# Law of Contracts

Modified Slides

# Chapter I: Introduction to Obligation

## Chapter Objectives

At the end of this chapter, you will be able to:

- ✓ *Define what obligation is*
- ✓ *Explain nature of obligation*
- ✓ *Identify sources of obligation*
- ✓ *Define what contract is*
- ✓ *Explain nature of contract*
- ✓ *Know types and importance of contract and contract law*
- ✓ *Describe historical development of contract law*

## Definition and Nature of Obligation

- In the modern legal systems and currently existing legal materials, there is no exact or single whole definition of obligation.
- Black's law dictionary defines obligation as 'a **legal or moral duty to do or not to do something'.**
- Common-law scholars such as Fredrick Pollock defines obligation in its popular sense as merely synonym for 'duty'.
- French judges define the term obligation as a legally binding relations to another party [where he/she] is obliged to give [or not to give] or to do or not to do something.
- Likewise the Ethiopian civil code, in the book IV of the code, uses the term obligations with out defining what it means.
- Obligations should be created by the competent parties with their express or implied consent; courts cannot create a contract for the parties.

# Sources of Obligation

- **In general, the fundamental sources of obligations can be classified into two:**
  1. ***Contractual sources of obligations and***
  2. ***Non-contractual sources of obligations***
- **While contractual sources of obligations arise from the terms of the contract, non-contractual sources, as the name itself implies, are obligations whose sources are other than contractual relationships.**
- In the Ethiopian legal system, even if there are no clearly stated classifications of sources of obligations, the close readings of the provisions of the civil code show that there are both contractual and non-contractual sources of obligations.
- In this regard, while Contractual obligations arise from Article 1675 of the civil code, non-contractual obligations arise from Arts. 2027-2178 of the same code
- **Non-contractual sources of obligations may, in turn, classified into three major categories which include:**
  - ***Obligations arising from tort (Arts. 2027- 2161 CC)***
  - ***Obligations arising from unjust enrichment (Arts. 2162-2178 CC) &***
  - ***Obligations arising from other laws***
- Obligation arising from the law is a unilateral obligation imposed on citizens or contracting parties without their consent. It includes among other things:
  - ✓ *Obligation to pay income taxes;*
  - ✓ *Obligation to render military services;*
  - ✓ *Obligations of creditors;*
  - ✓ *Obligation of debtors;*
  - ✓ *Obligations of families to their children, etc*

# Definition and Nature of Contract

- *Dear students, do you think we have a universal definition of contract? Why*

➢ Because various legal systems and countries fail to define it uniformly, there is no single and universal definition of the term 'contract'.

➢ However, owing to its nature, contract can be defined as **legally enforceable promise or agreement.**

- Contract is defined as legally enforceable promise or agreement because the breach of the promise or agreement gives rise to legal claim before a court of law.
- However, all promises or agreements are not enforceable. *Would you institute a legal action before a court of law if your friend fails to keep his promise of inviting you a tea?*

- Contract law is, in turn, defined as a law which governs such questions as which agreements the law will enforce?, what obligations are imposed by the agreement in question ? and what remedies are available if the obligations are not performed?

➢ More complete definition of contract is provided under **Article 1675** of the 1960 Ethiopian Civil Code which defines contract as:

***''An agreement whereby two or more persons as between themselves create, vary or extinguish obligation of proprietary nature''.***

➢ This definition contain so many points which worth separate analysis:

1) *" A contract is an agreement…."* similar with the general definition we analyzed above.
2) *"…whereby two or more persons…"* i.e. except in agency relationships(Art.2188), one cannot contract with oneself; there must be 2 or more persons to form a contract.
3) *"… as between themselves…"* i.e. except under Art. 1957 CC, the section on " promises and stipulations concerning third parties", the contracting persons can bind and entitle only themselves, not outsiders.

## Definition and Nature of Contract…ctd

4) "… create, vary or extinguish obligations…" powers of contracting parties … which makes the definition of contract more fitting and complete in Ethiopia.

5) "… obligations…" i.e. to mean contracts are legally enforceable obligations

6) "… of a proprietary( patrimonial ) nature.) This definition excludes contracts of "status", such as betrothal, marriage and adoption which creates obligations of status pre-defined by law of non-patrimonial nature.

## Types of Contract

- Based on the factors of classification (parties to the contract, the legal systems they operate in etc.), there are various types of contracts. Though they have certain overlapping features, some types of contracts include:
  1. Private vs Administrative Contracts
  2. Express versus Implied Contracts
  3. Solemn (Formal) versus Consensual (Informal) contracts
  4. Contract of Adhesion Versus Contract of Consultation (Freely Negotiated Contracts) and
  5. Bilateral vs Unilateral Contracts

❑ Just to address some of them:

- While private contracts is a contract between two or more private persons(whether natural or artificial), Administrative contract is a contract entered between Administrative agencies and private persons whose main aim is to maintain public interest (the common good).
- While express contract is the one whose terms of the agreement are fully and explicitly stated in words, either orally or in written form, implied contract is a contract created and defined by the conduct of the parties, rather than their words.
- While Solemn (formal) contracts are contracts that require a special form or method of creation (formation) to be enforceable or valid, consensual /informal/ contracts are contracts in which no special form is required to be enforceable or valid.
- While contract of adhesion is a type of contract written only by one party without negotiating with the other one (because the former has better bargaining power), Contract of Consultation (Freely Negotiated Contracts) as its name speaks is the contract negotiated b/n two equal parties with equal bargaining power.

## *Types of Contract…ctd*

- Conceptually, there is no difference b/n 4 & 5

## Importance of Contract and Contract Law

- **In general both helps to facilitate smooth business transaction(relationships) because contracts, *inter alia* :**
    1. are legally enforceable agreements or promises
    2. specify the rights and obligations of contracting parties
    3. are written documents that outline the full understanding of the business relationship and scope of the work. and
    4. minimize risks

## Historical Development of Contract Law

- The historical development of contract law can be traced back to ancient and classical Roman law.
- However, the foundation of the present day law of contract was laid in the 19th century, the historic period which saw rapid expansion of trade and industry which, in turn, made commercial disputes inevitable. Because of those Commercial disputes people turned to the court of law for solutions.
- Gradually, there developed a body of settled rules which was affected by the dominant economic philosophy, the so called the laissez-faire philosophy (individualism) or Market liberalism which propagates that states should not intervene in the functioning of markets and individuals should be free to determine their own destiny.
- The philosophy of laissez faire was mirrored in the law of contract by two assumptions:- freedom of contract and equality of bargaining power.
- But both freedom of contract and equality of bargaining power are proved to have their own limitations. Nowadays, the law limits freedom of contracts on the grounds of capacity, consent, object and the like.

## *Historical Development of Contract Law…ctd*

- Similarly, it was noticed that the theory of equality of bargaining power had brought certain unnecessary results because parties to a contract do not necessarily have equality. For example, employers and employees in the time of work and amount of wages etc, producers and consumers, lenders and borrowers do not have equal power in the negotiations.
- This all finally led to various dissatisfactions, riots & unrests which called for the intervention of the government to set minimum standards of enforceable contracts & this gave rise to modern contract laws in various corners of the world.

## Jurisdictions on Contract Law in Ethiopia

- **subject to material jurisdiction of the courts**, all courts in Ethiopia, both at federal and regional levels, have jurisdiction over contract matters
- Since Jurisdictional matters are the concern of procedural laws, students will have more detailed and clear picture of the matter when they take the courses.

# Chapter II: Formation of Contract

*Chapter objective*

- *The major objective of this chapter is to enable you describe and discuss elements of valid contract in general and under the Ethiopian legal system*

## Validity Requirements of Contract

- The state uses some yardsticks to check whether or not persons have made a contract. **They are called validity requirements or elements of a valid contract and contract is unthinkable without their fulfilment.**
- ***Dear students… can you mention the so called validity requirements or elements of a valid contract?***
- **The so called validity requirements or elements of a valid contract are:**
  1) ***Capacity;***
  2) ***Consent ;***
  3) ***Object and***
  4) ***Form, if any . Article 1678 CC***
- **While all contracts are expected to fulfill the requirements of capacity, consent and object, form is required only for few contracts . That is why it is phrased as 'form, if any'.**

## 1. Capacity

- *I hope you are familiar with the concept of capacity from your law of persons course. so, what is capacity? Is there distinction between capacity of natural persons and of artificial persons?*
- **In general, we can say capacity, in both cases, is the power to enter into legal transactions.**

## *Capacity…ctd*

- Regarding the capacity of natural persons, which is the concern of this course; **Minors, judicially interdicted persons (Insane & infirm) and legally interdicted persons** cannot enter into a contract.
- when a legally interdicted person enters into a contract which he was prohibited from, it is not limited to incapacity but also extends to illegality as per Art 1716.
- There are also some **special incapacities** such as **nationality and functions of persons** that prohibit the person from entering into a contract as provided under Art. 194 of the CC.

## 2. Consent

- Consent is a declaration of intention to be bound by an obligation. A person has to express his willingness (agreement) to create an obligation on himself, or give up some or all of his proprietary rights.
- **Consent is one of the defining features of individual autonomy and freedom of contract.**
- We cannot imagine a contract without the valid consent of the parties to the contract.
- as addressed in the opening of the 1st chapter too, **mere domestic or social agreements are not usually intended to be binding and, therefore, are not contracts.** This is because these agreements or promises are only moral agreements or promises which lack state backing for their enforcement .
- A binding contract, however, is usually in the nature of a commercial bargain, involving some exchange of goods or services for a price.
- **Consent in a contract is not about moral obligation; it is about legal obligation**. Here, for a contract to exist, parties must agree that any violation of the obligation would be punished by using state machinery.
- The phrases "…*consent sustainable at law* under Art.1678 (1) & *agrees to be bound thereby*…" under Art. 1679 imply the parties' intention to take any controversies, in relation to obligation, to court thereby allowing the court to interfere in their relation.

# Communication of Consent

- **Consent is expressed either in the form of offer or acceptance which are ways of communicating one's own intention to be bound by an obligation.**
- **Offer or acceptance is declared to another person by ordinary ways of communication which are:**
  1) ***Oral,***
  2) ***Written,***
  3) ***Signal and***
  4) ***Conduct***

## Offer and Declaration of Intention

- **Offer contains three important elements:**
  1) ***The content of the contract,***
  2) ***The agreement of an offeror to be bound and***
  3) ***Request of the offeror to the offeree to be bound by the offer.***
- **The offeror can make his offer in writing or orally, or by signs normally in use or by conduct (Art.1681 (1).**
- **The offeror has the autonomy not only to choose ways of the communications listed above but also to choose the ways that the offeree shall use to give a response (Art. 1681(2).**
- **Written declaration of offer is when all the elements of offer are reduced in writing on a paper or electronics and delivered to the offeree. For example, if the offeror sends his offer through letter, email or fax such is written communication of an offer.**

# Offer and Declaration of Intention…ctd

- **Oral communication of an offer is when the offeror uses his voice to tell to the offeree the contents of the offer and the offeree uses hearing (ears) to know what the offeror is communicating to him.**
- **Besides the face to face communication, using telephone, telegram e.t.c to communicate an offer is oral communication of an offer.**
- **Signal communication is of two types: gesture and object placed to give information (indicate intention to be bound). Mute and/or deaf people use such way of communication either to make or accept offer.**
- **Moreover, raising hand at auction to accept the offer, *nodding head*, *shaking hands and hammering down in an auction sale* are also examples of communication by gesture.**
- **Communication of offer by conduct is when the offeror performs partly or wholly the obligation that he will perform if the contract is entered into.**
- **Offer by conduct is an implied offer because the offeree is forced to infer the offer from the conduct of the offeror. If a father calls a doctor to see his minor child for some infection, the doctor infers that the father is the one who pays him .**
- **Offer is different from declaration of intention. In principle, an offer is binding on the offeror only if it is addressed to a specified person. In short, while offer addresses an identified person or beneficiary, declaration of intention does not.**
- **The ultimate goal of the declaration of intention is advertisement of a product or service without any intention to be bound by the content of the advertisement.**
- **The person declaring his intention can change his declaration at any time for whatsoever reason without any legal liability for unreasonable and arbitrary change of his intention.**

## *Offer and Declaration of Intention…ctd*

❖ **Articles 1687 & 1688 of the CC provide examples of declaration of intention. These are:**

1) **Sending price lists or tariffs ;**
2) **Posting up price list/tariff and catalogue in a public place ;**
3) **Display of goods for sale to the public and**
4) **Sale by Auction (until the winner signs a valid contract)**

❖ **All of the above instances are declarations of intention, not offer because:**

i. ***They do not address a particular person(beneficiary)***
ii. ***They are not binding***
iii. ***They do not indicate all terms of the contract such as due date, place of performance, quantity, etc & thus incomplete.***
iv. ***There would be multiple acceptances if the declaration of intention is to be considered as an offer.***

➢ **But, exceptionally, as per Art. 1689 CC, public promise of reward is a special and binding offer.**

➢ **Public promise of reward is notifying the public that whosoever performs a certain act indicated in the notice will be given benefit of proprietary nature by the promisor.**

➢ **Public promise of reward can be accepted by conduct.**

➢ **Public promise of reward can be published by posters or by any other means such as news papers or radio or Television etc.**

## *Offer and Declaration of Intention…ctd*

- **Some scholars argued that Public promise of reward does not include simple oral announcements even if made at public meetings. But some others argued against this very argument/view.**
- **Public promise of reward is a true offer. It cannot be withdrawn; and binds the offeror within the stipulated delay of Article 1690(1) or the reasonable delay of article 1691(1).**
- **What happen if the promise is performed by more than one person? In such case the promiser may reward in one of the following options:**
    1. ***to the first in time, or***
    2. ***to all in equal shares, or***
    3. ***fully to each.***
- **Acceptance of Public promise of reward is a complete contract.**

## Effects of Offer (Art.1690, 1691, 1693(1), 2055)

- Unlike the declaration of intention where the person declaring his intention can change his declaration at any time for whatsoever reason without any legal liability for unreasonable and arbitrary change of his intention, **the offeror cannot change his offer for unjustified reasons once he sent his offer to the offeree. In short, offer legally binds the offeror.**
- Once the offer is made, it means that one side of the parties to the contract (the offeror) has agreed to be bound by his/her offer. **Therefore, an offeror who changes his offer partially or totally is liable for any material damage sustained by the offeree.**

## *Effects of Offer…ctd*

- *Dear students…When does offer begin to be binding? Is it exactly at the time when the offeror sends his offer to the offeree or at the time the offeree knows and accepts the contents of the offer?*

❖ **An offer begins to be binding at the time the offeree accepts and takes decision that affects his material interest .**

❖ **However, if the offeror withdraws his offer after he has sent to the offeree, he should immediately inform the withdrawal of the offer to the offeree before he receives the offer or at least before the offeree takes decision that affects his material interest on the assumption of the offer. In such case, the law presumes the offer is not made (Art 1693).**

❖ **This means an offer may be withdrawn or modified as far as the offeree has not incurred expenses with a view to concluding a contract with the offeror. So, what is crucial is not the time when the offeree received the offer but the decision he has taken due to his knowledge of the offer.**

❖ The burden of proving that the offer is changed or withdrawn after he takes decision that affects his material interest is on the offeree.

❑ **As per Article 2055 of the civil code, changing/withdrawing an offer is a fault. However, change or withdrawal of an offer is not a fault when it is withdrawn or changed:**

i. ***before the offeree knows the offer or***
ii. ***at the time the offeree know the offer or***
iii. ***at any time before acceptance for justified reason***

- ***What about after acceptance but before the offeree takes a decision that affects his material interest?***
- ***How Long should the Offeror bound by his offer or how long should he wait for acceptance ?***

## *Effects of Offer…ctd*

- **The offeror may himself determine how long the offer remains binding.** However, after expiry of such time limit, the offeror can change, modify or withdraw his offer for whatsoever reason and without any liability to the offeree **(Art 1690).**

- ***What if the offeror fails to fix time limit for acceptance?*** **In case the offeror fails to fix time limit for acceptance, the offer remains binding for reasonable period (Art 1691).**

- Reasonable period indicates the time that the offeree needs to understand the offer and decide to accept or reject it. So, if the offeree remains or unable to decide within such reasonable time, the offeror will no longer be bound by his offer.

- ***But another important question is that how long is a reasonable period?*** **The length of reasonable period is the average time that the average person may need to determine on the offer.**

- **The length of reasonable period does not tolerate subjective weaknesses of the offeree b/c contract is not a charity and the offeror is running for gain and has no legal or moral obligation to sacrify for such weaknesses.**

- However, **objective criteria** such as **price fluctuation**, **market in/stability**, and **complication of content of the contract** should be taken into account to determine the length of **reasonable period** .

- Market and price have direct relation because market instability results in price fluctuation thereby affecting the decision of both the offeror & offeree. So, when there is market instability reasonable period should depend on the frequency of price change.

- **If the acceptance reaches the offeror after expiry of reasonable period, the offeror has a duty to inform the offeree the lateness of the acceptance by using the speediest medium of communication available.** Such medium should at least be as speedy as the medium used by offeree to send his acceptance.

## *Effects of Offer…ctd*

- **If the offeror fails to reject the acceptance immediately, the offeree has the right to claim that the acceptance was given within reasonable period and hence contract was concluded (Art 1691(2).**
- **The other ground that terminates the effect of an offer is the offeree's rejection of the offer (Art 1690(2).** **Rejection of an offer is, either making modification to the content of the offer or sending a "no" answer to the offeror.**
- **Offer is deemed to be rejected "where acceptance is made with reservation or does not exactly conform to the term of acceptance" (Art 1694).**
- **There is no reason for the offeror to wait for an expiry of reasonable period once the offeree rejects the offer.**
- Rejection releases the offeror because there is no justification for the offeree to get time to revoke his rejection and claim to accept the offer simply because the objective reasonable time has not yet expired. Moreover, there is a less possibility that an offeree who once rejected an offer could come to accept the same and forcing the offeror to wait such change of mind is fooling him and inequitable.

## Acceptance (Art 1681-1685, 1689(1), 1694) (1893(3)

- Acceptance is a positive response to an offer. In other words, **it is a declaration of intention to be bound by each and every contents of an offer.**
- Acceptance **is declaring agreement** which presupposes knowledge of the obligation for which the agreement is given.
- However; if the offer is **public promise of reward** the offeree is not known to the offeror; hence whosever performs the promise is considered as if he **accept by conduct.**

## *Acceptance…ctd*

❖ **Any slightest modification made to the content of the offer is considered as rejecting the offer and making, an alternative offer (Art.1694).**

- **On receiving an offer, the offeree has three alternative answers to an offer;**

1. **The "Yes" answer which means accepting the offer as it was made; without any modification or reservation,**
2. **The "No" answer which means totally rejecting the offer or**
3. **"Acceptance with reservation" which means having reservation** or alternative proposals for some of the contents of the offer.

- **Where acceptance is made with reservation or does not exactly conform to the terms of the offer" the offeree takes the position of the offeror and the offeror then becomes an offeree (Art. 1694).**
- **In such case, the [former] offeree (the current offeror) is bound by the new offer he makes until the time limit he fixes or the reasonable time for acceptance expires as per Art. 1690(1)& Art.1691(1) CC respectively.**

## How acceptance is Made

- Since acceptance is communication of intention, like an offer, it can be made **in all possible ways of communication (i.e. it can be made in writing or orally or by signs normally in use or by conduct).**
- **However, if a special form is prescribed by the offeror, the offeree should accept the offer only in the special form prescribed by the offeror (Art. 1681(2)). E.g. if the offer prescribes acceptance should be in writing/letter, even immediate telephone acceptance is of no effect.**

## *Acceptance…ctd*

## Silence where an offer is made

- If he/she is not willing to accept the offer, the offeree does not have a duty to give response to the proposal of the offeror. In such case his/her **silence should not be considered as acceptance** pursuant to **Art. 1682** of the CC which provides this principle.
- **Silence, in this context, means not answering to the offer in one of ways of communications addressed.**
- **Silence is not acceptance because there is no consent in silence.**

**Exceptions (Art. 1682 -1685)**

- The principle that silence is not acceptance has some exceptions . In general, **the exceptions emanate from the law or contract. In such cases, the offeror shall not wait for the acceptance of the offer by the offeree. See Art. 1683(1)CC.**
- The law or contract may impose on the offeree the obligation to accept offers made to it. This is mainly **when the offeree is a Public Enterprise** which provides:
  1. ***Vital services to the community, such as postal and telegraphic transmissions, telephone services, public transport etc… or***
  2. ***Vital supplies to the community, such as supplies of light, water etc…***
- Moreover, no acceptance shall be required where a party is bound by a concession granted by the authorities to enter into a contract on terms stipulated in advance.
- Terms stipulated in advance are terms which usually fix the scale of prices to be charged and the limitations on the undertaking's liability for non performance.

## Exceptions…ctd

- Pursuant to **Art. 1683(2)** of the CC, since no acceptance is required from the offeree (such undertakings), the receipt of offer makes the contract, which exists from that time onwards. In other words, **the offer alone creates the contract and makes it enforceable by the offeror against the offeree.**
- *For example, Ethiopian Electric Power Corporation, Ethiopian Telecommunications Corporation, Water & Sewerage Authorities are expected to accept offer for electric use, telephone line and pipe line. They cannot reject the offer from the public except on rare and justified grounds. In such cases, to avoid the presumption of silence, they have to respond per Arts. 1690(1) or 1691(1).*
- The writer of the teaching material argues against the literal meaning of Art. 1683 which can be interpreted as once offer is made, acceptance is automatic and the offeror can claim performance of the contract by the offeree.
- He argues this interpretation is illogical because:

1. **The offeree's consent is absent**;
2. **The offeree may lack resource to accept the contract;**
3. **The offeree may have legal or contractual or legal authority to stream line offerors i.e. duty to prioritise some groups, e.g. investors;**
4. **The offeree can refuse to perform his contractual or legal obligation ? [Without justified reasons????]**

- ***Based on these justifications, the writer, even recommends for the amendment of the provision as:***

***Where an offeree has legal or contractual duty to accept an offer, the offer shall be deemed to have been accepted unless the offeree rejects the offer with in time specified in the offer or where no time is specified within reasonable period.***

# Preexisting business relations

- In addition to the cases of public undertakings and concession contracts, **silence amounts to acceptance in preexisting business relations. However,** in p**reexisting business relations, offer is said to be accepted by silence when it:**
  - ***i. is to vary, supplement or complement preexisting contractual relation ;***
  - ***ii. is made in writing;***
  - ***iii. is written on special document and***
  - ***iv. contains warning that silence amounts to acceptance.***

**I. to vary, supplement or complement preexisting contractual relation**

- **Variation of a contract means changing, modifying or avoiding some of the provisions of the contract.** ***For example, in a sale contract, the buyer may offer to change the delivery date.***
- **Supplementary or subsidiary contract is a contract that may exist independently but that help to facilitate the implementation of preexisting contract.** Examples include:-
  - ✓ *you bought goods and the seller offers you to provide transport service;*
  - ✓ *Photocopier proposes to bind the paper s/he has photocopied;*
  - ✓ *a contractor who builds the house proposes to construct a fence for the same building.*

**II. The offer should be made in writing**

- In principle, offer can be made orally, in writing, by signs normally in use or conduct depending on the preference of the offeror. **But silence [by the offeree] can be interpreted as acceptance only if the offeror uses written form of communication that is addressed directly to the offeree (Art 1684(2).**

## III. The offer should be written on special document (Art 1684 (2)

- **The document that contains the offer should contain nothing else than the offer**. E.g. offer written on the back of an invoice should not be deemed to have been accepted by silence (Art.1685). **Moreover, offer should be written on a paper; E-mail is not a document.**

## IV. warning indicating that silence amounts to acceptance

- **The offeror should also expressly indicate in his offer that he considers the silence of the offeree as acceptance after expiry of time limit indicated in the offer (Art. 1690(1)) or reasonable period (Art.1691 (1) (Art 1684 (2)**

## Effect of Acceptance

- In general, it can be inferred from Art 1679 and 1693(2) that **once an offer is accepted, the offeree is bound by his word**.
- Acceptance begins to produce effect from the moment the offeree sends it to the offeror provided that it reaches the offeror within time specified under Art. 1690(1) or 1691(2)
- **The offeree may abort the contract by withdrawing his acceptance (Art.1693 (2). He can freely withdraw his acceptance before the offeror knows such acceptance or regardless of his/her knowledge.**

## General Terms of Business

- No party is bound by general terms of business which he did not agree to be bound with **(Art 1685);** *any annexes to main contract never bind a party who has not known its content and not agreed to be bound.*

# Negotiation vs. Consent (Art.1695)

- **Negotiation is a discussion made between parties intending to shape the content of a would be contract.**
- **Any proposal made during negotiation is not binding on the party making the proposal i.e. a party may withdraw from the negotiation at any time (Art 1695 (1).**
- ***However; if the negotiation is completed (content of the contract is determined) and both parties agree to be bound by the negotiation, then it ends up becoming a contract (Art 1695 (1).***
- **In negotiation, it is very difficult to know the party who made an offer. However; we may take as an offeror the party who proposes the content of the contract last.**
- In negotiation, parties need not reach agreement on all contents of the contract. They may expressly agree to be bound by contents of the negotiation thereby leaving detail to be completed by the law (Art 1695 (2).

# Defect in Consent and Available Remedies (Art 1696 – 1710)

- **If the consent expressed in the form of offer and acceptance does not indicate what the offeree or the offeror really intended, then, there exists defect in consent.**
- **The common causes of defect in consent are:**
  1) ***Wrong information*** *w/c comprises mistake, false statement and fraud;*
  2) ***Threat*** *w/c comprises duress, reverential fear, threat to exercise a right &*
  3) ***Lesion.***

## *Defect in Consent and Available Remedies…ctd*

- **The existence of defect in consent may be a cause for invalidation of contract per Art. 1696. However, it should be noted that there are cases where defect in consent does not necessarily lead to the invalidation of contract. These cases are :**
  - ✓ ***When a party who agreed to be bound because of defective consent fails to demand the invalidation per Art. 1808. and***
  - ✓ ***in those cases provided under Arts.1708, 1709, and 1710.***

## 1. Defect of Consent due to Wrong Information

- Mistake, fraud, and false statements may lead an offeror or offeree to have a wrong knowledge about the content of the contract **i.e. a person is passing a decision to be bound on the basis of wrong information**.

### I. Mistake (Art 1696- 1703)

- **is a false belief**, a belief in something which is untrue.
- **is when a party makes misunderstanding on the content of the contract or on the identity of the other contracting party.**
- **The person might have committed such misunderstanding either because of his own poor inference from given facts or false statement or deceitful practice of others person.**
  - *E.g. a buyer purchased a bracelet believing that it is pure gold and latter on found out that it is silver mixed. A seller says nothing to the buyer about the quality of the bracelet.*

*Defect of Consent due to Wrong Information...ctd*

- As per Arts. 1697& 1698, **one can invalidate or avoid his obligation on the basis of mistake if the following two conditions are cumulatively fulfilled**. These are:
  - **A. Mistake must be fundamental (Art 1698) and**
  - **B. Mistake must be decisive. (Art 1697)**

## A. Mistake must be fundamental (Art 1698)

- **A mistake is said to be fundamental when a person misunderstands the object or nature of the contract or identity of the contracting party (the person with whom he has entered into the contract).**
- **The 'element of the contract** which the parties deem to be fundamental' is the object (**rights & duties of parties to the contract)**; It does not mean the elements of a contract provided under Art. 1678 (consent, capacity, object and form ).
- **Mistake in the object of the contract** is not limited only to the **obligations** of the parties to the contract but also includes characteristics such as **size, quality** and **type** of the subject of the contract.
- **Nature of contract refers to types of contract.**
- ***Example of mistake in the nature of the contract is if a person who intended sale contract enters into donation contract etc.***
- ***Example of mistake in the object of the contract is when some one buys a television produced by china believing that it is Japan's product.***
- ***Example of mistake in the identity of the other contracting party is when the person concludes a contract with "B" believing that he is "A". B and A could be twins, supply similar product etc.***

## *Mistake must be fundamental …ctd*

- **The law also attempts to indicate what "fundamental mistake" means by telling us non fundamental mistake (Art. 1701)**. Mistake of the motive of a party or arithmetic mistake are non-fundamental.
- **Arithmetical mistake is taken as non- fundamental mistake because it can be easily corrected (Art 1701(2). This happens when both parties accept the arithmetic mistake. But if the arithmetic mistake is claimed by one party only, it may be fundamental mistake.**
- **Arithmetic error is all about clerical error or a slip of the pen; that is why it is said non- true mistake.**
- *Example of arithmetic mistake is when "A" signs a check believing that s/he orders a payment of 50,000 birr although the check indicated birr 500,000 which the payee read and accepted. In this case, the payee accepted the check believing that it carried an order of 500,000 birr but "A" believed it to be 50,000 birr.*
- **A mistake is arithmetic when amounts, numbers or even provisions are missed or improperly typed due to clerical error regardless of the common intention of the parties expressed in the form of offer and acceptance.**
- Generally, **arithmetic mistake is is editorial error** and may also be applied to any other editorial error such as missing of provisions that indicate rights and obligation of the parties. e.g. in a contract of sale, the phrase dealing with place of delivery is missed although the parties consented that it is in Addis Ababa.

## Mistake must be decisive. (Art 1697)

- **The mistake is decisive when the mistaken party proves that a rational person in his position would not have entered into such contract had it not been for the mistake (Art 1697).**
- **The decisiveness of the mistake should be determined by court taking into account the surrounding circumstances and subjective conditions of the mistaken party.**

## *Mistake must be decisive…ctd*

- **The criteria that are going to used by courts for the decisiveness of a mistake are subjective (Arts. 1697 & 1699).**
- The purpose of considering the subjective criteria is searching the intention of the mistaken party since contract is binding only when the person knows his rights and obligation and agrees to be bound. However, ***knowing intention of such mistaken party is possible only by putting oneself in his position i.e. 'what would I do as a rational person, had I been in his condition'.***

## Good Faith of Mistaken Party (Art.1702)

- The mistaken party must be in a good faith to be out of the contract concluded in such mistake.

## Reparation (Art.1703)

- **Invalidation of contract on ground of mistake entails payment of damages (compensation) by mistaken party to the other party. However, a mistaken party can escape such liability only if he proves that the other party knew or should have known such mistake (Art. 1703)**

## II. Fraud (Art 1704)

- **Is another category of wrong information which causes defect in consent.**
- **Fraud is an intentional act of preparing false or wrong information or changing or modifying the content of the subject matter of the contract in a manner that cannot be noticed by ordinary observation.**
- **Fraud is a mistake provoked by deceit or cheating.**
- **It is making things or documents to give wrong information.**

## *Fraud…ctd*

- **Fraud is a deceitful practice which may be accompanied by false statement, though false statement by itself, is not a fraud.**
- ***Examples of fraud common in our country include; The practice of mixing up banana with butter, red ash with pepper, milk with water, sugar with honey and so on.***

❑ **Fraud can have three fold aspect/effects:**

1. *A contract aspect, leading to invalidation;*
2. *A tort aspect, leading to damages and*
3. *Criminal aspect, leading to punishment.*

- Sub-article 2 of Art. 1704 provides that "a contracting party who has been deceived by a third party shall be bound by the contract unless the other contracting a party knew or should have known of the fraud on the making of the contract and took advantage thereof". *E.g. A, the employer wants to employ a qualified employee for some position in his company. B is a recent college graduate who is not well qualified for the position A is seeking to employ. If C who is a broker deceived A that B is qualified for the position and A employs B believing B is qualified, A cannot terminate contract of B but can institute court action against C provided that B has no knowledge about the fraud.*
- N.B A party who is unable to prove Art.1704 [fraud] may resort to proving existence of mistake although practically proving mistake is more stringent than fraud.

## III. False statement (Art 1705)

- **False statement is untrue statement made either intentionally or negligently.**
- **Misleading conducts (manners) or silence may also amount to false statement. Art 1705(2)**

## *False statement…ctd*

- **<u>In principle</u>, pursuant to Art 1705(1), even if it is made in bad faith and negligently, telling a false statement cannot lead to invalidation of contract. <u>It is what we may expect in free market economic system</u>. For example, the seller told the buyer that the product will serve for 5 years but it actually served only for 2 years.**
- **<u>Exceptionally, however</u>, false statement can be a ground for invalidation of contract where:**
  - ***A. There is a special relationship between the liar contracting party and the mistaken party and***
  - ***B. Such special relationship led the mistaken party to believe the statements of the other party.***

## A. <u>Special relationship between the liar contracting party and the mistaken party</u>

- Here, the special relation should be a **legally recognized relation which creates duty to trust one another**. **The duty to trust one another may be either legal or moral.**
- The verb "existed" in the past tense under sub-Article one of the provision at hand shows that the relationship must exist prior to the challenged contract and not created by it.
- ***Examples of legally recognized special relationships are husband-wife, doctor-patient, lawyer-client citizen-government, confessor-penitent, employer-employee relationships and the like.***

## B) Such special relationship led the mistaken party to believe the statements of the other party

- False statement or silence can be a ground for the invalidation of the contract in such relation only if it is made by the party to the contract, not by third party to the contract.
- Moreover, supplying false information have tort aspect which may lead to damages. (Art. 2059(1))

# 2. Defect in Consent due to Threat (Art.1706-1709)

- **A person may be threatened either physically or psychologically to make an offer or to accept an offer made to him.**
- In such case, the person is declaring his intention to be bound **as an alternative means of avoiding the effect of the threat.**
- In principle, parties enter into a contract for purpose of deriving economic benefit but **in case of threat, both or at least one of the party is entering into a contract to avoid a possible risk that has been directed against him, his relative or his property interest.**
- **So, had it not been for the threat, the person would not have declared to be bound i.e. intention to be bound is lacking.**
- **As highlighted in the opening, defect in consent due to threat includes:**
  - **I. Duress;**
  - **II. A threat to Exercise a Right and**
  - **III. Reverential fear.**

## I. Duress (Art.1706 & 1707)

- "Duress" is **the compelling of a party to consent to a contract by threats of grave and imminent harm to such party or his ascendants, descendants or spouse.**

## *Duress…ctd*

- **One can raise duress as a cause of invalidation of contract if the following conditions are <u>cumulatively</u> fulfilled:**

**A. <u>There is a threat or warning to cause harm</u>.**

- **The person must be <u>told expressly</u> that he has to choose either suffering from the harm or entering into a contract. In other words, <u>he should not infer the threat</u> <u>of harm from the behavior or identity of the parties.</u>**
- *For example, if some gangsters come to a home of certain rich man and remained in seat for an hour without giving any instruction to him he cannot claim duress if he writes them a check of 500,000 birr and made them to leave his house.*

**B. <u>The harm is on the person himself or his/her spouse or his/her ascendants or descendants</u>**

**NB:- The law limited the threat only to the above mentioned family members. So, this means one cannot invoke for the invalidation of contract made on ground of duress directed against his/her collaterals such as brothers, sisters, aunts, uncles and the like. *How do you See this provision??? Don't you think the latter family members should be included in the provision?***

**C. *<u>The harm is on person, life, property, and honor</u>*.**

- **<u>Harm on person</u>** is when the threat is to cause **bodily damage** to any of the above stated persons.
- **<u>Harm to a life</u>** is when the **threat is to kill** any of the above stated persons.
- **<u>Harm to honor</u>** is when the threat is to commit a certain act that negatively affects the **reputation or public image of any of the above listed persons** i.e. threatening to release information which the threatened person

## *Duress…ctd*

- **Harm to property** is when **threat is to destroy certain property. In other words , the person is threatened either to enter into a contract or he is going lose certain property.**

### D. The party believes that the harm will happen if he does not consent to the contract

- **The existence or non existence of** duress depends on the subjective mentality of a party. Therefore; **it is enough if the threat is apparent to a party, although there was no real threat**. ***For example, the fact that the pistol used to threaten a party was artificial does not matter; it is enough if he believed that the pistol was the true one.***

### E. The threat should be serious: -

- **The threat is said to be serious when the harm to be caused is greater than the obligation that a party enters into. *E.g. a simple warning that s/he would face a kiss on the lip or a slap on the face and the like if s/he is not consenting is not a serious threat.***

### F. The harm must be imminent:-

- **Here, the harm is going to happen soon; A party does not have time to think of another option to avoid the happening of the harm except by consenting to the contract.**
- **The person or property threatened should be under the control of the threatening party and the threatening party will cause the damage at the moment a party refuses to consent.**
  - ***Example of imminent harm is If Shibbiru and Ashebir kidnapped Abel's daughter, and made a telephone call to him that he either bring half million birr to the place where his daughter is detained within few minutes without reporting the fact to the police or they will rape his daughter***
  - ***Example of non-imminent harm is if a bank manager receives a letter warning him to sign a check of 1,000,000 birr for a burglar within a weak or he would suffer the consequence.***

## *Duress…ctd*

### G. The threat must impress a reasonable person:-

- **The law does not expect a citizen to be a hero who can have courage to resist any threat. It, however, does not want us to be cowardice. A citizen should have some courage to resist some threats.**
- **The law punishes cowardice by denying the opportunity to invalidate contracts if the threat was such that any ordinary person would have resisted it.**
- *For example, the law does not accept a healthy man of 35 to claim that he was threatened by a young girl of 12. Of course, here one may raise the weapon with which he/she is threatened*
- **In determining the cowardliness, the court should take into account the health, sex, age and position of the person threatened and threatening. Normally, males may be expected to defend themselves better than women. Adults are also expected to defend themselves better than minors.**
- Moreover; health, education and other psychological factors are also important to determine whether or not the person was cowardice or had reason for failure to resist the threat.

### Duress by third Party (Art.1707)

- **The threatened party can claim the invalidation of contract whether he is threatened by the other party to the contract or by a third party to the contract. (Art 1707 (1).** Thus, duress by anybody is a ground for the invalidation of a contract. This is justified on the ground that duress is dangerous to the social order.
- **Moreover; the other party cannot raise his unawareness of the duress as a justification to avoid invalidation. Such justification may, however; be a ground to claim damage from a party who got the contract invalidated (Art 1707 (2).**
- *E.g. if X threatened Y to make an offer to Z and Z accepts such offer being unaware that Y was threatened by X to make such offer, upon invalidation of the contract, Z may claim damage caused to him due to such invalidation.*

# II. A Threat to Exercise a Right (Art 1708)

- Unlike duress where physical violence is used as a means to compel a person to enter into contract, **a threat to exercise a right is when right is used as a means to compel a person to enter into a contract** i.e. a person is made to choose either to perform/undergo certain legal obligation or to enter into a contract.
- *E.g. "A" the owner and "B" the Architect entered into construction contract for residential house. The terms of the contract provides that "B" should complete the house within a year for otherwise he will pay 200,000 Birr as a penalty and the contract may be cancelled. "B" failed to accomplish the house within the agreed time and "A" warns him to build a fence (which is not part of the original contract) for otherwise he is using his right of claiming 200,000 Birr and cancellation of the contract. "B" builds a fence being threatened "A" is going to exercise his right as provided in the original contract.*
- **As per Art. 1708, a threat to exercise a right shall be no ground for invalidating a contract unless such threat was used with a view to obtaining an excessive advantage.**
- **However, if threat was used with a view to obtaining an excessive advantage i.e. an advantage which exceeds the weight of the right threatened with, it could be a ground for invalidating a contract.**
- Obtaining an advantage which exceeds the weight of the right threatened with is an abuse of right and amounts to duress which is, thus, open to invalidation.
- **However; the threat to exercise a right may be directed against the person from whom the threatening person does not have any right.** E.g. a threat to exercise a right may be directed against the father for the wrong done by his son or against the mother for the wrong done by her minor daughter etc. The father or mother enters into the contract to protect his/her son and daughter respectively.

# III. Reverential fear(Art. 1709)

- Reverential fear, as provided under the provision, **is fear of an ascendant or a superior.**
- **Reverential fear is a psychological threat. The threatening person is playing against the psychological (mental) feeling of the threatened person. It is a psychological intimidation that if the person does not give his consent to be bound by the contract he will be belittled by some one or the public in general. It is, in short, the fear of opinions.**
- Reverential fear **is also called undue influence (see Art. 868 of the civil code).**
- However; the mere existence of reverential fear of ascendant or superior is not enough to invalidate the contract. The reverential fear must make the person to lose certain advantages i.e. his bargaining power was reduced; he was not free to bargain properly so that the other contracting party get **excessive advantage** from the contract.
- **Even if a person enters into a contract which he did not want, he must prove financial loss to invalidate contract on the basis of reverential fear.**
- **What should be proved is not only the financial loss but also the fact that the financial loss has gone to the benefit of the person who is the source of reverential fear.**
- **In short, only contracts entered into with superior/ascendant can be invalidated on basis of reverential fear provided such ascendants/superior derived excessive advantage. Whether the advantage is excessive or not should be determined case by case by taking into account the economic position of both parties.**
- **Reverential fear is presumed. The fact that superior/ascendant made an offer is enough to prove the existence of undue influence. The offeree should be presumed that he entered into such substantially disadvantageous contract because of reverential fear. However; the superior/ascendant can disprove such presumption by any means.**

# 3. Defect in Consent due to Lesion/Unconscionable Contract (Art 1710)

- **Lesion or unconscionable contract is a type of contract which substantially favors only one party to a contract. Art 1710(1)**
- **In the free market economy, contracting parties are presumed equal. Moreover, Security of trade would be endangered if it is allowed to invalidate a contract merely because it is much more profitable for one party than for the other.**
- **Gratuitous contracts do not fall under the operation of sub-article 1 of Article 1710. This is because, there is no point in assessing the mutual advantage in gratuitous contracts w/c are precisely intended to be in favor of only one party. The law on donations addresses this point. Art. 2439**
- **Nevertheless, equality of contracting parties may be affected by individual want, simplicity of mind and business inexperience thereby giving the other party the opportunity to exploit such weakness. It is, thus, in such cases that the party who has given defective consent can claim the invalidation of the contract. Art 1710 (2)**
- "where justice requires" under **sub-article 2 of Article 1710**, means that the court is free to refuse this remedy (i.e. invalidation of the contract on grounds of equity). E.g. when the victim is rich and the transaction is insignificant.
- **The term "want" can be understood to cover cases of destitution or states of distress or necessity**. *E,g. if a woman agrees to pay whatever amount of money to certain rescuing group so that the group rescue her daughter from some other mafia group who detained her daughter and the rescuing group claimed 2,000,000$ after rescuing her daughter, there is no duress against the woman by the rescuing group but she is in distress/they are using her want.*

## *Defect in Consent due to Lesion/Unconscionable Contract…ctd*

- **Simplicity of mind is a kind of mental limitation which impairs the victim's judgment. It may results from illiteracy.**
- **Senility is general incapacity which may result from old age.**
- **But we should bear in mind that <u>all old people are not senile</u> and then generally incapable for there are even some old people who are wiser than the young people. The point is that there could be <u>some</u> old people with reduced consciousness and it is a contract entered with such old people which may be invalidated on the ground of senility.**
- **Business inexperience implies lack of familiarity with business transactions. Professional merchants cannot invoke this ground of contract invalidation but it can be invoked by non-merchants. Illiteracy and general lack of instruction may often amount to business inexperience.**
- **Simplicity of mind and business inexperience may overlap some times.** *E.g. A country side girl who over paid for a necklace, can claim the invalidation of the contract. i.e. she can invoke both the simplicity of her mind and business inexperience.*

## 3. Objects of Contracts (Art 1711-1718)

❖ Like capacity and consent, object is another crucial validity requirement of a contract.

### I. Definition

- What does the term "object" mean?

❖ **The objects of a contract are obligations to perform something**. *E.g. If "A" is a car seller and "B" is buyer, it is the obligation of "A" to show the car to "B" and it is, in turn, the obligation of "B" to pay.* **Strictly speaking, in the above sale contract, the object of the contract is the car**.

## *Objects of Contracts…ctd*

- **Broadly speaking, object of the contract is an obligation or agreement of parties to do something (obligation to act) or to refrain from doing something (obligation not to act) or obligation to give something to someone.**

❖ As we shall see ahead, lack of object makes a contract non-existent or null and void from the very beginning.

❖ As provided under **Article 1678c, an object of a contact should be sufficiently defined, and is possible and is lawful and moral**.

❖ **When it is said that object should be defined, it is to mean that obligations of the parties or of one of them should be ascertained with sufficient precision. Art. 1714(1).**

- ✓ *For example, the object of employment contract is the employers' agreement to pay wage and employees' agreement to do certain thing.*
- ✓ *In the same fashion, In contract of sale of house; the obligation of the seller is to transfer ownership and possession to the buyer and the obligation of the buyer is to pay price.*

## Freedom of Contract

➢ **As per Art 1679, <u>parties are the ones who define the content of their contract.</u> They are free to determine:**

- ✓ *what to perform,*
- ✓ *where to perform (place of performance)*
- ✓ *when to perform (time of performance)*
- ✓ *How to perform (manner of performance) and*
- ✓ *penalty for non performance*.

➢ **They are free to enter into any type of obligation, obligation to do "not to do" or "to give" (Art 1712(1).**

## ***Freedom of Contract*** *...ctd*

- **However; parties may fail to specify all the possible contents of the contract. In such cases and when dispute arises, courts could refer to good faith, equity, custom and law for matters that are not clearly settled in the contract.**
- **In order to settle disputes, courts should first refer to contractual provisions and if they are found to be insufficient, then to legal provisions and if still the matter is not resolved, to customs and at the end good faith and equity be applied.**
- **However; law, custom, equity and good faith merely supplements the contract. If there is no contract (main obligation), they cannot by themselves create contract (Art 1704 (1). *In other words, the object of the contract should be understood by referring to the contract itself without referring to law custom, equity or good faith***
- **That is why (Art 1714(2) provides that "the court may not make a contract for the parties under the guise of interpretation."**
- **So, a contract is interpreted only if it is sufficiently clear, at least on the main object, so that such sufficiency be completed.** For example, in a sale contract, the court should at least know obligation of a seller and then it can refer to the law to determine its price (See Art 2305-2307).

## Limitations to Freedom of Contract

- Parties' freedom of contract is not absolute (Art 1711). It is limited for the following major reasons. **Absolute freedom of one may violate the rights of others**. Moreover, **to attain social justice, peace and tranquility and public morality**; it is necessary to limit freedom of contract.
- **Under Ethiopian law; freedom of contract is limited depending on:**
  - **I. Clarity of the object** (Art 1714),
  - **II. Possibility of the object** (Art 1715),
  - **III. Legality of the object** (Art 1716(1) and
  - **IV. Morality of the Object** (Art.1716 (1)

# I. Clarity of the object (Art 1714):

- The object of a contract should be sufficiently clear; otherwise the court concludes as though parties did not exercise freedom of contract.
- **Where a Party's obligations cannot be sufficiently ascertained, the object is not defined and there is no contract at all.**

## II. Possibility of the object (Art 1715):

- The object of a contract or contractual obligations must be **humanly possible to perform. Parties' freedom does not allow them to bind themselves to perform humanly impossible things.**
- **Impossible obligation is the obligation whose performance is beyond the nature of human being. Impossible obligation is not an obligation.** *E.g. If "x" agrees to sell a dead sheep to "Y" the sale is void as the object of the contract is an impossible object.*
- **Moreover, the law wants to protect the public from some superstitious believes.** *For example, if a person agrees to raise a dead body; to duplicate money by mystery, to bring audio visual image of dead body; to make a person very rich etc the object of the contract is impossible.*

## III. Legality of the object (Art 1716(1):

- **The object of a contract should not violate any law of the country (The Constitution, International Treaties and Subordinate laws)** for otherwise it is of no effect. *E.g. Article 9(1) of the EDRE Constitution stipulates that:*

*"The Constitution is the supreme law of the land. Any law, customary practice or a decision of an organ of state or a public official which contravenes this Constitution shall be of no effect."* **Thus, contracting parties cannot enter into an obligation which contravenes the constitution.**

## *Legality of the object…ctd*

- Moreover, **parties cannot enter into an obligation which contravenes other subordinate laws of the country**. *E.g. a contract concluded by parties to abduct or assist abduction of a woman violates criminal law of the land. The object of this contract is illegal.*
- N.B restriction and prohibitions indicated under Art 1711 differ from legality of object. Restrictions and prohibition indicate the concept of social and customer protection where as legality indicates concept of public order.
- Restrictions and prohibitions are mainly found in labor law and trade practice law. They are also found in commercial code and civil code.
- **Restrictions and prohibitions are intended to protect the individual contracting party whereas legality is intended to protect the public.**
- **So, legality of the object is determined by referring to criminal law whereas restrictions and prohibitions are to be found in the private law area.**

## IV. Morality of Object (Art.1716 (1)

- Literally, morality **is a standard set by a society concerning the distinction b/n right and wrong or good and bad behavior.**
- **One problem with morality is that it is subjective;** i.e. what is moral in certain society could be immoral in some other society and vice versa.
- **As a means of self defense the society punishes those who violate morality. Law is part of morality** that is entrusted by the society **for its enforcement**. **The remaining part of morality is to be enforced by the society itself by means of public opinion**.

## *Morality of Object…ctd*

- **Even though the state does not have a duty to enforce morality, it should refrain from indirectly assisting the violation of morality. Therefore, any immoral obligation cannot be enforced by court or executive (Art.1716 (1).**
- The obligation may not be crime but it may be contrary to morality. *E.g. A contract for sexual intercourse/prostitution*.

# 4. Form of Contracts (Art 1719 – 1730)

## Definition

- **Form is the way in which the content of the contract exists or appears to others.**
- **It answers the question as to how third parties such as court could know the agreement of parties. Thus, it has a probative value.**
- **A contract may exist either in written form or oral form**. When contract is in written form, a court or third parties know the agreement by reading a paper on which it was written (Art.2003). And when contract is in oral form, the court can know the agreement of parties from oral testimony of the parties themselves or witnesses (Art 2002).
- Moreover, oral form of contract includes conduct, signs normally in use and partially written and partially unwritten agreement . **when part of the agreement is written while the remaining is unwritten, the written part could only be used as corroborative evidence to oral testimony.**

## Freedom of Form (Art 1719)

- **Most non lawyers think that for a contract to be binding it should be always in writing and signed by the parties to the contract. However, the law gives freedom to the parties to choose either written or oral form.**
- So, in ppl, a contract can be valid if consent, object and capacity requirements are fulfilled.

## Limitations(Exceptions) to Freedom of Form Art.1719 (2, 3)

- **Freedom of form is not absolute. It may be limited by law or contracting parties.** An offerer has a freedom to determine the form of acceptance (Art 1681 (2). If the written form proposed by the offeror is rejected, then the offer itself is rejected (Art 1694).

## Reasons for Limitation on Freedom of Form

### A. Evidentiary value:

- **Sometimes, we may feel insecure when we make contracts orally especially when the contract involves considerable property interest.**
- **Those factors which may exacerbate the insecurity are:**
- ✓ If we made **oral contract in the absence of witnesses**, there is a probability that a person with whom we entered into the contract denies the contract.
- ✓ **High mobility of people which creates shortage of information to properly know the personality of the individual we are contracting with.**
- ✓ **The disintegration of social life (Social bond) which** also contributes to our insecurity since **there is less possibility to use public opinion to punish the people who dishonor his words.**
- **So, to reduce such insecurity people may prefer to make their contract in written form.**

## *Reasons for Limitation on Freedom of Form …ctd*

## B. Recalling content of a contract:

- **There is an Amharic adage that says "በቃል ያለ ይረሳል በፅሑፍ ያላ ይወረሳል" may be translated as "things in mind can be forgotten; things in writing can be recalled."**
- **If a contract is formed orally, there is high possibility that its content be forgotten both by parties and witnesses specially when the content of a contract is a complex one and remains effective for a relatively longer period.**
- In general, **to protect parties against failure of memory as time passes,** parties may agree to make their contract in a written form.

## C. Indication of intention to create legal relation:

- **Making a contract in a written form is a clear indication of an intention to be bound.**
- **If a contract is to be made in writing, a party thinks twice before he gives his final consent to be bound**. The person thinks both before consenting to the contract and signing on the written contractual document. He has a time to think whether to insist in his consent or change his mind before the signing on the document.
- Moreover, **when one party proposes written form the other party may understand that the contract is being taken seriously by proposer of the form.**
- **Generally, written form makes parties to be conscious of the effect of the contract. So, written form may be taken as an indication of intention to create legal relation.**

## D. To Prevent or Minimize Corruption

- Under some special types of contracts such as Administrative Contract, written form of contract is mandatory. This is because it is believed that **oral contract opens a room for corruption since keeping information is difficult**.
- **Thus, to prevent or at least minimize corruption, administrative contracts shall be made only in written form.**

## Contracts made in Written Form (Art 1721 – 1726)

- **As we have addressed herein above, in principle, form is not an essential element of a contract; there is freedom of form. However, exceptionally, freedom of form can be limited either by the law or parties to the contract.**
- **As per Arts. 1719 (2) & 1720 (1), where a special form is expressly prescribed by law, such form shall be observed for otherwise it is not a contract but a mere draft.**
- Accordingly, the following contracts shall be made in writing:
  - ***A. Contracts the law requires to be made in writing,***
  - ***B. Contracts parties want to make in writing,***
  - ***C. Preliminary contract (Art 1721),***
  - ***D. Variation of contract made in writing (Art 1722***

## A/ Contracts the law requires to be made in writing

❖ Some of the contracts that **the law expressly requires to be made in writing** are:

I. **Contracts relating to immovable: - All contracts that affect a right on an immovable, except lease or rent of house, must be made in writing. Therefore, sale, usufruct, servitude, mortgage etc. should be made in writing. Art. 1723**

❖ However, as per FSCCD in the case between Rented Houses Administration Agency vs.Sosina Asfaw in a file No15992, lease or rent relating to immovable (House) need not be made in writing.

**II. Contracts with public administration (Art 1724): any contract to which a government agency is a party, including any type of employment contract, should be made in writing.**

- ***Can you mention the reasons behind making administrative contracts in written form*** **? The common reasons are:**

✓ **In public administration, because officials may leave their office by election, removal or resignation, it would be difficult to ascertain the content of the contract entered into during their stay in office unless it is made in a written form.**

✓ As we know, because contracts concluded by public officials representing the agency continues to be effective even after they leave their office, they should be made carefully in a written form.

✓ **Moreover, oral contract opens a room for corruption since keeping information is difficult in orally made contracts.**

## *Contracts required by the law to be made in writing…ctd*

- Some other types of contracts which the law requires to be made in writing include:
  - ✓ *Contract of guarantee* (Art 1725 (a);
  - ✓ *Contract of insurance* (Art 1725 (b);
  - ✓ *Partnership contract;*
  - ✓ *Pledge for a loan exceeding* 500 birr (Art 2828 (2);
  - ✓ *Sale and mortgage of business* (Art 152, 177 (2) comm. code);
  - ✓ *Promise of sale and preemptions* (Art 1412) and
  - ✓ *Agreement prohibiting assignment or attachment of a certain thing* (Art 1430)

## B. Contracts parties want to make in writing

- Under the section on freedom of the form, **we have seen that freedom of form can be limited either by law or parties to the contract.** Therefore, **using their freedom of form, parties are at liberty to choose their contract be made in a written form**.
- Moreover, ***we have already addressed the possible reasons why parties may prefer written contract over its oral counterpart.***
- **Once the parties agree to make their contract in writing, then contract will not be completed until such form is fulfilled. (Art 1726).** No party can require the performance of the contract until it is made in writing.
- Even if the parties have begun to perform the contract, the court does not help them to have the performance completed unless they comply with their prior agreement to make the contract in writing. This means parties cannot change their prior agreement impliedly by performing the contract.
- Express agreements cannot be changed by implied agreement. However, parties can change any express agreement by another express agreement.
- **As per Art. 1722, a contract made in a special form shall be varied in the same form. Therefore , If the agreement was made in writing its change should also be made in writing and *vice versa* .**

# C. Preliminary contract (Art 1721)

- Another type of contract which should be made in writing is preliminary contract. **Preliminary contract is a contract which has to be concluded before another contract.** It intends to lead to another contract.
- **Preliminary contract shall be made in writing if the contract to which it leads is required to be made in writing either by the law or the parties**. *The best example is agency contract. If the agent's power is to enter into a contract in writing, he should be conferred with such power in writing (Art 2200(1).*

## D/ Variation of contract made in writing (Art 1722)

- As we have seen under Art. 1675, **variation of contract is a contract itself.** So, if such contract relates to contracts indicated under **Art. 1723** (*contracts relating to immovables*), **Art. 1724** (*Contracts made with a public administration*) and **Art. 1725** (*Contracts for a long period of time*), **it should necessarily be made in writing.**
- **N.B The law provides form for creation and variation of a contract but it is silent about form for extinguishing a contract. The drafter also expressly states that provisions dealing with form of contract do not include extinction of contract (David.p.28).**
- The writers of the teaching material are of the opinion that when parties intend to extinguish contractual obligation that exists between them, they shall extinguish it in the same special form they made the contract.
- Moreover, t**hey are of the opinion that extinction of the contract should be made in the same form of its formation for the following reasons:**

I. **Extinction of contract is a contract itself**- As we have addressed in the **definitional part** too, a contract is not only an agreement to create and vary but also an agreement to extinguish obligations of proprietary nature. So, when the law provides that a contract be made in writing, it includes extinction since **extinction by itself is a contract**.

II. **Intention to create legal relation can be clear:** a person should be presumed to have changed his previous stand only when he uses the same way of declaration of intention as he used earlier. Art. 1726

III. **Probatory value of written instrument (Art. 2005):** A contract formed in written form has to be extinguished only in a written form; otherrwise, it is very difficulty to prove that a written contract has been extinguished by a later oral contract.

# Effects of form

- **When the law or parties requires the contract to be made in writing, failure to comply with such requirement make the contract a mere draft (Art. 1720). The contract never exists until the formality requirement is fulfilled.**
- As per **Article 1720 (1),Some contracts need to be registered. Such registration is normally intended to make third parties to be aware of the existence of such contract. such registration does not have any relationship with form of the contract. That means, even if the legal requirement of registration has not been fulfilled, the contract can still be enforced between parties.**
- Registration can affect the validity of contract only when the law expressly states that failure to register the contract shall make the contract non-existent (Art.1720 (3). E.g. although Art 1723 provides that contract relating to immovable be registered, it does not state that failure to register shall make the contract non-existence. Therefore, according to Art.1720 (3), contract relating to immovable remains valid even if the registration requirement is not fulfilled. **But FSCCD, Vol.4, File No.21448 makes registration mandatory.**

## Written form (Art 1727-1729)

A contract is said to be in writing where:

- ✓ The content of a contract is **written** i.e. the content is readable.
- ✓ The writing is made on a **special form**. Special form means any ***pure paper that is intended for a specific contract only***. Therefore; if a paper contains another contract or other things such paper is not a special document.
- ✓ Moreover; **writing on electronics does not fulfill the requirement of special document**.
- ✓ **Parties to the contract sign the special document**. Parties sign by putting hand written mark on the special document **(Art 1728**). Here, two things are interesting firstly the law does not allow the use of mechanical process such as stamp; secondly, thumb mark never binds unless it is made in the presence of notary, registrar or a judge acting in discharge of his duty( Art-1728 (2)
- ✓ At least two capable **witnesses** sign the special document. **Art-1729.**

# Other Special Forms

- There are also other special forms of contracts. **These other special forms should contain contents of the contract in a readable manner but the thing on which the readable content is found may be a special document, scrape of paper, electronics or any other thing.**
- **Moreover; such form may be signed either by both parties or only one of them or it may not be signed at all. Also, there is no need of witness to sign**. *The best example of such special forms is commercial instruments*. Signing or issuing a commercial instrument is concluding a contract. Such contract should be made in a special form.
- **Parties can also agree to make their contract in the special form.** E.g. they can agree the contract is binding without the need of witnesses etc. Therefore; **when the parties agree to make their contract in special form; they should clearly define what that special form means.**

## Consequences of Validity Requirements

- Validity requirements also known as elements of contract, as addressed above, are consent, object, capacity and form. **Generally a contract that misses any of these elements is either void or voidable.** Void and voidable contracts have differences and similarities.

## I. Differences between void and voidable contracts (Art, 1808-1814)

### A. Differences in terms of Definition:-

- ✓ Void contract is a contract which parties intend to produce binding effect but does not actually have any legal effect. **The obligation intended by the parties does not exist from the very beginning.** So, it is called *void abinitio*.
- ✓ voidable contract is a contract that has begun to produce effect intended by the parties however it contains certain **formation defects** that may destroy the effect it has produced.

## *Differences between void and voidable contracts…ctd*

- **Void contract cannot be cured but voidable contract may be cured by agreement of both parties to the contract (Art.1811).**

### B. Differences in terms of Cause

- A contract is said to be void when the object or form elements are missed.
- ✓ If t**he object is unclear (undefined), unlawful, impossible or immoral, the contract is said to be void contract**.
- ✓ Likewise, **if the especial form prescribed by law or agreed by parties is not complied with, the contract is said to be void contract**.
- On the other hand, a contract is said to be voidable if it contains defect in consent or capacity (Art.1808 (1).

### C. Differences in terms of plaintiff

- **Void contract can be brought before the attention of a court by any body, including the public prosecutor. Art.1808(2).** But **in case of voidable contract, only a person whose consent was defective or the person who was lacking capacity at the time of conclusion of the contract can bring the case to the attention of the court**(see Art.33 of Ethiopian Civil Procedure Code).

### D. Differences in terms of Relief Sought

- In case of **void contract**, the person bringing the contract to the attention of the court is not intending to have the contract invalidated since there is nothing to be invalidated. **Rather, he wants either to make sure that the contract is void or wants the court to stop parties from violating the law/moral standard of the society under the guise of performance of contract.**

## *Differences between void and voidable contracts…ctd*

- Moreover, a person **may apply to court to get back any thing he has given believing that the contract was valid**.
- **However, a party who is sure that the contract was void and has made no payment, need not go to court and shall refuse to perform the contract (Art 1809).**
- On the other hand, **voidable contract** is a contract that has begun to produce effect. **In case of voidable contract, the person bringing the contract to the attention of the court is intending to have the contract invalidated.** In short, the relief sought is to have such contract declared **void**.
- **Voidable contract produces legal effect unless the party whose consent was vitiated or incapable at the time of conclusion of contract challenges its validity (Art. 1808 (1).**
- But **unlike void contract** which does not exist from the very beginning, **voidable contract can be cured where:**

### a. Invalidation is not claimed within two years

- A party whose consent was vitiated loses his right to invalidate the contract unless he brings court action **within two years from the moment he knew the fraud or mistake or from the moment the duress disappears** (**Art. 1810(1**).
- In case of lesion, the period of two years begin to count **from date of conclusion of contract; not from the date a person knows the existence of lesion ( Art 1810 (2).**
- Notice that a contract affected by incapacity need to be invalidated within two year from the date the person became capable (Art 1810 (1).

## *Differences between void and voidable contracts…ctd*

### b. Contract is confirmed

- Voidable contract can be cured **where a person whose consent is vitiated waives his right to demand invalidation** (Art 1811(1).

### C. The injury is made good

- **A contract vitiated by lesion remains valid if the party taking undue benefit agrees to return such benefit (Art. 1812).**

### d. The vitiated provisions of the contract are avoided

- **Contract may be invalidated partially provided the valid one is independent of the invalid one (Art 1813). This is if a contract contains both lawful/moral and immoral/unlawful obligation, the immoral/unlawful obligation shall be considered as if not written and the remaining should be given effect, provided that it is clear and meaningful.**
- *E.g. C and D agreed that D shall serve as a maid servant and she shall also make herself ready for sexual intercourse twice a week with C and C shall pay birr 400 per month. Here, the part dealing with sexual intercourse should be considered as if not written or ( does not exist).*

## II. Similarities between Void and Voidable Contracts (Art 1815-1818)

- The following are similarities of void and voidable contract:-

**A. Unable to Produce Legal Effect on the Parties:** Like void contract, voidable contract is also considered as *void abinitio* once it is invalidated.

- Invalidation of voidable contract has a retroactive effect thereby denying the contract to produce any obligation from the moment of its inception. Invalidation of voidable contract is similar with aborting the embryo.

## *Similarities between Void and Voidable Contracts…ctd*

**B. Reinstatement (Art 1815-1818):** when a person inters into void or voidable contract and made undue payment, it does not mean that he will be without remedy. A party who received undue payment shall give it back and such giving back is called **reinstatement (** Art 1815 (2). **Thus, void and voidable contract which is invalidated are similar in reinstatement.**

- **Reinstatement is made either by returning back the payment (thing received) or by paying appropriate compensation for the thing that cannot be returned.**

- In the following cases, **reinstatement may be made by paying compensation:-**
  - i. **When Ownership of the thing is transferred to third party Possessor in Good faith** Art. 1161
  - ii. **When the thing is Lost or damaged by the fault of receiver Art.**2028
  - iii. **Obligation "to do" or "not to do":-** In these two types of obligation, there is no transfer of ownership or holding. The contract requires the parties to perform certain intellectual or physical (labor) activities that benefit the other or to refrain from exercising certain property rights. So the concept of reinstating the parties by returning the thing does not work since there was nothing delivered.
  - iv. **When the thing is transformed: where** the thing is transformed (**substantially changed or altered),** the receiver shall pay the price of the thing (Art 1817 (2*). E.g. Almaz bought flour from Shemsu's shop but she has already made a bread. In such cases since reintatement of the thing is impossible the receiver* should pay money.
  - v. **When returning the thing is uneconomical:** The thing may not have been transferred, damaged, lost or transformed, but **repayment expense may be high**. In such case, the court should not order the repayment of the thing. Rather, it should order payment of compensation.

- In short, if the contract is invalid, any performance made on the basis of such contract becomes invalid. This means the receiver shall return the thing he received (Art 1815). However, if returning is not possible for whatsoever reason, an appropriate compensation shall be paid (Art 1817).

# Chapter III: Effects of Contract

## Chapter Objectives

**At the end of this chapter, students will be able to:**

- *distinguish the different techniques of interpretation of contracts*
- *identify who may perform a contract, for whom the contract shall be performed*
- *analyze how the contract shall be performed*
- *identify the time and place of performance of contracts*
- *identify the ways of transfer of risk*
- *know the contracting party who bear the costs of payment*
- *Know what variation of contract is and who may vary a contract*

## What does effects of contract mean? (Art.1731)

❖The two major principles of contract are freedom of contract and its sanctity (binding nature).

❖ To make a serious promise certainly involves a moral duty to keep it. There is Latin saying *"pacta sunt servanda"* which means that a person is bound by his words. There is also an equivalent Ethiopian proverb, 'የተናገሩት ከሚጠፋ የወለዱት ይጥፋ' may be translated as "*failure to keep a word is worse than losing a descendant*."

❖ **Contract is binding not only morally but also legally i.e.** Once a contract fulfills the requirement of Art 1678 (consent, capacity, object and form, if any), it becomes a law. It is, thus, a law between contracting parties ( See Art. 1731/1).

❖As we know, law is enforced by executive and interpreted by the judiciary.

❖ As law makers, parties to the contract, can repeal or amend the contract.

## *What does effects of contract mean?...ctd*

- Moreover, the law must be implemented i.e. contract should be performed for violating a law entails punishment i.e. non- performance of contract leads to payment of damages.
- **Effects of contract, in this section, mainly address:**
  - ***I. Interpretation of contract,***
  - ***II. Performance of contract and***
  - ***III. Variation of contract.***

## I. Interpretation of contract (Art 1732 -1739)

- As a law, a contract may be interpreted. **Interpretation is giving meaning to the provisions of the law/contract**.
- **However, a law/contract is interpreted when it is vague, silent, illogical, ambiguous, and contradictory**. In other words, if the provision of the contract is clear, there is no need to interpret (Art 1733).
- Law is an express intention of the legislators. Interpretation is, therefore, searching the intention of the parties (Art. 1734(1).
- In line with art. 1733, in a case b/n Ethiopian Development Bank vs.Abdurahman Telisa, file No. 15662 presented to it on Megabit 13, 1999 FSCCD properly ruled that **whenever the provision of the contract is clear, court should not depart from clear meaning even if such clear meaning is unfair.**

# Presumption of Good Faith

- While interpreting a contract i.e., searching for the intention of parties, we have to presume that parties entered into a contract in good faith (Art. 1732).
- **Good faith** should mean that no party to the contract intends to deceive the other party by intentionally making the provision of the contract vague, ambiguous, silent or contradictory.
- While concluding a contract, it is presumed that parties neither know a problem nor thoroughly examined each provision believing that controversies would not arise i.e. they trusted each other that none of them would attempt to avoid the effect of contract (Art. 1732).
- **In short, good faith means that at the time of conclusion of a contracts each party believes that everyone in the contract intends to get his own fair benefit without harming another party.**
- Interpretation becomes necessary either because parties were not able to imagine the dispute, or words are imprecise by their nature, or errors are committed in formulating contract.

## When to Interpret a Contract

- As addressed herein above, **if the provision of the contract is clear, there is no need to interpret. Therefore, contract is interpreted when it is:**
  - ***vague,***
  - ***silent,***
  - ***illogical,***
  - ***ambiguous, and***
  - ***contradictory.***

# How to Interpret a Contract

- We said that interpretation is searching the intention of the parties (Art. 1734(1). In other words, to interpret a contract is to search for the intention of parties to the contract.
- While interpreting a contract, the court should take into account the following **techniques**:

A. **Conduct of the parties:-** a conduct of a person may be taken as a means of ascertaining what he was intending and what the other party understood from such conduct. As per Art. 1734 (2), the general conduct of the parties before and after the making of the contract shall be taken into consideration to[ interpret a contract].

B. **Context of the contract:- the meaning of a contract should be searched from the contract itself** since there is a possibility that one provision may indicate the meaning of another provision or word in the contract. (See Art. 1736(1)

C. **Business practice:- Business practice should also be taken into account to interpret a contract.**

D. **Good Faith:-** Here good faith indicates the innocent expectation of a party from a contract (Art. 1735). This is in accordance with the golden rule, "had I been in the position of my opponent what would I have expected from the contract?"

E. **Equity:- The fairness aspect should also be taken into account.**

F. **Positive interpretation:-** Provisions capable of two meanings shall be given a meaning to render them effective rather than a meaning which would render them ineffective.

**G. Interpretation in Favor of Debtor:-** if the court is unable to know the intention of the parties, the law guides the court to interpret the controversial provision or word in favor of the debtor (Art 1738(1)). But this is not always true ,esp., if the obligations of the parties to the contract are stipulated by the debtor b/c the debtor cannot be double beneficiary.

## II. Performance of contracts (Art. 1740-1762)

- Performance of contract means **fulfilling one's own obligation or executing validly formed contract as agreed**.
- To elaborate a little bit, If the obligation is to "do", doing what was provided in the contract exactly in the same way as provided, if the obligation is "not to do" forbearing from doing what is forbidden by contract and if the obligation is to "give" delivering the thing with its accessories on the agreed date and place is called performance of a contract.

- Performance of a contract extinguishes the obligation of the parties to the contract.
- Performance of an obligation addresses questions such as:
  1. **Who** performs a contract'?
  2. **To whom** should a contract be performed?
  3. **What** should be performed?
  4. **Where** to perform a contract ? and
  5. **When** to perform a contract ?

# 1. Who Performs a Contract?

- **As per (Art. 1740), a contract can be performed by the debtor or his agent or by a person authorized by court or by a law.**
- The persons authorized by law are tutors, liquidators, trustees and person authorized by court is either a curator or an interested creditor who wants to save the rights of the debtor by performing his obligation.
- However; the law is silent about performance of a contract by a third party not authorized by debtor, court or law. **Nevertheless, it can be argued that if the creditor accepts the payment, the debtor has no right to stop third party from performing the obligation. In such case, if the debtor insists on paying the debt, he can pay it to the person who paid the creditor** (Art. 1824).
- However, a creditor is not duty bound to receive payment from a person not authorized by debtor or court or law, he is free to accept or reject such payment without any effect on his right against the debtor.
- **The 2nd rule of performance of a contract, as per Art. 1740(1) is performance of an obligation only by the debtor. The debtor may perform his obligation personally in two cases.** The 1st case is when the contract or law expressly provides that the debtor shall perform the contract personally and the 2nd case is when the creditor proves that personal performance is essential to him.
- To start with the 1st one, a contract or law may expressly provide that the debtor shall perform the contract personally. E.g, Ethiopian labor law provides that the employee should perform the contract personally. So, if certain construction company employ's "A" as a daily laborer, he cannot authorize his son or brother to carry out the labor work and the company can refuse to accept "A"'s son or brother and dismisses "A" from work.
- As stated herein above, the second case where personal performance becomes necessary is when the creditor proves that personal performance is essential to him. The creditor can be able to prove that personal performance is essential to him only when the obligation is **obligation to "do" of a professional nature or art**. E.g, a lawyer, or a doctor cannot authorize a duty which he agreed to do. Moreover, a musicians, painters, Poet, actor, dancer etc cannot authorize someone to perform his obligation.

***Who Performs a Contract…ctd***

- **But do you think that the term "personally" imply performance only by the debtor without any assistance? No, it may include performance with the assistance of others but under the control of the debtor. However, the assistance should be limited assistance to say the debtor performed himself.**

## 2. To whom should a contract be performed? (Art. 1741-1744)

- Payment/ performance should be made to the creditor or a 3rd party authorized by the creditor (an agent)or by the court or by the law (tutor, liquidator, or trustee). Art. 1741

### Payment to Incapables (Art.1742)

- If the creditor is a minor or judicially and legally interdicted person, payment should not be made to such creditor; rather it should be made to his tutor or legal representative.

### Payment to Unqualified Creditor (Art.1743)

- In principle, payment to unqualified person (a person who is not authorized to receive payment per Art. 1741) is invalid. But in the following cases, such payment is valid. These are when:-
  - ***A. Payment benefited the real creditor or***
  - ***B. Payment is confirmed or***
  - ***C. Payment is made to a person with a valid title***

-

## A. Payment benefited the real creditor

- This is the case when the debtor pays the debt of his creditor. E.g. “X” borrowed 2000 Birr from “Y”. “Y”, in turn, once bought a jewelry that worth 2000 Birr from “Z” but not paid him. If “X” pays “Z” 2000 Birr, the debt of his creditor i.e “Y”, the payment benefits “Y”. Thus, this is an exception to the principle, ‘payment to unqualified person is invalid.’
- Notice that such payment may be paid either without the knowledge of creditor or even against his express opposition.

## B. Payment confirmed

- Here even if the creditor did not benefit from the payment, he may confirm the payment. E.g. “A” borrowed 5000 Birr from “B”. “C” is the daughter of “B”. “A” paid the money to “C” in the belief that she would give it to her father. If she consumed the money for her private affairs and her father confirms that, it is a valid payment. However, if her father is not willing to confirm, “A” can claim recovery of the money from “C” under the rules of undue payment(Art. 2164).

## C. Payment to a person with a valid title

- Here the holder of the title is legally entitled to claim payment although he is not the real creditor. The document gives an apparent right to the holder. The payment made to an apparent creditor is valid even if the document is invalidated later on. The following two cases elaborate this fact.

**I. Document evidencing power of agency:** a principal might have revoked the agency power but he may fail to collect the document from the agent and the agent may use the document to collect principal’s claim. If the debtor, in good faith, pays to the agent whose agency power is revoked, the payment is valid b/c failure to collect the document authorizing the agent is the fault of the principal not the fault of the debtor.

**II. Holder of Negotiable Instruments (Art. 716 & 751 of comm.c):-** A debtor who paid to a holder of negotiable instrument in accordance of the rules of transfer of negotiable instrument is released from his obligation. *E.g. "A" issued a check to "B" and thief stolen the check from "B"'s pocket and received payment from Dashen Bank. "A" is released by such payment. NB:- In both cases the debtor should be in good faith.*

## Doubt as to the Creditor

- when the debtor is unable to know the real creditor ( b/c two or more persons may independently claim the payment of a debt), he shall deposit the debt in court either by his own initiative or by the request of the claimants. ***(Art.1744)***

## 3. What should be performed? (Art. 1745 – 1751)

- What to pay (perform) answers the question relating to **identity, quality or quantity of the thing to be delivered.** To properly answer such question we may classify things into **definite thing, fungible things and money debts.**

### I. Definite Thing (Art. 1745 – 1746)

- **Definite thing is a thing that can easily be identified from similar things of the same species. In short definite thing has its own peculiar identity.** *Animals and immovable are most prominent examples of definite things.*
- If a thing is definite thing, we can not find its replicate in the world.
- However, for contract law definiteness of a thing simply indicates that a thing which is a subject of sale **is indicated in the contract in its own specific name.**

## What should be performed?...ctd

- ***As per Art.*** *1745,the debtor shall deliver the thing agreed i.e. the creditor is not bound to accept other than the thing agreed. The creditor may however, accept things of different identity if he wants.*
- If the creditor accepts the new thing offered to him by the debtor, it means that they agreed to vary or modify contract. *For instance, Abel agreed to sell Adaa teff to Gebru. But since Abel unable to get Adaa teff, he supplied Menjar teff of the same quality. Gebru would have an option either to reject or accept the delivery.*
- The creditor has also a right to refuse partial payment of a definite thing. He has also a right to claim partial payment and bring court action for the remaining part or give grace period for such part payment **(Art 1746)**.

## II. Fungible Things

- Fungible goods are **goods that are indicated in the contract by using generic terms** such as pasta, teff, wheat, barely etc.
- Unlike definite things, since **fungible goods are those goods which cannot be expressly indicated in the contract**, the contract is interpreted in favor of the debtor (Art. 1738 (1) and the debtor can freely determine its quality (Art. 1747) though the quality should not be less than the average quality (Art.1747 (2). *For example, if a seller agreed to sell five hundred quintals of teff, he can deliver teff of average quality regardless of where the teff is from.*
- As per **Art. 1748(1):-** *The creditor may not refuse fungible things on the ground that the quantity or quality offered to him does not exactly conform to the contract, unless this is essential to him or has been expressly agreed.*
- The theme of this provision is that since exact conformity between the offer and acceptance may not be met b/c of various reasons, **the creditor is recommended to tolerate small deficiency unless exact conformity is agreed upon or essential to him or unless it is declared to be fundamental breach of contract.**

## *Fungible things…ctd*

- *To use an example given by George krzeczunowicz, where [a debtor] accepted that he would deliver 100 litres of alcohol of 90 % concentration but delivers instead 99 litres of 89% concentration,* ***common sense and commercial usage*** *require that the creditor does not refuse them where this is not essential to him.*
- In the above example, it is for the creditor to prove that exact conformity is essential to him, through showing, **for instance, that the alcohol was ordered for medical or chemical purposes where 1% concentration deficiency makes an essential difference.**
- **Small deficiencies due to climate, transportation, etc are some times unavoidable and are customary tolerances**.
- But even if the quantity /quality is not essential or fundamental to the creditor, the contract may provide unilateral cancellation if such quality or quantity is violated (Art. 1786 cum. **1748 (1)**.

## III. Money Debts (Art. 1749–1751)

- If the debt is money debt, **payment should be made in local currency of place of payment** (**Art. 1749 (1)**. This is so for <u>two reasons:</u>
  - ✓ *Firstly, the debtor may not be able to get the foreign currency in the place of performance for this could be allowed only for some groups or prohibited totally.*
  - ✓ *Secondly, it may be illegal to carry foreign currency for more than a certain time limit.*

- **If payment is in a local currency, the exchange rate is determined on the basis of exchange rate on the day of payment (Art 1750).**
- **But the law never answers the place that is to be used as a reference to determine the rate**. For example the exchange rate of birr in dollar may differ in USA and Ethiopia on the same days.
- Although the law is silent on this point, the writers believe that **the place where the currency indicated on the contract serves as medium of exchanges should be taken as a reference market to determine the exchange rate.**
- **Notice** that parties may agree that payment shall be made in **actual currency** indicated on the contract (Art.1750).
- **Incidental to money debt are inflation of currency and interest rate**. **Parties may avoid inflation by determining the amount of money debt in reference to the price of a specified good**. *For example, a person who lends birr 200,000 to be repaid after ten years may say that the amount to be repaid shall be able to buy 50 tons of first quality Ada'a teff at the time of payment.*

## Appropriation of payment (Art. 1752-1754)

- Appropriation of payment **is important when the debtor pays only part of his obligation.**

## Principal Debts and its accessories

- **If a person is unable to pay the whole debt (principal, interest and cost) at one time, the partial payment made by the debtor shall be appropriated firstly to the cost; secondly to the interest; and finally to the principal (Art. 1752).**
  - ✓ *For example, Belaynesh borrowed birr 100,000 in 2000 at a rate of 9% per annum and debt was to be paid after five years. But Belaynesh failed to pay the debt, and the creditor brought court action and incurred cost of birr 10,000. So the principal debt is 100,000, interest, 72,000 and cost 10,000. Assume Belaynesh made a payment of 30,000;* ***the appropriation is first to the cost so the cost is extinguished and the remaining 20,000 is apportioned to the interest****. So the debt of Belaynesh is principal 100,000 and interest 52,000.* ***The effect is that the interest continues to count on the total 100,000 birr.***

# Multiple principal Debts (Art. 1753-1754)

- In case of multiple debts, choice is given to the parties and only if they fail to exercise their right of choice that the legislator chooses the debt to be paid first and the debt that follows.

***Choice by the parties (Art.1753):-*** unless the parties agree that choice should be made by the creditor, the law presumes that the right to choose is for **the debtor (Art 1753 (1). This is in accordance with the principle of interpretation in favor of the debtor.**

- However, if the debtor has failed to indicate his choice to the creditor and has not opposed the appropriation written on the receipt, the debtor is presumed to have given this chance to the **creditor**. So the choice of the creditor binds the debtor (Art. 1753) (2).

***Choice by the law (Art. 1754):-*** When both the debtor and creditor fail to indicate the appropriation the law presumes the following appropriation:

A. **Debts already due:-** Appropriation is to the debt which is **most advantageous to the debtor** (Art.1754 (2). For example the loan of 500,000 which imposes 12% interest rate and which was due on Jan 2, 2008 and **sale price without penalty**.

B. **Debts due vs. future debts:-** Appropriation shall be made to the debt which is already due (Art. 1754(1).

C. **Future debts Vs future debts:-** appropriation is to the debt which becomes due earlier (Art.1754 (1)

D. **Future debts having the same due date:-** appropriation is to the debt which **first appropriation benefits the debtor most** (Art. 1754(2) but if the advantages are equal payment shall be appropriated proportionally (Art. 1754(3).

# 4. Where to perform a contract (Place of Performance)

- Place of performance/payment has an implication on cost of payment, currency for money debts and territorial jurisdiction of court.
- The civil code, under Art. 1755, provides three alternatives regarding place of performance; agreed place, residence of the debtor and place where the thing situates.
- According to this provision, the 1st option as to the place of performance is left to the agreement of the contracting parties. This is pursuant to freedom of contract addressed in the earlier sections.
- However, if parties to the contract failed to mention the place of performance by their agreement, as a 2nd option, it is determined by the law (1755(2,3)).
- In this regard, the place of performance for the delivery of fungible things is the place where the debtor had his normal residence at the time when the contract was made & the place for the performance of definite thing is the place where such definite thing situate at the time of conclusion of the contract.
- We have seen that the place of performance for the delivery of fungible things is the place where the debtor had his normal residence at the time when the contract was made. This law reflects the principle of interpretation in favor of the debtor(Art. 1738,1). Here, the law aims at exempting the debtor from transportation cost, inconveniences and waste of working hours.
- *Dear students, where shall be the place of performance in case if the debtor has more than one residence?* In such cases, performance shall be made at the principal residence of the debtor.
- Coming to the place of performance for a definite thing, We have to notice that there may be difference between place of conclusion of contract and place where the definite thing situate at the time of conclusion of contract.
- Moreover, the place where a thing situate at the time of conclusion of contract and at the time of performance of a contract may be different i.e. the thing might have been shifted from the place where it was at time of formation of contract.

- Generally, Ethiopian civil code advises the parties to exercise their freedom of contract and determine place of performance. But if they fail to do so the law imports the old [French] maxim, "payments are not portable **[by the debtor to the creditor]** but " fetchable" **[by the creditor from the debtor]** i.e. the creditor has to go to either to the place where the definite thing situate or to the residence of the debtor.

## 5. When to perform a contract:-Time of Performance

- The last but not least question that should be addressed in the performance of a contract is time of performance.
- **Time of performance is very important to determine transfer of risk, cost of maintenance and preservation and most importantly to claim compensation for non-performance (see Art.1779-1783).**
- Time of performance greatly affects the benefit parties expect to derive from the contract. This is especially true when there is market instability which has become the feature of modern economy.
- The importance of time also depends on the nature of the contract or obligation of the parties.
- **Like in place of performance, in principle, payment shall be made at the agreed time. Art. 1756(1).**
- In the absence of contractually agreed time, payment may be made "forthwith" Art. 1756(2).
- *But the question is when is "forthwith"? Should it be construed as immediately?*
- **The general consensus is that the term "forthwith" should not be construed as immediate performance. This is b/c by their nature, most contracts cannot be performed immediately. Instead, the creditor is expected to give the debtor a reasonable time to perform his obligation.**

## *Time of performance…ctd*

- A creditor never invoke non-performance without giving **default notice (Art.1772)** and in his default notice he may fix a reasonable period that enables the debtor to carry out his obligation (Art.1774).
- Article 1756(3) comes with **3rd type of requiring performance. i.e., whenever a party requires the other party to perform his obligation** though this should not depend on the whim & will of requiring party but upon fulfilling the **standards provided** under **Art. 1757.**
- **As per Art. 1757, a party can require another party to perform his obligations when 2 things are fulfilled. These are:**
  1. ***The requiring party should be beneficiary of time limit having regard to the terms or nature of the contract or***
  2. ***He should himself performed or offered to perform obligation on his side****. i.e., to require the other party to perform his/her obligations, one should either perform his/her obligations or , at least, show his or her preparedness to perform his obligations.*
- But when it is clearly provided that the other party is not performing his obligations or his insolvency is declared by court, a party can refuse to carryout his obligations. This phenomenon is known as **anticipatory breach of contract** and it is provided under **Art.1757(2).**
- In conclusion, time of performance is determined either by contract or unilaterally by any party to the contract and the mere failure to indicate time of performance never makes the contract incomplete.

# Transfer of Risk

- **According to Article 1758(1), "**the debtor bound to deliver a thing shall bear the risks of loss of or damage to such thing until delivery is made in accordance with the contract."
- However, sub-article 2 of the same provision provides that the risk is transferred to the creditor if he fails to take over the thing.
- Transfer of risk is dependent on time of performance. However, transfer of risk is an issue only in contracts that involve transfer of ownership. It is not a common characteristic of all contracts. The relevant law to discuss transfer of risk is law of sales.

## Cost of Payment (Art.1760)

- Costs of payment are those of counting, measuring, weighing, packing etc. Cost of payment (also) comprises those of the receipt that is in practice the amount of any stamp duty on it, to be reimbursed by the debtor.
- The *unless otherwise agreed* clause under Art. 1760 is to mean that when the court is unable to ascertain a party that should bear the cost of payment by reference to their contract or custom, equity and good faith as indicated under Art 1713, the debtor should cover such costs.

## Debtor's Right to Receipt (Art.1761-1762)

- Whenever required, the debtor has a duty to prove that he has properly discharged his obligation (Art.2001 (2). One means that the debtor can use to prove the performance of the contract is by obtaining written evidence from the creditor (Art.2002).
- **Receipt** is, therefore; such written evidence given by the creditor to the debtor. The debtor has a right to claim receipt and a creditor has an obligation to give receipt.
- As per Art. 1761(1), the debtor can demand receipt for the payment s made, even if it is partial payment, and if the debt is fully paid, he can demand the delivery or cancellation of the document supporting the debt.
- Moreover, If the debt is partly performed, such part performance has to be indicated on the document evidencing the obligation. If the creditor alleges that the document is lost he has to give to the debtor another written document that contains his allegation. Art. 1762

# III. Variations of Contracts

- Another effect of contract is its variation. **Variation is making amendments to the provisions of a contract. Variation of Contract is equivalent to amendment of law.**
- As we have addressed earlier, variation of a contract by parties is a contract itself (Art.1675). Here parties to the contract can vary it for whatever reason and at any time.
- However, to vary a given contract, the validity requirements provided under art. 1678 should be observed.
- Variation normally becomes necessary **because of fundamental changes in circumstance that the parties or the legislator does not want to tolerate.** Minor changes may not lead to variation of Contract.
- It is not only the parties who can vary a given contract; **it can also be varied by the legislature and the judiciary.**
- Since a contract is a law the legislator may vary its contents either by a law issued prior to the conclusion of such contract or by a law that is issued to modify certain already concluded contracts.

## Judicial Variation of Contract

- *Dear students can a court vary a given contract? How do you understand Articles 1733 & 1763? Do you think they contradict or support each other?*
- A court may be delegated by the legislature to vary a contract. However, it is not at all times that the court can vary a given contract; it is when fundamental change in circumstance affects the object of the contract (Art.1766-1770). These can be taken as exceptions provided by the law.
- Moreover, court may also vary a contract where there is undue influence or lesion that never leads to invalidation of the contract.
- But if the defect in consent is a kind of defect that leads to invalidation , the court cannot vary the contract but only invalidate it.

## *Variations of contracts…ctd*

- In general, a court of law may modify the following contracts:-

1) ***Contract between persons having Special Relation, (Art. 1766):-***Here the phrase special relationship must refer to relations that are recognized by the law such as spouses, relation by consanguinity and affinity, employer-employee, lawyer-client, doctor-patient and agent principal etc. As it is widely addressed under consent part, a contract made in the afore listed relations may be varied on the ground of lesion, and undue influence(reverential fear) i.e. on the ground of defect in consent if such defect is not enough to invalidate the contract.

2) ***Contract with public administration*** , ***(See Art. 1767)***

3) **Partial Impossibility of Performance: - *on justified grounds such as force majeure (See Art. 1768)***

4) ***Time of Performance:- This is about the grace period that can be given by the court taking into account the position of the debtor. (See Art. 1770). This is an exception to Art. 1756.***

# Chapter IV: Non-Performance of Contract and Its Consequences

## Chapter objectives

- The major objective of this chapter is to enable you identify remedies available for the creditor in case where there is nonperformance of contracts or in other words to enable you identify consequences of non performance of a contract.

## Definition of Non-Performance

- Non-performance (breach of contract) refers to parties failure to perform contractual obligations in conformity with the terms of the contract and the law.
- **In general non performance includes:-**
  - ✓ **Total non performance,** where a party totally fails to honor the terms of contract or
  - ✓ **Partial non performance,** where a party has performed his/her obligations only partly or
  - ✓ Delay in performance **or**
  - ✓ Offering performance at a place other than the place agreed up on (place fixed by law) or
  - ✓ Delivering a thing that does not conform to the contract or delivering a defective thing.

## Default Notice: Requirement and Exceptions

- Before resorting to the remedies of non-performance (Specific performance, cancellation or Compensation), the victim party shall put the other party in default by giving him a notice. ( See Art. 1772).
- Default notice is demanding the debtor to perform his/her obligation within a certain time limit.

## *Default Notice…ctd*

- It has **a number of functions** including that of reminding the debtor and reducing litigation. Though contested, it also helps to transfer risks as the date of notice denotes date of transfer of risks.
- Moreover, default notice is an indispensable proof of the intention of non performing party because it helps the performing party to solicit the real intention of the party to be put in default.
- Nevertheless, before giving a default notice to the non performing party, questions like when to give notice, in what form and how much time should be given to the defaulting party to perform his obligations should be addressed
- These questions are addressed under **Articles 1773 & 1774**. Art. 1773(2) answers the question when to give notice. **Accordingly, notice should be given only after the obligation is due.**
- **On its part, Art.** 1773(1) ) answers the question in what form notice should be given? As per this article, there is no formal requirement for default notice & it may be given in any form: in writing, orally or clear conduct. What is crucial is an unambiguous, clear communication/expression of the creditor's intention to obtain performance of contract.
- In general, the law of notice does not force us to follow one or another form; however, issues of proof oblige us to give a notice which later on can be adduced without difficulty.
- The last question that should be addressed before giving a default notice is the time that should be given to the defaulting party to perform his obligations. Article 1774 addresses this question. As per Art. 1774(1) "*The creditor may in the notice fix a period of time after the expiry of which he will not accept performance of the contract.*"
- As per this sub-article, creditors have the right to fix a period of time within which they expect performance of the Obligation. Under such notice, the creditor will clearly show his intention not to accept performance after the lapse of the stipulated time.

## *Default Notice…ctd*

- The other question, in this regard, is how much time should be given by the creditor to the debtor to perform his obligations within fixed time? Even if the law does not fix such period, the creditor is expected to give a reasonable time having regard to the nature and circumstances of the case.
- Thus, nature and circumstances of the case are the criteria to determine whether the time fixed in the default notice is reasonable or not.
- However, there are exceptional circumstances to the rule of default notice where the creditor can resort to the remedies of non performance with out giving default notice to his debtor. **These circumstances are provided under Article 1775 where the law rules out the importance of giving notice in four circumstances. They are:-**
  - *i. If the obligation is to refrain from doing something;*
  - *ii. if the obligations assumed are those to be carried out within fixed period of time and when they are not carried out within this fixed period of time;*
  - *iii. If the debtor clearly shows in writing his/her intention not to perform his obligation or*
  - *iv. When the parties have an agreement not to give notice.*
- In the 1st case, i.e. when the obligation is to refrain from doing something (obligation not to do or negative obligation), **non-performance results from the debtor's doing of the prohibited act**. Since, the non-performance cannot be reversed /rectified by notice, the giving of default notice serves no purpose, and thus becomes useless/unnecessary.

## *Default Notice…ctd*

- In the 2nd case, i.e. when obligations should be carried out within fixed period of time but not observed, the nature of the obligation is a determining factor. It may be inferred from the contract that any performance after the expiry of the time fixed is useless for the creditor.
  - ✓ E.g. X ordered cakes and drinks for the celebration of his birthday but Y, the debtor, fails to perform his obligation within the time fixed. Here X need not give default notice to Y simply because performance is no more necessary after the birth date. He may invoke the remedies of non-performance with out giving default notice.
- In the 3rd case, i.e., when the debtor clearly shows in writing his/her intention not to perform his obligation notice should not be given. The debtor's refusal to perform his obligation in writing, also known as **anticipatory breach**, relieves the creditor of his obligations to give default notice.
- However, it is only when the refusal is communicated in writing that the creditor be relieved of the pre-requisite of default notice.
- The last case indicated in sub (d) of Art. 1775 is when the parties have in their contract (agreement) excluded the giving of default notice. This is a recognition and implementation of freedom of contract; the parties are free to disregard/exclude the provisions of article 1772, thereby non-performing party is in default as of the expiry of the time fixed for performance with out need for the creditor to give a default notice. Thus, the creditor may invoke the remedies of non-performance immediately.

# Consequences of Non-Performance

- Consequences of non performance of obligation by the debtor or otherwise remedies available for the creditor because of non performance of an obligation by the debtor are:-
    1) *Forced(Specific) Performance;*
    2) *Substituted performance;*
    3) *Cancellation and*
    4) *Compensation(Damages).*
- As addressed in the opening, save for the cases under Art.1775 where the creditor may directly resorts to the remedies of non performance without giving the default notice, as of a rule or in all other cases, he should give default notice to the debtor before resorting to these remedies.
- But if the debtor still fails to perform his/her obligation/s even after default notice, the creditor can resort to one or more of the remedies provided hereinabove.

## 1. Forced(Specific) Performance

- **One of the effects/consequences of non performance of a contract by the debtor is forced/specific performance which implies the physical compulsion of the debtor to discharge his/her obligation.**
- **refers to performance directly imposed on the debtor through the execution process. Thus, it take place through court order/judgment.**
- **Nevertheless, specific performance can be ordered only if it meets the two cumulative criteria provided under Article 1776 of the CC, which are especial interest to the requiring party and without affecting the personal liberty of the debtor.**

## *Consequences of Non-Performance…ctd*

- **Pursuant to this Art, the first thing that the court shall determine is whether performance is '<u>of special interest to the creditor</u>'. The presence of special interest can be inferred from the importance of the obligation required to be discharged towards the creditor and its possibility of being discharged otherwise. If forced performance has no special advantage to the creditor, then the court may not order it.**
  - *E.g. special interest to the creditor(consumer) exists with supply of vital goods like water. Where water supplying gov.t entity cuts off the supply, a court forces it to supply the same because it is <u>of special interest to the creditor i. e. Life is unthinkable without water.</u> However, physical coercion is contested here.*

- The other important thing that the court shall determine is whether performance affects the personal liberty of the debtor. In short, if specific/forced performance affects the personal liberty of the debtor, the court shall not order it.
- Contracts should affect only the proprietary interest of parties not their liberty. **A person cannot be deprived of his liberty for failure to discharge his contractual obligations**.
- The jurisprudence behind prohibiting forced performance emphasizes that since contracts are not servitudes/slavery, they should not go to the extent of subjugating the personal liberty of the debtor.
- There is freedom of contract subject to the requirements of law and morality but there is no slavery in the contract under the guise of freedom of contract or non performance.
- Forced performance cannot be employed as an instance of self help; it take place through **court order/judgment.**

# 2. Substituted performance

- Another remedy for the creditor because of non performance by the debtor is substituted performance, performance by the creditor himself or by the person authorized by the creditor.
- Substituted performance is made at the expense and cost of the debtor. The cost may include the increased cost due to non-performance .
- Court authorization is , however, indispensable for substituted performance because with out such authorization the creditor cannot recover the costs and expenses from the debtor.
- The rules concerning substituted performance are provided under **Arts. 1777& 1778**. They are similar with the rules of law of sales provided under **Arts. 2330 & 2333.**
- **Article 1777(1)** addresses substituted performance during non performance of **obligation to do.** As per this Art. *the creditor may be authorized to do or to cause to be done at the debtor's expense the acts which the debtor assumed to do*. E,g. If Ato Belay, the debtor, fails to dig a well, Ato Abel, the creditor can dig the well himself or have dug the well by any one at Ato Belay's expense up on court authorization.
- On the other hand, **Article 1777(2)** addresses substituted performance during non performance of **obligation not to do** (obligation to refrain from doing sth). The provision reads *"The creditor may be authorized to destroy or to 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."*
  - ✓ E,g. If "A"'s obligation was to refrain from erecting a building and fail to do so by erecting a building, "B", the creditor, can have the building destroyed or destroy himself.

- Article 1778 also deals with substituted performance in respect of obligation to deliver fungible things. It reads: *Where fungible things are due, the creditor may be authorized by the court to buy at the debtor's expense the things which the debtor assumed to deliver.*
  - ✓ *E.g.* If Mr. A fail to perform his obligation of delivering 500 quintals of coffee in due time, the creditor may buy the agreed amount of coffee from the market upon court authorization.
- The provisions of Articles 1779-83 also are aspects of substituted performance but they apply in different circumstances; when the debtor is ready to perform but unable to discharge his obligation either because the creditor refuse to accept performance or the creditor is unknown or uncertain or where delivery cannot be made for any reason personal to the creditor.
- In all these situations, the debtor has no fault; ready to perform but prevented from performing. Thus, the law allows him to discharge his obligations by depositing the thing or money at such place as instructed by the court. This will relieve the debtor from his obligations. However, the deposit shall be made upon court order and the debtor shall obtain a court confirmation as to the validity of the deposit.

## 3. Cancellation

- **One of the effects/consequences of non performance of a contract by the debtor is cancellation. In other words, it is a**nother remedy for the creditor because of non performance of the obligation by the debtor.
- A creditor may opt for the cancellation of the contract where the above discussed two remedies are unavailable or for any other reasons.

## *Consequences of Non-Performance…ctd*

- Cancellation ends an already existing contract. Cancellation may take two forms-
  - *i. Judicial cancellation, which is a rule (Art.1784 & 1785 ) &*
  - *ii. Unilateral cancellation (Art.1786 & 1789 ) which is an exception to the rule.*

## I. judicial cancellation

- In principle, cancellation of a contract takes place through court action, i.e., the party who claims cancellation as a remedy of non-performance shall bring an action to that effect.
- The court decides, after hearing the parties, upon the request for cancellation submitted by the aggrieved party. But it does not mean that the court automatically cancels the contract upon the mere request of the aggrieved party. See Art. 1784, which reads: *A party may move the court to cancel the contract where the other party has not or not fully and adequately performed his obligations within the agreed period of time.*
- The term 'may' in the above provision indicates that the court may or may not decide in favor of the party requesting cancellation; instead it should take into account the conditions provided under Article1785 of the CC. As per this Article, good faith should guide the court in deciding on cancellation.
- let us analyze sub-Article 1 of Art. 1785 which reads:- *In making its decision, the court shall have regard to the interests of [both] parties and the requirements of good faith*. As per this provision, the court should consider both the interest of the creditor and of the debtor. E.g. if the creditors interest is only slightly affected by the debtor's incomplete performance while the debtor's interest would be gravely affected by a cancellation of the contract, or vice versa, such factor should be taken into account.
- Both Sub-articles 2 &3 of the same provision addresses fundamental breach of a contract which means that non performance of a contract is total and irreversible. In such case, cancellation must be granted irrespective of sub article 1 which addresses interest of the parties and the requirement of good faith.

- The breach is fundamental where, because of its importance in relation to the whole contract, it can be reasonably assumed that the claimant would not have concluded the contract had he foreseen such breach.
- The burden of proving that the breach is fundamental rests on the party who requires such cancellation. As discussed right now, minor deviations from the terms of the contract (whether in quantity or quality or delay etc) may not be sufficient to cancel it. We may reiterate Art. 1748 (1) which reads that: *the creditor may not refuse fungible things on the ground that the quantity or quality offered to him does not exactly conform to the contract, unless this is essential to him or has been expressly agreed.*
- **But the refusal of the court to grant the cancellation does not affect the aggrieved party's right to compensation.**

## II. Unilateral cancellation (Art.1786-1789 )

- **Unilateral cancellation connotes cancellation of a contract by one party without going to the court of law.**
- **It is an exception to judicial cancellation of a contract. There are policy reasons for the introduction of these exceptions such as the rapidity of modern business, which requires quick solution and the need to avoid work load of courts of law.**
- **As addressed under Articles 1786-1789, there are four circumstances under which a party can unilaterally cancel a contract without going to the court of law. These are:-**
  - ***i. Where there is a cancellation clause in the contract;***
  - ***ii. Where the debtor has failed to honor certain time limits;***
  - ***iii. Where performance becomes impossible and***
  - ***iv. The case of anticipatory breach of contract***

## *Consequences of Non-Performance…ctd*

- **Now let us analyze the circumstances one by one.**
- **The first case, as indicated under Article 1786, is where there is a cancellation clause in the contract. Article 1786 reads as: *A party may cancel the contract where a provision to this effect has been made in the contract and the conditions for enforcing such provision are present.***
- **This provision is a reaffirmation of freedom of contract which enables parties to incorporate a cancellation clause in their contract.**
- **The second case as indicated under Article 1787, is where the debtor has failed to honor certain time limits. According to this Article: *A party may cancel the contract where the other party has failed to perform his oblations within the period fixed in accordance with Art. 1770* [i.e. period of grace], *1774* [i.e. period fixed in the default notice], *or 1775 (b)* [obligations that are such that they must be performed within the time fixed].**
- **In legal parlance, such periods are called compulsory periods.**
- **The third case as indicated under Article 1788, is where** performance becomes impossible. The Article reads as:- *A party may cancel the contract even before the obligation of the other party is due where the performance by the other party of his obligations has become impossible or is hindered so that the essence of the contract is affected.*
- This provision envisages situation where performance was possible at the time of the making of the contract but which becomes impossible afterwards. This is usually referred to as intervening impossibility. Here, the material fact for the cancellation of a validly formed contract occurs after the conclusion of the contract.
  - ✓ *E.g. "X" agrees to deliver his bracelet to "Y". Unfortunately "X" lost it before he delivers to "Y". In this case, because performance is impossible, "Y" can unilaterally cancel the contract. "Y" can do this even before the due date simply because there is no point in waiting the arrival of the due date.*

## *Consequences of Non-Performance…ctd*

- **The last case where unilateral cancellation can be invoked is the case of anticipatory breach of contract.** Anticipatory breach of contract is when party to the contract refuses to perform his obligation. Read **Art. 1789** of the CC carefully.
- As per sub – Article 1 of this provision, when one of the parties expressly communicates his refusal to perform, the other party may **unilaterally cancel** the contract if he chooses.
- But the question that may be posed under sub- Article 2 is that why the party who intends to cancel the contract shall place the other party in default even if the defaulting party expressly communicated his refusal to perform his obligation?
- Sub- Article 3 answers this question. As per this sub- Article, it is only where the defaulting party communicates his refusal orally that the other party may place him in default. However, if the refusal is communicated in writing, there is no need of default notice and the other party can immediately cancel the contract unilaterally.
- **Under sub- Article 2, the party who orally communicated his refusal may prevent the cancellation of the contract by furnishing, within fifteen days, sufficient security to guarantee that he will perform his obligations at the agreed time. The furnishing of the sufficient security within fifteen days is an indication of change of mind.**
- ***Dear students do you think change of mind benefits a party who has communicated his express refusal in writing?*** **The law is clear enough here, it is only a party who has refused orally who can benefit from the change of his mind.**
- **Even if this point is covered under chapter 7, the last but important point that should be raised in relation to cancellation of a contract is its effect. The teaching material wrongly states that the effect of cancellation is reinstating parties to the position which would have existed, had the contract not been made. As we shall see in chapter 7, however, the effect of cancellation is putting the parties in the position had the contract been performed, not had the contract not been made.**

# 4. Damages /Compensation (Art. 1771 (2) & 1790-1805)

- Damages/Compensation is another remedy for a party affected by non-performance. The cumulative reading of Articles 1771 (2) and 1790 shows that under Ethiopian law damages can be claimed as an additional or alternative remedy.
- Dear students what do you think is the purpose of compensation?
- The purpose of compensation for non-performance is to put the victim party in a position he would have been had the contract been performed.
- According to Article 1790(1) of the CC, a party is entitled to compensation only if he /she has incurred loss or damage as a result of non-performance. The central notion here is no loss, no compensation.
- *Dear students, do you think absence of fault is a defense against the claim of compensation for non performance?*
- Article 1791(1) answers this question. It reads:- *" the party who fails to perform his obligations shall be liable to pay damages notwithstanding that he is not at fault"*. As per this sub- Article (In principle), absence of fault is not a defense against the claim of compensation for non performance.
- However, Article 1791(1) should be read in conjunction with Article 1790 i.e. a party who is not at fault may pays compensation for non performance only if the creditor incurs loss/damage because of such non performance.
- *Drear students, do you think there are defenses for the party required to pay compensation?*
- **The answer is positive; There are two defenses for the debtor against the claim of compensation by the creditor.** The first defense is the absence of fault. Even if we said that in principle absence of fault is not a defense against the claim of compensation for non performance, under Articles 1795& 1796 of the CC, there are certain exceptions to this general rule.

## *Consequences of Non-Performance…ctd*

- As per these exceptional provisions, the plaintiff has to prove fault or grave fault on the part of the debtor so as to succeed in claiming compensation.
- The 2nd defense for the debtor is force majeure. Art.1791(2) states that " [the debtor] *shall not be released unless he can show that performance was prevented by force majeure*". **The *acontrario* reading of this provision suggests that the debtor is released of payment of compensation if he can show that performance was prevented by force majeure.**
- It is also important to look at:-
  - ✓ **Article 1792** which provides the criteria for determining what constitutes force majeure;
  - ✓ **Article 1793** which provides list of specific cases that constitute force majeure &
  - ✓ **Article 1794** which provides list of specific cases that do not constitute force majeure.
- Nevertheless, pursuant to **Article 1798** of the CC, force majeure is not defense if it happened after the debtor had been already placed in default.
- Once, the liability of the debtor for damage is determined, the next question is to assess the amount of compensation (damages) to be paid to the creditor. Compensation is assessed according to the rules of **Articles 1799-1805**.
- The basic principle in assessing compensation is that **compensation shall be equal to the damage/loss which non-performance would normally cause to the creditor** in the eyes of a reasonable person **(Art.1799 (1)**)i.e., damage=damages. Thus we have objective criteria for assessing damage.
- NB:- in case of money debts, a creditor is entitled to compensation at the rate fixed under 1803 & 1804 without the need to prove the extent of loss/damage he has sustained as a result of non-performance. However, the creditor may claim more compensation if the compensation to be assessed according to 1803 & 1804 are not adequate for the greater damage/loss he has sustained (see Article 1805).

# Chapter V: Special provisions relating to contracts

## Chapter Objectives

**At the end of this chapter you will be able to:**

- *Explain time provisions;*
- *Discuss conditional contract and their types;*
- *Explain alternative obligations;*
- *Define earnest and its effect;*
- *Discuss contractual provisions as to liability*

## Introduction

- Special provisions relating to contracts are those provisions which help as **gap fillers** i.e. they help to fill those gaps left by parties to the contract.
- The most frequent areas where the parties do leave gaps or agree less clearly are stipulation as to:- time, earnest, liability (penalty clause), alternative obligations and Conditional Contractual Obligations.

## 1. Provision as to time

- Parties to the contract may more probably provide the time of performance **within certain period of time** without specifically stating the time. They may also provide the time **in certain number of days,** weeks, months, or ambiguously on first, last, or middle of a month.
- The presence of different days in months in **Gregorian calendar** and the presence of **thirteen months in Ethiopian** calendar coupled with the presence of **holidays** in between the stipulated time might continually and unexpectedly create gap as to time.

## *Provision as to time…ctd*

- Provisions as to time generally deals with the time at which performance is due in order that the debtor can be clear as to exactly when to perform his obligation.
- **Article 1858** addresses **time fixed in days. According to this provision** Where the period is fixed in days, **the debt shall be due on the last day of such period, the day of the making of the contract not being included.**
  - *For instance, if a contract made on Hidar 23/03/09 stipulates that performance should be within 7 days* from the date of formation of the contract, the last date for the performance of the contract is on Hidar 30/03/09 excluding the reference time *Hidar 23/03/09. It is counted within 24, 25, 26, 27, 28, 29 ,30 (7 days excluding the date of formation).*
- **Article 1859** reveal the **calculation of the period fixed in weeks**. As per this Article, Where the period is fixed in weeks**,** the debt shall be due on such **day of the last week as corresponds by its name to the day of the making of the contract.**
- To illustrate, assume Samson concluded a contract to perform his obligation on **Monday** Sene 1/3/1998. He agreed to perform his obligation after three weeks from the making of the contract. The due date is then **Monday** 22/1998.
- **Here, Monday in the time of formation of the contract should correspond to Monday in the time when performance shall be made.**
- **Article 1860** reveal the **calculation of the period fixed in months**.
- As per sub-article 1 of **Article 1860,** Where the period is fixed in months or so as to include several months, the debt shall be due on such **day of the last month as corresponds by its number to the day of the making of the contract.**

## *Provision as to time…ctd*

- As per this sub-article, the last date to perform an obligation is the day of the last month which corresponds the day of the making of the contract **in number, not in name.**
  - *For example, the last date for someone, who entered into contract on Hidar **23**, 2009 promising to perform his obligation within three months, is Yekatit **23**, 2009.*
- *Here*, **Sameness shall be in date not in name. If t**he date in the formation of the contract is ***23*** and the date of performance shall also be ***23***.
- **Sometimes certain dates of a month in Gregorian calendar might not have corresponding number in other months**.
- In such cases, the absence of corresponding number might create uncertainty whether it will be transferred to the next month or it will be the last day of the month, which does not have a corresponding number.
- In filling such gaps, **Sub Article (2) of Article 1860,** stipulates **the due date to be the last day of the last month. Read the whole sub article**
- *For instance, the due date of someone who concludes a contract on October 31 to perform his obligation in four months is February 29. Normally the corresponding number shall be 31. But there is no such number in February. This is because February does not have the date 31. Its last date is 29. Accordingly, the due date is February 29.*
- Coming to Ethiopian Calendar, there could be a gap because of its 13th month, Phagume. This is because, as the thirteenth month has five or six days, the probability of not getting corresponding date is more probable.
- As a result, under **Sub Article 3 of Article 1860, the law opted to totally disregard the 13th month of Ethiopia**

## *Provision as to time…ctd*

- **Hence,** Phagume is not taken into account in monthly calculation of time and **a contract concluded on any day of Phagume is considered that it has been made on Meskerem 1 in the Ethiopian calendar.**
- Sometimes, contracts may stipulate time provisions with less clarity using indistinct and puzzling expressions like, **at the beginning, in the middle or at the end of a certain month.**
- **Article 1861 is designed to fill such gaps. As per Article 1861(1),** *Where the period expires at the **beginning** or at the **end** of a month, such period shall expire on the **first** or on the **last day of such month.***
- **As per Article 1861(2),** *Where the period expires in the **middle** of a month such period shall expire on the **fifteenth** of such month.*
- The law also wants to fill gaps which might be created because of holidays. According to **Article 1862,** *Where the period expires on a day which is **holiday at the place of payment**, such period shall expire on the next working day.*
- But the law is not clear as regards the type of holiday; is it only national holiday? Or limited to Saturday and Sunday? Or Religious or customary holiday? The writers believe that the holiday should not necessarily limited to national holiday.
- There are also some provisions addressing other time related issues from Article 1863-1868 which should be read by yourselves.

# 2. Conditional Contractual Obligations

- Providing a condition upon the fulfillment of which the effect of contract depends is one way by which parties to the contract exercise their freedom of contract.
- It is one way by which parties may determine the fate of their agreement.
- Contracting parties can make their contract conditional as a whole or partially (one of its terms).
- The rule (principle) of conditional contractual obligations is stipulated under **Article 1869** of the CC which reads as:- *"A contract shall be deemed to be conditional where* ***it relates to an obligation whose existence[or non-existence] depends on the occurrence or non-occurrence of uncertain event.***"
- **Condition determines the effect of contract in two ways. It either makes the contract effective upon its fulfillment or ends the effect of contract.**
- **While a condition which makes the contract effective upon its fulfillment is called Condition precedent or suspensive condition the one which ends the effect of contract is called condition Subsequent or resolutive condtion.**

## A. Condition precedent (suspensive) condition

- As we discussed it right now, a precedent (suspensive)condition is a condition of uncertain event upon the happening or fulfillment of which a contract subject to it becomes effective.
- In short it is a condition which keeps the contract **in suspense until its fulfillment. Contract is effective only upon the fulfillment of a condition.**
- Now look at **Article 1871** which states that**:-** *"Unless otherwise agreed,* ***the contract shall be effective as from the day when the condition is fulfilled".***

***Condition precedent (suspensive) condition***

- This provision provides **a presumption in favor of condition precedent** in the absence of agreement otherwise.
  - *For instance, Getachew concluded a contract with Alemu that **he is going to sell his car if he wins foreign scholarship.** In the case at hand, the contract of sale of car will have effect only if Getachew wins foreign scholarship.*

## B. Condition Subsequent (Resolutive condition)

- Is a condition of an uncertain event **upon the fulfillment of which the contract subject to it ceases to exist(terminated).** This condition is direct opposite of a precedent condition.
- In this type of condition, **the effect of the contract starts immediately after the formation of the contract but the contract ceases to exist (terminated) upon the occurrence of the event**.
- Now look at **Article 1872** which addresses this type of condition.

  *(1). A contract whose cancellation (***termination***) depends on the occurrence of an uncertain event shall be effective forthwith.*

  *(2). It shall cease to be effective where the event occurs.*

  *E.g. Chala concluded contract of house rent with Abdi on the condition that he lives in the house until Abdi gets married.*

- Even if the effect of the condition subsequent is **termination** of the contract up on its fulfillment an uncertain event, it is not followed by compensation since the **termination** is because of the agreement(Contract) of the parties .
- Another point worth mentioning as regards Condition Subsequent(Resolutive condition) is that during the agreement, parties to the contract should expressly agree that the condition is Condition Subsequent(Resolutive condition) for otherwise the law presumes the condition to be condition precedent**. Art. 1871.**

# Good faith in conditional contractual obligations

- *Dear students, what do you think if one of the parties to the contract prevents the fulfillment of certain event in a bad faith?*

- **Article 1870** has an answer for this question. It reads as:- *A party may regard a condition as fulfilled where the other party has prevented its fulfillment in a manner contrary to good faith.*
- Even though the condition is not fulfilled, if its fulfillment is hindered by one of the parties and **his act of hindrance emanates from bad faith,** the condition can be presumed to have been fulfilled. **Then the party may require the right he would have done so had the condition been fulfilled.**
- Let us see an example provided by the writers. *assume that Ato Abebe entered into a contract with Senait to sell his house if he is employed. Later, if Ato Abebe refuses the employment having got the chance, Senait can require performance of the contract proving that he did it in bad faith.*
- Article 1870 is equally applicable to condition subsequent(Resolutive condition too).
- In the earlier example, i.e. in the contract of house rent *concluded between Chala and Abdi on the condition that Chala lives in the house until Abdi gets married if Chala prevents the marriage of Abdi by whatever way to stay in the house, the law presumes that the condition is fulfilled i.e Abdi got married so that Chala should search for another house to rent.*
- Article 1873 lacks clarity even if it seems redundant in the presence of Article 1870.

## Acts of management with regard to the object of the contract subject to condition

- It does not mean, however, that the parties are absolutely excluded from any act with regard to the object of the contract subject to condition.
- Strict restriction not to do anything on the object of the contract not only renders it unproductive but also denies the holder the right to take necessary measures to protect damage and depreciation and administer the thing.
- In line with **Article 1874** of the CC, despite certain restrictions, the holder may exercise certain acts on the object of the contract subject to condition.
- According to **Article 1874,** *Acts of management done prior who exercises the right shall remain valid where the condition is fulfilled. Damage may be claimed where such acts were done in bad faith.*
- Acts of management are provided under **Articles 2204** which include Lease for term less than three years, the collection of debits, investment of income, discharge of debts, are acts of management
- These two provisions are not exhaustive lists which exclude other acts. Other acts may also be included by analogical interpretation now that these lists are illustrative lists.

## Acts beyond management with regard to the object of the contract subject to condition (Art.1875)

- Acts beyond management are those acts made to affect the interest of the party for whom performance will be made. They are acts made in bad faith and are subjected to invalidation.
- Acts beyond management are provided under **Article 2205** and includes alienating or mortgaging real-estate, investing capitals, signing a bill of exchange, effecting a settlement, giving consent to arbitration, making donations or bringing or defending an action are acts beyond management

## *Acts beyond management with regard to the object of the contract subject to condition… ctd*

- However, the invalidation of acts beyond management should not prejudice the rights of 3rd parties who have dealing with the actual holder.
- The law protects the interests of 3rd parties too. **Art.1875(2).**
- Another point worth mentioning as related to Conditional contractual obligations is about **Unlawful, immoral or impossible conditions.**
- In this regard, **Unlawful, immoral or impossible conditions are regulated by applying provisions relating to the impossible, unlawful or immoral object of a contract, starting Art.1715-1716.**

- **Class Discussion:- Discuss in groups what it mean by Unlawful, immoral or impossible condition by giving examples to each kinds of conditions.**

## 3. Alternative Obligations

- Another manifestation of parties' freedom of contract is their agreement for alternative obligations.
- **Alternative obligation happens in a contract when the debtor is to discharge one among different obligations.**
- *For instance, if Abeje, who is an engineer borrowed 2,000,000 Birr from Merkebu and their agreement provides that Abeje performs the obligation either by paying back the money in cash or building a house for merkebu, Abeje has the right to choose which one to perform.*
- According to Article 1880, the debtor is released by performing **either of the obligations** provided in the contract. In the above example, Abeje is released by **either paying the money in cash or** *building a house which can be built by 2,000,000 Birr.*

***Alternative obligations…ctd***

- *Dear students! Who, do you think, has a right to choose the obligation to be carried out among the agreed alternatives?* **Article 1881** has an answer to this question.
- *Dear students! What do you think is the fate of performance if one of the obligations becomes impossible?* **Article 1882** has an answer to this question . As per sub-article 1 of **Article 1882,** *if one of the obligations becomes impossible, the debtor shall discharge the other obligation.*

➢ On the other hand, As per sub-article 2 of **the same article,** if the impossibility is owing to fault of the party that is not entitled to choose, damage is required to be paid to the party that is entitled to choose.

## 4. Earnest

➢ is an old and frequent practice which is considered to be **testament** for the conclusion of a contract.

➢ As per Article 1883 of CC, the giving of earnest is the proof of the making of the contract.

➢ There are, however, different positions as to whether earnest entitles a party the right to terminate a contract unilaterally.

➢ When we see the position held by the Ethiopian law, termination of promise guaranteed by earnest unilaterally is possible upon certain limitations.

➢ As per **Article *1885(1)*,** *Unless otherwise agreed* ***the party who has given earnest may cancel the contract subject to forfeiture of the earnest given by him.***

➢ As per **Article *1885(2)*,** *Unless otherwise agreed*, ***the party who has received earnest may cancel the contract subject to repayment of double of the amount received by him.***

*Earnest…ctd*

- As it can be easily inferred from the provision, a contract secured by earnest can be **cancelled unilaterally by either party**. However, as it can be seen from the sub provisions, the effect is not the same for both parties *Unless otherwise agreed .*
  - *Dear students, what do you think happens to earnest if the contract is performed?* **Article 1884** has an answer and stipulates:- *Unless otherwise agreed the party who has received earnest shall return it or deduct it from his claim where the contract is performed.*
- But what is controversial regarding earnest is the issue of compensation upon non performance of the contract. *Do you think it is possible to claim compensation? If yes, in what amount , i.e. can one who has given earnest claim more than double of what he has given as earnest if he can establish damage in this effect? What about the one who received earnest in the same situation?*

## 5. Penalty Clauses/ Provisions as to liability

- The Ethiopian law of contract has provided remedies of non-performance as a gap filling ones. Nevertheless, **freedom of the parties to the contract to set aside such gap filling provisions and provide their own is permitted.**
- The parties can either extend or limit their liability subject to the legal limitation of unconscionable contract.
- As per **article 1886** of the CC, the parties can agree to extend their liability **even in the presence of force majeure**.
- Contrary to this, they may also agree that one of them held liable only upon committing a fault. **Article 1887.**
- **Determining penalty by the parties to the contract helps to encourage performance of the contract or in other words it discourages non performance.**
- Parties to the contract can fix penalty clause either in the main contract or in a separate document.

## *Provisions as to liability…ctd*

- However, freedom to fix the amount of damage (penalty) might on the other hand create unconscionable contract (Lesion) which is subjected to invalidation.
- Article 1710 shall, consequently, be applied to limit the extent of the amount of damage at the time of non-performance of contract.
- If the penalty is terribly maximum and backed up by condition that renders the party in unequal bargaining power, it is subjected to invalidation on the account of **unconscionable contract** pursuant to **Article 1710(2)** or to rectification pursuant to Article 1812.
  - *Dear students, what do you think is the fate of penalty clause in case if the contract in which it is prescribed is invalidated?*
  - *On the other hand, what do you think is the fate of the contract if the penalty clause is invalidated?*
- **Article 1894** has a clear answer to this questions. As per this provision:-

  *(1)* ***A penalty shall be of no effect where the contract in which it is prescribed is invalidated***

  ***(2) A contract shall remain in force notwithstanding that the penalty is not valid.***
- **The validity of a penalty clause can be affected by the validity of the main contract. Not Vice Versa.**
- Another important point regarding penalty clauses is that **the aim of inserting penalty clauses in a contract is not to give an option to the contracting party either to perform or pay penalty, rather it is to discourage non performance.**
- In other words, penalty clause should not be equated with earnest which gives option to the parties either to perform or cancel the contract upon paying the amount of earnest provided by the law or the agreed amount of earnest.

## *Provisions as to liability…ctd*

- *Dear students…! Do you think a creditor can require both performance and penalty from the debtor?*

➢ *Look at* **Article 1890** which reads:-

*(1) Unless otherwise agreed, the creditor **may require** the performance of a contract which includes a penalty.*

*(2) He **may not require** both the enforcement of the contract and the penality unless the penalty was provided in respect of delay or the non-performance of collateral obligations.*

- *Dear students…! Do you see any problem between sub-article 1 and 2? Do you think they are contradicting each other or one is principle and the other exception?*

➢ As to my position, sub-article 2 is more feasible compared to sub-article 1

- *Dear students…! Look at also* **Articles 1891 vs 1892(1)**! *Are they exception to one another or contradicting each other?*,

- *How can we apply **Article 1892(1)** in the absence of agreement? Do you think it possible to claim compensation in addition to penalty? **Article 1892(2)**?*

➢ Another point worth mentioning is variation of penalty provided under **Article 1893 which reads:- *The agreed amount of penalty** due for non-performance **may not be reduced by the court unless partial performance has taken place***.

➢ As per this article, the court can vary (reduce) the penalty clause if there is partial performance. This seems to be justified on account of securing justice…; Ordering the whole penalty while there is partial performance is actually unfair which begs correction .

## *Provisions as to liability…ctd*

- Contrary to what is addressed under chapter 4, (the part addressing non-performance of a contract) where there is contractual liability in the absence of fault , here, the parties may agree that they would be liable only where they commit a fault. See Article 1887 in this regard.

- **Parties to a contract cannot, however, exclude liability of non-performance because of fault as it encourages deliberate breach of contract.**
- **There is, however, an exception to** Article 1887 under **Article 1888**
- **Article 1888 (2):-** The effect of such limitation of liability should be only on the contracting parties.

# Chapter 6: Plurality of Debtors or Creditors

## Chapter Objectives

At the end of this chapter, students will able to:

- *Define joint and several liability or solidary obligations;*
- *Explain the effect of joint and several liabilities among co-debtors;*
- *Discuss the relationship of co-debtors with the creditor;*
- *Discuss the relationship of co-debtors among themselves;*
- *Define joint obligations in the case of plurality of creditors;*
- *Explain the effect of joint creditorship;*
- *Discuss the relationship of the joint creditors inter se;*
- *Distinguish indivisible and divisible obligations and explain their effects.*

## Introduction

- So far, we were addressing contracts which involve only single debtor and single creditor. **Law of contract also addresses contracts which involves several creditors and debtors.**
- The concept of plurality of debtors or creditors is treated as **solidary obligations** in the civil law and as **joint and several obligations** in the common law.
- The Civil law concept of solidary obligation and the common law concept of joint and several obligations have a common feature, i.e., the contract binds all obligors jointly as well as severally for the performance of the total obligation.
- Actually each party contracts a several promise to discharge the total obligation in addition to contracting a joint promise with the other.

# Joint and several liability in case of plurality of debtors under the Ethiopian law

- As we have addressed in the introduction part, an obligation is said to be joint and several among the debtors when each debtor is considered in his relation with the creditor as debtor of the entire performance (as if he were the only debtor) or where both debtors are jointly liable for the whole debt.
- In other words, each solidary debtor or both solidary debtors, in so far as the creditor or creditors are concerned, is/are the debtor (s) of the entire amount individually (severally) or jointly.
- Thus, each debtor is held liable until the obligation is fully discharged.
- The principles of solidary obligation are provided under **Articles 1896 & 1897 of the Civil Code.**
- As per Article 1896, *unless otherwise agreed or provided by law, co-debtors shall be jointly and severally liable*. **This implies that failing an express provision to the contrary, the very fact that there are two or more debtors makes them jointly and severally compelled to perform the obligation.**
- Unlike the foreign legislation such as French and German which favors debtors, the Ethiopian Civil Code is in favor of creditors regarding the point at hand.
- In joint and several liability of debtors, the creditor does not have to divide his actions between the joint debtors: he has a right to simply select the one most likely to be able to pay in full and lets him later take the risk of getting refunded from his co-debtors per Article 1908.

## The effect of joint and several obligations on the relations between creditor(s) and co-debtors

- All the effects, among debtors, derive from the principle that each of the co-debtors, taken separately, is bound towards the creditor so completely and absolutely as if he was the only debtor.
- Since the co-debtors are bound one for the others and each for all, for the entire debt, they must be considered in their collective relations with the creditor as representing each other. This representation benefits both the creditor and the co debtors.

## *Joint and several liability..Ctd*

- **In addition to those effects addressed so far, joint & several liability of debtors produces the following effects too:-**

### A. Effect on Resjudicata

- Resjudicata is a ppl which prohibits a plaintiff from bringing a court action for a second time against the defendant on the case finally decided. See Art. 5 of CPC.
- Coming to resjudicata in cases of joint and several liability, it does not work. As per **Article 1898** of the CC, ***Proceedings instituted against one of the debtors shall be no bar to similar proceedings being instituted against the other debtors.***
- The *acontrario* reading of **Article 1898** implies that, **the creditor who has instituted a court action against one joint debtor is prohibited from proceeding against the same person.** This is implied from the phrase **"other debtors".**

### B. Effect on Default notice

- As we know, a creditor who has a right to demand performance from co-debtors is required to put the debtors in default to claim rights arising from the non performance of the debtors unless it is unnecessary according to Article 1775 of the Civil Code.
- **A notice given to one is deemed given to all, and interrupts limitation** (see **Article 1899** of the Civil Code).
- Thus, the notice sent to one transfers risks for all debtors.

### C. Effect On void and voidable contracts

  - *Do you remember what void and voidable contract is from our previous sessions?*

- where the contract is void, any of the co-debtors can raise this defense against the creditor(s). This defense is **common defense available to all.**

## *Joint and several liability…ctd*

- *For instance, **if the object of the contract is unlawful, immoral or the contract doesn't fulfill the prescribed formality requirement**, any co-debtor can raise such defense.*

- ***In addition to this,*** payment and limitation of actions are other common defenses that are available to all the co-debtors. **Article 1901**
- On the other hand, where the contract is voidable this may not be raised by all the co-debtors. It is only a debtor who has the right to invoke invalidation of such contract that may raise it as a defense. Accordingly, **the defense is said to be a personal one.**
  - *For instance, if the contract suffers from defect in consent or in capacity by one of the co-debtors, it is only this co-debtor, who is mistaken, deceived, compelled, or incapable, that can raise this defense.*
- Effect of joint and several liability on void and voidable contracts *is provided under **Article 1900.*** In this regard sub-Article one seems to refer to void contracts while the second sub Article relates to contracts which are voidable.

# D. Effects on remission of debt

- **Remission is cancellation of debt by the creditor** in favor of a debtor.
- As per **Article 1902(1) w**here the creditor remits the debt **to one of the co-debtors,** then all the co-debtors will benefit from such remission. I.e. all of them become free from the obligation.
- However, **The creditor can make the remission to benefit only one of the co-debtors and reserve his right against the others for the remaining amount. In other words, he can collect from the other debtor/s the remaining amount deducting the amount he has remitted for one of the debtors. Art. 1902(2)**
  - ✓ ***Can he collect the full amount even if he has exclusively remitted the debt of one of the co-debtors?* As per the rule of joint and several liability, the answer seems positive but it contradicts the requirement of good faith in contracts.**
- **The *acontrario* reading of Article 1902(2)**implies that if the creditor fails to specify that the debt is remitted for the exclusive advantage of one debtor, remission made for such debtor releases all co –debtors.
- There is, however, **inconsistency between the two versions of Sub-Article 3 of Article 1902.** The English version erodes the presence of shares among the debtor. The Amharic version on the other hand, implies the presence of shares and thus **in line with the concepts of the other sub-articles. So, it prevails over the** English version which is confusing.

## E. Effects on Novation

- **Novation,** *as we shall address under chr7*, **is to substitute a new obligation for the original one.**
- In the same way to that of remission, **in case where the creditor agrees with one of the co-debtors to substitute a new obligation for the original one,(where novation occurs between one of the co-debtors and creditor), all the other co-debtors will be released from their obligation entirely. ( Article 1903(1).**
- **As it is the case in remission of debt, the creditor may limit the effect of the novation only to one of the co-debtors during which the remaining co-debtors will remain liable to the creditor but their liability will be reduced to the extent of the share of the co-debtor who has agreed with the creditor, ( Article 1903(2).**
  - ✓ ***By the way…what is the difference between novation and alternative obligations(the one we have addressed under chapter V)***

## F. Effects on set off

- **Set off,** as we shall see under chr7, **is the counterbalancing of debt between the creditor and debtor.**
- This is the situation where the creditor himself is the debtor of his debtor in another contract.
- **As per Article 1904 of the Amharic version, the co-debtor who is owed by the creditor can invoke setoff.**
- **In such case, the remaining co-debtors will remain liable to the creditor but their liability will be reduced to the extent of the share of the co-debtor who agreed to make set off with the creditor.**

*Effects on set off…ctd*

- **It also seems that when the question for set off is invoked by a co-debtor against the creditor, both the co-debtor with such right and other co-debtors are liable to the remaining amount unless the creditor limits the effect of set off to the former.**
- Unlike in the cases of remission and novation, the law is silent whether set of made with one of the co-debtors releases all co-debtor.
- **The two versions of Article 1904 seems to have discrepancy. However, the Amharic version seems appropriate for it clearly addresses issue of share.**
- *The issue, however, is whether or not the other co-debtors can invoke set-off on behalf of their co-debtor. What do you think?*

## G) Effects on Merger

- Literally defined, merger is the combining of two things e.g. 2 companies combined to form 1 company. Legally, merger is the combining of two estates or titles to form a single estate or title.
- As per article 1905 of the **Amharic Version**, If there is merger, on the debt between one co-debtor and creditor, the portion of the common debt that relates to one of the co-debtors will no longer exist.
    - *For example, C, D and E are joint debtors of A for 3,000 Birr. A dies and C is his heir. Merger therefore happens between A and C, the latter may request of D and E their share in the contribution, or 1000 Birr each.*
- As usual there is inconsistency between the Amharic and English versions of Article 1905. the Amharic Version seems appropriate.

# The relation of the co-debtors *inter se*

- is to mean the relation of the co-debtors as **between themselves or among themselves**.
- where several debtors are bound jointly and severally for the performance of one and the same obligation, they are **duty bound to promote the betterment of the condition of all of them.**
- Accordingly, a debtor is required to abstain from doing anything which might aggravate the situation of the other co-debtors. This principle is incorporated under **Article 1906** of the Civil Code.
- *For instance, failure to raise defenses available to all co debtors.* In fact, failure to raise defenses available to all co debtors makes the failing co debtor liable. **Article 1906(2).**
- The co-debtors will share the common debt after payment. After the performance of the obligation, the obligation becomes divisible among the co-debtors.
- Once the creditor has been paid, joint liability ceases and the principle is that of the division of the debt between the debtors, on an equal basis, unless otherwise provided **(Article 1907).**

**Right of recourse:** In so far as each debtor is liable to contribute to the extent of his part in the common debt, a debtor who has paid in excess of his share will be entitled to a right of recourse against the remaining co-debtors for the excess amount as per-Article **1908.**

- **However, where** one of the debtor's shares cannot be recovered, **Sub Article (2)** of **Article 1908** provides that such unrecovered amount is to be repaid by the other co-debtors in proportion to their share.

**Right of subrogation:-** a debtor who has paid in excess of his share will be entitled to a right of recourse against the other co-debtors who have not yet paid their shares pursuant to Article 1908 of the Civil Code.

*The relation of the co-debtors inter se…ctd*

- Such action is what is called **the legal right of subrogation** as a result of which **such paying debtor will be placed in the position of the creditor to the extent of the amount paid by him to the creditor.**
- In such cases, the creditor is legally required to hand over any document and make available all information to the paying debtor to enable the latter to claim from his co-debtors. Failure of this may raise to his liability. **Article 1909(3)**

## Joint Creditors

- As regards joint creditors, even if Article 1910 seems to stipulate the reverse of joint and several liability, the phrase **" unless otherwise agreed"** in the same provision and **the articles (1911 and 1912)** do not show any opposite stipulation.
- *The question that should be well addressed here is that what is the purpose of **articles (1911 and 1912)** if the idea of joint creditorship is the reverse idea of joint and several liability?*
- In this regard there is no clear-cut answer but only arguments. Accordingly, the first argument is that Article 1911 & 1912 of the Civil Code are applicable only when there is **agreement** between creditors as to joint and several entitlements.
- The second argument relates the applicability of **Articles 1911 and 1912** with the concept of **mutual representation or mutual agency** even though it is not clear on how such mutual representation is created without an agreement.
- To my understanding, the applicability of **Articles 1911 and 1912**, which is exactly the same with the concept of joint and several obligation of debtors, should be based on **agreement o**f joint creditors only which seems feasible compared to the argument of representation.
- Thus the discussion on **Articles 1911 and 1912** seems redundant since it is exactly the same with the concept of joint and several liability despite change of parties from co debtors to co creditors.

*Joint creditors…ctd*

- Still, **Articles 1913-1916** which address issues of **remission, novation, set off, and ultimate sharing, respectively,** are <u>not in line with the ppl of joint and several obligations.</u>

- Firstly, as per article **1913,** none of the joint creditors can remit the entire debt without the consent of the others. Where remission of debt is made by one joint creditor, the credit remains intact with regard to the other creditors. The remission will be effective only as to the part of the joint creditor who effected the remission.
- Secondly, similar to remission, a joint creditor does not have the mandate to enter into a novation agreement with regard to the entire credit. Any novation agreement made by a joint creditor will have effect only with respect to the share of that creditor as per **Article 1914** of the Civil Code.
- Thirdly, in case where the debtor becomes creditor of one of the co-creditors, the debtor may invoke set off against the other co-creditors only to the extent of the share of such creditor pursuant to **Article 1915** of the Civil Code.
- Lastly, where one of the co-creditors has collected the entire amount of the debt from the debtor(s), he is held liable to the others for the share in the obligation corresponding to them. A joint creditor who is paid more than his share must then distribute the surplus between his co-creditors, in proportion of their respective shares. **Article 1916**

# Non Joint Obligations

- There may be situations where there is plurality of debtors and/or creditors regarding an obligation that is not joint and several one. The obligation may be either **indivisible or divisible**. Indivisible obligation is treated under Article 1917 of the Civil Code and divisible obligation is treated under Articles 1918 and 1919 of the Civil Code.

## A. Indivisible obligations

- Indivisibility **is generally a characteristic of the object of the obligation**. For instance, a car is indivisible if this is the object of the obligation. The same applies to a given **obligation to perform a service.**
- where the obligation is indivisible, the debtor cannot execute the obligation in part. In such cases, it is impossible for the debtor to perform his obligation in part, but must be performed altogether.
- An obligation could be indivisible either by its nature or by the operation of law or by the agreement of parties to the contract.
- **Article 1917** provides that the provisions regarding joint obligations shall apply by analogy to obligations which are indivisible owing to their nature.
- Indivisibility of an obligation has its own effects in case of plurality of debtors and creditors.
- In terms of their effect indivisible obligations are the same with joint and several obligations. Accordingly, **the provisions dealing with jointly and severally liable co-debtors is applicable for those co-debtors whose obligation are indivisible by its own nature (see Articles 1896 through 1909 cum 1917 of the Civil Code).**

# B. Divisible obligations

- According to **Article 1918**,an obligation is said to be divisible where it is neither joint nor indivisible.
- The principle underlying divisible obligations among several debtors is that the debt is to be divided into as many fractions as there are debtors.
- In divisible obligation, there is no representation among the co-debtors.
- The following effects arise from the principle of divisible obligation:

- Firstly, each debtor is bound to pay, only his respective portion of the debt which of course is not necessarily equal to that of the others, rather depends on their contract or law in every case.
- Secondly, acts interrupting the period of limitation directed against only one of the debtors cannot be asserted against the other debtors.
- Thirdly, the risk of insolvency of one of the debtors is assumed by the creditor and not by the other debtors.
- Fourthly, where the divisible obligation is accompanied by a penalty clause, the penalty is incurred by the debtor who breaches the obligation and only for the portion of the principal obligation for which he is bound.
- Fifthly, the default of one of the debtors is absolutely without effect as to others.
- Sixthly, the remission of the debt made to one of them is without incidence on the others. The remission does not profit nor burden them, because their obligation is divisible.
- Lastly, a novation agreement made between a creditor and a co-debtor will release only such co-debtor, but no effect with respect to the other co-debtors.

- In general, the effect of a divisible obligation is that each link to the creditor is independent of the others and in this regard **there are many similarities between the effects of divisible obligations and the effects of joint obligations provided under Articles 1913-1918**

# Chapter 7: Extinction of Obligations

## Chapter Objectives

At the end of this chapter, you will be able to:

- *Distinguish invalidation, cancellation, and termination and explain their effects;*
- *Explain remission of debts and its effects;*
- *Discuss novation, set-off, limitation of actions and merger as grounds for extinction of obligations;*

## Introduction

- Extinction of an obligation Connotes the stoppage of an already existing obligation .
- As per the Cumulative reading of Arts.1806 & 1807 of the C.C, **grounds of extinction of obligation include:**
  - ***i. Performance,***
  - ***ii. Invalidation,***
  - ***iii. Cancellation,***
  - ***iv. Termination,***
  - ***v. Remission***
  - ***vi. Novation,***
  - ***vii. Set off,***
  - ***viii. Merger and***
  - ***ix. Period of limitation of a contract.***

# I. Performance of a contract

- *is not only an effect of contract but also a ground of extinction of obligation.*
- *Performance of the contract shall however be made according to the terms of the contract and mandatory provisions of the law if it shall extinguish contractual obligation.*

## II. Invalidation of a contract

- As it is discussed under chapter 2, Invalidation of a contract happens when there is defect in the formation of the contract (Defect in consent or Incapacity).
- **The effect of invalidation is restitution(reinstatement or retrospective)**. The contracting parties are put in the place where they were before the formation of the contract.
- Sometimes **compensation** might be ordered when a contract is invalidated.
- The damages/compensation following from an invalidation of a contract aims at **putting the contracting parties in the place they would have been had the contract not been formed/made.**
- Under Ethiopian law of contract, it is not anyone who can request the invalidation of a defective contract. It shall be the party who is affected by the invalid contract that can invalidate the contract. **Article 1808 (1)**
- This is to protect the interest of the affected party. The other party who is not affected is considered to have full information or rationality behavior. Hence, there is no reason to help him by empowering him to invalidate the contract
- Representatives of the party, that is potential to be adversely affected by the invalid contract might be in a position of enforcing the rights of the party.

*Invalidation of a contract…ctd*

- Unless an invalid contract is invalidated, the contract is upheld and becomes effective. **Logically speaking, it seems that, even if invalid, the contract which is not invalidated by court of law should be performed for otherwise the remedies of non performance will be due. However, Article 1809 stipulates the reverse of this. *How do you see it? Don't you think it is inconsistent with the ideas under Article 1808 and 1810?***
- The other controversial point as regards invalidation of a contract is **the invalidation of a void contract** as provided under **Article 1808(2). As per this sub article,** *"A contract whose object is unlawful or immoral or a contract not made in the prescribed form may be invalidated at the request of any contracting party or interested third party".*
- ***The question is that if void contract is a contract which does not exist from the very beginning, how can one invalidate something which does not exist? How can we demolish a house that we have not built from the very beginning?***
- Coming to the invalidation of voidable contract, the presence of invalid contract does not necessarily mean that the contract will be invalidated and the obligation will be extinguished.
- As we addressed under chapter 2 , **voidable contract can be cured where the party who is affected by defect in consent or capacity confirms the continuation of the kt**. In this regard, **Article 1811** reads "*the party whose consent was vitiated may waive his right to require invalidation where the cause which vitiated his consent disappeared.*" ***Article 1814*** *also deals with this point.*
- **Moreover, the right to invalidate a contract is limited by lapse of a certain period of time. Article 1810** connotes that a contract shall not be invalidated unless an action to this effect is brought within **two years** from disappearance of the ground for invalidation except, unconscionable contract for which the starting point is the formation of the contract.

- If the ground for invalidation is a mistake, within two years from the knowledge of the misperception , if the ground is duress, within two years from the avoidance of the threat, and if the ground is incapacity, within two years from the time the incapable becomes capable are the points where counting starts.
- But regarding unconscionable contract, period of limitation starts to count immediately after the formation of the contract and lasts only to two years from that specific date. But the law is silent regarding the counting of period of limitation if the injured is under age.
- But one point worth consideration regarding the period of limitation to invalidate a contract is inconsistency between **Articles 1810(1) and 1845**, the former provides 2 years while the latter provides 10 years? **Shall we use the term *"unless otherwise provided by law"* under Article 1845, to precede Article 1810 over Article 1845? What about the redundancy?**
- The other point worth consideration in the invalidation is the interest of 3rd parties to the contract. In this regard**, Article, 1816** provides that "*Acts done in performance of a contract shall not be invalidated where the interest of third parties in good faith requires*"

## III. Cancellation of a contract

- Another very important ground of extinguishing a contract is its cancellation.
- Cancellation is making validly formed contract ineffective when there is non-performance.
- It serves both as a ground of extinguishing a contract and remedy of non performance (as addressed under chapter 4).

- Even if there exist some similarities between invalidation and cancellation, the two concepts are not the same.

❑To discuss the **similarities** first:-

- ✓ both invalidation and cancellation are the grounds to extinguish a contract,
- ✓ both invalidation and cancellation are the grounds to claim compensation,

- **<u>Coming to the points of difference between invalidation and cancellation</u>**:-
  - ✓ The first point of difference is their **ground.** Accordingly while the ground for the invalidation of a contract is defect in the formation, the ground for the cancellation of a contract is non performance.
  - ✓ The second difference between invalidation and cancellation is in their effect as related to compensation. In this regard, Even though the effect of both invalidation and cancellation is restitution, cancellation additionally entitles the party a compensation that rewards the benefit of contract. ***i.e., reinstatement + entitlements to the compensation that rewards the benefit had the contract been performed.***
  - ✓ In other words, while the compensation following from an invalidation of a contract aims at **putting a contracting party in the place he would have been had the contract not been formed/made, i.e. restitution,** the compensation following from cancellation of a contract aims at **not only restitution but also to the entitlements had the contract been performed.**
  - ✓ This shows compensation for cancellation is more stringent when compared to compensation for invalidation. i.e. in cancellation, compensation is paid not only to restitute a party but also to entitle him benefit of a contract. **This shows that compensation for cancellation has both retrospective and prospective effect.**

- In this regard, **Article 1815,** which makes the effects of invalidation and cancellation the same thing is a wrong provision which might be applied only to invalidation. The phrasing *"invalidation or cancellation"* is wrong as they are different concepts.

➢ Another point which makes Article 1815 meaningless as regards compensation due to non performance of a contract is the presence of Article 1790(1) which is rightly provided under the title of non performance of a contract. In this regard please look at George Krzeczunowicz's analysis of the provisions at page139 of his book (Formation and Effect of Contracts in Ethiopian Law).

➢ He concludes that in case of inconsistency Article 1790(1) should prevail over Article 1815.

## IV. Termination of Contract (ዉል ስለ ማስቀረት)

➢ is also one way by which obligation is extinguished.

➢ is making the contract ineffective starting from the time of termination of the contract.

**Similarities and differences between invalidation and cancellation on the one hand and termination**

➢ The similarities between termination and the other two (invalidation and cancellation) is that all are the grounds to extinguish obligation.

❖ The basic difference between z two categories is their **effect and ground**.

❖ In terms of effect, **while the effect of Invalidation and cancellation is retrospective** [*even though cancellation additionally entitles the party a compensation that rewards the benefit of contract]*, that of the termination is **prospective** (forward looking).

*Termination of Contract…ctd*

- As per the definition of contract provided under **Art.1675,** agreement to terminate a contract is a contract itself. i.e. for it reads, *agreement to extinguish obligation of proprietary nature.*
- Based on these grounds, there are **three types of terminations:**

**I. Bilateral Termination** :- is putting an end to a contractual obligation by the agreement of both parties. i.e. either by inserting **bilateral termination clause in the contract or by later agreement.**

**II. Unilateral Termination:-** is made in two ways.

- The 1st one is by the effect of agreement, i.e. by inserting **a unilateral termination clause** in the contract and when a condition which entitles unilateral termination is fulfilled. **The best examples are conditional contractual obligations, especially, subsequent condition.** *In this regard, please correct both your notes and the teaching material by substituting termination in the place of cancellation.* **See Prof. Tilahun Teshome's book (Basic Principles of Ethiopian Contract law ) p 157-160.**
- The 2nd way of unilateral termination of a contract is by giving **notice i**n advance. The time of notice might be either fixed by law, by custom, or reasonably by parties to the contract.

**III. Judicial Termination:** Court termination is the principle and termination by the parties is an exception as parties shall not be judges on their own case.

- *The other important point in termination of a contract is that termination of a contract should not affect the rights of third parties to the contract. Look at the examples given by Prof. Tilahun at page 158. e. g sub contractors…*

## *Termination of Contract…ctd*

- *Termination of a contract also better suits temporary nature of obligations or contract. E.g. termination of employment contract entered into for a certain period of time, termination of contract of rents, termination of contract of service, termination of contract of usufruct, termination of contract of agency etc.*
- *But one important thing that should not be ignored is the importance of giving default notice in the above cases.*
- *In general , look at* ***Articles 1819-1824*** *for Termination of contracts.*

**V. Remission of debt**

- is also one way of extinction of obligation.
- is voluntary release of debtor from his obligation by the creditor.
- As per **Art.1825,** *"Where the creditor informs the debtor that he regards him as released, the obligation shall be extinguished unless the debtor forthwith informs the creditor that he refused his debt to be remitted ."*
  - *Dear students, why do you think the debtor may refuse the remission of the debt?*
- According to Article 1825 of the C.C the mere willingness of the creditor to release the debtor by remission is not enough to make the remission effective and result in extinguishing of obligation. The willingness of the debtor to that effect is also required.
- However, the provision does not put express acceptance of the remission as a mandatory requirement. The debtor shall object when he is informed of the remission if he wants the remission not to be made. Unless such protest is made the law seems to presume **silence as acceptance** in the case of an offer to effect remission of debt to the debtor.

# VI. Novation

- is also another way of extinguishing an obligation.
- **is substitution of an existing obligation by new obligation in its nature or object.** Mere difference without substantial change either in the object or in the nature does not amount to novation; rather it is **variation in fact. Art.1826.**
  - ✓ *For instance, change of place of the contract is not novation. In such case, neither z nature nor z object of the original obligation is different. Change of sugar by coffee is, however, novation as the object of the contract has been changed/substituted.*
- When original obligation is different from the substituted obligation in its **cause,** it is also considered to be novation.
  - ✓ *E.g. Assume that Bekele owes Ayele Birr 20,000 for some goods he purchased from him; it is agreed later in the new contract that Bekele will keep the 20,000 Birr as a loan from Ayele. This is* ***novation by change in the cause:*** *Bekele's debt has the same object, but henceforth, it has a different cause. Bekele owes Birr 20,000 because Ayele lent it to him, not because he purchased the goods from him.*
- **Novation is required to be intentional** so that it can have the desired consequence in accordance with **Article 1828.** As per this provision, *Novation shall not occur unless the parties show the unequivocal intention to extinguish the original obligation.* **Replacement of certain obligation with other obligation in the absence of intention to make novation does not have the effect of novation.**
- Read also **Art. 1829** for **the negative meaning of novation and Art. 1827** for **effects of novation.**
- As per article 1827, Novation in its effect extinguishes not only the principal obligating but also the accessory ones. Accessory obligations in pledge, mortgage and personal guaranty are extinguished as the principal obligation extinguished by novation.

# VII. Set off

- is also among the grounds by which a contract is extinguished.
- happens when parties to the contract are creditors to each other in different transactions. **Article 1831**

➢ Set-off can be made upon the fulfillment of certain conditions. These conditions have been put as **positive and negative conditions under Articles 1832 & 1833 respectively.**

➢ The conditions that are provided in Article 1832 are.

(a) The debts shall be **money debt or fungible things of the same species.**

(b) The debts shall be liquidated/due.

➢ Set-off is not possible if someone owes in item and the other owes in money. Nor is set-off possible when the debts are items unless the items are fungible things of the same species.

➢ However, there is exception to the requirement of "liquidation" of the debt. According to Article 1841 even though one of the debt is not liquidated, the court may decide that set-off has been made to the extent of the admitted amount.

➢ The other condition is that the debt shall be due at the time set-off is required. The time when both obligations are required to be performed shall be at the same time. If one of the debts is to be paid on September 1 and the other debt is to be paid on October 3, set-off cannot be made with regard to these two debts on September 1 since both debts are not due by then.

➢ This requirement protects the debtor who can be beneficiary of time limit. The one who shall perform the obligation in October 3 is the beneficiary of time limit and refusal of set-off is not to affect such contractant adversely.

*Set off…ctd*

- An exception to this requirement has been provided under Article 1834 dealing with period of grace. Granting of period of grace does not bar set-off although the time in which payment shall be made is protracted by the court order of period of grace.
- The other point regarding set off is that for the set off to occur, the debt should not be necessarily equal always. **Article 1836.**
- As per Article 1837, Set- off shall not affect the interest of third parties.
- Moreover, set-off cannot be made in the absence of intention to do so. Article 1838 provides that if the debtor fails to inform the creditor his intention to effect set-off, set-off does not occur.

## VIII. Merger

- Is another method by which an obligation is extinguished.
- As per **Article 1842,** *Merger shall occur and the obligation shall be extinguished* ***where the position of creditor and debtor are merged in the same person.***
- The position of creditor and debtor are merged in the same person for the reasons of **succession, merger of companies, formation of partnership** and so on.
- Once the creditor and debtor become the same, performance of obligation after merger is not actually realistic since performing certain obligation towards one self is actually absurd.
- As is true in other grounds of extinction so far discussed, the rights of third parties should not be affected by merger. **Article 1843.**

*Merger…ctd*

- Merger has certain peculiar characteristics, as obligation extinguished by merger might revive in certain circumstances. E.g. when a person who is declared absent returns or when a previously merged organizations **may split again. Article 1844**

## IX. Limitation of Action/Period of Limitation

- Is also one and the last way of extinguishing an obligation.
- Making period of limitation a means of extinction of obligation creates security of business transaction by avoiding uncertainty among parties to the contract.
- It is important to first see what the concept of **Prescription** is before going into the details of Period of limitation.
- Accordingly, **"Prescription is defined as a manner of acquiring the ownership of property, or discharging debts, by the effect of time, and under the conditions regulated by law.“**
- Period of limitation is one component of the broader concept of **prescription** which , in turn, classified into liberative and acquisitive prescription.

✓ **Liberative prescription:-** relieves (liberates) the beneficiary from certain obligations (duties) after the expiry of certain period of time.

✓ **Acquisitive prescription:-** entitles the beneficiary with certain right after the expiry of certain period of time. i.e., a party **acquires** certain right after the expiry of certain period of time.

- *where do you think limitation of actions/period of limitation falls?*

✓ Limitation of actions/period of limitation falls under **Liberative prescription**.

- In liberative prescription, there can be **limitation of right and limitation of action. Limitation of right absolutely extinguishes the right of the other party while limitation of action/period of limitation extinguishes the right to bring action i.e. court action.**
- For the purpose of Ethiopian contract law, period of limitation is provided under **Article 1845**, which reads: *Unless provided by law, action for performance of a contract, action based on non-performance of a contract and action for invalidation of a contract shall be barred if not brought within ten years.*
- According to this provision "action for performance" refers to bringing a court action to effect performance, "action based on non-performance of a contract" refers to bringing court action aimed at remedies of non-performance like damage, cancellation and even forced performance, and "action for invalidation of a contract" refers to bringing court suit to have a contract invalidated.
- Except for the controversial relation between Articles 1810 and 1845, addressed so far, all the rest actions shall be barred unless brought forward within ten years.
- As related to period of limitation, there is a controversy whether it bars right or action/suet only. In this regard, while some argue that it bars only an action/suet, for instance, raising Article 1850 and the title itself, some groups argue that in spite of the title, period of limitation bars rights after 10 years.
- The other important point regarding period of limitation is about annuities (Beyegizew yemikefel). In this regard, **Article 1847** provides that *"in respect of annuities*, ***the period of limitation shall run from the day when the first payment not made was due."***
- Regarding calculation of period of limitation, you are expected to read Article 1848 in line with gap filling time provisions addressed under chapter 5.

- The other important point regarding period of limitation is about collateral claims provided under Article 1849 which reads "*Interests and collateral claims shall be barred where the principal claim is barred*."
- Read the rest provisions related to period of limitation Arts. 1851, 1852 and 1853 which addresses interruption of period of limitation , its effects and special relation between the parties.
- Interruption of period of limitation is of a great importance for the creditor as this prevents his right from being barred.

# Chapter 8: Suretyship

## Chapter Objectives

Upon successful completion of this chapter, you will be able to:

- *explain the nature of suretyship;*
- *discuss the effects of suretyship on guarantor towards the creditor;*
- *explain the effects of suretyship on debtor towards the guarantor;*
- *distinguish simple guarantor from joint guarantor;*
- *distinguish counter guarantor from secondary guarantor;*
- *explain different effects of suretyship.*

## Nature and Effects of Suretyship

### Nature of Suretyship

- "Suretyship" is a contract by which a person binds himself to a creditor to satisfy an obligation in case if the main debtor fails to satisfy (perform) it. This person (whether natural or artificial) is called surety and he/she/it is considered as a second debtor for the creditor.
- Suretyship, thus, involves a three party relationship of **creditor, debtor and surety**.
- The obligation of the surety presupposes and depends upon the existence of an obligation of a principal debtor.
- The ppl of suretyship is provided under **Article 1920** which reads:- *Whosoever guarantees an obligation shall undertake towards the creditor to discharge the obligation, should the debtor fail to discharge it.*

## Nature of Suretyship…ctd

- The fundamental advantage of suretyship is **to make transactions much easier** by increasing the safety of the creditor entering such a secured transaction.
- In suretyship, the creditor has in fact two (or more) debtors for the same debt in which in case of a default of the main debtor, he can resort to the guarantor(who is considered as a 2nd debtor).
- It is not only the creditor who can be benefited by Suretyship. It has advantages for the debtor too. The debtor who produces surety gains credibility and will be able to trade.
- However, the advantages of suretyship for the guarantor are not evident. *Can you mention them?*
- Suretyship supports the creation of new businesses and buttresses a developing economy. It is furthermore a cheap way of curing credit, obtaining loans … etc.
- Even though the suretyship is an accessory obligation to that existing between the creditor and the debtor, the debtor is not a party to the suretyship. The suretyship does not have to be known by the principal debtor. **Article 1921. i.e.** He should not necessarily give his express consent to such suretyship, and it can even be concluded without his knowledge.
- You should not confuse suretyship with other institutions such as warranty, insurance and property securities such as pledge and mortgage.

- *warranty is a written guaranty by the manufacturer promising to repair or replace a purchased thing if it is defective*
- *Insurance is also d/t from suretyship in that in a contract of insurance, one party, the insurer, undertakes to pay a second party, the insured or a person nominated by the party for the loss occasioned by the happening of the specified event.* ***In other words, suretyship is a collateral contract while insurance is an independent original contract involving only two parties owing obligations each other.***

- When we come to property securities, just for the sake of your general knowledge, security/surety might be classified into two, personal security/surety and real security/surety or property securities, namely, pledge and mortgage.

❖ The scope of this chapter is on personal security/surety. Accordingly , when we say suretyship under this chapter and course, it is to mean only personal security/surety.

❖ Even if the Civil Code provisions dealing with suretyship are silent regarding the form of suretyship contract, **Article 1725** which addresses contracts for a longer period of time stipulates that **it should be made in a written form**.

❖ Pursuant to **Article 1727** of the Civil Code, a contract of guarantee needs satisfaction of **three elements**: special document, signature of parties bound and attestation of two witnesses.

❖ **Since suretyship contract binds only the guarantor** (i.e. since it is unilateral kt), it is only the guarantor who should sign on the kt of guarantee in the presence of two witnesses who also should sign on the document for the purpose of better evidence.

❖ A contract of suretyship must be express. The essential rule is that a suretyship may not be presumed, it has to be expressly given for the law does not admit tacit suretyship.

❖ A suretyship must have limits and a maximum amount must be indicated, the law requires that the contract of suretyship must specify the maximum amount of which the surety will be held liable for. **Article 1922(3).** The sanction for failure to fulfill this requirement is simply that the suretyship would be void.

- The provisions of the Civil Code dealing with suretyship equally applies to guarantees for a person in the contract of employment.
  - *Would the surety be liable to pay interests and legal cost even beyond the maximum amount fixed in the suretyship agreement?*
- Article 1930 of the Civil Code states that unless there is agreement otherwise, the surety is held to pay interests when the debt guaranteed bears interest. But this extension of his obligation remains limited to the maximum amount he has given his suretyship for.
- The scope of the suretyship may not exceed that of the principal obligation **Article 1924. S**uretyship cannot exceed that which is due by the debtor. The surety may undertake an obligation equal to or less, but not greater, than that of the principal debtor.
- ***Suretyship is an accessory obligation; it does not stand by itself in the absence of the principal obligation (kt).*** Pursuant to **sub-Article (1) of Art 1926** of the Civil Code, the fact that the principal obligation is discharged results in the release of the surety. Similarly, where the principal obligation is void, there cannot be any guarantee with respect to such obligation, **Article 1923.**
- As per **sub-article 2 of Article 1923**, a contract affected by defect in the formation cannot be guaranteed unless the guarantor/surety was aware of such defect/s.
- Another very important point regarding suretyship is that it works not only for the current obligation but also **for future and conditional obligations**. In other words, it is not necessary that the debt to be secured be presently in existence. Just as one can promise future things, one can become surety for a future debt. **Article 1925.**

- The scope of the suretyship may not be extended by the contracts concluded between the principal debtor and the creditor after the consent for the suretyship is once given. So, the guarantor's conditions may not be worsened through a posterior agreement between the principal debtor and the creditor.
- The code does not prohibit, on the other hand, the agreement tending to reduce the extent of the guarantor's obligation, because it is obviously in his favor **(Art. 1928 (1)**
- **S**uretyship may be applied to every obligation, whatever its object. But in fact it is principally used to guarantee the payment of money debts.

## Effects of Suretyship

- suretyship produces effects b/n the creditor and the surety on the one hand and b/n the debtor and the surety on the other hand.

### 1. Effects of Suretyship between the Creditor and the Surety

### A. The moment for action

- Period of Limitation will probably be amongst the first line of defense of the surety. **As per Article 1929** *Proceedings instituted against the principal debtor shall interrupt the period of limitation as regards the guarantor*. Thus, in this regard, the surety cannot benefit from the period of limitation.

### B. Maturity of debt

- The surety may not be required to perform his obligation prior to the maturity of the debt. (See **Art. 1932(1)** of the Civil Code).
- Apart from this, where the principal parties (the principal debtor and the creditor) had agreed to a notice before the debt is due, such a notice has to be served to the surety too. **Art. 1932(2&3)**

## C. Effects of suretyship in simple suretyship and joint suretyship

### I. Simple suretyship

- Simple suretyship is a suretyship in which a surety/guarantor is required to perform an obligation only if the principal debtor failed to perform it. In other words, the obligation of the guarantor is secondary obligation, not primary/direct obligation.
- simple suretyship is a principle and joint suretyship an exception.
- The provisions of the Code dealing with simple suretyship are Articles 1934 through 1937 of the Civil Code.
- **Article 1934,** which reinforces **Article 1920,** provides that a guarantor shall not pay the creditor unless the principal debtor fails to discharge his obligation.
- This indicates that the obligation of the simple guarantor subsidizes the principal debtor. i.e it is only where the principal debtor fails to perform his obligation that the guarantor is required to perform the obligation. **Article 1920.**
  - *Then, when is the principal debtor deemed to have failed to discharge obligation?* In this respect, we can think of three situations: Soon after performance is due; after the debtor has been placed in default; after the creditor brings action against the debtor and fails to obtain performance.
- **Article 1934,** which reinforces **Article 1920,** sets the principle of simple guarantee. The main condition/ppl to obtain payment from the guarantor is the non execution of contract by the principal debtor.
- Even if an action is brought against the guarantor following this procedure, the guarantor could have appropriate defenses. The first defense, in this regard is **benefit of discussion** as provided under **sub-article 2 of Article 1934 and Article 1935. In the case of simple suretyship, the engagement of the surety is subsidiary; he images himself to pay only if the principal debtor does not. The idea is that he is not to pay simply because the main debtor arbitrarily refuses to do so.**

- **From the reading of Article 1935(1),** we see that the benefit of discussion is not automatic and has to be required by the guarantor when he is himself sued. By availing himself of this benefit, the guarantor can compel the creditor to first seize the property of the debtor.
- Additional conditions that should be fulfilled by the guarantor are provided under **Article 1936** which reads:-
  - *(1) A guarantor requiring discussion shall indicate the debtor's assets to the creditor and advance sufficient money for the costs of their discussion.*
  - *(2) He may not indicate such debtor's properties as are subject to litigation, or situate outside the country of payment, or mortgaged as security for the debt but no longer in the debtor's possession.*
- As per sub article 1, the burden of identifying the debtor‘s property that can be discussed and also covering the cost of discussion are on the guarantor.
- Obviously, the guarantor cannot exercise benefit of discussion where the insolvency of the principal debtor has already been judicially established. **This is obvious since an insolvent does not have assets that can be discussed.**
  - *What do you think would happen when the guarantor has successfully managed to satisfy all the conditions necessary to exercise the benefit of discussion?*
- Where the guarantor has raised the benefit of discussion at the earliest possible time, identified the debtor's properties that can be discussed, advanced the costs for their discussions, **the court will suspend the suit against the guarantor and grant the creditor permission to institute fresh action against the principal debtor pursuant to Article 278(2) of the Civil Procedure code.**

❖Accordingly, **the consequences of the defense of the benefit of discussion** are the following:-

i. *If the assets are sufficient for a total or part payment of the main debt, the guarantor benefits accordingly and is discharged in part or totally of his suretyship.*

ii. *If no money can be made from the debtor's assets, the guarantor has no option but to pay the main debt, pending his action against the principal debtor.*

iii. ***Art. 1937,*** *Where the guarantor has indicated the assets as provided in Art. 1936 and has supplied sufficient money for their discussion, the creditor is answerable to the guarantor, up to the value of the assets thus indicated, for an insolvency of the principal debtor due to the creditor's failure to proceed*

- ***Is joinder of the principal debtor and the guarantor possible in our legal system?***

❖ Even if our substantive law on suretyship is silent on this issue, it is possible for the principal debtor and the guarantor to be joined in the same suit pursuant to our procedural laws(i.e., Art 36 of cpc).

❑The other defense of guarantor, which, of course, not special for simple guarantor, is the possibility to raise the principal debtor's defenses. **Article 1942 (1)** of the Civil Code.

## II. Joint suretyship

➢ The concept of joint guarantee is provided under **Article 1933** which reads *Where the person undertaking the guarantee described himself as joint guarantor, co-debtor, or used equivalent terms, the creditor may sue him without previously demanding payment from the debtor or realizing his securities.*

➢ Unlike in simple suretyship where the obligation of the guarantor is secondary, **the obligation of joint guarantor is primary and direct obligation**. Where the suretyship is joint, the creditor is entitled to proceed against the guarantor without demanding payment from the principal debtor.

- **In principle**, pursuant to **Article 1920 and 1934, every suretyship is presumed to be simple.** There can be joint guarantee only where the person who becomes a surety expressly described himself as joint guarantor by using words implying the same.
- **The direct effect of joint guarantee is the deprivation of the surety of his benefit of discussion.**
- **Joint guarantee is a dangerous situation for the guarantor, who may then be required to pay for a debtor who still has some assets(since z guarantor can not raise benefit of discussion).**

## D. Acceleration of action by guarantor

- address those things which should be done by the guarantor to minimize the risk of paying to the creditor. **Article 1938 and 1939.**

## 2. Effect of Suretyship between the Debtor and the Surety

- occurs where the guarantor has paid the debt in place of the debtor because of the latter's failure to pay.
- When the surety pays the creditor, he is discharging the obligation of the principal debtor. The principle is that **the guarantor, who has paid the creditor instead of the debtor, shall be indemnified by this debtor**. Accordingly, the guarantor is entitled to be indemnified by the principal debtor.
  - *Do you think the guarantee given without the consent of the principal debtor relives him from indemnifying the surety?*
- The fact that the guarantee may be given without the consent of the principal debtor does not relive him/her from indemnifying the surety what the latter paid to the creditor. **Article 1940(1)**

*Effects of Suretyship…ctd*

- In exercising his right of indemnification, the surety enjoys two rights of action; **the right arising from the contract of suretyship and the right of subrogation,** which arises from the substitution of the principal creditor after paying him/her. The first is called **chirographic action** while the latter is the **right of subrogation** in which the previous guarantor becomes the new creditor of the debtor by substituting the former principal creditor.
- The personal action of the surety arises from the contract of suretyship itself. The action is based on the theory of implied mandate. Accordingly, this recourse is open to the surety only against those debtors for whom he has become surety and not against the other debtors.
- **This personal action entitles the surety to claim the principal, interest, expenses and damages** if any.
- The principal is not just the amount of the debt paid. It includes every thing the surety has paid in acquitting the debtor. **Thus, as regards the surety, the interest due to the creditor and paid by the surety is considered as forming the principal of his payments, so that they in turn produce interest**.
- In addition to interests, the surety is entitled to be indemnified for all damages (including costs) he suffers as a result of the debtor's fault or negligence. In this respect, **see Articles 1940 (2) and (3) and Article 1941 CC.**
- There are two kinds of subrogation: **conventional and legal subrogation**. As the terms imply, conventional subrogation is achieved by the agreement of the parties, whereas legal subrogation is achieved by the effect of the law.
- The surety is entitled to legal subrogation because he is the one who, being bound for others for the payment of the debt, had an interest in discharging it. Legal subrogation is provided under **Articles, 1944 and 1971** of the CC.
  - *The details on rules of subrogation will be addressed in the 9th chapter, ahead.*

# Protection of guarantor's action against debtor

- Addresses the following concerns:-
  - ***i. Duties of a creditor,***
  - ***ii. Securities obtained from principal debtor (Recourse before payment),&***
  - ***iii. Loss of Right.***

## I. Duties of a creditor

❖ The creditor who has been paid has a duty to **ensure** that, as far as possible, the guarantor enjoys an **effective action against the debtor**. Three situations are provided for:

1. **Article 1945 of the Civil Code:-** *The creditor shall hand over the documents of title to the guarantor who pays him and perform such formalities as will enable the guarantor to exercise his remedy and realize the securities available to the creditor.*
2. **Article 1946 of the Civil Code:-** *The guarantor, shall be relieved of his obligation towards the creditor where the guarantor's subrogation to the rights, mortgages and liens of the creditor can no longer be effected owing to the creditor's act or omission. For instance, where through his negligence, the creditor let a mortgage expire. So, before paying, the guarantor has a right to check that the subrogation in the rights of the creditor is still possible.*
3. **Article 1947 of the Civil Code:-** *Debtor's bankruptcy*

   *(1) Where the debtor becomes bankrupt the creditor shall prove in the bankruptcy.*

   *(2) He shall inform the guarantor of the bankruptcy as soon as he is aware of it.*

   *(3) Where the creditor fails to comply with these rules, he shall lose his rights against the guarantor to the extent of the latter's loss resulting from such failure*

## II) Securities obtained from principal debtor (recourse before payment)

- The surety who has paid to the creditor has a right of recourse against the debtor for indemnification.
- The guarantor, who is informed of a serious chance that the principal debtor is not going to pay, may take protective measures through securities demanded of the debtor, even before any payment is made to the creditor. **Three situations are limitatively mentioned under Article 1948.**

The guarantor, even before he has paid, may take action against the debtor and demand securities from him where:

(a) the debtor has been given notice to pay his debt;

(b) the debtor has been declared bankrupt;

(c) either by reason of the losses the debtor has suffered or as result of a fault committed by him, the guarantor runs a considerably greater risk than when he undertook the guarantee.

## III. Loss of Right

- The general principle is that upon payment the surety has a right of recourse against the debtor. However, there are two situations in which the surety loses his right against the debtor.
- The first exception is where the indemnity claim has lapsed. The guarantor has a duty to set up all available defenses of the debtor he reasonably knew of. If not, he is debarred from indemnification by the debtor. Article 1942 of the Civil Code. **You may compare Article 1942 with 1940(3)**
- The second exception to the principle is the case where a second payment is made by the debtor (**Article 1943 of the Civil Code**).

# Plurality of Guarantors

- The idea of a plurality of guarantors is that **the risk of suretyship is spread over several persons.** Three situations can be considered:-
    i. **Counter guarantor**
    ii. **Secondary guarantor and**
    iii. **plurality of simple and /or joint guarantors.**

**I. Counter Guarantor**

- Is the mechanism whereby the main guarantor is protected by having himself a guarantor.
- **In suretyship, counter guarantor appears only for the benefit of the guarantor, not for the benefit of the creditor.**
- This counter-guarantor will only step in where the main guarantor has been called to pay for the principal debtor.

- **It must be noted that, there is no relation(nexus) between the counter guarantor and the creditor**. Since the counter guarantor appears only for the benefit of the guarantor, not for the benefit of the creditor, **he involves only between the principal debtor and the guarantor.**

- **Article 1949** of the Civil Code which governs counter guarantors state that, *"[t]he counter guarantor guarantees towards the guarantor the effectiveness of his indemnity claim against the principal debtor."*

- *How do you understand the phrase "guarantees the effectiveness of indemnity claim against the principal debtor"? Does this mean that the counter-guarantor agrees to act so that the debtor pays the guarantor, or simply undertakes to pay in his (debtor's) place?*

- **In fact, both duties seem enforceable.**

*Plurality of guarantors…ctd*

- ***What are the relations between guarantor and counter-guarantor?*** *Can counter-guarantor, for instance, impose discussion of assets of the main debtor, where it is possible, although the guarantor has not required it?*

❖ The answer should appear to be positive: the counter-guarantor must benefit of all the particular advantages of the main guarantor, even if this seems against the will of main guarantor.

## II. Secondary Guarantor

❖ Unlike with the counter guarantor where he appears only for the benefit of the main guarantor; not for the creditor, **secondary guarantor appears for the benefit of the creditor.**

❖ Unlike with the counter guarantor where there is no relation between the creditor and the counter guarantor, **there is a relation between the creditor and the secondary guarantor for the latter stands for the sole benefit of the creditor.**

❖ Compared to counter guarantor where the creditor can challenge only the principal debtor and the main guarantor, in secondary guarantor, the creditor can challenge, not only the debtor and main guarantor, but also the secondary guarantor.

❖ So, we see that the creditor is more secured in secondary guarantor than counter guarantor because he has wider option with secondary guarantor than counter guarantor. Accordingly, we have longer chain in secondary guaranty than in counter guaranty.

- **Article 1950** of the Civil Code, which deals with secondary guarantors reads:

  *1) A person [the creditor] may stand surety not only for the principal debtor but also for his guarantor.*

  *2)* ***The secondary guarantor shall be in the same position towards the guarantor as a simple guarantor is towards the principal debtor.***

  *3)* ***Merger between the principal debtor and the guarantor shall not extinguish the creditor's right of action against the secondary guarantor.***

- As of a rule, unless the creditor exhausts all his remedies against the principal debtor and the main guarantor, the secondary guarantor shall not be held liable. But if the secondary guarantor is willing to pay the creditor without seeking benefit of discussion, he can do so.

- In such cases, both the principal debtor and the main guarantor are considered as principal debtors of the secondary guarantor and he can be indemnified from either or both of them. But the principal debtor and the main guarantor are considered as principal debtors of the secondary guarantor **after the secondary guarantor paid to the creditor w/o seeking benefit of discussion, not before payment made to the creditor.**

- His action against the simple guarantor is justified pursuant to Article 1950(2). His action against the principal debtor is justified, for the latter is the one who should bear the ultimate burden of the debt as he benefited from it.

- Even if the law is silent, from the normal rules for suretyship, it follows that the secondary guarantor who paid the creditor is **subrogated** in the rights of the creditor against both the debtor and the main guarantor.

## III. <u>Plurality of Simple and/or Joint Guarantors</u>

- A creditor may seek and obtain guarantees from more than one person in respect of the indebtedness of one principal debtor. **This is the situation whereby the creditor wishes to spread his risk over several persons acting as guarantors for the same debt and for the same debtor.**

*Plurality of guarantors…ctd*

- This situation is governed under **Article 1951** of the Civil Code.

> **Art. 1951. - *Plurality of guarantors*.**
>
> *(1) Where several persons became at the same time guarantors of the same debtor in respect of the same debt,* ***each of them shall be liable as simple guarantor for his share and as secondary guarantor for the shares of the others.***
>
> *(2) Where the guarantors entered into their undertakings by successive acts, he who bound himself in the second place shall be held liable as secondary guarantor of the guarantor who bound himself before him*
>
> *(3) Where the guarantors expressly bound themselves as joint guarantors either with the principal debtor or as between themselves, each of them shall be answerable for the whole debt, subject to contribution from the others proportionate to their shares.*

- As per Article **1951(1)** , the creditor has to divide his action in as many actions as there are guarantors, which is called benefit of division, and ask the appropriate amount from each b/c a guarantor shall not be compelled to pay the debt of his co-guarantor **if the latter can pay himself**. But if not, liable as 2ry
- **What Article 1951(2)** tries to address is when guarantors granted security at different time.
- **Article 1951(3)** affords the maximum protection to the creditor because he can ask the whole debt from one guarantor only. E.g. he can demand the whole debt from the one who can pay him so that the latter initiate several actions against his co-guarantors.

# Relationship between/among Co-sureties

- When there are several sureties for **the same debtor** in respect of **the same debt,** the one who pays the creditor is entitled to **contributions** from the others.
- **The basis of contribution is payment by surety of more than his share and equity.**
- Under our law, **Article 1951** provides that guarantors who are either severally, or jointly and severally liable for the same debt and who stand as surety for the same debtor at the same time are **entitled to proportionate contribution.**
- The other point worth consideration as regards the relationship between co-sureties is that **a co-surety who paid the creditor can demand contribution from his co- sureties only after the creditor is fully paid.**
- This is because there could be a situation where he can still be liable for the creditor if he has not been fully paid. **So, to exactly know their shares, co –sureties are expected to wait until the whole debt is discharged.**
- The other point worth consideration as regards the relationship between co-sureties is that **a co-surety who paid the creditor even if he has valid defenses, which might relieved him from payment, loses his right of contribution from his co-surities.**
- Still, another point as regards the relationship between co-sureties is that you should bear in mind that **the claim of contribution is not limited only to the principal/actual share only; rather extended to costs incurred and legal interests.**
- Last but not least, even though the law is silent it can be argued that because of the ppl underlying the benefit of division and contribution between the co-sureties, **the security held by one co-surety should be deemed to have been held for the benefit of all the co-sureties.**
- However, if the security have been prejudiced or destroyed by the surety, the co-sureties will be relieved of their obligation to contribute to the extent of the value of the property so prejudiced or destroyed.

# Extinction of Suretyship

- As suretyship is a contract, it can be concluded that most of the grounds of extinguishing a contract, discussed under chapter 7, are the grounds to extinguish suretyship.
- Accordingly, **payment, novation, remission, set off, merger, period of limitation, nullity of the principal obligation etc are the grounds to extinguish suretyship.**
- Just to see the grounds one by one briefly:-
- **The first ground to extinguish suretyship is payment/performance**. Even if the effect of surety might be continued some time between the principal debtor and his guarantor or between the co-guarantors, **payment to the creditor extinguishes suretyship.** The creditor is entitled to only one payment for otherwise he would be liable by law of unlawful enrichment.
- The second ground of extinguishing suretyship is **novation.**
- As we have addressed under chapter 7, Novation **is substitution of an existing obligation by <u>new obligation in its nature or object.</u>**
  - Accordingly, **if the creditor and the principal debtor agrees to substitute the existing (guaranteed) obligation with a new obligation, such new agreement extinguishes the suretyship**.
  - *For instance, if the object of the existing contract which is guaranteed was soap and later the creditor and the debtor agreed to substitute with sugar, suretyship extinguishes.* **But this should not be construed as the former guarantors cannot be guarantors for the new obligation if they are willing to do so.**
- **Thirdly, a voluntary remission by the creditor to the debtor discharges the surety as well, since the remission of the main obligation also extinguishes the accessory obligation**.

- **However, remission to a surety/guarantor alone does not discharge the principal debtor as the creditor is considered to have abandoned only the security, but not the primary obligation.**
- Fourthly, **set-off** extinguishes suretyship **when the creditor and principal debtor are indebted to each other.** In fact, the surety/ies can raise set off as a defense against the claim of the creditor.
  - *But the question is what if the amount to be set off is not equal, is the set off of whatever amount extinguishes surety as a whole or the surety is relieved only by the amount of set off made?*
- The 5th ground of extinguishing suretyship is **merger**. As per **Article 1842,** *Merger shall occur and the obligation shall be extinguished* ***where the position of creditor and debtor are merged in the same person.*** Regarding suretyship, there are **three possible cases of merger.**

- The 1st case is **merger of debtor and creditor**. Accordingly, a merger of debtor and creditor extinguishes the principal obligation and the accessory suretyship obligation . *E.g. if the debtor is the heir of the creditor and the creditor dies.*
- The 2nd case is **merger of surety and creditor.** merger of surety(guarantor) and creditor extinguishes the obligation of suretyship but does not extinguish the principal debtor's obligation. *E.g. if surety dies and the creditor is his sole heir or vice versa.*
- The 3rd case is **merger of debtor and surety. In the same way to the 2nd case,** merger of debtor and surety does not extinguish the main obligation of the debtor but extinguishes the obligation of suretyship. This is because the person cannot be his own surety

o However, the merger which takes place when the principal debtor and his surety become heirs for one another does not extinguish the creditor's rights against a sub-surety of the surety."

*Extinction of Suretyship…ctd*

- The 6th ground of extinguishing suretyship is **nullity of the main obligation. i.e., if the main obligation is void, the accessory contract of suretyship is also void.** However, in cases where the principal obligation is voidable, the contract of suretyship may or may not be invalidated. See **Article 1926 (3) and 1923.**
- The 7th ground of extinguishing suretyship is **period of limitation**.
- The 8th ground of extinguishing suretyship is **where the creditor has accepted a payment in the form of an immovable or any good, even if he is later dispossessed (Article 1927 of the Civil Code**). The creditor, not the surety, bears the risks of the thing accepted in payment.
- The last but important ground of extinguishing suretyship is **where the creditor, without special permission given by the guarantor, has granted a delay (prolonged time) to the debtor (Article 1928 (2)** of the Civil Code).

- This is because the creditor is extending on the back of the guarantor the delay during which he is held liable.
- **An extension of time for performance or payment, granted by the creditor to the debtor, is an alternation of the original obligation which is considered prejudicial to the surety. Thus, the prolongation of the time granted to the principal debtor without the consent of the surety, operates as discharge of the latter from his obligation.**

# Chapter 9: Third parties in relation to contracts

**Chapter objectives**

**After successful completion of this chapter, you will be able to:-**

- *Explain the nature and effects of promises and stipulations for third parties;*
- *Discuss the conditions for valid assignment of rights;*
- *Explain the concept of subrogation and its different types;*
- *Explain the effects of assignment of rights and subrogation;*
- *Discuss delegation and assignment of obligations;*
- *Explain the rights of heirs of the parties; and*
- *Discuss the rights of creditors of the parties and the limitation thereof.*

## Introduction

❖ Both in civil law and common law legal systems, **the ppl is that contracts shall produce effects only as between the contracting parties.** The same is true as regards Ethiopian Contract law (**Article 1675cum 1952(1)).**

❖ In spite of this ppl, there may be exceptions in which case a contract may produce effect(whether negative or positive) on third parties. **This chapter discusses such exceptions or situations.**

- ✓ The 1st exception, in this regard, is that of **promises and stipulations concerning third parties**, whereby a party to the contract sets out that the contract will have effect on a third party.
- ✓ The 2nd exception is where the **right of a contractual party is assigned to a third party.**
- ✓ The 3rd exception addresses the reverse situation where **a liability may be assigned to a third party.**
- ✓ And the final **exception** concerns the **special situation of the heirs of the parties and the protection of creditors of contractual parties.**

# 1. Promises & stipulations concerning third parties

- It is legally possible that persons may conclude a contract by reserving a right to substitute a third party in their place or by promising that a third party will commit a certain act or omit from performing an act.
- It is also possible to make contractual stipulations for the benefit of third parties.
- The contracting parties may provide in their agreement that a future third party may become part of their contract. Three situations are considered by the Civil Code. The third party:
  - ✓ *may be **substituted** to a contracting party,*
  - ✓ *will **become the debtor** of the contract, and*
  - ✓ *will **become the creditor** of the contract.*

## The option to substitute a third party

- As per **Article 1953,** *[A]t the time of the making of a contract, a party may reserve the option to substitute for himself another person assuming the rights and obligations under the contract.*
- **It should be noted** that the identity of the third party to be substituted is not required at the time of the formation of the contract. In fact, such a third party may be perfectly unknown to the other party and we can also imagine that he is still unknown to the party stipulating such possibility.
- Another remark is that such an option is open both to the creditor and to the debtor. Each side can introduce a clause of this type and **it is theoretically possible that the parities actually performing the contract are not the parties who concluded it**.

## *Promises & stipulations concerning third parties…ctd*

- The advantage of the possibility opened by Article 1953 is to introduce flexibility in the choice of partners. It corresponds to a great number of modern transactions, where the identity of the person who will perform the contract is irrelevant, and what matters is only the quality of the work.
- It enables a person who does not have the adequate facilities or equipment to perform the contract to substitute himself a person better equipped.
- **It makes it possible to contract secretly in the name of a person who does not want to be known to the other party until the contract is concluded.**
- One may also consider the potential of the provision to introduce a third party to perform part of the contract concluded, as a co-debtor, or as often in construction cases, as a sub-contractor. For instance, a builder concludes a contract for the construction of an entire house, but reserves the possibility to substitute himself an electrician for the electrical installation.
- The effect of the contract where the substitution effected within 3 days or not is provided under **Article 1954** of the Civil Code.
  - Sub Article 1 states that where the third party is substituted within the following three days from the formation of the contract, the contract will produce effect as between the third party substituted and the other party. In this respect it can be said that the person who reserved the option of substituting another person for himself is the agent of the third person.
  - As per sub Article 2, where the appointment/substitution is not made within three days, the contract shall be effective as between the parties who made it.

# The promise for third party

- As per **Article 1955**, "*A person may stand promisor for a third party by promising an act or omission by the said third party*".
- **Even if the provision looks very vague, its idea seems that a current contracting party may enter into temporary kt with another current contracting party who promises to conclude future permanent kt with 3rd party and a current contracting party , i.e., the one who is concluding a kt with the promisor believes that the 3rd party, in turn, promises an act or omission.**
- The point here is **there are two contracts in such promise**; the temporary or current kt concluded b/n a contracting party and the promisor and permanent but future kt between the promisor and the 3rd party.
- The **effects of such promise** are provided under **Article 1956** that reads:

  *(1) Where the third party ratifies the promise concerning him, the person who stood promisor shall be released.* ***Means, where the third party concludes a kt with the promisor, the person who stood promisor (i.e., a contracting party with the promisor) shall be released.***

  *(2) Unless otherwise agreed, such person shall not guarantee the proper performance of the contract.* ***'Such person' refers to [the person who stood promisor i.e., a contracting party with the promisor]***

  *(3) Where the third party does not ratify the contract,* ***[i.e., when he fails to conclude a kt with the promisor]*** *the person who stood promisor for him* ***(i.e., a contracting party with the promisor)*** *shall be liable towards the other contracting party[****the promisor****] for the damage resulting from the non-performance of the contract.*

# Stipulation for the benefit of a third party

- **Art.1957 and the following** of the CC open **the possibility for two contracting parties to conclude a kt for the benefit of a third party.** A best example here is life insurance for the benefit of 3rd party.

## 2. Assignment of Rights and Subrogation

### Assignment of Rights (መብትን ስለ ማስተላለፍ)

- The assignment of right is a **transfer of the right to the performance of the contract.**
- **The principle of assignment of rights** is provided under **Article 1962** of the Civil Code which reads: *[A] creditor may assign his rights to a third party without the consent of the debtor, unless such assignment is forbidden by law or the contract, or is barred by the very nature of the transaction.*
- **Thus, an assignment is a contract concluded between the assignor and the assignee, whereby the assignor transfers his rights under the contract or part of it to the assignee.**
- **It must be noted that the consent of the debtor is not required for an assignment to be valid.** The debtor is normally indifferent (uninterested) to an assignment because it only **changes the beneficiary of his performance** or payment and not the scope of such performance or payment. This may be the reason why the debtor is not informed of the assignment of rights.

# Types of Assignment

- There are two types of assignments; **an onerous assignment and gratuitous assignment.**
- **An assignment of right made for consideration is said to be an onerous assignment.** This consideration(economic benefit) which can either be in kind or in cash or both, is furnished by the assignee for the assignment of the right.
- **A gratuitous assignment, on the other hand, is a voluntary transfer of the creditor's right to the assignee which is made without consideration.** In such cases, the assignor gets no economic benefit.
- In case of assignment of rights, **warranty** may or may not be required depending on the form of the assignment.
- **Article 1964 (1)** of the Civil Code provides that **the assignor has to guarantee the existence of the right at the time of the contract when the assignment is made for consideration.**
- **As per Article 1964 (2),** the assignor does not guarantee the solvency of the debtor.
- However, the situation is entirely different where the assignment is made gratuitously in which case the assignee should not expect any legal warranty (**Article 1964(3)**.
- **Article 1966** deals with the **valid defenses** the debtor have against the assignor and assignee.

# Subrogation

- Subrogation is the situation where a right, with all its accessories, is transferred from one person to the other.
- In case of subrogation, there are three persons: **subrogor** (z original creditor), **subrogee** (the new creditor who is subrogated on the right of the original creditor), and **the debtor**.
- The mechanics of subrogation involve the substitution of the subrogee to the position occupied by the subrogor, who is a creditor of the principal debtor. The subrogee is then able to exercise the rights of the creditor- subrogor after he has effected the subrogation by payment of the debt.
- Thus, subrogation can be said is a situation where an obligation extinguished with regard to the original creditor **by payment** which he has received from a third person. Thus, **subrogation always accompanies payment.**

## Types of Subrogation

- Generally, subrogation is classified into two: conventional (contractual) subrogation and legal subrogation. Conventional or contractual subrogation is, in turn, divided into two: subrogation by the creditor and subrogation by the debtor.

## I. Conventional (contractual) subrogation

- is a subrogation created by a contract concluded between the subrogor and the subrogee b/c of payment made by the subrogee to the subrogor.

## Types of Subrogation…ctd

### A. Subrogation by the creditor:

- The most frequent form of contractual subrogation is where the creditor subrogates to his rights the third party who has paid him the debt (**Article 1968 of the Civil Code**).
- The third party is thus exactly transferred into the position of the creditor and is granted to refunded by the original debtor.
- The contract of subrogation must be express and must provide that the subrogation takes place at the time of payment.

### B. Subrogation by the debtor

- occurs when the dr & 3rd party agree so that z 3rd party pays z cr even against his(cr's) consent.
- Here, z 3rd party is discharging the duty of the original debtor. Then, the creditor's rights against the debtor are transferred to the third party[who paid z cr). i.e a/r paying to the cr, the 3rd party is entitled to the rights the original creditor have against the debtor. Even if vague you may see **Articles 1969 and 1970** for these points**.**

### II. Legal subrogation

- Is subrogation by the operation of the law, without the necessity of any agreement at all.
- In legal subrogation cases, the law recognizes a special interest of the payer in the extinguishment of the other person's debt.
- Article 1971 provides three situations where there could be legal subrogation:
  1) *payment by a person bound with another or on behalf of others,* ***i.e., subrogation as co-debtor or guarantor.***
  2) *payment by a person who is owner of a property or who enjoys the rights of lien, mortgage or pledge, i.e.,* ***Subrogation as holder of sureties*** *&*
  3) *other cases of subrogation provided by law.*

- In essence, legal subrogation does not differ from the conventional type as **both are based upon payment of the debt or obligation to the creditor** and their effect is the same. Accordingly, a legal subrogee as well as a conventional subrogee is subject to any defenses which were available to the debtor against the original creditor.

## Effect of subrogation and assignments

- **Articles 1973** and following of the Civil Code state the consequences common to assignments and subrogation. Accordingly, The assignment or subrogation to a right entails:
  - ✓ The right to exercise the liens, securities and accessory rights attached to it, with an exception in respect of a pledge.
  - ✓ The original creditor has a duty to cooperate to ensure as much as possible that the assignee or subrogee has the best chances of being paid by the debtor.

## 3. Delegation and Assignment of Obligations

- Unlike assignment of rights, what is delegated is obligation; Thus, in case of delegation, the debtor may delegate performance of his duties to a third person. On the other hand, rights arising out of a contract with its corresponding duties can be transferred to a third person by way of assignment of obligation.

### A. Delegation of Obligations

- Delegation is **the act by which a person delegates the performance of his obligation to a third person.**
- The ppl of delegation is provided under **Article 1976** of the civil code, which reads**: "A debtor may with the consent of the creditor, or without such consent in cases provided by law or usage, delegate to another the performance of his obligations."**

*Delegation and assignment of obligations...ctd*

- There are three persons in cases of delegation. These are: **the delegator**, the person who makes the delegation (i.e., the original debtor); **the delegatee (** *the new debtor also known as* ***the delegate-debtor or the delegate or*** *the third party who is delegated and becomes a debtor* **), & the creditor.**
  - ***NB:- There might be some confusing usage of these terms in your teaching material. So, you need to take these ones as the correct terms.***
- In case of delegation of obligation, in principle, unlike assignment of rights, **the debtor has to ask the creditor to accept a third person as his debtor,** who consents to bind himself to him. The change of debtor could be very detrimental to the creditor, this is why the latter's consent is required as a rule.
- The Ethiopian law, however, reserves cases where usage or the law itself allows such substitution of debtors without the consent of the creditor.
- In the delegation of obligations, most often, the delegator is the creditor of the delegatee and delegation is a means whereby he (the delegator ) frees himself from his obligations towards the delegatee.
- The economic importance of delegation is that **it simplifies transactions** and obtain, by means of a single act, the same result as if two payments will be made successively, one by the delegate debtor (delegatee) to the delegator the other by the delegator to the creditor.

## Types of delegation and their consequences

- Delegation of obligations may be **perfect delegation** or **imperfect delegation**.
- **Perfect delegation** is the case in which a creditor who has been provided with sufficient securities by the delegate debtor releases the original debtor. In such cases the creditor has no right over the original debtor after delegation.

*Types of delegation and their consequences…ctd*

- In perfect delegation, the creditor consents to release the delegator(the original debtor) **except** for the **insolvency** of the delegate debtor **at the time of delegation,** not after the delegation has been made. **If it is after the delegation, the creditor has no right to demand performance from the original debtor. Article 1981(2).**
- **Imperfect delegation,** on the other hand, is the case in which the creditor who has consented to delegation still retains his right against the original debtor in case if the delegate debtor fails to pay him. **Article 1977** gives recognition for imperfect delegation.
- In the case of imperfect delegation, the relationship of the original debtor *vis-a-vis* the creditor is that of **a simple guarantor and a creditor.** The creditor retains his right against the original debtor but he may not demand satisfaction from the original debtor before demanding performance from the delegate debtor (see **Article 1977(2)** of the Civil Code).

## Effects of delegation on third parties

- Third parties who have secured the debt of the original debtor by their property or guarantors (personal securities) will not be liable towards the creditor upon delegation unless they consented it. **Art. 1982.**
- **So, the delegation extinguishes the obligation of the security unless the security re-consented to be bound.** This is because, they have given a surety in respect of the first contract; the one linking the creditor to the original debtor and cannot be presumed to have extended it to benefit the delegate debtor.

## B. Assignment of Obligation

- Can be taken as **a special forms of delegation of obligation** and **addressed by Articles 1983 to 1985** of the Civil Code, which **all rest on the same idea of an amalgamation of estates** which include both assets and liabilities. **Article 1984, which deals with amalgamation(merger)** is more clear to understand the point at hand.

# 4. Heirs and creditors of the parties

- The last instance in which contract produces effect [on third parties] is upon heirs and creditors of the parties.
- The heirs of the contracting parties may be accorded the right to acquire rights and duties from a contract made by the deceased by the mere fact that they are heirs. This is clearly governed by **Articles 1986 and 1987** of the Civil Code.
- Similarly, creditors are accorded with certain rights so as to make them able to enforce their rights. These rights include **preservatory measures and revocation, among others.** Such rights are provided under **Articles 1988 through 1999** of the Civil Code.

## A. Heirs of the Parties

- Heirs of the parties continue the person of the deceased if they have accepted the succession. As per **Article 1986** *"The heirs of a person shall be substituted for him in contracts to which he was a party, unless the contrary was stipulated or flows from the nature of the contract."*
- In respect of stipulations for third party beneficiaries (as addressed under Articles 1957 and following) the heirs of such a party are entitled to the performance of the obligation considered, if the deceased had already accepted the stipulation but dies before receiving the performance. **Article 1987.**

## B. Creditors of the Parities

- When it is said creditors of the parties, it means that the creditors of parties to a contract (creditors of the creditor or creditors of the debtor) **by another contract**. **It is the concept of plurality of creditors because of contracts concluded with different creditors by the same debtor.**

## *Creditors of the parities…ctd*

- **Creditors of the parties can be taken as a special category of third parties in respect of the contracts made by their debtor. i.e., One creditor considers another creditor as third party**
- The ppl here is that the debtor should not conclude a contract if he cannot adequately secure the performance of the contract. **Article 1988,** which talks about attachment is all about property security.
- As per **Article 1988,** a creditor has a general right to attach and have sold any asset belonging to the debtor in order to get paid. **However, certain assets cannot be attached essentially the basic living commodities and tools of the debtor's trade** (seeArt.404 CPC).

### ***Agreements entered into by the debtor***

- The mere fact that someone is a debtor of another does not totally preclude him from entering into agreements regarding his property. **Article 1989**
- **Exceptions, in which Article 1989 will not apply:**
  - ***Article 1990*** *of the Civil Code which deals with* ***preferred creditors*** *(****secured creditors****). Preferred creditorship may arise* ***from a contract or from the law.***
  - *The second important exception is that of* ***simulation.*** *Simulation is defined by* ***Article 1994*** *of the Civil Code as* ***the case where the debtor enters a simulated contract with a third party, i.e. a contract which was not intended to be carried out.***
  - *The simulated act is the apparent/unhidden act, whilst the reality of the situation is in a hidden act, called* ***the counted deed or back letter. For instance, the debtor shows the contract of sale for a car at 10,000 birr, when the counter-deed was in fact for 100,000 birr just for the sake of tax evasion.***
  - *Every simulation presupposes the concurrence of two contradictory agreements, to which it is impossible to give a cumulative effect with regard to the same person.*

### *Creditors of the parities…ctd*

- *The parties did not intend to be bound by the apparent act or the simulated contract, rather they intend to be bound by the hidden, non simulated act.* ***As per Article 1991(2) of the Civil Code, it is the counter-deed or secret contract which alone is given effect.***

❖There are third parties against whom the secret agreement will not be effective and others against whom the apparent act is not admissible.

❖ For those third parties against whom a secret agreement is not admissible, they should be able to rely on apparent acts as these are the only agreements known to them. That is why Article 1991(2) clearly states that **counter deeds shall bind contracting parties only**. Thus, in all cases where the production of counter deed would entail unfavorable result as to those good faith third persons, the apparent act alone is observed.

❖On the other hand, for those third persons against whom the apparent act is not effective, their right is put under Article 1994.

## Rights of the creditors of the parties

❖*The following are rights of creditors of the parties.*

i. **Preservation measures, Article 1992**

ii. **Exercise of debtor's right or oblique action:-**

- One clear instance where the creditor may be entitled to take preservatory measures is through an action called an **oblique action or otherwise called exercise of the debtor's rights.**
- One stage further is **where the creditor seeks to avoid the impoverishment of his debtor,** there again because such impoverishment diminishes the scope of the security offered to the creditor.

## *Rights of the creditors of the parties …ctd*

- The origin of the impoverishment is indifferent, provided the risk is there; it may be that **the debtor is unaware of the risk, incompetent, absent or simply negligent.**
- The **oblique action** is the necessary consequence of the principle incorporated under Article 1988(1) of the Civil Code, "the debtor's property is the common pledge of his creditors."
- This general right of the creditor would be exposed to too many causes of loss or diminutions if the debtor could without any consequence let his patrimony perish. By lack of care or by negligence he would bring about his insolvency, or at least would accept a creeping impoverishment, which at the end would affect his creditors.
- The law thus affords creditors a means of preserving the debtor's patrimony, a kind of supervision.
- The action is based upon the psychological observation that a debtor on the verge of insolvency often becomes discouraged and fails to manage him patrimony with the customary prudence.
- The oblique action's chief purpose is to prevent the debtor from negligently allowing his valuable rights to extinguish. In cases of oblique actions, creditors do not act in their own name, directly, against the debtors of their debtor.
- The creditor can take oblique action upon the fulfillment of certain conditions so as to avoid his intervention in the personal affairs of the debtor:
  - The first condition is that the creditor must secure court authorization to take the oblique action(**Article 1993(1)).**
  - The second condition is that the creditor should prove risk of impoverishment of the debtor is real and that the impoverishment is such that it jeopardizes the payment of the debt.
- The actions included in the oblique action are intended to apply only to the actions having pecuniary object.

*Rights of the creditors of the parties …ctd*

- The oblique action is available to any creditor, without distinction between secured or unsecured, privileged or unprivileged. The very fact that a person is a creditor, entitles him to such action, subject, of course, to the conditions laid down by the law.

## III. The Paulian or Revocatory Action

- The Paulian or revocatory action **is an action given to creditors to obtain the revocation of acts done by their debtor in fraud of their rights.**
- The creditor will have to prove the fraud to his rights and thus obtain the annulment of the disputed agreement. Article 1995 of the Civil Code opens the right to what is called *"actio paulian"*
- An act is deemed to a fraud, in the meaning of **Article 1996** of the Civil Code, **when it was intentionally made by the debtor so as to become insolvent, or with the intention of becoming insolvent.** *For instance, the debtor sells his properties to a friend for a very low price.*
- Note here that the action is brought by the defrauded creditor in his own name and not as a representative of his debtor as in Article 1993.
- *To* succeed in his revocatory action against the debtor's act, the creditor should satisfy the court by proving two cumulative conditions:
  - ***i. That the act have caused a prejudice to him. And***
  - ***ii. That the prejudice is known by the debtor*** *because fraud strictly speaking consists in the intention to harm.*

## *The paulian or revocatory action…ctd*

- Regarding the effects of the revocatory action, the prime object of the revocatory action is to make reparation to the creditors for the damage they have suffered by the fraud committed against them by the debtor.
- ***Paulian action* benefits only those creditors who took the action.**

# Chapter 10: Proof of Contracts

## Chapter objectives

❑ **After the successful completion of this chapter, the students will be able to:**

- *Define evidence and explain burden of proof;*
- *Discuss burden and admissibility of proof;*
- *Explain the probatory value of written evidence;*
- *Explain presumption of payment; and*
- *Distinguish rebuttable presumption from irrebuttable presumption.*

## Evidence in General

❖ **Evidence** can be defined as **something presented before the court of law for the purpose of proving or disproving the existence or non existence of a disputed fact (issue ).**

❖ In other words, evidence is the means of satisfying/persuading the court of law the truth or untruth of a disputed fact between the parties in their pleadings.

❖ The party who alleges the existence of a certain fact has to prove its existence and the party who denies its existence has to prove its non existence.

❖ However, certain fact/thing is said to be an evidence iff it is brought before a court of law or any institution with a judicial or quazi judicial power.

❖ In general, it can be concluded that **Evidence is the "Key" which a court needs to render a decision.** Without evidence there can be no proof and no valid decision.

# Evidence in Contracts

## Burden of proof and admissibility of evidence

- Burden of proof (Latin *onus probandi*) is the obligation to prove allegations which are presented in a legal action.
- **The rule, in civil cases such as contracts, is that the one who complains certain fact should prove it by producing relevant evidence.**
- The burden of proof also applies to negative assertions. E.g., producing an evidence to prove that the debtor is not performing his obligations.
- In both cases, be it positive or negative assertion, burden normally lies upon the claimant who alleges some contention against others. In most cases he will be a plaintiff.
- Now look at **Article 2001.**
- However, if the defendant admits the allegation of the plaintiff but raised **counterclaim, the burden of proof as to existence of facts raised as defense shifts to the defendant**. This is what **Sub-Article 2 of Art. 2001 affirms.**
- In deciding as to what type of evidence to be produced, the guiding principle resides in the relevancy and admissibility of facts. These two principles are limbs of law of evidence governing what types of facts to be adduced to prove alleged facts.
- When it is said an evidence must be relevant, it means that it must have a capacity to make a fact in issue be more or less probable. Since the function of evidence is to enable the court know what is really true, facts expected to demonstrate this reality should have direct or indirect connection to the point of dispute. See Articles 263 of the CPC & 137 of the CrPC.

- Even though relevancy is the prerequisite for facts to be admitted as evidence, it is not the ultimate license. Rather, there are situations which may render relevant facts inadmissible for **policy reasons**.
- From this, we understand that relevance of evidence is narrower in scope when compared to admissibility of an evidence the final facts the courts depend upon to render decision. In other words **all relevant evidences are not admissible evidences but all admissible evidences are relevant evidences.**
- So, evidences screened by the rules of admissibility would be admissible be it written, oral, presumptions, or admission of the party according to rules and prescribed forms ( **Art. 2002**).
- However, Art. 2003 is an exception to the inclusive rule discussed under article 2002. ***Art. 2003. Contracts to be in writing***.

*"Where the law requires written form for the completion of a contract, such contract may not be proved by witnesses or presumptions unless it is established that the document evidencing the contract has been destroyed, stolen or lost."*

- **Written evidence is normally used interchangeably with documentary evidence.** Letters, contract, deeds, licenses, certificates, tickets, or other writings are documentary/written evidences.
- *You can read* articles 2005ff CC or law of evidence course for the details regarding written type of evidence.
- But one another point worth noting as related to the written evidence is **THE BEST EVIDENCE RULE. According to this rule the person who produces a written evidence before a court of law should produce the original document, not its copy, unless the law permits otherwise.**

# The Role of presumptions

- As provided under **Article 2002 CC,** presumptions are also considered as one type of evidence. For instance, Article 126 of the Federal Family Code provides a presumption that "A child conceived or born in wedlock has the husband [of his mother] as father."
- presumptions can be rebutable presumptions or irrebutable presumptions. While rebutable presumptions are presumptions which can be rebutted by producing the opposite evidence, irrebutable presumptions are those presumptions which cannot be rebutted by producing any kind of evidence.
- The above example is a typical example of rebutable presumption because it might be rebutted by invoking Article 168 of the same code by proving decisively that the alleged father have had no sexual intercourse with the mother during the period between the 300th and 180th day before the birth of the child.
- An example of irrebutable presumption is **presumption of innocence**.

## Presumptions of Payment

- As addressed herein above, presumptions are one means of proof and resolving disputes. **By presumption of payment it means presumption of payment or performance by the debtor to the creditor.**
- The party in whose favor the presumption is taken need not produce evidence in support of his allegation. However, the opponent party can produce evidences to disprove the presumption.
- The civil code provides **4 instances in which presumption of payment should be taken.** They are:

1) **Handing over of evidencing documents (Art.2020 of the C.C ):** When the creditor hands over to the debtor documents of title evidencing the existence of the debt, presumption of payment takes place.

**2. Creditor's entries (2021 C.C): Entries (a piece of writing or note)** made by the creditor **in the contractual document** which indicates that the debtor has paid his debt and which tends to release the debtor from his/her obligation raises the presumption of payment.

**3. Prior or Concomitant Debts (2022):-** The idea of **Sub-Art. 1** is that if the debtor is indebted to the creditor with different debts at different time and if the creditor issues a receipt for the last month's payment without any indication in the text as to unpaid debts, the law presumes that all the debts preceding such period are already paid. **Sub-Art. 2 is clear.**

**4. Period of time related presumptions (Arts.2023 and 2024):-** These presumptions of payment are taken if the creditor fails to accept the payment/performance by the debtor within legally specified time period.