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## **Course Introduction**

Dear learners, well come to the course Business law. This is to mean that it is the first time for you to deal with a law course. Thus, it is quite imperative to familiarize you with the very concept of law as a prelude to the subsequent discussion. When you read different legal texts, you may come across with different definitions of the term “law”. You may have different definitions of the term law. Law is a term that is amenable to various definitions. Though different definitions may be given to the term law identifying a widely accepted definition of law at this juncture seems to be essential. In an endeavor to come up with a working definition or at least, a definition which is granted a wider acceptance, recourse shall be made to various writings pertaining to the concept. Although it can be said in simple terms that law is the body of rules to which person are expected to conform”, more other elements should be added to this definition so as to have a full-fledged one. It may be defined as rules of conduct that are imposed by a government authority and backed by sanction. Law serves different purposes.

The emergence of law is traced back to the origin of human society though the emergence of human society proceeds.

Business law is the area of law that governs relations of people in business. It deals with legal aspects of business behavior. In this course the concept of legal personality, contract in general, contract of sale, agency and business organizations will be treated. All the items in this course deal with the rights and obligations of “persons”. The concept person is going to be dealt with in some what depth manner. Therefore, before discussing rights and duties of persons, you must have some basic ideas on the concept. This shall be

followed by “Contract in General”. The foundation of every business activity is contract. The provisions of Contract in General lay a foundation for other areas of business law. Moreover, the provisions of contract in general are applicable to all other branches of Business law. Then you will be dealing with law of Agency, special contracts and law of business organizations.

In due course, you will find that Business Law is one of the most interesting subjects. To have a clear understanding of the subject matter of the course you need to read the whole text very closely.

### **Objectives:**

After completing this Course, you will be able to:

- discuss the concept of law and the role that law plays in business;
- supply yourself with legal knowledge in the area of business;
- specifically understand some basic tenets of contract in general, contractual capacity of persons, elements of contracts (basic requirements for the validity of contracts);
- have a general idea on the rules governing agency;
- understand the legal relationships created in a contract of sale and the respective rights and duties of the parties to the contract of sale; and
- have basic knowledge on the forms of business organizations under the Ethiopian law, formation of business organizations, requirements for the acquisition of legal personality, liabilities of business organizations; and

# UNIT ONE

## LAW OF PERSONALITY

### **Introduction**

Dear distance learners, this is the first unit of the course on business law. In this Unit, you will be going to deal with the concept of personality. More over the unit will be addressing the beginning point of personality. This shall be followed by an explanation on the concept of personality. The concept of personality is a fundamental one in law. One may even consider it as the most fundamental one as it provides for the definition of those beings or things, either natural or artificial, which will be bound by the law. Thus, it is quite imperative to learn on personality in some what depth manner as it lays down a corner stone for all subsequent discussions. This is to mean that in order to study other branches of law the first point to be settled is the ascertainment of parties to be governed by law. It is only parties recognized as person under the law that will be subject of rights and obligations (duties).

### **Objectives:**

After completing this Unit, you will be able to:

- Discuss the concept of legal personality;
- Explain the beginning point of personality;
- draw a distinction between enjoyment of rights and exercise of rights;
- discuss certain attributes of personality; and
- Discuss the difference between rights granted to persons before and after birth; and

## ❖ The Concept and Nature of Personality

### 1.1 Personality

**What do you understand by personality? You can use the spaces left below to give your answers**

---

The concept of personality is a fundamental one under the law. Under any modern legal systems, it is only persons that are the subjects of rights and duties. Only persons enjoy rights. Only persons are bound by law. The concept is, thus, important because it provides for the definition of those beings that can be bound by law.

### 1.2 The Nature of Personality(Legal and Physical)

**What do you understand by the term person?**

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The word “person” has a wider meaning and scope than the word “human being”. A person is anything recognized by law as capable of bearing rights and duties. “Person” is a legal concept that is conferred on people by law. Thus, a person is anything that can have legal relations with each other.

Legal personality is an artificial or fictitious creation of law. All entities recognized by law as capable of being parties to a legal relationship are legal persons. Thus, a legal person can be an association, an organization, a company, group of persons and etc. The state is recognized by law as a person. Provided that they are given personality by law, these entities are persons and can have legal relations with each other.

Legal personality, then, refers to a particular device by which the law creates or recognizes units to which it ascribes certain powers and capacities. Under the law, persons possess certain capacities. These capacities are called attributes of personality.

What are the attributes of legal personality?

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The following are some attributes of legal personality.

- 1) A legal person can own and administering its own property. Property belonging to a legal person is different from that of individuals who own the legal person. Property belonging to members chartering up the company is completely different from property belonging to the legal person (the company). Property belonging to the company is distinct from the property belonging to its owners.

A legal person administers its own property. It is obvious that a legal person acts through human agents. A legal person acquires rights and incurs liabilities through the acts of its human agents (representatives) in accordance with the provisions governing agency.

- 2) A legal person may sue or be used in its own name. To sue is to bring a legal action against another. If three people A, B and C form a company, after a company has satisfied the legal requirements for the acquisition of legal personality (after it has become a legal person), it brings legal actions (legal suits) against others in the name of the company, not in the name of A, B or C. Thus, there is a distinction between the liability of the company and the liability of individual persons forming it.
3. The same can be said about contractual relations that may be entered in to by a legal person. We have already seen that a legal person is an entity that can be a party to a legal relationship; therefore, a legal person can enter into contracts with another company or with a physical person (Human being). The rights acquired and liabilities incurred as the result of the contract, remains the rights or liabilities of the company. It is the company that is either the creditor or the debtor of a third party.
4. A legal person has an obligation to pay taxes on its property and any other income. We have already noted that a legal person may own property in its own name. Similarly we know that a legal person may carry on business. In the same way that a physical person pays tax on his income, a legal person is also required to pay tax on any income it derives.

## ❖ Natural Persons

### 1.3 Beginning of personality

**What is meant by physical personality? When does personality begin for human persons (natural persons)?**

You can use the spaces left below to give your answers.

---

Personality refers to the capacity of holding rights and bearing the corresponding duties. This course dwells on personality as it appertains to physical or natural persons. The knowledge of the exact moment at which this personality begins is of a paramount importance. For personality to exist there has to be a person up on whom it is to be conferred.

For easy understanding of the subject, the relevant civil code provisions are reproduced here in below. Read them very closely.

#### Article 1. Principle

*The human person is the subject of rights from its birth to its death.*

#### Article 2. Child merely conceived.

*A child merely conceived shall be considered born whenever his interest so demands, provided he is born alive and viable.*

#### Article 4. Viable or not viable child.

- (1) A child shall be deemed to be viable where he lives for forty-eight hours after his birth, notwithstanding any provision to the contrary.*
- (2) A child shall be deemed to be not viable where he dies less than forty-eight hours after his birth.*
- (3) The presumption laid down in sub-article (2) may be rebutted by proving that the death of the child is due to a cause other than a deficiency in his constitution.*

The importance of a definition of person in the physical sense of the word lies in the fact that there can be persons in the physical sense of the world who are not considered as holders of rights and duties, in the same way that there may be holders of rights and duties who are not fully person in the physical sense of the word.

Such was the case in the first instance for slaves in Roman law, monks during the middle ages or people sentenced to civil death in modern times. All these were undoubtedly human beings in the full sense of the word; still from the moment they acquired the status of a slave, entered a monastery, or were sentenced to civil death, they no longer existed in the eyes of the law and thus would not be considered as persons in the sense of the Ethiopian Civil Code. They were deprived of their rights and not bound any more by the duties incurring to persons.

**When do you think does personality begin? (You can use the spaces left below to give your answers)**

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Most legal systems lay down the rule that in cases where personality is granted to human beings, it begins at birth. In the Ethiopia legal system, birth is sufficient in itself to confer personality; no conditions are laid down in this respect. This differentiates Ethiopian law from many, if not most, other codified systems. Article 1 of the Ethiopian Civil Code provides that the human person is the subject of rights from its birth to its death. When the article provides that the human person is the “subject of rights”, it means that a human person begins to enjoy, or to hold rights starting from the time of birth. In principle, therefore, the personality of natural persons begins at birth and ends at death. In principle, there is no personality before birth or after death.

Birth means a complete extrusion of the child from its mother’s womb. Whether the extrusion is natural or by an operation like th

e Caesarean, it makes no difference. Under the Ethiopian law, birth is sufficient in itself to confer personality. No other conditions are laid down in this respect. Once a human baby is born, it is a person.

For some purposes, a merely conceived child is considered as a person. This is another legal fiction. A fiction was invented that in all matters affecting its interests, the unborn child in the womb shall be regarded as already born. But this is only for the purpose of enabling the child to take a benefit. Note that there are certain conditions under Article 2 of the Civil Code. These conditions will be seen in a manner stated below.

1) A child merely conceived is considered as though born where its interest so requires provided it is born alive and viable. Thus, the benefit of personality is granted to a child in the womb of its mother on three cumulative conditions: the interest of the child must justify the granting of personality; the child must be born alive and it must be born viable.

**Under what condition does the interest of a baby in the womb be affected? (You can use the spaces left below to give your answers)**

In most cases, the interest of a merely conceived child comes into picture where a father dies before the birth of the child. For easy apprehension of the subject under discussion I have reproduced the relevant provisions from the Ethiopian civil code on law of successions.

#### **Article 842(1) First Relationship**

*The children of the deceased shall be the first to be called to his succession.*

#### **Article 843**

*Where the deceased is not survived by descendants, his father and mother shall be called to his succession.*

In line with the provisions stated herein above, if a person dies leaving behind property, his or her property devolves (passes) to his child or children, if he or she has got any. If the deceased person is not survived by a child or children, his or her property passes to his parents. In a chain of succession under the Ethiopian law, a child or children come first. If no child or children, the parents of the deceased come second in the line of succession.

If the inheritance devolves to the second group in line (parents of the deceased), the interest of the child in the womb is adversely affected. So, in order to protect the interest of the child in the womb, the law created a fictitious personality or gives personality to a baby still in the womb. The interest of the baby requires that he be considered as though born so that he can be able to get his father's property. Thus, in cases of the kind Article 2 of the Civil Code shall apply. When we apply Article 2 of the civil code what we are in effect saying is that the succession of the deceased person shall not open until the baby is born.

2) From the wording of Article 2 you can see that there are two more conditions that must be considered. In addition to the interest of a baby, the baby must be born alive and viable. These two conditions are considered after birth.

a) In order to be considered as a person, the baby must be born alive. Whether the baby was alive or dead at birth must be verified by medical personnel. Not much needs to be said on this condition. This will essentially be a question to be determined by medical evidence. As already mentioned, a test consists in establishing the existence of respiration by checking the entry of air into the lungs; another one refers to independent circulation. Let us only mention that the condition of being born alive is as essential as the previous one; a child, dead in his mother's womb, will never be considered as having had personality. But it is also true that this condition has no importance as such because of the existence of the viability condition. Obviously if the child has to live for forty-eight hours in order to be considered a person, he must necessarily be born alive. If he is born dead, he will certainly not prove viable.

b) The child shall also be born viable.

**What does the term 'viable' envisage? (You can use the spaces left below to give your answers)**

In order to apply Article 2 of the Civil Code the baby born alive must be viable. Viability is capacity to live. Under Article 4(1), a child shall be deemed to be viable if it lives for forty-eight hours after birth. A child who lives for the next forty-eight hours after birth is presumed to be a person from the moment of conception onwards. If, in our example, We gives birth to a healthy baby three months after the death of her husband, and the baby lives for forty-eight hours, the baby is considered as though it was born at the time of H's death. It is considered as if the baby was a "person" when H. died. This presumption is irrefutable (cannot be challenged). There is another presumption. A baby born alive may die in less than forty-eight hours after birth. According to Article 4(2), if the child dies in less than forty-eight hours, it shall not be deemed to be viable. If not viable, Article 2 shall not apply. That means, even though the baby was born alive, it is not a person. Without the acquisition of personality, the baby cannot be considered as the subject of rights.

Under Article 4 of the Civil Code, the Ethiopian legislator has opted for a solution in which some presumptions are constituted enabling one to determine (in some cases without any possible contestation) if a child is or is not viable.

First, a child who lives for 48 hours is presumed to be a person from the moment of his conception onwards. This presumption is irrefutable. The only important point in this case is the exact determination of the hour of birth as, once the time has passed; there is no possible rebuttal of the presumption.

Second, if a child dies before the expiry of the 48 hour limit, there is a presumption that he is not viable and the first presumption, that he was a person from the 300<sup>th</sup> day before his birth onwards, cannot operate. But contrary to the first case, the second presumption is not irrefutable and can be challenged in court. Again medical evidence will be essential as the party challenging this presumption will have to prove that death is not the result of a deficiency in the child's constitution. These last six words are fundamental for the application this section of Article 4. They cannot be interpreted at the moment as it will be for the courts, on the basis of medical evidence, to decide progressively what are or are not deficiencies in a child's constitution. Still there are obvious cases where the death does not result from a constitutional deficiency, e.g., if the child is dropped by someone and dies of a fracture of the skull, if he is killed in an automobile accident, etc. If it is proved that death came as a result of something other than a deficiency, then the child can be considered as having been viable.

**But does it make any difference if the death of the baby is not natural? (You can use the spaces left below to give your answers)**

The presumption that a child is not viable if it dies in less than forty-eight hours after birth is rebuttable and can be challenged in the court of law. If medical evidence is produced to show that the death is not the result of a deficiency in the child's constitution, the child may be presumed viable even though it died in less than forty-eight hours.

**Is the enjoyment and exercise of rights the same? (You can use the spaces left below to give your answers)** Enjoyment and exercise of rights are not the same. To enjoy rights means to have or to hold rights. A physical person enjoys rights, holds rights or is the subject of rights starting from the time of birth. The principle governing the holding of rights and duties is that as soon as personality begins, all rights and duties under the civil law are held by an individual even though the person may not exercise such rights personally. All persons enjoy rights without exception, but all persons do not have the same capacity to exercise

rights. Some persons have a limited or a restricted capacity. Some persons are incapable of exercising rights.

#### **1.4 End of physical personality**

Death is the only way through which personality can be completely brought to an end (apart from the case where death is established by the court as a result of procedure in order to have absence declared (Art. 172 c. c) In the same way that the beginning of legal personality of physical persons coincides with the beginning of physical personality (birth), the end of physical personality (death) names end of personality before the law.

#### **Summary**

The concept of personality is a fundamental concept under the law. Under any legal system, it is only persons that are the subjects of rights and duties. Only persons enjoy rights. The concept “person” is wider than the concept “human being.” The word “person” refers to both human beings and other entities recognized by law as persons. “Person” is a legal concept. Personality is conferred on people by law. The law may accord personality to anything: a corporation, an association organization, etc. Provided that they are given personality by law, these entities are persons and can have legal relations with each other. They acquire all the attributes of personality.

In most legal systems, the enjoyment of rights begins at birth. The same is true under the Ethiopian law. The human person is the subject of rights from its birth to its death. Even though, in principle, a human person is the subject of rights from its birth, a baby not yet born may be considered as a subject of rights for the purpose of protecting its interest.

Enjoyment of rights is different from the exercises of rights. All physical persons enjoy rights without exception. But all physical persons do not have the same capacity of exercising rights.

#### **Self-to do Exercises**

Read the following questions very carefully and answer them in the spaces provided.

1. When does physical personality begin under the Ethiopian law? How about legal personality?

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2. Explain the situation where a merely conceived baby is accorded personality by the law.

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3. Birth alone is sufficient for physical persons to acquire personality. Can it be argued that once an organization is established, it becomes a legal person by virtue of its establishment?

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# UNIT TWO

## CONTRACTS IN GENERAL

### Introduction

Dear learners, this unit deals with sources of obligations, the definition of contract and the basic requirements for the existence of a valid contract before the law. Obligations may be imposed by law or they may be created by agreement of parties. This Unit concentrates on contractual obligations. In this unit a brief highlight will be made on the sources of obligations. Definition of the term contract will follow. The requirements for the existence of a valid contract, effects of a validly formed contract, non-performance of a contract and issues affiliated with it will be treated in this unit.

### Objectives:

After completing this Unit, you will be able to:

- discuss the difference between legal and contractual obligations;
- identify the two sources of obligations;
- define the term "contract";
- discuss the four basic requirements for the existence of a valid contract;
- discuss the effects of a validly formed contracts; and
- explain the remedies available following non-performance of contractual agreements.

### ❖ Sources of Obligations

#### 2.1 Sources of Obligation

##### What are the different sources of obligations?

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There are two sources of obligations. Obligations may arise either from the law or a contract.

##### a) Law as a source of obligations

Some obligations result from the direct operation of the law. This is to mean that the law it self sometimes imposes obligations on persons. Legal obligations are binding or enforceable

on all persons. Legal obligations do not depend on the willingness of persons. Whether you like it or not, you must respect legal obligations.

The following instances explain obligations which make law their source.

- All persons are bound by legal obligations, for example, every person who earns income (both physical and juridical person) is required to pay taxes. Thus, the obligation to pay tax is binding on all persons.
- Obligation to give military services or obligation to defend one's country against an external enemy is another example of a legal obligation.
- Obligation of maintenance also has the same effect. The obligation to maintain your parents in their old age does not depend on your willingness. It is the law that imposes such obligations. In this regard, Article 198 of the Revised Family Code is pertinent. You are advised to go through this provision.

#### **b) Contract as a Source of Obligations**

##### **? How can an obligation emanate from a contract?**

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Obligations can also be created by the agreement of the contracting parties. Contractual obligations are different from legal obligations (obligations imposed by law). Contractual obligation is something undertaken willingly. One may enter into a contract only if he/she is willing. When a contractual agreement is made, a binding obligation is created.

##### **? What is the difference between legal obligations and contractual obligations?**

**(You can use the spaces left below to give your answers)**

---

Since contractual obligations are created by agreement; they are binding on the parties who agreed to be bound by. Contractual obligations are not binding on third parties or on non-contracting parties. Two persons, by their agreement, cannot impose an obligation on a third party.

## ❖ Definition of a Contract

### 2.2 Definition of a Contract

#### ? What is a contract?

---

Contract is one of the important legal devices ever developed in the quest for economic security and stable society. All persons make contracts in their daily lives. When you go to shop and buy a stationary material, when you take a taxi and served thereby, when you go to a restaurant and get service, when you visit your doctor in a clinic, when you rent a dwelling house, etc, you are making contracts. Although the government has a power to command obedience, much of its work is accomplished by means of contract entered into voluntarily. Thus, contract is a binding agreement; an agreement enforceable by law. It is a promise or set of promises for the breach (violation) of which the law gives a remedy. You can also say that a contract is an agreement the performance of which is recognized by law. In other words, contract is an agreement intended to produce binding obligations. An agreement which does not create vary, or extinguish obligation cannot be considered as a contract.

**? How is the term contract defined under our law? (You can use the spaces left below to give your answers)**

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The pertinent provision of the Ethiopian civil code which defines the term ‘contract’ is Article 1675. For convenience purpose, this Article is reproduced herein below.

*A contract is an agreement whereby two or more persons as between themselves create, vary or extinguish obligations of a proprietary nature.*

This is a standard definition of a contract under the Ethiopian law. It applies to all types of contracts.

The first element in the definition is that a contract is an agreement. It is something willingly undertaken. Contract is not something imposed on you. No body forces you to make a contract. You make a contract only if you are willing to do so. Accordingly, a contract is the result of free will. Parties to a contract are always persons. They may be juridical or physical persons. Two natural persons, two legal persons, one physical person and one legal person may be parties to a contract.

All contractual agreements create obligations. If no obligation is created in an agreement, that agreement is not a contractual agreement.

The freedom of the parties is not limited to the creation of obligations. After creating obligations, contracting parties may want to vary some terms of their obligations. They are free to do so. Obligations created by two contracting parties may be varied only by those two parties. Contracting parties create and vary obligations freely. If they want to do so, they can extinguish obligations; they can bring the obligations to an end totally by their agreement. Parties to a contract create obligations only as between themselves, without affecting the interest of a third party.

## ❖ Basic Requirements for the Existence of a Valid Contract

### a) Formation of Contracts

#### ? What are the requirements for the existence of a valid contract before the law?

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Read the following provision of the Ethiopian civil code which is reproduced herein below.

Article 1678C.C. - Elements of contract

*No valid contract shall exist unless:*

- (a) *the parties are capable of contracting and give their consent sustainable at law;*
- (b) *the object of contract is sufficiently defined, and is possible and lawful;*
- (c) *the contract is made in the form prescribed by law, if any.*

In line with the above provision of the civil code, no valid contract shall exist unless four essential conditions are satisfied. If these elements are not met the contract becomes invalid.

These basic or essential elements of contract are:

- 1) Consent
- 2) Capacity
- 3) Object; and
- 4) Form

Let us see these essential requirements one by one.

### 1. Consent

Consent is one of the essential conditions for the existence of a valid contract.

Article 1679 C.C. Consent necessary

*A contract shall depend on the consent of the parties who define the object of their undertakings and agree to be bound thereby.*

Consent is an agreement that is free from any defect. The freedom of contract is expressed in consent. There are two aspects to consent. First, there must be an agreement on each detail (identify, price, mode and dated of delivery and payment, etc) .secondly consent is the willingness of the parties to be bound by the agreement.

**? How is consent expressed? (You can use the spaces left below to give your answers)**

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There are two theories: **the theory of intention and the theory of declaration**. Reading the mind or the intention of another (what is in the mind of another person) is difficult. Consequently, the Ethiopian law has adopted the theory of declaration. Therefore, the consent of the parties must be declared: the contract is completed when the parties have expressed their agreement (declared their intention).

**Consent is expressed (declared) through offer and acceptance. ? What is an offer?**  
**(You can use the spaces left below to give your answers)**

---

Expresses the willingness of the offeror (one who takes initiative to declare his intention to the other) to enter into contractual agreement regarding a particular thing (subject). It is a promise which is conditional upon an act (to give something or to do something), a forbearance (to refrain from doing something) or return a promise that is given in exchange for the promise or its performance.

**? How can an offer are declared?**

---

Offer may be declared in writing, orally or by using sings (physical movement) or conduct. Social invitations or invitations to social affairs are not “offers” in the eyes of the law. The acceptance of social invitation, such as an invitation to go to dinner, does not give rise to legally binding contract. Likewise an extravagant offer of a reward made in the heat of excitement can not be acted upon as an offer.

There are also some instances that appear to be “offers” but not offer in the legal sense. Ordinarily, a seller sending out circulars or catalogues listing prices is not regarded as making an offer to sell at those prices, but merely indicating willingness to consider an offer made by any person on those terms. This principle is also applied to merchandise that is displayed with price tags in store windows and to most advertisements.

However, it must be noted that there are also implied terms. Although an offer must be definite and certain, not all of its terms need to be express. Some of the omitted terms may be implied by law.

### **? To whom shall the offer be made?**

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The offer must be communicated to the offeree. Until the offer is made known to the offeree, the offeree does not know that there is something that can be accepted. To be effectively communicated the offer must be made verbally or indicated by the actions of the offeror or authorized agent. If the offeree learns of the offeror’s intentions from some other source, no offer results because no offer has been communicated.

Read the following civil code provision.

#### Article 1680

*(1) A contract shall be completed where the parties have expressed their agreement.*

In short, this means that the consent of the parties must be expressed. But how is consent expressed? What are the expressions of consent? There are two theories: the theory of intention and the theory of declaration. Can you read what is in the mind of the other party? Do you know the intention of the other until it is expressed? Reading the mind or intention of another is difficult. Consequently, the Ethiopian law has adopted the theory of declaration. Therefore, the consent of the parties must be declared (expressed). The contract is completed when the parties have expressed their agreement (when the intention is declared).

The two expressions of consent are offer and acceptance. Agreements are usually arrived at by means of an offer and acceptance. An offer is a definite statement by one party called the offeror, of the terms under which he will contract. You can also define an offer as a proposal made by one party (the offeror) indicating his willingness to enter into contractual agreement

regarding a particular thing. An offer typically consists of a promise or commitment by the offeror to give something, to do something or not to do something (to refrain from doing something) in the future.

On the other hand, an acceptance is unqualified agreement of the other party, called the offeree, to the proposal stated by the offeror.

There was no intention to create a binding obligation. Neither intended to enter into a legal agreement to sell or buy a car. Similar situations arise when an "offer" is made to enter into a social agreement, or when a proposal is made as a joke, and both parties know that it is a joke.

In addition to intention to create a binding obligation, an offer must be definite and certain to be enforceable.

If a vague or indefinite offer is accepted, courts will not enforce the apparent agreement against either party. The terms of the offer must be sufficiently defined and certain to allow a court to determine what was intended by the parties, and to state the resulting legal rights and duties.

Very often, an invitation to negotiate is confused with an offer. Similarly, social invitations or invitations to social affairs are not "offers" in the eyes of the law. The acceptance of a social invitation, such as an invitation to go to a dinner does not create a legally binding obligation.

There are also some instances (cases) that appear to be offers but not offer in the legal sense. There are cases called declaration of intention. In this regard, Article 1687 of the Civil Code provides the following:

Article 1687

*No person shall be deemed to make an offer where:*

- (a) he declares his intention to give, to do or not to do something but does not make his intention known to the beneficiary of the declaration, or*
- (b) he sends to another or posts up in a public place tariffs, price lists or catalogues or displays goods for sale to the public.*

Ordinarily, a seller who sends out catalogues of his products listing prices is not making an offer to sell at those prices. But he is merely indicating willingness to consider an offer made by any person on those terms.

Read the following provision of the civil code very carefully.

Article 1688

*(1) Whosoever offers a thing for sale by auction shall be deemed to make a declaration of intention and not an offer.*

*(a) In such a case, the contract shall be completed only when the thing is knocked down upon the last bid being made.*

There are two types of auction sales: those "with reserve" and those "without reserve". In the auction with reserve, the auctioneer is merely inviting bids or offers. Once the bidders make offers, the auctioneer like any other offeree, may accept or reject the offer (a bid). If the auction is without reserve, the auctioneer must sell the item to the highest bidder.

So far, the discussion was on the rules relating to offer. Do we have similar rules governing acceptance? When the offeror expresses a willingness to enter into a contractual agreement, the offeree has two choices: he may accept or reject the offer extended to him. Acceptance of an offer is a manifestation of one's agreement to the terms of the offer in a manner invited or required. Acceptance is measured by outward manifestation. Reservations or restrictions intended by one party shall not affect his agreement as expressed. The offeree must manifest his acceptance (his agreement to the proposal) in a manner that is clear. In other words, acceptance must be definite and certain. The offeror is entitled to know whether the offeree accepts the offer.

Acceptance must be absolute and unconditional. One must accept just what is offered. Acceptance must agree to the terms of the offer; it must conform to the manner prescribed by the offeror. If the offeree changes terms of the offer, or adds new conditions or qualification, there is no acceptance because the offeree does not agree to what was offered. The addition of any qualification converts the "acceptance" into a counteroffer. In effect, a counteroffer is a rejection of the offer.

**? How do you express your acceptance? (You can use the spaces left below to give your answers)**

---

In the absence of a contrary requirement, an acceptance may be indicated by an informal Ok; by a mere affirmative nod of a head, or by performing the act called for. Acceptance of an offer can also be shown by conduct. But it must be clear that the offeree intended to accept the offer.

An offer may be accepted only by the person to whom it is directed. If anyone else attempts to accept it, no contract with such a person arises. If the offer is not directed to a specified individual, but to a class of persons, any person within that class can accept it. If the offer is made to the public at large, any member of the public may accept it.

Acceptance must conform to any condition expressed in the offer concerning the manner of acceptance. When the offeror specifies that there must be a written acceptance, it must be accepted in writing. In this case, an oral acceptance may not lead to the formation of a contract

#### Article 1682 - Principle

*Silence where an offer is made shall not amount to acceptance.*

#### Article 1683 - Duty to accept.

*(1) No acceptance shall be required where a party is bound by law or by a concession granted by the authorities to enter into a contract on terms stipulated in advance.*

*(2) In such a case, the contract shall be completed upon receipt of the offer.*

#### Article 1684 – Pre-existing business relation

*(1) An offer to continue or vary an existing contract or to enter into a subsidiary or complementary contract may be accepted by silence.*

*(2) Such shall be the case where the offer is made in a special document informing the other party that the offer shall be regarded as accepted if no reply is given within a reasonable period of time.*

Article 1682 is a principle governing silence. In principle, silence of the offeree does not mean acceptance. The next two articles deal with two exceptional cases where silence may mean acceptance.

The best example of Article 1683 is the case of public enterprises dealing with public utilities such as electric light, water supply, telephone services, etc. These enterprises make contracts on terms stipulated in advance. If a member of a public agrees to enter into a contract on the terms stipulated by the enterprise, the enterprise does not have any reason to reject the offer. Thus, it has a duty to accept an offer made by any person provided he has agreed to the terms stipulated. Once the offer is received by the enterprise, there is a complete contract even if the enterprise does not respond.

**? When does the exceptional case under Article 1684 come in to application? (You can use the spaces left below to give your answers)**

---

Article 1684 deals with the cases where the offeror and the offeree have preexisting business relation. There are two conditions to be met so as to apply the aforementioned provision. These are:

1. The offer to extend the contract must have been made in a special document (a document prepared for the purpose of making an offer); and
2. The offeror must specify the time within which he expects the response of the other. If the offeree does not respond within a reasonable period of time, the offer shall be deemed to have been accepted.

**? When does an offer terminate?**

---

An offer communicated to the offeree does not remain in force (open) indefinitely. It may lapse or it may be revoked. Thus offer may come to an end by:

- |                                                                 |                    |
|-----------------------------------------------------------------|--------------------|
| a) Revocation                                                   | b) counter – offer |
| c) Rejection                                                    | d) lapse of time   |
| e) Death, disability or declaration of absence of either party. |                    |

## **1. Revocation**

**? How and when can an offer be terminated? (You can use the spaces left below to give your answers)**

---

Ordinarily, an offer may be revoked (withdrawn) at any time before it is accepted even though the offeror had expressly promised that the offer shall remain in force for a stated period of time and that period has not yet expired, and even though the offeror had expressly promised to the offeree that the offer would not be revoked before a specified time.

Thus, the bidder at an auction sale may withdraw or revoke a bid (offer) before it is accepted. But there is a very important question that should be answered: when does revocation become effective? Is it when the letter of revocation is dispatched (mailed), or is it when the letter is accepted by the offeree? There are two theories: the theory of dispatch and the theory of reception.

According to the theory of reception, a letter or telegraph revoking an offer to a particular offeree is not effective until it is received by the offeree. It is a revocation neither at the time it is written by the offeror nor even when it is mailed or dispatched. On the other hand, the dispatch theory states that revocation is effective at the time the letter is mailed or dispatched. It makes no difference. The second theory (dispatch theory) is supported by Art. 1692 (1) of the Ethiopian civil code.

## **2) Lapse of time**

Offers may be made with or without time limits. Whosoever offers to another to enter into a contract and fixes a time limit for acceptance shall be bound by his offer until the time limit expires. The offer remains active until the time limit expires. On the other hand, if the offer does not specify a time limit acceptance, it will lapse after a reasonable period of time. What constitutes a reasonable period depends on the circumstances of each case: the nature of the subject matter, the nature of the market in which it is sold and other factors of supply and demand.

### **3) Counter offer**

According to Art. 1694 of the Civil Code, the offer shall be deemed to be rejected and a new offer shall be deemed to have been made where the acceptance is made with a reservation or does not exactly conform to the terms of the offer. Thus, any departure from or addition to the original offer is counter offer and brings an end to the original offer.

### **4) Rejection**

If the offeree rejects the offer and communicates his rejection to the offeror the offer comes to an end even though the period for which the offeror agreed to keep the offer open has not expired.

### **5) Death, disability or declaration of absence of either party**

If either the offeror or the offeree dies or become incapable (insane) before the offer is accepted, it is automatically terminated. Declaration of absence of either party also produces the same effect.

### **Defects in consent (vices of consent)**

It has already been noted that in order to create a binding obligation, the consent of the contracting party must be free from defect. But how does consent become defective and give rise to the invalidation of a contract? A contract may be invalidated on the ground of consent given by mistake, or where fraud or duress is exercised by a contracting party on the other, or as the case may be by a non-contracting party (third party). Thus, the major defects in consent are take, fraud and duress.

#### **Mistake**

According to Article 1696 of the civil code a contract may be invalidated where a party gave his consent by mistake.

**? What do you understand by the term mistake? (You can use the spaces left below to give your answers)**

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In contract law, mistake is defined as an erroneous belief in a thing or in a fact. In order to invalidate a contract, the mistake must be decisive.

**? When is mistake considered to be decisive? (You can use the spaces left below to give your answers)**

---

It is decisive where a mistaken party wouldn't have entered into the contract had he known the truth. This criterion of the knowledge of the mistaken party is subjective. On the other hand, there is an objective standard (criterion): the mistake must be fundamental. It must relate to some fundamental elements of the contract.

**What are these elements fundamental to the contract? (You can use the spaces left below to give your answers)**

---

In order to invalidate a contract on the ground of mistake, it must be a fundamental mistake. If the mistake is non-fundamental, a contract cannot be invalidated. A mistake is fundamental:

1. If it relates to the nature of a contract. There are different contracts each with its own nature. One contract may be different from the other in several ways. For instance, contract of sale is completely different from the contract of donation. Even though the ownership of the thing passes from one person to another in both contracts, in sale contract, there is always give and take. But donation is one-sided contract. Only one party benefits by the contract. Therefore, if a man intends to sell something but by mistake signs a contract prepared for donation, this is a fundamental mistake. And the mistaken party can invalidate the contract.
2. A mistake is fundamental if it relates to the object of contract. The concept "object of contract" in this context means the obligations that parties assume towards each other.
3. Mistake relating to identity or qualification of a contracting party. This is another fundamental mistake. But why is the identity of your contracting party important. It is important because you don't make a contract with any person in the street. You select your contracting party. When you select, you use different criteria: financial position of the person, his personal integrity, his credit worthiness, etc.

**? When is a mistake considered to be non-fundamental? (You can use the spaces left below to give your answers)**

---

Article 1701. Non-fundamental mistakes.

- (1) A contract may not be invalidated on the ground of mistake where such mistake only relates to the motives which led to the making of the contract.*
- (2) Arithmetical mistakes in a contract shall not affect its validity and shall be corrected*

Under the Ethiopian Civil Code, mistakes relating to the motives of the parties and arithmetical errors are the only mistakes considered as non-fundamental. Arithmetical mistake are errors in computation (calculation), typing errors, etc. Motive is something you have in mind. You may have a purpose for making a given contract. As long as your motive is not communicated to the other party, it does not affect his interest.

### **Fraud (Deceit)**

**? What is fraud? How does it give rise to invalidation of a contract? (You can use the spaces left below to give your answers)**

---

A contract may be invalidated on the ground of fraud where a party resorts to a deceitful practice to induce another to make a contract. It is act or practice made with the intention of misleading another. Fraud creates a wrong impression (belief) in the mind of another. Fraud exists where a person intentionally acts in such a way as to mislead into entering into a contract.

Article 1704. Fraud

- (1) A contract may be invalidated on the ground of fraud where a party resorts to deceitful practices so that the other party would not have entered into the contract, had he not been deceived.*

Accordingly, an act intended to mislead another is fraud and it invalidates a contract. On the other hand, a mere false statement is not fraud.

## Article 1705 - False statements

*(1) A contract may be invalidated where a party in bad faith or by negligence made false statements and a relationship giving rise to a special confidence and commanding particular loyalty existed between the contracting parties.*

**? What is a false statement based on this Article? (You can use the spaces left below to give your answers)**

---

A false statement becomes fraud where the false statement is made in bad faith or by negligence. A relationship of confidence and loyalty must exist between the contracting parties. For instance, if a contract is made between a father and son, and the father intentionally makes a false statement to induce his son into the contract, you can say that the false statement of the father amounts to fraud. This is because there is a relationship of confidence between the two. As between common customers, where there is no such relationship, false statements are not considered as fraud.

Where one contracting party defrauds another contracting party, contract is always invalidated. But when fraud is by a third party against one of the contracting parties, the contract may be invalidated or may not be invalidated. There are two possibilities. Then, how do you distinguish between the two situations? The determining factor is the knowledge of the other contracting party. Look at the following example:

### **Duress**

**? What is duress? (You can use the spaces left below to give your answers)**

---

Duress is the other vice that vitiates consent of the contracting parties. If one person compels another to enter into an agreement by threat of force, or by an act of violence, the agreement is said to be obtained under duress. Duress makes an agreement voidable. When there is duress, a person is denied the exercise of free will in entering into contract. When a person is forced or threatened, he is not free to make his own decision. Even if he agrees under that situation, he does it only to avoid the danger. The threatened or actual violence may be to the life, liberty or property of the victim, the victim's immediate family or near relatives.

## Article 1706 - Duress

- (1) A contract may be invalidated on the ground of duress where the acts of duress led a party to believe that he, one of his ascendants or descendants, or his spouse, were threatened with a serious and imminent danger to the life, person, honor or property.*
- (2) Duress must be such as to impress a reasonable person.*
- (3) The nature of duress shall be determined having regard to the age, sex and position of the parties concerned.*

The act of duress may be directed to contracting party himself, his ascendants (parents or grand parents), his descendants (children, grand children) and his/her spouse. Where the danger is directed against the victim or against any one of those mentioned the effect is the same. The right under threat may be life, person, honor or property.

**? Is the list under Article 1706(1) exhaustive? (You can use the spaces left below to give your answers)**

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The list under the mentioned provision of the civil code is exhaustive. Duress directed against someone else not mentioned under the above article does not give rise to invalidation of a contractual agreement.

To invalidate a contract on the ground of duress, the existence of duress (danger) by itself is not enough. The danger must be relatively serious and imminent to impress a reasonable person.

**? What is an imminent danger? (You can use the spaces left below to give your answers)**

---

An imminent danger is an immediate danger. If you don't have means of avoiding the danger, it is imminent. It is a danger that cannot be avoided (averted) without submitting to the threat. If you have a possibility of avoiding the danger, then it is not imminent.

**? What about the ‘seriousness’ of a danger? (You can use the spaces left below to give your answers)**

---

Seriousness of danger may depend on the capacity of the act to inspire fear in your minds to influence your decision. The fear of a small or unlikely injury is not enough. The fact that one threatens you at a gun point is enough to inspire fear in your mind. Therefore, the danger was a serious danger, at the same time, it was imminent danger.

Sometimes, duress may be exercised by a person other than a contracting party. But whether it is exercised by a contracting party or a third party, the effect is the same.

Article 1707

*(1) A contract may be invalidated on the ground of duress notwithstanding that duress was exercised by a person other than the party who benefited by the contract.*

Article 1708 - Threat to exercise a right.

*A threat to exercise a right shall be no ground for invalidating a contract unless such a threat was used with a view to obtaining an excessive advantage.*

A person is usually not guilty of duress when the act or threat is to do something the person has a legal right to do.

You have a right to threaten the other party with a legal suit if he owes you something. Threat to exercise your right does not constitute duress.

Another related issue is reverential fear (fear of an ascendant or of a superior). Under Article 1709, fear of an ascendant or of a superior can not be a ground for invalidating a contract where no duress was exercised. Reverence is respect that you owe to your ascendants or superiors. It is something normal. However, where the contract is made with a person inspiring the fear and such person derived an excessive advantage from the contract, the contract may be invalidated.

Reverential fear is sometimes called undue influence. When there is a relationship of trust and confidence between the contracting parties, a dominant party may overpower the will of the other. Such a relationship may exist between husband and wife, parent and child, guardian and ward, attorney and client, physician and patient, etc. Undue influence may arise from family relationships, mental weakness, business relationships involving trust and confidence. When a person makes a contract under undue influence, the contract is voidable. Contract is not invalidated on the sole ground that you had a respect to the other party. It is invalidated only if the other party obtained an excessive advantage from the contract.

## **2. Capacity**

The second essential element for the validity of a contract is the capacity of the parties. It is the essence of a contract that there should be at least two parties and the contract involves the meeting of two minds. Contracting parties, therefore, must possess the faculty of giving their consent.

For agreements to be valid contracts and enforceable, the persons who make them must have the capacity to contract. Capacity means the ability to understand ones actions and the effects of those actions. Persons with the capacity to contract are legally competent. Legal capacity depends on the age of a person, mental condition of a person and a criminal sentence (penal sanction) passed on a person. Under the Ethiopian law, a person must be at least eighteen years of age of a sound mind and free from any judicial interdiction.

**? Who are capable persons? (You can use the spaces left below to give your answers)**

---

You have already noted that capacity is ability to understand one's actions and the effects of those actions. Capacity is presumed. Every party to a contract is presumed to have contractual capacity until the contrary is proved. According to Article 198 of the civil code *“Every physical person is capable of performing all the acts of civil life unless he is declared incapable by the law.”*

Though, as a rule, every physical person is incapable, the law, for one reason or another, declares some members or groups of society incapable.

**? What are the groups of persons declared incapable under the law? What are the reasons or grounds for their incapacity? (You can use the spaces left below to give your answers)**

---

Article 193, identifies three grounds or reasons for general incapacity: age, mental condition and sentence passed on a person. Based on that identification, there are three groups of incapable persons under the Ethiopian Law: minors, insane persons and judicially interdicted persons.

**a) Minority**

Article 198 of the Ethiopian civil code defines a minor as a person of either sex who has not attained the full age of eighteen years. Minors are treated differently by the law than adults when it comes to capacity to contract. Minors are given special protection under the law. For their own protection, minors are restricted in their freedom to contract.

**? But why does the law protect minors? (You can use the spaces left below to give your answers)**

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The reasons most often given for the protection extended to minor is the minors' need for protection from the consequence of immaturity. The assumption of the law is that minors are inexperienced in business and in life. If they are left to make contracts, there is a possibility that adults may take advantage of their inexperience. If left by themselves, minor may not make wise and reasonable decisions. As the result of their immaturity, they may make decisions that may negatively affect their own interests. If that is the case, then how does the law protect minors? What are the protections given to minors under the Ethiopian law?

The following provisions are reproduced from the Ethiopian Civil Code.

Article 199

- (1) A minor, as regards the proper care of his person, shall be placed under the authority of a guardian, whom he shall obey.*
- (2) In matters concerning his pecuniary interests and the administration of his property, a minor shall be represented by a tutor.*
- (3) The minor may not perform juridical acts except in the cases provided by law.*

Article 313 - Principle

*Juridical acts performed by the minor in excess of his powers shall be of no effect.*

Article 314 - Application for nullity

*(1) The nullity of such acts may be applied for only by the minor, his representative or his heirs.*

Article 318 - Mere statement of majority

*The mere statement made by a minor that he is a major shall not deprive him of the right of availing himself of his minority.*

These provisions impart a message as to the protections given to minors. For his own protection, a minor is placed under the authority of other persons: the guardian and the tutor. The guardian is responsible for the proper care of the minor's person. The guardian provides a minor with a shelter, that is to say, he/she fixes the place where the minor is to reside; he watches over the health of the minor; educates the minor, supervises his social contacts. These are the responsibilities of the guardian. On the other hand, the tutor is responsible for the pecuniary interests of the minor and the administration of his property, if any. The tutor looks after the financial interest of the minor. If need be, it is the tutor who makes a contract for the minor. He receives payments in the name of a minor, and he makes payment in the name of a minor. This is the first protection accorded to minors.

**b) Insanity and Infirmary**

As a rule, a valid contract requires that the parties to it have a contractual capacity. An insane person lacks such capacity. He or she cannot make a binding contract. That is, if the other party to an agreement is insane when he/she enters into it, you just cannot enforce the contract you cannot go to court and make him perform or collect damages from him.

**? What is damage? (You can use the spaces left below to give your answers)**

---

Damage is the legal term for money you collect to compensate you for your losses as the result of the other party's failure to perform his contractual obligation.

**? Who is an insane person? (You can use the spaces left below to give your answers)**

---

Read the following provision of the Ethiopian civil code before you go any further.

#### Article 339 – Definition

- (1) *An insane person is one who, as a consequence of his being insufficiently develop or as a consequence of a mental disease, or of senility, is not capable to understand the importance of his actions.*
- (2) *Persons who are feeble - minded, drunkards or habitually intoxicated persons, and persons who are prodigals shall in appropriate cases be assimilated to insane persons.*

An insane person is one who, as the result of insufficient development of mind or as the result of mental disease or senility, is not capable to understand the consequences of his actions. Persons who are feeble-minded, drunkards or habitually intoxicated persons and persons who are prodigals are in appropriate cases assimilated to insane person.

To determine the effect of insanity on the juridical acts of persons, the law classifies insanity into Notorious and non-notorious. A person is deemed to be notoriously insane where; by reason of his mental condition he is an inmate of a mental hospital or of a nursing home for the time for which he remains an inmate.

A different standard is applied in rural communes to determine notorious insanity. By definition, a rural commune is a locality with less than 2000 inhabitants. Accordingly, in rural communes the insanity of a person or those with whom he lives, keep over him a watch required by his mental condition and where his liberty of movement is restricted by those around him.

Juridical acts performed by a person at a time and in a place in which his state of insanity was notorious, may be challenged by that person, his representative or by his heirs. The same rule applies to an infirm person where the infirmity renders such a person unfit to take care of himself and to administer his property.

If the contract is invalidated on the ground of notorious insanity and the invalidation affects the interest of a third party in good faith (the good faith of a third party in presumed save proof to the contrary), the insane person is liable for damages.

Non- notorious insanity does not give rise to the invalidation of a contract as of right. In order to avoid a contract, the insane person or his tutor is required to show that at the time of contract he was not in a position to give consent free from defects.

The fact that the juridical act of a notoriously insane person is not binding on him does not mean that he is also free from extra contractual liability. He is liable extra contractually as though he were of sound mind.

### **c) Judicial Interdiction**

**? What is judicial interdiction? (You can use the spaces left below to give your answers)**

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Judicial interdiction is the withdrawal of a person's legal capacity by the order of the court to protect his interest, or the interest of his presumptive heirs. Judicial interdiction may also be pronounced in the case of a person who is unable through permanent disability to govern himself or to administer his estate (Art. 340 and 354 and 351 civil code). A distinction must be drawn between judicial interdiction and legal interdiction. According to Art. 380 of the civil code, a Person interdicted by law is one from whom the law withdraws the administration of his property as a consequence of a criminal sentence passed on a person.

Judicial interdiction may be demanded by the insane person himself, by his/her spouse, by any relative by consanguinity or affinity or by public prosecutor as it is indicated under Art. 353 of the Ethiopian civil code.

There are certain procedures to be followed preceding the pronouncement of the interdiction and after the interdiction is declared. The person whose interdiction is sought must be produced in the court and be seen by the court to establish the factual situation of the person and to convince the court of the necessity of interdiction. If such person is not in a position to appear in a court, the court examines him either by delegating one of its members or by appointing an expert. After the declaration of interdiction, the fact that he has been interdicted must enter in the special register for such persons within the jurisdiction of the court pronouncing the interdiction in all places where the interdicted person resides.

Regarding the protection accorded to the judicially interdicted person, Art. 358 of the civil code states that he is subject in respect of his person and of his property to same rules of protection as a minor.

**? What are the protections accorded to a minor? (You can use the spaces left below to give your answers)**

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On the other hand, the interdiction of an insane person does not have an everlasting effect. If is withdrawn by the court where it appears that the causes of interdiction have ceased to exist and where the interdicted person is in a position to conduct his affairs. It is withdrawn upon the application of any person who can apply for the interdiction except the interdicted person himself.

### **3. Object of a Contract**

**? What do you think is object of a contract? (You can use the spaces left below to give your answers)**

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Read the following civil code provision before you go any further.

Article 1711 - Determination of object.

*The object of contract shall be freely determined by the parties subject to such restrictions and prohibitions as are provided by law.*

Object of contract means obligations undertaken by the contracting parties. Contracting parties are free to create and to determine the nature of their obligations. No body shall determine a contractual obligation to the contracting parties as it is also clear from the reading of the Article defining the term ‘contract’. But their freedom is not absolute. There are restrictions and prohibitions provided by law. Even though parties are free, their freedom is exercised within the limits of law. Contracting parties cannot violate public policy in determining their obligations. They can not create obligations against the moral values of the society.

The object of a contract may be positive or negative. Contracting parties may undertake obligations to give something, to do something or not to do something. The object of a contract is the obligation undertaken by the parties. The object of contract may be positive or negative. The obligation (objects) to give something or to do something is positive obligation whereas an obligation not to do something (to refrain from doing some thing) is a

negative one. An obligation to give is an obligation to procure to the other party a right on a thing.

The obligation to do includes all those obligations the object of which is an act which the debtor binds himself to perform. The obligation not to do includes all those obligations the debtor is to refrain from doing an act which otherwise he would have the right to do.

Contracting parties are free to determine their obligations but their freedom is not an absolute one – it is subject to such restrictions and prohibitions as are provided by law.

A party who undertakes to do something may undertake to procure to the other party a specified advantage or to do his best to procure such advantage. For example, a lawyer does not guarantee his client that he shall win the case. Provided he has done his best under the circumstances, he has discharged his obligations. The same can be said about a physician and a patient. As it has been said, an obligation to give something is the obligation to transfer a right to another person. On the other hand, the obligation to do something may be the obligation to produce a given result or to do to one's best or diligently to produce such a result. For instance, if a medical doctor makes a contract with a patient to do something in which case it should be to treat the patient, his obligation is to treat and to do his best to cure the patient. But the doctor cannot guarantee a cure. If he tries his best to cure the patient, he may not be blamed of breaching a contract where the patient dies. Provided he had done his best, he has discharged his obligation.

- The object of a contract must be defined with sufficient precision.

**? What does this mean? (You can use the spaces left below to give your answers)**

---

A contract shall be of no effect where the obligations of the parties or of one of them can not be ascertained. An obligation that is not defined by the parties cannot be defined by the courts of law. The court may not make a contract for the parties under the guise of interpretation.

- The object of a contract must be possible to be performed. A contract shall be of no effect where the obligations of the parties or of one of them relate to thing or fact

which is impossible and such impossibility is absolute and insuperable. For example, suppose that A entered in to a contract with B. The obligation that A assumed to discharge is to deliver the moon in consideration for a price which is agreed to be one million birr. You can not imagine performance of a contract the obligation which one of the parties assumes to discharge is not possible. Parties to a contract may undertake impossible obligations, something that cannot be carried out. This may be the result of superstitious beliefs. Whatever the reason, if the obligation is absolutely impossible, the contracting parties can invalidate the contract.

- The object of contract must be lawful. Where the obligations of parties or of one of them are unlawful or immoral, the contract ends in invalidation. The relevant provision of the Ethiopian civil code is Art. 1716. The object of contract must be lawful. If the object of the contract is not lawful, the contract shall have no effect. You know that contracting parties are free to determine their obligation. But that does not mean that they may contract entirely as they wish. The formation, purpose and performance of contract must be lawful. Where the obligations of parties or of one of them are unlawful or immoral, the contract ends in invalidation.

#### **4. Form of a Contract**

Contracting parties have a freedom of choosing the form of their contract unless the law specifies a special form for certain contracts. Where a special is expressly prescribed by law such form shall be observed there shall be no contract but a mere draft of a contract. In addition to the stipulation of law as to the form of a contract contracting parties may also stipulate that contract shall be made in the form prescribed in respect of final contract

##### **Article 1719 - Form of contracts**

*(1) Unless otherwise provided, no special form shall be required and a contract shall be valid where the parties agree.*

*(2) Where a special form is expressly prescribed by law, such form shall be observed.*

Sometimes, the contracting parties themselves may agree to make their contract in a special form even if the law does not prescribe a special form.

Most contracts are oral. Many are made by telephone. Others are made and carried out in a single face to face conversation.

**? What are the types of contracts required to be made in a special form? (You can use the spaces left below to give your answers)**

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The following are contracts which are to be made in written form.

- Contracts relating to immovable.
- Contracts made with a public administration; and
- Contracts for a long period of time (contract of guarantee, insurance contracts).

Read the following civil code provisions before you go any further.

Article 1723 - Contracts relating to immovable

*Any contract relating to immovable property must be in writing and registered with the court or with the notary. Land and buildings are examples of immovable property. Therefore, any contract relating to houses (lease, sale, mortgage, etc.) must be in writing and registered.*

Article 1724 - Contracts with a public administration

*Any contract binding the government or public administration shall be in writing and registered with the administration or notary or with the court.*

Where a contract is made in writing, all the parties bound by the contract must put their signature to the document. Moreover, such contract must be attested by at least two witnesses.

Sometimes contracts may be made by persons who cannot write or read - blind or illiterate persons. Instead of written signatures, they are required to affix their finger print or thumb mark to the document. Affixing finger print or thumb mark is not enough; there is another procedure. The thumb mark or finger print of such a person must be authenticated by a judge, notary or registrar acting on his official capacity. To authenticate means to establish that the finger print or thumb mark is genuine. The procedure is meant to avoid the possibility of fraud that may be exercised against the blind or illiterate person.

**? What are preliminary contracts? (You can use the spaces left below to give your answers)**

---

#### Article 1721 - Preliminary contracts

*Preliminary contracts shall be made in the form prescribed in respect of final contracts.*

A preliminary contract is a contract leading to the formation of another contract. Assume that someone appoints you as an agent. Further, assume that he authorized you to sell his house. Note that you have two contracts. The first contract is the one in which the other party appointed you. When you sell the house belonging to that person on his behalf, you are going to make a second contract. Under the Ethiopian law, a contract relating to a house (immovable property) must be in writing. In other words, the contract you are going to make with the buyer of the house must be made in writing. That is, the final contract is in writing. Therefore, the preliminary contract (contract of authorization) must also be made in writing.

Read also the following civil code provision.

#### Article 1722 - Variations

*A contract made in a special form shall be varied in the same form.*

A contract made in writing may be varied only in writing. If the contract is made in writing and if it is registered, variation must also be in writing and registered.

Similarly, under Article 1725, contracts for a long period of time, such as contract of guarantee, contract of insurance, etc. shall be in writing. Here, registration is not required.

Any contract is required to be made in writing shall be supported by a special document signed by all the parties bound by the contract. Moreover, such contract must be attested by at least two witnesses. If the parties or any one of them is a blind person or an illiterate person, a finger print or a thumb mark of such person must be affixed to the document. Furthermore, the finger print or thumb mark of a blind or illiterate person does not have any binding effect on such person unless it is authenticated by a notary, a judge or a registrar.

## Effects of Contracts

**What do you think are the effects of validly formed contracts?(You can use the spaces left below to give your answers)**

---

Contract is nothing but a law for the contracting parties. Pursuant to Article 1731 of the civil code, the provisions of a contract validly formed shall be binding on the parties as though they were law.

The contents of contracts shall be freely determined by the parties subject to the mandatory provisions of the law. Even though the contracting parties are free to determine the contents of their contract, they cannot go against the mandatory provisions of law. Once determined, the obligations created by contracts are binding on the parties as though they were legal obligations.

## Interpretation of Contract

Article 1733 - Limits of interpretation.

*Where the provisions of a contract are clear, the court may not depart from them and determine by way of interpretation the intention of the parties.*

Interpretation is the process whereby uncertainties or ambiguities in the words of a contract are resolved. In principle, a contract may be interpreted only when the provisions of the contract are not clear. Where the provisions of contract are clear, the court may not resort to interpretation. The court may not make a contract for the parties under the guise of interpretation.

The terms of a contract should be clearly stated and all important terms should be included. If they are not clear, the parties may interpret them differently. When such differences cannot be resolved satisfactorily by the parties, and the issue is brought before the court, there are rules or principles to apply.

- In every contract, there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of contract.

A contract is to be enforced according to its terms. The court must examine the contract to determine what the parties intended. The court must give effect to their intention. It is the intention of the parties as expressed in the contract that must prevail. The impression of one contracting party has no effect. A secret intention of a party that is not expressed in the contract has no effect.

- Where the provisions of a contract are not clear, the common intention of the parties must be sought. The general conduct of the parties before and after the contract shall be taken into consideration. This means that it is by studying the history of the contract (negotiations, discussion before the contract) that one can determine the common intention of the parties.
- The contract should be considered as a whole. The provisions of a contract shall be interpreted through one another. Each provision shall be given the meaning required by the whole contract.
- Provisions capable of two meanings shall be given the meaning to render them effective rather than the meaning which would make them void. The court must give a meaning to make the contract valid.
- The word debtor means a person who makes performance. In cases of doubt, a contract shall be interpreted against the party who stipulated the obligation or against the party who drafted the contract. This interpretation is also called strict interpretation. This rule applies in contracts of adhesion, such as insurance policy (insurance contract) where one party stipulates conditions of contract in advance.

### **Performance of Contract**

**Who Shall Perform? How do contracting parties perform their contract? (You can use the spaces left below to give your answers)**

---

Contract creates two relationships between the contracting parties: the relationship of a creditor and a debtor. Creditor is a party who demand performance or who receives performance. On the other hand, debtor is the one who makes performance. It is clear that the debtor performs. But the important question is, should the debtor always perform personally or can a third party perform on behalf of the debtor?

#### Article 1740 - Performance by whom

- (1) *The debtor shall personally carry out his obligations under the contract where this is essential to the creditor or has been expressly agreed.*
- (2) *In all other cases, the obligations under the contract may be carried out by a third party so authorized by the debtor, by the court or by law.*

The debtor must perform in person: where it has been agreed to that effect and where the performance of the debtor is important to the creditor. The second condition depends on the nature of contract. Where the obligation relates to the payment of money or delivery of a thing, it makes no difference whether the creditor receives the money or the thing directly from the debtor or a third party. The creditor is interested in getting the money or the thing. Identity of the person who makes payment or delivery is not important. But where the obligation of the debtor is to do something, his skill or qualification is involved. Therefore, he must perform personally because the creditor may attach importance to the skill or qualification of the debtor.

#### **? Who Shall Receive Performance? (You can use the spaces left below to give your answers)**

---

#### Article 1741 - Payment to whom made

*Payment shall be made to the creditor or a third party authorized by the creditor, by the court or by law to receive it on behalf of the creditor.*

It is a creditor who must receive payment. It can also be made to a third party authorized by the creditor. Third party authorized by the creditor means the agent of the creditor. Under the law of agency, payment to the agent is the same as payment to the principal. A third party authorized by law can also receive payment on behalf of a creditor. If the creditor is a minor, he cannot receive payment. It is his parents who receive payment on behalf of a minor. The parents are legally empowered to represent their minor child or children in all civil matters.

#### Article 1743 - Payment to unqualified person

- (1) *Payment to a person unqualified to receive it on behalf of the creditor shall not be valid unless the creditor confirms it or such payment has benefited him.*

*(2) Payment shall be valid where it is made in good faith to a person who appears without doubt to be the creditor.*

In principle, if you make payment to unauthorized person, your payment is not valid. That means you are not released from your obligation. You may be required to make another payment. But there is an exception to the principle in any one of the following conditions.

- if the creditor confirms it;
- if the debtor proves that the payment has benefited the creditor;
- if the payment is made in good faith to a person who appears to be the creditor.

**? What Things are to be performed? (You can use the spaces left below to give your answers)**

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Go through the following civil code provisions before you go any further.

Article 1745 - Identity of the object

*The creditor shall not be bound to accept a thing other than that due to him notwithstanding that the thing offered to him is of the same or of a greater value than the thing due to him.*

Article 1747 - Fungible things

*(1) Unless otherwise agreed, the debtor may choose the thing to be delivered where fungible things are due.*

*(2) The debtor may however, not offer a thing below average quality.*

Where the debtor had undertaken to deliver a definite (specific, identified) thing, he must deliver the exact thing. Delivery of a different thing does not release him. The fact that the thing offered to him is of the same or greater value does not make difference. The creditor is entitled to get what he had contracted for. The creditor is not bound to accept a different thing. If he willingly accepts a different thing, the law does not interfere.

Where the debtor had undertaken to deliver a fungible thing, the applicable rule is different. Fungible things mean a class of things, which has within that class, different qualities but serve the same purpose. Wheat is the name of a class. There are different varieties, qualities

within this class of wheat. Where the contract mentions only the name of a class the obligation of the debtor (seller) is not the same.

**? Where Performance shall be made? (You can use the spaces left below to give your answers)**

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Article 1755 - Place of payment

- (1) Payment shall be made at the place agreed.*
- (2) Where no place is fixed in the contract, payment shall be made at the place where the debtor had his normal residence at the time when the contract was made.*
- (3) Unless otherwise agreed, payments in respect of a definite thing shall be made at the place where such thing was at the time of the contract.*

If the parties have not stipulated place of payment, it must be made at the place where the debtor resided at the time of contract. In the case where the parties are two different places and the thing is at a third place, payment shall be made at the place where the thing was at the time of contract.

**? When Shall Payment be made? What is the time of payment? (You can use the spaces left below to give your answers)**

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Article 1756 - Time of payment

- (1) Payment shall be made at the time agreed.*
- (2) Where no time is fixed in the contract, payment shall be made forthwith.*
- (3) Payment shall be made whenever a party requires the other party to perform his obligations.*

The first rule is the same as in the case of place of performance. The agreement of the parties prevails and is considered first as to the time of performance. If the parties have not fixed the time of payment in the contract, payment shall be made forthwith, meaning immediately. There is also a third option. Where it is not made immediately, payment may be made upon demand (when the other party requires).

## **Transfer of Risk**

**? When does the risk of loss or damage to the thing pass from the debtor to the creditor? (You can use the spaces left below to give your answers)**

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Article 1758(1) Transfer of risk

*The debtor bound to deliver a thing shall bear the risks of loss or of damage to the thing until delivery is made in accordance with the contract.*

The debtor bound to deliver a thing shall bear the risk of loss or of damage to the thing until delivery is made in accordance with the contract. Risk passes upon delivery. Therefore, the determining factor is the time of delivery. It is only under exceptional cases that risk of loss may pass to the creditor before delivery. So, that is the exceptional cases where the risk passes before delivery.

## **Non-performance of contracts**

**? What is non-performance? (You can use the spaces left below to give your answers)**

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Non-performance may be defined in different ways. Non-performance is breach of contract or violation of agreement. It may also be defined as failure to carry out contractual obligation. Non-performance or breach may be total, partial or improper. As the name indicates, total breach means that there was no performance at all. Partial breach shows a case where part of the obligation was performed and the other part breached. In improper performance, there is an attempt to perform but it is carried out irregularly or improperly. Whether the breach is total, partial or improper, it all amounts to non-performance.

The relevant civil code provision is reproduced for you herein below.

Article 1772

*A party may only invoke non-performance of the contract by the other party after having placed the other party in default by requiring him by notice to carry out his obligations under the contract.*

Where a party does not carry out his obligations, the other party is given certain remedies for such a breach. However, before asserting or exercising his right arising from the non-performance, the creditor must put the debtor in default. In other words, the creditor must give the debtor a notice. Notice is a reminder to the debtor. Its purpose is to remind the debtor that time for performance has become due (has matured). In the majority of cases, notice is a necessity. The creditor cannot go to court and institute a legal action without giving notice. There are only few cases where notice is not necessary.

**? What should the form of this notice look like? (You can use the spaces left below to give your answers)**

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The form of notice may be written or any other means of communication. The only requirement is that it must indicate (denote) the creditors' intention to obtain performance. But notice may not be given before due date for performance.

**? What are the cases where default notice is not necessary? (You can use the spaces left below to give your answers)**

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Read the following civil code provision before you go any further.

Article 1775

*Notice need not be given where:*

- a) the obligation is to refrain from certain acts; or*
- b) where the contract was to be performed only within a given period of time and that time has expired;*
- c) the debtor has declared in writing that he would not perform his obligation;*
- d) it has been agreed in the contract that notice shall not be required.*

In all the above cases, the creditor need not give notice to the debtor. If a party who had undertaken not to do something violates his agreement, the injured party can exercise his right without giving notice. Secondly, where the contract was agreed only to be performed within a given period of time, the creditor can institute action without giving notice upon the expiry of the period. The third case is what you can call anticipatory breach of contract. This is breach of contract before due date. If your contracting party informs you in writing

that he is not going to deliver or pay, you don't have any reason to wait for the due date because you already know his intention. The last case is the result of your agreement. If you agree at the time of contract to avoid notice, your agreement is respected.

**? What are the remedies for non-performance of contractual agreements? (You can use the spaces left below to give your answers)**

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Under Article 1771 where a party does not carry out his obligations under the contract, the other party may:

- a) Require the enforcement of the contract, or
- b) Require the cancellation of the contract,
- c) Cancel the contract unilaterally, and
- d) Require that damages caused to him by non-performance be made good.

**a) Specific Performance (Forced performance)**

The term "specific performance" or forced performance refers to a case where the debtor may be forced by the court to carry out his obligation specifically as agreed. If a debtor fails to perform his obligation, the creditor may request the court to force (to compel) the debtor to perform in accordance with his agreement. The court may force the debtor to deliver, to pay, to do or not to do as agreed. When the request is made by the creditor, the court may force the debtor or may not force him. That is to say, specific performance is not ordered whenever the creditor requests the court. To order specific performance, two conditions must exist. These two conditions are indicated under Article 1776.

**? What are the two conditions that must exist? (You can use the spaces left below to give your answers)**

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The first condition is that the creditor must show (prove) that he has a special interest in the performance of the debtor. If the subject matter of the contract is something unique, such as a rare work of art that cannot be obtained else where, or where the loss suffered cannot be measured in money, the court may order specific performance because the creditor has a special interest. If there is another remedy that is adequate, specific performance is not ordered.

The second condition is that the enforcement must be carried out without affecting the personal liberty of the debtor. Contract of employment may not be the object of specific performance. Forcing a person to work for another is the same as slavery. Rather than forcing a person to work against his free will, the court may order monetary compensation to the injured party. In connection with delivery of goods, specific performance may be considered normal because the interest at stake is property rather than liberty. The court may consider the second condition, only if it is convinced to force the debtor.

### **b) Cancellation of a Contract**

**? What is cancellation of contract? (You can use the spaces left below to give your answers)**

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Cancellation of contract is the result of breach. Cancellation of contract may be with the order of the court or unilateral. Even though a contract may be cancelled as the result of breach or failure, it is not cancelled whenever it is breached. According to Article 1784, a party may move the court to cancel the contract where the other party has not or not fully and adequately performed his obligation within the agreed time. A contract may be cancelled only if a fundamental provision of a contract is breached. For instance, the obligation of a seller is to deliver a thing at a specific place agreed. Instead of delivering at the place agreed, he may make delivery at a different place. If a contract is cancelled, the parties are reinstated in the positions which would have existed had the contract not been made. This is the affect of cancellation. The thing sold is returned to the seller and the money paid is refunded to the buyer. Sometimes, this process is called restitution.

### **c) Damages (Monetary Compensation)**

*Compensation may be awarded to the injured party independently or in addition to other remedies. Compensation may be ordered as an adequate (sufficient) remedy by itself. If a contract is cancelled, there is something that the other party loses. Therefore, compensation may be ordered even if the contract is cancelled. If a contract is enforced (if specific performance ordered), there is a time gap between due date and the time of enforcement. There is also a possibility that the creditor may lose something. Accordingly, the purpose of compensation is to re-establish that balance that was disturbed by non-*

***performance. Compensation is not awarded whenever a contract is breached. It is awarded only when the non-performance has caused the creditor to suffer some economic loss.***

**? Is there any case where by compensation may not be paid by the non-performing party?**

**(You can use the spaces left below to give your answers)**

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Pursuant to Article 1791, a party who fails to perform his obligations shall be liable to pay compensation even though he is not at fault. Here, compensation is not ordered to punish a non-performing party. The purpose of compensation is to keep the relations of parties in balance. It is a civil sanction; not a punishment. Therefore, even if the debtor is not at fault, he may be required to pay compensation.

There is only one case where the debtor may not be forced to compensate. Article 1791(2) provides that if performance was prevented by force majeure, the non-performing party is released (is excused). It is a defense available to the debtor. He must show that his performance was prevented by force majeure.

**? What is force majeure? (You can use the spaces left below to give your answers)**

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Force majeure is an event or occurrence which takes place after the contract and that prevents you from carrying out your obligation. It is something beyond your control or something for which you are not responsible.

According to Article 1792, force majeure results from an occurrence which the debtor could normally not foresee and which prevents him also lately from performing his obligations.

The following occurrences may, according to the circumstances, constitute cases of force majeure.

- a) The unforeseeable act of a third party for whom the debtor is not responsible.
- b) An official prohibition preventing the performance of contract.
- c) A natural catastrophe such as an earthquake, lightning or floods.
- d) International or civil war.

- e) The death or serious accident or unexpected serious illness of the debtor. Illness that existed at the time of contract is not force majeure. That is the meaning of “unexpected serious illness.”

The following shall not be deemed to be cases of force majeure. If agreed in advance, such events may constitute force majeure. In the absence of such agreements, they are not. These are:

- a) Strike or lockout taking place in the undertaking of a party or affecting the branch of the business.
- b) An increase or reduction in the price of raw material necessary for the performance of the contract.
- c) The enactment of a new legislation whereby the obligations of the debtor become more onerous (burdensome).

### **Extinction of obligations**

**? What grounds give rise to extinction of contractual agreements? (You can use the spaces left below to give your answers)**

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The following are the possible grounds which give rise to extinction of contractual agreements.

#### **1. Invalidation and Cancellation of Contracts**

The grounds for invalidation and cancellation of contracts are not the same. But they have the same effect on the relations of the parties.

Cancellation deals with a valid contract. Invalidation of contractual agreements, on the other hand, deals with invalid contracts. As far as cancellation of contractual agreements there is nothing wrong with the contract in its formation. Cancellation is the result of a breach of a contract.

Article 1808

- 1 .A contract which is affected by a defect in the consent or by the incapacity of one party may only be invalidated at the request of that party.*

*2. A contract whose object is unlawful or immoral or a contract not made in the prescribed form may be invalidated at the request of any contracting party or interested third party.*

In the case of defects in consent, it is only the mistaken party, the party who was defrauded or the party who was forced or threatened that can require invalidation.

In the case of object of contract which is unlawful, immoral, impossible or indefinite, anyone of the contracting parties may require invalidation. Moreover, any interested third party can require invalidation. A party who is entitled to require invalidation can withhold his performance at any time. That is, he can refuse to perform. The right of invalidating a contract must be exercised within two years from the ground for invalidation having disappeared. If a minor enters into a contract the ground for the invalidation is minority.

**? When does the incapacity of a minor disappear? (You can use the spaces left below to give your answers)**

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It is when he becomes of age or when he is emancipated. Therefore, the minor can invalidate the contract that he made at two years after becoming of age or two years after emancipation.

Mistake disappears when you become aware of that mistake. Starting from the point of awareness, you can invalidate the contract with in two years. If the ground for invalidation is fraud, it disappears as soon as the defrauded person knows of the act of fraud. Duress disappears when you get a legal protection.

**? What if the problem pertains to the object or form of the contract? (You can use the spaces left below to give your answers)**

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Where the ground for invalidation pertains to the object or form of a contract the rule of two years does not apply because they do not disappear. In such a case, it is the period of ten years which has to apply.

**? What do you think is the effects of invalidation and cancellation of contractual agreements (You can use the spaces left below to give your answers)**

#### Article 1815 - Effect of invalidation or cancellation

- 1 .Where a contract is invalidated or cancelled, the parties shall, as far as possible, be reinstated in the positions which would have existed had the contract not been made.*
- 2. Acts done in performance of the contract shall be of no effect.*

The effect is restitution or reinstatement. That means parties would go back to the positions they had been before the conclusion of the contract. In a contract of sale, if the seller had delivered the thing, it is returned to the seller. If the buyer has paid the purchase price, it is refunded to the buyer. It is as if no contract existed between the two.

Restitution or reinstatement is not always possible. Acts done in performance of the contract shall not be invalidated where such invalidation is not possible or would involve serious disadvantages or inconveniences. When reinstatement becomes impossible or inconvenient, the alternative is payment of damages.

#### **2. Termination of Contracts and Remission of Debt.**

A contract may terminate where the parties agree to such effect. The only requirement is the agreement of the contracting parties.

In this regard, the pertinent civil code provision is reproduced as follows.

#### Article 1819 - Consent of the parties

*A contract may terminate where the parties so agree.*

Termination shall have no retrospective effect. If a contract is terminated, the part that is already performed remains intact. But once it is terminated, it shall not produce any effect.

As of the date of termination, the contract does not have any binding force on the parties.

The effect of termination is only prospective – no binding effect (force) in the future.

Termination can be unilateral. One party to the contract can terminate a contract unilaterally on notice. But this is possible only if agreed in advance.

Where more than two persons enter into a contract, provisions may be made to the effect that the contract shall terminate with regard to one of them and remain in force with regard to the other parties. This also depends on a prior agreement. Based on the agreement reached in advance, one party may decide to retain the contract even if his partner may terminate his part. Where a contract is made for an indefinite period of time, both parties may terminate it

on notice. This is a typical case of contract of employment. A contract of employment may terminate by the agreement of the employer and worker.

The party who terminates a contract shall comply with legal or customary periods of notice. Where the period of notice is not fixed by law of custom, it shall be reasonable having regard to the circumstances.

**? How can remission of debt be a ground for termination of a contract? (You can use the spaces left below to give your answers)**

---

The creditor may remit the debt of the debtor. If the creditor remits the debt, the debtor is released and the obligation is extinguished.

Novation, merger and set-off are other three causes of extinction of obligations.

**How does novation extinguish obligations? (You can use the spaces left below to give your answers)**

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The intention to novate must be expressly stated in the second contract. Otherwise, the second contract may be considered as an entirely new contract. In other words, novation may not be presumed. Novation may be recognized only if the intention of the parties to carry out novation and to extinguish the original obligation in this way is unequivocal.

Set-off is still another way of extinguishing obligations. It takes place when two persons owe debts to one another. In such a case, debts cancel each other and the obligations of the parties are extinguished. But there are conditions: positive and negative conditions. As the term itself indicates, positive condition is a condition where set-off can take place. Negative condition indicates the cases where set off are not allowed.

**? What are these conditions? (You can use the spaces left below to give your answers)**

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Article 1832 - Positive conditions

Set-off shall not occur unless both debts are money debts or relate a certain quantity of fungible things of the same species and both debts are liquidated and due.

The law does not impose set-off unless the items involved are exactly of the same value. Both debts must be debts in money. In the case of fungible things, they must be of the same

species. Both debts must be liquidated (ascertained) and both debts must fall due. These are the positive conditions. If the requirements indicated are satisfied, debts may set-off.

**? What are the effects of set-off? (You can use the spaces left below to give your answers)**

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In this regard, Article 1836 provides the following:

Article 1836 - Effect of set-off

*The debts shall extinguish each other as from the day when they both exist and to the extent of the amount of the lesser debt.*

Merger is another way of extinguishing obligation. It occurs when the positions of creditor and debtor are merged in the same person. It results from amalgamation of two or more business organizations. If a creditor and debtor organizations are merged or amalgamated, the position of the debtor disappears. It may also result from the sale of one business organization to another. If a creditor organization buys the debtor organization before the debt is paid, the position of the debtor disappears again as a result of merger. Merger shall not affect the rights of third parties.

**? What is a period of limitation? (You can use the spaces left below to give your answers)**

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Article 1810 - Action for invalidation

*1 .No contract shall be invalidated unless an action to this effect is brought within two years from the ground for invalidation having disappeared.*

Article 1845 - Period of limitation

*2. Unless otherwise provided by law, actions for the performance of contract, actions based on the non-performance of contract and actions for the invalidation of a contract shall be barred if not brought within ten year.*

Limitation period is a time within which one is expected to bring action against another. There are definite times for bringing or instituting legal actions. The range differs from country to country. In our system, the limitation period is ten years except in some specific cases where shorter periods are provided. If the creditor does not exercise his right within

the period of limitation, he loses his right of action. If the creditor loses his right of action, the debtor is released and his obligation will be extinguished.

Under Article 1845, the period of limitation is ten years. Actions for the performance of contracts, actions based on the non-performance of contracts, actions based on the non-performance of contract and actions for the invalidation contract, must be instituted within ten years. Under Article 1810, the period is two years. Both Article 1845 and Article 1810 mention about invalidation of contract. In one case the period is ten years and in another it is two years. What is the difference between the two provisions?

#### Article 1846 - Beginning of period

The period of limitation shall run from the day when the obligation is due or the rights under the contract could be exercised.

The period begins on the day when the obligation falls due. The limitation period does not include the day on which the obligation falls due.

### Summary

A contract is a legally enforceable agreement between two or more persons. It results from a valid offer and acceptance. An offer must be made with the offeror's intention to be bound by it. If not accepted, an offer is ended at the time stated in the offer and at the end of a reasonable time if no time is stated. It is also ended by revocation, counteroffer or by rejection. Acceptance must be unconditional, definite and it must be in the form prescribed by the offeror.

To have a valid contract, four basic requirements must exist: capacity, consent, object and form. Minors, insane and judicially interdicted persons lack contractual capacity. To be valid, a contract must not violate the law. Unlawful agreements are void. Unless required by law, contracts need not be made in writing so as to sustain validity. Contracts relating to immovable property, contracts with a public administration and contracts for a long period of time must be in writing and registered.

Interpretation is a process whereby uncertainties in the words of contract are resolved. Provisions of contract are interpreted only if they are not clear. When interpretation becomes

necessary, contracts must be interpreted in accordance with good faith, to give affect to the common intentions of the parties, by reading the whole contract. It must also be interpreted in a manner that favors the debtor and a party who does not benefit from the contract.

Contractual obligations must be carried out as agreed. Contract may be performed by the debtor in person or by a third party. Payment may be made to the creditor or his agent. Payment to unauthorized person does not release the debtor. If the debtor is in doubt as to who should be paid, he can refuse payment and can deposit the amount with the court. The debtor must deliver the exact thing. Delivery of a different thing does not release him. In the case of fungible things, the debtor may choose the exact thing to be delivered, but must choose a thing of an average quality. Place and time of performance may be agreed. If not agreed, legal provisions shall apply. Risk of loss or of damage to the thing passes from the debtor to the creditor when the thing is delivered. If the creditor is in default for not taking the thing, risk of loss may pass before delivery. Variation of contract is the right of the contracting parties. Courts of law may vary contracts only under very few exceptional cases. Non-performance is a breach of contract or violation of agreement or failure to perform. When a party does not carry out his obligations under the contract, the other party may exercise his right arising out of non-performance. But before exercising his right, he must put the non-performing party in default by giving notice. Notice is a necessary measure before going to court. If the debtor does not carry out his obligations within the time limit fixed in the contract, the next step is the institution of a legal action. When you institute a legal action, the court may make different orders. It may order specific performance cancellation of contract or award compensation to the injured party. These are the effects of non-performance or remedies for non-performance. Specific or forced performance is ordered only if the performance of the debtor is important to the creditor and only if the enforcement does not affect the personal liberty of the debtor. Cancellation of contract may be with or without the decision of the court. A contract may not be cancelled unless fundamental provision of a contract is breached. Monetary compensation may be ordered where the non-performance (breach) has caused the other party to lose something economically. A party who fails to perform his obligations under the contract is liable to pay compensation. The debtor is released only if his non-performance is the result of force majeure.

## Self check Exercises 2

Answer the following questions in the spaces provided.

1. Z declared to his friend B that he is going to give 50000.00 birr to D (his other friend). The moment this declaration was made D was not around.

Was there any contractual relationship between D and Z?

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2. Distinguish between contractual and social obligations.

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3. Discuss the respective grounds giving rise to invalidation and cancellation of contractual agreements.

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4. What will be the fate of a contract which is made in written form but which is not attested by witnesses?

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# **UNIT THREE**

## **FORMATION AND PERFORMANCE OF CONTRACT OF SALE**

### **Introduction**

Sale is a contract. If it is a contract the basic or essential requirements for the existence of a valid contract must be satisfied in the sale contract. The provisions of sale apply to the sale of corporeal chattels or movable things.

### **Objectives:**

After completing this Unit, you will be able to:

- explain how sale contract is formed;
- define sale;
- explain the meaning of corporeal chattels;
- identify the obligations of the seller and buyer;
- learn that delivery may be made in different ways;
- distinguish and explain the two ways of transferring ownership;
- note that only the owner or his agent may transfer ownership by contract;
- define and explain warranty;
- distinguish between express warranty and implied warranty; and
- Solve related legal problems.

### **3.1 Formation of Sale Contract**

Sale contract relates to corporeal chattels or movable things. You will also learn what is meant by corporeal chattels.

#### **3.1.1 Contract of Sale**

**? What is a sale contract? (You can use the spaces left below to give your answers)**

---

Pursuant to Article 2266 of the civil code a contract of sale is a contract whereby one of the parties, the seller, undertakes to deliver a thing and transfer its ownership to another party,

the buyer, in consideration of a price expressed in money which the buyer undertakes to pay him.

What are the elements of this definition?

1. According to the above Article, sale is a contract. Thus, it must meet all the basic requirements for the validity of any contractual agreements. Both the seller and buyer must be capable persons. The consent of both parties must be free from defects. The obligations of both parties must be defined, possible and lawful. Sale contract must also be made in the form prescribed by law, if any.

2. The requirement that the thing passes from the seller to the buyer and the money from the buyer to the seller implies that there must be two distinct parties in the contract of sale i.e. the buyer and seller.

3. Another element that you find in the definition is consideration/price. Price is significant in determining whether a given contract is a contract of sale or not. Article 2266 of the Civil Code provides that a contract of sale should consist of a consideration of price expressed in money. If the consideration is not expressed in money, a contract is not sale. It is the involvement of money that distinguishes sale contract from barter. In barter transaction, you exchange one item for another. There is no involvement of money in barter.

Read the following civil code provisions before you go any further.

#### Article 2267 – Corporeal Chattels

The provisions of this chapter (meaning the chapter dealing with sale) shall apply to the sale of corporeal chattels.

When you read articles 2266 and 2267 together, you note that the subject matter of sale contract is corporeal chattels.

**? What are corporeal chattels? (You can use the spaces left below to give your answers)**

The definition of corporeal chattels is given under Article 1127 of the Civil Code. It reads:

*Corporeal chattels are things which have a material existence and can move themselves or be moved by man without losing their individual character.*

Basically, Sales is a contract whereby the seller delivers a thing and transfers its ownership to the buyer. But what does term “a thing” mean in that definition? A “ting’ is subject matter

of sales contract. The “thing” as the subject matter of sales contract refers to corporeal chattels or corporeal movables and the intrinsic parts or elements immovable which can be separated and transferred as corporeal movable.

Corporeal chattels are things which have a material existence and can move themselves or be moved by man with losing their individual character. Things which are part of immovable that can be separated there from are considered as movables, and are the intrinsic elements of an immovable such as trees, crops on the land, and materials of building under demolition or products of quarry. Unless provided to contrary, the term corporeal movable also includes claims other incorporeal rights embodied in securities to bearer. And natural forces of an economic value such as electricity are also considered as corporeal movables.

Thus, sales relates to corporeal movables, intrinsic elements of immovable, claims and other incorporeal rights embodied in securities to bearer and natural forces economic value.

**? To what does the term “thing” refer? (You can use the spaces left below to give your answers)**

A thing, as the subject matter of sales contract, may be an existing thing, future thing, or a thing belonging to a third party. An existing thing refers to a thing that exists at the time of the contract whereas a future thing is a thing to be manufactured or to be acquired by the seller after the contract. The future thing is a thing which does not exist at the time of the contract (at the time when the contract is formed).

A distinction is drawn between a sale on delivery and contract of service. A contract for the delivery of a corporeal movable to be manufactured or produced shall be deemed to be a sale where the party who undertakes delivery is to provide to basic materials necessary for the manufacture or production.

The fact that sale relates to a thing belonging to a third party implies that the seller is not always the owner of the thing. The seller can be any person authorized by the owner (agent) to sell the thing on behalf of the owner.

## **3.2 Performance of sale contract**

### **3.2.1: Obligations of the Seller**

Dear learners we have seen in unit 2 of this course that the essence of a contractual agreement is to create an obligation. There are three main obligations that the seller undertakes vis-à-vis the buyer.

#### **a) Obligations to deliver the thing**

**? What is delivery? (You can use the spaces left below to give your answers)**

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Delivery is the transfer of possession. By definition, delivery of a thing includes delivery of its accessories. You do not make two separate contracts for the main thing and its accessories. Under Article 1136 of the Civil Code, accessory is defined as "anything which the possessor or owner of a thing has permanently destined for the use of such thing". When you buy a new TV set, you may be given a remote control together with the set. There are instruments that always go together with a motor vehicle. These are examples of accessories

#### **b) Obligation to Transfer Ownership**

Ownership is the widest right that one may have on a corporeal thing. It is called the widest right because it embodies other rights in it. The owner has the right of use, possession, enjoyment and the right to dispose of it. He can also exploit his property in a manner he thinks fit. Accordingly, transfer of ownership means transfer of all these rights. But how is ownership transferred from one person to another?

Article 1184 of the Civil Code states that:

*Ownership may be transferred by virtue of law or in pursuance of agreements entered into by the parties.*

According to this Article, ownership may pass from one person to another by the operation of law or by contract. Thus, the Ethiopian law recognizes two ways of transferring ownership title. One can give many examples of cases where ownership passes by law. The best example, however, is succession. According to Article 826(2) C.C., the rights and obligations of the deceased which form the inheritance shall pass to his heirs and legatees in accordance with the provisions of the Civil Code governing succession. Another example is possession in good faith or by acquisition. In possession in good faith, ownership passes by

the operation of law. The cases where ownership may pass by agreement include contract of sale and donation.

### **c) Obligation of Warranty**

**? What is warranty? (You can use the spaces left below to give your answers)**

Article 2287 of the Civil Code

*The seller shall guarantee to the buyer that the thing sold conforms to the contract and is not affected by defects.*

Warranty is a guarantee by sellers with respect to the goods they sell. Warranties may be express or implied. An express warranty is an affirmation of a fact or a promise made by the seller to the buyer concerning the nature of goods. A promise of this sort becomes the basis for the contract. That is, the buyer has purchased the goods on a reasonable assumption that the goods were as stated by the seller. Express warranty usually takes the form of oral or written statements. No particular language is required as long as the seller represents facts to the buyer to induce him to buy the goods. Express warranty may be made in either of the following ways.

A. Any affirmation of a fact or a promise that relates to the goods creates an express warranty that the goods will match the fact or promise.

Any description of the goods creates an express warranty that the goods will match the description

B. Any sample or model of the goods creates an express warranty that the goods will conform to the sample or the model.

The following civil code provision is also pertinent.

Article 2282 of the Civil Code

*The seller shall warrant the buyer against any total or partial dispossession which he might suffer in consequence of a third party exercising a right he enjoyed at the time of the contract.*

**? What is the element of this warranty? (You can use the spaces left below to give your answers)**

The element of this warranty is that the seller guarantees the buyer that he, the seller, has a valid title on the thing and that; he has a right to transfer this title to the buyer. Furthermore, he shall not be dispossessed totally or partially.

**? What is the obligation of the seller if the title passed to the buyer is challenged and the buyer is dispossessed? (You can use the spaces left below to give your answers)**

In case of dispossession, warranty of title imposes on the seller the obligation to return the price to the buyer in whole or in part.

There is also what is called an obligation of the seller to warrant the thing against non-conformity.

**? What is the obligation of the seller under this warranty? (You can use the spaces left below to give your answers)**

The obligation of the seller is to deliver to the buyer a thing that conforms to the contract. If the seller delivers to the buyer part only of the thing sold or a greater or lesser quantity than he had undertaken to deliver or if the seller delivers to the buyer a different thing or a thing of a different species, then we say there is non-conformity to contract. Non-conformity is a breach of warranty.

**? What are the remedies available to the buyer in the case of non-conformity?**

**(You can use the spaces left below to give your answers)**

When the seller delivers a greater quantity, the buyer may refuse taking delivery of the thing in excess or may take the whole thing delivered to him. If the buyer decides to accept the quantity in excess, he assumes additional obligation of paying additional price.

When lesser quantity is delivered, the buyer may reduce his obligation proportionately. However, when the seller delivers a different thing or a thing of a different species, the buyer may require specific performance.

**? When do you think is the thing delivered considered to be defective and thus hold the seller liable under the warranty obligation? (You can use the spaces left below to give your answers)**

Go through the following civil code provision which is reproduced herein below.

Article 2289 .Warranty Against Defects

The warranty shall become effective where:

- a. the thing does not possess the quality required for its normal use or commercial exploitation; or*
- b. the thing does not possess the quality required for its particular use as provided expressly or impliedly in the contract, or*
- c. the thing does not possess the quality or specifications provided expressly or impliedly in the contract.*

If the thing delivered is defective or if there is breach of warranty against defects, the buyer may exercise his right against the seller. He can bring an action against the seller. In order to claim his right arising out of warranty provisions on the condition that the buyer has met the duty of examining the thing without delay.

A buyer who takes delivery without examining the thing or who does not notify the seller of his discovery loses his right of warranty. However, if the seller admits the existence of the defect or non-conformity, the buyer is still protected under the warranty provisions.

**? Is there any period of time provided for under the law within which an action should be brought? (You can use the spaces left below to give your answers)**

The buyer must bring action against the seller within one year if there is a breach of warranty against defects in the thing. The period of one year begins to run from the day the buyer gave notice to the seller. The contracting parties cannot shorten this period of action by agreement. If the buyer fails to bring action against the seller within the specified period of time, he will lose his right of action.

### **3.2.2 Obligations of the Buyer**

There are two major obligations of the buyer: payment of the purchase price and obligation to take delivery. These two obligations of the buyer will be treated one by one in a manner that follows.

#### **a. Payment of Purchase Price**

Pursuant to Article 2303 of the civil code the buyer has the obligation to pay the price of the thing which is expressed in terms of money.

**? How could price of a thing be determined? (You can use the spaces left below to give your answers)**

Price of a thing could be determined in different ways.

- It may be fixed by the contracting parties at the time of contract. Contracting parties are free to determine the object of their undertakings of which determining the price of the thing is mentionable.
- It is also possible that parties to a contract of sale may, by agreement, leave the determination of the price of the thing sold or purchased to a third party.
- Where in the contract of sale price of the thing is to be determined by weight, the parties shall weigh the thing and determine the price. For this purpose it is the net weight that is to be considered.
- If the parties indicate that the price be determined by the market, the price to be effective is the one prevailing at the time and place where delivery takes place.
- Where it is difficult to ascertain the price by any of the above mentioned method, and the subject matter relates to a thing which a seller normally sell, then the parties are deemed to have concluded the sale at the price normally charged by the seller having regard to the time and place where delivery takes place.

A point to be emphasized is that the obligation of the buyer to pay price includes the obligation to take any step provided by the contract or by custom to arrange for or guarantee the payment of price.

### **b. Taking Delivery**

The second main obligation of the buyer is to take delivery by appearing at the place and the time agreed. The buyer is required to take such steps as are necessary to enable the seller to carry out his obligation to deliver the thing. If the buyer does not appear at the place agreed and on the time fixed for delivery, he bears the risks of loss or damage to the thing after he is put in default.

### **3.4 Common Obligations of the Buyer and the Seller**

There are also some common obligations of the buyer and the seller.

**? What are these common obligations? (You can use the spaces left below to give your answers)**

There are three such obligations: obligations relating to expenses of contract, preservation of the thing and transfer of risk of loss. You will study these three obligations in this Section.

#### **a. Expenses**

There are different expenses involved in sale contract which may be borne by the seller or by the buyer. The expense of a contract of sale and expenses of payment shall be borne by the buyer. Where the seller has changed the address of his place of business or residence after the contract is made, he shall bear any additional expenses arising from the change. According to Article 2316 of the Civil Code, expenses of delivery are borne by the seller. These expenses include the cost of counting, measuring, weighing and packing. Any expense incurred after delivery is borne by the buyer.

Expenses of transport may be borne by the seller or by the buyer. Where the thing sold is to be transported to another place than the place agreed for delivery, the buyer shall bear the expenses of transport. If the place of delivery is agreed by the parties or if it is fixed in the contract, the seller shall bear the expenses of transport up to the place agreed for delivery.

#### **b. Preservation of the Thing**

Preservation of the thing sold is the common obligation of the parties. Both the seller and buyer are required to ensure the preservation of the thing. But the two may preserve the thing under different circumstances.

The obligation of the seller to preserve the thing arises when the buyer is late in taking delivery. Here the preservation is carried out at the expense of the buyer. In order to do that the seller must put the buyer in default by giving him notice. Until the buyer indemnifies him of his expenses, the seller can retain the thing. But this presupposes that the purchase price is already paid.

If the thing delivered is defective; the buyer may return the thing to the seller. Until he returns it, he must preserve the thing at the expense of the seller. The buyer must notify the seller of the defect. It is only after notice that the expense of preservation may be borne by the seller. And, in order to return the thing, the buyer must have a good cause.

### **c. Transfer of Risks**

Risk of loss or risk of damage to the thing may be borne by the seller or by the buyer. Risk of loss or risk of damage to the thing passes from the seller to the buyer upon delivery. Even if the thing delivered may not conform to the contract, the risk of loss is with the buyer as of the time the thing is in his possession. If the buyer has cancelled the contract or has required its cancellation, risk shall not rest with him.

The risk shall also be transferred to the buyer from the day he is late in paying the price. Where the sale relates to fungible things, the delay of the buyer shall not transfer the risk.

### **3.5 Non-performance of contract of sale**

Dear learners we have seen in unit two of the course the remedies available following non performance of contractual agreements.

Article 2329. Non-performance of obligation to deliver.

*Where the thing has not been regularly delivered, the buyer may demand specific performance or forced performance of the contract where it is of particular interest to him.*

This article deals with the case where the buyer may demand forced performance. To demand forced performance, the buyer must show that the performance is of particular interest to him. According to Article 2330 of the Civil Code, the buyer may not demand the forced performance of the contract where the sale relates to a thing in respect of which purchase in replacement conforms to commercial practice. In other words, if the contract relates a thing available elsewhere, the buyer may be authorized by the court to buy the thing at the expense of the seller

**? Could there be any instance where the seller may demand forced performance? (You can use the spaces left below to give your answers)**

The right of the seller to demand forced or specific performance is related to non-payment of price by the buyer. Where the buyer fails to pay the price, the seller may demand forced performance. That is, the seller may require that the buyer be forced to pay. If compensatory sale is possible, the seller cannot exercise this right

## **b. Cancellation of Sale Contract**

Failure to perform or breach of contract may be total, partial or improper performance. Whether the breach is total, partial or improper the effect is the same. Accordingly, a party may move the court to order cancellation on any of these grounds. But before ordering cancellation, there are factors that are to be taken into account by the court. According to Article 1785(1) of the Civil Code, in making its decision, the court shall have regard to the interests of the parties and the requirements of good faith. A contract shall not be cancelled except in cases of breach of a fundamental provision of the contract. Nor shall a contract be cancelled unless its essence is affected.

**? What are the instances under which cancellation of a contractual agreement is ordered?**

**(You can use the spaces left below to give your answers)**

- A contract is cancelled by the order of the court if the compulsory date for delivery has expired. The date is deemed to be compulsory if the thing has a market price to which the seller can apply to obtain it. Where the date fixed for delivery is not compulsory, the court or the buyer may grant the seller a period of grace. A period of grace is an additional time given to the seller within which he shall perform.
- A contract may not be cancelled on the ground that delivery of the thing was made at a different place than agreed.
- The court may order the cancellation of the contract where the seller has not transferred to the buyer the whole ownership. Under Article 2282 of the Civil Code, the seller must transfer to the buyer a title free from any right belonging to a third party. The buyer may move the court to cancel the contract if he is dispossessed of the thing in violation of warranty provisions.
- If the defect relates to part of the thing only, the contract is cancelled for the defective part only and the price to be paid by the buyer is computed accordingly. There is one exception to this rule. If the defective part cannot be separated from the whole, the buyer may cancel the contract for the whole. The cancellation which relates to the principal thing shall extend to its accessories.
- The seller may forthwith declare the cancellation of contract in case of non-payment where such right has been expressly given to him by the contract of sale.

- *Where the buyer fails to take delivery of the thing on the conditions laid down in the contract, the seller may require the cancellation of the contract.*

### **c. Damages (Monetary Compensation)**

This is the other remedy available if a contract is not performed.

**? When could a court grant monetary compensation? (You can use the spaces left below to give your answers)**

Whenever a breach of contract occurs, the injured party is entitled to bring an action for damages. The rationale behind the grant of damages is to bring the parties to the positions where they would have been had the contract been performed according to their agreement.

**? What is the amount of damages to be paid to the injured party? (You can use the spaces left below to give your answers)**

Read the following civil code provisions before you go any further.

Article 1799 of the Civil Code, Normal amount of damages

- (1) Damages shall be equal to the damage which non-performance would normally have caused to the creditor in the eyes of a reasonable person.*
- (2) The nature of the contract, the profession of and the relations between the parties and any circumstances known to the debtor who surrounded the making of the contract shall be taken into consideration in assessing the amount of damages.*

In line with the above provision of the civil code the amount of damages shall be equal to the damage actually caused. According to Article 2362 of the Civil Code, where the contract is cancelled and the thing has a current price, damages shall be equal to the difference between the price fixed in the contract and the current price as on the day when the right to declare the cancellation of the contract could be exercised. Moreover, expenses of a purchase in replacement or compensatory sale shall be taken into account. Where the contract relates to fungible things and the seller fails to deliver it, the buyer may be authorized to buy the thing at the expense of the seller. This is what you can call purchase in replacement under Article 2330 of the Civil Code. When the buyer buys the thing there may be a difference between the price of the original contract and the second contract. Similarly, if the buyer does not take delivery or does not pay the purchase price, the seller may be forced to sell the thing to another buyer. Here also a difference may occur in price. If the seller is forced to sell the

thing for a lesser price than originally agreed, it is the buyer that is responsible for the difference in price. Thus, the expenses of purchase in replacement and compensatory sale are considered when assessing the amount of compensation.

The price to be taken into account shall be that of the market where the buyer or seller would buy or sell the thing to which the contract relates.

Damages shall be equal to the damage actually caused. However, there are cases where damages may be greater than the damage actually caused. This is the case where the party who had failed to perform the obligation was warned by the other party at the time they concluded the contract. In such a case, we consider that the debtor has accepted the risk of having to pay higher damages if he does not perform the contract properly.

Read also the following provision which is reproduced from the Ethiopian civil code.

Article 2365. Thing having no current price

Where the thing has no current price, damages shall be equal to the damage which non-performance would normally cause to the creditor in the eyes of a reasonable person.

In cases of anticipatory breach of contract, damages shall be calculated having regard to the market price of the thing on the last day of the period fixed in the contract for the performance of the contract.

In the case of delay in the payment of price, the buyer shall pay interest at the legal rate, or a high contract rate, if there was any.

## Summary

Contract of sale is a contract. Like other contractual agreements it needs to meet all the essential conditions for the existence of a valid contract. This is to mean that a contract of sale shall be made by capable persons. Consent of the contracting parties, that is to say, the buyer and the seller, shall be free from defects. The object of their contract or their respective obligations shall be sufficiently defined, possible to perform and shall also be lawful and moral. A contract of sale made with out complying with the above requirements will lose effects before the law.

A contract of sale is different from other contractual agreements in that it calls for exchange of goods for a price expressed in terms of money.

There are different obligations that parties to a contract of sale required to discharge Vis-a-Vis each other. The buyer has to pay he price of the thing and take delivery of the thing. The seller has to deliver the thing, transfer an ownership title over the thing to the buyer and warrant the thing against dispossession, non-conformity and defects.

Non-performance of sale contract produces certain effects: forced performance, cancellation of contract and monetary compensation. Specific performance is an order requiring the defaulting party to carry out the obligation according to the specific terms agreed upon. To demand specific performance, the buyer must show that the performance of the seller is of a special interest to him. That means forced performance is not ordered whenever requested by the buyer. The seller can also demand forced performance when the buyer has not paid.

The buyer and seller cancel sale contract on different grounds, the buyer may move the court to cancel the contract when the compulsory date for delivery has expired, when the whole ownership is not transferred and when the thing delivered is defective.

Whenever a breach of contract occurs, the injured party is entitled to demand compensation for the loss suffered due to breach, compensation is awarded to reestablish the balance that has been lost as the result of breach. There are different ways of assessing compensation. And compensation may be awarded independently or in addition to other remedies, moreover, compensation may be claimed whether the contract is cancelled or not.

### Self to do Exercises 3

Answer the following questions in the spaces provided.

1. Discuss the obligations of the buyer and the seller in a contract of sale.

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2. A sale contract may relate to a future thing. What does this mean?

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3. What makes contract of sale different from a barter contract?

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# UNIT FOUR

## AGENCY RELATIONS

### Introduction

Agency is a relationship based up on an express 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. Agency relationship is a fiduciary relationship which results from manifestation of consent. It is created in different ways. It can be created by contract or by operation of law, or even by decision of a court of law.

### Objectives

After completing this Unit, you will be able to:

- distinguish different ways of creating agency relationship;
- describe the scope of agency power;
- discuss the duties of the principal and the agent; and
- Discuss the different ways agency power could be terminated.

### 4.1 Definition and Scope of agency power

#### 4.1.1 Definition

##### ? What is agency?

Read the following civil code provision which is reproduced herein below.

Article 2199- Definition

*Agency is a contract whereby a person, the agent, agrees with another person, the principal to represent him and to perform on his behalf one or several legally binding acts.*

Though the above provision ostensibly indicates that agency power emanates from the agreement of the parties, it does not mean that contract is the only source of agency power. The civil code under its Article 2179 clearly states that the main sources of agency are two: the law and contract. The authority to act on behalf of another may result from agreement (contract). An agency relationship is created by mutual assent of two parties. It is a

relationship where two persons have agreed that one of them is to act on behalf of the other to effect contractual, personal or commercial transactions with a third party.

**? What elements do you note from the above Article defining agency? (You can use the spaces left below to give your answers)**

From the definition we can see that agency is a contract. Article 1678 of the Ethiopian civil code provides that there are some essential requirements for the existence of any contract. These basic requirements are: consent, capacity, object and form.

**a.** Consent- Contract is the result of the free will of the contracting parties. It is not something imposed by one on another. The same holds true for contract of agency. As an essential element, there must be mutual consent of the parties.

**b.** Capacity- All the parties to the contract of agency must be capable persons in the eyes of the law. They must have contractual capacity to enter in to a binding contract.

**c.** Object- Object here means obligations undertaken by the contracting parties. Thus, the obligations of all the contracting parties to the contract of agency must be sufficiently defined.

**d.** Form- Authority to represent another may be conferred on a person expressly or impliedly. Where the act to be performed by the agent is under the law to be made in a prescribed form, such form shall be complied with in conferring authority up on the agent.

Principal- agent relationship may also be created by ratification.

**? What is ratification? (You can use the spaces left below to give your answers)**

Ratification is approval of a prior unauthorized act of an agent. As agency is a consensual agreement between the principal and an agent, one who lacks authority does not bind the principal. However, the principal may affirm or ratify the act of the agent made without authority or in excess of authority. Thus, the question of ratification arises when an agent who has express or implied authority goes beyond the scope of his authority. It may also arise when one acts in the name of another without authority. Ratification of unauthorized agreement will be inferred, if the principal, having full knowledge of it accepts any performance under the agreement.

Read the following civil code provision.

Article 2190: Abuse or lapse of power

*(1) Contracts made by an agent in the name of another outside the scope of his power may be ratified or repudiated at his own option by the person in whose name the agent acted.*

*(2) The provisions of sub-article (1) shall apply where the agent acted under an authority which had lapsed.*

#### Article 2192: Effect of Ratification

*Where the contract is ratified, the agent shall be deemed to have acted within the scope of his power.*

Ratification brings about or produces some interesting changes in the relationship of the parties and in their respective rights and obligations. Until the act is ratified, the agent is considered as he has acted without a due authority. Therefore, the agent is personally liable to a third party. Normally, the act of the agent done with a due authorization would hold the principal liable to third parties. As the agent acted without authority, the principal is not bound by the act of the agent. The purported agent is established as the agent of the principal for the purpose of the contract. The agent's liability to a third party disappears and the principal is bound to the third party once the act of this agent has got the blessing of his principal. Ratification releases the agent from liability to the third party. Ratification is based on the action that the principal's ratification related back to the date the individual purported to act.

**? Who are the parties to the agency relationship? (You can use the spaces left below to give your answers)**

There are three persons that are involved in the contract of agency; the agent, the principal and the third party. The agent is a person who makes contracts for and on behalf of another person. The principal, on the other hand is a person that authorizes the agent to represent him and to act in his name. The third party is a person that enters in to a contract with the agent. Even though three persons are involved only two of them are contracting parties. The agent is not a contracting party because he simply serves as a tunnel via whom the interest of one party passes to the other.

The authority to act on behalf of another may also result from the operation of law.

**? How can agency power emanate from the law? (You can use the spaces left below to give your answers)**

An agency relationship by operation of law is implied regardless of express or implied intentions of the parties. Any action taken by an agent or employee in an emergency which is necessary to protect the interest of the principal gives rise to agency.

Under the Civil Code, parents are legally empowered to represent their minor child or children. According to Article 199(2) of the Civil Code in matters concerning his pecuniary interest and the administration of his property, a minor shall be represented by his tutor. And under Article 204 of the civil code, in matters concerning his pecuniary interests and the administration of his property, a minor shall be represented by his tutor. And under Article 204 of the Civil Code, the father and mother are during their marriage, jointly guardians and tutors of their minor children. This authority of parents is the result of the operation of law.

Article 319 of the Civil Code provides that acts performed by the tutor, within the limits of his powers or with the necessary authorizations, may not be he invalidated by alleging that they have been performed for a minor. Such acts may be binding on the minor as though he had performed them himself, being major. This is a typical case of principal agent relationship. The principal is the minor and the tutor is the agent. Under Article 2189 of the civil code, the act of the agent is the same as the act of the principal. When acting on behalf of the minor, the tutor must act within the limits of his powers given by law. If the tutor acts in violation of legal provisions, his acts may be treated as those acts performed by the agent in excess of his powers.

One other example to be noted in connection with this is the case of commercial employees. Commercial agent may act as agent by express or tacit agreement. Article 32 of the Commercial Code clearly states that a commercial employee in charge of sales has the power of an agency. The employee in charge of sales in a store shall be deemed to have a power of agency for the purpose of selling or receiving goods which come within the normal business activities of stores of such nature.

A contract that exists between a salesman and a trader is a contract of employment. But the very fact that a salesman is placed in the store empowers him to represent the trader for the

purpose of selling and receiving goods. A salesman may demand that goods sold by him are to be paid to him, unless payment is to be made to a special account. However, a salesman may not demand payment outside the store unless so expressly authorized or unless he produces a receipt signed by the trader.

**? Who may be a principal? (You can use the spaces left below to give your answers)**

To make a contract, contracting parties must be capable persons. Any person, who is capable to contract, may act through an agent. In other words, to appoint or to authorize an agent, one must be a capable person. Thus, anyone who has a legal or contractual capacity may be a principal and may act through an agent. This is because the authorized acts of the agent are, legally, the acts of the principal. For the same reason, one who is not capable to contract cannot escape that incapacity by appointing an agent or by acting through an agent. The appointment of an agent by a person having capacity is generally voidable to the same extent that a contract made by such a person would be. A minor lacks full capacity to contract. Hence, if a minor appoints an agent the appointment is regarded as voidable by the minor. Similarly, contracts made by the agent for an incapable principal would be voidable by the principal.

**? Who may be an agent? (You can use the spaces left below to give your answers)**

There are two arguments regarding the capacity of a minor. Some people argue that all parties to the contract of agency must be capable persons. This is because agency is a contract and a valid contract shall not come into existence unless the parties are capable others argue differently. This argument is based on a different ground. Under the law, a contract made by an agent is the contract of principal. Therefore, they argue, is immaterial whether or not the agent has legal capacity to make a contract since he does not personally undertake any obligation.

The first argument seems to be in line with principles of contract law. If agency is a contract and contract requires capacity as a condition of validity, all parties to a contract must be capable persons.

**? What is the form of contract of agency? (You can use the spaces left below to give your answers)**

Read the following civil code provision before you go any further.

Article 1719: Form of Contract

*(1) Unless otherwise provided, no special form shall be required and a contract shall be valid where the parties agree.*

*(2) Where a special form is expressly prescribed by law, such form shall be observed.*

Article 2200: Form of agency

*(2) Authority may be conferred upon an agent either expressly or impliedly.*

*(3) Where the act to be performed by the agent is under the law to be made in a prescribed form such form shall be complied with in conferring authority upon the agent.*

**? What do you observe from the reading of these two provisions of the civil code?**

**(You can use the spaces left below to give your answers)**

Agency relationships can be formal or informal. Most agency relationships come into being by informal arrangements. Except in exceptional situations, no formalities are required to establish an agency. If the contract to be made between the agent and the third party requires a special form; in other words it has to be made in writing, then the authority must be given in the same form. The agent's authority must be expressed with at least the same formality as prescribed for the act that the agent is authorized to perform for the principal.

**? What should the object of their contract be? (You can use the spaces left below to give your answers)**

Usually an agency may be created to perform any act which the principal could lawfully do. The object of contract (including agency) must not be illegal nor may it be contrary to public policy. Acts that one may not lawfully do personally may not be done through another. If it is unlawful for you to buy something yourself, you may not buy it through an agent.

Read the following civil code provision very closely.

Article 1716 - Unlawful or immoral object.

*(1) A contract shall be of no effect where the obligations of the parties or of one of them are unlawful or immoral.*

The object or the obligation to be undertaken by the agent should be lawful and moral. Besides, the obligation that the parties assume towards each other shall be ascertained with a sufficient precision and that, what the agent undertakes to perform shall be possible to perform.

#### **4.1.2 Scope of Agency power**

**? What power or how much authority does an agent have? (You can use the spaces left below to give your answers)**

Article 2180- Scope of the power of attorney

*(1) The scope of the power of attorney given by contract shall be fixed in accordance with the contract.*

Article 2202 of the Civil Code: Scope of Agency.

*(1) Where the scope of agency is not expressly fixed in the contract such scope shall be fixed according to the nature of the transaction to which it relates.*

Based on these two articles, you can see that the scope of the power of agency is fixed by contract. The extent of the power of an agent is determined in the contract. An agent has power to bind the principal in contract to the extent the principal authorized him. The agent's power to bind the principal is manifested to the agent expressly or impliedly. That is to say, authority may be given to an agent expressly or its may be an implied form in the words or conduct of the principal. An express authority is written or oral instruction that a principal spells out to an agent. Even though it is possible for a principal to express in detail the authority of an agent, usually an agent's express authority may be defined by the principal in more general terms. The principal's express words may be extended by implications. For example, a principal may authorize his agent expressly to manage his horse. From this general directive given to the agent to manage the horse, the agent may imply authority to do all acts consistent with the general direction, depending on the place, to feed and all other things associated with it. All other activities to be undertaken to discharge the management of the horse is implied or not expressly given.

A fundamental rule of law of agency is that the principal is only liable in contract for the authorized contracts of an agent. Whether the agent received the power expressly or

impliedly, the effect is the same. The act of the agent performed within the scope of his authority binds the principal.

There is what the law calls apparent authority. An Agency relationship may sometimes result from the appearance created by the principal.

Read the following provision which is reproduced herein below.

Article 2195 (c): Liability of the principal

*The principal shall be jointly liable with the agent: where he caused in any manner, in particular by his statement, behavior or failure to act, a third party to believe that the person with whom he was dealing was authorized to act on behalf of the principal.*

**? Under what conditions do you think that apparent authority holds the principal to third parties? (You can use the spaces left below to give your answers)**

This is not a true agency, because there has been no agreement or contract between the agent and the principal.

Read the following civil code provision very carefully.

Article 2202 (2)

*The agency may either be special for a particular affair or certain affairs only or general for all the affairs of the principal.*

Scope of agency may be expressly fixed in the contract by the contracting parties. Where it is not expressly fixed in the contract, such scope shall be determined according to the nature of transaction to which it relates.

The scope of agency is either general or specific. The agent may be given a special authority or general authority, general agent is one authorized to contract all the business of the principal or all of the principal's business of a particular kind at a particular place.

A general agent is authorized to transact all of the principal's business at a given place. According to Article 2203 of the civil code, agency expressed in general terms shall only confer upon the agent authority to perform acts of management.

Article 35 of the commercial code: Powers of Manager.

- (1) In his relations with third parties, the manager shall be deemed to have full power to carry out all acts of management connected with the exercise of the trade, including the power to sign a negotiable instrument.*
- (2) Unless expressly authorized to do so, he may not sell or pledge immovable property, nor may sell, hire or pledge a business.*

Unless the power of the manager is limited by the principal, he has power to hire and fire workers, to pay them, to buy supplies, to maintain the building and grounds, and to do all the act necessary for the operation of his task.

Article 2203: General Agency.

*Agency expressed in general terms shall only confer upon the agent authority to perform acts of management.*

Article 2204: Acts of management

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

As it is indicated herein above, acts of management are those acts which are done for the preservation or maintenance of property, leases for terms not exceeding three years, the collection of debts, the investment of income, and the discharge of debts. More over, the sale of crops, goods intended to be sold or the sale of perishable commodities shall be deemed as acts of management.

**? What about special authority? (You can use the spaces left below to give your answers)**

Article 2206: Authority of special agent.

- (1) Special agency shall confer upon the agent authority only to conduct the affairs specified therein and their natural consequences according to the nature of the affair and usage.*

Special agent is appointed to do some specific act or acts. Special agent can act for the principal only in a specific transaction or only for a particular purpose. As compared with that of the general agent, special agent has a narrow scope of authority.

An act performed by a special agent outside the scope of his authority shall not bind the principal unless he ratifies it, or in accordance with the principles governing unauthorized agency.

### **Unauthorized Agency**

**? When do you think unauthorized agency occur? (You can use the spaces left below to give your answers)**

An 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 affairs without having been appointed an agent. Where the agent has acted beyond his power or without authority, the principal may be held liable in accordance with the principles governing unauthorized agency.

Article 2257: Unauthorized Agency.

*Unauthorized agency occurs where a person who has no authority to do so undertakes with full knowledge of the fact to manage another person's affairs without having been appointed an agent.*

In a few instances, an agency may be created by necessity. Under unusual and emergency circumstances an agent is authorized to do reasonable and appropriate acts which are not within the scope of his ordinary authority. Even though one may manage another person's affairs without being authorized, the management cannot be undertaken against the interest of the principal.

When one acts in the name of another without being authorized, the acting person must inform the principal that he has undertaken the management. The acting person shall act in the strictest good faith towards the principal.

Article 2264- Duties of principal

*(1) Where the principal's interest required that the management be undertaken, he shall ratify the acts done by the acting person in his name.*

Where the principal's interest required that the management be undertaken, the principal shall:

- Ratify the acts done by the acting person in his name
- Indemnify the acting person for all liabilities he personally undertook
- Reimburse him the expenses incurred in his interest
- Compensate him for any damage he suffered in connection with the management and not due to his fault.

Expenses made by the acting person shall produce interest as from the day they were made. Where the principal is bound by law to ratify the transaction or he in fact ratifies it, the provisions governing shall apply.

## **4.2 Duties of the agent and the principal**

### **Duties of the Agent**

**? What do you think are the duties of the agent towards his principal? (You can use the spaces left below to give your answers)**

#### **a. Duty of Strict Good Faith**

*Article 2208 Civil Code: Strict good faith.*

*(1) The agent shall act with the strictest good faith towards his principal.*

*(2) He shall disclose to his principal any circumstance which would justify the revocation of the agency or a variation of its terms.*

**? What do you understand by the term "strict good faith?"**

**(You can use the spaces left below to give your answers)**

The act of the agent performed within his authority is legally binding on the principal. Therefore, the principal places a great trust and confidence in an agent. The agent may not intentionally or negligently act. The relationship between the agent and the principal is not that of a mere debtor and creditor. It is a relationship of trust and confidence. The agent is held to a high standard of honesty. The most important obligation the agent assumes is the

obligation to be loyal to the principal. Loyalty may not be defined with precision. It depends much upon the accepted standards in the community. The agent must refrain from placing himself in a position that may encourage conflict between his interests and those of the principal. The agent must put the interest of the principal ahead of his own interest.

Article 2209 (1): Effect.

*The agent shall act in the exclusive interest of his principal and may not, without the latter's knowledge, derive any benefit from any transaction into which he enters in pursuance of his authority.*

To minimize the dangers that may arise from divided loyalties, the agent is prohibited from making a secret profit from a contract made for the principal. He may not accept the benefit of any kind from anyone while acting in the name of the principal. Accepting gifts, commissions, bonuses may influence the decision of the agent. If it is with the knowledge of the principal, there is nothing wrong.

The duty of strict good faith includes duty not to use confidential information. Article 2209 (2) of the Civil Code provides that the agent may not use to the detriment (disadvantage) of the principal of any information obtained by him in the performance of his duties as an agent. The agent may not use for his own benefit or for the benefit of a competitor; confidential information that he gains (obtains) in the course of his agency.

**? What, do you think, are these confidential information sources?**

**(You can use the spaces left below to give your answers)**

A principal's confidential information usually takes the form of trade secrets. A trade secret consists of any information, procedure, and process used in a business that may give the principal an economic advantage over his competitors. A trade secret is any information guarded by the principal because it gives him a peculiar economic advantage. It may be an engineering process, a formula, use of tools, quality control procedure, and customer attitude study. A trade secret may consist of any formula patent, device, or compilation of information which is used in one's business and which gives him an advantage over competitors who do not know it or who do not use one like his.

As part of his duty to be loyal to his principal, an agent has a general duty to keep the principal fully informed of all facts that materially affect the subject matter of agency. That is what Article 2208(2) Civil Code states that the agent shall disclose to his principal any circumstance which would justify revocation or a variation of the terms of the contract of agency. The duty extends to any information coming to the agent's knowledge that would put the principal in a more favorable bargaining position in the future.

One who acts as an agent for another becomes a fiduciary with respect to matters within the scope of agency. An agent owes his principal a duty to disclose all material information which the agent learns in the course of his agency.

### **b. Duty to Account**

Article 2210: Accounts

*(1) The agent shall account to the principal for all sums received by him and all profits accruing to him in the course of his employment, notwithstanding that the sums he received were not owned by the principal.*

If an agent receives money or property from the principal or from a third person, the agent must keep records of the transaction and must account for all the money or property received.

### **c. Duty of Diligence**

**What standard of care is expected from an agent in the discharge of his duty?**

Article 2211: Diligence required of an agent

*(1) The agent shall exercise the same diligence as a bonus pater familias in carrying out the agency as long as he is entrusted therewith.*

*(2) He shall be liable for fraud and for defaults in the performance of his duties.*

An agent owes a duty to his principal to use reasonable care and skill in performing his agency. It is the duty of an agent to act with the care that a reasonable person would exercise under the circumstances. In addition, if the agent possesses a special skill, the agent shall exercise that skill. Failure to do so make the agent liable to the principal for any loss or injury sustained. The basic element of this duty of the agent is a duty not to be negligent in the performance of services.

#### **d. Duty to Perform Personally**

Article 2215: Delegation of authority

- (1) *The agent shall carry out the agency in person unless he was authorized by the principal to appoint a substitute.*

Agents are usually selected because of their personal qualifications. Owing to these elements of trust and confidence, an agent may not delegate his duty to someone. In the absence of express or implied consent of the principal, an agent has no power to appoint another agent. Agency relationship is a personal nature.

An agent may, under certain circumstances, have the actual or implied authority to appoint other agents for the principal.

Article 2215 (3) - Delegation of authority

*The agent shall appoint a substitute, where the interest of the principal so requires, when unforeseen circumstances prevent him from carrying out the agency and he is unable to inform the principal of these circumstances.*

This is the case where the agent is prevented from carrying out his duty by *force majeure*. The interest of the principal requires such appointment. If a substitute is not appointed to take case of the interest of the principal, it is his interest that may be exposed to danger. Even in this case, the agent is required to inform the principal of the circumstances before appointing a substitute.

The substituted agent has to show what led him to such a belief. Sometimes, the act or the conduct of the principal may create the impression that the original agent had authority to appoint a substitute. This is a case of apparent authority. Even if the substituted agent cannot prove apparent authority, he is still protected under the law. The original agent may prove that the appointment was in the interest of the principal. If the act of appointment was necessitated by circumstances which required the protection of the interest of the principal, the principal has an obligation of ratifying the appointment according to the rules governing unauthorized agency.

#### Article 2264 Civil Code

- (1) Where the principal's interest required that the management be undertaken, he shall ratify the acts done by the acting person in his name.*
- (2) He shall indemnify the acting person for all liabilities he personally undertook, reimburse him the expenses incurred in his interest and compensate him for any damage he suffered.*

To be protected under this provision, the original agent must have acted in good faith with the intention of protecting the interest of his principal.

According to Article 2216 Civil Code, the agent shall be liable for the acts of any person whom he appointed without authorization. The substituted agent is the agent of the original agent not that of the principal. The contracts of the new agent do not affect the principal.

Even though the agent is authorized to appoint a substitute, must be obliging in selecting his substitute. He must select a reliable person. If the agent is careless or negligent in the selection, he has not exercised due care.

#### **f. Duty not to Act for Third Persons**

##### Art. 2209 of the Civil Code

- (1) The agent shall act in the exclusive interest of the principal.*

The agent shall not assume double loyalty. An agent cannot represent two persons at the same time unless both parties know of the dual relationship and consent to it. If two persons agree to be represented by a common agent there is a danger that the agent might prefer one principal over the other. The laws of some countries may allow such dual relationship where the duty of the agent is merely to bring the parties together without fixing contractual terms for them. The best example of such an agent is a broken one.

An agent may not, without the knowledge of his principal, act as a third party in a contract in which the agent is acting for the principal. Under Article 2188 Civil Code, a contract made by an agent may be cancelled at the request of the principal where the agent made the contract with himself, whether he acted on his own behalf or in the name of a third party. This situation may arise where the agent is engaged in selling or buying for a principal. An agent who is employed to sell a property must not purchase the property for himself.

## **Duties of the Principal**

**? What are the duties of the principal? (You can use the spaces left below to give your answers)**

### **a. Remuneration**

Article 2219 Civil Code

*(1) The agent shall be entitled to the remuneration fixed in the contract.*

*(2) The court may reduce the remuneration fixed in the contract where it appears excessive and out of proportion to the service rendered by the agent.*

Agents are entitled to be compensated for their services. Whether an agent is entitled to compensation (remuneration) depends upon express or implied agreement between the principal and the agent. If there is no agreement between the two, the amount of remuneration is fixed by courts of law in conformity with recognized rate and usage. The court may consider reasonable value for the service rendered by the agent. The reasonable value will be the customary rate in the community for such services.

Courts are involved in the issue of remuneration at two stages. If the rate of remuneration is not specified in the agreement, the court fixes the amount. The court can also reduce the amount already specified. This happens when it appears from circumstances that the amount is greater than the service rendered by the agent.

### **b. Duty to Reimburse the Agent**

Article 2221 - Diligence required of agent.

*(1) The principal shall advance to the agent the sums necessary for carrying out the agency.*

*(2) He shall reimburse outlays made and expresses incurred by the agent in the proper carrying out of the agency.*

**? What is reimbursement? (You can use the spaces left below to give your answers)**

When the principal appoints an agent, he is required to advance or to give to the agent money necessary for the execution of the agency. If the principal has not advanced the necessary money, the agent may be forced to spend his own money in the interest of the principal. In such a situation, the principal is under duty to reimburse, that is, repay the agent for any expense necessary for the proper discharge (execution) of the agency. An agent has a right

for reimbursement. But there is a limitation to his right. To get back his money, the expenditure must be reasonably spent. If the expenditure was due to the misconduct or negligence of the agent, he is not entitled for reimbursement. Moreover, the agent may not recover disbursements made on illegal purposes.

The reimbursement shall include interest from the day the expense was incurred. To demand interest, the agent need to put the principal in default (the agent need not give notice to the principal, Article 2221 (3) Civil Code)

### **c. Duty of Indemnity**

Article 2222 Civil Code- Liabilities and damages

*(1) The principal shall release the agent from liabilities which incurred in the interest of the principal.*

*(2) He shall be liable to the agent for any damage he sustained in the course of the carrying out of the agency and which was not due to his own default.*

**? What are the two duties of the principal in the above provision? (You can use the spaces left below to give your answers)**

The first one is the duty of the principal to release one agent from any liability. The agent has a reason to believe that the instructions given by his principal are correct. If the agent has acted according to the instructions of the principal, the agent is not personally liable to the third party. The principal must assume responsibility towards the third party.

The second duty of the principal is duty of indemnity. The agent is entitled to indemnity from the principal for any losses or damages sustained in carrying any authorized, lawful act. However, the loss must result directly from the execution of authority granted. Moreover, the loss must not be due to the fault of the agent. When the loss sustained is due to the failure of the agent in following the instructions given by the principal, the principal is not liable.

The principal may not refuse to pay the sums due by him to the agent on the pretext that the transaction was not successful. Whether the transaction succeeds or fails, the agent has a right to get it. Until the payment is made, the agent shall have a lien right on the property in his possession. That means, the agent can hold the property belonging to the principal as a security for payment.

## **Liability of the Principal and the Agent**

**? When the principal is held liable to third parties? (You can use the spaces left below to give your answers)**

Read the following civil code provision very closely.

Article 2189 Civil Code: Complete agency

*(1) Contracts made by an agent in the name of another within the scope of his power shall be deemed to have been made directly by the principal.*

1. As long as an agent acts within the scope of his power given by the principal, the principal is liable to the third party. He shall perform any contract made by the agent. The contract of the agent is the same as the contract of the principal. The agent is a mere connecting link making or negotiating contracts in the name of the principal. Once the contract is made, he disappears from the scene. In other words, the agent is not a party to the contract he made with the third party. It is the third party and the principal who have contractual rights and duties to each other.

Therefore, the first liability of the principal to the third party arises when the agent has a duly conferred authority.

Article 2206 (2)

*An act performed by the agent outside the scope of his authority shall not bind the principal unless he ratifies it or in accordance with the principles governing unauthorized agency.*

Article 2190– Abuse of lapse of power

*(1) Contracts made by an agent in the name of another outside the scope of his power may be ratified or repudiated at his option by the person in whose name the agent acted.*

2. The principal is liable to third party if he ratifies the contract made by the agent outside the scope of his power. Unless he ratifies such contracts, he is not liable. There is no obligation of ratification, it is optional. If he is not interested, he has another option of repudiation. If the principal repudiates the contract the agent is personally liable to the third party. According to Article 2192 Civil Code, where the contract of the agent is ratified, the agent

shall be deemed to have acted within the scope of his power. Under Article 2206 (2) of the Civil Code, the principal may be liable in accordance with the principles governing unauthorized agency.

According to Article 2257 Civil Code, unauthorized agency occurs when a person who has no authority to do so undertakes with full knowledge of the facts to manage another persons affairs without having been appointed an agent.

According to this principle, the principal may become bound by ratifying an unauthorized contract. Ratification related back to authority at the commencement of the act. It cures the defect of lack of authority and creates the relation of principal and agent.

As a general rule, ratification does not bind the principal unless he acts with full knowledge of all relevant facts attending to the negotiation and execution of the contract, especially, when ratification is to be implied from the conduct of the principal, he must act with knowledge of all important details.

As indicated earlier, ratification may be either express or implied. Any conduct that definitely indicated an intention on the part of the principal constitutes ratification. It may take the form of words of approval to the agent, a promise to perform, or actual performance, such as the delivery of the product called for in the agreement. Accepting the benefits of the contract or basing a suit on the validity of an agreement amounts to ratification. Knowing what the agent has done, if the principal makes no objection, ratification results from the operation of law.

3. If fraudulent acts are committed by an agent who is acting within his authority, the principal is liable to third parties for such acts. For example, if an agent defrauds a customer, while selling something to that customer, the principal is liable for any damages that may result.

Article 2189 (3) of the Civil Code provides:

*Any fraud committed by the agent may be set up against the principal by the third party who entered into contract with the agent.*

**? What is the substance of this provision? (You can use the spaces left below to give your answers)**

If the principal is liable for the fraud of the agent who is acting within his authority, the principal is liable to third parties for such acts. If an agent defrauds a customer the principal is liable for any damages that may result.

Article 2189 (2) of the Civil Code in this regard provides:

*The principal may avail himself of any defect in the consent of the agent at the time of the making of contract.*

**? When the agent is held liable to third parties? (You can use the spaces left below to give your answers)**

The agent is liable to the third party if he acts without authority. The agent may act in the name of his principal with a power that has lapsed or expired. When the principal decides to repudiate the contract of the agent, it is the agent who is liable to the third party. The same rule shall apply when the agent acts with a power that has lapsed. The principal may ratify or repudiate it. If the act is repudiated, the agent is personally liable to the third party.

Moreover, the agent is personally liable if he exceeds his authority. In order to bind the principal, the agent must act within the authority given by the principal. Any contract made by the agent beyond his powers shall not affect the principal.

**? When the principal is jointly held liable with the agent? (You can use the spaces left below to give your answers)**

The following provision is pertinent with the case at hand.

Article 2195 - Liability of principal.

*The principal shall be jointly liable with the agent:*

- (a) Where he informed a third party of the existence of the power of attorney but failed to inform him of the partial or total revocation of such power; or*
- (b) Where he failed to ask the agent to return the document evidencing the power of agency and failed to seek a judicial decision to the effect that such document was revoked; or*

*(c) Where he caused in any other manner, in particular by his statements, behavior or failure to act, a third party to believe that the person with whom he was dealing was authorized to act on behalf of the principal.*

Under sub-article (a), it is failure to notify third parties that leads to joint liability of the principal and the agent. When an agency is terminated by act of the parties or of one of them, the principal must give immediate notice termination to all persons who may have learned of the agency. Failure to give notice may lead the agent with apparent authority. Without such notice, the agent may go on making contracts for the principal. To avoid such a situation, all third parties who knew of the existence of agency must be informed. It comprises those who have done business with the agent but whose identity is not known. The principal can publish notice of termination in a newspaper of general circulation in the area where the agent was representing the principal.

The issue of returning the document arises when the principal revokes the power of the agent. It is the principal who must ask the agent to return the document. If the document evidencing his power is left behind, the agent may go on making contracts with third parties pretending that he is still the agent even though his power has been revoked. Therefore, the principal must not leave the document with the agent.

Sometimes, the agent may not be willing to return the document. He alleges that it is lost stolen or destroyed. The principal has another alternative action in such cases. He may seek a judicial decision to set the document revoked. That is, upon the application of the principal, the courts may declare that the document is revoked. After such judicial declaration, the document may not have any binding force on the principal. Thus, failure to ask the return of the document and failure to seek a judicial decision may lead to faint liability.

Joint liability may also result from his conduct, behavior or failure to act. If the principal make a third party to believe that the person with whom he was dealing was authorized to act, the principal is giving apparent authority to the agent. If the agent pretends to have authority and the principal does not object as to the very conduct of the agent that may create a wrong belief in the mind of the third party.

### 4.3 Termination of Agency power

Agency power is not given for a person to act on behalf of the principal in such a manner as to enable the former to undertake activities of the latter for ever. There are mentionable cases where this agency power, that is to say the power to act on behalf of some other person, comes to its end.

#### a. Revocation

**What is revocation? (You can use the spaces left below to give your answers)**

Revocation is the withdrawal of the power of the agent.

*(1) The principal may at any time restrict or revoke, as regards third parties, the authority he gave to the agent to make contracts in his name.*

*(2) Any waving of such rights shall be of no effect.*

*Article 2226 Civil Code*

*(1) The principal may revoke the agency at his discretion and, when appropriate, compel the agent to restore to him the written instrument evidencing his authority.*

Article 2228 - Plurality of principals.

*(1) Where the agent has been appointed by several principals for a common affair, the revocation of the agent may be effected only by all the principals.*

*(2) One of the principals may not without the others consent to revoke the common agent unless such revocation is founded upon a just motive.*

The principal may at any time restrict or revoke the authority that he had given to the agent. There is no restriction on the power of the principal to revoke or to withdraw the authority that had been given to the agent. He can do it at any time. However, if the principal revokes the agency in breach of contract, the principal is liable to the agent for damages. When the power of agency is revoked by the principal, the agent must return to the principal documents, if any, evidencing his power. If the revocation causes any loss to the agent, the principal shall indemnify the agent.

#### b. Renunciation by the Agent

Read the following civil code provision before you go any further.

Article 2229 - Renunciation of agent

- (1) The agent may renounce the agency by giving notice to the principal of his renunciation.*
- (2) Where such renunciation is detrimental to the principal, he shall be indemnified by the agent unless the latter cannot continue the performance of the agency without himself suffering considerable loss..*

The agent is free to renounce the agency or to resign from his post at any time. The only condition is that he must give notice to the principal. However, if the renunciation constitutes a breach of the agency contract, the agent is liable for damages.

### **c. Death or Incapacity of the Agent or the principal**

The general rule is that the death of the principal or agent terminates an agency. Insanity or declaration of absence of either party does also be a cause for termination of agency power.

Article 2230 Civil Code

- (1) Unless otherwise agreed, a contract of agency shall terminate by the death of the agent or where he is declared absent, because incapable or is adjudicated bankrupt.*
- (2) The heirs or the legal representatives of the agent who are aware of the agency shall inform the principal of these circumstances without delay.*
- (3) They shall, until such time as the necessary steps can be taken by the principal, do whatever is required in the circumstances to safeguard the principal's interest.*

### **Summary**

Agency relationship is a fiduciary relationship. It results from contract and operation of the law. The authority given to an agent may be express or implied. Express authority may be written or oral. An agent is impliedly authorized to perform those acts which are reasonably necessary to carry out his express authority. The authority to act on behalf of another may also result from the operation of the law. An agency relationship by the operation of the law is implied regardless of express or implied intentions of the parties.

As a rule, an agent is required to act within his authority. If the agent exceeds his authority, the principal may repudiate or ratify the act of the agent made beyond his power. Ratification releases the agent from his liability to third party and the principal is bound to the third party.

The intent of the agent's power to act for the principal depends upon the authority granted by the principal. The scope of the power of the agent is fixed by agreement in that the agency is either special or general. The principal is liable only for the authorized acts of the agent. General agent has more extensive power than the special agent.

The law of agency is concerned with issues of contractual liability. There are cases where the principal is held liable to third parties. There are also cases where the agent is personally liable to the third party. Sometimes, the principal and the agent may jointly be liable to the third party. Agency relationship terminates in different ways. The principal may revoke (withdraw) the power of the agent. The agent may also renounce his power or may resign from his post. These are ways in which termination is by the act of the parties. Agency also terminates by the operation of the law. Death, incapacity declaration of absence declaration of bankruptcy of either party may terminate agency.

#### **Self to do exercises 4**

Read the following questions very carefully and answer the questions that follow in the given spaces beneath them.

1. When does the act of an agent bind a principal to third parties? In other words, what conditions are to be met to bind a principal to third parties for the acts of his agent?

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2. Is sub-delegation of agency power not possible under the Ethiopian civil code? (If there is any possibilities deal with the instances).

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3. What kinds of acts require specific authorization?

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# UNIT FIVE

## BUSINESS ORGANIZATIONS

### Introduction

There are many provisions of law governing or regulating business organizations which may not be modified by agreement. Except for joint ventures, all forms of business organizations under the Ethiopian law have legal personality.

In this Unit, you will study the general provisions applicable to all forms of business organizations.

### Objectives

After completing this Unit, you will be able to:

- define business organization;
- explain a partnership agreement;
- describe legal personality and attributes of legal personality; and
- distinguish between limited and unlimited liability of business organizations; and

### 5.1. Definition

**? What is a business organization? (You can use the spaces left below to give your answers)**

---

A business organization is any association arising from a partnership agreement.

Article 211- Partnership Agreement

*A partnership agreement is a contract whereby 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 and in the profits and losses arising out thereof.*

**? What are the elements in the definition? (You can use the spaces left below to give your answers)**

A partnership agreement is a contract. A business organization is not created unless the parties have a contract which fulfils all the basic requirements for the existence of a valid contract. Like any other contract, at least two persons must be parties to a partnership agreement. This is true for all business organizations except the share company, for which there must be at least five. The minimum requirement of two persons means that one person cannot form a business organization by himself. There is no limit on the number of persons who may be members of a business organization, except in the private limited company where the number of members may not exceed fifty. In most cases, the number of members in a partnership or joint venture will normally be small. This is because of a close personal relationship involved. On the other hand, the number of members of a share company may be huge.

General contract requirements must also be met in as far as formation of partnership agreement is concerned. The parties to it must be capable persons and give their consent free of defects. The object of the contract must be sufficiently defined and is possible and lawful. The contract must be made in the form prescribed by law; if any.

Generally speaking, the following persons may not enter into contracts: minors, notoriously insane persons, persons with permanent infirmities affecting their ability to consent, persons judicially interdicted. A contract made by such persons is invalidated by the incapable person or his representative. Even though these persons may not enter into contracts by themselves, contracts made by their representative are binding on them. Thus, if the tutor of an incapable person enters into contracts in the name of the incapable, the contract is binding on the incapable person.

The same rule of incapacity applies to partnership agreement. Its validity is affected by the incapacity of a partner. The Commercial Code adds some rules. Incapable persons cannot become traders. Even an emancipated minor cannot carry on a trade unless authorized to do so in writing by the family council.

In order for a contract to be a valid partnership agreement, the parties to it must have intended to join together and to cooperate. In a sense, this means that they intend to form business organization.

**? What do the different forms of business organizations look like? (You can use the spaces left below to give your answers)**

The formation of any business organization other than a joint venture shall be of no effect unless it is made in writing. Except the joint venture, all the other forms of business organizations shall be made in writing and publicized in newspapers and by registration. A business organization shall not have existence unless these formalities are complied with.

Each party to a contract must give his consent free from defects; this is without mistake, fraud or duress. These defects may arise in various ways in the formation of business organizations.

Like any contract, the partnership agreement must have a sufficiently defined, possible and lawful object. Object refers to the respective obligations of the contracting parties. In a partnership agreement, object consists chiefly of the undertakings of the parties to make contributions. But the object of a partnership agreement also may be interpreted to include the purposes of the business organization, thus requiring that such purposes be defined, possible and lawful. The object of a contract is not the same as a motive of the parties who make it. Motive is the reason why or the purpose for which the parties enter into the contract.

In order to have a valid partnership agreement, each party must undertake to make a contribution to the business organization. In return for the contribution he or she makes, receives a membership interest in the organization. Each contribution must be something of value. In the case of business organizations other than a share company and private limited company, the contribution may be in cash, in kind or services

Contributions in kind are contributions of corporeal or incorporeal property. For instance, one can contribute immovable or movable property. It is also possible to contribute rights of literary or artistic ownership. When property is contributed, the value of each contribution must be agreed upon by the parties and written in the partnership agreement. The person who contributes his services or skill works for the organization, but is not paid a fixed salary or wage for the services he contribute. Instead, he receives a share in the profits.

If the organization is a legal person, the contributions in kind are owned by the organization. In joint venture, each member of the venture owns his own contribution. Sometimes, only the use of the property may be contributed. In such cases also, the one who contributed the property retains ownership.

Partnership agreement is always established or formed to carry on economic activities. This means, any business organization is established for the purpose of making profits. The parties to a partnership agreement must also intend to participate in profits and losses. The shares of the members in profits and losses need not be equal. There may be inequality among members. The partnership agreement may not give all profits to one partner or relieve one or more partners of their share in the losses. Any stipulation in the agreement to that effect has not effect.

## **5.2 Forms of Business Organizations**

**? What are the six forms of business organizations which the commercial code of Ethiopia recognizes? (You can use the spaces left below to give your answers)**

Article 212. Different Business Organizations.

*(1) There are six forms of business organizations under this code:*

- a) Ordinary partnership*
- b) Joint venture*
- c) General partnership*
- d) Limited partnership*
- e) Share company*
- f) Private limited company*

### **5.2.1 Ordinary Partnership**

This is an organization usually of a relatively small number of persons. It may not be a commercial business organization. That means, ordinary partnership may not carry out any of the activities specified in Article 5 of the Commercial code. Since Article 5 mentions most profit making activities, the use of ordinary partnership form is extremely limited.

Each partner shall make a contribution which may be in money, in property or skill. Property or the use of property may be contributed. Where property is contributed, the contributing partner shall carry out the duties of the seller.

A party who contributes a property has the same obligations of a seller, that is, to deliver the thing, to transfer ownership and to warrant the buyer against defects. Where property is contributed, the risks shall pass to the partnership in accordance with provisions relating to sale.

### **5.2.2 Joint Venture**

**? What are the salient features of this business organization? (You can use the spaces left below to give your answers)**

This organization is usually formed with a relatively small number of persons or for a limited purpose or for a short period of time. Unlike all other forms of business organizations, the joint venture is not a legal person and its existence may not be disclosed to third persons.

Joint venture is not a legal person. It does not have independent existence. It does not have the attributes of personality. A joint venture agreement need not be in writing and is not subject to registration and other forms of publication required in respect of other forms of business organization. In the joint venture, every partner owns his contribution. This is because it does not own property since it does not have legal personality.

**? How is the liability of the partners determined in joint venture? (You can use the spaces left below to give your answers)**

The liability of the members of the joint venture depends on the memorandum of association.

### **5.2.3 General Partnership**

This organization usually is formed with a relatively small number of persons. Its members do not have limited liability. General partnership may have a trade name.

### **5.2.4 Limited Partnership**

The limited partnership is basically the same as general partnership. But there is one exception. In limited partnership, there are two types of partners. One or more of its

members have limited liability. General partners in limited partnership have unlimited liability. A limited partnership has a firm name.

### **5.2.5 Share Company**

The share company is fundamentally different from the forms of business organizations. All of its members enjoy limited liability. It may consist of many members. Membership is freely transferable. Share Company is the form of business organization usually chosen to operate enterprises which require huge amount of money.

For a share company, the capital shall not be less than 50,000 Birr as the law stands now. A share company may not be established by less than five members. Persons who sign the memorandum of association and subscribe the whole of the capital shall have the legal status of founders. The founders may reserve personally to themselves at least one fifth of the net profits. This is in addition to their rights as shareholders. However, such right to get one-fifth of the net profits must be mentioned in the memorandum of association. A share company shall not remain in business for more than six months after the number of members is reduced to less than five.

### **5.2.6 Private Limited Company**

This organization is the mixture of the share company and the partnership. It is like the share company in that all of its members enjoy limited liability: it is like the partnership in that it usually has a small number of members.

A private limited company shall not have less than two or more than fifty members and it is always commercial in nature

The capital of private limited company shall not be less than 15,000 Birr. Private limited company shall not undertake banking, insurance or any business of a similar nature.

## **5.3 Commercial Business Organization**

**? What is a commercial business organization? How do you understand it? (You can use the spaces left below to give your answers)**

Read the following commercial code provisions.

Article 10 of the Commercial Code.

- (1) A business organization shall be deemed to be of a commercial nature where their objects under the memorandum of association or in fact are to carry on any of the activities specified in Article 5 of this Code.*
- (2) Share Company and private limited companies shall always be deemed to be of a commercial nature whatever their objects.*

An ordinary partnership may not be a commercial business organization. General partnerships, limited partnerships and joint ventures may or may not be commercial. Only commercial business organizations are required to keep accounts. And only commercial business organizations go through bankruptcy.

#### **5.4. Legal Personality of Business Organizations**

**? Do you recall about legal personality? (You can use the spaces left below to give your answers)**

As you can recall from what has been discussed under Unit One of this course, persons are the subjects of rights and obligations. They may be compared with goods, which are objects of rights and obligations. There are mentionable cases where the law confers personality to things. There are purposes that the law tries to achieve by doing so. Thus, Article 210(2) of the Commercial Code of Ethiopia provides that any business organization other than a joint venture shall be deemed to be a legal person. This is a way of enabling any business organization other than a joint venture to become the subject of rights and obligations.

A business organization is mainly a collection of physical persons and of property. If the organization is not treated as a person, the member would normally be joint owners of the property. A contract may be made in the name of one or more of the members. When the law provides that a business organization is a legal person, the organization itself may own property and a contract may be made in the name of the organization.

The concept of a legal person is used in many areas other than business organizations. A legal person has certain attributes which are going to be discussed in a manner that follows.

### **a. Capacity**

**? Can you recall a discussion on the concept ‘capacity’? What does it mean?**

**(You can use the spaces left below to give your answers)**

---

Capacity is the extent to which the law permits a person to possess and exercise rights. There is a distinction between enjoyment of rights and their exercise. When we speak of the capacity of legal persons, we are only referring to its enjoyment of rights. A legal person cannot by its very nature exercise any rights by itself; it must act through agents. A business organization cannot do things physical persons can do, which depend on the human nature of a physical person. A business organization, as a legal person, cannot make its own decisions. On the other hand, a business organization is not subject to incapacities which relates to human characteristic of physical persons.

### **b. To sue or be sued in its Own Name**

To sue means to bring a legal action against another. Once an organization acquires personality, it can bring actions against others in its own name, not in the name of the members of the organization.

### **c. The Right to Own Property**

The property of the organization is not the same as the property of its members. The personal debts of its members cannot be recovered from the property of the organization. But a personal creditor may proceed against the membership interest of the members.

### **d. It Can Enter into Contracts in its Own Name**

The debt of the organization may not affect personal property of individual partners unless the liability of the organization is unlimited. Where the liability of the business organization is unlimited, its debt may extend to personal property of its members.

## **5.5. Liability of Business Organizations**

The liability of a business organization may be limited or unlimited. Suppose a business organization incurs contractual obligation and the organization does not have sufficient fund to perform its obligation. May the members be made to fulfill it?

In some business organizations, the members may be held liable for a debt of the organization, if the organization fails to pay the debt itself. Such business organizations are said to have unlimited liability. That is, the liability of the organization may extend to personal property of members. In other business organizations, the members are not liable to the debt of the organization. The creditors may sue the organization and seek payment from the assets of the organization. In other words, the liability of the members for the debts of the organization is limited to the amount of their contributions. Such organizations are said to be limited liability.

Share Company and private limited company always have limited liability. Ordinary partnership, general partnership and general partners in limited partnership have unlimited liability. Note that there are two types of partners in limited partnership: general partners and limited partners. General partners have unlimited liability whereas limited partners have limited liability. The liability of a joint venture may depend on the memorandum of association.

### **? Does limited liability have any advantage to businessmen?**

Limited liability is a great advantage to a businessman. He may operate his business without the fear of losing all his personal property if the business fails. If a business fails, he will lose only what he contributed to the business organization.

On the other hand, limited liability contains some dangers for creditors of the business organization. Organizations in which the members have limited liability must have a specified minimum capital or must have at least one member without limited liability. These rules are meant to protect creditors. The capital of the organization serves as a security for the payment of the debt of the organization. Even though the profits of the organization may be distributed to its members, an amount of money or property equal to the capital is retained by the organization. The capital is not distributed among the members while the organization is in existence. This principle is very important in the organization in which all members have limited liability (The Share Company and private limited company). The property of the organization is the only place a creditor may look to satisfy an unpaid debt of the

organization. If the members do not have limited liability, the principle is not very important because unpaid creditors may sue members.

Article 216 of the Commercial Code provides that a business organization shall acquire rights and incur liabilities by its agents in accordance with the rules governing agency. This is because a legal person cannot act by itself. Each organization has one or more managers who have general powers to represent the organization. In share companies, the management function is divided between a board of directors and a general manager.

In general, pursuant to the rules of agency, a business organization is bound by any contracts or other acts made in its name by an agent acting within the scope of his powers. A business organization is liable to third parties for contracts made in its name. This is what we call civil liability. There is also another source of civil liability: extra-contractual liability. A business organization is subject to extra-contractual liability when one of its agents or employees incurs a liability in the discharge of his duties. The liability is presumed to have occurred in the discharge of duties if the damage is caused at the place where or during the time when the agent or employee is normally employed.

A person may be criminally liable if he is found guilty of a criminal offense.

**? Is a business organization criminally liable?**

**(You can use the spaces left below to give your answers)**

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It is not clear whether a legal person is subject to penal liability, in the absence of an express provision making it liable. To answer the question, read Article 23 of the Penal Code:

**Art. 23 Offences**

- (1) A criminal offense is an act or omission which is prohibited by law.
- (2) The criminal offense is only completed when all its legal, material and moral ingredients are present.
- (3) A criminal offense is punishable where the court has found the offense proved and deserving of punishment.

According to sub-article (2) of this Article, three elements must be present for a penal liability. The first is legal elements. That is, to be criminally liable he a person must commit an act prohibited by law or omit the act where is

required to do so. The second element is commission or omission. The third element is a moral element. This is sometimes called mental element. To be criminally liable, the person must commit or omit the act forbidden by law intentionally or negligently.

Therefore, a doubt as to the penal liability of legal person arises from at least four sources. First, being without mind, a legal person cannot satisfy the mental or moral element. That is, a legal person cannot have the intent or negligence in action. Secondly, in the Civil Code, there is a provision that makes a legal person civilly liable for the acts of its agents and employees (Article 2129 C.C.). The Penal Code does not have similar provision. In the absence of clear provision, you cannot hold a legal person criminally (penally liable). Thirdly, Article 689 of the Penal Code states that if an economic or commercial (business) offense is committed in the management of a body corporate (legal person), punishment is imposed on the managers, agents, member, directors, auditors or liquidators who committed the offense. In other words, a legal person is not liable for the criminal offense committed by these persons. Punishments such as death and restriction of liberty cannot be imposed on a legal person.

### **Summary**

A business organization is any association arising out of a partnership agreement. A partnership agreement is a special contract. As a contract, it must meet all the requirements. Under the Ethiopian Commercial Code, there are six forms of business organizations. Any business organization other than a joint venture shall be deemed to be a legal person. Any business organization other than an ordinary partnership may be a commercial business organization. The formation of any business organization other than a joint venture shall be of no effect unless it is made in writing. Any provision in the memorandum of association giving all profits to one partner or relieving one or more of the partners of his share in the losses shall be null and void. A business organization shall acquire rights and incur liabilities by its agents in accordance with the provisions governing agency.

A business organization shall have neither legal existence nor personality until all the rules relating to registration and publicity are carried out.

The liability of a business organization may be limited or unlimited. Share Company and private limited company have always limited liability. Limited partnership has two types of partners and, therefore, two types of liabilities. General partners in limited partnership have unlimited liability where as limited partners have limited liability. The liability of ordinary partnership and general partnership is always unlimited. The liability of a joint venture depends on the memorandum of association.

### **Self check Exercises**

#### **Part I. Answer the following questions in the given spaces.**

1. What is a business organization? How do you distinguish it from other kinds of associations?

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2. An ordinary partnership is made to be one of the six forms of business organizations which the Ethiopian commercial code recognizes. Yet, it is different from other kinds of business organizations in that it does not share the features with which the other business organizations are characterized.

So, can we take ordinary partnership as a business organization proper? Why/ why not?

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3. Is a business organization criminally liable like physical persons? If your answer is yes, deal with the instances.

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#### **Part II. Read the following questions very carefully and answers them in the spaces provided.**

1. Distinguish between contractual obligations and social obligation.

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2. Contracts involving interests in land (such as a contract for the sale of a house) must be in writing. What is the legal effect of an oral contract in this situation?

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3. Ato Dayaso went to the telephone book and sent letters to randomly selected names. The letter to each stated it is agreed that we will paint your house for a price based on the cost of our labour and paint plus an additional 10% for profit.'

He sent such a letter to Woizero Dancho.

- a. Is there a contract between Ato Dayaso and Woizero Dancho? Why or Why not?
- 

- b. How do you explain the nature of the offer made by Ato Dayaso?
- 

- c. Is woizero Dancho duty boun to pay Ato Dayaso if she did not respond but her hause is painted by the of feror?
- 

4. C' took a package of food from a shelf of Bambis super Market and paid for it at the cashier's counters. C' later on sued the Bambis super market because of a defect in the product. The super market raised the defense that it could not be sued because it had never made a contract with C' for the sale of the product. Is that a valid defense?
- 

5. 'A' made a contract to construct a house for 'B' subsequently 'B' sued 'A' for a breach of a contract. 'A' raised the defense that the contract was not binding because it was not sealed. Is the presence or absence of a seal a formal requirement for the validity of contract?
- 

6. 'D' and his wife, daughter and grandson, lived in the house owned by 'D'. At the request of daughter and grandson, 'P' made some improvements to the house. 'D' did not authorize these but he knew that some improvements were being made and did not object to them. 'P' sued 'D' for the reasonable value of the improvements. Is 'D' obliged to pay for such improvements?
-

7. 'H' had a fire insurance policy with the Ethiopian Insurance Corporation for the last five years. 'H' used to renew his policy at the end of each year. Prior to the expiration of the fifth year, 'H' sent EIC a renewal offer covering the next year together with a bill for the renewal premium. The bill stated that the offer should be returned promptly if the renewal was not desired. EIC did not return the offer or take any other action relating to the insurance. Is the EIC duty bound to cover the loss if the risk materializes?
- 

8. Tana Department store ran an advertisement in a newspaper stating that a certain television set was on sale for 3500 Birr. Chaltu phoned the store and replied that the set was sold out already and it cannot satisfy her order. Chaltu sued the Department for a breach of contract. Is the store liable?
- 

'K' mailed 'P' an offer which stated that it was good for ten days. Two days later she mailed 'P' another letter stating that the original offer was revoked.

- a. Is a binding contract created between 'K' and 'P'? Base your argument on the theory of dispatch and reception.
- 

9. 'M' was 16 years old. He purchased a motorcycle to go on a summer trip. After having driven the motorcycle for 5000 k/ms and after having wrecked and repaired it once, he brought it back to the dealer who sold the motorcycle demanding the return of the full purchase price.

- a. Can 'M' invalidate the contract?
- 

Is the dealer required to take back the motorcycle and refund the purchase price?

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10. 'N' telephoned 'M' one morning and offered to sell 40 quintals of orange at a certain price. 'N' then telephoned 'K' and made another offer to sell a used car. Both 'M' and 'K' told 'N' they would "think about it". How long would these offers remain open?
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11. Distinguish between an express offer and implied offer.

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12. 'E' owned a poultry farm that 'P' without success, had offered to buy. 'E' was induced to sell only after 'P' threatened to "have someone burn his barn because if he (p) cannot have that farm, no one will" 'E' later repudiated the contract and 'P' sued. Would 'P' win the case? Why or why not? Was the danger posed against 'E' serious and imminent? What other factors can be considered before deciding the case in favor of 'E' or 'P'?

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13. 'F' signed a written document to pay 'L' 300 Birr for installing gutters on his house. When he was sued on the contract 'F' pleaded mistake, claiming that he believed he was to pay only 30 Birr and that he had not read the document before he signed it. Could 'F' avoid that contract on the ground of mistake?

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14. 'B' contracted with 'G' to take care of her children during the day while she was at work. When 'G' was unable to carry out her agreement to take care of the children, she told 'B' that she had transferred the contract to her friend, 'M'. 'B' objected and refused to accept 'M'.

A. What Issue is Involved In this Problem?

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B. Was 'B' within her right?

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# CHAPTER SIX

## NEGOTIABLE INSTRUMENTS

### 6.1 Definition of Negotiable Instruments

The word negotiable means ‘transferable by delivery’ and the word ‘instruments’ means a written document by which a right is created in favor of a person. Thus, the term negotiable instrument literally refers to a document containing rights that can be transferred by delivery.

Similarly, Article 715(1) of Ethiopian Commercial Code of 1960 defines the term negotiable instruments as any document incorporating a right to an entitlement in such a manner that it is not possible to enforce or transfer the right separately from the instrument.

The rights that could be incorporated in negotiable instruments may be rights for payment of money arising out of various contracts such as the contract of loan, sale, lease, or any other contract performed by payment of a certain amount of money. Such rights may also arise from ownership in companies or loan made to the government or to a share company. The rights that are incorporated in negotiable instruments may be rights to receive goods under voyage or deposited in a warehouse. According to this provision, the holder of negotiable instruments can transfer the rights incorporated in the instrument by transferring the instrument. Similarly, a person who claims the rights incorporated in negotiable instruments may enforce or exercise them only if he has possession of the instrument, i.e., he should be a holder to whom the instrument is issued or transferred following the rules governing its transfer. He must also present the instrument to the person who is supposed to perform the obligations arising out of the instrument. (See also Art 716/1/). The fact that the rights incorporated in negotiable instruments may be transferred by the transfer of the instrument and the fact that a person may not exercise or enforce them unless he is in possession of the instrument are the two main features which distinguish negotiable instruments from other documents evidencing rights such as a title deeds whose transfer does not transfer the rights they establish. /Refer to Art 1185 and 1195 of the Civil Code/

Another point that has to be noted here is that negotiable instruments are issued or negotiated based on other contracts. For instance, a person may issue a bill of exchange to repay the money he has borrowed from the payee, the company issues a share certificate or debenture certificate as evidence of the person's right arising out of contract of partnership creating the company or a contract of loan respectively. / Art 211 and 429 of the Commercial Code/. The warehouse person or the carrier issues the warehouse goods deposit certificate or the bill of lading / consignment note based on contracts of warehousing or carriage respectively. Finally, the definition of negotiable instruments under the Ethiopian law is much wider than the one adopted by most legal systems, particularly those following the Common Law tradition. This is evident from the Uniform Commercial Code of the United States and the Bill of Exchanges Act of 1882, which restricts the concept to bills of exchange, checks and promissory notes.

Based on the purpose and rights incorporated in the instruments, Article 715(2) of the Commercial Code categorizes negotiable instruments into three main types, i.e., Commercial Instruments, [Transferable] Securities and Documents of Title to Goods.

## **6.2 Types of Negotiable Instruments**

### **6.2.1 Commercial Instruments**

Commercial instruments are negotiable instruments incorporating rights for payment of a specified amount of money. They are issued and negotiated on the basis and with the purpose of performing an obligation that can be performed by payment of a certain amount of money. Hence, they are used as a substitute for money. These are bills of exchange, promissory notes, checks, travelers' checks and warehouse goods deposit certificates as the types of commercial instruments recognized under the Ethiopian law.

### **6.2.2 Transferable Securities**

Securities are negotiable instruments incorporating rights for payment of money. The sources of such rights may be investments made in companies or loans provided to the government or its subdivisions through purchase of government bonds and treasury bills or to companies through the purchase of debentures. A person who invests in a company is entitled to share in

the profits of the company if any, i.e., he has the right to receive dividends and to share in the assets of the company where the company is dissolved. /Art 345/ On the other hand, the person who has purchased a government bond or a treasury bill or a company bond, also called a debenture, acquires the right to receive repayment of the money he has given on loan plus interest. /Art 433/. Refer also to the provisions of Arts 2490-2511 of the Civil Code.

However, all securities are not negotiable instruments. What makes securities negotiable instruments is their transferability according to rules of negotiation. Therefore, if it cannot be negotiated, it is difficult to circulate as money. Bonds, stocks and transferable shares are instances of securities which are negotiable instruments considered.

### **6.2.3 Documents of Title to Goods**

These are negotiable instruments containing rights of ownership over goods that are being transported or goods which are warehoused and which enable their holders to receive such goods. Refer Arts 571-576 and 610-619 of the Commercial Code regarding documents of title to goods under voyage and Arts 2814-2824 of the Civil Code regarding documents of title to goods warehoused.

## **6.3 Checks Bills of Exchange and Promissory Notes**

### **6.3.1 Bills of Exchange**

Bills of exchange are negotiable instruments incorporating an unconditional order, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum in money to or to the order of a specified person.

Bills of exchange, therefore, involve an order to pay money rather than a promise to pay money. The person issuing the order is the drawer, the person ordered to pay is the drawee and the person who receives the payment is the payee.

The Commercial Code of Ethiopia does not provide a definition of bills of exchange. However, Art 735 enumerates the requirements to be fulfilled for drawing a valid bill of exchange from which one may deduce the definition of the term under Ethiopian law.

Accordingly, a bill of exchange must contain;

-  The term “bill of exchange”
-  An unconditional order to pay a certain sum in money
-  The name of the person who is to pay ( the drawee)
-  The time of payment
-  The place of payment
-  The name of the person to whom or to whose order payment is made or an indication that it shall be payable to bearer
-  The date when and the place where the bill is issued.
-  The signature of the person who issues the bill (drawer)

A bill of exchange that does not contain any one of the above requirements shall not be valid and the drawer or any other party to the instrument can raise defect of form against any person who claims based on the bill. Art 717/1/ However, a bill which does not contain the time of payment is presumed to be payable at sight or on demand. A bill which does not mention the place of payment, shall be deemed to be payable at the domicile or at the address of the drawee, and a bill which does not provide place of issue, is deemed to have been drawn at the place mentioned beside the name of the drawer.

### **6.3.2 Promissory Notes**

A promissory note is defined as a document incorporating an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person or to bearer. This, definition implies that promissory notes are promise to pay money and they are only two parties i.e., the maker of the promise and the payee to whom payment is effected.

Similar to the cases of bills of exchange, the Commercial Code of Ethiopia does not provide the definition of a promissory note apart from the requirements provided under Art 823 for validity of promissory notes, which are identical with the definition given above. These requirements are essential for the validity of a promissory note.

Thus, a promissory note must contain;

-  The term “promissory note”
-  An unconditional promise to pay a sum certain in money
-  The time of payment

-  The place of payment
-  The name of the person to whom or to whose order payment is to be made or a statement that the note is payable to bearer
-  The date when and the place where the note is issued
-  The signature of the person who issues the instrument

These requirements should be observed for promissory note to be negotiable instrument. Failure to comply with these requirements results in the invalidity of the instrument except in the cases provided by Art 824, which fills gaps in case of absence of time of payment, place of payment and the place of issuance. Accordingly, a promissory note which does not specify time of payment, shall be deemed to be payable at sight or on demand, a promissory note which fails to indicate the place of payment is presumed payable at the address of the maker of the promise and note which does not indicate the place of issuance deemed to have been drawn at the place indicated beside the name of the maker.

It is important to note the following distinctions between bills of exchange and promissory notes, i.e. a promissory note contains promise to pay whereas a bill of exchange contains an order to pay. The maker of promissory note is always primarily liable and its liability is the same as the acceptor of a bill of exchange, but in case of drawer of bill of exchange once the bill is accepted he is only liable as surety in the event of dishonoring of bill of exchange. The concept of acceptance is not applicable to promissory notes unlike bills of exchange that may be accepted. Finally, promissory notes involve two parties only as opposed to bills of exchange that under normal circumstances involve three parties.

### **6.3.3 Checks**

A check is the most widely used form of commercial instrument. It is bill of exchange drawn on a bank and payable on demand. The English Bills of Exchange Act of 1882 defines a check under Art 73 as a bill of exchange drawn on a banker payable on demand. Therefore, since check is defined by reference to a bill of exchange, most provision governing bills of exchange are applicable to check. The check is an unconditional order in writing, addressed by one person, the drawer, to a banker, signed by the drawer, requiring the bank to pay, on demand, a sum certain in money to or to the order of specified person or to bearer.

The following are the main differences between checks and bills of exchange. A check is always drawn on a banker and is always payable on demand while a bill of exchange may be drawn on any one and may be made payable on demand or at fixed or a determinable future time and a check can be crossed in several ways but bills can not be crossed. Acceptance is not necessary for a check since it is payable on demand as opposed to bills of exchange which may be made payable at fixed or determinable future time presentment for acceptance may be necessary.

It is also important to note that a drawer of a bill of exchange and a check or the maker of a promissory note may antedate or postdate it, provided that he has not committed a fraud. In other words, unless the drawer or maker intended to jeopardize the interest of the payee by causing the rights contained in the instrument to lapse, the mere fact of antedating or post dating an instrument does not make it invalid. If, for instance, a sold furniture worth 1000 Birr to B on credit and the latter issued a bill of exchange on 1/4/07 payable 60 days after date, and ante dated it, i.e., indicated a date prior to date of actual drawing, say 1/1/07, since this bill has to be presented for payment on March 2, 3 and 4 2007, it means that A has already lost his right on the bill before it is issued. B/ the drawer of the bill/ has committed a fraud or fault because he has caused the rights of A to lapse by antedating and hence such bill is invalid. /Arts 744/.

Though the provisions of the commercial code relating to promissory notes i.e. Art 823-27 do not refer to Art 744, a promissory note may also be antedated or post dated as bills and notes are identical with respect of maturity.

## **Summary**

The word negotiable means transferable by delivery and the word 'instruments' means a written document by which a right is created in favor of a person. Thus, the term negotiable instrument literally refers to a document containing rights that can be transferred by delivery.

The rights that could be incorporated in negotiable instruments may be rights for payment of money arising out of various contracts such as the contract of loan, sale, lease, or any other contract performed by payment of a certain amount of money. Such rights may also arise from ownership in companies or loan made to the government or to a share company. The rights that are incorporated in negotiable instruments may be rights to receive goods under

voyage or deposited in a warehouse. According to this provision, the holder of negotiable instruments can transfer the rights incorporated in the instrument by transferring the instrument. Similarly, a person who claims the rights incorporated in negotiable instruments may enforce or exercise them only if he has possession of the instrument, i.e., he should be a holder to whom the instrument is issued or transferred following the rules governing its transfer. He must also present the instrument to the person who is supposed to perform the obligations arising out of the instrument. See also Art 716/1/. The fact that the rights incorporated in negotiable instruments may be transferred by the transfer of the instrument and the fact that a person may not exercise or enforce them unless he is in possession of the instrument are the two main features which distinguish negotiable instruments from other documents evidencing rights such as a title deeds whose transfer does not transfer the rights they establish. /Refer to Art 1185 and 1195 of the Civil Code/

Based on the purpose and rights incorporated in the instruments, Article 715(2) of the Commercial Code categorizes negotiable instruments into three main types, i.e., Commercial Instruments, [Transferable] Securities and Documents of Title to Goods.

### **Nature and Purpose of Negotiable Instruments**

Negotiable instruments represent one form of property rights, i.e., exercised over incorporeal things “choses in action.” In other words, they are property rights in relation to objects of property which do not have physical or material existence and hence which cannot be perceived by the senses. A right of action under contract is a class of property known as ‘choses in action’ and can be distinguished from a corporeal movable property/ a ‘chose in possession’ which represents property rights exercised in relation to objects which have material or physical existence and hence can be perceived by the senses such as a book, a table or a watch. A holder of this type of property right must have actual possession of the object to exercise rights arising there from. Rights incorporated in negotiable instruments, rights of an inventor arising out of a grant of a patent in respect of his invention, rights of a copyrights holder, rights of a trader in respect of his trademark trade name and goodwill are instances of choses in action.

Negotiable instruments also represent one kind of contract as every instrument embodies a contract or promise to pay a certain amount of money or to deliver goods according to terms agreed upon. As contracts, the general rules of contract shall apply unless they are specifically excluded from application by the special law applicable to negotiable instruments. As a result, the requirements necessary for the formation of a valid contract must be fulfilled for issuance of a valid and enforceable negotiable instrument.

The main purpose of negotiable instruments is facilitation of commercial transactions. Commercial instruments are substitutes for money and are used as means of performance of money obligations. Dealing with them reduces the risk of loss or theft and the ease with which they can be transferred creates convenience which will in turn facilitate business. Transferable securities have the purpose of raising capital in the form of contributions made by purchase of shares and bonds, which is used for starting new businesses or expansion of existing businesses thereby increasing the production of goods and services in the country. A document of title to goods, whose negotiation transfers the goods represented by them, creates convenience and facilitates transactions involving the goods. For instance, a person selling warehoused goods can do so by endorsing and transferring the certificate of deposit and without the need to actually deliver the objects. When we come to the specific purposes of commercial instruments, promissory notes can be used as means of borrowing money, buying goods and services on credit and as method of evidencing a pre-existing debt. Certificates of deposit can be used as “device for encouraging individuals to deposit funds in banks, in return for which the holder of the certificate has the right to receive interest. Bills of exchange on the other hand have the purpose of collecting accounts financing, the movement of goods, and transfer funds. Checks serve as “vehicles for transfer of money and also used to aid in keeping records, reduces the risk of loss and destruction and theft of currencies.”

### **Review Questions**

1. Define what negotiable instruments are.
2. Pin point the nature and purpose of negotiable instruments.
3. Clearly show the role of negotiable instruments.
4. Discuss commercial negotiable instruments, transferable securities, and documents of title to goods.
5. Discuss what a holder in due course means in the Ethiopian Commercial Code.

