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Ethiopian Business Laws Module

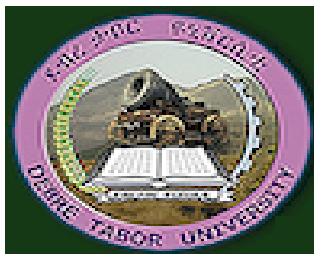
Course Code: law 3101

Credit Hour: 3

Writer: Samuel Maireg (LL.B., LL.M. in Business laws)

June 2018

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University

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Course Prerequisite: None

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Course and Module Introduction

Dear Students, nevertheless business law by its very nature is a supportive or common course given by the law department to the students of the school of business; it is an integral (substantial) part of the curriculum developed to the students of school of business. The scope of business law, in the technical sense, is too broad and it covers large number of jurisprudence and credit hours in proper legal education. However, when it comes to business law for the consumption of school of business it is only the highlight version of the major areas (principles) of business law in Ethiopia which is to be covered.

The general purpose of the course is to introduce business law students with the major, business oriented, legal principles that have an everyday application in due course of operating a business in both ends of the transaction.

Business law in its rough parlance can be defined as the law which is meant to govern business, business transactions, business organizations, and business persons. Business law is the law which lays down the genuine and sustainable ways and foundations of undertaking business transactions. It is the law which defines the rights, duties and liabilities of all the stakeholders in the market. Business law as a law tries to cover every aspect of the players in the market place from formation, operation and all the way to liquidation. By so doing, it guarantees security of transaction by avoiding various suffocations in the business place. It is the law that ascertains the safest (secured) means of forming, operating and extinguishing business activities.

The relevance of the course comes in to picture when one considers the fact that the subjects of business law such as business persons, business organizations and market actors are basically staffed by student graduates of the school of business. Here lays the direct correlation as between the market place, business law students and business law as a course. The main purpose of the course is to equip the students of school of business with the jurisprudence and application in context of the main principles of business laws which enables them to safely play their part as an integral part of the market in the future. There can be no actor in the market place that can contribute a great deal than a business professional that is properly trained in business laws. This is however, without denying the fact that students should also have basic understanding of the other subject matters in their profession other than business law.

Among other things, the writer believes that, the availability of adequate legal training is also

a typical tool in guarantying steady source of revenue to the government. It is only a trader who is properly aware of its rights and duties that is motivated to voluntarily pay its taxes as they appear due on the balance sheet.

Dear Students this module gives much emphasis to the analysis or elaboration of all the pertinent legal provisions relevant to business. Each element of the laws has been discussed and analyzed respectively. An effort is made to make the analysis of the laws more practical and contextual to the various realities in the market place. In addition to the discussion and analysis of the laws, the writer has tried to discuss the related legal doctrines, maxims and scholarly interpretations associated with the legal provisions. A big part of the writing is accompanied by precise, contextual and practical examples that are directly relevant to the market place. Each of the chapters in the module have a destined portion for chapter introduction, chapter objective, definition of key words, chapter exercise and review questions and chapter based list of references.

The module has been written in a way it can guarantee a business law education in DTU which results in business professionals who are pragmatically equipped with the necessary knowledge regarding the law in the market place. The writer believes that universities should guarantee practical knowledge of the subject matter they teach. It will be futile or meaningless to teach mere science of laws absent the necessary practical application. The law-ness of a law lays in its applicability. To ascertain this objective the module contains practical analysis and example of the business laws in practice.

As mentioned above the business law course does not cover or deal with all the constituent elements of business law jurisprudence as the case of law department. This is, among other things, due to the fact that the course is given only as a three credit hour course which makes it impossible to encompass all the elements of business law in to it; the fact that it is a common course to the students of school of business by itself, dictates that the course is meant to introduce such students with only introductory versions of the main principles of business law; and thirdly, the fact that legal education is full of verbosity and technical language (legalese) requires course instructors to find or put to use appropriate yet precise ways of teaching in due course of dealing with students other than law-proper students. By its nature, the methods and principles of business law are very different from the rest of the courses taken by business students this requires course instructors to find the possible appropriate simple ways to deliver the course.

Based on the above reasoning, in this module, the writers tried to cover the following areas of

business law which are identified based on merit or relevance or professional use in the future career of the students of school of business.

Accordingly chapter one deals with the issues of introduction to law. Inside it we will deal with the Definition of Laws, natures of Laws, function of laws, Hierarchy of Laws and Classification of laws. In chapter two we will discuss the various issues related with the concept of Legal Personality such as the definition of a person, the requirements to be considered as a person, the commencement of legal personality and its requirements, the types of persons and requirements attached to them, the end of legal personality and its grounds, the attribute features of legal personality and the fundamental nature of legal personality. Under chapter three we will cover the major Principles of contract law such as, the sources of obligation, the definition of contracts, the types of contracts, formation of contracts, Elements of a valid contract, effect of contracts, Performance and non-performance of contracts, and Grounds of extinction of contract law.

Then Chapter Four will deal with the law of Contract of Sales on Definition of contract of sales, formation of contract of sales, Performance and non-performance of contract of sales and so on. Chapter five on its part deals with the various issues related to law of agency such as the Definition of agency, the need for agency, the sources of agency, the types of agency, the scope of representation, the obligation and liabilities of the agent, the obligation and liabilities of the principal, and the grounds of termination of agency.

The final chapter, chapter six is dedicated to introductory points on the law of insurance such as the definition of insurance, the nature of insurance, the importance of insurance and finally the major principles of law of insurance.

Chapter One

Introduction to Law

Chapter Introduction

Dear distance student, this is the first chapter of your business law module. Hence it will be the main purpose of this chapter to particularly introduce you to the various aspects of the law. To that end this chapter will serve as a chance for you to acquaint yourselves with the introductory points about the various aspects of the law. The writer of the module is convinced that before we proceed to directly tackle the issues and principles of business law we should at least have an introductory glimpse on the law in this chapter.

Accordingly, it will be the main purpose of this chapter to deal with, among others, the definition of laws, the basic feature or nature of laws, the function of laws, the sources of laws in general, the classification of laws and hierarchy of laws.

Chapter Objectives

After the completion of this particular chapter, the student will be able to:

- Explain the nature of law;
- Enumerate the various functions of the law;
- Distinguish the available types of Legal Systems;
- Deduce the elements of the definition of law;
- describe the distinction between law and morality;
- Identify the possible sources of Laws;
- Compos ideas on the types and classification of laws;
- categorize laws in their hierarchical order;
- Appreciate the relationship as between the law and the state.

1.1. Definition of Law

The notion law is so elusive that it is actually difficult to coin one objective (universal or conventional) definition to it. Different jurists have tried to provide their own definition of law from different perspectives.

Dear Student, What is Law? Can you guess the essential points that should be taken into account to define law? It has been known by numerous names in different countries. It is known as ‘Dhama’ in Hindu jurisprudence and ‘Hukum’ in Islamic systems. Romans called it ‘jus’ and in Germany and France, it is called as ‘Recht’ and ‘Droit’ respectively.

Defining the term ‘law’ is not an easy task because the term changes from time to time and different scholars define the term variously. Definition of the term may vary due to the different types of purposes sought to be achieved. Definitions given to the term law are as many as the available legal theories. In this regard it is better to deal with the different definitions provided by different scholars.

According to the Black’s Law Dictionary law in its generic sense, is a body of rules of action or conduct prescribed by controlling authority, having binding legal force. That which must be obeyed and followed by citizen’s subject at sanctions or legal consequences is a law. Law consists of rules of action or conduct. These rules are issued by an authority. In addition, these rules have binding force and are obeyed and followed by citizens. Sanction or other legal consequence may help the law to be abided by citizens.

Cheesman defines law as “that which must be obeyed and followed by citizens subject to sanctions or legal consequences; a body of rules of action or conduct prescribed by controlling authority, and having binding legal force”.

From the pragmatic point of view, American jurist, Benjamin N. Cardozo defines law as “a principle or rule of conduct so established as to justify a production with reasonable certainty that it will be enforced by the courts if its authority is challenged.” According to Holmes “the prophecies of what the courts will do in fact and nothing more pretentious, are what are meant by the law”. It is observable from these definitions that courts play great role in applying as well as creating the law.

Austin defines law as in its most general and comprehensive sense as any rule of action and includes any standard or pattern to which action are or ought to be in conformity. In its judicial sense, ‘law’ means a body of rules of conduct, action or behavior of persons, made and enforced by the state. It expresses rule of human action.

From the sociological perspective, Max Weber suggests that an order will be called law if it is externally guaranteed by the probability that coercion (physical or psychological), to bring about conformity or avenge violation will be applied by a staff of people holding themselves especially ready for that purpose.

He further argues that law has three features that distinguish it from other normative orders such as custom or convention:

- a. There must be a pressure that comes from an external organ in the form of actions or threats of action by others regardless of the person wants to boycott the law or not;
- b. These external actions or threats of action always involve coercion or force;
- c. Individuals whose official role is to enforce the law must enforce the coercive action.

He refers to the state particularly when he talks about officials who enforce the law because they are state officials who are empowered to do that (the Coercive Force of the State, namely the courts, police and the penitentiary system).

According to Blackstone, law in its most general and comprehensive sense, signifies a rule of action, and is applied indiscriminately to all kinds of actions, whether animate or inanimate, rational or irrational. Thus, there is law of gravitation, of optics, of mechanics, as well as the law of nature and of notions.

In ancient states, law was conceived as divinely ordained set of rules of human action. Therefore, it was believed to have a divine origin. Although these definitions are no longer applicable in modern times but they still have a theoretical significance.

According to Justinian, law is the king of all mortal and immortal affairs which ought to be the chief, the ruler and the leader of the noble and the base, and thus the standard of what is just and unjust, the commander to animals naturally social of what they should do, the forbidden of what they should not do.

Ulpian has defined law as the art of science of what is equitable and good. The ancient Hindu jurists held law to be the king of kings, far more powerful and rigid than nothing can be mightier than law, by whose aid, as by that of the highest monarch even the weak may prevail over the strong.

The above idealistic definitions of law were given at the time when there was no distinction between law, morals and religion and law was broadly conceived as part of religion. These definitions have therefore lost their credence in modern time when law is being treated as an

instrument of social change. The elements of justice in law are however considered necessary even in the present time. Nevertheless, what law contemplates today is legal justice and not abstract justice as visualized by the ancient jurists.

In the present age law pervades all the sphere of human activities and the state seeks to regulate them through the instrumentality of law. The law, therefore, plays a positive role in regulating human conduct. The modern jurists have defined law as a means to secure legal justice.

Expressing his views regarding confusion about an exact definition of law, Lord Lloyd observed, ‘since most juristic ink has flown in an endeavor to provide a universally accepted definition of law, but with little sign of attaining that objective.’ Morris also holds similar views about the lack of unanimity in the definition of law and opines that since law has been variously defined by various legal scientists, from different point of views, there could not be any unanimity of opinion regarding the real nature of law and its definition. Despite there being lot of literature available on law, there is no common definition of law, which could be acceptable to all.

Modern jurists have defined law from different angels. Some have defined it on the basis of its nature, some concentrate mainly on its sources. Again, some writers define law in terms of its effect on society while others prefer to define it in terms of its end or purpose. For instance, Ihring defines law as the form of the guarantee of the conditions of life, of society, assured by states power of constraint. Thus, he treats law only as a means of social control and its obedience is secured by the state through external compulsion. This author emphasized that law is an instrument for serving the needs of human society.

According to Gray, law is a statement of the circumstances in which public force will be brought to bear up on men through courts. Thus, it consists of rules, which the courts lay down for the determination of legal rights and duties. Salmond, defined law as the body of principles recognized and applied by the state for the administration of justice. The object of law is to achieve justice. On the other hand, Roscoe Pound stated law to be “social control through systematic application of force of politically organized society”. Thus, law can be described in terms of legal order accepted by society at large functioning within the limits of the state. Thurman Arnold observed, law is ultimately a set of positive, prescribed formal rules enforced by the Sovereign authority with the approval of common public opinion in response to social change emanating from contemporaneous factors and currency of forces.

Professor H.L.A Hart has defined law as a system of rules- primary and secondary rules, their union or combination may justly be regarded as the essence of law. The primary rules according to Hart are duty imposing and secondary rules are power conferring.

Dear Student, for the sake of your business law class however, consider the following generalized definition of law as, “law is a bundle of rules (constitution, Proclamation, Regulations or directives) enacted by the state (made by the legislature (House Peoples Representatives), implemented by the executive (the Council of Ministers) and interpreted by the judiciary (Courts)) to govern the behaviors of its members”.

In general, law may be described in terms of legal order tacitly or formally accepted by the society and enforced. A body of binding rules sufficient compliance of them is ensured by some mechanism accepted by community is called law.

1.2. Basic Features of the Law

Analyzing the features and nature common to all laws would help us to understand the concept of law. Among these features and natures, the ones considered as essential include generality, normativity and sanction. Let us deal with them turn by turn:

a. Generality

Law is a general rule of human conduct. Rules and regulations that constitute the law of a country are general statements of possible human behavior. Laws do not specify the names of specific persons or behaviors. Hence, its generality is both in terms of the individuals governed and in terms of the social behavior controlled. Laws do not deal with a particular person or they are not meant to regulate the behavior of a particular person. Legal rules are also said to be general because it is possible to apply a single rule to a potentially unlimited number of cases. That is to say, legal rules will not go in to the particulars of daily life but they set general criteria by which many acts and situations are covered. Moreover, legal rules are general because they are usually designed to apply for indefinite period of time for the future. The extent of generality of a law depends on whom the law is made to be applicable.

Illustrations:

1. “Everyone has the right to life, liberty and the security of a person.” (Art 3 of the Universal Declaration of Human Rights). This rule is made to be applicable to every person on this world. Therefore, it is universal.
2. “Every person has the inviolable and inalienable right to life, the security of person and

liberty.” (Article 14 of the 1995 Constitution of the Federal Democratic Republic of Ethiopia).

This constitutional provision is made to be applicable to every person in Ethiopia. So, the extent of its generality is national. However, this is less general than the first illustration.

3. “Every Ethiopian national, without any discrimination based on color, race, nation, nationality, sex, status, has the following rights...

(b) On attainment of 18 years of age, to vote in accordance with the law.” (Article 38(1) (b) of the 1995 Constitution of the Federal Democratic Republic of Ethiopia).

This law is made to be applicable only to Ethiopian nationals who attain 18 years of age. Therefore, it is even less general than the second illustration.

4. “Whoever intentionally spreads or transmits a communicable human disease is punishable with rigorous imprisonment not exceeding ten years.” (refer to article 514 (1) of the 2004 Criminal Code of the Federal Democratic Republic of Ethiopia).

This law is made to be applicable only on a person who commits the crime. Therefore, it is even less general than the third illustration.

5. “The term of office of the presidents shall be six years. No person shall be selected president for more than two terms” [Article 70(4) of the 1995 Constitution of the Federal Democratic Republic of Ethiopia].

This law is made to be applicable only to a person who becomes a president in Ethiopia. Therefore, it is even less general than the fourth illustration.

In all of the above illustrations, the subjects of laws are given in general terms. However, the extents of the generalities decrease from universality to an individual person. Generality of the subject of the law may serve two purposes. Firstly, it promotes uniformity and equality before the law because any person falling under the group governed by the law will be equally treated under the same law. Secondly, it gives relative permanence to the law. Since it does not specify the names of the persons governed, the same law governs any person that falls in the subject on whom the law is made to be applicable. There is no need to change the law when individuals leave the group. This is what can clearly be seen from the fifth illustration. Even if the former president’s term of office has lapsed, the same law governs the present and future presidents without any need to change the law. The permanence of law is indicated as relative for there is no law made by person, which can be expected to be

applicable eternally.

Generality of law, as indicated above, does not only refer to the subjects governed but also the human conduct, which is controlled. The human conduct in any law is given as a general statement on possible social behavior. It does not refer to any named specific act like stealing, killing by shooting and killing by spearing. Just a law can govern millions of similar acts and that saves the legislator from making millions of laws for similar acts, which may make the law unnecessarily bulky.

b. Normativity

Another basic feature of law is its normative aspect. A statement of the law is not a mere description of things or facts. Law does not simply describe or explain the human conduct it is made to control. It is created with the intention to create some norms in the society. Law creates norms by allowing, ordering or prohibiting the social behavior. It is not a statement of fact. It is not interested in what happened in the past. It is not all about facts. It is prescriptive rather than descriptive. It is interested in stating what ought to be done or what must not be done in the future. It is interested in shaping human behavior. The law describes a certain human behavior (such as theft or adultery) and takes position towards that behavior. In doing so it is shaping the way how individuals in society should act or behave.

Illustration:

Consider for example article 11 of the Revised Family Code of Ethiopia, which provides that, “a person may not conclude marriage so long as he is bound by the bond of a preceding marriage”. This provision described bigamy as the act of coinciding another marriage by a person who is already married. And the position of the law towards this behavior is prohibitive in that it prohibits married persons from exhibiting the behavior of entering in to another marriage so long as they are bound by previously concluded marriage. This shows the normative feature of the law. Based on this feature, law can be classified as permissive, directive, prohibitive and rewarding.

i. Permissive Law

Permissive laws allow or permit their subjects to do the act they provide. They give right or option to their subjects whether to act or not to act. Most of the time such laws use phrases like:

‘has/have the right to’ or ‘is/are permitted/allowed to’ or ‘shall have the right’ or ‘shall be entitled to’ or ‘may’ or ‘is/are free to’

Illustrations:

1. “Every person is free to think and to express his idea.” (Article 14 of the 1960 Civil Code of Ethiopia).

The human conduct to think and to express ideas is permitted by this law. Therefore, we can say it is a permissive law.

2. “Accused persons have the right to be informed with sufficient particulars of charge brought against them and to be given the charge in writing.” (Article 20(2) of the 1995 Constitution of the Federal Democratic Republic of Ethiopia).

The phrase ‘have the right to’ in this provision shows that the subject (an accused person) is given the right or permitted to get the charge in writing and to be informed its particulars. Therefore, it is permissive law.

ii. Directive law

Directive law orders, directs or commands the subject to do the act provided in the law. Obedience to such laws is not optional. Therefore, the subject has legal duty to do it whether s/he likes it or not, otherwise, there is a negative consequence that s/he incurs unless s/he does it as directed by the law. Directive law usually uses phrases or verbs like: ‘must’ or ‘shall’ or ‘has/have the obligation to’ or ‘is/are obliged to’ or ‘is/are ordered to’ or ‘shall have the obligation/duty’

Illustrations:

1. “The debtor shall personally carry out his obligations under the contract where this is essential to the creditor or has been expressly agreed.” (Refer to article 1740 (1) of the Civil Code of Ethiopia.). The phrase “Shall.... carryout” in this article shows that the contracting party, the debtor, is directed, ordered or commanded by the law to act in accordance with the order given. Therefore, this law is a directive law.

2. “Every worker shall have the following obligations to perform in person the work specified in the contract of employment.” (Refer to article 13(1) of the 2003 Labor Code Proclamation No. 377/2003). The phrase “Shall have the ... obligations to” in this law shows that the worker is directed by the law as it is provided in the law. Therefore, we say it is a directive law.

In general, directive laws are mandatory (imperative) provisions of the law. They oblige the subject to act, as they require him/her to act. The observance of mandatory provision of the

law is none negotiable.

iii. Prohibitive law

Prohibitive laws discourage the subject from doing the act required not to be done. If the subject does the act against the prohibition, a sanction follows as the consequence of the violation. In this regard, all the provisions of the criminal code can be sorted as prohibitive laws. Prohibitive laws usually use phrases like: ‘must not’ or ‘shall not’ or ‘should not’ or ‘no one shall/should’ or ‘no person shall/should’ or ‘may not’ or ‘is/are not permitted/allowed’ or ‘is/are prohibited’ or ‘is/are punishable’ and ‘is a crime’.

Illustrations:

1. “Any unmarried person who marries another he knows to be tied by the bond of an existing marriage is punishable with simple imprisonment.” (Article 650(2) of the 2004 Criminal Code of Ethiopia).

The phrase “is punishable” used in the above article indicates that the law discourages such act. Therefore, it is prohibitive law.

2. “No one may enter the domicile of another against the will of such person; neither may a search be effected there in, except in the case provided by law.”(Civil Code Art 13].

The phrase “No one may” shows that any one is discouraged from acting as provided by the law and so it can be identified as a prohibitive law.

iv. Rewarding Legal Norms (rules)

this are the kind of legal rules, which usually exempt from observing the mandatory prohibitive or permissive norms or entitle a person to receive some benefits in turn for the usual activity that an individual performed.

Illustration: consider the following typical examples of a rewarding legal rule:

Proclamation No. 15/1992 article 13 (2) states that, “domestic and foreign investors shall be entitled to exemption from payment of income tax for a period of three years from the date of commencement of production or operation”. Plus, article 84 (1) of the income tax proclamation no. 286/2002 states that, “where a person provides information of tax evasion through concealment, under reporting, fraud or any other improper means, the informer shall be granted up to twenty percent of the amount of the tax evaded at the time of the collection of the said tax”.

c. Law Regulates Social Behaviors

It is also interesting to note that law is not concerned with every kind of human behavior, but only with the social behavior of man, his behavior as far as it matters to certain social relations. Law addresses man as a social being. Law essentially regulates relationship between human beings. Law is concerned with the man to man relations. In other words, law is not interested in the relation of man with machines or animals. If a single man was to live in absolute salubrity in one of the islands of Lake Tana the law is unnecessary for him because law is necessary only to regulate man-to-man-relationship.

Exercise:

Dear, distance student, do you agree with the idea that law regulates only man-to-man relation?

How do you see for example article 777 of the penal code which prohibits cruel treatment of animals or the law protecting the natural environment? Do not you think that in these instances the law is regulating rather the man to animal or man to environment relations?

d. Law is intimately related with the State

The other important feature of law and in fact, which distinguish it from other category of social norms, is its affinity or relation with the state. The relation of state and law is such that it is impossible to think the existence of one without the other. In fact we can say that they are two sides of the same coin. You can not envisage the state without the law and the law without the state.

Exercise:

Dear Student, what makes the two inseparable? How are they related? Which one precedes the other? Can one talk about the one without the other?

There are several factors that relate the state and the law. These factors make the two mutually interdependent. First it is necessary to understand that the state has three branches or arms of government. These are: (1) the legislative organ- this branch has the function of making new laws. In different countries this organ is known by different names. It is known in Britain as 'parliament', as 'congress' in the USA, as 'duma' in Russia, 'Bundestag' in Germany and so on. (2) the executive organ- has the function of executing or enforcing the law and policies of the country. (3) the judiciary- has the function of interpreting the law and resolving disputes by applying the law. It refers to the courts. Hence, law is made by the state

through its legislative branch that brings the law in to existence. Plus, the law is enforced by the state via its executive branch. The law for its practical implementation is fully dependent on up on the state. Moreover the law is to be interpreted and applied by courts and even it is also repealed (revoked) or amended by the state. In a nutshell, the law is dependent on the state for its formation, operation and extinction.

On the other side of the coin however, the state for its existence is dependent on the law. To begin with the state itself is to be created by law, particularly by the constitution. It is the constitution, which is the supreme law of all the laws in a state that constitute or establish a state. If you refer to the preamble of the constitution of the Federal Democratic Republic of Ethiopia you will understand that it is the constitution that establishes the state and determines and define the respective powers and functions of its organs.

Exercise:

Do you think law is the only mechanism to regulate social relation? What would happen if there were no law in our society? Is the law the only instrument to create an orderly life in the society? What would be the fate of society if there was no law?

e. Sanction

The other main feature of the law is it is backed by sanction. Failure to comply with the law results in the infliction of sanction. Each and every member of a society is required to follow the law. Where there is violation of the law sanction would follow. Sanction according to the Black's Law Dictionary is a penalty or coercive measure that results from failure to comply with a law. The main purpose of sanction is to prompt a party (a wrong doer) to respond. In other words, sanction will make the wrong doer to think that s/he made a fault and s/he should correct (rectify) it. Sanction may be criminal or civil in nature. Criminal sanction is a sanction attached to criminal liability. If the fault committed is defined by criminal law, the person will be liable to a sanction provided under the criminal law. On the other hand, civil sanction is a sanction imposed by a civil court. The infliction of sanction on wrong doers is one of the major differences as among law and other norms of social control.

1.3. Functions of the Law

Dear Students, in this section you will study why do we need the law? What functions does law have in your localities? What purposes it serve to society?

Similar to the issue of definition of the law, there is no agreement among scholars as to the functions of law. Jurists have expressed different views about the purpose and function of

law. It is well known that law is a dynamic concept, which keeps on changing with time and place. It must change with changes in the society. Law, in the modern sense, is considered not as an end in itself, but is a means to an end. The end is the securing of social justice.

Almost all theorists agree that law is an instrument of securing justice. As Salmond rightly pointed out, “law is a body of principles recognized and applied by the State in the administration of justice.” Even Hobbes and Locke recognized the positive role of law when they said, “the end of law is not to abolish or restrain but to preserve or enlarge freedom and liberty.” For Kant, the aim of law is the adjustment of one’s freedom to those of other members of the community. Jeremy Bentham, gave a very practical version of the purpose of law, which according to him, is maximization of the happiness of the greatest number of the members of the community.

According to Holland, the function of law is to ensure the well-being of the society. Thus it is something more than an institution for the protection of individuals’ rights.

Roscoe Pound attributed four major functions of law, namely: (1) maintenance of law and order in society; (2) to maintain status quo in society; (3) to ensure maximum freedom of individuals; and (4) to satisfy the basic needs of the people. He treats law as a species of social engineering.

The Realist view about the purpose and function of law is that for the pursuit of highest good of the individuals and the state as such controlling agency.

The object of law is to ensure justice. The justice may be either distributive or corrective. Distributive justice seeks to ensure fair distribution of social benefits and burden among the members of the community. Corrective justice, on the other hand, seeks to remedy the wrong. Thus if a person wrongfully takes possession of another’s property, the court shall direct the former to restore it to the latter. This is corrective justice. Rule of law is *sine qua non* for even-handed dispensation of justice. It implies that everyone is equal before law and law extends equal protection to everyone; judges should impart justice without fear or favor and like cases should be treated alike.

Today the following are taken as important functions of law:

i. Maintaining Peace, Order, Security and Stability in the society

In their daily life people engage themselves in different types of social, cultural, economic or political activities. If people are to conduct these activities of daily life in a descent manner, peace and order must be maintained. In the absence of such states of affairs, then the people

will not be in a position to regularly and properly perform their daily activities. Hence, the law is there to create peace and order by the threat (sanction) of death, imprisonment and/or fine penalties.

ii. Means of Regulation of Social Interaction

Members of the society may have different social values, various behaviors and interests. It is important to control those behaviors and to inculcate socially acceptable social norms among the members of the society. There are informal and formal social controls. Law is one of the forms of formal social controls. As to Roscoe Pound, law is a highly specialized form of social control in developed politically organized society. Lawrence M. Freedman explains the following two ways in which law plays important role in social control:

First, law clearly specifies rules and norms that are essential for the society and punishes deviant behavior. “Secondly, the legal system carries out many rules of social control. Police arrest burglars, prosecutors prosecute them, courts sentence them, prison guards watch them, and parole boards release them.

iii. Law as a means of Dispute settlement

Disputes are unavoidable in the life of society and it is the role of the law to settle disputes. Thus, disagreements that are justiciable will be resolved by law in court or out of court using alternative dispute settlement mechanisms.

iv. Law as a means of Social change

A number of scholars agree about the role of law in modern society as instrument to social change. Law enables us to have purposive, planned, and directed social change. Flexibility of law provides some measure of discretion in law to make it adaptable to social conditions. If law is rigid and unalterable, it may not respond to changes spontaneously which may lead to resentment and dissatisfaction among the subjects and may even result into violence or revolution. Therefore, some amount of flexibility is inevitable in law.

v. Protection of Citizens from Excessive and Arbitrary Government Power

The Government or its officials have every sort of power that enables them to compel citizens. It has both the purse and the gun. Unless its power is duly curbed citizens may become victim of excessive and arbitrary exercise of power by the government. It is one of the functions of the law to protect citizens from unlimited or arbitrary government power. In this regard, the constitution in the form of fundamental rights and freedoms of citizens

imposes limitation on arbitrary exercise of government power. Human rights and freedoms are limitations on government power. Administrative law also protects citizens from maltreatment by administrative agencies.

vi. Bringing Efficiency, Harmony and Balance in the Functioning of the Government Machinery

The function of the state as a social institution is to maintain peace and order internally, to protect the territory from external invasion and to detect and facilitate economic growth. To enable the state to achieve these goals effectively and prevent abuse of power, state power is apportioned to the three branches of government: legislative, executive and judiciary. Each of these branches does have their own sphere of power that they exercise which is component of the state's task of administration. An in built system of check and balance is also found among these branches. Hence, the law is the main instrument in guaranteeing all this. It is the constitution that establishes the state, determines its organs and their responsibilities and lays a system of check and balance among the three organs of the government.

vii. Fighting Harmful Traditional Practices

Law is also an instrument of fighting traditional practices that are harmful to the society such as genital mutilation, abduction, rape, early marriage, drug use and trafficking and so on.

viii. Protect and Encourage Innovative and New Ideas

The patent and copy right laws by giving recognition and extending protection to innovative ideas and new works encourage more and more inventions.

Finally and most importantly however, almost all legal scholars and theorists agree that the law is, cumulatively and above all, an instrument of securing justice. As clearly put by Salmond, "law is a body of principles recognized and applied by the state in the administration of justice".

1.4. Sources of the Law

In the literature of jurisprudence the problem of 'sources' relates to the question: where does the judge obtain the rules by which to decide cases? In this sense, the following sources of law will be commonly listed, statutes; judicial precedents; custom; the opinion of experts; morality; and equity. In the usual discussions, these various sources of law are analysed and some attempt is made to state the conditions under which each can appropriately be drawn upon in the decision of legal controversies. Our concern here will be with 'sources' in a much

broader sense than is used in the literature of jurisprudence. From where does the law generally draw not only its content but its force in person's lives?"

In the context of legal research, the term 'sources of law' can refer to three different concepts, which should be distinguished. One, it can refer to the origins of legal concepts and ideas. Two, it can refer to governmental institutions that formulate legal rules. Three, it can refer to the published manifestations of the law.

The source of law can also be defined in three ways as follows:

1. It may mean the Formal Source, that which confers binding authority on a rule and converts the rule into law. We noticed that even primitive societies were governed by rules, and that these rules became laws in the full sense of the term only when the state came into existence. The state therefore is the formal source of law and for every law this type of source is the same, the will of the state. No rule can have authority as law unless it has received the express or tacit acceptance of the state.
2. The source of law may mean the place, if a person wants to get information about the law; s/he goes to look for it. The place where a person can get information about the law is naturally the literature on the subject. In this sense, the term source means the Literary Source i.e., that from which actual knowledge of the law may be gained. These are: (i) statutes; (ii) reports of decided cases; and (iii) text books. These are the authorities from which a person can obtain information on the law.
3. Thirdly, it may mean that which supplies the matter or content of the law. Custom, religion, agreement, opinion of text - writers, statute, precedent or judge made law, all come under this category. All these may supply the material content for the law.

Dear student, all the laws of a given legal system, which its members are to observe, and its law applying institutions apply are derived from the various sources of law recognized in that legal system. The definition of source of law as a concept is very necessary but it is actually easier to enumerate the various sources of law workable in many legal systems than defining the concept. Accordingly, legislations, case laws (precedents), customary laws, legal writings of jurists, international treaties, international customs, and doctrines are all sources of law. You should also be aware of the fact that courts applied morals rules, principle of equity and religion as law and these are also sources of law. Two reasons account for the difficulty of defining the concept of 'source of law' for the purpose of general application of the concept. Firstly, the different legal systems have different system of law and they have their own way

of defining the concept based on their systems and as dictated by their legal scholars. And secondly, it is owing to the diversified nature of the various source of law.

All the legal systems in the world have no exactly identical systems of sources of law though there may be similarities based on the family of legal systems countries belong to. The major sources of law which different countries accept are; legislations, case laws, customary law, international treaties and writings of jurists. Accordingly let us deal with them turn by turn as follows:

i. Legislations

Legislation is an intentionally created law by a certain law making body, having the power to legislate. Legislation as a source of law in a given legal system includes the constitution, primary legislations and delegated legislations. At present, legislations are the major sources of law in all legal systems of the world. For the enactment of legislations, legislatures (law making bodies) are constitutionally empowered. This law making body is given different names in different countries: in Ethiopia (HPR), USA (congress), England (parliament), Russia (duma), Israel (Conset), Iran (Mejlis). However, even if the law making power is given to the legislative organ of the state, other organs may also be involved in law making activities through delegation of power. For example the council of Ministers in the Ethiopian government may enact laws based on a delegated legislation from the House of Peoples representatives. One of the distinguishing features of the legal systems of the modern political societies is that there is state power, which exercises law making power.

The term legislation as it stands denotes two things. Firstly, the process of deliberate law making and secondly, it denotes the results or products of the legislature process. Legislation as the outcome of the law making process is law to which the adherence of people is required. Legislation is always designed to establish rules. It is natural in the creation of legislation that it is always backed by the coercion of its creation of the subjects of the law to conform to it. Hence, legislation is an intentionally made law subjecting people to conform. Legislation is usually made by the state organs and it is a legal rule established by a direct action of Governmental organs. The promulgation of a legislation is an important mechanism by which the legislation (the new law) will come to the knowledge of its subjects or addresses and by which also the coming in to force of legislation is ascertained.

Legislation is of three main categories. These are: constitution, Primary Legislation and Delegated Legislation. These three types of legislations are distinguished from one another

on the basis of who makes them, the manner of their making, their legal forces, i.e., their hierarchical positions and the purposes for which they are made.

All the above types of legislations are made in different manners, i.e., they pass through different process of law making. Accordingly, the constitution is the highest (supreme) law of a country. The making of the constitution is different from the making of other legislations. Many countries adopt their constitutions with the participation of the people in the final decisions for the adoption of the constitution. The drafting of the constitution is also made by the highest state organ. For instance, in the case of the FDRE constitution there was the constitution drafting commission. The adoption of constitution by the final decision of people is called referendum or plebiscite. Similarly, the amendment of the constitution is usually left to the higher law making body and the procedure of the making of amendment to the constitution is set by the constitution. In addition, unlike other legislation, the amendment of the constitution is not frequently made and if it is to be made it requires strict procedural requirements. You are invited to refer to articles 104 and 105 of the FDRE Constitution.

On the other hand, the making of primary legislation is usually started by Initiation, and then follows the Drafting. These legislations are usually made by the parliament and they will be subjected to discussion (deliberation) of the parliament at their draft stage. Then it will be approved after through deliberation. Finally such legislations will come to force up on publication according to the Ethiopian practice. Hence first they must be passed by the legislature. Then declared to be the law as a proper document and then ordered to be published and finally come in to force.

Secondary legislations on their part are laws issued by other government organs pursuant to delegation from the legislative organ of the government. When the HPR enact proclamations it usually delegates some law making power to other government organs particularly to the executive branch of the government and its various agencies- the Council of Ministers.

Dear Student, what do you think is the main reason behind delegation of the law making power? The main reason behind is the lack of technicality and expertise related to technical subject matters on some areas of law on the part of the members of the legislative organ which administration of the daily life of citizens require. Thus, the following re the major types of subsidiary legislation issued pursuant to a delegation. (1) Regulations: these are rules issued by the council of ministers by virtue of a delegation made to it by the House of Peoples Representatives. In this regard, refer to article 76 of the FDRE constitution. (2) Directives: are issued by individual government offices or administrative agencies, such as,

Ministries, Commissions, Authorities, Agencies and Bureaus and so on.

ii. Decision of Courts

Case law is that source of law, which is the outcome of decisions of judicial bodies of a given legal system. It arises from the decision of the judicial body or court on a certain matter referred to it by people. It was a major source of law in earlier times when there were no legislations as in modern times. Today also it is a source of law of many countries to a great extent in addition to legislation and other sources of law. The law making role of courts is found and applicable in the common law legal system. A decision of a court on a certain matter referred to it by disputants serves as a law for the settlement of similar cases in the future. Such decision of a court on a certain matter will be binding on subordinate courts on a hierarchical basis when adjudicating a case of similar fact which is already decided. In the common law countries, the law making role of courts can be understood in two ways.

Firstly, courts decide case on the basis of legislation, customary laws and rules from other sources of law. Secondly, the courts law making power in real sense can be seen in the fact that where there is no law governing a new factual situation from legislation, or custom or other sources of law, the courts will decide on the 'new case' by framing their own rules and there by establishing a precedent for future cases. This law making power of courts is called the principle of *stare decise* or 'gap filling law making' or 'Interstitial Legislation'. In general, in some countries court decisions have binding forces on other courts of the same level or lower level. That is to say, if a court passes decision on a certain case, other courts of the same level or lower level are bound to follow such decision on similar cases. Such system is the practice of the Anglo American Countries. Such system practices the principle of judicial precedent.

iii. Customs

Custom is one of the oldest sources of law making. However, the importance of custom as a source of law continuously diminishes as the legal system grows. The reason being that with the emergence and growing power of the State, custom is largely superseded by legislation as a source of law. A custom may be defined as a continuing course of conduct which by the acquiescence or express approval of the community observing it, has come to be regarded as fixing the norm of conduct for members as society.

Dr. Allen defines custom as the uniformity of habits or conduct of people under like circumstances. When the people find any act to be good and beneficial, apt, and agreeable to

their nature and disposition, they use and practise it from time to time, and it is by frequent use and multiplication of this act that the custom is made. Prof. Keeton defines custom as those rules of human action, established by usage and regarded as legally binding by those to whom the rules are applicable, which are adopted by court and applied as a source of law because they are generally followed by the political society as a whole or by some part of it. In general, different authors define custom in various manners.

Custom is material source of law because the law derives its contents from the custom. Custom is a set of social attitudes that the society regarded as part of law and enforced. Custom, to be regarded as source of law, it must be reasonable; be consistent with a written law; be observed as of right; it should have been continuously in existence from the time immemorial; and be certain.

Under Ethiopian law, custom is applicable where the law refers it, and when the judge interprets the law.

iv. International Treaties

These are agreements concluded as between or among sovereign states. Treaties are mostly sources of international law. Of course there are other sources of international laws. So states as representatives of their countries or people make treaties with one another on various matters of interest. International treaties are written agreements between states to govern their behaviour in their relation to one another. They are sources of international law and at the same time sources of municipal law when they are converted in to domestic legislations or depending on the countries legal system may directly form part of the domestic system of source of law by taking a certain Hierarchical rank among the laws of the country.

Such treaties may be Multilateral (involving many states) or bilateral (involving only two states) or regional (as between countries of the same geographical or economic region) or Global (between all the countries in the world).

Dear student, in this regard, you are invited to read article 9 (4) and 13 (2) of the FDRE constitution, which states that all international agreements ratified by Ethiopia are an integral part of the law of the land. That means, international agreements which are ratified by Ethiopia are have, by law, become part of Ethiopian law or are sources of law for the country. Countries are often seen to include such treaties in to their own domestic laws via the mechanism of incorporation and reference to such international laws. The following are typical examples of treaties: the UDHR, the ICCPR, the ICESCR, the BANGUL (African

charter) and so on.

v. Doctrines

Sometimes the codified law is unable to cover all the situations that arise in the real world. This may be because of the rapid changes in the society and the technology. Gaps which are not covered by law are called the legal lacunae. Then, what do you think is expected of the judge when s/he is encounters a legal lacunae? Should the judge close the case or should he entertain it in the absence of any legal rule? The answer to this question depends on whether the law is civil or criminal law.

According to the principles of criminal law, no person may penalized unless the fault he has committed is written in the penal code as a crime (refer to article 2 (1) of the penal code). If the offence is not threatened in the penal code, the court cannot entertain the case because no crime has been committed. If, on the other hand, the fault committed involves civil matters, the court may not close the case on the ground of legal lacunae. The court is expected to fill the gap from other sources such as doctrines, equity, reasoning etc. accordingly; doctrines are legal explanations, ideas, commentaries and findings of researches done by people specializing in law. Such commentaries and explanations, however, have no binding force on the judge. But they may effectively influence the judge. When passing decisions, the judge may base his decisions on such doctrines and by so doing he could fill the legal lacunae.

vi. Religious Rules

There are also instances where religious norms are given effect to govern the social behaviour of man alongside with legal norms. Consider the messages of the following provisions of the law:

- i. This constitution shall not preclude the adjudication of disputes relating to personal and family laws in accordance with religious or customary laws. (refer to article 34 (5))of the FDRE Constitution)
- ii. Marriage may be concluded in accordance with the religion...of future spouses.
- iii. The conclusion of religious marriage and the formalities there of shall be prescribed by the religion concerned. (Refer to article 26 (1) of the Revised Family Code).

Dear distance student, it is in this context that religious norms are part of the Ethiopian law. You can also take the clear case of the Sheria law in the Ethiopian legal system, which

governs various relationships or affairs of disputants that submit themselves to the procedure willingly.

vii. Rules of Public Morality

Social behaviour cannot be exclusively governed by legal norms but also by the rules of public morality. This is evident from the article 2030 (1) of the civil code which provides for the tort liability of a person who contravenes public morality. The provision states that, a person commits an offence where he acts or refrains from acting in a manner or in conditions which offend morality. This provision illustrates the tacit admission by the law maker of moral rules as part of the general law governing human conduct.

1.5. Classification of Laws

Classifying laws in to different branches has many advantages. Classification simplified the law making process for the legislature as it allows the legislature to conduct its deliberations in specific areas of law. It makes the work of the executive and the judiciary efficient because the executive and the judiciary will easily pick up the provisions of the law they want when discharging their duties. A systematically classification of laws simplifies the study of law at law schools as well as for conducting research into legal problems. However, classifying law into various sections is not an easy task. This is so because; it is difficult to put a certain section of the law in a definite category without having an overlap. It should also be noted that, all laws do not have similar character rather they differ on the areas they are dealing with. However, the classification is not mutually exclusive. That is to say, one branch cannot be completely excluded from the other. In spite of this, the law is divided based on different frame of references. The following major classifications of the law are conventionally adopted throughout the legal systems in the world:

1.5.1. Public vs. Private Law

Public law regulates the acts of persons who act in the general interest, in virtue of a direct or immediate delegation emanating from the sovereign. As Salmond propounded 'public law' is not the whole of the law that is applicable to the state in its relations with its subjects, but only those parts of it which are different from the private law concerning the subjects of the state and their relations to each other.

Private law is thus the residue of the law after we subtract public law. Private law regulates the acts, which individuals do in their own names for their own individual interest.

Public law can be further sub divided into constitutional and administrative law.

Constitutional law defines the organization of the state, its fundamental rules, mode of government, and the attributions of its political organs, their limits and their relations. Constitutional law deals with the ultimate questions of the distribution of legal power and of the functions of the organs of the State. Administrative law regulates the operation of the executive power in all its degrees, beginning with cabinet ministers and descending to its most humble representatives. It also regulates such local, departmental and communal administrations. Very wide in its application administrative law comprises many matters, which impinge upon private law. This is because the administration often takes individuals under its tutelage.

It is thus that the operation of mines, of waterfalls, and of railways is governed by provisions of administrative law. In addition, the creation and functioning of certain groups of persons, such as labor unions, associations, and mutual aid societies are governed by administrative law, even though private persons may be acting in their own private interest.

Criminal law, the infliction of punishment directly by the organs of the state, is also usually regarded as falling under the head of public law. Some would say that civil procedure should also be placed in this section, since these rules regulate the activities of courts, which are mere agencies of the State; but civil procedure is so linked with the enforcement of private rights that it is more convenient to regard it as belonging to both public and private law.

Private law governs in principle all the acts of individuals in their private capacity. However, in France and in most civilized states, it is at present divided into three sections. They are civil law, procedure, and commercial law.

1.5.2. International vs. National Law

Law may be classified into international and local (domestic/national) law. International law is the law of nations which was named as international law by Bentham in 1780. It consists of rules which regulate relations between State *inter se*. Oppenheim has defined international law as “the body of customary and conventional rules which are considered legally binding by civilized States in their intercourse with each other.”

Starke defines International law as “rules of conduct which states feel themselves bound to observe and therefore do commonly observe in their relations with each other and which includes also (a) the rules of law relating to functioning of international institutions and organizations, their relations with each other and their relations with States and individuals; and (b) certain rules of law relating to individuals so far as the rights and duties of such

individuals are the concern of the international community.”

Salmond, however, believes that international law is essentially a species of conventional law and has its source in international agreements. These international agreements may be of two kinds, namely - (1) express agreements as contained in treaties and conventions; and (2) implied agreements as found in customary practices of the States.

National law is the law that pertains to a particular nation (as opposed to international law). It is a law of a nation, for example the law of the United States of America, France, or Ethiopia. Such law is applicable all over a country in question. It is also known as law of the land. It is in effect in a country and applicable to its members. The law may be statutory, i.e. enacted law, administrative or case law.

1.5.3. Substantive vs. Procedural Law

Civil procedure is nothing but a detached part of the civil law governing the manner of asserting and defending rights before courts. According to Salmond, substantive law is that which defines a right while procedural law determined the remedies. Procedural law is also called ‘law in action’ as it governs the process of litigation. Substantive law is concerned with the administration of justice seeks to achieve while procedural law deals with the means by which those ends can be achieved. For example, law of contract, family, property, succession, negotiable instruments, are substantive laws whereas the laws of civil procedure or criminal procedure are procedural laws. The rules that are provided under procedural law are inseparable from the substantive law. For example, civil procedure law is inseparable from the civil code that deals about contract, filiations, adoption, and the like.

1.5.4. Civil vs. Criminal Law

Civil law is that branch of law dealing with the definition and enforcement of all private or public rights, as opposed to criminal matters. The law enforced by the State is called civil law. In Ethiopia, we have a civil law codified in 1960, which is known as Civil Code. The force of State is the sanction behind this law. Civil law is essentially territorial in nature as it applies within the territory of the State concerned. The term civil law is derived from the Roman word *jus civile*. Austin and Holland prefer to call civil law as ‘positive law’ because it is enforced by the sovereign political authority. However, Salmond justifies the term ‘civil law’ as the law of the land. He argues that positive law is not necessarily confined to the law of the land. For example, international law is a kind of jus positivism but it is not a civil law.

On the other hand, criminal or Penal law unquestionably forms part of public law. The state

alone, representing the nation, has the right to punish. Prosecutions and condemnations are carried out in the name of the state. The application of penalties is a part of the administration of a state. Today we have a criminal law enacted in 2004 which is a revision of the 1957 Penal Code of Ethiopia. The designation is changed to criminal law because penal law has negative connotation which carries penalty only.

1.6. Hierarchy of Laws

Dear student, to fully understand the essence and nature of laws, it is essential to consider their hierarchies. What do we mean by hierarchy of laws? The term “hierarchy” expresses the “ascending series ranks or degrees of power and authority with the correlative subjection, each to the one next above”. It is used to describe the structure of power relationship with varying amount of power and authority. It is believed that laws derive their validity from the authority that respective makers possess. Thus, the superior and subordinate kind of relationship exists between the laws.

Therefore, hierarchy of laws is “a chain of subordination” between laws. Hierarchy of laws is a system in which all the laws of a certain country are put at various levels or ranks according to their order of importance. The order of importance of laws is very much related to the order of importance of state organs that make laws. In other words, hierarchy of laws is the reflection of, a coordinated aggregate of persons among whom power relationships hold so as to establish an order of superiors and subordinates.

Under the 1994 FDRE Constitution, the constitution is the supreme law of the land. Hence it is at the top of the hierarchy of laws. Then, the constitution is followed by international treaties which have been given the place of proclamation at the federal level. These international treaties and agreements, being part of the federal laws of Ethiopia, should not be affected by the laws of Regions. However, it is hard to determine the hierarchy between such treaties and agreements and the law of Regions.

Further, all laws (proclamations) made by the House of Peoples’ Representatives are second to the Constitution. Other laws enacted by subordinate bodies of the Federal State (such as regulations and then directives) are inferior to the proclamations, except decrees enacted by the Council of Ministers in case of emergency. Such decrees may be promulgated as emergency proclamation where the House of Peoples’ Representative approves them.

Furthermore, it should be noted that the House of Peoples’ Representatives enact regulations and directives according to the power given under proclamations.

Regarding the regional states, State Constitutions are superior in hierarchy. Regions have the power to enact emergency decrees where the State Council is not in session. The decrees should be submitted to the Councils and they may prevail over regulations made by the same body. A point should be taken that decrees come on the upper ladder compared with regulations in the regions.

Chapter Summary

Dear Student, this chapter was dedicated to deal with the introductory matters related to various issues and aspects of the law. I hope you have by now understood why it is important to study the notion law before trying to deal with the principles of business law. In this chapter we have tried to enumerate and discuss the various definitions of the law provided by various scholars from different perspectives. We have also discussed the major functions of the law such as the maintenance of peace, order, security and stability with in the society. The sources of the law was also an integral part of this chapter in that the law may emanate from various sources such as legislation, precedents, custom, and international treaties. The writer also hope that by now you can very well classify the various types of laws as national, international or private, public or criminal, substantive or procedural and so on. The final segment of this chapter was dedicated to the hierarchy (order of importance or application) of the laws in a country. Accordingly, it is discussed that the constitution is the supreme law of the land at the top of the hierarchy of laws followed by proclamations, regulations, and directives. Dear Student, as part of measuring your understanding of the issues that we have discussed in this chapter I invite you to do the following review questions and exercises.

Chapter Exercise and review Questions

- 1) Explain the concept of distributive justice.
- 2) Analyse the functions of law as stated by Roscoe Pound.
- 3) State the functions of law as stated by Holland.
- 4) Do you think that the functions of law as stated by Cheesesman are wide? Reason out.
- 5) What are the theories on the relationship between law and state?
- 6) State creates law. Explain.
- 7) Law and state are the two sides of the same coin. Do you agree with this assertion? Reason out.
- 8) What are the relations between legal and non-legal norms?

- 9) Why we need to classify laws into different legal systems?
- 10) What do we mean by common law system?
- 11) What are the basic features of common law?
- 12) Which countries are followers of common law legal system?
- 13) Explain civil law legal system.
- 14) What are the basic features of civil law?
- 15) Enumerate countries that follow civil law.
- 16) What are the basic differences between common law and civil law legal system?
- 17) Who are the makers of law in common law?
- 18) Analyse how law is made in civil law.
- 19) To which legal system does the Ethiopia belong? Give your reasons.

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Chapter Two

The Concept of Legal Personality

Chapter Introduction

Dear distance student in this chapter you are going to learn about the concept of legal personality. In order to operate business first of all a ‘being’ should make sure that it is considered as a person. Business cannot be operated by a non-person. Every acceptable thing before the eyes of the law begins from personality. The concept of personality is so fundamental in Ethiopia that it is treated under the very first article of the Ethiopian civil code. Personality is so fundamental in that if a ‘being’ does not have personality s/he will remain to be remediless before the eyes of the legal system in which she or he is living. In this chapter, you are going to have preliminary understanding of the concept of legal personality, its definition, the types of persons, the requirements of personality, the commencement and extinction of legal personality, and the legal effect of personality.

Chapter Objectives

At the end of this chapter students are expected to be able to:

- Contrast physical and juridical persons;
- Contrast the definitions of “human being” and “person”;
- Define and illustrate “subject” of law and “object” of law;
- Explain the beginning of physical personality;
- Define the term personality
- Explain the end of legal personality
- Define birth, conception and viability;
- Analyse the scope of application of the concept of viability;
- Enumerate the attribute features of legal personality,
- Enumerate practical examples of various types of persons

2.1. Definition of Terms

According to the Black's Law Dictionary, a person, in the first instance, is a human being, who is individual member of the society and it also refers to an entity (such as a corporation) that is recognized by law as having the rights and duties of a human being.

Dear student, you should understand that a person is any being whom the law regards as capable of rights and duties. Any being that is so capable is a person, whether a human being or not, and no being that is not so capable is a person, even though he be a man. Persons are the substances of which rights and duties are the attributes. It is only in this respect that persons possess juridical significance, and this is the exclusive point of view from which personality receives legal recognition.

Hence, a person is a being or an entity that possesses rights and duties or is a subject of rights and duties before the eyes of the law. What awards to a being the status of a person is not the fact that it is having two eyes or two legs as a person but it is rather whether it is the possessor of rights and the subject of duties or not. (refer to article 1 of the civil code)

Legal personality is the legal status of one regarded by the law as a person: the legal conception (device) by which the law regards a human being or an artificial entity as a person. It is a particular device by which the law creates or recognizes units to which it ascribes certain powers and capacities.

Legal personality is the attribute feature of being the subject of rights and duties before the eyes of the law. If one is the subject of rights and duties it is a person and the process is called personality.

2.2. Types of Persons

There are two types of persons recognized by the law. These are:

i. Natural or Physical Persons

A natural person is a human being, as distinguished from an artificial person created by law, who is an individual member of the society. A natural person is a being which is born physically in the appearance of a human person.

At the present time, every human being is considered as a person before the eyes of the law without the fulfillment of any other additional subjective requirement. Or when a person is born physically legal personality is presumed to it or automatically conferred up on it.

When a person is born physically, s/he is also born legally. Legal personality would be

conferred up on every physical person automatically up on birth. Hence, every physical person is the possessor of rights and duties from the moment of its birth up until its death.

ii. Artificial or Juristic Persons

Artificial persons are entities such as corporations or associations and so on created by law and given certain legal rights and duties of a human being. An artificial person is a being, real or imaginary that for the purpose of legal reasoning is treated more or less as a human being. Such persons are also termed as fictitious persons, legal persons, and Moral persons. (refer to articles 394 -549 of the civil code)

As it can be plainly understood from the name itself, these are not human beings. They can't, by themselves, do what human beings can do physically. They are represented (even lead by) by physical persons to do their activities. Legal personality is not conferred up on them naturally. Hence, personality is not presumed to them. Their existence, unlike human beings, is fictitious. Legal personality is given to them by law, artificially, for the sake of convenience in control up on the fulfillment of certain requirements, such as application to the required office, registration, publications, legality of object of incorporation and so on.

Physical persons exist in reality, and we can see and touch one another. However, juridical persons are creations of the human mind. It is to be noted that juridical persons are different from the managers and employees who work for them. They are also different from the buildings they use as premises, because such premises are analogous to the houses physical persons live in. Although we cannot empirically touch, see and perceive juridical persons, we can conceive them as entities. And, the term "persons" attached to them signifies the fact that they "take part in legal relations".

The legal recognition of entities other than physical persons became necessary when they started to take part in juridical relations as entities separate and distinct from their owners or members. Such entities acquire personality upon recognition by domestic laws and upon their subsequent establishment, registration and publicity as the case may be. The development of international law has further widened the scope of juridical personality onto the international plane. States and international institutions, for example, have international legal personality.

Dear Student, be aware that, for their personality is given to them by law it may also be withdrawn by law for failure to keep up with the requirements of formation set by law the law.

In conclusion, artificial persons are the subject of rights and duties from their formation

(registration and publication) to their liquidation (winding up).

The following are typical examples of artificial persons: Companies (share companies or private limited companies), Hotels, Religious Organizations (such as the Ethiopian Orthodox Church or the Islamic Council), and Government Ministries.

Issue for Discussion: Dear Student, try to thoroughly consider the following paragraph and develop your own arguments regarding the subject matter of the discussion

In the ancient times, not everybody who is born physically is considered as a person and there by possess or exercise rights and duties before the eyes of the law. For instance, during slavery, slaves were considered merely as a Living Merchandise or chattels of their Masters. They do not have rights and duties as people; they were not the subjects of rights and duties rather slaves were the objects of the law- be aware that slaves were sold by their masters as merchandise or animals. At that time, a slave is considered as a person if and only if it is freed by the master. They did not even have legit names of their own. They only have had the so-called Slave-Names. The same was the reality regarding most of the rights related to women and children up until the turn of the 20th century. In this regard, the recognition of the right of women to election, succession, possession and administration of property are only recent events.

2.3. The Beginning of Legal Personality

Article 1 of the Civil Code of Ethiopia dictates that: the Human person is the subject of rights and duties from its birth to its death. In order to understand this provision we need to define each element of the article turn by turn. Accordingly, 'birth' can be defined as the culmination of pregnancy or the cutting (severing) of the umbilical-cord or the complete extrusion of the baby (child) from its mother's womb (uterus) naturally or via a C-section. Or we say a child is born when the child begins an independent existence, by itself, in the real world by taking advantage of its own internal bodily organs.

A 'right' can also be defined as the legal ability or capacity, entitlement, or privilege to do something (*rights-in-rem-* or rights to be exercised in relation to a thing e.g. a chair) or to prohibit others from doing something (*rights-in- personam-* rights to be exercised against a person). For example the right to own and administer property is a typical example of a right.

On the other hand, 'Duty' it is certain legal or contractual obligation that has to be discharged accordingly or otherwise constitutes a fault and entails legal liability. Typical example in this regard would be the duty to pay tax or to maintain the elderly.

On the other hand, death can be define as the complete metabolic (bodily) breakdown or collapse of a human person or we say a physical person is dead when its heart stops beating

or the lung stops functioning or both.

In conclusion, for physical persons, the status of being a person before the eyes of the law is given naturally (via the instrumentality of birth) and it would only be taken away naturally by death.

Article 2 of the civil code of Ethiopia stipulates the exception rule to the principle stated under article 1 of the same code. Article 2 envisages that, a child merely conceived shall be deemed as though born whenever its interest so demands provided that it is born alive and viable.

According to this article the law does not only confer the status of being a person after birth but also exceptionally before birth up on the fulfillment of three complementary requirements. These are:

1. Conception: per article 3 of the same code, a child is deemed to have been conceived on the 300th day which precedes its birth.
2. There needs to be an interest (mostly economic) of the fetus to be protected in its favor nevertheless it is yet to be born. For instance, the right to succession or Donation. The presumption of the law is, if the child is to be born after nine months why should we preclude him from enjoying his rights merely because it is yet to be born. and
3. The child should be born (when it is born) Alive and Viable. I.e., when the child is born after the completion of pregnancy it should be born:

Dear Student, according to the third requirement a child merely conceived shall not be considered as a person unless it is born:

a. Alive: to be born alive means, being born with a functioning lung or with a breath or as different from a stillbirth. And

b. Viable: literally defined a child shall be viable means it should be born, as a person, with the potential (physical requirements) to survive in the future. However, the technical definition of viability is stipulated under Article 4 of the Civil Code, the article stipulates that:

4(1): a child shall be deemed to be viable where it lives for 48 hours (at least) after its birth, notwithstanding any proof to the contrary. Hence, it is considered as a person and its interest, if any, are protected if and only if it lives at least 48 hours after its birth.

4(2): a child shall be deemed to be not viable where it dies in less than 48 hours after its birth and the cause of death being an Internal or Natural factor or due to a deficiency of bodily

constitution, such as, Cancer or HIV. Hence, it is not considered as a person and its interest would not be protected. Remember: if a child becomes not viable, it will be considered, for all legal purposes, never to have been born. And,

4(3): a child shall be exceptionally deemed to be viable where it dies in less than 48 hours after its birth and the cause of death being an external factor or a factor other than deficiency of its internal bodily constitution, such as an accident. This is because the presumption of the law becomes had it not been for the external factors the child would have survived and become viable. Hence, in this case, though it died in less than 48 hours, the child would be exceptionally considered viable and considered as a person and its interest, if any, would be protected.

Issue for Discussion:

Dear Student, Consider the following scenario and respond to the question that follows

Imagine that a child is born with three eyes, four hands and three legs? Or it is born with genetic physical mutation or deformity. Can we say s/he is born with the potential to survive in the future or viable? Should the law consider such child as a person?

2.4. The Attribute Features of Legal Personality

Dear Student, by the attribute features of legal personality we are referring to those characteristics or attributes that distinguish beings endowed with legal personality from beings with no legal personality. Accordingly, the following are the typical attribute features of legal personality:

1. The right to have a name (to be named) to be identified by it. If one is not a person s/he does not meaningfully cause use of their name. In Ethiopia we follow a three degree naming scheme, which is consecutively, First Name, Father's Name and Grand Father's name.
2. The ability to sue or be sued by its own name.
3. The ability to own and administer property, whether the property is movable or immovable; tangible or intangible.
4. The ability to engage in a Juridical Act (an act to be effected by the law), such as concluding a contract, issuing of a WILL and so on.
5. The obligation (duty) to be pay taxes as per the conditions prescribed by law.

Exercise:

Dear Student, Can you enumerate additional attribute features of legal personality of both or either types or verities, i.e., both the rights and the duties?

2.5. The Fundamental Nature of Legal Personality

Legal personality is so fundamental to a person's meaningful existence that creates a legal bondage or connection or attachment as between the individual and the laws and opportunities that are available to him or her in a certain country where s/he is living. Consequently, if one does not have legal personality, s/he is not considered as a person or there is no legal recognition as to his or her existence and his /her existence becomes remedy-less before the eyes of the law of that particular state.

As we have discussed earlier what makes a being qualify to be considered as a person is not the fact that it has a particular type of physical appearance but whether it is practically the subject of rights and duties before the eyes of the law. If not, it will not have legal personality and the immediate consequence of the absence of legal personality is the inability to be the subject of rights and duties before the eyes of the law. As a student you should be aware that the concept of legal personality is so fundamental and a necessary condition for the applicability of the rest of the laws in a country that, it is treated as the first crucial subject matter under the very first article of the civil code of Ethiopia.

Chapter Summary

Dear Student, in this chapter we have discussed that legal personality is the process by which a being becomes the subject of rights and duties before the eyes of the law. We used the word 'being' deliberately to signify the fact that it is not only natural persons that are considered as a person. Or the parameter to award the status of being a person to certain being depends on whether such being is the subject of rights and duties or not. Accordingly we have discussed that there are two types of persons. Those that are considered as a person up on the natural process of birth and those that are bestowed with legal personality artificially by the law for various reasons. The second groups of persons are called artificial persons. Regardless of the type of the person at issue both natural and juristic persons possess and exercise rights and duties before the eyes of the law.

Dear Student, in order to genuinely evaluate your acquired knowledge on this chapter you are invited to do the following exercises and review questions.

Chapter Exercise and Review Questions**1. Consider the following case Scenario and respond to the Questions that follow**

Dear Student, try to thoroughly consider the following case-scenario and respond to the questions that follow.

Ato Berihun and W/ro Alemitu were happily married for the last three years and very recently their house was blessed with good news of Alemitu's first ever pregnancy. She went to the hospital and knows that she is three months pregnant. She told the information to her husband and he was rushing home to celebrate the good news with his wife when he encountered a horrible car accident which resulted in his death.

Now imagine that the succession of the father is opened which constitutes a hereditary estate of 200000 Birr and two groups emerged as contenders to become beneficiaries of the succession. These are W/ro Alemitu the mother of the child and the parents of the deceased father. Who should be the beneficiary if:

- a. The child is dead on the 49th hour after his birth due to Cancer;
 - b. The child is dead on the 36th hour after its birth due to HIV AIDS;
 - c. The child is dead on the 20th hour after its birth due to a fire accident in the hospital.
2. What do you mean by the legal personality?
 3. Can you provide your own definition of the term person?
 4. Is a child brought to life through cloning a human person?
 5. Under slavery, birth and viability were not (for some people) sufficient for the acquisition of personality. Explain the statement.
 6. How is the term 'person' defined in your community? Does your community attribute personality to a tribe, a clan, a family or common lineage?
 7. What are the two recognized types of persons under Ethiopian laws?
 8. What are the main points of similarity and differences as between the two types of persons?
 9. When does a natural person commence to have legal personality?
 10. When the legal personality of a natural person does come to an end?
 11. When an artificial person does commence to have legal personality?
 12. When the legal personality of an artificial person does come to an end?
 13. Can you enumerate typical examples of artificial persons?
 14. What is the legal consequence of not having legal personality?

15. Why do you think is legal personality so fundamental?

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Chapter Three

The Law of Contracts

Chapter Introduction

Dear Students, in this chapter we are going to discuss the major principles of the Ethiopian laws of contract law which are enumerated from articles 1675 to 1808 of the civil code of Ethiopia. As students of school of business it is mandatory that you possess preliminary knowledge of entering in to contractual transactions. Business or commerce cannot be realized without the conclusion of a contract and there are various formal and substantive requirements, set by law that has to be strictly adhered to in due course of making a binding agreement. Of course traders or business persons may engage in ordinary agreements to exchange commodities or lend money and that will not be a problem by itself. Moreover, as a would be business professional you should pay due attention to this subject matter for it will have robust application in your future professional career. However, the importance of contract law comes in to being when the promises made by the parties to such agreements are not observed by the parties to the agreement. In this regard, the law of contract is indispensable in that it guarantees security of transaction by protecting such agreements and ascertaining that they are properly performed.

In light with this in this chapter we will discuss, the major principles of the Ethiopian contract of law.

Chapter Objectives

After successful completion of this chapter the students will:

- Enumerate all the possible sources of an obligation (legal or contractual);
- Identify the various elements of definition of a contract;
- Exhaustively analyse the essential elements of formation of a valid contract;
- Discuss the various types of contracts;
- Discuss the immediate effects of conclusion of a contract;
- Appreciate the meaning, types, ways, and requirements of performance of a contract;
- Understand the meaning, instances, and legal remedies of non-performance of a contract;
- Enumerate the grounds of extinction of contractual obligations.

3.1. Sources of Obligation

Dear Student, an obligation can be defined as certain duty (either contractual or legal) that has to be discharged or otherwise constitutes a fault and entails legal liability. Hence, regardless of the source or the nature of the obligation, the essence of an obligation lays in the fact that it requires to be discharged or it is obligatory to be performed and if one of the parties failed to discharge their obligation there is an obvious legal consequence- Liability.

Accordingly, there are two basic sources of an obligation. These are:

1. Law: this is a legal obligation that mandatorily emanates from the direct operation of the law. The law directly imposes various imperative obligations on citizens to preserve various interests. The typical interest that such obligation stands to defend is public interest. The protection of the interest of the public at large is non-negotiable. Hence, every law stands to protect public interest. Legal obligations are mandatory in nature and require due obedience. Otherwise stipulated, such obligations may not be freely disregarded by the parties.
2. Contracts: as different from legal obligation sometimes the parties to certain contractual engagement may up on their own free will (volition or consent) create and impose an obligation towards one another. This is not an obligation imposed on the parties by the direct order of the law. Rather, this is an obligation created by agreement of the parties- according to the principle of *Freedom of Contracts*. As a result, most of the obligations involved in contracts are permissive in nature, which are imposed by the parties themselves. A certain obligation is said to be permissive if it can be disregarded by agreement of the parties. However, once a contract has been duly constituted before the eyes of the law, after fulfilling the requirements of formation, each provisions of the contract bind the parties as a law. Hence, failure of either party to honor the terms of their agreements results in legal liability.

Dear Student, can you enumerate other possible sources of obligations in addition to the law and contracts?

3.2. Definition of Contracts

Literally defined a contract is an agreement between 2 or more parties creating obligations that are enforceable or otherwise recognizable at law- Binding Contracts. Not all agreements are enforceable at law. Hence, only agreements that are enforceable at law result a contract. The law does not negotiate on the enforcement of contracts.

However, the technical definition of a contract is stipulated under Article 1675 of the Civil Code of Ethiopia, according to this provision, “A contract is an agreement whereby two or

more persons, as between themselves, create, vary or extinguish obligations of patrimonial nature.”

In order to have meaningful understanding of the above provision, we need to dissect each element of the provision as follows:

a. A contract is an agreement

According to the Black’s Law Dictionary, an agreement is a mutual understanding between 2 or more persons about their relative rights and duties. It can also be defined as the manifestation of mutual assent by 2 or more parties, legally competent persons, to one another. An agreement is in some respects a broader term than a contract or even than bargain or promise. Accordingly, we say the parties to the contract have agreed when:

- i. They negotiate, deal or bargain on all terms of the contract whether fundamental or incidental terms of the contract. And/or
- ii. They understand each other and express their understanding. And/or
- iii. They have mutual understanding or consensus on the terms of the contract-*Consensus ad idem* or there should be *meeting of minds*. And/or
- iv. They, as much as possible, bargain in a win-win-situation.

Dear Student, do you think that all agreements result in a contract? Or what do you think are the main points of difference as between an agreement and a contract?

The answer to the above question is obvious in that not all agreements result a contract. However, be aware that, all contracts are necessarily the results of an agreement. Or the signing of an agreement is a necessary condition for the constitution of a contract. The main justification behind the fact that all agreements do not result a contract is the fact that people engage in the conclusion of millions of agreements (of many types for numerous purposes) every day and it is very difficult to consider all of them as contracts. The purposes of contracts are very limited compared to the purposes of an agreement. Agreements do not only serve (have) business objects. They, unlike contracts and in addition serve numerous social purposes or relationships. Agreements have broader purposes and wider concepts.

Hence, the next question we need ask and simultaneously respond to is, if all agreements do not result in a contract, what type of agreements result in a contract?

Only agreements in which the parties have agreed to be bound (obliged) by the terms of their agreement result a contract. Or the agreements which result a contract are those in which the

parties have assumed the intention to be bound (*intentio obligandi*) by the terms of the contract. As mentioned above, the parties should not only agree but also consent to be bound by the terms of their agreement either expressly or impliedly.

In conclusion, only agreements enforced (sanctioned) by law result in contracts. Or failure of either or both parties to perform (honor) according to the contract entails sanction by law against the failing party. This principle is called the principle of *sanctity of contracts*. The law does not negotiate on the keeping of promises. This goes in line with the Amharic maxim- *failure to keep a promise is worse than losing a descendant*. Or the Latin maxim- *Pacta sunt servanda*.

Dear Student, please consider the following types of agreements that may not result in a contract:

- i. Social or domestic Agreements: promise of dinner invitations between friends, a father's promise to a son or good neighborly promises made to help each other during harvest and so on.
- ii. Simulated Agreements: where the parties secretly agree not to be bound by their agreement.
- iii. Gentlemen's Agreement: where the parties made an open stipulation or an exculpatory clause that their agreement does not result in liability.

b. ... Where by two or more parties...

In order to conclude a legally binding contract there should be at least two or more persons that are the parties to a contract. A person may be able to talk with his own self but a person cannot legally or validly or safely conclude a contract with himself. If a person is allowed to make a contract with himself it makes the very essence of engaging in a contract (i.e., exchange of consideration) futile or meaningless. The main objective behind the conclusion of a contract is to exchange an economic value dictated by self-insufficiency. If a person is allowed to sell his own car to his-self he has, practically, exchanged no value hence there will be no contract.

However, some scholars mention article 2188 of the civil code of Ethiopia and argue that a special agent empowered to sell car of the principal may conclude a contract with his own self and sell the car to his self. Are they justified?

Consider the following scenario:

Mr. Alemu is a rich business person. He is so busy that he does not have time to sell his own car. Hence, he appointed Mr. Tibebe, as a special agent only for the purpose of selling the car, on behalf of Mr. Alemu. Now, Mr. Tibebe, the selfish, taking advantage of his power of representation, sold the car not to another person but to himself. Now, the seller is Tibebe and the buyer is also Tibebe.

Can we say Mr. Tibebe has concluded a contract with himself? Is the contract viable before the eyes of the law? Why or why not? What are the practical problems if Mr. Tibebe sells the car of another person to his own?

c. ... ‘As between Themselves’...

The legal effect of a contract, whether positive or negative, shall be restricted to the parties to the contract or the contractants or the signatories of the contract- Privity of Contracts. The rule is, nobody shall be bound by any undertaking to which s/he has unconsented. Hence, the parties or their agreement can only bind themselves not outsider parties or non-signatories or non-contractants or third parties to the contract. However and exceptionally, there are some situations where by a third party or its interest may be affected (mostly benefited) by a contract concluded by other parties. In this regard, you are invited to read provisions of the Civil Code stipulated from Article 1952 and the following entitled Promises, Stipulations, Assignments, delegation of rights Concerning Third Parties. However, the most prominent example is a contract of life insurance, where by the subscriber enters in to a contract with the insurer having named a 3rd party beneficiary who will be paid the insurance money up on the death of the subscriber. In this case nothing prohibits the named beneficiary to benefit from a contract to which s/he is not, technically, a party.

d. ...Create, Vary, Or Extinguish Obligations...

Up on the conclusion of a valid contract the parties to the contract may:

- i. Create a totally new contractual obligation. Example, ‘A’ lend 600 birr to ‘B’ and signed a new contract of Loan to that effect. Or
- ii. Vary or supplement or complement or alter the terms of an existing contractual obligation by a subsequent contract. Example, concluding a new contract to increase the amount of rent based on an existing contract- it was 300 Birr now they increased it to 500 Birr or it was a loan or debt without guarantee now they signed a contract to add the guarantee. Or they had a prior insurance contract and they conclude a new contract to increase the amount of the premium to be paid by the insured.
- iii. To extinguish or terminate the effects of an already existing contract by a subsequent

contract. Examples are: Novation (on article 1826 of the civil code of Ethiopia) - where the parties terminate the effect of an old obligation by changing and replacing its nature or content and constitute a new obligation which is different from the old obligation. And Set-off or Off-set (article 1831): where the parties terminate their existing counter obligation to one another by agreeing to off-set such obligations as they exist.

e. Obligations of Patrimonial Nature

Not all types of obligations are the subject matters of a contract. The main objective of a contract is to exchange an economic value. The obligation to be exchanged should be patrimonial i.e., pecuniary (monetary) or proprietary. Persons should not enter in to contracts to kill time. Rather, they should engage in contracts to exchange Consideration. In legal jurisprudence, consideration is certain benefit or advantage or entitlement or accrual to be enjoyed in exchange for certain disadvantage or forbearance to be suffered. At the end of the day, the consideration to be exchanged, as between the parties, should be appreciated in terms of money or property.

The exchange of consideration identifies contracts from the so-called “obligations of status” such as ‘marriage’, ‘Adoption’ and ‘Betrothal’.

Dear student after thoroughly considering all the elements of the technical definition of contracts, do you think ‘Marriage’ is a contract? Why or why not? What is the main purpose of ‘marriage’ when compared to the purpose of contracts?

3.3. Formation of Contracts

3.3.1. Elements of a Valid Contract

Dear Student, Formation of a valid (legally acceptable) contract requires the fulfillment of four essential elements. These are: capacity, consent, object and form.

According to article 1678 of the civil code,

No valid contract shall exist unless:

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

Now let us discuss the four essential elements for the existence of a valid contract turn by turn.

1. Capacity

Capacity can be defined as the legal ability to exercise (practically) the attribute features of legal personality or to perform juridical acts. As we have discussed earlier, the human person is the subject (possessor) of rights and duties from its birth to its death. This, however, by no means implies that s/he begins to exercise their capacity from the moment of birth onwards. There is a big difference as between the mere possession of rights and duties on the one hand and the ability to exercise them on the other.

According to article 192 of the civil code, the rule regarding capacity is, the human person is presumed capable of performing all acts of civil life unless s/he is expressly declared incapable by the law.

Consequently, the following groups of persons are expressly declared incapable by law for various reasons:

a. Minors

A minor is a person of either sex who has not attained the full age of 18 years. (Read Art. 198 of the civil code). Minors are precluded from exercising their rights and duties by themselves. Minors are presumed to be mentally and physically immature or incompetent. They are presumed to have no discretionary capacity. They are declared incapable for their own protection or in order to prohibit third parties from taking advantage of the simplicity of the mind of a minor. However, this does not mean that their rights and duties will remain unexercised. To that effect, the law has appointed the office of a Guardian (to act on behalf of the minor and take care of its person) and a Tutor to take care of the economic interests of a minor, if any. (Refer to article 198-338 of the civil code).

Minors may not perform juridical acts except in the case provided by law- the so-called “acts of Everyday Life”. By these acts we are referring to minor transaction which does not involve an amount of money greater than 500 birr.

On the other hand, as per the dictation of article 328, the disability of a minor shall cease on his attaining majority or being emancipated (as of right by marriage or attains the age of 15 years). Be aware that, the effect of emancipation is majority or an emancipated minor shall be deemed under the law to have attained majority in all that concerns the care of his person and the management of his pecuniary interests.

b. Insane Persons

According to article 339 of the civil code, an insane person is one who, as a consequence of

his being insufficiently developed or as a consequence of a mental disease or of his senility, is not capable to understand the importance of his action or to appreciate his respective rights and duties. These are persons with an unsound mind or lunatics or deficiency of mental constitutions or inmates of mental hospitals.

They, like the case of minors, are declared incapable for their own protection in their relation with third parties and similarly, the law appoints a guardian and a tutor on their behalf for the exercise of their rights and duties.

Dear Student, there are three forms of insanity recognized under the Ethiopian civil code. These are:

- i. Merely Insane Persons: these are insane persons whose insanity is neither notorious nor judicially interdicted. These are presumed to be sane persons for all practical purposes unless they can show that, at the time the acts are performed, s/he was not in a condition to give consent free from defects due to their insanity.
- ii. Notoriously Insane Persons: these groups of insane persons come in two forms based the nature of the place they live in accordingly, in urban areas, they are persons where by reason of their mental condition, they are an inmate of a hospital or of an institution for insane persons or of a nursing home, for the time for which they remain an inmate and in rural areas however, they are persons where their families or those with whom they live, keep over them a watch required by their mental condition, and where their liberty of moving about is, for that reason, restricted by those who are around them.
- iii. Judicially Interdicted Persons: these are persons whose insanity is pronounced by the court where their health and interest so requires. (refer to articles 339-379 of the civil code)

c. Disabled Person

These groups are those deaf-mute, blind persons and other persons who as a consequence of a permanent infirmity are not capable to take care of themselves or to administer their property. Hence, they are at liberty to take care of their interests by themselves as long as they have the potential to do so or otherwise, or if incapable to do so, they can invoke in their favor the provisions of the law which afford protection to those who are insane. (Refer to article 340 of the civil code)

d. Legally Interdicted Persons

These are persons from whom the law withdraws the administration of their property, as a

consequence of a criminal sentence passed on them. Hence, unlike the above three groups of persons, these are declared incapable not for their own protection from third parties but as a punishment against crimes committed by them.

Remember, these groups of persons are not affected by mental problems or they are of a sound mind. The only incapacity inflicted on such persons is regarding the administration of their property. To that effect, the law appoints a tutor to act on their behalf and administer their economic interests.

Finally, take note of the point that the interdiction imposed on such persons by law shall come to an end when the person interdicted has undergone the punishment for the duration of which the disability was to last. (Refer to articles 380-388 of the civil code)

f. Foreigners

The disability imposed by law on foreigners living in Ethiopia is special in that it pertains to the fact that they are not citizens of the country. Although foreigners are as a matter of principle fully assimilated to Ethiopian subjects as regards the enjoyment and exercise of civil rights, they are specifically incapable to participate in the government or the administration of the country. Generally however, the various incapacities imposed on foreigners (for instance inability to own an immovable property in Ethiopia) can be lifted via the instrumentality of a work permit (license) or an order issued by the government to that effect. (refer to articles 389-393 of the civil code)

Dear Student here you are advised to be cautious that, the incapacity referring to minors, insane and infirm persons and legally interdicted persons is imposed up on them generally due to problems related to age or mental condition of such persons or sentences passed up on them. Hence, it is named as General Disability. On the other hand, the incapacity imposed on foreigners and other professional persons are called Special Disabilities for they have become incapable due to special reasons imposed up on them such as nationality and the nature of the functions exercised by them.

Moreover, it is also important to properly understand the fact that the effect of lack of capacity and consent in a certain contractual relationship is Invalidation of the contract up on the application or request of the person affected by the incapacity or the defective consent. In turn, the immediate effect of invalidation of a contract is Restoration (reinstatement) of the parties to their position before the making of the contract. (in this regard you are advised to refer to articles 1808 to 1818 of the civil code of Ethiopia).

2. Object

The object of a contract is the obligation to be created or varied or extinguished by the parties via the instrumentality of the conclusion of the contract. Object of a contract can also be defined as the main content or consideration or undertaking assumed by the parties to be exchanged in due course of the contract. For example, if the contract is made for the sale of a horse. The object of this contract would be the 'sale of the horse'.

The object of a contract may be constituted in two forms. These are:

- i. Positive (commission) Object: such obligations are discharged by an action or the commission of an act such as obligations related to payment, delivery or rendering of a service and so on. Typical examples would be obligations to pay, to do, to deliver a thing or a service.
- ii. Negative (omission) object: in such type of objects the duty of the doer of the obligation is to undo or abstain or forbear from doing something. In this regard, typical examples would be obligation not to do, or to undo or not to build and so on.

As a rule, according to the principle of freedom of contract, the parties to the contract shall freely determine the object or contents of their contract. For instance, if the object of the contract refers to loan of money, the parties to the contract may freely determine the following: the amount of the loan; the time of payment; the place of payment; the way of payment: whether an interest is to be paid or not; the need for a guarantor if the borrower cannot pay and so on.

However, under the disguise of freedom of contract, the parties shall not derogate mandatory provisions of the law (restrictions and prohibitions set by law) in relation to the object of a contract. Accordingly, the object of a contract shall be:

- i. Sufficiently defined: by this we are referring to the fact that the parties to the contract should ascertain the objects of their contract with sufficient precision or the object should be certain or definite in meaning, quality or quantity. If the object of a contract is not sufficiently defined it will be very difficult to be performed and becomes of no effect.

For instance, if the obligation of the contract is sale of a house, among other things, the parties should sufficiently define, issues related to: the house number, the design of the house, the surface area of the house, the city, sub-city, *wereda*, *kebele*, and even the house number, if any where the house is situated, and so on.

- ii. Possible: the performance of the object of the contract shall be humanely possible at the

time of the contract. An impossible obligation is not an obligation at all. The obligation assumed by the parties should not relate to an insurmountable task. We say an obligation is impossible when its impossibility is absolute and insuperable which cannot be cured by either purchase-in-replacement or a compensatory-sale. Impossibility may relate to a thing or a fact. Typical examples in this regard would be the sale of a thing which does not exist at the time of the contract or the sale of a thing which in a non-merchantable-state at the time of the contract or the sale of things that are not declared by law as subject matters of sale. As an example you can take celestial bodies which are not mastered by man and put to use such as the moon or the stars.

iii. **Lawful, moral and in line with Public Policy:** The object of a contract shall not be contrary to public laws or mandatory provisions of private laws. Or it should not be against any applicable law of the land or it should not be declared illegal by an express legal manifest or a statute or proclamation. E.g. sale of *extra-commercium* things and things under public domain is prohibited. Signing a contract to operate smuggling is illegal. And so on.

Additionally, the object of a contract shall not violate the morality of the place of the contract. As different from law, morality is a relative concept that has to be strictly interpreted relative to the time and place of the contract. E.g. Sale of dog's meat or donkey's milk or celebration of marriage between two male individuals to establish a civil partnership may be moral or immoral depending on the moral requirements of the place where such contracts are made.

Here you should also consider that in addition to the requirements of legality and morality, the object of a contract should not also violate the requirements of public policy set by the government or its enterprises in due course of administration public resources. E.g. the government does not provide governmental house rental services to those persons that already have a house in their name. Hence, if any of such persons engage themselves in contractual relationship with the pertinent organ of the government in charge of housing the contract would be automatically of no effect. (Refer to articles 1711-1718 of the civil code)

3. Form

As different from the other three elements for the validity of contracts (which are mandatory) form is not a mandatory requirement. Or the requirement of form is permissive to the parties. Accordingly, the requirements attached with the form of a contract can be illustrated as follows:

i. as a rule, the parties to the contract are at freedom to agree to follow form of their choice. As a result, they may conclude the contract orally or in writing.

ii. However, once the parties have agreed to follow a particular (special) form the contract shall not be deemed to be completed until it is made in the agreed form. And

iii. If a particular type of contract is required by law to be in writing that shall be observed. For instance, for one reason or the other, the law requires the following types of contracts to be in writing: Contracts relating to immovable; contracts made with a public administration and contracts made for a longer period of time such as contracts of guarantee, insurance and so on. (Refer to articles 1719 – 1730 of the civil code)

Dear Student, here you should also take note that contracts required to be in writing shall be: supported by a special document signed by all the parties bound by the contract; attested by two witnesses and duly signed or thumb-marked and finally registered in the pertinent office of the Government.

NB.: Dear students, earlier we have asked the question that, what will be the effect of Contracts that does not fulfill the requirements of capacity and consent. And we said that such contracts would become invalidated (valid until invalidated). Similarly, what do you think will happen to contracts that have problems of object and form? If you provided the answer that such contracts would become Void or of no effect, then you are right. Of course, such contracts will be considered as if they have never been made from the beginning. Dear student, what do you think is the main difference as between ‘invalid’ and ‘void’ contract? (refer to articles 1808-1818 of the civil code)

4. Consent

Dear Student, Consent is the willingness (volition/assent) of a person to enter in to a contract. It is the major principle of contract law that consent given by a party to the contract shall be sustainable at law or not vitiated. The consent to enter in to a contract should be given by the parties to the contract freely, voluntarily and genuinely.

Consent should not result from the so called ‘vices of consent’ or abnormal circumstances, such as Fraud (deceit), Duress (coercion), Mistake (error), False Information, Threat to exercise a right, Reverential fear (undue influence) and unconscionableness (lesion). Or the parties to the contract should not give their consent as a result of the infliction of either of the above circumstances.

However, if consent is given by a party to certain contract due to either of the above factors

such consent would not be considered to be a sustainable consent before the eyes of the law. This makes the consent given vitiated for the law presumes the fact that the person who gave the consent would not have consented had it not been for the existence of the vices of consent.

Dear Student, here you need to be aware of the fact that, under a microscope, the components of a valid consent are, on the one hand the agreement of the parties on all the terms of the contract freely and genuinely and on the other, their agreement to be bound by the terms of their contract. (Refer to articles 1679-1695 and 1696-1710 of the civil code)

3.3.2. Offer and Acceptance

Dear Student, as mentioned earlier, by now, I believe that you are aware of the fact that a valid consent is the one which is expressed and declared by the parties. Hence, it is natural to expect the parties to the contract to declare their consent via the instrumentality of offer and acceptance.

Now let us deal with offer and acceptance in detail under the following segment of the writing:

a. Offer

Offer is a proposal or an invitation expressing the willingness of a party (called the *offeror*) to create contractual relationship with another party (called the *offeree*). In order to be binding an offer should fulfill the following characteristics:

i. An offer may be declared orally, in writing, by gesture (symbol) or by conduct. Though the oral and written forms of declaration are the most common and evident ones, what truly matters, at the end of the day, is whether the parties have clearly expressed their will and understand each other after the declaration of the offer. Hence, whenever an offer is made by sign (symbol) the parties should use a sign normally in use (conventionally known sign) justified by continuous general or local usage of the sign, such as a hand shake, nod of head or the knocking down of a hammer and so on. Similarly, when the parties declare their offer via conduct, such conduct should express that in the circumstance of the case there is no doubt as to the parties' agreement. Typical example of offer and acceptance by conduct may be calling a doctor home, using what is delivered, bringing a lost object in case of promise of a reward and so on.

ii. An offer shall always accompany an intention of the *offeror* to be bound by the terms of the offer s/he made for the lapse of either a specified period mentioned on the offer (duration

of the offer) or if no such time is fixed on the offer, for the lapse of a reasonable period of time to be determined having seriously considered the circumstances of the case. A subtle *offeror* however stipulates a time limit on the offer and bind itself only to the lapse of such period mentioned on the offer. In case an offer is made with no duration of acceptance, various factors should be considered to determine the binding life of the offer such as: the Present (conversing parties) or absent (corresponding) nature of the parties to the contract; complication in post office; seasonality and marketability; whether the parties have pre-existing business relationship; the nature of the transaction itself and so on.

iii. Be aware that, once an offer is made by the *offeror* for either a fixed duration of acceptance or with no duration of acceptance, it is the right of the *offeree* to bind the *offeror* (by the terms s/he made on the offer) for the lapse of the fixed period or a reasonable period of time.

In order it can be an offer it has to be written down in definite enough terms and should encompass detailed (full-fledged) bargain or substance.

An offer is different from a 'mere declaration of intention' made by the *offeror* to enter in to a contract with the *offeree*. A typical, binding, unilateral offer is an offer which is directly communicated to the intended (the particular) *offeree* or its agent. If it is not communicated to the particular *offeree* or its agent or if it is communicated (declared or made) to another person (in the absence of the *offeree*), it only amounts to a mere declaration of intention and not a binding offer.

iv. An offer is different from 'an invitation to offer' or 'an invitation to threat'. As a result, the posting up of tariffs, price-lists or catalogues or the display of goods or symbols for sale or menus or the release of advertisements (ads.) by mass media such as product advertisement or advertisement of an auction, are not by themselves binding offers rather they amount to an invitation made by the *offeror* to the interested *offerees* to look for such symbols or tariff or price tags and make an offer to the party who originally announced the advertisements. Hence, the contract begins when a customer look for a displayed good, get attracted by it and then requests the vendor to buy the good. The *offeror* is the customer and the vendor becomes the *offeree*.

v. An offer may be made to a particular person (specific offer) or generally to the public at large or a particular group out of the public at large (general offers). In this regard, you should understand that real offers are those that are made to a particular *offeree*. This is the

case because when offers are made to large number of people it creates various practical legal complications due to the fact that it can be accepted by more than one person. Typical example of a binding general offer in Ethiopia is 'Public Promise of a Reward.' This is an advertisement made to (addressing) large number of persons via a mass media of wider circulation stating that a reward will be given to that particular person who has performed (knowingly or unknowingly) a particular activity advertised by the *offeror*. Public promise of a reward is an exception to the principle that advertisements are not valid offers. (Refer to articles 1681-1695 of the civil code)

b. Acceptance

Acceptance is the agreement of the *offeree* to the terms of the offer made by the *offeror*. The following are the essential characteristics of a valid acceptance:

- i. An acceptance may be made in writing or orally or by symbol or implied from conduct and it has to be communicated to the *offeror*. However, if a particular type or mode of acceptance is required (dictated) by the *offeror* the acceptor should comply with the same.
- ii. An acceptance always implies an agreement and an intention to be bound by the terms of the offer. Or a serious intention to accept should be there.
- iii. Acceptance shall be made while the offer is still in force or not withdrawn by the *offeror*. Where the offer is made in alternative terms, the acceptance must make it clear to which set of terms it relates.
- iv. A person cannot accept an offer of which he has no knowledge. Dear Student Can a person accept an offer of which he has no knowledge? If you replied by saying No a person cannot accept an offer of which s/he has no knowledge, then you are right.
- v. 'Cross-offers' do not constitute an agreement or acceptance. Cross offers are identical offers made by two parties to one another and their offers are crossed say in a post office but neither offer is accepted by either party.
- vi. An acceptance shall be made in the form and in conformity with the terms specified on the offer or the *offeror* controls the offer or the method of the acceptance should be reasonable to the method of the offer. We say there is an acceptance and there by a contract, if and only if the terms of the offer and the acceptance mirror each other this is called the mirror image rule. If the acceptance is not the mirror image of the terms of the offer there will be no meeting of minds we have discussed earlier.
- vii. An acceptance shall be made absolutely (totally or as is), unconditionally and

unequivocally (vividly) or otherwise stated, if the terms of an offer are amended or altered or complemented or supplemented by the *offeree*, it does not amount to an acceptance rather it amounts to a counter-offer or as if the *offeree* has made an entirely new offer to be accepted by the original *offeror* and there will be a contract if and only if the new offer is accepted by the first *offeror*. To stipulate it otherwise, if there is a tiny discrepancy as among the terms of the offer and the acceptance, the contract or the agreement or the offer and the acceptance knock-out each other, this is called the ‘Knock-out rule’. (Refer to articles 1690-1695 of the civil code)

3.3.3. Silence when an Offer is made....

Dear Student as a matter of principle, according to article 1682 of the civil code of Ethiopia, Silence when an offer is made shall not amount to acceptance. When we say silence, we are referring to the ‘lack of response’ in all means possible such as words, signs or conduct. So when the *offeror* provides the offer to the *offeree* the *offeree* remained silent. Now the question is does the silence of the *offeree* amount to acceptance?

In normal times, the silence of the *offeree* does not, by itself, amounts to an acceptance.

Dear Student, What practical legal problems would be created if silence when an offer is made amounts (is considered) to acceptance? Or what are the anomalies the law intends to avoid by not considering the silence of the acceptor as an acceptance?

However, there are three exceptional situations whereby silence when an offer is made amounts to acceptance. These are:

- i. When it is duty of the *offeree* to accept the offer, made to it, by law or by concession. In such case the reception of the offer, on its own, amounts to acceptance. This principle works to those organizations duty bound to deliver basic necessity services (such as water, electricity) to the public at large under a concession with the government. Hence, once a customer has fulfilled the requirements expected of him to acquire an energy service from the Ethiopian Electric Power Corporation and submitted his offer to that effect to the agency the agency may not refuse the provision of the service by remaining silent for the silence of the agency amounts to acceptance.
- ii. In case of general terms of business prescribed by public authorities. These are general guiding terms of working of an institution which are prepared, pre-stipulated and approved by it. Hence, they are not as a rule subjected to negotiation with a fellow customer rather the customer is expected to know and adhere to them accordingly as long as they are prescribed

by such authorities. Hence, such rules become automatically applicable on a customer who is trying to access the service of such public authority whether the customer remained silent or not. As an example refer to the rules at the back of a lottery you have purchased or the rules at the back of the bank-pass-book you have opened in the commercial bank of Ethiopia or the transport tariffs prescribed by the government. It is the duty of the transport user to accept such tariffs prescribed by the government. So it does not make a difference whether the customer remains silent or not.

iii. In case of pre-existing business relationship between two parties and an offer is made to continue or vary an existing contract or to enter in to a subsidiary or complementary contract may be accepted by silence. However, such shall be the case where the new offer is made in a special document informing the other party that the offer shall be regarded as accepted (warning clause) if no reply is given within a reasonable period of time. Refer to articles 1682-1689 of the civil code)

3.3.4. Time for the Completion of a contract

The time for the completion of the contract (time of acceptance) becomes significant not in case a contract is made between present or conversing parties that are making the contract face to face. The relationship of such parties is mostly instant in that they can complete the contract by simultaneously exchanging their obligations face to face.

However, if the parties are not making the contract face to face or if they are absent or corresponding parties they cannot complete the contract (exchange offer and acceptance) simultaneously. So, there should be another important question we need to answer regarding when is the time to say the contractual relationship between the parties is completed or the process of the exchange of the offer and acceptance is deemed to be completed as between the *offeror* and the *offeree*?

Per the dictation of general jurisprudence of contracts there are two theories that are used as a frame of reference to determine the exact time of completion of a contract in case a contract is made via an intermediary such as a post office or along the telephone and as between absent or corresponding parties. These are:

i. Theory of Dispatch: this is also called the mail-box-theory. According to this theory, a contract is deemed to be completed (made) at the place where and at the time when the acceptance was sent to the offeror. If the contract is made by telephone, it shall be deemed to be completed at the place where and the time when the party was called. Hence, without

considering the likelihood of various complications or delay in the post office or without making sure whether the acceptance sent by the *offeree* is actually received by the *offeror* or not, this theory concludes that the contract is automatically completed up on the moment it is dispatched to the *offeror* in the post office by the *offeree*.

Dear Student, to which party do you think is this theory advantageous or disadvantageous? Why? Why not? Is it to the *offeror* or the *offeree*?

ii. Theory of Reception: according to this theory, a contract is deemed to be completed at the place where and the time when the acceptance was received by the *offeror*. So per this theory, a mere sending of the acceptance by the *offeree* does not suffice or complete the contract unless the acceptance has finished its journey in the post office and is practically received by the *offeror*.

Dear Student, to which party do you think is this theory advantageous or disadvantageous? Why? Why not?

Finally, which theory do you think is applicable in Ethiopia? Why or why not? What are the practical legal problems if we apply either of the theories? (Refer to articles 1691-94 of the civil code)

3.3.5. Grounds for the Termination of an Offer

In line with the general saying that everything that has a beginning has an end, offers are made to be viable forever. The following are the major grounds for the termination of an offer:

i. Lapse of the Duration of the Offer: the law dictates that whosoever offers another to enter into a contract and fixes a time limit for acceptance shall be bound by his offer until the time limit fixed expires. If it is not made with a time limit, then the offer will be terminated after the lapse of a reasonable time within which the *offeror* expects the *offeree* to decide on the offer. If the *offeror* sets a time limit for the acceptance of the offer, it must be honored.

Illustration:

Assume that Abel has offered to sell Dawit his motorcycle for 18,745 birr. Abel tells Dawit the offer will remain open until noon of the following day. To create the contract, Dawit must accept within that time. If no time for acceptance is stated in the offer, it must be accepted within a reasonable time. Otherwise, no contract exists. What is a reasonable time depends on the circumstances. For example, a reasonable time to accept an offer for purchasing a

truckload of ripe tomatoes would be different from a reasonable time to accept an offer for purchase of a house.

ii. Revocation (withdrawal) of the offer by the *offeror*: Revocation of the offer is the taking back of an offer by the *offeror*. The *offeror* has a change of mind or circumstances and decides to withdraw the offer before it has been accepted. An offer shall be deemed not to have been made where the *offeree* knows (learns) that the offer made to him is withdrawn before he knew or at the time when he knows of the making of offer.

Illustration:

Andargachew offered to sell his CD burner to Muluken for 250 birr. Muluken examined the CD burner and found that it was in good condition. However, Muluken couldn't decide if he wanted to spend so much money for a used piece of equipment. He told Andargachew that he would consider his offer. In the meantime, Andargachew decided that he didn't want to sell his CD burner after all. He telephoned Muluken and informed him of his decision. Andargachew could revoke his offer because Muluken had not yet accepted it.

iii. Rejection by the *Offeree*: nevertheless an offer is made with a time limit or not, the offer will be terminated, if it is expressly rejected by the *offeree* either before the lapse of such fixed time or the lapse of the reasonable period of time. The only reason to fix the duration is to give more time to the acceptor to consider the offer. If the acceptor rejects it forthwith, fixing a period of time on the offer serves no purpose. For example, if someone says to you, "I'll sell you my camera for 1500 birr," and you say, "I don't want it," then the offer has come to an end.

Illustration:

Elfinesh decided that she wanted to make some extra money by selling some dried floral arrangements that she had made using flowers from her own garden. Elfinesh spoke to her neighbor, Aregash Hotel, about the flower arrangements and offered to sell them for 40 birr each. Aregash liked the descriptions and decided to take a look at Elfinesh's work. When Elfinesh showed the arrangements to her, however, Aregash realized that they were not what she had expected. Aregash decided to reject Elfinesh's offer.

iv. A counter-offer by the *Offeree*.

Illustration:

A counteroffer ends the first offer. If someone says to you, "I'll sell you my camera for 2500

birr,” and you say, “I’ll give you 2400 for it,” no contract comes into existence unless the original *offeror* accepts your new offer. If you later say, “Okay, I’ll give you 2500 birr for the camera,” you will be making a new offer, which the original *offeror* may accept or reject.

v. Death, incapacity or bankruptcy of the *Offeror* or the *Offeree* depending on the nature of the obligation to be performed. Refer to articles 1690-95 of the civil code

3.3.6. Additional Points to Consider on Offer and Acceptance

As noted earlier, an offer is a proposal by one party to another party to enter a contract. The person making the offer is the *offeror*, and the person who receives the offer is the *offeree*. An offer has three basic requirements. It must be: Made seriously, Definite and certain, and Communicated to the *offeree*.

i. Serious Intent: An offer must be made with the intention of entering into a legal obligation. An offer made in the heat of anger or as a joke would not meet this requirement.

Illustration:

A friend complaining about her unreliable car might say, “Give me 100 birr and it’s yours.” This statement may sound like an offer, but your friend cannot be forced to sell her car for 100 birr. Often an invitation to negotiate is confused with an offer. Sellers usually have limited merchandise to sell and cannot possibly sell an advertised product to everyone who sees an advertisement. For this reason, most advertisements in newspapers, magazines, and catalogs are treated as rather than as offers. They are also called invitations to deal, invitations to trade, and invitations to make an offer.

Illustration:

An advertisement in the newspaper read, “A steel knife for, 49.98 birr.” Helen work, went to the store the next day and said, “I would like to buy the Knife.” A clerk, named Berihun, apologized, saying the Knife had been sold within an hour after the store opened.

The advertisement in the above Example was merely an invitation to the public to come in, see the Knives, and make an offer. When Helen said, “I would like to buy the Knife,” she was actually making an offer to buy at the advertised price of 49.98 birr. The storeowner is free to accept or reject the offer. There are exceptions to this rule.

The courts consider some advertisements as offers when they contain specific promises, use phrases such as “*first come, first served*,” or limit the number of items that will be sold. In such cases, under the terms of the advertisement, the number of people who can buy the

product becomes limited, making the advertisement an offer rather than an invitation to negotiate. Price tags, signs in store windows and on counters, and prices marked on merchandise are treated as invitations to negotiate rather than as offers. This rule of law probably stems from days when people negotiated for products more than they do today.

ii. Definiteness and Certainty: An offer must be definite and certain to be enforceable. A landlord (*lessor*) of an apartment with faulty plumbing might agree to pay “a share” of the cost if the tenant (*lessee*) fixes the plumbing, but the court would not enforce the contract because it was not possible to determine what the parties meant by “a share.”

Example: Mr. Wendu was offered a position as an account executive in Grand Resort Hotel in Bahir Dar at a salary of 20,400 birr a month plus a “reasonable” commission on total sales. Is this a definite and certain offer? No, because it would be difficult to determine exactly what a “reasonable” commission is. The court, however, could fix a commission based upon general practices of the trade.

iii. Communication to the Offeree: Offers may be made by telephone, letter, telegram, fax machine, e-mail, or by any other method that communicates the offer to the *offeree*. However, the offer should be communicated to the particular *offeree* with whom the *offeror* intended to make a contract with.

Illustration:

Mr. Gobeze found a wallet. A driver’s license identified the owner, and Gobeze returned the wallet. The owner thanked him but did nothing more. Later in the evening, while reading the newspaper, Gobeze discovered that the owner had offered a reward for return of the wallet. Dear Student do you think Gobeze can claim the wallet nevertheless he has returned the wallet without the knowledge of the reward? If you answered yes, then you are right. According to the Ethiopian law of contract what matters to claim the reward is whether the mentioned condition has been met by the claimant and it does not matter whether the claimant has knowledge of the reward or not. (Refer to article 16 of the civil code on ‘public promise of a reward’).

On the other hand, the second element of a legally binding contract is acceptance of the offer by the offeree. As in the case of an offer, certain basic requirements must be met: the acceptance must be unconditional and must follow the rules regarding the method of acceptance.

i. Unconditional Acceptance: The acceptance must not change the terms of the original offer

(as is) in any way. This principle is called the Mirror Image Rule. Any change in the terms of the offer means the *offeree* has not really accepted the offer but has made a Counteroffer. In that case, the original *offeror* is not obligated to go along, and no contract results. Instead, the *offeror* becomes an *offeree* and may accept or reject the counteroffer.

Illustration:

Mr. Shiwangizaw sent a letter to Mr. Alebachew, offering to buy the latter's home for 800,000 birr. Mr. Alebachew, who had advertised his house at 800,000 birr, wrote a reply stating, "I accept your offer. However, i would like the price set at 830,000 birr."

Ato Alebachew didn't really accept Shiwangizaw's offer, as his letter claimed. Instead, he made a counteroffer, which Shiwangizaw is free to accept or reject. He may choose to make a counteroffer of his own, agreeing to buy the home for an amount somewhere between 800,000 and 830,000 birr.

Then the initiative to accept or reject would shift back to the seller. This process could continue until the terms of the offer and the acceptance "mirror" each other. The parties could also decide they will never agree on a mutually satisfactory price.

ii. Methods of Acceptance: The time at which an acceptance takes place is important because that is when the contract comes into existence. When the parties are dealing face-to-face or on the telephone, no special problem exists.

One party speaks, and the other listens and communicates the offer or the acceptance. Special rules, however, govern acceptances that take place when the parties are separated by a distance and must communicate by letters, telegrams, or fax. According to the Ethiopian contract law an acceptance that must be sent over long distances is effective when it is sent. Any method of communication that has been expressly or impliedly endorsed by the *offeror* would qualify. The law also says that an acceptance is implied when the *offeree* accepts by the same or a faster means than that used by the *offeror*.

Consequently, the acceptance of a mailed offer for goods would be effective when it is sent electronically, via fax, or through an overnight carrier. If the *offeror* states in the offer what method the *offeree* must use to accept, that method must be followed. Sometimes an offer specifies that it must be accepted by an action. In these cases, the action must take place before there is an acceptance.

Illustration:

i. Mr. Melaku, a sponsor, promised to pay Mr. Chalachew, a musician, 10,000 birr to Abebech Gobena Orphans suit and march with the band at a football game's halftime. Mr. Chalachew would have to perform the action to accept the offer. The *offeror* cannot impose silence on the *offeree* as the means of acceptance unless he or she has previously agreed to this condition or has allowed silence to signal acceptance in the past. In contrast, if the *offeror* has established silence as the means of acceptance, then he or she will have to live by that condition if the *offeree* accepts by remaining silent.

ii. Shegitu wrote a letter to Belaynesh offering to sell her motorcycle. "If I do not hear from you, I shall assume that you have accepted my offer," she said. However, Belaynesh's silence after receiving the offer would not bind her to pay. A person cannot be forced to respond to avoid a binding agreement. On the other hand, if Belaynesh intended to accept the offer and complied with Shegitu's directions to remain silent, then Shegitu must honor that silence as her acceptance.

3.4. Additional Points on Contracts in General**i. Understanding Contract Law**

When was the last time you made a contract? If you bought your first car last year or sold your bicycle at a local market, you probably know that these activities involve contracts. Many common daily activities may also involve contracts, from buying a fast food meal to filling your car with gas. Most people think a "contract" is a long, preprinted, formal document that they sign when buying a vehicle, selling their house, or purchasing insurance. Such formal documents represent only a small fraction of the contracts that you will make in your lifetime. The truth is that you create a contract any time you agree to exchange things of value. Because contracts pervade your life, you need to know about their nature, purpose, and effect. Further, contract law forms the foundation for all other areas of the law that we will explore in this text.

Understanding contract law is necessary to grasp the law of sales, consumer law, agency law, property law, employment law, partnership law, corporate law, and computer law. We will begin with the most basic concepts: what contracts are and how they come into existence.

ii. The Nature of a Contract

A contract is any agreement enforceable by law. You should never enter into a contract without understanding the legal responsibilities involved. Not all agreements are contracts,

however. A Son's promise to take the garbage to the curb before his father returned home is probably not a contract. In contrast, Mr. Kebede's agreement to run an advertisement in a local newspaper is undoubtedly a contract. Similarly, if someone answers Mr. Kebede's advertisement and returns his lost laptop, he will owe that person what he promised as a reward in the advertisement.

iii. The Three Theories of Contract Law

The legal responsibilities associated with contracts are based on what the involved parties do and say to one another. In the past, courts asked whether the parties to a contract exchanged things of equal value. This approach was called the 'equity theory' of contract law.

However, the advent of industrial capitalism and the need to support a profit-making system forced the courts to shift their focus. When asked to settle a contract dispute, the courts would ask whether the parties had agreed to the terms set forth in the agreement. This new theory was called the 'will theory' of contract law because it focused on the exercise of each party's free will. The courts no longer asked if the contract was fair; instead they pondered, "Did the parties really agree to these terms?"

One problem with the will theory is that it was difficult to know what the parties were actually thinking when they entered into an agreement. Consequently, the courts studied actions and words to determine if the parties reached a "meeting of the minds." Gradually, this approach led to a search for certain fixed elements to contracts. If these elements existed, the courts would hold that a contract existed. This approach became known as the 'formalist theory' because it relied on the form of the agreement.

iv. The Elements of a Contract

The six elements of a contract can be stated as: offer, acceptance, genuine agreement, consideration, capacity, and legality. To be legally complete, a contract must include all six elements. Notice that the list does not include anything written. Not all contracts have to be in writing to be enforceable. Now let us stipulate the definition of each of them as follows.

- i. Offer: is a proposal by one party to another intended to create a legally binding agreement.
- ii. Acceptance: is the second party's unqualified willingness to go along with the first party's proposal. If a valid offer is met by a valid acceptance, a contract exists.
- iii. Genuine Consent: Some circumstances, such as fraud, misrepresentation, mistake, undue influence, and economic duress, can destroy the genuineness of an agreement.

iv. Capacity: The fourth element is the legal ability to enter a contract. The law generally assumes that anyone entering a contract has the capacity, but this assumption can be disputed.

v. Consideration: the fifth element is the exchange of things of value. The parties to the contract should exchange things of value to one another. If not, there is no consideration in that agreement.

vi. Legality of Object: People cannot enter into contracts to commit illegal acts. Consequently, legality is the final element of a contract.

v. Characteristics or Types of a Contract

Contracts can be created in different ways and can assume diverse forms. A contract can be described by any of the following characteristics: Valid, void, voidable, or unenforceable. Express or implied. Bilateral or unilateral. Oral or written. Any contract can have characteristics from one or more of these four groups. That is, a contract can be valid, express, bilateral, and written. Let's take a closer look at what these characteristics indicate about a contract.

i. Valid, Void, Voidable, or Unenforceable

The word valid means legally good, meaning that a valid contract is one that is legally binding. On the other hand, a contract that is Void has no legal effect. An agreement that is missing one of the previously discussed elements would be void, such as any agreement to do something illegal.

When a party to a contract is able to void or cancel a contract for some legal reason, it is a Voidable contract. It is not void in itself but may be voided by one or more of the parties. A contract between two minors, for example, could be voidable by either of them. An unenforceable contract is one the court will not uphold, generally because of some rule of law, such as the statute of limitations. If you wait too long to bring a lawsuit for breach of contract, the statute of limitations may have run its course, making the contract unenforceable.

ii. Express or Implied

An express contract is stated in words and may be either oral or written. An implied contract comes about from the actions of the parties. People often enter into implied contracts without exchanging a single word.

Illustration:

Alemayehu went to a self-service AGIP gas station that requires payment before the attendant will turn on the pumps. He handed the attendant 10 birr, returned to his car, pumped 10 birr worth of gas into his tank, and drove off. Neither party spoke a single word, yet an implied contract arose from their actions.

iii. Bilateral or Unilateral

The word bilateral means two sided. Thus, a bilateral contract contains two promises. One party promises to do something in exchange for the other's promise to do something else. If a friend says, "I'll sell you my DVD player for 150 birr," and you say, "I'll buy it," a bilateral contract comes into existence. Each of you has made a promise- you have promised to buy, and your friend has agreed to sell. Most contracts are created in this way.

In contrast, the word unilateral means one-sided. It contains a promise by only one person to do something, if and when the other party performs some act. If your friend says, "I'll sell you my DVD player for 150 birr if you give me the cash before noon tomorrow," he or she will not be required to keep the promise unless you hand over the cash before noon on the following day.

A reward offer (public promise of a reward) is one of the most common instances of a unilateral contract. The acceptance of the reward offer must precisely comply with the offer.

Illustration:

Say Mr. Belete placed an advertisement in the *Addis Zemen* newspaper offering a reward for the return of his lost laptop. However, Mr. Beletes's offer of a reward alone did not create a contract. The contract would come into existence only when someone returns the laptop. Mr. Belete would then owe the finder the reward.

iv. Oral or Written

An oral contract is created by word of mouth and comes into existence when two or more people form a contract by speaking to each other. One person usually offers to do something, and the other party agrees to do something else in return. Most contracts are oral contracts of this nature.

Sometimes, however, it is desirable to put contracts in writing. A written contract assures that both parties know the exact terms of the contract and also provides proof that the agreement was made. For instance, the Civil Code of Ethiopia requires that certain contracts, such as,

contracts related to immovable, Administrative contracts and contracts for a longer period of time must be made in writing to be enforceable.

Dear Student, What do you think are the advantages of concluding a contract in writing than orally?

3.5. Effect of Contracts

Dear student, as you may recap from the definitional part of contracts we said that the effect of a contract, whether positive or negative shall be restricted to the parties to the contract. Or a contract shall not provide an advantage or a detriment to third parties to the contract or non-contractants.

According to article 1731 of the Civil Code of Ethiopia in order to be effective a contract shall be lawfully formed. This is the case where the requirements of formation (Capacity, Consent, Object and Form) are fulfilled. The following three sentences briefly summarize effects of contracts:

- i. The provisions of a lawfully formed contract bind the parties as though a law or each provisions of a contract serve as law of the parties. Refer to *Sanctity of Contracts*.
- ii. The rule is the parties are at freedom to determine the contents of their contract.
- iii. However, they may not derogate mandatory provisions of the law (restrictions and prohibitions) under the guise of such freedom. For example, the parties to the contract may not shorten period of limitations fixed by law (Art. 1855). The parties however may derogate permissive provisions of the law by providing their own solutions for all possible aspects of the contract. Permissive provisions that are not excluded by the agreement of the parties become binding. For instance the parties can fix “time of payment”, “place of payment”, “legal interest” or “quality of fungible things”. If the parties do not particularly agree on permissive provisions the law fills the gap in their agreement by providing the required solutions. (Refer to article 1731 of the civil code)

3.6. Performance of Contracts

Dear Student, performance is the carrying out of the obligations assumed by the parties under the contract according to the law and their agreement. In this section, we will deal with the various aspects of performance in the form of a question and Answer as follows:

Who shall perform?

Both parties to the contract shall perform their respective obligations and this is the

recommended way of extinguishing contractual relationships. However, it is normal to expect the debtor to start performance first. For example, in case of sale contract we should normally expect the seller should take the initiative to deliver the things to be sold to the buyer.

Who is the Debtor?

The debtor is the party who is at duty to discharge his/her obligations under the contract but who has not discharged yet or who has failed to do so. For example, if the buyer has already collected the thing but has not yet discharged his duty of payment, s/he becomes the debtor.

Who is the creditor?

The creditor is the party who has already discharged his obligation and is expecting the same from the debtor. In the above example the seller has already discharged his obligation of delivering the thing sold and he is expecting the buyer to discharge the obligation of payment.

How should the debtor perform its Obligation?

The debtor may perform in either of the following types or ways of performance:

a. In person or personal performance: this is a type of performance where a party is at duty to cause the performance of the obligation by himself and only by himself or personally. Personal performance is the rule. This excludes the opportunity of performing an obligation through the instrumentality of another person. Personal performance occurs in the following cases:

- i. If the performance requires the particular skills, experience, or training (expertise) of the debtor. Or if the creditor has a particular interest in receiving such personal performance in that the creditor cannot require the performance from another person in the circumstance of the case.
- ii. If personal performance is expressly agreed up on by the parties in the contract. Or if the parties to the contract have excluded other types of performance by agreement. And
- iii. If personal performance is dictated by the very nature of the obligation to be discharged by the debtor.

b. Performance via the instrumentality of a third party: this is a performance made by a third party to the contract that is so authorized to perform on behalf of the debtor either by the debtor himself (agent of the debtor) or the law (heirs-at-law of the debtor or co-debtors with the debtor or guarantors of the debtor) or by the order of the court (the court may order a third party to perform on behalf of the debtor such as liquidators of succession). In this case,

regardless of the doer of the performance, what actually matters is the fact that the creditor has received the performance. Typical examples of performance via a third party are those types of performance related with payment of a price, delivery of a thing and so on where it does not make a sensible difference whether the performance is made by the debtor or a third party on his behalf. This type of performance is the exception to the rule of performance (personal performance) and it refers to all types of performance other than in person performance.

To whom shall the debtor perform its Obligation?

The debtor shall perform (either personally or through a third party so authorized) to the creditor or a third party so authorized either by the creditor himself (agent of the creditor) or by law (heirs-at-law) or by order of the court (such as joint creditors or liquidators). In this case however, you should bear in mind that an authority is a necessary condition for receiving the performance on behalf of the creditor or a third party cannot stand from the middle of nowhere and accept the performance without an express authority to that effect.

What is the fate of a payment (performance) made to an incapable creditor?

This is a payment or a performance made to a creditor who is declared incapable by the law. As you are aware, if there is no capacity, there is no valid contract. Or the contract becomes invalid (valid until invalidated). As a result, payment made to a creditor incapable of receiving it is invalid. The legal consequence is, the first payment made by the debtor is invalid means second payment can be claimed by the representatives of the incapable creditor as if no payment was made in the first place. However, such payment may become exceptionally valid if:

- i. The payment is ultimately confirmed by the capable creditor or
- ii. The payment has benefited the creditor or it is to the advantage of the estate of the creditor.

What is the fate of a payment (performance) made to unqualified or unauthorized creditor?

This is a scenario where by payment is made to a person who is not authorized to receive the payment on behalf of the creditor. Payment made to unqualified person is invalid. The thing is, if the first payment is invalid, a second payment can be claimed by the real or qualified creditor as if no payment was made in the first place. However, such payment may be exceptionally valid where:

- i. The payment is confirmed by the real creditor, or
- ii. The payment is to the advantage of the estate of the creditor, or
- iii. The payment is made in good faith to a person who appears without doubt to be the creditor. For example, a payment made to an heir-apparent of the creditor who turned out to be not an heir of the creditor later on.

What if two or more persons appear to be the creditor and claim performance from the debtor? To whom should the debtor make performance?

Where there is a doubt as to who is qualified to be paid, in case more than one person claim to be the creditor, the debtor may refuse to pay and release himself by depositing the amount due with court. However, the debtor shall pay at his own risk where he is aware of a pending litigation (contest) and pays to any of the persons (contestants) who hold themselves out to be creditors. Moreover, where a case is pending in court and the debt is due, any of the persons who hold themselves out to be creditors may require the debtor to deposit the amount due.

Identity of the thing to be delivered?

The creditor shall not be bound to accept a thing other than that due to him. So what the debtor is expected to deliver is only a quality (the same species) of the thing that has been particularly agreed up on the contract. Otherwise stated, the debtor may not force the creditor to accept a thing other than what is mentioned in the contract. Be aware that the principle still works if what was actually delivered is a thing of similar or a greater value than the one agreed originally. This should be seen in line with the principle that agreements of the parties bind them as a law. So, if the creditor wanted a particular thing or quality of a thing s/he may have a particular reason in receiving such particular thing or quality of a thing. The debtor cannot force the creditor to accept a thing only because it is of a greater value than the one agreed up on the contract.

What if the debtor caused a partial payment?

Partial payment can be defined as any payment which is lesser than the full amount of the payment agreed on the contract. So, the question should the creditor accept a partial payment made by the debtor? The creditor shall not refuse partial payment unless the debt is liquidated (an ascertained and admitted debt) and fully due (matured or exigible debt). In the rest of the circumstances the creditor should not refuse to accept partial payment. However, where only part of the debt is contested, the creditor may accept the admitted part of the debt and claims for the remaining.

Dear Student, Why do you think is partial payment prohibited? Can you mention scenarios where it is justified to pay partially?

What if fungible things are due for delivery?

Fungible things are things of an interchangeable quality, test, and value. These are things that are regarded as commercially interchangeable with other property of the same kind. They are generally referred to as supplementary goods in economics literature. For instance, ‘teff’, ‘Corn’, ‘wheat’ and ‘oil’ are fungible in nature there are various qualities of ‘teff’ and ‘oil’ that can be used interchangeably. For instance, oil can be made from different types of grains that can be used interchangeably.

The rule is, if the delivery is related to ‘fungible things’ and the parties have not specified the specific quality of the thing, the seller may choose the specific quality to be delivered. However, the seller may not take advantage of his right to choose the specific quality and offer a thing below average (medium) quality.

What if an insufficient quantity (non-conformity) or quality (defect) of fungible things is delivered?

The creditor may not refuse fungible things on the ground that the quality or quantity offered to him does not exactly conform to the contract, unless this is essential to him or has been expressly agreed up on. Hence, the creditor should be able to prove the fact that the delivery of the exact quality or quantity of the contract is fundamental to him or he cannot use the delivery for the intended purpose unless it of that particular quality of quantity or he has a special interest in receiving that particular quality of the thing and if there is a slight non-conformity of quality the thing becomes of no use to him.

Where the thing does not exactly conform to the contract, in terms of quantity, the creditor may proportionately reduce (appropriate) his own performance or where he has already performed claim damages. This goes in line with the doctrine of ‘substantial performance’. I.e., the creditor shall not refuse a non-conforming delivery as far as the debtor has performed substantially or the major part of the delivery.

What amount of interest shall be due?

The rate of interest shall be nine percent per annum where interest is due and the rate has not been fixed. Bear in mind that interest would be calculated if and only if the parties have reached on an agreement that an interest is due but they did not agree as to how much should be calculated. In such case the law presumes that they have agreed on 9 percent per annum.

Legal interest rate shall not apply where another rate has been fixed either by parties (contract) or law or customary rules. The maximum amount of interest imposed is for loan (2479) which is 12 percent per annum. However, a rate of interest above the maximum amount will be reduced to 9 percent per annum and the same holds true if the parties only mention that an interest is due but did not specific at all.

Where should be the place of payment or performance?

Determination of place of payment or performance of a contract is very significant in that it determines various aspects of the contract. Such as, the legal tender to be used by the parties as a means of payment, the jurisdiction of the court that adjudicates the parties if a dispute arise, which party covers the cost of transport, the transfer of risk from the seller to the buyer. Accordingly the following three rules are applicable:

- i. Agreed place of payment or delivery on the contract, if any, shall be respected.
- ii. Where there is no agreed place fixed on the contract, payment shall be made at the place where the debtor had his principal residence at the time when the contract was made.
- iii. However, if the thing is a definite or specific thing, payment in respect of it shall be made at the place where the thing was at the time when the contract was made. E.g., a car found in a garage.

When should be the time of payment?

Determination of the time of payment is also essential in that it determines various aspects of the contract, such as: the calculation of interest, the transfer of risk, the calculation of damages and so on. The following are the rules in relation to time of payment:

- i. Agreed time of payment or delivery, if any, shall be respected
- ii. Where no time is agreed up on or fixed on the contract, payment may be made forthwith or immediately, and
- iii. Payment shall be made whenever a party requires or demands the other party to perform his obligation. (up on demand).

When should Risk Transfer?

Risk refers to the payment of the value of the thing if the thing is lost (stolen), deteriorated (degraded in quality) or destroyed (damaged). The rule is risk perishes with the owner or risk follows possession. The party who is at duty to preserve the thing is the party who is in possession of the thing (possessor). Hence, risk always begins from the possessor and

transfers to the other party (the next possessor) due to various factors:

- i. After actual delivery of the thing to the buyer
- ii. After the date of delivery and nevertheless delivery yet to be made
- iii. After the date of payment and if the payment is agreed by the parties in the contract to be the condition of delivery of the thing.
- iv. When the things are under voyage, the risk in the things will be transferred from the seller when the things are delivered to a carrier or a third party custodian (consignment).

Dear Student, You should also bear in mind that, risk applies only to corporeal chattels or things and the non-performance of a fundamental obligation is always a ground for the transfer of risk. (Read Arts. 2323 – 2327 of the Civil Code of Ethiopia.) Dear student, in order to acquire detail understanding of our discussions on performance of contracts I invite you to read the pertinent provisions of the civil code starting from article 1740 to 1762.

3.7. Non-performance of a contract

As per Article 1731 (1), a contract formed lawfully binds the parties as if it was law, which means that the parties shall perform (discharge) their obligations according to their contract and the law. If performance is made according to the contract and the law, it is deemed to be valid and releases a party (the debtor) from his obligation.

Thus, non-performance of a contract refers to the failure of either one or both of the parties to perform contractual obligations in conformity with the terms of the contract and the law. It is also called breach of a contract.

The following scenarios can be taken as the major instances of non-performance:

- i. This failure or breach may be total- where a party totally fails to honor the terms of a contract.
- ii. It may also be partial- where a party has performed his/her obligations only partly.
- iii. It may also relate to delay in performance. Or failure to observe the time of performance stated on the contract.
- iv. Offering performance at a place other than the place agreed up on by the parties or at a place fixed by law also constitutes non-performance.
- v. Delivering a thing that non-conform to the contract or
- vi. Delivering a defective thing also amount to the breach of contract.

vii. Moreover, an interruption of a successive delivery also amounts to non-performance.

Generally any deviation by a party from the terms of the contract amounts to non-performance.

3.7.1. Legal Remedies of Non-Performance

It is clear that breach by one party affects the interest of the other party, which usually is referred to as the Victim party. Thus, it is logical to provide a solution or remedy for the party affected by non-performance. We have discussed that one function of contract law is to enforce contracts. One way of doing that is to provide remedies for non-performance particularly by sanctioning failures. Otherwise parties would be reluctant to enter in to a contract. It is commented that the rules on non-performance are intended to avoid the deterrence effect of non-performance on *contractants* for fear that their contract may not be performed or in other words, it is intended to secure security of contractual transactions.

It is important at this junction to note that the parties may stipulate contractual remedies for breach of their obligation. For example, they may incorporate their own penalty clauses. These kinds of remedies may be enforced by the law (see articles 1886-1895). However, the law of contract provides remedies even if there is no contractual provision to that effect. These are called legal remedies against non-performance.

Default Notice

It should be noted however that the creditor before proceeding to exercise (invoke) the remedies of non-performance should fulfill one more legal formality in that s/he should put the debtor at default or give the debtor a default notice. Notice can be a written demand or by any other act denoting the intention of the creditor to obtain performance. The creditor should fix a reasonable period of time in the notice after the expiry of which he will not accept performance of the contract. (Refer to article 1772-75 of the civil code)

The purpose of giving default notice is to remind (warn) the debtor that his obligations are due and it is time to perform his obligation or otherwise the creditor will resort to exercising the legal remedies. Giving of notice also begins the calculation of interest against the debtor. It also begins the calculation of damages for delay in favor of the creditor.

You should also bear in mind that giving of a notice is not always mandatory or there are scenarios whereby the creditor may directly proceed to exercise his legal remedies against the failed debtor. We call such cases where notice is unnecessary. In the following scenarios Notice is unnecessary:

- i. In case of an omission type of obligation where the obligation of the debtor was to refrain from certain acts or doing something
- ii. the debtor assumed to perform an obligation which the contract allows to be performed only within a fixed period of time (*a compulsory-date*) and such period has expired; e.g., A Birth Date
- iii. In case the parties have expressly agreed on the contract that notice is unnecessary
- iv. In case of Anticipatory Repudiation (breach). AR is a situation where by the debtor expressly informs the debtor that he would (can) not perform his obligations or it is a written intent not to perform.

The legal remedies for non-performance protect the interest of the party that is affected by non-performance. The interest that is affected by non-performance of the contract is the benefit that could have been gained had the contract been performed. Accordingly, the remedies are supposed to put the victim party in the position he would have been had the contract been performed.

As such, the Ethiopian law of contract generally recognizes the following three remedies against non-performance:

1. Forced (Specific) Performance of the contract

This is a remedy in which the creditor requests the court to force the hands of the debtor to perform his obligation according to the contract or the law. This is designed to satisfy the victim party by enforcing the terms of the contract. It may be done either by compelling the debtor (failing party) to perform his or her obligations or by authorizing the creditor (victim) party to perform the debtor's obligation at the cost and expense of the debtor. The former is usually referred to as forced performance, while the latter is called substituted performance.

The court shall not award specific performance of a contract up on compliant and in favor of the creditor unless:

- i. It is of a special interest to the party requiring it- that the creditor cannot acquire similar performance from other sources or the performance of the obligation was the very reason of the creditor to enter in to the contract. And
- ii. The contract can be enforced without affecting the personal liberty of the debtor. Only proprietary interest shall be affected not personal liberty of the debtor.

Illustration;

Dear Student, try to consider the following two examples:

- i. Assume that a monopolistic entity, which supplies vital goods (e.g., water or electricity) or services (e.g., postal or telecommunication) to a customer cuts off its supplies. In this case the goods or services are so essential that the customer cannot get them from other sources. Thus, it may be said forced performance is of special interest to the creditor, i.e., the customer. At the same time, ordering the entity to provide these goods or services cannot deprive the entity's liberty (as only physical persons enjoy liberty). So, in this case the court may order forced performance.
- ii. In another scenario, if an artist who has agreed to present his songs on a certain occasion in consideration of payment fails to discharge his obligation at the agreed time, it may arguably be said that the contract is entered into in consideration of his talents and that his performance of the obligation is of special interest to the creditor. However, to order the artist to sing without his will amounts to deprivation of his liberty. Thus, in such cases, forced performance cannot be ordered even if it is of special interest to the creditor.

Accordingly, substituted performance can be ascertained in two ways:

- i. If the obligation that the debtor has failed to perform was an obligation to do, the court may order the creditor to do or to cause to be done at the expense of the debtor the acts which the debtor assumed to do.
- ii. If the obligation that the debtor has failed to perform was an obligation not to do, the court may authorize the creditor to destroy or cause to be destroyed at the debtor's expense the things done in violation of the debtor's obligation to refrain from doing such things.

Otherwise stated the creditor will be authorized to cause a *Purchase-in-replacement* or a *Compensatory Sale*.

Illustration:

Dear Student, try to consider the following examples:

- i. Ato Belay (debtor) fails to dig a well; the creditor can have dug the well by any one at Ato Belay's expense upon court authorization.
- ii. If Ato Belay's obligation was to refrain from erecting a building and fail to do so by erecting a building, the creditor can destroy the building or have it destroyed. Such act shall be made upon court authorization and at the expense of the debtor.

2. Cancellation of the Contract

The second remedy available to the creditor is cancellation of the contract. This may take place either by court judgment (judicial cancellation) or the unilateral act of the creditor. Unilateral cancellation is a condition where by a party cancel the contract where a provision to this effect has been made in the contract and the conditions for enforcing such information are present (materialized). In all other cases, the creditor may apply to court for declaration of cancellation and it is the court that is vested with the ultimate power to declare cancellation or not. The effect of cancellation is to put the parties to the position that would have existed had the contract not been made. Thus, the creditor can claim restitution of what he has paid or delivered during performance.

In making its decision regarding to cancel a contract or not, the court should have regard to the interest of the parties, the requirements of good faith or whether the breach of the debtor is related to the fundamental provision of the contract in that the creditor would not have entered in to the contract without the term which the debtor has failed to execute being included. Do not also forget that contracts to be canceled are those that have problem of performance rather than problem of formation the later are to be invalidated than canceled. A party may apply to cancellation in case of all the instances of non-performance mentioned above such as in case of delay, impossibility of performance, anticipatory repudiation and so on.

3. Compensation or Damages

The third remedy is damages (compensation). The creditor can claim compensation for the damage or loss he has incurred as a result of non-performance. This remedy may be claimed in addition to (additional) either of the above remedies or independently.

In applying any of or a combination of these remedies, one should take in to account not only the interest of the creditor (victim party) but also that of the debtor (failing party) i.e., for example, the debtor cannot be required to pay excessive compensation or his personal liberty be deprived under the guise of the legal remedies.

The purpose of awarding compensation to the creditor is to maintain the disturbed equilibrium of interest as between the interest of both parties as a result of the non-performance. The court shall not award damages to the creditor to retaliate the debtor for his failure to perform the obligation. As a principle, in law of contracts, damages refer only to economic loss (as different from moral loss) and the party who is claiming the compensation

is at duty to prove the economic loss he has sustained due to the non-performance of the obligation assumed by the debtor. As a rule, the compensation to be awarded by the court to the victim party should be equal to the economic loss sustained by such party. Dear student, in order to have detailed understanding of the non-performance of a contract and its legal remedies I invite you to read articles 1771-1805 of the civil code of Ethiopia.

3.8. Extinction of Contractual Obligations

Dear Student, by extinction of contractual obligations we are referring to those grounds the fulfillment of which results in the extinction or extinguishment of the contractual obligations assumed by the parties under the contract.

As discussed earlier no contract can subsist forever. An extinguished obligation is an obligation that does not have effect as between the parties. According to the Ethiopian law of contracts the following are the main grounds for the extinction of contractual obligations:

1. Proper Performance: this is the most appropriate and recommended mechanism of bringing an end to a contractual obligation. When both parties to the contract perform their respective obligations according to their agreement and the law, we say the contract has accomplished its purpose and the contractual relationship between the parties exists no more. As article 1806 of the civil code clearly stipulates an obligation shall be extinguished where it is performed in accordance with the contract.
2. Invalidation of the Contract: contracts to be invalidated are those contracts which have problem of formation in relation to defect incapacity or consent. A contract that has defect of consent or capacity is invalid or it is valid until invalidated by the party whose consent has been affected or who is incapable. Hence, when a contract is invalidated by the court at the request of such party we say the obligation of the parties is extinguished. The legal effect of invalidation of a contract is Reinstatement of the parties to the position which would have existed had the contract not been made. Reinstatement is possible via the restoration of the things exchanged as between the parties where such is possible or it will be effectuated via the payment of damages. Refer to articles 1808-1818 of the civil code)
3. Cancellation of the Contract: Contracts to be canceled do not have problems associated with the requirements of formation. Or such contracts are lawfully formed. They have problems related to non-performance. The court may cancel a contract up on the complaint of a party to the contract where the other party has not or not fully and

adequately performed his obligation with in the agreed period of time in the contract. The next question should be what should be the legal effect of cancellation of a contract? Should it be the same with invalidation? How about the things exchanged as between the parties until time of cancelation. The civil code dictates that the effect of cancellation and invalidation is the same i.e., reinstatement of the parties to the position before the making of the contract. Do you accept this assertion? Why or why not? (refer to articles 1784-89 of the civil code)

4. Termination of a Contract: the parties to a contract may terminate their contractual relationships up on mutual agreement or unilaterally. A party may unilaterally terminate a contract by taking advantage of a 'Termination Clause' made in the contract to effect that the parties or one of them may terminate the contract on notice. A contract which is terminated shall no longer be performed. (Refer to articles 1819-1824 of the civil code)
5. Remission of Debt: a contract of debt would be extinguished in favor of the debtor where the creditor informs the debtor that he (creditor) regards him (debtor) as released and the debtor is in agreement to the proposal submitted to him for the remission of the debt. (refer to article 1825 of the civil code)
6. Novation: an obligation shall be extinguished where the parties agree to substitute therefore a new obligation which differs from the original one on account of its object or nature. For instance, an obligation to pay may be changed to an obligation to render a service. However, the parties to a novated obligation shall show unequivocal intention to extinguish the original obligation. (Refer to articles 1826 – 1830 of the civil code)
7. Off-Set or Set-Off: where to persons owe debts to one another set-off shall occur and the obligation of both persons shall be extinguished. However, off-set shall not occur unless both debts are 'money debts' or the debt relates to certain quantity of fungible things and both debts are liquidated (certain in amount and uncontested) and fully due (matured or exigible). Set of shall occur to the extent of the lesser amount and it does not occur in case of the negative conditions of set-off mentioned on article 1833 of the civil code. (Refer to articles 1831-1841 of the civil code)
8. Merger or Confusion: merger shall occur and the obligation shall be extinguished where the positions of the creditor and debtor are merged or confused in one of the contracting parties. For example, imagine that an only son was the debtor of his own father (creditor) and before the time of payment of the debt the father died unfortunately leaving the

succession to his only son. In such case we say the status is merged with in the son and he is no more a debtor. However, remember that the obligation shall revive where the merger comes to an end. Another typical example is an amalgamation made between two companies (company 'A' and 'B'), that have a debtor and a creditor relationship, to form company 'AB'. When company 'AB' is formed there will be no more debtor-creditor relationship in between. (Refer to articles 1842-1844 of the civil code)

9. Period of Limitation: per article 1845 of the civil code of Ethiopia, actions for the performance of a contract, actions based on the non-performance of a contract and actions for the invalidation of a contract shall be barred if not brought within ten years. (Refer to articles 1845-1856 of the civil code)

There are two basic types of Legal Prescription. These are:

- i. Acquisitive Prescription: the lapse (expiry) of the limitation period creates a right to the party in whose favor the period is running.
- ii. Liberative Prescription: the lapse (expiry) of the limitation period relieves (liberates) the debtor in the contract from discharging his obligation under the contract

Chapter Summary

Dear Student, I hope, by now, you have understood the importance of law of contracts to the proper function of the economy of a country in general. Contracts are agreements that are to be enforced by law. The existence of the provisions of law of contract is the guaranty for the due honoring of agreements and the ultimate summation of all of it will result in security of transaction in a state. In this chapter we have discussed the definition, types, effects, formation, and performance, non-performance of contracts and grounds of extinction of contracts. The main purpose of law contract is to provide business persons and consumers the genuine and lawful ways of exchanging money or property via the instrumentality of signing an agreement. Dear Student, in order to genuinely evaluate your acquired knowledge on law of contracts I invite you to contemplate on the following exercise and review questions.

Chapter Exercises and Review Questions

1. Enumerate all the possible sources of an obligation
2. What are the main points of difference as between legal obligations and contractual obligations?
3. what do we mean by an agreement?
4. what is the main difference as between an agreement and a contract?

5. can you enumerate some agreements which do not result a contract?
6. what are the requirements of an agreement?
7. what do we mean by the principle of Freedom of contracts?
8. what do we mean by the principle of *sanctity* of contracts?
9. what do we mean by the doctrine of *privity* of contracts?
10. can a person make a legally binding contract with itself? Why or why not?
11. what do we mean by consideration of a contract?
12. can you enumerate the validity requirements of a contract?
13. what is the fate of contracts that have problem of capacity and consent?
14. what is the fate of contracts that have problem of form and object?
15. what is the difference between invalidation and cancellation of a contract?
16. can you explain general and special types of incapacities?
17. why do you think legally interdicted persons are declared incapable?
18. can you enumerate five grounds for the invalidation of a contract due to problems related to consent?
19. why do you think a minor is prohibited from entering a contract?
20. what will be the fate of signing a contract on an empty paper?
21. can you discuss the immediate effects of the conclusion of a contract?
22. can the parties to the contract increase or shorten period of limitation set by law?
23. can the parties to the contract violate mandatory provisions of law?
24. can you enumerate all the requirements related to the object of a contract?
25. what do we mean by in person performance and what are the justifications behind such performance?
26. what do you think is the fate of a performance given to an incapable creditor?
27. do you think all payments made to an incapable creditor are always invalid?
28. What is the difference between an incapable creditor and unauthorized creditor?
29. do you think the creditor has the right to refuse partial payment as of right? Discuss
30. what do we mean by fungible things?
31. what are the parameters set by law to determine the place of delivery?
32. what are the advantages of knowing the place of delivery of a contract?
33. whether the calculation of interest is a mandatory requirement or not?
34. when does risk transfer from the seller to the buyer?
35. can you enumerate all the possible instances of non-performance of a contract?
36. what do we mean by default notice?

37. is default notice always a mandatory requirement?
38. what are the advantages of giving a default notice?
39. what do we mean by forced performance?
40. what do we mean by substituted performance?
41. what are the grounds for cancellation of a contract?
42. what are the immediate functions of cancellation of a contract?
43. what is the purpose of awarding compensation to the creditor against a failed debtor?
44. can the creditor claim damage greater than the loss suffered by him/her?
45. Can you enumerate all the possible grounds for the extinction of contractual obligations?

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Chapter Four

Law of Contract of Sales

Chapter Introduction

Dear Student, in this segment of the module you are going to learn about the law of contract of sales. As we have mentioned earlier, contract of sale is the most prominent type of bilateral contract that involves a genuine exchange of consideration as between the seller and the buyer. Contract of sales is a special type of contract in that there are many attributes of sales contract that are exclusively applicable to contract of sales and as different from general provisions of contract law. For example, one of the peculiar features of sales contract is fact that the duty of the buyer is always to pay a price expressed in terms of money. That is to say, the buyer can only perform his obligation in a contract of sales only through the payment of a price and no other means. For instance, the buyer may not offer to the seller one thing for another thing. Or if the buyer offered a thing to the seller as a means of performing his obligation under the contract, we do not say that is a contract of sale but barter.

Dear student, the other peculiar feature of contract of sales is the fact that it only refers to the sale of things or movable property as different from other types of property. Under Ethiopian laws immovable property are to be sold under different portion of the law. In this chapter, we are going to deal with the formation, nature, effect, performance and non-performance of Contracts of sales

Chapter Objectives

Dear student, after successful accomplishment of this chapter, you will be able to:

- Develop the skills to identify contract of sales as compared to other contracts;
- Discuss the peculiar features of contract of sales
- Enumerate the subject matters and non-subject matters of sales;
- Identify the fundamental and subsidiary obligations of the seller;
- Identify the fundamental and subsidiary obligations of the buyer;
- Enumerate the common obligations of the seller and the buyer;
- Discuss the instances and legal remedies of non-performance of sale contract.

4.1. Definition of Contract of Sales

According to article 2266 of the civil code of Ethiopia sale is a contract whereby one of the parties, called the seller, undertakes to deliver a thing and to transfer its ownership to another party, the buyer, in consideration of a price expressed in money which the buyer undertakes to pay him.

Dear Student, let us try to understand the elements of the above definition in the form of question and answer.

The first question we need to ask will be whether sale is a mechanism of assignment of rights? Did you answer yes? If that is the case you are right. Under Ethiopian laws, contract of sales is one of the mechanisms of assignment of right over a thing from one party to another for consideration or the payment of price by the buyer to the seller. (article 1962 of the civil code of Ethiopia)

Secondly, we need to ask the question who is the seller? The answer is the seller is the party who is at duty to deliver the thing to the buyer, to transfer its ownership and to provide warranty for the good quality of the things sold. The seller is also the party who accepts the payment of the price. The other name for the seller is 'vendor'.

The other question we need to answer is who is the buyer? Similarly, the buyer is the party who is at duty to pay the price of the thing which is expressed in terms of money and to take delivery of the thing by being available at the time and place of the delivery of the thing.

The other important question refers to the obligations of the seller. Accordingly the seller has the obligation to deliver the thing, to transfer ownership of the thing and obligation to provide warranty (against dispossession (title), defect (quality) and non-conformity (quantity)). The sellers also have other subsidiary obligations related to the main obligations.

On its turn the buyer also have the obligations to pay the price of the thing (also called consideration), to take delivery of the thing made to him by the seller and other related (subsidiary) obligations.

The next question that should be raised naturally is which obligations of the seller and the buyer are fundamental or determinative or consequential obligations in nature? Hence all the obligation of the seller and the buyer mentioned above other than those mentioned as related or subsidiary obligations constitute a fundamental obligation in that it is difficult to constitute a contract of sales without an agreement on such obligations.

Once we have identified what are the fundamental obligations, we need also to quantify the attributes of being a fundamental obligation. Accordingly we say certain obligation is fundamental when the obligation affects the very existence of the contract of sale or when it is the duty of the parties to agree on such obligation to constitute a contract of sale. The other main attribute of a fundamental (determinative/consequential) obligation is the non-performance of the obligation by one party can be taken as a good cause for cancellation of the sale contract by the other party. Moreover, the non-performance of a fundamental obligation by one party results in the transfer of risk from the other party to the failing party.

Consequently we need also to identify the obligations of the seller and the buyer that are non-determinative or incidental obligations? Non-fundamental obligations are those obligations the non-fulfillment of which does not affect the existence of the contract or if the parties do not agree on them, it does not matter, because the law fills the gap by providing remedies to such undiscussed terms of the contract. Moreover, the non-performance of incidental obligations cannot be taken as a ground to invoke cancellation of the contract or does not result in the transfer of risk to the other party. For instance, the seller has the duty to appear at the time and place of delivery so that the delivery would be possible and the buyer may have the duty to open his store to accept the delivery or to open a bank account or surrender collateral to make sure the payment is effectuated. But these are just subsidiary obligations which are not as such important compared to fundamental obligations.

Let us ask the final question in this section, which is whether sale is a special type of contract or not? Did you answer yes of course? If so, you are right. Sale is a special type of contract which exclusively deals with the sale of corporeal chattels (movable property) always up on the payment of a 'price' which is expressed in terms of money (the legal tender). As a result, General provisions of contract law (those principles we discussed in chapter three) become applicable if and only if: the special provisions of sales contract refer to such general provisions or do not expressly exclude general provisions or the provisions of sales law remain silent to alleviate their own problems. Dear, student, you need to be aware of the fact that as far as the provisions of law of sales are considered one can identify three different degrees of specialty or applicable laws. For instance, if Abebe wants to sell his Cow, there might be three different levels of laws to be applied on such contract for the sale of the cow according to their order of importance. These are: 1. Contracts for the sale of cattle and other living animals. Then, 2. Law of contract of sales and finally general provisions of contract law.

4.2. Peculiar Features or characteristics of contract of sales

Dear student as we have mentioned earlier, sale is a special type of contract and the following are the main peculiar attributes of contract of sale:

- i. Sale is a contract. So, all the essential elements for the existence of a valid contract mentioned under article 1678 of the civil code shall be fulfilled. These are the requirement of Capacity, Consent, Object and Form.
- ii. There should at least be two or more parties in certain sales contract. No one can validly or safely sale or buy his own property to his self. Why not? What do you think are the practical problems if a person is allowed to contract with himself by selling his own car to himself?
- iii. Mere delivery of the thing by the seller to the buyer, without the transfer of its ownership does not amount to sale of the thing. Hence, the seller, in addition to actually (physically) delivering the thing, should transfer unassailable right of ownership to the buyer. An ownership right with no risk of dispossession (encumbrance free) by third party or defect or non-conformity shall be transferred. To that effect, the law imposes the duty of implied warranty on the seller against risk of non-dispossession (warranty of title). This requirement distinguishes sale from Bailment or Custody.
- iv. Consideration of contract of sales is always a price expressed in terms of 'money'. The duty of the buyer is always to pay the price expressed in terms of money. This identifies 'sale contracts' from Barter in which things are offered for other things. Barter was an earlier stage in the evolution of contract of sale or it is a contract allied to sale.

4.3. Subject Matters and Non-subject Matters of contract of sales

Dear student, when we are referring to subject matters of contract of sales we are referring to those things that can be sold under the provisions of the Ethiopian civil code based on article 2266 and the following. Simultaneously, when we refer to non-subject matters of sale contract we are not implying the fact that this things are absolutely *extra-commercium* or will not be sold at all. Rather, such things cannot be sold under the provisions of the law set to sale movable things.

For example, an immovable property is not subject matter of sales. However, this does not by any means imply that immovable properties are not allowed to be sold at all. You should be aware that there are provisions of the law that are exclusively destined for the sale of an immovable property. The laws for various reasons do not want to attach the sale of movables with their immovable counter parts. Hence, there is a chance that both types of properties can

be sold independently.

a. Subject Matters of Sales Contract

Subject Matter of Sale is always a thing or goods. Dear, student according to the definition stipulated under article 1126 and the following of the civil code, a thing may include the following:

i. Movables (corporeal chattels) property: these are things which have a material existence and can move themselves or be moved by man without losing their individual character. (Art. 1127)

ii. Accessories of a thing: an accessory is a thing which is permanently destined for the use of another thing. For example, a seller who sales a bicycle is at duty not only to deliver the bicycle but also all the things destined for the proper use of the bicycle such as the ‘pompa’ with which flat tires of the bicycle will be inflated (Art. 1135 of C.C). Hence the sale of the bicycle amounts to the sale of all the things destined for the use of the bicycle.

iii. Intrinsic Elements of an Immovable Property (Immovable by Destination): these are things which form parts of an immovable property that can be severed or separated from the main element and sold without damaging the main element. An intrinsic element of a thing is anything which is materially united to the main thing and which cannot be detached therefrom without destroying or damaging such thing. For instance, a ‘Roto’ water tanker made of fiber is a movable property by itself however when it is fixed with a pipeline and placed at the roof of the house it becomes an intrinsic element of the house. The thing is, if we can safely detach the water tanker from the house (i.e., without damaging the house) it can be sold independently of the house. (Refer to article 1132 of the civil code). The typical examples in this regard are Trees, Crops and Quarries which were intrinsic elements of the land until separated from it and get sold.

iv. Natural Forces of an Economic Value such as electricity, wind and geothermal energy, shall be deemed to be corporeal chattels where they have been mastered by man and put to use. Dear student I invite you to read articles 1126-1139 of the civil code.

b. Non-subject Matters of Contract of Sale

According to the above discussion, the following are non-subject matters of sale contracts:

i. Immovable Property such as land and building. Immovable properties shall not be sold under the portion of the law destined for the sale of movable property. This is dictated by the

very nature of immovable properties that they are more valuable and the formal requirement of their sale is more rigorous or stringent than the sale of movables. As a result, they are to be sold under a different segment of the law. (Refer to article 2875-2895 of the civil code)

ii. Actionable Claims or a right of Legal Action against another. Any person that has a right of legal action to be exercised against another person (usually a debtor) can assign such right to a 3rd person that was not a party to the contract, either for consideration or gratuitously.

iii. Money: Money is a price unit by which things get sold. It is a medium of exchange by which things get sold. The possessor of money is presumed to be its owner. The possession of money cannot be ascertained by a title deed to be issued to the owner. Currency (legal tender of the place of the contract) may in no case be claimed from a person who acquired it in good faith. (Refer to articles 1147, 1165, 1167)

Dear Student, what is the main difference as between ‘sale of money’ and ‘exchange of money’ or are they similar?

iv. All things that are not mastered by man and Put to use such as Celestial bodies are not subject matters of sale contracts because their performance or delivery would be absolutely insuperable and insurmountable one.

4.4. Performance of Sale Contracts

As we have discussed in chapter three, performance is the carrying out of the obligations assumed by the parties according to the law and the contract. It is the duty of both the seller and the buyer to perform or discharge their respective obligations. The obligations related to performance incorporated under law of sales are divided in to three. These are: Obligations of the Seller, Obligations of the Buyer and Common Obligations of the Seller and the Buyer. Let us deal with them one by one as follows: (refer to article 2273 of the civil code)

4.3.1. Obligation of the Seller

The seller has the following three basic obligations:

a. Obligation to Deliver the Thing:

Delivery is the handing over or conveyance of the thing and its accessories in accordance with the law and contract. An accessory is a thing permanently destined for the use of another thing. (Refer to articles 2274-2280 of the civil code)

Dear Student the parties to certain sale contract may adopt either of the following major modes of delivery:

i. Actual Delivery: the physical handing over of the thing and its accessories directly to the buyer or its representative. The most frequent and recommended mode of delivery.

ii. Constructive Delivery: this does not result in physical delivery of the thing to the buyer but the seller will keep possession of the thing on behalf of the buyer. (Art. 1145 C. Code)

iii. *Traditio Longa Manu*: in such mode of delivery, the seller does not physically hand over the thing to the buyer but make ready and point out the placement of the thing to the buyer. As an example the seller may tell to the buyer to go and fetch the property from Alemu's store.

vi. *Traditio Brevi Manu*: in such mode, the buyer is already in possession of the thing even before the making of the contract for various reasons such as the buyer has rented the thing and was using it later on the seller agreed to sell the thing to the buyer anyway. Hence, in such case the conclusion of the contract is the way of delivery. E.g. Hire Purchase.

iii. Symbolic Delivery: the delivery of a symbol representing the thing amounts to the delivery of a thing. E.g., Delivery of a key of a car or a Bill of Lading for things under voyage amounts to the delivery of the car or the arrival of the container.

iv. Delivery via a Carrier: this is a delivery via the instrumentality of a carrier such as an airline or a shipping line or railway line.

Dear Student, the obligation to deliver the thing also includes the obligation to deliver the agreed thing in terms of quantity and quality of a thing and at the time and place of delivery agreed on the contract or fixed by law.

Moreover, you need to be aware that the principles of Time and Place of Delivery (performance/payment) that we have discussed under general provisions of contract law are also *Mutatis Mutandis* applicable to law of sales. (Refer to articles 2276 and 2277 of the civil code).

b. Obligation to Transfer Ownership of the Thing

As per the dictation of Article 1204 of the civil code, Ownership is the widest right that may be had on a corporeal thing. It is only an owner of a thing that can exercise all the rights associated with the thing. These include the right to use the thing or use the fruit (monetary/economic profit out of the thing) of the thing or dispose or sell the thing. For instance, a mere possessor of a thing cannot sale the thing legally due to the fact that s/he lacks the title of ownership. (Refer to articles 2281-2286 of the civil code)

Ownership can be transferred either by law (succession) or by contract (sale). Ownership

transfers up on transfer of possession and possession transfers up on delivery. However, mere delivery does not transfer ownership.

The main point to know here is that, in order to transfer a good title of ownership, the seller must be the real owner of the thing sold in the first place. There is a maxim which goes in line with this that “no one can transfer a greater right in property (title) than he himself has” or “*nemo dat quod non habet*”. It is to mean, the seller can only transfer a title on the thing, to the buyer, as good as his own over the thing sold. Or otherwise stated, if the seller was a mere possessor of the thing the greatest right he can transfer to the buyer is at most the right of possession. Dear student, why do you think people do not advise buyers to buy property from a thief? What are the practical problems of buying a thing from a thief or a person who is in charge of the thing illegally?

Accordingly, the seller is at duty to take all the necessary steps for transferring to the buyer unassailable rights of ownership over the thing. The seller shall transfer an encumbrance (disturbance/dispossession) free (total or partial) right of ownership to the buyer.

c. Obligation to Provide Warranty against Dispossession (title), Defect and Non-conformity

Warranty is a mechanism devised by law and imposed on the seller to transfer unassailable right of ownership to the buyer. Warranty is a legal (implied) or contractual promise made by the seller regarding the quality, character, title or suitability of the goods he has sold. There are two types of Warranty. These are:

- i. Express Warranty: it is created where the seller makes a statement of facts or a promise to the buyer concerning the goods that become part of the bargain. However, mere opinion or recommendation made by the seller to this effect may not amount to warranty.
- ii. Implied Warranty: these are responsibilities imposed by law on the seller for the good quality of goods he sold. It does not matter whether or not the seller has made express promises as to the quality of the goods. Implied warranties are imposed on the seller in the interest of promoting higher standards in the market place and due to the following points:
 - i. The buyer commonly has little or no opportunity to examine the goods carefully before making a decision to buy them. The buyer might be influenced by an information asymmetry in that the seller may not provide the buyer with all the relevant information about the thing.
 - ii. The complexity and technicality of some goods made it difficult to buyers to inspect or test the things before purchasing them. And some defects are latent defects in that they can not be

identified by an ordinary inspection of the thing or they require a professional inspection.

iii. The seller has every opportunity and position to inspect and know the thing.

iv. The principle of “*Caveat Venditor*” or ‘*Beware the Seller*’. According to this principle, the seller has the duty to provide an implied warranty on the thing to the buyer

Warranty against dispossession is an implied warranty that will be effective if and only if the buyer is not aware of the threat of dispossession or defect in the thing. If the buyer is aware of such defect or risk of dispossession by a third party and purchased the thing anyway, s/he may not invoke the duty of the seller to provide warranty. This is the case because the presumption of the law changes that if a person knowingly purchased a defective thing (a second-hand property) it is presumed that such person might purchase it at a relatively cheaper price.

Dear Student, here it should be noted that, it is also the counter duty of the buyer to examine the thing, before purchasing it, whenever s/he gets the opportunity and if the result of the examination shows defect in the thing the buyer is at duty to notify any defect to the seller in due time if the buyer wants to cause use of the implied warranty against the seller.

Otherwise if the buyer knowingly buys a defective thing from the seller, the seller shall not be forced to make good the warranty. This principle is called “*Caveat Empitor*” or “*Beware the Buyer of the duty to examine the thing and notify the seller*”. Dear student, in order to understand this section in detail I invite you to read articles 2287-2301 of the civil code.

4.3.2. Obligations of the Buyer

The two fundamental obligations of the buyer are the obligation to pay the price and take delivery of the thing. Now let us deal with them one by one:

a. Obligation to Pay the Price

Price is the amount of money that the buyer undertakes to pay to the seller in consideration of a thing. You need also to bear in mind that, the obligation to pay the price of the thing includes the obligation to take every step necessary provided by law, custom, to arrange for or guaranty the payment of the price. For example, it may be opening an account or deposit money in a bank or issue a check, or surrender collateral if necessary. Also beware that each type of sale may pursue its own customary requirement. (Refer to article 2304-2312 of the civil code)

The other issue we need to ascertain is as to how do the parties determine price of the thing.

Accordingly, price of the thing can be determined by:

- i. Agreement of the parties: this is the appropriate way to determine price
- ii. Weight: in this case the parties should consider using the ‘net weight of the thing’ or the weight of the thing minus the weight of the container.
- iii. Things at current price: the parties may also use the market price of the thing if the thing is quoted in the market.
- iv. Price at which the seller normally sells in the normal circumstance of a market
- v. Price determined by third party.

Dear Student, the principles that we have discussed in chapter three in relation to the time and place of payment of the price are also *mutatis mutandis* applicable to contract of sales.

b. Obligation to take delivery of the thing

The buyer is at duty, after delivery, to take such steps as may be necessary for completing the delivery of the thing. This may include the obligation to go to the place of business of the seller or opening of his store or be present at the time and place of delivery or to tell the seller to keep it on himself. (Refer to articles 2313 of the civil code of Ethiopia)

The other question we need to answer is whether the obligation to take delivery of the thing is really an obligation or not? Considering the selfish nature of the human person it is presumed that once the buyer has paid the price s/he will for sure take the delivery of the thing. It should however, be noted that what makes it an obligation is the fact that failure to take delivery of the thing has a legal consequence to be borne by the buyer. For example, if the buyer has failed to take delivery of the thing at the agreed time and place of delivery risk to the thing, if any, transfers to him, the seller can consider the failure of the buyer as a ground to claim the cancellation of the contract and also the buyer is at duty to cover cost of preservation of the thing, if any, incurred by the seller for the care and preservation of the thing under his custody.

4.3.3. Common Obligation of the Seller and the Buyer

These are common obligations in the sense that they are obligations imposed on both the seller and the buyer but each party discharges his or her obligations independently. Accordingly, the following are the common obligations of the seller and the buyer:

a. Obligation to Pay or Cover Expenses

First of all, understand that the parties incur no expenses at all if the sale is an instant type of

sale. However, one should also presume the fact that the expense of the parties would increase with the increase of the amount of money involved in their contract. Not let us deal with the expenses of the buyer and the seller turn by turn: (refer to articles 2314-2322 of civil code)

a. Expenses of the Buyer

The buyer should cover the following expenses:

- i. The expenses of payment. These are the expenses incurred by the buyer to realize the payment of the price of the thing. For instance, the buyer may be forced to pay some amount of money to a bank to transfer the price of the thing to the seller. Here you need also to differentiate as between ‘expenses of payment’ and the ‘payment of the price’.
- ii. The expense of the contract. This refers to various expenses related to the procedure and conclusion of the contract. It may start from the cost of paper all the way to writing the contract.
- iii. Forwarding transport cost. The term ‘forwarding’ signifies the fact that it is the duty of the buyer to cover the cost of transport if the thing is to be taken to another place after the place of delivery.
- iv. Any expense arising after the place of delivery shall also be covered by the buyer.

b. Expenses of the Seller

The seller, on his part, should cover the following expenses:

- i. The expenses of delivery of the thing. Such as expenses related to counting, measuring, weighing of the thing to be delivered.
- ii. Various expenses until place of delivery
- iii. Expense of transport until place of delivery unless the transport arrangement of the parties is ‘Carriage Free’. If their agreement is carriage free then it will be the exclusive duty of the seller to cover the cost of transport all the way to its final place of destination.
- iv. The seller also covers additional expenses incurred by the buyer as a result of changing of residence by the seller.

The other important issue we need to ascertain here is who covers the price increase or decrease related to the thing caused due to an increase or a decrease in customs duties or tariffs made by the Government on the thing after the time of the making of the contract but

before the time of payment of the price. It is an obvious fact that, the amount of customs duty imposed on a thing at the time of import has an obvious implication on the fixing of the price of the thing. The rule is, where import customs duties or other duties charging the imported thing are to be paid by the seller and such duties increase after the contract is made, such an increase or decrease shall be added to the price accordingly.

b. Obligation to Preserve the Thing

Beware that preservation of the thing made by one party (seller/buyer) is always made on behalf and at the expense of the other party to the contract. The other requirement to preserve a thing is possession of the thing that it is only the possessor of a thing that has the opportunity (duty) to preserve the thing. In addition, preservation of the thing is to be made if and only if the cost of preservation is not greater than the actual value of the thing to be preserved. If cost of preservation is greater than the actual value of the thing to be preserved, the party who is at duty to preserve the thing can sale the thing and deposit the proceeds of the sale accordingly.

The seller shall preserve the thing (on behalf and at the expense of the buyer) in case the buyer is late to take delivery of the thing and in case of *constitutum Possesserium* or the thing has continued under the possession of the seller up on the agreement of the parties.

In due course of preservation of the thing, the seller may incur various expenses related to hiring a guard, renting a ware house or maintenance of the thing and such expenses shall be refunded by the buyer or otherwise the seller may refuse to deliver the thing to the buyer or exercises his 'lien-right' on such things by holding to the thing or refusing to surrender the thing to the buyer until duly indemnified.

You should also be aware that the seller is liable to any damage to the thing caused due to lack of preservation and the normal rules of risk does not apply in such cases.

The buyer should also preserve the thing (on behalf and at the expense of the seller), if s/he intends to refuse the thing either owing to defect in the thing delivered or non-conformity. In line with this, you should know that if the buyer claims to cancel the contract or requires the replacement of the thing risk shall not transfer to him nevertheless the thing is under his possession. In the meantime, the buyer should preserve the thing or if the risk is due to lack of preservation by the buyer, the buyer will be liable to cover the price of the thing.

Finally, it should also be understood that the seller and the buyer or the party who has the duty to preserve the thing has the right to relieve itself from the duty of preserving the thing

by consigning the thing to a third party custodian (usually a professional keeper) according to the provisions of the Civil Code on consignment of things by third parties to the contract of sale on articles 1779 – 1783 of the Ethiopian civil code. Dear student, in order to have good understanding of this obligation refer to articles 2320-2322 of the civil code.

c. The Obligation to Shoulder Unpreventable Risk related to the Thing

First of all, we should define risk as the financial liability of a party that arises due to loss (stolen), deterioration (degrading of quality) or damage (destroyed) of the thing. The rule is risk follows Ownership or Possession- '*res per domino*'. Or it is the owner or the possessor of a thing who bears the risk in the thing. It is the person who is in the possession of the thing that has the duty to preserve the thing. This is due to the fact that risk shall be borne by the party who is in a better position to avoid or avert the risk and it is the custodian of the thing that have every opportunity on earth to take care of the thing. (Refer to articles 2323-2328 of the civil code)

Risk shall also be shared by both parties (seller and buyer) if none of the parties are in a better position to avert/avoid the risk. This is a scenario where by the thing is in the custody of a third party for various reasons. In such cases, the presumption is the risk shall be borne by such third party, such as a shipping line or a carrier, who has bound itself to transport the thing under a contract made with either the seller or the buyer. The main motive behind the rules on 'transfer of risk' is to cause the efficient allocation of risk among the parties.

Dear Student, the effect of shouldering a risk by a party is that the person who bears the risk is to cover the value of the thing which has been damaged or lost. The other point you need to understand here is the fact that risk refers only to corporeal chattels or movable property where the duty to transfer ownership is imposed on the seller. Or for instance, risk does not concern (is not related to) or money.

Finally, you should bear in mind that, due to all the factors we mentioned above, risk always begins from the possessor (seller) and up on the fulfillment of the following factors/grounds it transfers to the buyer:

- i. After actual delivery (physical handing over) of the thing to the buyer.
- ii. After the date of delivery (lapse of the date) and even if delivery is yet to be made due to the default of the buyer. In such case the buyer not only loses the thing but also pays the price of the thing.
- iii. If the buyer fails to pay the price and payment has been a condition for delivery of the

thing

iv. If fungible things has been identified/isolated and allocated by the seller and their placement is notified to the buyer.

v. If the things are under voyage, risk transfers when the thing is handed over to the carrier by the seller.

However, remember that, risk is not transferred in a situation where at the time of the making of the contract, the seller knew or should have known that the thing has perished or was damaged. Here you should understand the logical analogy that the knowledge of risk in the thing by the seller protects the buyer from shouldering the risk. Hence, the rules on risk and warranty become applicable only in the absence of knowledge of the risk or the defect in the thing subjected to the warranty.

Dear Student, here I want to make an important point that, due to the very reason that sales is the most prominent and special type of contract, the general provisions of contract law are generally and usually applicable to contract of sales unless the provisions of contract of sale do not exclude such an application. In line with this, you need to be aware of the fact that the majority of the principles we have discussed in relation to general contracts in chapter three are also applicable to the contractual relationship as between the seller and the buyer and there is no need to discuss them all the way again. For instance, the rules of general contract on formation of contracts, performance of contracts, effects of contracts, time and place of performance (delivery or payment), the instances of non-performance, the legal remedies of non-performance and the grounds for the extinction of contractual obligations; are also generally and mostly (*mutatis mutandis*) applicable to contract of sales. Hence, for example, in order to understand the time of delivery in certain contract of sale between two parties you can just go back to the discussion under chapter three on a similar topic and determine such time of payment based on the rule mentioned there in and the same is the case for all the applicable principles I mentioned here in above. (Refer to articles 2336- 2364 of the civil code)

Chapter Summary

Dear Student, this chapter was in a way the continuation of the last chapter in that sale is a special type of contract that exclusively deals with the sale of corporeal chattels. We have discussed that one of the peculiar feature of sale (as different from general contracts) is that the duty of the buyer is always to pay a price expressed in terms of money. I hope in this chapter you have understood why sale is a special type of contract and what the relationship is as between sales and the general provisions of contract law. Sale is the most prominent type of contract in that there is a bilateral flow of obligation from the parties to one another. Sale is also the most frequently applicable type of contract in your profession in the world. Hence, as a business student you are advised to have through understanding of this chapter.

Dear Student, to properly evaluate your acquired knowledge on contract of sales I invite you to ponder on the following exercises and review questions.

Chapter Exercise and Review Questions

1. Can you define contract of sale? How many parties are there in certain contract of sale?
2. What are the duties of the seller and the buyer?
3. What is the relationship between knowledge of defect in the thing and the right to claim warranties?
4. Why is money not a subject matter of sale? What is the difference between sale and exchange of money?
5. What do we mean when we say immovable properties are not the subject matters of sale?
6. What is the difference between sale and barter?
7. What is the difference between sale and custody?
8. Can you explain the principles of 'beware the buyer' and 'beware the seller'?
9. What is the problem if person buy a thing from a thief?
10. Can a party who does not bear risk have the obligation to preserve a thing? Why/why not?
11. Discuss, no one can transfer a greater right of property than he himself has?
12. What is the element of the definition which distinguishes sales contract from lease and donation?
13. What is the difference between sale and agreement to sale?
14. What are the grounds of cancellation of sale contract by the seller?

15. What are the grounds of cancellation of sale contract by the buyer?
16. What are the grounds of claiming cancellation of sale contract by both the seller and the buyer?
17. Can you outline the main points of difference as between general provisions of contract under chapter three vis-à-vis provisions of contract of sale?
18. What is the similarity between the obligation to preserve the thing and the obligation to shoulder the risk in the thing?
19. Which mode of delivery is preferable to you? Why or why not?
20. When do we say a thing is defective to be sold?

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Chapter Five

The Law Agency

Chapter Introduction

Dear Student, in this chapter you are going to learn about the major principles of the Ethiopian law of agency. Agency is one of the laws of the country that has numerous practical applications to your profession. It is obvious that no business person or trader can be in more than one place at a time or do more than one things at a time. Or no matter how rich a person may be s/he may not be able to do everything by himself or herself all the time and in all circumstances. It seems, persons are somehow constrained by various factors to accomplish numerous things by themselves and at a time. Contract of agency is another mechanism devised by law to secure the uninterrupted accomplishment of business transactions due to various constraints faced by traders.

Contract of agency provides a trader with another opportunity to continue its business via the instrumentality of an intermediary called the agent. It is not fair to abstain from doing business only because one faced some constraints such as being busy to do more than one things at a time or in a place or because a person lacks knowledge or expertise in a particular field. All this constraints can be eradicated by hiring an agent who acts in the name and on behalf of the principal who faced the constraints and was about to stop doing business.

Agency is the solution devised by law to overcome all these constraints and to extend the hands of traders or business persons to do more than one thing at a time or simultaneously accomplish multitude of activities for the very nature of business requires diversification. So the main purpose of the agent would be to serve the exclusive interest of the person s/he is representing in his relationship with third Parties. The other fascinating point about the law of agency is the fact that the law has somehow managed to help the principal to do many things at a time and at the same time by shielding (veil) the agent or its interest from assuming personal liability so long as s/he is representing and acting in the best (exclusive) interest of the principal.

Chapter Objectives

Dear Student after successful study of the following chapter you will:

- Identify the justifications behind the need for agency;
- Discuss all the elements of the definition of contract of agency;
- Enumerate all the possible sources of agency?

- Appreciate the various types of agency and/or agents?
- Discuss the duties and the liabilities of the parties to a certain agency relationship;
- Understand the grounds for the extinction of an agency relationship?

5.1. The Need for Agency

Issue for Discussion: Dear Student try to thoroughly consider the following set of facts and try to appreciate from what justification the need for agency has come in to being.

It is plainly discernable from the very first article of the Ethiopian civil code that the human person is the subject of rights and duties from its birth to its death. In a similar fashion, artificial persons are also the subjects of rights and duties from their formation (registration) to their liquidation (cancellation of register). Furthermore, per the dictations of the civil code, every person is presumed capable unless expressly declared incapable by law. i.e., s/he is presumed to have the necessary legal capacity to exercise the attribute features of his or her legal personality or to personally take care of his or her interest.

From this logic a question should emanate that, so far as every person is capable of personally exercising his or her own affairs in everyday life (which is the most preferable), why should there be a need for representation or agency by another person (who is even presumed to have his own personal engagements)?

The practical experience (legal or otherwise) in Ethiopia or elsewhere reveals that the following are the major rationales that triggered the need for representation by another person:

- a. It helps to overcome limitation (constraints) of time and place: imagine that you are a prosperous business person running your business throughout the country and it is also in the nature of the businesses you are running that they require your immediate attention or else the consequence will be unbearable. On the other hand, nevertheless the modern commercial world is too complex, you are just a human person that can only be at a place at a given time or do a thing at a time. In such situations, the basic way out to escape bankruptcy would be hiring an agent who act on your behalf and help you to overcome such inherent limitation.
- b. It helps to overcome lack of business knowledge or experience: it is an open secret that knowledge and experience are not the only inputs to start a business. However, with them added to the menu of a trader, the business venture can get more attractive. In this regard, hiring an agent (a professional) enables one to perform certain tasks which s/he has neither the required knowledge nor experience to perform by themselves.

c. It is a tool to overcome the pitfalls of incapacity: as mentioned above, for various reasons the law has precluded some groups of persons from personally exercising their rights and duties. However, it is not fair that they should remain remedy-less for they are at least possessors of rights and duties as a person. Here emerges the necessity of agency that these groups of persons can be capable of safely exercising their rights and duties (take care of their interests) via means of representation by other capable individuals.

d. The very nature of artificial persons: it is a clear fact that such persons are endowed with legal personality artificially (as opposed to naturally) for the sake of convenience in control and other rationalities. Otherwise, they are non-living things (associations of capital) that lack the necessary mental capability to analyze the cost and benefit of their transaction. Hence, it is inherent in their very nature that they need to be represented by physical persons who will act on their behalf and deal with third parties. For instance, the founders, managers, directors, and secretaries, of all business organizations are natural persons who are authorized to act on their behalf.

5.2. Sources of Agency

The representative capacity (power of attorney) to act on behalf of another person (artificial or natural) may emanate from the following basic sources:

5.2.1. The Law

It is obvious from the reading of Art. 2179 of the civil code of Ethiopia that, the authority to act on behalf of another person may derive from the law. This is the case where the law appoints an agent to act on behalf of another person for reasons like the protection of the principal that may otherwise be at stake if s/he acts by himself or herself. This become crucial in case the principal is declared incapable by law. The other situation where the law appoints an agent is the case of agency of necessity or unauthorized agency. In this regard the very nature of artificial persons that necessarily dictate their representation by natural persons to perform their day to day activities is typical.

5.2.2. Contract

The basic source of agency is a contract. As different from the first, this is a relationship created between the agent and the principal based on their genuine contractual engagement. The contract should, among other things, define the scope of the representative capacity of the agent and its duration. (Refer to articles 2266 of the civil code)

5.2.3. Decision of the Court

This is a situation where the authority to do an act or acts of a certain kind on behalf of another emanates from the decision of a court. Such types of agents are known as curators. (Refer to articles 2253-56 of the civil code of Ethiopia)

5.3. Definition of Contract of Agency

Per Article 2199 of the civil code, 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.

As we can understand from the above definition, agency is a contract. It is actually a special type of contract which expressly deals with the relationship between the agent and the principal. For contracts are the cornerstones of the economy the law has stipulated stringent requirements of validity. Hence, agency as a contract is expected to fulfill the essential validity requirements for the existence of a valid contract mentioned under article 1678 of the civil code in relation to capacity, consent, object and form.

The other point to discern here is, this contract refers only to the internal contract concluded as between the agent and the principal and it basically governs their bilateral relationship. However, this contract is the main input for the conclusion of another contract, called external contract, as between the agent and another third party. It is understandable that the purpose of appointing an agent is to deal with third parties via means of an intermediary.

The other point of emphasis should be how many parties are there in a certain agency relationship? Before one dares to answer this question, as mentioned above, s/he should be aware of the fact that there are two types of contracts under a certain agency relationship. Having this in mind the following are the parties to a certain agency relationship:

- i. The person represented- the principal.
- ii. The representative- the agent.
- iii. The person with whom the agent concludes the external contract- the third party.

Technically however, one should raise a question as to whether the agent is really a party to the external contract concluded between the agent and the third party? And the answer is obvious, i.e., the agent is not presumed to be a party to a certain agency relationship for s/he is a mere facilitator or mediator as between the principal and the third party with whom the contract is concluded. Otherwise stipulated, the agent does not assume any personal liability

or benefit from the transaction as far as s/he is representing the best interest of the principal or act on behalf, in the name of and the exclusive interest of the principal.

Finally, we should understand that the acts which the agent undertakes to perform on behalf of the principal are juridical acts- acts that are legally binding or otherwise constitute a fault and entail legal liability. However, in the normal course of events (without personal fault on his part), the agent is not liable to the performance of the contract contracted with the third party.

5.4. Scope of Representation

By scope of representation we are indirectly referring to the 'object' of the internal contract. The main object of the internal contract is not different from defining the depth and nature of the power of attorney vested on the agent. That means, the agent can act and bind the principal if and only if he performed those powers vested in him by the contract of agency. Though the scope of agency shall be expressly stipulated in the contract, which may not be always the case. In such cases, the scope shall be determined or fixed according to the nature of the transaction to which it relates. The non-fulfillment of this obligation would be against the interest of the principal for it will encourage unauthorized agency. Refer to articles 2181, 2201-2207 of the civil code

5.4.1. Complete Representation

The agent is deemed to completely represent the interest of the principal in the following cases:

- i. If the agent acts in the name and on behalf of the principal and the third parties with whom the agent is contracting are aware of the fact that he is an agent of another person. This is the case of disclosed principal.
- ii. If the agent is acting with the scope of representation vested in him by the internal contract. And,
- iii. If the agent is representing the best interest of the principal or acts with the exclusive interest of the principal. (Refer to articles 2189 of the civil code)

Dear Student, You should be aware of the legal implication of complete representation that, if the agent completely represents the principal, s/he would not assume any personal liability and all the acts of the agent bind the principal towards the third party as if they are performed by the principal himself. In all other case however, the agent is presumed to have acted in his

own name and behalf which will make him personally liable to the third party with whom he is contracting. The latter case amounts to the cases of undisclosed principal.

5.5. Types of Agency

According to Article 2202 of the civil code, there are two types of agency. These are General and Special types of agency. Now let's discuss them as follows:

a. General Agency

General agency is a situation where the agent is vested with the power to deal with all the affairs of the principal of a particular type or in a particular place. Such agents are agents who are in general authorized to represent the principal. One could say they are trustworthy persons to the principal in that the principal authorizes them to entirely represent his interest. As a result, such agents are only authorized to perform acts called Acts of Management on behalf of the principal. (Refer to article 2203-04 of the civil code)

What kind of acts do you think are acts of management? The following are some examples of acts of management:

- i. Acts done for the maintenance or preservation of property;
- ii. Lease for terms not exceeding three years;
- iii. The collection of debts that are matured or exigible;
- iv. The discharge of debts;
- v. The investment of income; and
- vi. The sale of crops or goods intended to be sold or perishable commodities

b. Special Agency

It is an agency whereby the agent is authorized to transact or deal with specific business affairs of the principal. Such agents are mostly professional agents who expertise in cutting a deal for a specific transaction. As a result, most of the acts done by such agents are called Acts of Liquidation or Disposal. Such agents are prohibited from performing acts called acts of management. Besides, their service as an agent is deemed to be of a short term (until disposal). The other thing one should be aware is special agency shall confer on the agent authority only to conduct the affairs specified in the contract and their natural consequence according to the nature and usage therein. (Refer to articles 2205-07 of the civil code)

What kinds of acts, do you think are acts of disposal? An agent may not deal with the

following acts without a special power of agency:

- i. Alienation or mortgage of immovable property;
- ii. The investment of capital
- iii. Sign bill of exchange
- iv. Make donation
- v. Effect a settlement; and
- vi. Defend an action on behalf of the principal.

a. Special Types of Agents

Dear Student, read the definition of the following types of special agents envisaged under the commercial code of Ethiopia and identify their possible differences.

a. Commission Agents: is an agent (natural or juristic person), who independently, professionally and for gain, undertakes to buy or to sell in his name, but on behalf of the principal, goods, movables or any other thing of a similar nature (securities or other fungible things).

b. Forwarding Agents: are agents, which may be a carrier or a shipper who undertakes to act on his own name but on behalf of another person, called the principal, into a contract for the forwarding of goods.

c. Curator Agents: this are agents appointed by a court to represent and perform legally binding acts on behalf of another person up on application to that effect by the relatives or the spouse of the principal.

d. Commercial Agents (brokers): is an agent (a natural or artificial person) who independently, professionally and for a gain, brings parties together for the purpose of their entering into an agreement such as contract of sale, lease, insurance or carriage. Dear student, to have detail understanding of such special types of agents I invite you to read articles 37 - 62 of the commercial code of Ethiopia.

5.6. Duties and Liabilities of the Parties to the Contract of Agency

It is obvious that agency is a contract in which at least two parties bilaterally counter oblige themselves to perform certain obligation towards each other. Hence, both the agent and the principal in a certain agency relationship have their own respective duties in need to be discharged according to their agreement in particular and the law in general. i.e., failure to

discharge by either party, if any, entails liability.

5.6.1. Duties and Liabilities of the Agent

The following are the main duties of the agent in a certain agency relationship:

a. The duty of strict good faith: the agent shall act with strict good faith towards his principal. This duty, among other things, requires the agent to disclose to his principal any circumstance which would justify the revocation of the agency or the variation of its terms. (refer to article 2208 of the civil code)

b. The duty to act in the exclusive interest of the principal: as mentioned earlier the agent is a mere facilitator. S/he shall not claim to have any personal benefit in their engagement with a third party on behalf of the principal. As a result the agent is required to act in the exclusive interest of the principal and s/he may not, without the latter's knowledge, derive any benefit from any transaction in to which s/he enters in pursuance of his or her authority. Moreover, the agent may not make use to the detriment of the principal of any information obtained by him in the performance of his duties as an agent. The thing is, though it is normal that in due course of his activities the agent may face a conflict of interest, however, s/he should refer it to the ultimate decision of the principal. (Refer to article 2209 of the civil code)

c. The duty of accounting: this is the other vital duty of the agent for mostly the activity of agents is related to the finance of the principal. Hence, it is the duty of the agent to account to the principal for all sums received by him and all profits accruing to him in due course of his employment, notwithstanding that the sums he received were not owed to the principal or there being existed an adverse claim to the monies collected. Besides, where the agent converted to his own use monies he owed to the principal, he shall be liable for the payment of interest as from the day of such use, without it being necessary that notice be given to him. Finally, this duty is deemed to be discharged when the accounts of the agent are duly approved by the principal. (Refer to article 2210-2214 of the civil code)

d. The duty of diligence: the office of the agent, though voluntary in nature, creates a fiduciary relationship with the principal. Hence, the agent is expected to show the qualities of care, interest and fitness in his activities. Two folds of diligence may be expected from the agent. Firstly, the agent shall exercise the same diligence as a *bonus pater familias* in carrying out the agency as long as he is entrusted therewith. This is called the objective standard of duty expected from a paid or professional agent. Secondly, the agent is required to show the same degree of diligence or care as to his own or that he show in due course of

taking care of his own personal affairs. This is called the subjective standard of care mostly expected from a gratuitous agent. Finally, the agent shall be liable for fraud and for defaults in the performance of his duties. (Refer to article 2211 of the civil code)

e. The duty of ‘no delegation’ of authority: it is inherent in the nature of the obligation of the agent that s/he should perform his activities personally. As a result, the rule is the agent shall carry out the agency in person unless he is authorized by the principal to appoint a substitute or a delegate. However, such delegation may be impliedly accepted where from usage it appears a matter of indifference whether the agent acts personally or by the deputy or where the interest of the principal so requires or when unforeseen circumstances prevent the agent from carrying out the agency and he is unable to inform the principal of these circumstances. (Refer to articles 2215-2218 of the civil code)

On the other hand, in the following circumstances the agent shall be personally liable towards the third party he is dealing with and/or the principal:

a. In case of undisclosed or partially disclosed principal: this is a situation where the agent acts on his own behalf with third parties, notwithstanding the fact that such thirds parties know that he is an agent of somebody else or not. Such an agent shall personally enjoy the rights or incurs the liabilities deriving from the contracts he makes with third parties and his acts whatsoever may not bind the principal. (Refer to article 2197-98 of the civil code)

b. In case the agent abuses his authority: this is against the essence of fixing the representative capacity of the agent by the internal contract of agency concluded between the agent and the principal. Accordingly, the agent shall be liable to contracts made by him in the name of the principal outside the scope of his authority. However, it is up to the discretion of the principal to either opt to ratify or repudiate such *ultra vires* acts of the agent. (Refer to 2190-91 of the civil code of Ethiopia)

c. In case the agent acts on a lapsed authority: sometimes the parties to the relationship may determine the duration of the viability of their relationship by fixing a period of time to that effect. That means the agent can legally represent the interest of the principal only and until the lapse or expiry of such period. Otherwise, if the agent acts on behalf of the principal after the expiry of the duration of his power of representation, s/he shall be personally liable. (Refer to article 2190 (2) of the civil code)

d. In case of unauthorized agency: an agent who undertakes, with full knowledge of the acts, to do or manage the affairs of another person without having been appointed as an agent shall

be personally liable towards the third party to the performance of the obligation he undertake to discharge. In a nutshell, the acts of such an agent shall not bind the person whose affairs have been taken care of. However, the principal may exercise either of the following options towards such acts of the agent and thereby bind himself or not for the deeds of the agent towards the third party: (refer to articles 2257-2265 of the civil code of Ethiopia)

i. Ratification: this is the situation where the principal approves or ratifies the acts of the agent, nevertheless they are unauthorized. This happens, mostly, in cases where the interest of the principal required that the management be undertaken as a necessity. Ratification has a legal effect of making the unauthorized acts of the agent binding against the principal. (Refer to article 2192, 2265 of the civil code)

ii. Repudiation: this is a situation where the principal rejects or disapproves the unauthorized acts of the agent. This automatically entails the personal liability of the agent towards the third party. The more the acts of the agent put the interest of the principal at stake, the more the principal tends to repudiate them. (Refer to article 2193 of the civil code)

e. The agent shall be generally liable towards the principal for his failure to discharge his obligation according to the contract of agency. i.e., failure to discharge all the duties of an agent mentioned above makes the agent personally liable to the principal. For instance, bad faith in due course of discharging the activities; in case of conflict of interest with the principal (in case the agents acts on behalf of multiple principals other than the one or the agent contracts with himself on behalf of the principal); failure to disclose important information; failure to account his activities or to submit report of the management of his affairs up on demand or periodically; fraud and defaults in his work; the agent shall be liable for the acts of the person whom he appointed or delegated without authorization as his substitute as if they were his own; the agent is also liable for the care with which he selected his substitute and gave him instructions, even with authorization of the principal to appoint a delegate. (Refer to articles 2194-2198 of the civil code of Ethiopia)

5.6.2. The Duties and Liabilities of the Principal

Most of the duties of the principal towards the agent are related to the fulfillment of various types of payments and security of resources of the agent who is acting on his behalf. On the other hand, the basic duty of the principal towards the third party is performance of the obligation undertaken by the agent towards the principal.

The following are the main duties of the principal towards the agent:

a. The duty of remuneration: remuneration is a commission paid to the agent for the activities exercised by him. The problem is, due to either the voluntary nature of the office or the fiduciary nature of the relationship *per se*, the agent cannot claim remuneration as of right unless, such payment is contractually agreed upon or the acts are performed on a professional level (all cases of special agency) or it is customary to do so in the nature of the activities done by the agent. Moreover, though such payment may be contractually agreed upon, it is subjected to the full discretion of courts to either reduce or increase it, if it appears to be excessive or out of proportion to the services rendered by the agent. (Refer to articles 2219-20 of the civil code)

b. The duty of Reimbursement: it is the main duty of the principal to advance to the agent the sums necessary or entirely the resources needed for the proper performance of his activities. Such expenses are called outlays and expenses. Otherwise, if the acts of the agent are left behind due to the non-resourcefulness of the principal the latter shall be liable to the third party. This being the case however, if the agent happens to have covered such outlays or expenses by himself, then it is the duty of the principal to reimburse to the agent such costs incurred in the proper carrying out of the agency. The duty of reimbursement also includes the payment of interests by the principal, which are due from the day when they were incurred. (Refer to article 2221 of the civil code)

c. The duty of Indemnification: this is also another type of payment, but for a different reason. This duty obliges the principal to make good (compensate) any damage of the agent sustained in the course of carrying out of the agency and which was not due to his own default. So the only Burdon of proof required from the agent would be to prove that the damage was sustained while practicing his agency. (Refer to article 2222 of the civil code)

It is similar for all the above types of payments required from the principal that, first; they are not subjected to off-set by the principal under the pretext that the transaction was unsuccessful and second, until the payment of the sums due to him by reason of the agency, the agent shall have a lien on the objects entrusted to him by the principal for the carrying out of the agency. (Refer to articles 2223-24 of the civil code)

Dear Student, Do you think the agent can exercise his right of lien on the documents evidencing the agency? Dear student to have holistic idea of the issue Refer to Articles 2184-2186 of the civil code of Ethiopia.

5.7. Grounds for the Termination of Agency Relationship

It is a universally known fact that everything that has a beginning has an end and agency relationship is not an exception to it. The following are the main grounds of termination of a certain agency relationship:

- a. Revocation of agency by the principal: it is within the full discretion of the principal to restrict or revoke the representative capacity (the authority he gave to the agent to make contract in his name) of the agent at any time and to force the agent to restore to him the written instruments evidencing his authority. However, unless otherwise where the date was agreed upon in the principal's interest, the he is at duty to indemnify the agent for any damage caused to him by the revocation where such revocation occurs prior to the agreed date or under conditions detrimental to the agent. If the principals are plural, the revocation of the agent may be effected only by the agreement of all the principals. (Refer to articles 2226-28 of the civil code)
- b. Renunciation by the agent: this is the action of the agent where he renounces or resigns his office voluntarily. In this case however, the agent is at duty to give notice of his resignation to the principal. This is due to a legal presumption that the agent is deemed to properly resign from his duties if and only if he is replaced by another. In a similar fashion, if such renunciation is detrimental to the interest of the principal, it is the duty of the agent to indemnify the principal unless the latter cannot continue the performance of his obligation without himself suffering a considerable loss. (Refer to article 2229 of the civil code)
- c. Death or incapacity of the agent: in the absence of an otherwise agreement a contract of agency shall terminate by the death, declaration of absence, bankruptcy or incapacity of the agent. In such case the principal has a right to information about the happening by the heirs or representatives of such agent and the latter are at duty to take all the necessary steps to safeguard the interest of the principal. (Refer to article 2230 of the civil code)
- d. Death or incapacity of the principal: in a similar fashion the death, absence, bankruptcy or incapacity of the agent terminates the agency relationship. In this case however, for the agent is still alive he has a duty of continuing its management serving as a care-taker until the legal representatives of the principal are in a position to take it over themselves. (Refer to article 2232 of the civil code)
- e. Expiry of the duration of agency: if the contract was made for a defined period of time, the relationship terminates with the lapse of the period of time mentioned in the contract.

f. Achievement of Object: if both parties perform properly and achieved the very purpose of their relationship there will be no reason for the continuation of their relationship.

Chapter Summary

Dear Student, in this chapter we have in depth dealt with the various aspects of law of agency. We have discussed that the recognition of the scheme of agency by itself has contributed a great deal to the expansion of business all over the world. Contract of agency empowered business persons to extend their business hands and do business in more than one places at a time. It has helped them to escape the various constraints related to time, place, lack of professional expertise and so on. Agency is a mechanism devised by law to enable the principal to deal with third parties via the instrumentality of an agent or a mediator (go-between) who will do the activities up on the payment of remuneration. I hope in this chapter you have acquired working knowledge on the sources, definition, types, performance, and grounds of termination of certain agency relationship.

Dear Student, in order to genuinely evaluate your acquired knowledge on contract of agency I invite you to meditate on the following exercises and review questions.

Chapter Exercise and Review Questions

1. What do we mean by agency?
2. Why are we after all in need of agency?
3. Can you stipulate the rationales behind the need for agency?
4. How many parties are there in a certain agency relationship?
5. What do we mean by the internal agency contract? What is the main purpose of the internal contract?
6. What do we mean by the external agency contract? What is the purpose of the external contract? Who are the parties to the external contract?
7. Can you enumerate the sources of agency?
8. Do you think the agent is strictly speaking a party to the contract concluded between him and the third party?
9. What do we mean by complete representation?
10. What is the legal implication of complete representation?
11. What do we mean by a disclosed principal? Undisclosed principal?
12. In what scenarios is the agent personally liable to third parties to the contract?
13. What are the main duties of the agent?

14. What are the main liabilities of the principal?
15. What do we mean by general agency? And a general agent?
16. What do we mean by special agency? And a special agent?
17. Whether a general agent performs an act of disposal or not?
18. Whether a special agent can perform acts of management or not?
19. What are the grounds for the extinction of agency relationship?

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Chapter Six

Introduction to the Contract of Insurance

Chapter Introduction

Dear Students, the adventure of business is filled by full of surprises. Of course every business man immerses itself in to business adventure basically having the motive of maximizing profit. However, this may not be always the case in that not few numbers of businesses are out of business in the first year of their incorporation. The risk of bankruptcy however, is not the only impediment to doing business.

There are various types of catastrophes or peril or risks faced by individual traders or businesses from numerous sources that may force a business person to stop or close such business. Such perils are mostly related to his property or life or body. In the presence of such abnormal circumstances it will be cumbersome to operate business as usual and become profitable. Though basically not a preventive scheme, it is in this regard that the relevance of insurance comes in to picture in the adventure of business. When abnormality or risk imminently surrounds and victimises the property or life or bodily constitution of person insurance remedies the problem as a curative measure.

However, it should be known that such relief via the payment of an insurance compensation (indemnity) can be found if and only if the person who taught to be at risk was subtle enough to sign a contract of insurance to that effect. In the absence of the purchase of an insurance policy, payment will not materialize out of thin air. For insured individuals insurance comes as cure to their problems and help to continue their business or life as usual. Dear student, in this chapter we will deal with introductory matters on the contract of insurance.

Chapter Objectives

After the proper accomplishment of this chapter students will be able to:

- Clearly understanding of the definition of insurance;
- Discuss the importance of insurance to the insure, insurer and the economy in general;
- Enumerate the nature of contract of insurance
- Discuss the types of insurance;
- Appreciate the major principles of law of insurance.

6.1. Definition of Insurance

From the viewpoint of the individual (Policyholder or insured or assured or subscriber), insurance is defined as a mechanism of risk transfer or an economic device where by a person called the insured (subscriber of policy) transfers a risk of financial loss resulting from unforeseeable events affecting Property, Life or body to a person called the Insurer for consideration (payment of premiums). (Refer to articles 654-656 of the commercial code)

Illustration:

A typical example can be, Abebe was bothered about the loss or destruction of his motor vehicle due to an accident or collusion and to preserve his property he purchased a Motor Vehicle Insurance Policy from the Ethiopian Insurance Corporation.

From the perspective of the Insurer (assurer), insurance is a mechanism via which a risk is distributed among the group of persons (insured) who are exposed to the same type of risk, i.e., persons who bear the risk of suffering a Financial Loss as a result of events affecting property, life or body.

Illustration:

Nyala Insurance Company sold 200,000 Fire Insurance Policies in 2015 covering losses related to Buildings in case of Fire Accident. It has collected premiums from 200,000 individuals. Now imagine that out of the 200,000 insured individuals only 10,000 of them actually sustained a covered financial loss in the financial year 2015.

Now, it is the duty of the insurer to pay compensation only to the 10,000 individuals (subscribers), who suffered the loss, which is covered according to the contract, out of the pool of premiums collected from 200,000 individuals. If one policy is worth (sold for) 10,000 birr, the entire collected amount would be $200,000 \times 10,000$ birr which equals to 2,000,000,000 birr. However, the insurer paid only $10,000 \times 10,000$ birr which equals to 100,000,000 birr. So imagine the difference in money when 2,000,000,000 - 100,000,000 which equals to 1,900,000,000 birr. As a result the insurer has distributed the loss sustained by only the 10,000 persons among the remaining 190,000 individuals whose property were not damaged.

From the definitions provided above, we can understand that insurance is a cooperative economic device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to insure themselves against that risk. This means that insurance provides a pool to which many persons contribute a certain amount of money

called the premium, and out of which the insurer compensates the few who suffer losses. This is always true in the case of property and liability insurance which cover contingencies and given for a short period of time, usually a period of one year, but does not so fully apply to insurance of persons particularly life insurance(see Art 692) in which the policy usually becomes a claim ultimately.

We can also understand that by insurance, the risk is transferred from the individual to the insurer who takes into account the total or probability of loss in a certain period, and then fixes the premium to be paid by each person insured.

For example, in the case of motor vehicle insurance, if the total likely loss of Euro Trucker Trucks is 50 per year, valued Birr one million each and the total number of trucks expected to be on voyage per year is estimated to be 25,000 trucks, the premium for each truck will be Certain amounts of money, say Birr 500, for administration expenses and profit, i.e., Birr 2500. Thus, it can be seen that insurance is a device by which an insured person can protect himself from heavy loss likely to be caused by an uncertain event by paying a comparatively much smaller sum of money as premium.

$$\frac{50 \times 1,000,000}{25,000} = \text{Birr } \frac{50,000,000}{25,000} = \text{Birr 2000 plus}$$

Here, it has to be noted that insurance does not and cannot prevent loss of property, incurring civil liability, death, or injury or illness, rather it provides financial compensation for the effects of misfortune. In other words, we can say that insurance does not protect the insured property from loss or damage, or the insured from incurring civil liability or the insured person from death or injury or illness, but provides a financial compensation to the insured or the beneficiary who has suffered pecuniary losses as a result of loss or damage to property, or because he has incurred a civil liability or illness or death of the insured.

Hence, insurance is a cooperative device to spread (distribute) the loss caused by a particular (specified on the contract) risk over a number of persons (many persons) who are exposed to it and who agree to insure themselves against the risk.

Insurance is advantageous to the insured person for it enables him or her to protect himself from heavy (unbearable) losses likely to be caused by an uncertain event by paying a comparatively much smaller premium.

However, be aware that, insurance does not and cannot prevent loss of property or the incurring of civil liability or the death of a person or bodily injury or illness of the insured

person. It does not prevent the happening of the risk by itself. It is rather a curative (not preventive) remedy which provides financial compensation for the effect of misfortune.

6.2. Nature of Insurance Contract

i. Insurance is a type of contingent or conditional contract. It is a contract in which the performance of the obligation by the parties or one of them is dependent up on the condition or contingency agreed by the parties on the contract. If the contingency or condition does not materialize there will be no payment of insurance compensation.

ii. Insurance is a contract. As a result, the essential validity requirements of a contract are applicable. You need also identify the rights and duties of the parties to the contract of insurance.

iii. An insurance contract is an *Aleatory Contract* rather than Cumulative Contract. *Aleatory* contracts have a chance element (not all subscribers would be paid) and uneven exchange (not always win-win). Under such contracts the performance of at least one party is dependent up on chance.

iv. Insurance is a unilateral contract in that it is only the insurer that makes a legally enforceable promise to pay a claim or provides other services to the insured.

v. Insurance is a contract of Adhesion. All the terms and conditions of the contract are not the result of negotiations between the parties. Or the contract is articulated by the insurer and all the insured has to do is accept (adhere to) it.

vi. Insurance works by the Law of Large Numbers or pool of premiums.

6.3. Significance of Insurance

Stipulated in a nutshell, insurance as a mechanism of transfer of risk has great economic and social benefits to the individual insured, his family, the insurer and the economy of a country in general.

The following are the major advantages of the contract of insurance:

i. Indemnification of Losses: payment of compensation by the insurer for losses permits individuals and their families to be restored to their original financial position after a loss has occurred. Businesses will remain in business or employees continue to keep their jobs or families remain intact and so on

ii. Reduction of Worry and Fear: it reduces or eradicates worry and fear either before or after the happening of the loss. A person who is insured for a 'long term disability' do not have to

worry about the loss of earning if a serious illness or accident occurs.

iii. Source of Investment Funds: the insurance industry is an important source of funds for capital investment and accumulation. The premiums collected by the insurer and other funds which are not needed to pay for immediate losses and expenses can be loaned to businesses or invested in manufacturing or Real Estate.

iv. Means of Loss Control: if no effort is made to prevent or minimize occurrence of insured risks or losses, the premiums would have a tendency to rise. Hence, insurers should participate in various programs and sponsorship schemes to minimize or reduce the chance of risk such as road building, fire safety standards and so on. Insurance should be taken as a mechanism of risk management.

v. Enhancing Credit: when a person is insured, the fact that s/he is insured enhances a person's credit .i.e., it makes him or her as a borrower a better credit risk to the lender because it guarantees to the lender that the value of the borrowers collateral and gives the lender (creditor) a greater assurance that the loan will be paid.

6.4. The Major Principles of Law of Insurance

6.4.1. The Principle of Insurable Interest

The word 'interest' can have a number of meanings. In the present context, it means a financial relationship to something or someone. There are a number of features to be considered with 'insurable interest', as below.

6.4.1.1. Definition

Insurable interest is a person's legally recognized relationship to the subject matter of insurance that gives them the right to effect insurance on it. Since the relationship must be a legal one, a thief in possession of stolen goods does not have the right to insure them.

6.4.1.2. Importance of Insurable Interest

An insurance agreement is void without insurable interest. The rules relating to return of premiums under such an agreement vary as between the different classes of insurance. These rules are the general rules on illegality of contract and the relevant provisions of the Insurance Companies Ordinance.

6.4.1.3. Its Essential Criteria

For insurable interest to exist, the following criteria must be satisfied:

i. there must be some person (i.e. life, limbs, etc.), property, liability or legal right (e.g. the

right to repayment by a debtor) capable of being insured;

ii. that person, etc. must be the subject matter of the insurance (that is to say, claim payment is made contingent on a mishap to such person, etc.);

iii. the proposer must have the legally recognized relationship to the subject matter of insurance, so that financial loss may result to him if the insured event happens. (However, insurable interest is sometimes legally presumed without the need to show financial relationship. For example, any person is regarded as having an insurable interest in the life of their spouse.

Dear Student, you should remember that a financial relationship alone is not sufficient to give rise to insurable interest. For instance, a creditor is legally recognized to have insurable interest in the life of his debtor, but is not allowed to insure the debtor's property despite his financial relationship to it, unless the property has been mortgaged to him.

6.4.1.4. How It Arises

Insurable interest arises in a variety of circumstances, which may be considered under the following headings:

i. Insurance of the Person: everyone has an insurable interest in his own life, limbs, etc. One also has an insurable interest in the life of one's spouse. Further, one may insure the life of one's child or ward (in guardianship) who is under 18 years of age, and a policy so effected will not become invalid upon the life insured turning 18.

ii. Insurance of Property (physical things): the most obvious example arises in absolute ownership. Executors, administrators, trustees and mortgagees, who have less than absolute ownership, may respectively insure the estate, the trust property and the mortgaged property. Bailees (i.e. persons taking possession of goods with the consent of the owners or their agents, but without their intention to transfer ownership) may insure the goods bailed.

iii. Insurance of Liability: everyone facing potential legal liability for their own acts or omissions may effect insurance to cover this risk (sometimes insurance is compulsory), such liability being termed 'direct liability' or 'primary liability'. Insurance against vicarious liability is also possible, where, for example, employers insure against their liability to members of the public arising from negligence, etc. of their employees.

iv. Insurance of Legal Rights: anyone legally in a position of potential loss due to infringement of rights or loss of future income has the right to insure against such a risk.

Examples include landlords insuring against loss of rent following a fire.

Dear Student, here you need to be aware that anyone (agent) who has authority from another (principal) to effect insurance on the principal's behalf will have the same insurable interest to the same extent as the principal. For instance, a property management company may have obtained authority from the individual owners of a building under its management to purchase fire insurance on the building. There is no question of a fire insurance effected under such authority being void for lack of insurable interest, even if it is the property management company (rather than the property owners) which is designated in the policy as the insured.

6.4.1.5. When Is It Needed?

- i. With life insurance, insurable interest is only needed at policy inception. Suppose a woman had bought a whole life policy on the life of her husband, who died some years later. When the woman presented a claim to the insurer, the latter discovered that at the time of the man's death, they were no longer in the relationship of husband and wife. That means the woman had no insurable interest in the life of the deceased at the time of the death. Nevertheless, this lack of insurable interest will not disqualify her for the death benefit.
- ii. However, with marine insurance, insurable interest is only needed at the time of loss.
- iii. The above marine insurance rule is probably applicable to other types of indemnity contracts as well.

6.4.2. The Principle of Utmost Good Faith

6.4.2.1. Ordinary Good Faith

Most types of contracts especially those that involve fiduciary relationship are subject to the principle of good faith, meaning that the parties have to behave with honesty and such information as they supply must be substantially true. However, it is not their responsibility to ensure that the other party obtains all vital information which may affect his decision to enter into the contract, or may affect the terms on which he would enter into the contract.

6.4.2.2. Utmost Good Faith

Insurance is subject to a more stringent principle of good faith, often called the principle of utmost good faith. It means that each party is under a duty to reveal all vital information (called material facts) to the other party, whether or not that other party asks for it. For example, a proposer of fire insurance is obliged to reveal the relevant loss record to the

insurer, even where there is not a question on this on the application form.

Dear Student, you need to be aware of the following facts:

- i. Insurers sometimes extend the duty of utmost good faith by requiring the proposer to declare (or warrant) that all information supplied, whether relating to 'material' matters or not, is totally (not simply substantially) true. For example, where a proposer for medical insurance enters '30' as his current age on the proposal form when he is aged 31, this is a technical breach of the above kind of warranty, if any, although this inaccuracy is unlikely to be material in the eyes of the insurance law principle of utmost good faith as applied to medical insurance.
- ii. On the other hand, a policy provision may state that an innocent or negligent (as opposed to 'fraudulent') breach of the duty will be waived (excused).

6.4.2.3. Material Fact

- i. Statutory Definition: 'every circumstance which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will accept the risk'. From this definition, it can be seen that there are three categories of material facts, by reference to the kinds of decisions likely to be affected by their disclosure. The first one only concerns the decision to accept or to reject a proposed risk (e.g. the fact that a proposed life insured has an inoperable malignant brain tumor.) The second only concerns the setting of premium (e.g. the fact that the insured person of a proposed personal accident insurance is a salesperson). And the third concerns both (e.g. where a proposed life insured is a diabetic). You should also note that the law looks at an alleged 'material fact' in the eyes of a prudent insurer - not a particular insurer, a particular insured or a reasonable insured.
- ii. Facts that need not be disclosed: In the absence of enquiry, certain facts need not be disclosed; they include:
 - a. Matters of common knowledge (e.g. the explosive character of petroleum);
 - b. Facts already known, or deemed to be known, to the insurer (e.g. the problem of piracy in Somalia);
 - c. Facts which diminish the risk. **Illustrations:** A proposer for commercial fire insurance did not mention the fact that his premises were protected by an automatic sprinkler system, which fact, if disclosed, would have influenced the determination of the premium. This omission does not breach utmost good faith, as the fact (although very relevant) actually indicates a

lower risk.

6.4.2.5. Types of Breach of Utmost Good Faith

A breach of utmost good faith can be in the form of either a misrepresentation (i.e., the giving of false information) or a non-disclosure (i.e., failure to give material information). Alternatively, it can be classified into a fraudulent breach and a non-fraudulent breach (i.e., a breach committed innocently or negligently, rather than fraudulently). Both classifications combined produce a four-fold categorization as follows:

- i. Fraudulent Misrepresentation: an act of fraudulently giving false material facts to the other party;
- ii. Non-fraudulent Misrepresentation: an act of giving false material facts to the other party done either innocently or negligently;
- iii. Fraudulent Non-disclosure: a fraudulent omission to give material facts to the other party; or
- iv. Non-fraudulent Non-disclosure: an omission to give material facts to the other party done either innocently or negligently.

6.4.3. The Principle of Proximate Cause

6.4.3.1. Meaning and Importance of the Principle

The proximate cause of a loss is its effective or dominant cause. Why is it important to find out which of the causes involved in an accident is the proximate cause? A loss might be the combined effect of a number of causes. For the purposes of insurance claim, one dominant cause must be singled out in each case, because not every cause of loss will be covered.

6.4.3.2. Types of Peril

In search of the proximate cause of a loss, we often have to analyze how the causes involved have interacted with one another throughout the whole process leading to the loss. The conclusion of such an analysis depends very much on the identification of the perils (i.e., the causes of the loss) and of their nature. All perils are classified into the following three kinds for the purposes of such an analysis:

- i. Insured peril: It is not common that a policy will cover all possible perils. Those which are covered are known as the 'insured perils' of that policy, e.g. 'fire' under a fire policy, and 'stranding' under a marine policy.
- ii. Excepted (or excluded) peril: This is a peril that would be covered but for its removal from

cover by exclusion, e.g. fire damage caused by war is irrecoverable under a fire policy because war is an excepted peril of the policy.

iii. Uninsured peril: This is a peril that is neither insured nor excluded. A loss caused by an uninsured peril is irrecoverable unless it is an insured peril that has led to the happening of the uninsured peril. For example, raining and theft are among the uninsured perils of the standard fire policy.

6.4.3.3. Application of the Principle

The principle of proximate cause applies to all classes of insurance. Its practical applications may be very complex and sometimes controversial. For our purposes, we should note the following somewhat simplified rules:

- i. There must always be an insured peril involved; otherwise the loss is definitely irrecoverable.
- ii. If a single cause is present, the rules are straightforward: if the cause is an insured peril, the loss is covered; if it is an uninsured or excepted peril, it is not.
- iii. With more than one peril involved, the position is complex, and different rules of proximate cause are applicable, depending on whether the perils have happened as a chain of events or concurrently, and on some other considerations. Specific cases should perhaps be a matter of consultation with the insurer and/or lawyers, but the general rules are:
 - a. Uninsured perils arising directly from insured perils: the loss is covered, e.g. water damage (uninsured peril) proximately caused by an accidental fire (insured peril) in the case of a fire policy;
 - b. insured perils arising directly from uninsured perils: the loss from the insured peril is covered, e.g. fire (insured peril) damage proximately caused by a careless act of the insured himself or of a third party (uninsured peril) in the case of a fire policy.
 - c. the occurrence of an excluded peril is generally fatal to an insurance claim, subject to complicated exceptions.
- iv. Other Features of the Principle: in this regard the following are typical:
 - i. Neither the first nor the last cause necessarily constitutes the proximate cause.
 - ii. More than one proximate cause may exist. For example, the dishonesty of an employee and the neglect on the part of his supervisor of a key to a company safe may both constitute proximate causes of a theft loss from the safe.

iii. The proximate cause need not happen on the insured premises. Suppose a flat insured under a household policy is damaged by water as a result of a fire happening upstairs. The damage is recoverable under the policy, although the insured flat has never been on fire.

iv. Where the proximate cause of a loss is found not to be an insured peril, it does not necessarily mean that the loss is irrecoverable under the policy.

Illustration: There are four containers of cargo being carried on board a vessel and insured respectively under four marine cargo policies. The first policy solely covers the peril of collision, the second fire only, the third explosion only, and the fourth entry of water only. During the insured voyage, because of the master's negligence, this vessel collides with another. The collision causes a fire, which then triggers an explosion. As a result, the vessel springs several leaks and all the cargo is damaged by seawater entering through the leaks. These facts show that the cargo damage was proximately caused by negligence. Bearing in mind that negligence is merely an uninsured rather than insured peril of each of the four cargo policies, an immediate, important question that has to be grappled with is: 'Is the cargo damage irrecoverable under those policies?' In search of an answer to this question, we must look at the links between the individual events of the incident. Negligence, the identified proximate cause, naturally causes a collision, which then naturally causes a fire. The fire naturally leads to an explosion, which then naturally causes an entry of water.

At last, the water damages the cargo. Before us is a chain of events, happening one after another without being interrupted by other events. With respect to each policy, the water damage is regarded as a result of its sole insured peril, notwithstanding that this peril can be traced backward to an uninsured peril. Therefore, the only conclusion that we can reach is that each of the policies is liable for the water damage to the cargo it has insured. Of course, if the proximate cause is found to be an excepted peril, the opposite conclusion will have to be made.

6.4.4. The Principle of Indemnity

6.4.4.1. Definition

Indemnity means an exact financial compensation for an insured loss, 'no more no less'.

6.4.4.2. Implications

Indemnity cannot apply to all types of insurance. Some types of insurance deal with 'losses' that cannot be measured precisely in financial terms. Specifically, we refer to Life Insurance and Personal Accident Insurance. Both are dealing with death of or injury to human beings,

and there is no way that the loss of a finger, say for instance, can be measured precisely in money terms.

Thus, indemnity cannot normally apply to these classes of business. Beware that medical expenses insurance, which is often included in personal accident and travel insurance policies, is indemnity insurance unless otherwise specified in the policies. Other insurances are subject to the principle of indemnity.

Dear Students beware that, it is sometimes said that life and personal accident insurances involve benefit policies rather than policies of indemnity. Since indemnity cannot normally apply, the policy can only provide a benefit in the amount specified in the policy for death or for the type of injury concerned.

6.4.4.3. Link with Insurable Interest

Insurable interest represents the financial ‘interest’ in the subject matter, which is exactly what should be payable in a total loss situation, if the policyholder is to be completely compensated. However, life and personal accident insurances may generally be regarded as involving an unlimited insurable interest, and therefore indemnity cannot apply to them.

6.4.4.4. How Indemnity is provided

It is common for property insurance policies to specify that the insurer may settle a loss by any one of four methods named and described below. However, both marine and non-property policies are silent on this issue so that the insurer is obliged to settle a valid claim by payment of cash.

- i. Cash payment (to the insured): This is the most convenient method, at least to the insurer.
- ii. Repair: Payment to a repairer is the norm, for example, with motor partial loss claims.
- iii. Replacement: With new items, or articles that suffer little or no depreciation, giving the insured a replacement item may be a very suitable method, especially if the insurer can obtain a discount from a supplier.
- iv. Reinstatement: This is a word that has a number of meanings in insurance. As a method of providing an indemnity, it means the restoration of the insured property to the condition it was in immediately before its destruction or damage.

Dear Student, you are absolutely correct if you understand that the term ‘reinstatement’ overlaps in meaning with ‘repair’ and with ‘replacement’.

6.4.4.5. Salvage

When measuring the exact amount of loss (which indemnity is), it has to be borne in mind with certain property damage that there will sometimes be something left of the damaged subject matter of insurance (fire-damaged stock, the wreck of a vehicle, etc.). These remains are termed 'salvage'. If the remains have any financial value, this value has to be taken into account when providing an indemnity. For example:

- i. The value of the salvage is deducted from the amount otherwise payable to the insured (who then keeps the salvage); or
- ii. The insurer pays in full and disposes of the salvage for its own account. The term 'salvage' in maritime law has a very different meaning, where it usually refers to acts or activities undertaken to save a vessel or other maritime property from perils of the sea, pirates or enemies, for which a sum of money called 'salvage award' (or just 'salvage') is payable by the property owners to the *salvor* provided that the operation has been successful. The term is sometimes also used to describe property which has been salvaged.

6.4.4.6. Abandonment

This is a term mostly found in marine insurance, where it refers to the act of surrendering the subject matter insured to the insurers in return for a total loss payment in certain circumstances. This is quite standard in marine practice, but in other classes of property insurance, policies usually specifically exclude abandonment. The important thing to be remembered with abandonment is that the subject matter insured (or what is left of it) is completely handed over to the insurer, who may therefore benefit from its residual value.

6.4.5. The Principle of Contribution

6.4.5.1. Equitable Doctrine of Contribution

This is a claims-related doctrine of equity which applies as between insurers in the event of a double insurance, a situation where two or more policies have been bought by or on behalf of the insured on the same interest or any part thereof, and the aggregate of the sums insured exceeds the indemnity legally allowed.

Illustration: Suppose a husband and wife each insure their home and contents, each thinking that the other will forget to do it. If a fire occurs and 200,000 birr damage is sustained, they will not receive 400,000 birr compensation. The respective insurers will share the 200,000 birr loss. Apart from any policy provisions, any one insurer is bound to pay to the insured the full amount for which he would be liable had other policies not existed. After making an

indemnity in this manner, the insurer is entitled to call upon other insurers similarly (but not necessarily equally) liable to the same insured to share (or to contribute to) the cost of the payment.

6.4.5.2. Rateable Proportions

Where contribution applies, the ultimate proportion of the insured's loss that any one particular insurer is responsible for is called the 'rateable proportion' of that insurer. It is not difficult to understand that the sum of all the insurers' rateable proportions equals one, that is to say, 100% of the insured's loss. A few methods are available for calculating rateable proportions. But as an insurance intermediary, it is not essential that you should know them well, bearing in mind that how much your clients will ultimately get paid for a loss will not depend on the basis of contribution to be employed.

6.4.5.3. How Arising

The criteria (or essentials) that need to be satisfied before contribution applies are:

- i. the respective policies must each be providing an indemnity (rather than benefit) to the loss in question (this is the reason why it is said that contribution is a corollary (i.e., a natural consequence of an established principle) of indemnity);
- ii. they must each cover the interest (which term does not mean property, liability, etc.) affected;
- iii. they must each cover the peril (cause of loss) that has given rise to the loss;
- iv. They must each cover the subject matter of insurance (property, liability, etc.) that has been affected; and
- v. each policy must be liable to the loss (i.e. not be subject to a policy exclusion or limitation preventing contribution).

6.4.6 The Principle of Subrogation

6.4.6.1 Definition

Subrogation is the exercise, for one's own benefit, of rights or remedies possessed by another against third parties. As a corollary (i.e., a natural consequence of an established principle) of indemnity, subrogation allows proceeds of claim against third party be passed to insurers, to the extent of their insurance payments. As per the law, an insurer's subrogation action must be conducted in the name of the insured.

Illustrations: for example, a car, covered by a comprehensive motor policy, is damaged by

the negligence of a building contractor. The motor insurer has to pay for the insured damage to the car. As against the negligent contractor, the insured's right of recovery will not be affected by the insurance claim payment. However, the motor insurer may, after indemnifying the insured, take over such right from the insured and sue the contractor for the damage in the name of the insured. From this, it will easily be seen how subrogation seeks to protect the parent principle of indemnity, by ensuring that the insured does not get paid twice for the same loss.

6.4.6.2. How Arising

Subrogation rights arise in several manners as follows:

- i. In tort: This usually arises where a third party negligently causes a loss indemnifiable by a policy. For example, a fire insurer, after paying a fire loss, discovers that the fire was caused by a negligent act of a neighbor of the insured. It sues the neighbor in the name of the insured for damages recognized by the law of tort.
- ii. In contract: This arises where the insured (perhaps a landlord) has a contractual right (perhaps under a tenancy agreement) against another person (perhaps a tenant) for an insured loss. After indemnifying the insured for the loss, the insurer may exercise such right against that other person in the name of the insured.
- iii. Under proclamation or statute: If a person is injured at work, his employer, if any, will have to pay an employee compensation benefit to him in accordance with the provisions of the Ethiopian Labor Law. The law will then grant subrogation rights to the indemnifying employer against another person who is liable to the employee for the injury. In turn, the employer has to pass these rights to the insurer who has paid the employee compensation benefit for or on behalf of the employer.
- iv. In salvage: The insurer may be said to have subrogation rights in what is left of the subject matter of insurance (salvage), arising under the circumstances already discussed.

6.4.6.3. How Applicable

As with contribution, subrogation can only apply if indemnity applies. Thus, if the life insured of a life policy is killed by the negligence of a motorist, the paying life insurer will not acquire subrogation rights, as this payment is not an indemnity.

6.4.6.4. Other Considerations

Dear Student, also beware that in this regard there are other features to note. Such as:

i. In principle, subrogation rights are only acquired after an indemnity has been provided. Non-marine policies usually remove such restriction by stipulating that the insurer is entitled to such rights even before indemnification.

ii. Some considerations arise in respect of proceeds of subrogation: (i) the insurer cannot recover more under subrogation than he has paid as an indemnity. By way of example, suppose there is an insured loss of an antique. The insurer pays, and sometime later when the antique is found, its value is much higher. The insurer can only keep an amount equal to what he has paid and any balance belongs to the insured. (ii) The above saying is not true in the event of subrogation arising after abandonment of the property to the insurer. There, all rights in the property belong to the insurer, of course including the right to 'make a profit'. (iii) Sharing of Subrogation Proceeds Where the insurer has only provided a less-than indemnity on the basis of certain policy limitations, the insured may possibly be entitled to part of - sometimes even the whole of - the subrogation proceeds, depending on what limitations have been applied in the process of claims adjustments.

The following are illustrations of several manners in which the sharing of subrogation proceeds between the insured and the insurer can be done: (a) Excess: Suppose the insured is responsible for a loss (excess) of 10,000 birr before his liability insurer pays 40,000 birr, and 20,000 birr is subsequently recovered from a negligent third party. The whole of 20,000 birr will belong to the insurer. However, if the subrogation recovery is 45,000 birr instead, the insured will be entitled to 5,000 birr and the insurer 40,000 birr.

(b) Limit of Liability: Suppose an insured contractor has incurred liability to a road user in the amount of 1.5 million birr, of which the insured has to pay 0.5 million birr out of his own pocket because his policy is subject to a limit of liability of 1 million birr. Any recovery from a joint tort-feasor will belong to the insured, except where it amounts to more than 0.5 million birr in which case that part over and above the 0.5 million birr threshold will belong to the insurer up to the amount of insurance payment.

(c) Average: Suppose a fire insurer has paid 80% of a loss where there is a 20% underinsurance. The insured is entitled to 20% of subrogation proceeds as if he was a co-insurer for 20% of the risk.

Dear Students, in order to have detail understanding of the major principles of insurance I invite you to thoroughly read articles 654-712 of the commercial code of Ethiopia 1960.

Chapter Summary

Dear Student, in this chapter we have discussed about the contract of insurance. We have stated that insurance is a mechanism devised by law to mitigate the various risks associated with the property, life or limbs (body) of a consumer or a trader. As we have discussed insurance is a curative measure which mainly targets to compensate (indemnify) an economic loss faced by an insured person and there by maintain the disturbed equilibrium that occurred due to the occurrence of a specified risk. The main advantage of insurance is that it enables the insured person to continue its business adventure regardless of the materialization of the risk. However, it should be noted that, in order to become beneficiary of an insurance compensation, the due or prior purchase of an insurance policy is a prerequisite or the payment of an insurance compensation cannot be claimed out of thin air.

Dear Student, in order to properly evaluate your understanding of this chapter I invite you to ponder on the following exercises and review questions.

Chapter Exercise and Review Questions

1. Why is after all insurance necessary?
2. Insurance is a curative than a preventive measure. Discuss.
3. Can you define insurance from the perspective of the insured person? The insurer and the economy in general?
4. What do we mean by an insurance premium?
5. Can you enumerate scenarios where by the insured is not allowed to claim an insurance compensation?
6. Insurance is both a contingent and an aleatory contract. Explain?
7. What do we mean by insurance is a contract of adhesion?
8. What is the main difference between life and property insurance?
9. Briefly discuss what principle of utmost good faith is.

10. Clearly discuss what principle of indemnity is.
11. What do we mean by proximate cause in relation to insurance?
12. What do we mean by insurable interest?
13. Briefly discuss doctrine of subrogation.
14. What is the difference between the subscriber and the beneficiary of an insurance policy?
15. What kind of similarity do you notice as between insurance and gaming?
16. Insurable interest may be described as:
 - (a) Possession of certain goods;
 - (b) The amount always payable for insurance claims;
 - (c) A legally recognized relationship to the subject matter;
 - (d) The interest payments due if the insurance premium is paid late

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