instruments for making business research*

Traders and other interested individuals by referring to the books and accounts that were kept at different periods may make research with the intention of solving business problems. The traders may compare and contrast potential customers, the type of item to be produced and the method of dealing and decide on steps that may be followed to have a maximum profit.

- *Books and accounts may be produced as evidences in favor of the government*

As per art. 72 of the Ethiopian commercial code, books and accounts may be taken as evidence against the party who kept them. If a trader denies business profit he/she has earned, the authorities may produce the books and accounts as evidences against the trader. In this regard, the books and accounts are not beneficial to the trader, but you can consider it as an advantage from the view point of the public at large. The commercial code dictates traders and commercial business organizations to keep books and accounts but doesn't show the effect of the non-observance of such an obligation. Nevertheless, the tax proclamation put a harsh penalty on a trader or business organization that failed to keep books and accounts in accordance with the

requirements of the law by compelling him or it to pay a penalty of 20% tax determined by the tax authorities. (Art. 89(1) of procl. # 286/2002).

In addition to the above mentioned advantages, books and accounts may also safe guard the interest of members from abuse by the management of the business. If books and accounts are properly kept and all source documents are well handled, it may not be easy to embezzle assets of a business organization. The accounts have to be audited and reported. Every financial transaction may be checked and reviewed.

The obligation to get registered

Every trader and commercial business organization before commencing business/commercial activity shall be registered. The process of registration is to be regulated by the different relevant laws of the country. It is clearly stated that no person shall engage in any commercial activity unless registered in the commercial register. Thus, registration is compulsory to all business organizations having permanent place of work. The laws on commercial registration have established three kinds of registers, these are,

- A commercial register managed by regional bureaus of trade and industry,
- A commercial register managed by the Ministry of Trade, and
- A central commercial register.

The place of first (principal) registration depends upon the place where business license was issued. If the trader has got business license from any one of the regional offices, it will be registered there. Import export activity, hospital business, colleges and similar activities are fields in respect of which the Ministry of trade issues business license in spite of the fact that their place of establishment is any where in the country. Every trader or commercial business organization that either was registered in the regional bureau or in the ministry of trade shall be re-registered in the central commercial register. Such a register is also located in the Ministry of trade. Commercial Register managed by the Ministry of trade is almost equivalent to the commercial registers maintained by the regions while central commercial register is a register in which a trader or business organization will be registered for the second time by the document sent to the Ministry for second registration. Here a logical question may be raised that what would happen if a business organization or a trader operates business in different regions? In such a situation, the trader or business organization operating business in more than one region will be principally registered in the first region or in the region in which the head office is

situated. In the second and other regions, it will be registered summarily by referring to the first register.

Failure to register in the commercial register entails fine or imprisonment. If a trader or a business organization attempt to operate business without being registered in the concerned government organ may be forced to pay a fine of birr 30 to 60,000 and with rigorous imprisonment from 3 to 5 years. (Art. 60(3) of the new (Amended) commercial registration and business licensing proclamation # 686/2010. The over all purpose of registration of traders and business organizations is for statistical data and taxation.

The obligation to have business license

Every trader and commercial business organization (except joint venture) before commencing the commercial activity should acquire business license. Of course, this is the logical consequence of registration that after being registered, the next step is getting a license i.e. a kind of permission to run the business is going to be issued. Traders and business organizations can exercise their constitutional rights to trade within the frame work and direction of law enacted to safeguard public interest. The process of acquiring a business license was regulated by the former (repealed) laws; i.e. procl. # 67/1997 and council of ministers reg. # 13/1997. And now, is regulated by the new (Amended) commercial registration and business licensing proclamation # 686/2010 art. 30 and the following.

Sale and mortgage of Business

Sale of a business

If the owner of a business wants to sell the business, the contract of sale must be made in writing and the buyer must express his/her full consent to buy it by paying the agreed purchase price. Unless the contract of sale of a business is made in writing, the contract will not be valid and as it is a contract, both the seller and the buyer assume some obligations toward one another. The rights of the seller are the obligations of the buyer and the opposite is also true. Let us now look at the respective obligations of both parties as follows.

Obligations of the seller

A. handing over the business with its constituent parts, unless there is an agreement to the contrary,

B. enabling the buyer to take over the goodwill by handling to him/her all the necessary documents and information,
C. keeping book of account for two years available to the buyer from the time when the business has been transferred to the buyer,
D. handing over commercial correspondence relating to the business to the buyer,
E. Refraining from doing any act of competition likely to injure the buyer for five consecutive years from the sale of the business to the buyer. In particular, the seller may not carry on in the vicinity of the business he sold, a trade similar to the trade carried on by the buyer. To exemplify this, "A" sold her bakery shop to "B" and later on, "A" opened a new bakery shop just adjacent to the bakery shop she sold to "B", in such a situation, the court may order "A" to close down the shop that she opened since it is against the rules of fair competition and the laws of sale of a business. (Look at Article 158(1) of the Ethiopian Commercial Code of 1960)

Obligation of the buyer

A. the obligation to pay the agreed price,
B. ensuring the fact that a notice of sale is published so that the creditor/s of the seller may be aware of the fact that the business is sold,
C. furnishing a legal mortgage as a security to the seller until payment is fully made,
D. Refraining from disposing of proceeds of sale/paying the full price to the seller until the period of time for making applications to set aside expires or any such application has been made, until the rights of the creditors have been settled by agreement or by the court and such creditors have been paid. To put it simply, "A" sold her business to "B". Nevertheless, the business is held by "C" as a security of debt owed by "A" to "C". There fore, "B" must not pay the agreed price to "A" until "C" s claim is settled either by agreement or by the decision of the court. This is because of the fact that if "A" has nothing to pay to "C", in stead of "A", "C" will be entitled to receive the payment that will be made by "B". (Look at Article 162(1) of the Ethiopian Commercial Code of 1960)

Mortgage of a business

Mortgage is a contract where by a debtor or a third party furnishes an immovable as a security for the performance of the obligation of the debtor and if the debtor fails to discharge his

contractual obligation, the immovable property held as a security will be sold by a court order to settle the debt. Exceptionally, some movables like business can be mortgage. The source of mortgage of business flows from the law or a contract and whether the mortgage emanates from law or a contract, it must be registered in the concerned government organ. (Look at Articles 171 and 172 of the Ethiopian Commercial Code of 1960)

Legal and contractual mortgage of business

Legal mortgage of business

The seller of a business, until the full price is paid by the buyer, has a mortgage right over the business sold in the same way as the seller of an immovable has a legal mortgage on the sold immovable until the total purchase price is paid to him/her by the buyer. The other situation for legal mortgage arises from a creditor who has a claim on a bankrupt trader. The creditor has a priority right against the other unsecured creditors over the assets of the bankrupt trader.

Contractual mortgage of business

Any person, whether legal or natural, capable under the law and owns a business may enter in to contract with another to mortgage its business. The following essential points are with regard to contractual mortgages and must be kept in mind.

3. business mortgage shall be made in writing and registered in the concerned government authority during the month within which the mortgage deed is drawn up,
4. The mortgagee (creditor) has the right to be paid in priority from the proceed of the sale of the mortgaged property. As between the secured creditors, the rights shall rank in accordance with the date on which such rights have been registered; mortgages registered on the same day shall rank concurrently.
5. The legal mortgage of the seller shall rank prior to contractual mortgagees.
6. Another right of mortgage is the right to pursuit or the right to follow the immovable. A secured creditor may claim from any third party as the mortgage follows the business into what ever hands it may fall.
7. The third party who acquired the business owner may avoid attachment for sale by paying fully to all secured creditors. (Look at Articles 177 and 178 of the Ethiopian Commercial Code of 1960)

4.3. Business organizations

Definition

As usual we will start our discussion by defining the term Business Organization. As per art. 210(1) of the Ethiopian commercial code, a business organization is defined as any association arising out of a partnership agreement. Actually, any association is not a business organization, in order to be a business organization; the association must arise from a partnership agreement. A partnership agreement is defined under art. 211 of the commercial code as ***a contract*** where by ***two or more*** persons who intend to join together and to cooperate undertake to bring together ***contributions*** for the ***purpose of carrying out activities of an economic nature*** and of ***participating in the profits*** and ***losses*** arising out there of, if any.

The basic elements of this definition of a partnership agreement are, therefore;

- It is a contract, so it should fulfill the four essential requirements of a valid contract, i.e. the partners should have the necessary capacity and consent and the agreement should be in a special form, and also the object of the partnership agreement should be sufficiently defined,
- there should be two or more parties that duality of parties is the other essential requirement,
- these parties to a partnership agreement should make a contribution,
- the purpose of the contribution and overall intention of establishing the association should be to carry out activities of an economic nature, i.e. the ultimate purpose of any business association, as the name it self clearly indicates, is to maximize profit. This is the basic element which distinguishes business organizations from other associations. An association may be of two types, i.e. a business organization and a civic association. a business organization's ultimate purpose is, as we have seen above, profit maximization and registered by the ministry of trade and industry or the respective trade and industry bureau of regional states, where as the purpose of civic associations is not profit maximization rather they have various purposes, for instance, professional associations like associations of accountants, lawyers, medical doctors, economists, engineers, chemists, etc…have the objective of maintaining and developing the profession's dignity and protecting the rights and interests of the professionals, and these associations are registered and licensed by the ministry of justice.

- This carrying out of economic activities should be with the view to share in the profits and losses. thus, any provision giving all the profits to one partner or some partners shall be void, however by way of exception, a partner who contributes skill may be entitled to shares in the profit only and not in the loses as per art. 254 of the commercial code.

4.2. Types of business organizations

There are six different kinds of business organizations recognized in the Ethiopian commercial code. These are;

a) Ordinary partnership
b) Joint venture
c) General partnership
d) Limited partnership
e) Share company (S.C) and
f) Private limited company (PLC)

- *General partnership*

This partnership consists of partners who are personally, jointly, severally and fully liable as between themselves and to the partnership for the firms undertaking. when a partnership is created, the parties often draw up a memorandum of association which covers such matters as the business purpose of the firm, the contribution of each partner, the value of each contribution, the services required from persons who contribute their skill, the share of each partner in the profits and in the losses and the period of time for which the partnership has been established. A partner in a commercial partnership is considered as a trader. The general partnership needs to have a firm name consisting of the names of at least two of its partners and followed by the words "General Partnership".

- *Limited partnership*

Limited partnership differs from general partnership in that it comprises two types of partners, i.e. *general partners* who are jointly, severally and fully liable; and *limited partners* who are only liable to the extent of their contribution, this means unlike general partnership, in limited partnership, some members can have limited liability. As a result, the limited partners are not liable for the debts of the partnership beyond the funds they contributed. The limited

partnership needs to have a firm name consisting of the names of the general partners and followed by the words “Limited Partnership”. The limited and the general partners draw up a memorandum of association covering such matters as the business purpose of the firm or the enterprise, the contribution of each partner, the value of each contribution, the services required from persons who contribute their skill, the share of each partner in the profits and in the losses and the period of time for which the partnership has been established and the managers and agents of the firm.

In limited partnership, only the general partners can be appointed as managers. A limited partner takes no part in the management activity. If a limited partner by chance happens to be a manager, he/she will be considered as a general partner and become jointly and severally liable to the debt of the partnership. The limited partners can only consult with other partners, deal with the firm, investigate managerial acts, give advice and counsel to the firm.

- *Share Company*

A share company is a business organization whose capital is fixed in advance and divided in to shares and whose liabilities are met only by the assets of the company. (Art. 304 of the Ethiopian commercial code), so, what we can understand from the above legal definition of a share company is that the liability of the share holders is limited. One holds a share issued by the company in return for payment and is called share holder. In other legal systems, the term share company is not known rather they are known by the term corporation and the legal materials which refer to these companies are entitled as “*Law of Corporations*”. you should not confused the term corporations also with some public enterprises in Ethiopia like the telecommunication corporation as this corporations are owned by the government as public enterprises and their governing law is called charter, i.e. they are chartered corporations. Those who form the company are called founders. They must not be less than five in number, they initiate the plans and facilitate the formation of the company, and they prepare various documents including the constitutional documents of the company, i.e. article and memorandum of association and submit them to the relevant government authorities for the purpose of registration. The memorandum of association consist the name of the company, the objective or the purpose for which the company is formed, the par value of the shares, the amount of the capital subscribed and paid up, the period of time for which the company is to be established, etc…the article of association, on the

other hand, regulates the internal management, the rights and duties of share holders *vis-à-vis* the company, etc…

-*Private Limited Company* (PLC)

In private limited company, the members are liable only to the extent of their contribution (share). It needs to have a firm name followed by the words "Private Limited Company" the membership cant be less than two and cant be more than fifty. As opposed to share companies, the shares issued by PLC are not freely transferable to outsiders or third parties. The capital of a PLC should not be less than 15,000 birr. The amount of each share can't be less than 10 birr. PLC may or may not follow a formal management structure like in the case of Share Company. PLC is easier to establish and may be managed informally and the members may exclude unwanted outsiders not to be share holders.

Review questions

1. What is a business?
2. List down and explain the constituent elements/components of a business.
3. Some people say that competition is encouraged in order to provide quality product and service in the market while others say that competition is not a healthy act of a trader. Discuss.
4. How do you distinguish between a business, trade and commerce?
5. What is a business organization?
6. What is a partnership agreement?
7. What is the difference between a general and limited partnership?
8. Three individuals approached you who want to establish a business organization but are not sure as to what kind of business organization they should establish. They have some 30,000 birr to be allocated as an initial capital. Two of them have other businesses and thus can't act as managers of the organization. What kind of business organization do you think would best suit the purpose of the three individuals in view of the facts given above and why?
9. W/ro Fatuma is a lawyer. She owns a large law library, several word processors, a lease on a good office and furniture. She employs three other lawyers and a non-legal staff of five people. Does W/ro Almaz operate a business? Why or why not?

10. What is the difference and similarity between a PLC and S.C?

Chapter 5

Law of Insurance

5.1. *Definition of insurance*

Regarding the definition of insurance, we two different types of approach of definitions. The term insurance can be defined from the perspective of its function and from the perspective of its being a mere contract. Let us see these two approaches of definitions.

- *Functional approach of definition*: functionally, insurance may be defined as a cooperative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to insure themselves against the risk.
- *Contractual approach of definition*: according to this approach insurance is a contract where by one party, the insurer agrees to pay a specified sum of money on the happening of a particular event to another party called the insured or a third party beneficiary designated by the original insured person, who in turn agrees to pay a sum in the form of a premium for its consideration.

5.2. *Obligations of parties in contract of insurance*

As any other contractual relationship, contract of insurance is also a juridical act from which obligations and rights emanates. Let us see now the respective obligations and rights of the parties to an insurance contract.

5.2.1. Rights and obligations of the insurer

a) The insurer assumes the obligation to pay the insurance benefit to the insured person when the risk covered under the policy[41] occurs/materializes. The insurer is duty bound to pay the agreed sum of money only if the risk[42] specified in the policy occurs. For instance, if the risk which is covered in the policy is fire but the property was destroyed by an earth quake, the insurer may not be liable to pay compensation.

[41]. *A policy is the actual document on which the contractual terms are stipulated.*

[42] . A risk, in the sense of insurance transaction, is the chance or possibility of loss or injury of some one or something.

b) The insurer assumes also the obligation to pay the amount specified in the insurance policy. In other words, the insurer may not be liable to pay money which exceeds the amount specified in the policy, save, however, some exceptional circumstances.

The insurer has the right to refuse payment if the object of the insurance contract is destroyed due to an intentional act of the insured person (beneficiary); in this case, the insurance company will have the right to with hold the premium for itself.

5.2.2. Obligations of the insured (beneficiary)

a. The beneficiary (insured person) has the obligation to pay premium. The amount of the premium will be determined by the agreement of the parties. The assessment of the risk, the extent and the likely hood of the occurrence of the risk and the exposition of the object to a risk will be assessed by the insurer to determine the amount of the premium. The time of payment of the premium will also be determined by the parties. If the insured person failed to pay the agreed amount of premium, the insurer will have the right to suspend the policy that the right of the insured to be indemnified will be temporarily stopped until he/she pays the premium.
b. The insured person has also the obligation to disclose or provide all the necessary and correct material facts or information about the nature and current situation of the subject matter insured and other pertinent circumstances. This may help the insurer to determine the amount of the premium that the insured person is to pay. If the insured person intentionally conceals or hides important information or misinform the insurer about any material fact or information regarding the nature of the subject matter, the insurer will have the right to withhold the premium and cancel the contract.
c. The other obligation of the insured person is the obligation to notify to the insurer that the risk is occurred and he/she has to notify the occurrence of the risk within two years. The insurer should also be notified if there is an increased risk within 15 days from the occurrence of the increasing of the risk. Some times, the risk that the object (subject matter) of the contract may increase from time to time due to various reasons and if this is so, the insurer should be informed so that the insurer may decide either to increase the amount of the premium or to share the coverage of the risk with other insurers in a form of re-insurance relationship or to cancel the contract at all. If the insured person intentionally failed to inform the insurer about the increasing of the risk, the contract will

be terminated as a result of which the premium will be retained by the insurer. Assume that a person bought a life insurance policy from an insurance company by concealing his hypertension. One day, while he was taking a bath failed and died immediately. The cause of his death, the insurance company argued, was the hypertension and no benefit is going to be paid. The deceased's family, on the other hand, insisted that the death was the result of the fall and hypertension was just a subsequent event. How would you dispose this dispute if the medical statement proved that the person's fracture on the head, which came as a result of the fall, may cause his death as well as his hypertension had the same effect?

Let us see another example. "A" bought a property insurance for her car and paid the required premium. In the mean time, she changed the status of the car from personal use to city taxi cab without informing the insurance company from which the insurance policy was bought. If the car is damaged of an accident, the insurance company may refuse payment. The rationale behind such legal provision is that had the insurer known the change of the status of the car from personal use to a city taxi cab, it would have increased the premium since the risk will necessarily increase. In adition to this, the insured person has, as discussed above, a legal obligation to disclose all the material facts/information or any new thing relating to the subject matter insured to the insurer to enable the latter to take a proper course of action and failure to do so entails a legal liability on the insured who concealed the fact.

Elements of an insurance policy

An insurance policy is the document on which the respective rights and obligations of the parties are clearly stipulated and every insurance policy should contain the following elements;

- the place and date of the contract,
- the names and addresses of the parties,
- the item (property), liability or person insured,
- the nature of the risk insured,
- the amount of the guarantee,
- the amount of the premium, and

- The term for which the contract is made.

But have you noticed that the signature of both parties is not required to be included in the policy, and due to this, there are some business lawyers who argue that an insurance policy is different from that of the actual contract of the insurance. Do you hold the same view? *Discuss*!

Classification of insurance

There are various types of insurance, among which, the following are the major ones.

1. Marine insurance: - is the oldest form of insurance which covers the risk or perils involved in the transaction of goods and passengers by sea. a ship transporting goods or passengers may be damaged or destroyed or the whole or part of the cargo can be lost, and consequently, there can be loss of freight; and marine insurance there fore, cover such kind of risks.
2. Fire insurance: - is the other type of insurance which covers loss caused by fire. It is always possible that a fire may spread and destroy big factories, ware houses and shops and all these losses can be covered by fire insurance.
3. Life and accident insurance: - a life insurance is a combination of saving and security element. It provides for a payment of a specified amount of money to persons whose names are stated in the policy or to the insured's heirs if death occurs within the time limit specified in the policy. If the insured is alive and the policy matures for payment, the savings will be helpful in his/her old age. The other life insurance type is accident insurance, which covers risks of bodily harm resulting in injuries.
4. Liability insurance: - is the other type of insurance which covers the risk of liability towards third parties which the insured is required to pay such as damages on property belonging to third persons, non-performance of contractual obligations, injuries or death of third parties due to the fault of the insured person, etc…

In the Ethiopian commercial code, the recognized types of insurances are; - Property insurance

- Liability insurance
- Life insurance, and
- Accident and illness insurance.

Fundamental principles of insurance contract

Insurance contract, though it is a contract and shares some common elements and features with other types of contracts, it has its own unique principles which differentiate it from other contracts. Let us now consider these principles as follows;

I. The first one is *the principle of utmost good faith*. it is an inherent duty of both parties in the contract to make full and fair disclosure of all material facts relating to the subject matter of the proposed insurance. Both parties should not conceal any fact from each other. The insured party should disclose all the necessary information (material facts) truly and fully and the insurer should also inform genuinely the exact and correct amount of the premium that the insured is going to pay.

II. The second one is *the principle of indemnity*. Except life and body injury insurance which may not be always indemnified, the insurer assumes the duty to indemnify the insured party for a loss or damage resulting from specified perils. The main purpose of indemnity is to place (reinstate) the insured after a loss in the same position as she/he occupied immediately before the event.

III. The third one is *the principle of insurable interest*. This means the insured must posses some proprietary or pecuniary interest in the subject matter of the insurance contract. If there is a pecuniary benefit or loss from the existence or destruction of the subject matter, there is an insurable interest.

IV. The fourth one is the principle of *Causa Proxima* (Latin) or proximate cause. The insurer is liable to pay the agreed insurance benefit if the risk or peril occurs with out interruption. The accident must have a cause-effect relationship that the cause of the event has a close relationship with the effect (result).

V. The fifth one is *the principle of commencement of the risk*. The risk commences or begins after the contract of insurance is entered in to and the risk must be attached with the risk, if the property insured is safe (still exist) the risk wont attach and the premium may be recovered.

VI. The other one is *the principle of mitigation of loss*. The policy holder (the insured) is duty bound to take all the necessary steps for at least reducing the loss as much as possible.

VII. The seventh one is *the principle or doctrine of subrogation*. After the insured being indemnified in full by the insurer, the insurer will put it self in the shoe of the insured (the insurer will take the right and the position of the insured) and will become entitled to the

remnant of the property insured and all the rights and claims which the policy holder may have against third parties.

VIII. The last one is *the principle or doctrine of contribution*. In cases of double insurance, all insurers must share the burden of payment in proportion to the amount assured by each.

The concept of Double Insurance and Re-Insurance

When the same risk and the same subject matter are insured with more than one insurer, there is said to be double insurance. If for instance, an owner of a certain house insures the house against fire for 100,000 birr with insurance company X and again insures the house for another 100,000 birr with insurance company Y.

On the other hand, Re-insurance means the transfer of a part of the risk by the insurer. An insurer assuming larger risk from the direct insurance business may arrange with another insurer to offload the excess of the under taken risk over its retention capacity. Suppose that a ship has been insured for 10,000,000 birr, the insurer may feel that the risk is too heavy to borne by it alone, if so, it can transfer a part of the risk to another insurer.

Review questions

1. What are the two approaches of the definition of insurance?
2. What are the respective rights and obligations of the insurer and the insured?
3. What are the major types of insurance?
4. What is a risk and what is a policy?
5. What is a premium?
6. Discuss the basic principles of an insurance contract.
7. What is the difference and the similarity of double insurance and Re-insurance?

Chapter 6

The law of Negotiable Instruments and Banking Transactions

6.1. Law of negotiable instrument

- ### Definition and nature of negotiable instrument

Art. 715 of the Ethiopian commercial code defines negotiable instrument as any document incorporating a right to an entitlement in such manner that it be not possible to enforce or transfer the right separately from the document/instrument.

Therefore, a negotiable instrument is;

- ✓ A document, i.e. it is a contract in writing and there is no such thing as an oral instrument, i.e. oral promise to give some thing or to pay money is out of the scope of negotiable instrument.
- ✓ The document must embody a right to an entitlement that it should contain a promise to give some thing or to pay some amount of money and this promise to pay or to give is an obligation to the person issuing it (the drawer)[43] or putting it in circulation (the endorser)
- ✓ The rights/obligations contained in the document/instrument are negotiable/transferable that the document can be transferred like any other property. if a person takes a negotiable instrument in good faith i.e. believing that the giver is the legitimate owner of the instrument, he/she will be also the true owner of the instrument though he/she took it from a thief or a mere finder, and the rights in the negotiable instrument can't be enforced or transferred with out the document.

- Types of negotiable instruments

There are various types of negotiable instruments. The Ethiopian commercial code recognizes three types of negotiable instruments. These are;

- Commercial instruments
- Transferable securities
- Documents of title to goods.

- *Commercial instruments* includes
  - bill of exchange
  - promissory note
  - cheques
  - travelers cheque
  - ware house goods deposit certificate

- *Transferable securities* includes

[43] . In the transaction of negotiable instruments, *the drawer* is the person who draws up the document by singing on it and give it to the payee, *the payee* is the person who is to be paid, and *the drawee/payer* is the person/institution who has the obligation to pay the amount of money stated in the document to the payee. But this distinction doesn't apply in the case of promissory note as there are only two parties in promissory note transaction, i.e. the promissor (the maker of the promise) and the promissee (the beneficiary of the promise), we will use these terms frequently in our subsequent discussions.

- shares and debentures[44]
- life insurance policies

- *Documents of title to goods,* these documents embodies ownership rights to goods and includes
  - bill of loading
  - air way bill
  - Railway bill and others.

- The obligation of the debtor (the drawer) in negotiable instruments

The obligation of the debtor (the drawer) is to pay the amount of money specified in the document to the holder of the document. The drawer is required to pay the amount of money stated in the document, be it a cheque or a bill of exchange or a promissory note when,

i. The instrument/document is presented to him/her as presentment of the instrument is a very essential requirement, and the holder may not exercise his/her right without presenting the instrument.
ii. When the possessor/holder satisfies him/her (the drawer) that he/she is a true owner of the instrument.
iii. The document is presented to the debtor (the drawer) at maturity, i.e. the debtor (the drawer) is only required to discharge his/her side of the obligation on the day at which the obligation is due.

- Defenses available to the debtor (the drawer)

When a debtor (drawer) is required to debts incorporated in the negotiable instrument, there are some defenses that he/she (the drawer) may raise against the holder of the instrument. Art. 717 of the commercial code mentions all the available defenses which the debtor (the drawer) may raise, these are;

1. Defenses based on personal relations between him/herself and the payee, i.e. the creditor. For instance Mr. X and Mr. Y may conclude a contract of sales and Mr. X; the buyer gave a cheque to the seller Mr. Y for the payment of the commodity that he has bought from Mr. Y. unfortunately, the seller Mr. Y couldn't discharge his side of the obligation that he failed to deliver the commodity he had sold to Mr. X and he went to the bank and require payment, but the bank dishonored the cheque, i.e. refused payment as it has been ordered by the drawer not to effect payment. then, Mr. y, the

[44]. A debenture is a security document which confirms a debt, it just an acknowledgment of debt.

payee of the cheque, recourses to the drawer and used him in a court of law, at this time, the drawer may raise his personal (contractual)relation with Mr. Y as a defense that he stopped payment as Mr. Y failed to perform his obligation and he may be successful in the suit.

2. Defenses of form and those based on the text of the instrument that if the instrument is altered/cancelled or if one or more requirements of the validity of the document are missing, the drawer (the debtor) will have the right to raise this as a defense.
3. Defense based on the falsification of the signature of the drawer. If the signature of the drawer (the debtor) is proved to have been falsified or forged, he/she (the drawer) has the right to raise defense based on such ground and refuse payment.
4. Defense based on lack of representation (authority). When a person sings on a negotiable instrument on behalf of another person without having been authorized to do so, the person on whose behalf the instrument/document is signed can't be held liable and he/she may raise it as defense when required to effect payment.
5. Defense based on lack of capacity. Any person who is incapable (who lacks capacity) can't perform or entered in to any kind of juridical act.[45] Since singing and issuing is one of the juridical acts which have a legal effect, the drawer may raise this as defense by saying that "*I was not legally capable at the time of singing and issuing of this document so I should not be compelled to effect payment*".
6. The last defense available to the debtor not to pay the amount of money stated in the negotiable instrument is defense based on the absence or non-fulfillment of the necessary conditions for bringing legal proceeding. when a holder of an instrument is being refused payment, before instituting a law suit on the drawer,
    - ❖ first, he/she (the holder or the payee) must present the instrument at maturity,
    - ❖ secondly, he/she must get a letter of protest from the refusing party,[46]
    - ❖ Thirdly, he/she has to give a notice to the drawer that he/she has been refused payment by the drawee/payer.

the holder of the instrument must follow these procedures before taking the case to the court, and the drawer may raise these as a defense by saying "*the holder haven't bring the*

[45]. Remember our discussion concerning capacity under the first and second chapter of this hand out.

[46] . In cheque transaction, if banks refused to effect payment for various reasons, they usually give a letter of protest which confirms their refusal to the payee as per art. 717(2) and art. 869(1) and (2) and art. 871(1) and (2) of the Ethiopian commercial code.

instrument at maturity" or "*the holder haven't received letter of protest from the refusing party*" or "*the holder didn't give me a notice*".

- Holder in-due-course (Good faith acquirer)

In negotiable instrument transaction, if the a person acquires the instrument/document in good faith, he/she will be the true owner of the instrument even though he/she took it from a thief or a finder and the debtor/the drawer may not have the right to raise the defenses, which are available to him/her (to the drawer) against the original payee, against such holder-in-due course unless it is proved that the holder knew or should have known the defective title of the original owner/payee of the document.

In order to be a holder-in-due course/good faith acquirer, the individual must have acquired the instrument in good faith that he/she knew nothing or shouldn't have known any thing about the defect or a wrong doing concerning the document. If the holder-in-due course proves him/herself to be a good faith acquirer, as have been said earlier, the debtor can't raise defenses which he/she can raise it against the original holder/payee. But if the individual/holder of the document acquires the document in bad faith, he/she will be an ordinary assignee that he/she wont have a better title than his/her transferor has, this means that the transferee's right is highly depends on the right of the transferor.

- Negotiation or form of transfer of a negotiable instrument

The law has devised rules governing negotiation or form of transfer of a negotiable instrument in order to avoid unnecessary conflict. These forms are

-to bearer instrument

-to a specified name instrument or to order.

a. *To bearer instrument* : since there is no clearly specified name in the document, any one who bears or holds the paper or the document is fully entitled to the right that document gives. Assume that the following is a bearer cheque which is one of negotiable instruments.

Date_____

_____

_____

Pay to: - "*bearer*"

Mr. A (the drawer)
(Signature)

b. *To a specified name instrument or to order*: in this case, the specified name of the payee is clearly stated in the document and it is only that particular individual whose name is clearly specified in the document or any one who have got a title from the original payee can demand payment from the drawer or the drawee/payer. Consider the following sample cheque as an example of such form of transfer.

Date_____

_____

_____

Pay to: - "*Mr. X" or to order*

Mr. A (the drawer)
(Signature)

In the above instrument, Mr. X is the payee and he has two options. The first one is, he may himself enforce or claim the right incorporated in the instrument, or he can transfer the instrument to another person either by way of endorsement.

- The concept and form of endorsement

An endorsement is a signature written on the negotiable instrument usually on the back side of the document. The person who writes or puts his/her signature on the back side of the document is called "*the endorser*" while the person to whom the instrument is endorsed is known as "*the endorsee*".

There are some legal requirements to be fulfilled for a valid endorsement, these are;

- ✓ It should be written on the back side of the instrument and signed by the endorser,
- ✓ It should not be conditional, i.e. it should not be depend on the happening of a certain event; and if there is such kind of pre-condition attached to it, it shall have no effect,
- ✓ It should not be partial that the endorser should transfer all the rights in the instrument.

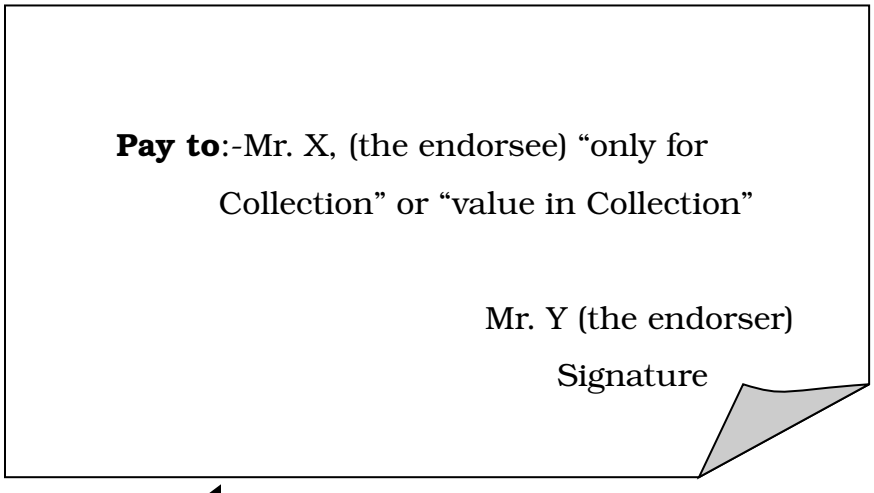
Types of endorsement

There are three types of endorsements. These are

- Special/in-blank endorsement
- Restrictive/non - restrictive endorsement and
- Qualified/unqualified endorsement.

Let us consider them each as follows.

1. if the endorsement clearly specifies the name of the endorsee, it is *a special endorsement* and it is only that particular individual whose name is mentioned have the right to demand payment, on the other hand, if the endorsement bears only the signature of the endorser without specifying the name of the endorsee, it will be *in-blank endorsement*, and usually in-blank endorsements have similar effect with that of bearer instruments.
2. *A restrictive endorsement* specifies a particular use to which the endorsed instrument is to be put, or in some other way limits the way in which the endorsee may deal with the instrument. On the other hand, *a non-restrictive endorsement* doesn't have such restriction or limitation.



This is a restrictive endorsement.

3. If the endorser is not going to guarantee payment to other receivers or subsequent endorsees, then the endorsement method is said to be *a qualified endorsement*. But if the endorser guarantees payment to other subsequent endorsees, it is unqualified endorsement.

Effects of endorsement

An endorsement transfers all the rights arising out of the instrument, provided that the legal requirements are fulfilled, and it entitles the endorsee to all the rights contained in the instrument. The endorsee, on the other hand, can enforce the right him/herself by claiming the money or else, he/she may re-endorse it to another person unless the endorsement is not restricted by situations which we have seen above.

When we consider the effect of in-blank endorsement, the endorsee;

- may simply transfer it to another person without filling up the blank and with out re-endorsing it just like a bearer instrument, OR
- may fill up the blank with his/her own name or the name of another person, OR
- May also re-endorse the instrument in blank by only putting his/her signature to another person.

- Commercial instruments

It is a piece of paper which entitles a person to a specified sum of money and which is transferable from person to another person by mere delivery and by endorsement and delivery.

- They embody a right to an entitlement
- The right contained in commercial instrument is a sum of money whose amount is clearly fixed
- they are transferable

Bill of exchange

Definition: - these are instruments by means of which payment may be effected with out the use of cash, or payment postponed by the granting of credit; Bill of exchange are used for both domestic transactions and in international trade.

There are three parties in the bill of exchange transaction. These are;

- the drawer (the issuer) the person who issues the bill of exchange
- the payee, the person to whose favor the bill is issued
- the payer (the drawee), on whom the order to pay is made

Form of bill of exchange: - a bill of exchange shall contain

- ✓ the term "Bill of exchange" inserted in the body of the document and expressed in the language employed in drawing up the instrument,
- ✓ an unconditional order to pay a sum contain in money,
- ✓ the name of the person who is to pay the bill (the drawee/payer)
- ✓ the time and place of payment (how ever, if the time of payment is not clearly stated in the document, the bill will still remain valid and become a *time bill* [47])
- ✓ the place of payment (again, if the place of payment is not clearly stated in the document, the bill will still remain valid and become a *sight bill* [48])
- ✓ The name of the payee or an indication that it shall be payable to bearer,
- ✓ the date and place of the issuance of the bill,
- ✓ The name and signature of the drawer, i.e. the person who draws up/issues the bill and gave it to the payee.

Bill of exchange

Birr 3,000 Date: - July 3, 2006

Addis Ababa

Pay to Mr. X (the payee) or to his order on July10, 2006/upon presentment at his office or at sight, the sum of birr 3000.00 with interest at the rate of ___percent____ from date, until paid.

To Mr. Y (the drawee/payer)

Miss. Z (the drawer)

Signature

Model bill of exchange

Cheque

[47]. A time bill is a kind of bill which should be payable at any time when the payee demand payment.

[48] . A sight bill is a kind of bill which should be payable at sight or a fixed time after sight, i.e. at the place where presentment of the instrument is made.

A cheque is an unconditional order in writing drawn on a bank singed by the drawer, requiring the banker to pay on demand a sum certain in money to bearer, to a specified name or to order.

- drawer is the person who singed the cheque and authorized the bank to pay the money,
- drawee (the banker) is the entity which is authorized to pay the money to the payee,
- The payee is the party who is to be paid by the order of the drawer.

Form of a cheque

A cheque shall contain

- an unconditional order to pay a sum certain in money
- the name of the drawee/the bank which is to pay
- the place of payment
- the place and time of the issuance of the cheque
- the name of the person who is to be paid (the payee) or an indication that payment is to bearer
- The name and signature of the drawer.

Payment of cheque

The banker (drawee) will honor the cheque, i.e. will accept the cheque for payment if;

- there is sufficient amount of funds in the account of the drawer that the balance standing to the creditor of his customer is sufficient to pay,
- the cheque is drawn in the proper form,
- There is no legal prohibition which prevents payment, i.e. the bank should verify the signature affixed is the actual signature of the drawer, the presenter is the lawful possessor, it should be checked that it is presented within 6 months time and it should be free form any kind of defense.

The bank may, however, have the right to dishonor the cheque, i.e. refuse payment if;

a. the bank receives notice from the drawer to stop payment,
b. the bank has a knowledge of any defect in the title of the person presenting the cheque,
c. The bank knows the death or mental incapacity of the drawer especially before singing the cheque.

The payee should give receipt to the drawee if he/she is paid partially as he/she can’t surrender the cheque to the bank, but if he/she is fully paid, he/she must surrender the cheque to the bank.