Wollo University
College of Business and Economics

Business Law Module

Distance Education Program

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UNIT ONE
INTRODUCTION TO LAW

Introduction

Law is a dynamics concept, which keeps on changing with time and place. It must change with change in the society. Because of its dynamic nature, scholars try to understand the subject matter by look into the basic features of law, its functions in the society and its relation with the state and its distinguishing from other category of social norms like customary, religions and moral rules. Accordingly, this unit introduces you with the concept of law by appreciating it from different perspectives.

Objectives

At the end of this Unit, you are expected to be able to;

- Understand the indefinable nature of law
- Know the various theories of law
- Know the basic features of law
- Understand the functions of law
- Distinguish law from other category of social norms
- Distinguish different classifications of law
- Appreciate out of court dispute resolution mechanisms

1.1. Definition of law

How would you define the "law"?

(You can use the space below to write your answer)

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Law and the ideals that it stands for is difficult to define over the millennia of time legal. Legal writers and philosophers, from Ancient Greece and Rome, such as, Aristotle and Plato to modern times, John Lock and Thomas Hobbes have tried to define law. However, so far no universally acceptable and an all-convincing definition has been found. Despite the fact that, there are many

varied definitions of the 'law', the common theme with all of them is that, it is a set of rules that regulate the relationship of people in the society to ensure legal, social and political order.

Laws have been designed by people in order to solve 'people' problems and they are intended to be obeyed by people in a given society. With the evolution of time of course, the idea or meaning of what constitute law change with the needs and accepted norms of the society. It should be made learn that not all rues become law. Many bodies, professional associations, schools and clubs in society lay down rues that must be obeyed and if they are broken then the person who broke the rule will be subject to punishment and even payment of fine. However, these rules are not laws as such, as they are made to regulate the activities of the individuals with in those groups and they do not concern the general public as a whole.

Law in in a given society consists of rules which are recognized as 'actual law' by the public and which are enforced in public courts with in a given legal system. Law declares how we must behave and consist of those rules which are enforced by the legal system. The idea and phenomenon of law suggests rules/or principles which have some binding force to them. They are law having the weight of legal institution of state behind them. laws are made by these public legal institutions and they are enforced by them.

Dear learner! The more we learn about how law has evolved and is made, a greater understanding of the nature of law can be ascertained. So in the heading that follows some of the definitions and theories propounded by different scholars will be discussed.

1.2. Major Theories of Law

To have a good understanding of law, let us see some of the definitions and theories propounded by different scholars. Various scholars that tried to define the term 'law' are categorized based on their views in to groups known as School of taught. Though there are a number of schools of thoughts or theories, only four of them dealt with here in under. They are Natural, Positive, Marxist and Realist Law theories.

1.2.1. The Natural Theory of Law

Dear learner, what do you think it mean by natural law? What is natural about it?

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Natural theory of law is is the oldest of all school of taught. It was developed in Greece by Philosophers like Socrates, Plato, and Aristotle. It was then followed by other philosophers like Cicero, Hobbes, Lock, and Rousseau. According to the followers of this school of taught there are two sets of laws that govern the relation of the human society. These are natural law and man-made law.

Natural law is a set of rules that are given by supra natural power 'God' in the form of justice and morality. It is eternal, unchangeable and serves as a standard against which man made laws are to be tested for their validity. Its content justice and morality is once handed down by God and the power of men in making laws is to discover these principles of justice and morality by the dictate of reason and logic.

Man-made law/positive law on the other hand, is differs in space and time. As to the proponents of natural theory of law, although man made laws differs from one country to another and from time to time due to different conception of justice and morality of societies at different times and places, they must follow universal principles of morality, justice and religion. In the case when man made laws are in contradict with natural law principles of morality and justice, citizens should not obey for those laws made by human beings. Thus, natural law is serving as a standard against which man made laws are to be tested for their validity.

It is to be noted that, 'natural law' is distinct from other notions such as, '***law of nature'*** and '***state of nature'***. ***Law of nature*** connotes the sense of laws that govern the physical world. '***State of nature'***, indicating the condition in which man lived, or is by some philosophers supposed to have lived (e.g. Hobbes & Locke), before the birth of ordered society.

Natural law theorist teach that citizens should resort or appeal to natural law in case of contradiction between natural law and state law, do you think it is practical?

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Dear distance learners, the problem with this theory is that, as stated above it presupposes that law is a set of rules, which is just and morally correct. However, this is not always the case. We have ample evidences and historical facts that illustrate sometimes law may be contrary to logic, morality and justice. Look for example the extermination of millions of Jews by Nazi Germany. It was all done by issuing a law, which by no means can be considered as just and acceptable to the Christian morality of the then Europe and the World at large. Take also the 1975 proclamation in Ethiopia, which nationalized without compensation major meanses of production and distribution owned privately.

Moreover, who judges a certain law as just, unjust, moral, or immoral and by what parameters? These and other related questions are unanswerable question of this theory of law. A given rule may be just for one person and may appear for another person unjust. There is no commonly acceptable standard to say something just or unjust, right or wrong.

1.2.2. The Positivists (Imperatives) School of taught

This school of taught founded by Thomas Hobbes and which got predominance in the 19th and 20th century. It sharply separates law from morality and justice. It contrasts with the natural law school theory of law that is based on the belief that all written laws must follow universal principles of morality, religion and justice.

A typical definition adopted by this school of taught is that:

"*Law is a command of a political sovereign backed by sanction."*

In this definition, we can see three important elements. These are; law is a command, that it is a command of a political sovereign and thirdly that it is backed by sanction.

This theory strongly advocates that, law is a command of the sovereign enforced by sanction. The existence of law is one thing, its merit or demerit is another. Irrespective of its merit citizens should obey it.

Dear students, do you agree with the definition of law as given by positive school of, particularly as it being a command, and on the sovereign power?

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According to the positivists, law is not a mere command of the political sovereign. The command for the purpose of its enforcement is backed by sanction. The subject or citizens have to obey the law not at their own wish but at the pain of penalty. If and when people fail to observe the law which is handed down in the form of command, they will be subject to punishment which may be in the form of loss of life (death penalty), loss of liberty (imprisonment) or loss of property (fine or confiscation).

This theory of law serves two major positive values. First by requiring that all laws be written, it ensures that the government will explicitly apprise the members of the society of their rights and obligations. Second, positivism curbs judicial discretion. This theory of law does not allow an appeal to equity and principles of natural justice by courts whenever they are not satisfied with the outcome of a case that would be dictated by the orthodox application of the existing laws.

Despite these positive sides, this theory has various defects. First, it equates all laws with commands, which is not always valid. Some sections of the law may be in the form of command but not all. For example do not steal! ; Do not commit adultery! Are rules of the law that are in the form of command. However, we have also right or power conferring rules, which are not in the form of command. Take for example provisions of the constitution, which provide everyone's right to marry and establish a family or the right to acquire and own property.

Second, this theory associates all laws with a sovereign political authority. For the positivists all laws emanate from the sovereign. However, this does not always hold true. We have customary laws that do not emanate from the parliament or other organs, rather from habitually repeated practice in a certain fashion over a long period of time. International law is also a case in point.

Third, this school of thought views the sovereign as unlimited and unaccountable to anyone whereas today every government organ is legally limited and accountable to the public.

Fourth, the theory divorces law from the ethical foundation of equity, justice, morality and fairness. The extermination of Jews by Nazi Germany, the discriminatory treatment of Black Americans in America and blacks in South Africa under the Apartheid regime were all carried out by issuing law inspired by positivist thinking.

1.2.3. Legal Realism

The theory was first made popular by the famous American Supreme court chief Justice Oliver Wendle Holmes. Rousco Pound who described law as "social engineering" and the utilitarian Bentham are also staunch advocates of this theory of law.

This theory understood law not as formal rules and principles set by the parliament but something that are pronounced by courts of law based on social interests. The Realists believe that, legislatures cannot constitute the law of a country. For the Realists law is what the judge says in his decision to a particular case. For them, the judge gives life to the dead statements of the lawmaker. Realists believe that the law made by the parliament is nothing unless it is applied by the courts. They say that a law made by the legislature is a mere prediction on what the judges courts may decide. It is only when the judge makes a rule by applying the law to the particular fact situation that the law is known. It is for the courts to define refine and delineate the scope of the law given by the parliament and that which is worked out by the court in this way is the law.

Legal realists contends that positive law cannot be applied in the abstract, rather, judges should take into account the specific circumstances of each case, as well as economic and sociological realities. This theory emphasizes on the role of the judge.

Dear learner, what do you think the defects of this system?

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Like all the other theories of law, the theory of legal realism hardly escaped criticisms. This theory views the courts as the real lawmakers. Nevertheless, this severely violates the well-established and operating constitutional principle of separation of power and functions. The theory of legal realism is violating this principle by advocating judicial law making which means over taking the function.

1.2.4. Marxist Theory of Law

Marxists believe that private property is the basis for the coming into existence of law and state. They provide that property was the cause for creation of classes in the society in which those who have the means of production can exploit those who do not have these means by making

laws to protect the private property. They base their arguments on the fact that there was neither law nor state in primitive society for there was no private property.

The Marxists` main thesis is, law emerged at a certain point in history (with the emergence private property) and it will disappear in the future when classless society emerge at communism stage of the evolution of society.

What do you think the critics towards this school of thought?

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The theory has the assumption that people can attain a perfect equality at the communism stage in which there would be no private property, no state and no law. However, this was not yet attained and even the practice of the major countries like the former United Soviet Socialist Russia (U.S.S.R.) has proved that the theory is too good to be turn. Some asserts that even the communism system cannot survive without the law. Human existence without private property is near to impossibility and if the existence of law is related with the existence of private property then law is to be there forever.

As we have seen the different school of thoughts discussed above, there is no satisfactory answer for the question ‘what is law’? What do you think the reasons thereof?

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The first reasons for failing to come up with a satisfactory definition is that in defining it scholars give emphasis only to one or some of its aspects and do not address all aspects of law. For example, as pointed out above the Natural law theorists emphasis only on the content of law while the legal positivists emphasized on the form.

The other explanation for the problem why it is difficult to get complete and universally acceptable definition of the concept of law is the dynamic nature of the law. The rise and fall of

different political, social and economic ideologies in this world has contributed a lot to make law, a fluidly and elusive concept causing it to become difficult to define.

1.2 Basic Features of Law

Dear distance learner, are you getting the themes of our discussions so far? I hope you are. If there are any problems, I advise you to go back and revise the particular Section that you found difficult to understand and to discuss the point with your Friends. I am now going to introduce you to the basic characteristic features of laws that are common to all laws to understand more about the subject. Among these features and natures, the ones considered as essential include generality, normativity and sanction.

1. Generality

Rules and regulation that constitute the law of a country are general statements on a possible human behavior. Legal rules are said to be general because:

First, they do not deal with a particular person that is, they are not meant to regulate the behavior of a specific person. A legal rule cannot be made expressly by name to Ato Kebede or Ato Abebe. Generally legal rules are made in such a way as to be applicable to any person- the young or elderly, females as well as males.

Second, legal rules are also said to be general because it is possible to apply a single rule to a potentially unlimited number of cases. That is, legal rules will not go in to the particulars of daily life but they set general criteria by which many acts and situations are covered.

Third, legal rules are usually designed to apply for indefinite period for the future. It is because of this nature of laws that made the Ethiopian Civil code of 1960 and other laws to apply or to be valid for more than 50 years. It is, however, important to note that the assertion that laws are made to apply for an indefinite period for the future does not always hold true. Some laws are issued only for a definite period. For example, Emergency decree and fiscal year budget proclamations

2. Normativity

Law does not simply describe or explain the human conduct it is made to control. It is created with the intention to create some norms in the society. Law creates norms by allowing, ordering,

or prohibiting the social behavior. This shows the normative feature of the law. Based on this feature, law can be classified as permissive, directive or prohibitive.

- ***Permissive Law***: it allows or permits their subjects to do the act they provide. They give right or option to their subjects whether to act or not to act.
- **Directive law**: it orders, directs, or commands the subject to do the act provided in the law. It is not optional. Therefore, the subject has legal duty to do it whether s/he likes it or not, otherwise, there is penalty imposed by the law.
- **Prohibitive law:** it discourages the subject from doing the act required not to be done. If the subject does the act against the prohibition, punishment follows.

3. Sanction

Each member of a society is required to follow the law. Where there is violation, the legal sanction would follow. Sanction is a penalty or coercive measure that results from failure to comply a law. The main purpose of sanction is to prompt a party (a wrong doer) to respond.

1.4. The Functions of Law

Why we need law? What functions does law have in your localities?

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Jurists have expressed different views about the purpose and function of law. Law, in the modern sense, is considered not as an end in itself, but is a means to an end. The end is securing of social justice. Almost all theorists agree that law is an instrument of securing justice. It must, however, be stated that justice alone is not the only goal of law. Today the following are taken as important functions of law.

- **Maintaining peace and order in the society:** For the people to conduct their daily activities in a descent manner, peace and order must be maintained. Thus, the law is there to crate peace and order by the threat of death, imprisonment, and/or fine penalties.
- **Regulate social interactions:** Social interactions (political, economic, social or cultural) are part of the life of a society. There are positive interactions (concluding marriage or entering

into contracts, etc) as will as negative interactions (disputes or conflicts). The law in its own way regulates these interactions.

- **Protection of citizens from excessive and arbitrary government power:** The government has every sort of power that enables it to compel citizens. It has the purse and the gun. Unless its power is curbed by the law, citizens may become victim arbitrary exercise of power by the government.
- **Fight harmful traditional practices:** Law is also instrumental in fighting traditional practices that are harmful to the society such as genital mutilation, abduction, rape, early marriage, traffic in drug etc.
- **Protect and encourage innovative and new ideas:** The patent and copyright laws by giving recognition and extending protection to innovative ideas and new works encourage more and more inventions.

1.5. Difference between Legal Norms and Non-Legal Norms

What are legal norms? What do you understand by non-legal norms? What do we mean by norm?

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Although, both law and other category of social norms are similar in that they are general, normative and regulate or shape human behavior, there is a significant difference between them. Let us see these differences carefully.

- **Mechanism of enforcement:** Law has centralized and institutionalized mechanism of enforcement. Social norms other than law (non-legal norms), however, have no centralized and institutionalized enforcement mechanism. Although they have sanction, it is weak and it is taken in a decentralized manner. That is, it the society in a decentralized manner that take the sanction, for example by out casting or segregating those who contravene the alleged customary, religious or moral norm.
- **Scope of application:** A law enacted by the appropriate organ of the state is applicable with in the entire territorial jurisdiction of that state be it a sovereign sate or member of a federation. Non-legal norms on the other hand are limited to a certain locality. Religious norms apply only to followers of that religion.

- **Exhaustiveness and clarity of rules:** Legal rules are exhaustively and clearly written. So, citizens will be able to know in advance what the rules are and the possible punishment for the violation of the rules. However, the contents of non-legal norms are not exhaustively written and in advance known.

1.6. Classification of law

The law may be classified in various ways. The most important classifications are as follows:

A. Public Vs private law

Public law: Public law is concerned with the relationship between the state and its citizens. This comprises several specialist areas such as:

i. **Constitutional law**: it concerned with the workings of the Ethiopia constitution. It covers such matters as the position of the government, the composition and procedures of parliament, the functioning of federal and regional government, citizenship and the civil liberties of individual citizens.

ii. **Administrative law**: it deals with the complaints of individuals against the decisions of the administering agency.

iii. **Criminal law**: Certain kinds of wrongdoing pose such a serious threat to the good order of society that they are considered crimes against the whole community. The criminal law makes such anti-social behavior an offence against the state and offenders are liable to punishment.

Private law: Private law on the other hand is primarily concerned with the rights and duties of individuals towards each other. The state's involvement in this area of law is confined to providing a civilized method of resolving the dispute that has arisen. Thus, the legal process is begun by the aggrieved citizen and not by the state.

B. Criminal Vs civil law

Dear students, what is the difference between criminal law and civil law?

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Legal rules are generally divided into two categories: criminal and civil. It is important to understand the nature of the division because there are fundamental differences in the purpose, procedures and terminology of these branches of law.

Criminal law: The criminal law is concerned with forbidding certain forms of wrongful conduct and punishing those who engage in the prohibited acts. Criminal proceedings are normally brought in the name of the state. Prosecutions are not undertaken by private individuals rather it is undertaken by public prosecutor.

The consequences of being found guilty in criminal cases are so serious that the standard of proof is higher than in civil cases: the allegations of criminal conduct must be proved beyond a reasonable doubt. Punishments available in criminal cases are imprisonment, capital punishment fines, or community orders such as an unpaid work requirement.

Civil law: The civil law deals with the private rights and obligations, which arise between individuals. The purpose of the action is to remedy the wrong that has been suffered. Enforcement of the civil law is the responsibility of the individual who has been wronged; the state's role is to provide the procedure and the courts necessary to resolve the dispute. In civil cases, the claimant will be successful if he can prove his case on the balance of probabilities, i.e. the evidence weighs more in favor of the claimant than the defendant does. If the claimant wins his action, the defendant is said to be liable and the court will order an appropriate remedy, such as damages (financial compensation) or an injunction (an order to do or not do something). Many of the laws affecting the businessperson are part of the civil law, especially contract, tort and property law.

The distinction between the criminal and civil law does not depend on the nature of the wrongful act, because the same act may give rise to both civil and criminal proceedings. For instance, if a man kills someone, he will be criminally liable and at the same time he may require to give compensation for deceased parents in civil suits.

1.7. Alternative meanses of dispute resolution mechanisms and its virtue in business

Dear students, what do we mean by Alternative Dispute Resolution?

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Conventionally, every dispute involving legal questions, civil or criminal, has been determined formally by the regular law courts. Nowadays, however, this trend is a bit changing, for variety reasons, in favor of what we call alternative dispute resolution (ADR) for civil cases. ADR

techniques provide a viable and preferable alternative, as its naming can tell, to court proceedings in the swift disposition of legal matters.

Why business persons prefer ADR mechanisms than court room settlement of disputes?

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Business persons prefer one or the other of the two dispute disposition alternatives for the following reasons;

- **Flexibility**: Court settlement is conducted in an extremely formalistic manner and is surrounded by legal/procedural technicalities. Business persons would choose simple means of dispute disposition and **such is effectively provided by ADR.**
- **Less costly and time saving**: adjudication by courts entails greater cost litigation and consumes time and energy. A backlog of court cases awaiting trial and subsequently accompanied by delayed resolution is very unwelcoming to business world that deals in the fast-paced commercial transactions.
- **Win win approach**: a final judicial disposition of a legal dispute is usually accompanied by a winning and losing spirit. In court settlement, a judgment that satisfies one of the litigants and that disappoints the other is rendered. This in turn will create an adverse relationship between the disputants and potential beneficial relationship between these very disputants would be jeopardized. Out of court settlement, on the other hand, is based on the concept of reciprocity (give and take) so that both litigants would go home satisfied and future relationship is possible.

1.7.1. Types of ADR mechanisms

Methods of ADR range from neighbors sitting down over a cup of coffee to work out their differences to huge multinational corporations agreeing to resolve a dispute through a formal hearing before a panel of experts. The following are the most known kind of alternative dispute resolution mechanisms.

A) Negotiation

In this process, the parties come together informally, with or without attorneys to represent them. In such an informal setting, the parties air their differences and try to reach a settlement or resolution without the involvement of independent third parties. Because no third parties are involved, negotiation provides the simplest and swift opportunity of dispute disposition outside the court structure. It has to be noted here that the presence of an attorney to represent one or both of the parties dose not in any way imply the involvement of an independent third party. Attorneys, if any at all, get involved in the dispute by representative capacity stepping into the foot and taking the place of the party they represent and hence they are regarded as parties to the dispute.

B) Mediation

Mediation is usually a private, voluntary, and informal process where a party-selected neutral assistants to the disputants to reach a mutually acceptable agreement. The mediator is not empowered to render a decision. The mediator is not a judge or arbitrator. The mediator's role is to facilitate the conversation and dialogue between and among the parties to the dispute. The mediator acts as a third-party neutral.

There are varieties of mediation styles of practice that a mediator can use. A mediator's style depends upon the nature of the conflict, its setting, the experience and resources of the disputants, and the background and training of the mediator.

C) Arbitration

Arbitration is a procedure for settling disputes in which both the disputants usually agree to accept the decision of the arbitrator as legally binding. This means the parties cannot take court action, except to enforce the award if the judgment debtor refuses to discharge his obligation.

The arbitrator, the person who hears and decides the dispute, is selected by the parties. Frequently, the arbitrator is an authority and experienced in the area in which the dispute arises. Unlike the case compromise, there is a decision to be given by the arbitrator. This decision, unless it gravelly violates one of the parties right, is like a court decision and the parties are bound by it. The arbitrator, like a judge, weighs the evidence, applies the law, and renders a decision, which as stated earlier becomes a binding decision against the parties to it.

Summary

For one reason or the other, the concept of law is indefinable in the sense that it is near impossibility, as shown above, to come up with commonly and universally acceptable definition of law and we need not venture to find one or to create our own definition. In order to understand law, we had look into different theories of law, the basic features of law, its functions, factors that distinguishes it from other category of social norms like customary, religions, and moral rules.

Some theorists (natural law theory) have tried to explain it in terms of its content (justice and morality), others positivists have defined it in terms of form (as a command) while others (the Realists and Marxists) analyzed it in terms of its practical application and significance, respectively.

When we see the function of law, its primary function is creating harmony, peace, stability and economic progress in the society. It is an instrument to create an environment suitable to human survival and translate human desire into reality. In fact, it must be also noted that law can be abused by political forces to serve as an instrument of oppression and barbaric rule. History is full of evidence of this fact. We can cite for example the case of Nazi Germany, Fascist Italy and socialist Russia.

At this time, ADR (Negotiation, Mediation, and Arbitration) techniques provide a viable and preferable alternative for civil disputes. ADR has many advantages over court litigation; like it saves time, relatively less costly, confidential, flexible procedure, and win-win approch and preserves relations.

Exercise

1. Define law in your own word?

2. Discuss the Marxist theory of law

3. Explain normativity as a basic feature of law

4. Explain the distinctions between legal and non-legal norms.

5. Explain the difference between civil law and criminal law;

UNIT TWO

LAW OF PERSON

Introduction

Law of person is a body of rule concerned with the legal position of the human person comprising their rights, capacities, and duties. It pertained to various aspects of a person status as an individual to conclude a contract, conclude marriage, establish business etc. It determines the requirements and qualifications for legal subjectivity and the rights and responsibilities that attached to it. Thus, this unit devotes to discussions of the concept of personality, attributes of personality, capacity, and incapacity of individual persons.

Unit objectives:-

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

- Understand the concept of personality
- Understand the concept of person under the law
- Understand the attributes of personality
- Appreciate the circumstances where legal and natural personality is commences
- know the similarities and differences between physical persons and artificial persons
- appreciate the concept of capacity and incapacity under the law
- appreciate the situation where legal and natural personality come to an end

2.1. The concept of legal personality

Dear distance student, what do you understand by the term "legal personality"? Do you think that the term "person" could be interchangeably used with the word "human being"?

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Law is an instrument that regulates the relation of persons. By determining the respective rights and duties of persons, law helps to create smooth relations in the life of the society. In the language of the law, the term "person" is not used in it's literally or usual meaning. The words

'person' in its usual meaning refer to anyone who is member of humankind and it is interchangeably used with the word 'human being'.

In the modern legal parlance however, the words 'person' has a wider meaning than the word 'human being' does. While all human beings are persons, there are also other entities other than human beings who take part in legally defined relationships and considered as a person. In law, a person possesses certain rights and owes certain duties.

Contemporary legal legal systems around the world recognize two categories of persons as follow:

i. **Natural persons**

Natural persons also known as physical or real persons, refers to human beings. Non-human creatures are not legal persons and do not have the full range of rights and duties which a human being acquires. In the earlier times where there was the slave owning practice, not all human beings were considered as persons by law. Slaves, which were persons in the strict sense of the term, were not considered as persons by law. They were considered as property of their masters and they used to have no rights and duties under the law. Now a day the dichotomy of human beings in to slave and freeman has disappeared and all human beings are considered as person by law and are subjects of it. So, every human being acquires rights and duties at some point in his life and losses them upon death.

ii. **Artificial persons**

Legal personality is not restricted to human beings. Artificial person's also known as fictitious persons or legal persons are non-human entities, which are recognized by law as persons and given certain rights and duties and are, treated more or less like human beings for the sake of convenience in control. Artificial persons can be an association, an organization, a company, a group of person, state etc. If they are given personality by law, these entities are persons and can have legal relations with each other or with natural person.

2.2. Commencement and Termination of Artificial Personality

When do you think personality of artificial person commences?

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The way in which artificial personality commences depends on the type of the artificial person itself. There is no uniform rule concerning the acquisition of artificial personality. There are different mechanisms through which artificial persons will begin to have legal life. Of these mechanisms, the famous ones are issuance of a specific legislation, effecting registration and requirements of publicity. For instance, public enterprises will start to have personality upon the enactment of establishment regulations with no other conditions attached to it. On the other hand, private business organizations need to be registered with a competent public authority in order to acquire legal personality. They should also comply with publicity requirements. So, acquisition of personality by business organizations is realized by meeting the requirements of both registration and publicity, and only as a consequence of such they can validly undertake acts of civil life.

Dear student, When do you think personality of Artificial person come to an end?

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The same way personality begins it will mostly end. That is to say, just like artificial personality commences through issuance of statutes or effecting registration and publicity, it ends through the enactment of dissolving law or the striking out of name of the entity from the public registry. To terminate the legal personality of a public enterprise, regulations would be issued and these would serve the purpose of ending the legal life of the enterprise. Ordinary business organizations would cease to have legal life when they are canceled from the registry and/or through the revocation of the license issued to them as evidence of personality. Artificial personality may also end as a matter of fact where the object for which the entity is established becomes impossible to achieve or where that organization is dissolved because of bankruptcy. In all the above cases, the fictitious beings would die out and they can no more be parties to

transactions having effect at law. Any act done by these beings after their personality has terminated is deemed never to have happened for all legal purposes.

2.3. Attributes of legal personality

Dear student, could you guess some of the capacities that legal personality may attribute?

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As discussed above, legal personality is a particular device by which the law creates or recognizes units to which it ascribes certain power and capacities. Under the law, persons possess certain capacities and these capacities are called attributes of personality. The followings are some of attributes of legal personality.

a) **Having name**; every person, physical or artificial is identified by name and necessary need to have name.
b) **The ability to sue or be sued in its own name**: Once an individual human being or an artificial person acquired personality after fulfilling certain requirement, it can bring an action against others. Similarly, others can institute an action against it. For instance, Samson, yohannes and Asamn establish a company. After a company has satisfied the legal requirements for the acquisition of legal personality (after it has become a legal person), it brings legal suits against other in the name of the company, not in the name of Samson, Yohannes and Asamn. Consequently, there is a distinction between the liability of the company and the liability of individual persons forming it.
c) **The ability to own and administer property**: Only a person can own and administer property. Property belonging to a legal person is different from that of individuals who own the legal person. For instance in the example cited above, peoperty belonging to Samson, yohannes and Asamn is completely different from property belonging to the legal person (i.e. the company). As well, property belonging to the company is distinct from the property belonging to its owner.
d) **The ability to enter in to contracts:** once a human being or an entity acquired personality, it can enter in to contracts and acquire rights and duties for itself. For instance, Niyala Insurnce Company may conclude a contract with National Bank of Ethiopia. The rights acquired and

the liabilities incurred, as the result of the contract, remains the right and liabilities of the company. It is the company, not the individual owners, that is either a creditor or the debtor.

e) **The obligation to pay taxes**: a legal person may own property or carry business in its own name, in the same way that a physical person pay tax on his or her income, a legal person is also required to pay tax on any income it derives

☞ These are various attributes of personalities, which physical persons and artificial persons commonly share. There are also specific attributes that are applicable only to physical persons or artificial persons. The ability to make will, holding fundamental rights (e.g. the right to life,) are for example, attributes of only physical persons.

2.4. Commencement of Natural personality

When do you think personality is granted to natural persons or a human being ?

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Dear student, the personality of natural persons begins through a couple of ways. As of a rule, birth is regarded as the starting point of personality and as an exception; there is anticipated personality in which personality also commences.

2.4.1. Birth

Most legal systems accept birth as a time when personality of a human being begins. Similarly, Art.1 of the Ethiopian Civil Code provides

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

So, in this respect the beginning of physical and legal existence are simultaneous. Birth refers to the complete extrusion of the baby from its mother's womb either in a natural way or by a medical operation. Birth alone is a sufficient condition to confer personality under the Ethiopian law, and no other requirements are attached to it.

2.4.2. Anticipated personality

As stipulated under Art 1 of the civil code, personality begins at birth as a matter of principle. As per this provision, an unborn child is not a person in the eyes of the law and can have no rights. However, this general rule has an exception in that personality may be granted to a merely conceived baby without waiting for its birth for some purposes. Art 2 of the Ethiopian Civil Code states that,

> *"A child merely conceived is considered as though born where its interest so requires provided it is born alive and viable."*

Thus, as per this provision personality is granted to unborn child if the following three cumulative requirements are met;

i. **The interest of the child must require**:

The exception of granting personality for fetus generally revolves around the interest of the unborn child. This exception is based on the justification that a child who has already lost his father while being in its mother's womb should not be subjected to further pain of losing a benefit which it would have secured had it been born before its father's death.

In most cases, the interest of the unborn baby comes into the fore where a father dies before the birth of the child leaving behind property. If a baby has to wait until birth to acquire personality, i.e. if Art 1 of the Civil Code is strictly applied, it will definitely lose the succession to its father's property because succession constitutes a juristic act and being a beneficiary when it opens necessarily requires personality. Opening of succession is legally made at the death of the father and the property would devolve upon those having the capacity and the right to succeed at such time. Therefore, when there is an interest of the baby at stake, the unborn baby in the womb should be regarded as already born and should be allowed to take advantage of the interest.

ii. **The child must be born alive**

In order to be considered as a person, the baby must be born alive so much so that, for instance, personality will never be granted if the fetus is aborted.

iii. **The child born must be viable**

Viability refers to the ability to live or the potential of surviving. This is to exclude from the ambit of personality impotent newly born babies or those incapable of surviving because of some congenital factors. The law takes certain presumptions to settle questions of what baby is viable

and what is not. The law *irrebutably* presumes that a child that lives for 48 hours after its birth is viable, so that no contrary evidence can be admitted to disprove this presumption. The law also provides for another presumption *in the negative* that a child that dies before 48 hours after its birth is deemed to be *not viable*. However, this presumption is *rebuttable* in that it can be shown to the contrary by proving the child was viable.

Does the child is still not viable if the child dies before 48 hour owning to artificial causes? That is to say, if the child dies for instance owning to mishandling by the nurse?

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External factors that may have caused the death of the child before 48 hours can be used to disprove the presumption of non-viability. If, for instance, the baby dies on the 43rd hour after its birth because of mishandling by nurses or by hunger or due to a car accident can be employed to challenge the above presumption by proving that the baby would not have died had it not been for the extraneous factors..

2.4. Capacity and incapacity of Physical Persons

Dear students, what do you understand by the term capacity?

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Enjoyment and exercise of rights are not the same. To enjoy rights means to have or to hold rights. A physical person enjoys rights, holds rights or is the subject of rights starting from the time of birth. This means that all persons enjoy rights without exception up on birth; however, not all persons have the same capacity to exercise rights. Some persons are incapable of exercising rights.

Capacity in its legal sense is the ability of physical persons to exercise their rights and discharge their duties by themselves. The law presumes capacity. In all acts of civil life, physical persons may be assumed that they are dealing with equals who not only hold but also exercise the same rights and duties as theirs. In this regard, Article 192 of the civil code states that:

Every physical person is capable of performing all the acts of civil life unless he is declared incapable by law.

Even if personality is a necessary condition for capacity, it is not a sufficient one to enable one to personally carry out juridical acts and certain conditions may incapacitate an individual still possessing personality. In certain circumstances, the law may explicitly declare that person is considered incapable to exercise rights and duties. Let us now see in brief some of legally prescribed conditions of incapacity recognized under Ethiopia legal system.

a) Minority

Minority in civil law is an incapacitating condition that occurs because of age. Article 215 of the revised Federal Family Code defines persons regarded as minor. It states:

"A minor is a person of either sex who has not attained the full age of eighteen years"

Thus, a person below the age of 18 years is called a minor and is incapable of exercising rights and duties by him/herself. The law intends that these persons have immature intellectual faculty and lack the proper degree of appreciation when they transact acts of civil life. The law interferes to protect minors from exploitation by others. Accordingly, any civil act undertaken by the minor without authority is subject to invalidation. A minor may, however, validly perform acts of daily life, i.e. simple and small matters that are quite frequently done and that do not significantly affect the legal position of the minor.

There are two institutions of representation recognized by the law to exercise rights and duties on the behalf of the minor. These are guardianship and tutorship.

- **Guardianship**: guardian of the minor is entrusted with the task of running the personality affairs of the minor (i.e. keep the physical and psychological well-being of the minor). Personal interests include food, clothing, shelter, and schooling. The guardian thus, is responsible for such interests of the child.
- **Tutorship**: tutor is answerable for the protection and management of the minor's economic (pecuniary) interests such as securing income, investing same, running business, administering property and the like.

The incapacity arising because of minority may terminate through the following couple of ways.

- **Majority**: A minor assumes capacity to exercise rights and duties him/herself when he/she attains the age of majority (18 years).
- **Emancipation**: The incapacity of a minor may also come to an end through emancipation even if the person is still below the age of eighteen. A minor may conclude marriage in

exceptional circumstances approved by the appropriate public body, and we call this situation emancipation.

b) Judicial Interdiction

The court may sometimes interdict a certain categories of individuals due to their mental problem. These individuals do not understand the consequences of their action due to their mental condition. Therefore, the law steps in to protect the interests of persons with mental problem because of insanity, infirmity, senility and the like. Insane persons are believed to be unable to understand the nature and consequences of their actions because they have got a mental problem. Infirm persons are those with serious physical deformities so that such deformities will have the ultimate substantial reduction in mental functioning. For example, if a person is simultaneously deaf-mute and blind, he/she is deemed infirm. Senility is deterioration in mental faculty because of old age. The court can declare the interdiction of the above persons with mental deficiencies. Any interested party may apply to the court for the interdiction.

Judicially interdicted persons will lose the authority to exercise rights and duties as of the date of their interdiction. But they, just like minors, exercise rights and duties they hold through guardians if the interest pertains to the personality of the incapable person and through tutors where the interest is a proprietary one.

Note that the offices of guardian and tutor have certain general features in cases of both minority and judicial interdiction.

- The offices are compulsory – it is a civil duty to become a tutor or a guardian and no consent is needed.
- The offices are in principle non-remunerative. A guardian or a tutor gives the service for free.
- The tutor/guardian must be a capable person. It is clear that an incapable person cannot exercise representing others rights and duties that he/she cannot personally exercise.
- The essence of the distinction between the offices of guardianship and tutorship is the type of activity undertaken and it does not mean that two different persons should hold the offices. Both functions can be assumed by a single person.

c) Legal interdiction

This is an incapacity imposed by the law. A person will be legally interdicted because of the pronouncement of a legally prescribed punishment for the violation of criminal law. The prescribed sentence will deny the person the capacity to carryout economic affairs. A legally interdicted person retains capacity over his personality interests and thus no guardian is necessary. A tutor may represent the legally interdicted person to exercise the latter's pecuniary rights/duties. The assumption of the office of tutorship is, unlike that of minority or judicial interdiction, voluntary. The evident reason is that a person who lost his privilege because of commission of a crime should not be favored by compelling others to assume the role of tutorship on his behalf.

2.5. Termination of Physical Personality

When the personality of natural person is come to an end?

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The Ethiopian civil code deals with grounds, which terminates the personality of human beings. These grounds are death and declaration of absence.

a) Death

Article 1 of the Ethiopian Civil Code provides for the way personality of individuals ends through death. It states that;

"*Human person is the subject of rights from birth to* ***death****…*"

b) Declaration of absence

The other mechanism where personality of human persons comes to an end is the declaration of absence. If a certain person is disappeared and no news of him has heard for two years, any interested party may apply to the court for the declaration of absence. If once the court declares that the person is absent, the absentee is considered dead. And death is considered as the ground to end the personality of the absentee.

Summary

The term person in law is different from its conventional meaning. Personality in law refers to the authority accorded to a being (individual or organization) by law so that the latter would be able to enter into various transactions having effect at law. It is only a person in the eyes of the law who can conduct legally binding transactions.

There are different mechanisms through which artificial persons begin to have legal life. Among these mechanisms, the prominent ones are issuance of a specific legislation, effecting registration and requirements of publicity. The same way the legal personality begins it will mostly end.

Being recognized as a person by the law makes the person possess certain attributes. The most noticeable of these attributes are having a name, to sue and be sued (in one's name), entering into contractual relations, ownership and administration of property and obligation to pay taxes.

Birth is the only condition to confer personality for human beings under the Ethiopian law. As an exception, however, personality is given for unborn child if its interest so requires provided it is born alive and viable. The personality of human beings comes to an end when the person dies or declared absent.

Holding or enjoyment of rights is different from the exercise of rights. All physical persons enjoy rights without exception up on birth. Nevertheless, not all physical persons have the same capacity to exercise rights. Minors, judicial interdicted persons, and legal interdicted persons are incapable to exercise a juridical act.

Exercises

1. Discuss briefly the circumstances at which the personality of Artificial persons commences and terminate

2. Discuss the requirements to give personality for fetus or merely conceived child under Ethiopia law.

3. What are attributes of personality?

4. What is legal incapacity? Who are incapable persons?

5. Discuss briefly general features of guardianship and tutor ship in cases of both minority and judicial interdiction

UNIT THREE

LAW OF CONTRACTS

Unit objectives:-

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

- Distinguish obligations arise from the law and obligation arise from contract
- Identify formal requirements to make contract
- Appreciate various defects of consent
- Appreciate effect of contract
- Identify remedies for nonperformance of contractual obligations
- Identify and explain the different ways in which contractual obligations are extinguished

Introduction

People and business enter into a various contracts every day, covering the daily essentials of living, such as food and transport or entering into contracts for large purchasers such as a house. This unit thus, dealt with rules and principles regulating contractual obligations under Ethiopia law. Essential requirements for existence of valid contracts, effect of contractual obligations, remedies for non-performance of contractual obligations and the way contractual obligations extinguished are discussed under this unit.

3.1. Overview on the obligations

3.1.1. Sources of obligations

In Ethiopian legal system, there are no clearly stated classifications of sources of obligations. Art.1675 of Ethiopian civil code generally expresses obligations as arising from contractual agreements. However, the close readings of the provisions of the civil code show that there are two major sources of obligations. The two sources of obligations are the law and contract.

a) Law as a source of obligation

As far as an obligation arising from the law is concerned, it happens in situations when law imposes obligations on persons to give or not to give, to do or not to do some acts recognized in almost all-legal systems.

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.

b) Contract as a source of obligation

In contract, the will of the parties forms the basis of the obligation. It is something undertaken willingly. No body forces you to make contract. You enter into a contract only if you are willing. When you make a contractual agreement, a binding obligation is created. For instance, if you sell something to someone, you willingly undertake to transfer the right that you had on the thing to the buyer. The buyer pays you because he willingly bought something thereby consenting to pay. He pays you not because he has legal obligation but because by his agreement he agreed to pay. Since contractual obligations are created by agreement, they are binding on the parties who agreed to be bound. Contractual obligations are not binding on third parties or on non-contracting parties.

3.2. Definition of Contracts

What is contract (define in your own language)?

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Giving definition for a concept is the heart of any subject. However, there is no unanimous definition given by scholars about contract. Different legal systems have their own definition. Contract in general however is a binding agreement; it is a promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty. Art 1675 of the Civil Code defines contract as

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

Let us discuss the elements embodied in this definition:

A contract is an agreement: agreement is one of the major characteristics, which differentiate, the law of contracts from other laws. An agreement is the expression by two or more persons, either by words or by conduct, of a common intention. It is when the parties to the contract manifest their common intention that we say there is an agreement.

Every contract is an agreement, but not every agreement is a contract. A contract is different from non-compulsory exchange of consent. For instance, an act of courtesy or gentlemen agreement for a gratuitous action, free performances of services are not contracts even if they are based on agreement between two or more persons because such manifestation of assent are not intended to be legally binding,

Contract is not a unilateral legal instrument: In order to make a contract enforceable before the law, at least two parties are necessary. There may however be more than two parties but not less than that. This is because a person cannot enter into a contract with himself, for such contract cannot operate to affect his legal relations with someone else.

The agreement should be as between themselves: contract takes effect only between the parties concerned. Hence, contract cannot, as a general rule produce any effect upon third persons that are not parties to the contract. This fact is clearly stated under Art. 1952(1) of the Civil Code. This article reads, “Except in cases provided in this code contracts shall produce effects only as between the contracting parties".

The effect of contracts is to create, vary or extinguish obligations: An obligation might be created, amended or terminated using contracts. The parties can, through the instrumentality of contracts, not only create legal bonds that had not existed before but also vary existing contracts between them or, if they want to, can totally extinguish obligation that had previously been in existence.

The agreement should relate with something proprietary. This is to show that the agreement should relate with goods, physical or intellectual service, and this, excludes contract of status, such as betrothal, marriage, adoption which create obligation of status predefined by law; of a primarily non patrimonial nature.

3.3. Formation of contract

As discussed in the above section, contracts emerge out from the free will of the contracting parties. However, it may be the case that such free will would be exercised improperly so that the economic interest that is the subject matter of a contract may be prejudiced. A party may enter in to a contract because the other party may have improperly induced him to do so. Therefore, there are two interests at stake here: one is that free will must be reasonably made and must be legitimate in the circumstances; the other is that the formed contract should be enabled to produce the economic effect intended.

Accordingly, parties are free to determine whatever they like on such regard but the law has regarded formative requirements as essential and, therefore, compulsory upon the parties to comply with. In this regard, Article 1678 of the Ethiopian Civil Code provide the following;

No valid contract shall exist unless;

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

In other words, four mandatory conditions are evident in the provision above: capacity, consent, object, and formality. Let us turn ourselves on to briefly exploring the nature and scopes of these conditions.

3.3.1. Capacity

Dear student, what is a legal capacity? Who are capable person?

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As discussed in unit 2, although human beings are subject to rights and duties from the moment of birth to death some may not be entitled to exercise such rights and duties. Still others may exercise only some of their rights. However, capacity is presumed. Every party to a contract is presumed to have contractual capacity until the contrary is proved. Art 192 of the civil code state that;

> *Every physical person is capable of performing all the acts of civil life unless he is declared incapable by law.*

Furthermore, Art 196(2) of the civil code stated that:

Any person who alleges the disability of physical person shall prove that such person is under disability.

Accordingly, capacity is presumed. You may not be required to prove that you are a capable person. That is already established by law. If someone alleges the incapacity, it is up to him to prove its existence.

Even though, every physical person is presumed to be capable as of a rule, the law for one reason or another declares some members or groups of society incapable. Minors and judicially interdicted persons cannot enter into a contract. However; when a legally interdicted person enters into a contract, which he was prohibited, from such is not limited to incapacity but also extends to illegality. The same holds true for special incapacities. Some persons like foreigners for instance may be incapable to inter in to certain form of transactions. For instance, foreigners cannot own immovable property under Ethiopia law.

3.1.2. Consent

Consent is the other basic requirement for the validity of contract. Consent is a defect-free mutual agreement by the contracting parties. It is a manifestation of freedom of contract, and therefore is the basis upon which rests the entire law of contractual obligations. Consent carries a double aspect:

- The parties must agree on the scope of their undertaking (there must be agreement on each and every important detail) and,
- There must be a willingness on the part of the contracting parties to make their undertaking legally binding.

The agreements of contracting parties are usually arrived by means of offer and acceptance. One party offers a certain bargain to another party, who then accepts that bargain. The parties are required to manifest to each other their mutual assent to the same bargain. A contract is therefore the meeting of the offer with an acceptance. Thus, Offer and acceptance are ways of communicating one's own intention to be bound by an obligation.

Offer

Offer is a definite proposal made by one party (so called the offeror) indicating his willingness to enter in to contractual agreement regarding a particular thing. In other word, it contains the

intention of the person making it to be bound by the content of the offer. To be effective before the law, an offer has to consist of the following three important elements. If these elements are not present, the offer is incomplete and cannot be accepted in this situation.

A. Serious intention (firm proposal)

An offer is firm when the offeror has the effective intention of being bound by the offer. For instance, Samson and Ali have taken parts in a play. Samson reading his lines says to Ali, "I will sell you my house for 70,000 birr." He also reading his line replies, "I accept your offer." Do you think that there is a firm intention here? Certainly, there is no intention to create a binding obligation between Samson and Ali.

Whosoever sends to another or posts up in a public place tariff, price lists or catalogues, or displays goods to the public shall not be deemed to make an offer. Such publications are not in themselves offers creating the power of acceptance, they are meant to excite people to offer.

B. Certainty or definiteness

An offer is deemed precise where at least the essential elements of the future contract are précised. The terms of the offer must be sufficiently defined and certain to allow a court to determine what was intended by the parties and to state the resulting legal rights and duties. For instance, a person offered to sell his house at a "reasonable price." Assume an offeree accept the offer to buy the equipment at a "reasonable price." What is the obligation of the buyer? How much he shall pay? This offer is not definite and certain because it would be difficult to determine exactly what a "reasonable price is.

C. Communication

An offer must also be directly communicate to the offeree. The communication of the offer does not call for any special formality. It could be orally, in written, though sign or conduct. The only requirement is to have no doubt as to the intention to undertake an obligation. However, in order for an offer to ripen into a contract by acceptance, it must be completed by the act of communicating it to a specified person. An offer, which is not communicated to a specified person, is not an offer in the legal sense of the words, but it is a mere declaration of intention. For instance the, a proposal made by an advertisement does not aim a specific person, but the general public.

Termination of offer

Once the offer is made, it means one side of the parties to the contract (the offeror) has agreed to be bound. The party making an offer cannot change his opinion. An offeror who changes his offer partially or totally is liable for any material damage on the offeree. However, an offer made by the offeror does not remain open indefinitely. It will cease to have a binding effect, and the offeror would be released from the legal bond. Offer terminates or comes to an end in the following situations:

A) ***Lapse of time:*** offer may be made with or without a time limit for acceptance. An offer terminates automatically by law when the period specified in the offer has passed (if a time-limit has been stipulated). If no time for acceptance is specified in the offer, the offer terminates at the end of a reasonable *period* of time.

B) ***Revocation or withdrawal of offer;*** A withdrawal of an offer is possible when the offeror revokes his offer before the offeree knew or at the time when he knows of the offer. A withdrawal is therefore impossible after the moment the offeree has gained knowledge of the offer.

C) ***Rejection of the offer by the offeree***; 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"

D) ***Death or Incompetence of Either party;*** - An offeree power of acceptance is terminated when the offeror or offeree dies or is deprived of legal capacity to enter into the proposed contract. An offer is personal to both parties and cannot pass to the descendant's heirs.

Acceptance

Acceptance is complete agreement of the other party, called the offeree, to the proposal stated by the offeror. In short, acceptance is a "Yes" answer to all the contents of the offer. Acceptance must agree to the term of the offer, it must conform to the manner prescribe by the offeror. This is the mirror image rule that requires acceptance to mirror (reflect back) the full images of the offer. Any slightest modification made to the content of the offer is considered as rejecting the offer and making, a counter offer. And in effect, a counter offer is s rejection of the offer.

Acceptance must be communicated. Acceptance can be communicated orally, in writing,

through signs normally in use or conduct. However, if the offeror stipulates a special form of acceptance in the offer, such a specific term is deemed to be part and parcel of the offer itself, and therefore acceptance, by definition, must conform to the special form demanded by the offer.

Dear students, What happen if the offeree does not respond in any way after receiving the offer? Is his silence amount to acceptance?

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Art 1682 of the civil code is a principle governing silence. It stated that;

"Silence where an offer is made shall not amount to acceptance"

Accordingly, in principle silence of the offeree does not mean acceptance. This principle has a logical explanation deriving from the basic ideal of contractual liberty. If silence is to amount to acceptance, a converse situation that imposes upon offeree to resort to mechanisms of express rejection is created. This would make life unbearable for all of us, who are constantly subjected to a stream of unsolicited offers.

There are however exceptional cases where silence amount to acceptance in our law. For instance, in certain cases the government will grant an economic operator the exclusive right to manage a given activity /bus services, electricity supply, water resource, telephone lines, and public utilities generally/. These exclusive suppliers are not be allowed to refuse offer made by customers. Under such circumstance silence when an offer is made amount to acceptance.

Once an offer is accepted, the offeree is bound by his word. However, 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. Timely withdrawal of acceptance that terminates the binding effect of the contract is that made before the acceptance reaches the offeror in which case one could say that the theory of reception is reborn in respect of the withdrawal of an acceptance.

Defect in consent (Vices of consent)

As discussed in the previous section, contractual parties must give their consent freely and willingly to form a valid contract enforceable before the law. If the consent given by either party is defective, a valid contract may not be created.

Dear students, what do you think the situations where the consent of contracting parties become defective?

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Art 1696 of the civil code clearly stated that;

A contract may be invalid where a party gave his consent by mistake or under deceit or duress.

Thus, as per the above provision, the cause of defect in consent is either mistake, deceit (such as false statement, fraud) or duress (threat, reverential fear, and threat to exercise rights or lesion). If a party make a contract by mistake or if s/he deceived, or, threatened, his or her agreement is not free. It results in invalidation of contract (Art 1696).

☞ The existence of defect in consent does not necessarily lead to the invalidation of contract.

- Defect in consent can invalidate a contract only if a party who agreed to be bound because of information or threat demands invalidation (Art 1808).
- In some cases, the party whose consent was defective may not be entitled to claim invalidation if elements under the law are not met properly.

a) Mistake

A mistake in common language is the erroneous belief that a situation is true or real, when in fact it is not. In the legal context, only certain types of mistakes will be admissible in order to avoid contractual insecurity. As stipulated under the civil code, one can invalidate or avoid his obligation because of mistake if the following two conditions are cumulatively fulfilled (Art 1997, 1998).

i. **A mistake must be fundamental;** mistake is fundamental if it relates to the nature or the object of the contract or it relate to the identity or qualification of a contracting party.

For example, if a person intended sale something but by mistake sign a contract prepared for donation, it is a fundamental mistakes on the nature of the contract. On the other hand, if Ayele

employed Dr. Samson as his private Doctor believing that Dr. Samson is the one who had a long time working experience at *Tikur Anbesa Hospital* but this Samson is the one who was recently graduated from private medical college as junior Medical Doctor. This is a fundamental mistake on the identity or qualification of a contracting party.

It has to be noted that there are non-fundamental mistakes, which do not affect the validity of a contract. A non-fundamental mistake may affect the reason for entering into the contract, or touch some matter of inducement, but it leaves untouched the subject matter or essence of the agreement itself. Thus, mistakes, as to the motive of the parties and arithmetical or calculation error, are classed as non-fundamental mistakes, because they touch neither the existence nor identity of the thing sold, nor the basis of the transaction.

ii. ***The mistake must be decisive***: 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). According to Art 1699 (b) a mistake is decisive where;

"The mistaken party had undertaken to make a performance substantially greater or to receive a consideration substantially smaller than he intended'**.**

b) Fraud

Fraud by definition is misrepresentation of material facts to induce a person into a contract. For example, mixing of banana with butter and sold as a pure butter, suger with honey and sold as pure honeys are frauds. However, it is not all forms of frauds, which invalidates a contract. As stipulated under Art 1704 of the civil code

"A contract may be invalidating on the ground of fraud where a party resort to deceitful practices so that the other party would not have entered into the contract, had he not been deceived".

Accordingly, for fraud to exist, in addition to the false statement, there must be a deceitful action (practice) such as forgery of documents. Therefore, if someone lies to you about the existence of a certain fact and gets you into a contract, you may not be able to invalidate the contract by simply raising the false statement. There must be an action to support the lie told.

A mere false statement by itself may not invalidate a contract. However, the contract may be invalidated by the existence of a mere false statement where there is a confidential relationship among the contracting parties. Confidential relationship refers to relations that should depend upon confidence, trust, and loyalty among the people concerned. For instance, relations between close relatives, agent and principal, and the insurer and the insured are considered confidential relations.

Here one point that you need to be noted is fraud committed by third party other than the contracting party himself or herself. When fraud is by a third party against one of the contracting parties, the contract may be invalidated or may not be invalidated. If the other contracting party Knew or should have known of the fraud on the making of the contract and took advantage thereof, the contracting party who has been deceived by a third party is entitled to invalidate the contract. However, if the other contracting party did not know the existence of fraud and entered in the contract innocently without taking advantage of the situation, the contract is maintained and the deceived party may only seek a legal remedy against the third party.

c) Duress

If one person compels another to enter into an agreement by threat of force, or by an act of violence, the agreement is aid to be obtained under duress. As laid down under Art 1706, One can raise duress as a cause of invalidation of contract if the following conditions are cumulatively fulfilled.

- ***There is a threat or warning to cause harm***. The person must be told expressly that he has to choose either suffering the certain harm or entering into a contract.
- ***The harm is on the person himself, spouses or his ascendant or descendants***. The existence of threat cannot be a ground of invalidation of a contract unless it is directed on the party himself or his spouse or his ascendants and descendant. If the threat is on collaterals such as brothers, sisters, it cannot be a cause of invalidation.
- ***The harm is on person, life, property, and honor***.
- ***The party believes that the harm will happen if he does not consent to the contract.*** That means the party would not have entered into the contract had it not been for the threat.

- ***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.
- ***The harm is imminent*** that is the harm is going to happen soon and a party does not have time to think of another option to avoid the happening of the harm except by consenting to the contract.

As far as invalidation owning to duress is concerned, it does not make any difference whether the duress is made by one of the parties or a third party.

A person is usually not guilty of duress when the act or threat is to do something the person has a legal right to do. Thus, A person may have a right to threaten the other party with a legal suit if he owes you something. Threat to exercise once right is not duress.

3.1.3. Object of the contract

Object of a contract is what parties have actually agreed to undertake. The obligation may be to do something, to refrain from doing something, or to give something to someone. Therefore, object of a contract is the agreement of the parties to act, not to act, or to give. The object of contract sale of house, for example, is the obligation of the seller to transfer ownership and possession to the buyer and the obligation of the buyer to pay price. Object of contract differs from subject matter of contract. For example, in the above case, the house is the subjects of the contract.

Object of contracts are freely determined by the parties (Art 1711). However, the freedom is not absolute. Though parties are free, their freedom is exercised with in the limit of the law. Accordingly, the object of the contract must be (Art 17116);

- ***Sufficiently defined***; to constitute an obligation enforceable in law, the rights and liabilities given and imposed must be definite. If the thing to be done is so indefinite or uncertain, the court cannot enforce the agreement. The power of the court is to enforce a contract as defined by the parties. If there is anything that is not clear in the obligation, the power of the court is to invalidate the contract. However, even if a contract is very detailed, it is very unlikely that

it will provide for all the obligations. There will be lacuna or gaps in the obligation set by the parties. The lacunae as to the objects of a contract can be filled in through a reference made to custom, good faith, and equity pursuant to Art 1713 of the Civil Code and of course through supplementary provisions of the Civil Code.

- ***Possibility of the object:*** a contract shall be of no effect where the obligation of the parties or or of one of them relates to a thing or a fact which is impossible and such impossibility is absolute. The impossibility of the object of the contract must be considered at the time of the contract. For example, if one of the parties assumes an obligation, say for instance, to bring up a soil from sun in return for payment of a million birr, this agreement is invalid and cannot be taken to courts of law because bring a soil from the sun is humanly impossible.
- **Legality and morality of the object;** no person can be bound by contract to violate any law or moral value of the community. For example, if a man agrees to pay money to get sexual gratification from a woman, such contract is not illegal but immoral. Therefore, the man or the woman cannot get state assistance to have the contract performed.

The motive for which the parties entered into a contract shall not be taken in to account in determining the unlawful or immoral nature of their oligation (Art 1717). For instance, if Mr. A agreed to lease his houses to Mr. B for birr 5000 birr per month. They agreed that the contract remain effective for 2 years. Mr. A later on came to know that Mr. B has planned to use the house as a head quarter for terrorist activities in East Africa. Mr. A cannot claim the invalidation of contract. The only option he has is to inform the case to police.

However; if the illegal or immoral motives of a party is understandable from the content of the contract itself i.e., the illegal criminal motive is indicated as one of the content of the contract, such contract may not be enforced although it has nothing to do with the objects of contract.

3.1.4. Form of contract

Dear students, when do you think a contract required to be in written form?

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Most non-lawyers believe that for a contract to be legally binding, it must be made in writing and signed at least by the parties to contract. However, these people forget that they have entered into so many contracts in their life without following written forms. However, the law gives freedom to the parties to choose either written or or any other form (such as oral, sign or conduct). However, this freedom is not absolute. The freedom may be limited by the law or the parties.

The Ethiopian Civil Code requires the use of special forms for certain types of contracts. Some of the contracts that the law expressly requires to be made in writing are:

- **Contract relating to immovable** (Art 1723): - As regards immovable, Art. 1723 of the Civil Code requires that contracts relating to such objects should be in writing and registered with court or notary. Land and building are examples of immovable property. Therefore, any contract relating to house (sale, usufruct, servitude, mortgage, antichresis partition, compromise and even arbitration agreement) must be in writing and registered.
- **Contract 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.
- **Preliminary contract** (Art 1721): a preliminary contract is a contract leading to the formation of another contract. The best example is agency contract. If the agent's power is to enter into a contract that required to be in writing, the preliminary contract (contract of authorization) must also be in writing (Art 2200(1).
- **Long-term contracts** (Art. 1725): Those contracts as contract of guarantee, the insurance contract, and any other contract described as such have to be in writing.
- **Variation of contract made in writing** (Art 1722) : Variation of contract is a contract itself (Art. 1675). So, if such contract relates to contracts which required to be in written form, the variation should necessarily be made in writing. However, in case of a contract made in writing by parties' agreement, parties and courts may feel that such contract can be varied by any form.

When the above contracts are made in writing it is not enough that the terms of the contracts are written down and signed by the parties. In addition to the parties signature, there must be at least *two witnesses* that must sign on the same document.

3.4. Effect of Contracts

Article 1731(1) of the Civil Code states that, the contract lawfully formed, in accordance with the previously examined articles on consent, object and form, is the law of the parties. Parities are bound by their agreement and have a moral and legal 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, *failure to keep a word is worse than losing a descendant*" /የተናገሩት ከሚጠፋ የወለዱት ይጥፋ/.

Accordingly, effect of a contract implies that it becomes the law between the parties in the sense that the executive has a constitutional duty to implement it and the judiciary has a constitutional duty to interpret it. Moreover, since it is a law it is modified (amended) by the law marker only (either the parties themselves or the legislative). So, effects of contract are interpretation, performance, court's inability to vary contract and effects of non-performance.

3.4.1. Interpretation of Contract

Interpretation is the process whereby uncertainties or ambiguities in the word of the contract are resolved. In principle, contract may be interpreted only when the provision of the contract are clear. Where the provisions of contract are clear, the court may not resort to interpretation. The court may not make a contract for the parties under the guise of interpretation (Art 1733).

When the terms of the contract are not clear, the parties may interpret them. However if the difference cannot be resolved satisfactorily by the parties, the issue is brought before the court. The court is authorized to remedy the defective terms through interpretation having regard to the common intention of the parties, custom, good faith, and equity.

3.4.2. Performance of contract

Performance of contract means fulfilling one's own obligation as agreed. 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. Thus, here the major questions during performance are five "WH" questions; who, whom, what and when should the contract be performed.

a) Who Performs Contract (Art. 1740)

Who shall perform a contract? or in other word should the debtor always perform contractual obligations personally or can a third party perform on behalf of the debtor?

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The answer to the question "who must perform," must be answered in the way that "the person who undertook the obligation." In the majority of cases, this does not create any problem. However, one question may arise: May a third person could perform the contract, in the absence of any agreement of the parties?

In this regard Article 1740 of the Civil Code states that where it is expressly provided for in the contract or where the personal qualifications of the debtor are important, the obligation must be discharged by the debtor himself and no one else. In other cases, it does not matter. For instance where the obligation relates to the payment of money or delivery of a thing, it makes no difference whether the creditor receives the money or the thing directly from the debtor or third party.

b) To Whom Ought Payment To Be Made?

In this regard, Art 1741 states that

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

In this provision third party authorized by the creditor means the agent of the creditor. Under the law of agency, payment to the agent is the same as payment to the the principal. A third party authorized by law can also receive payment on behalf of the creditor. If the creditor for instance is a minor, he cannot receive payment. His parent or tutor receives payment on his behalf.

Performance made to incapable person or unauthorized person is not a valid performance. If the debtor's performance is not a valid performance, the debtor is required to do his obligation again to other people having the authority to act on behalf of the incapable creditor. However, the existence of two facts may release the debtor from his obligation. If the incapable or the real creditor obtained benefit from the performance or if the act of the debtor confirmed by real creditors or legal-representatives, the performance should be accepted as valid performance.

Sometimes two or more persons may independently claim the payment of a debt. In such a case, the debtor may doubtful as to for whom the payment should be made. This mainly arises when

the original creditor dies and heirs and creditors are claiming payment. In such a case, the debtor shall refuse to pay to any of them. If he wants to release himself from obligation, he can deposit the debt in court of law (Art. 1744 (1).

c) What to perform

As of a rule, Art 1745 of the civil code states that performance must exactly be the same with the contract. Failure to do so normally amounts to non-performance. When a contract calls for payment in money, performance requires the payment of the exact amount of money. The one to whom the money is owed need not accept anything else. Likewise, when the contract requires delivery of a computer, the exact computer must be delivered. Delivery of Apple Laptop, worth 35,000 Birr, while the contract requires delivery of Toshiba laptop, worth 15,000, is not a valid performance and the creditor (i.e. the buyer in this case) can reject the offer of performance and demand some solution under the law although the substituted performance seems to benefit the buyer.

d) Where performance shall be made?

Place of performance has an implication on cost of payment, currency for money debts and territorial jurisdiction of court. Therefore, determining place of performance has multifaceted consequences.

In considering the place of the performance, the agreement of the parties is always considered. Other options are considered only if the parties have not agreed. If the parties have not stipulated place of payment, it must be made at the place where the debtor resided at the time of contract. In the case where the parties are two different places, and the thing is at third places, payment shall be made at the place where the thing was at the time of contract.

e) When shall payment be made?

Time of performance is very important to determine transfer of, cost of maintenance and preservation and most importantly to claim damage for non-performance. As of a rule, Article 1756 states that the contract has to be performed on the agreed time if there is. However, where no time for payment is fixed in the contract, the parties may normally be required to perform their obligations immediately. Failing these two situations, performance will have to be made as soon as the other party demand or require.

3.5. Non-performance of contracts

Dear students, as discussed above, a contract formed lawfully binds the parties as if it were law, which means that the parties shall perform their obligations according to their contract and the law. Accordingly, non-performance refers to party's failure to perform contractual obligations in conformity with the terms of the contract and the law. This failure/breach may be total, where a party totally fails to honor the terms of contract. It may also be partial, where a party has performed his/her obligations only partly. It may also relate to delay in performance. Offering performance at a place other than the place agreed up on (place fixed by law) also constitutes non-performance. Delivering a thing that does not conform to the contract or delivering a defective thing also amount to breach of contract. Generally, any deviation by a party from the terms of the contract amounts to non-performance.

If your contracting party fails to perform the contract, what is the first action you take?

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Where a party does not carry out his obligation, the other party is given certain remedies for such a breach. However, before resorting to the remedies of non-performance, the victim party shall put the other party in default by giving him a notice. Notice is a reminder to the debtor. its purpose is to remind the debtor that time for performance has become due. The form of notice could be written or any other means of communication.

In majority of cases, notice is necessary. However, as stipulated under Article 1775 of the Civil Code notice is not necessary in in the case when;

- Parties specify in their contract that there is no need for a special notice,
- If the obligation is to refrain from doing something (obligation not to do)
- If the nature of the obligation is accomplished with in a fixed period of time(e.g. wedding cake)
- If the debtor himself supplies the written document stating, he will not perform his obligation (anticipatory breach of contract).

3.6. Effect of non-performance

What do you think the remedies available to the creditor when the debtor fail to perform the contract?

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As stipulated under Article 1771 of the civil code, the creditor can demand the following remedies of nonperformance according to the circumstances:-

i. Specific performance (forced performance),
ii. Cancellation, and
iii. Compensation /damages

These remedies are alternative remedies. Therefore, the victim party may choose any of the remedies based on the circumstances. However, compensation can be claimed as independent remedy or additional remedy. Thus, damages may be claimed independently (for example where performance is delayed) or in addition to enforcement or cancellation. Let us discuss each remedy separately.

3.6.1. Specific performance or forced performance

The word "forced performance" or "specific performance" implies the compelling of the debtor by the court to discharge his obligation. It refers to performance directly imposed on the debtor through the execution process. Thus, it takes place through court order/judgment. However, it is important to note that the court may not order forced performance merely because the creditor has requested. The court has the power to order forced performance or decline considering the requirements set by the law.

When we see Art. 1776 of the Civil Code, its stipulation is making forced performance exceptional. It clearly provides that;

> *Specific performance shall not be ordered unless it is of a special interest to the party requiring it(creditor) and the contract can be enforced without affecting the personal liberty of the debtor.*

Pursuant to this provision the requirements for the application of forced performance are; first, the creditor's special interest. The court shall to determine is whether performance is "of special

interest to the creditor." If forced performance has no special advantage to the creditor, then the court may not order it. For instance, if A agreed with B to sell an object that is not found anywhere else and if B highly needs the thing, he can claim the forced performance of the (contract in the event A fails to carry out his contractual obligations. However, if B can get the thing somewhere else even for substantially higher price, he cannot seek specific performance.

The second condition is the preservation of the debtor's personal liberty. Then, the court shall consider whether forced performance affects the personal liberty of the debtor. A person cannot be deprived of his liberty for failure to discharge contractual obligations. Thus, if forced performance affects the personal liberty of the debtor, the court shall not order it. For instance, A concludes a contract with B, a singer, to entertain customers at his grocery. B fails to show up for' the performance. Now A cannot claim the forced performance of the agreement by B because this affects B's personal liberty.

These two conditions or requirements are cumulative not alternative. If either of these conditions is missing, forced performance cannot be had.

3.6.2. Cancellation

Cancellation is another remedy for non-performance. Cancellation ends an already existing contract. Cancellation may take two forms-judicial or unilateral.

A. Judicial cancellation

A party affected by non-performance may apply to a court requesting it to order the cancellation of the contract. However, it is important to note that a party has applied for cancellation does not necessarily mean that the court will order cancellation. The court is particularly prohibited from declaring the cancellation of the contract where the breach is not fundamental.

B. ***Unilateral cancellation***

Unilateral cancellation connotes cancellation of a contract by one party without going to court of law. The Ethiopia civil code recognizes and gives effect to the automatic right of parties to cancel contract in the case where a provision to this effect has been made in the contract, performance becomes impossible and if the debtor informs the creditor in an unequivocal manner that he will not carry out his obligations.

Thus, cancellation made by judicial or unilateral is a remedy for the party affected by non-performance. By so doing, the contract comes to an end.

Dear student, what do you think the consequence of cancellation?

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The most important consequence is, the parties shall be reinstated in the position, which would have existed, had the contract not been made (Art 1815). The implication is that whatever the parties have performed in pursuance of the contract has no effect, and what they have paid or delivered shall be returned. Thus, by canceling the contract, the party affected by non-performance may claim back what he has paid or delivered. However, this may not be sufficient to satisfy him because he may have lost a benefit he could have gained from performance. In this case, he may claim compensation in addition to cancellation.

3.6.3. Damages or compensation

The other remedy available for the creditor at the time of nonperformance of contracts is payment of damages for the prejudice sustained (1771 (2)). This remedy will be granted in addition to forced performance or cancellation. It will also be granted apart from forced performance or cancellation (Article 1790(1)).

Irrespective of the fault of the debtor, damages is granted for the creditor. The fault of the debtor however, may be exceptionally taken into account. The law recognizes two cases where damages are due only when fault is established.

The first case is when the contract relates to obligations of means, in which the debtor undertakes to do his best to achieve a result without guaranteeing the result. If the debtor in good faith and has done his best within his competence and capacity, he is not the one to blame for the failure to achieve the end. This is because failure is in the nature of the contract itself. Such contracts as those concerned with lawyer-client and physician patient relationships create obligations of means.

The second case is when the contract made for the exclusive advantage of one party, or contracts, which create unilateral obligation (gratuitous contract). Contracts of donation and

deposit are good examples. In such contracts, the debtor is free from the payment of damages of non-performance unless he commits fault. The exclusion of damages in these cases reveals that the party who is not benefiting from the contract in the first place should not be further penalized by the· payment of compensation for damages resulting from non-performance without his fault.

The defendant is also entitled to assert a defense if the non-performance is the result of force majeure, the party will be released from the payment of compensation for the resulting damage. Force majeure is a circumstance that is unforeseen and makes performance absolutely impossible. Unforeseeability and absolute impossibility are cumulative preconditions for the existence of force majeure, and the absence of one denies the failing party to claim the defense. The law makes an illustrative list of cases of force majeure. It includes

- The enactment of a law that prohibits the implementation of the contract;
- a natural catastrophe such as earthquakes, thunder and floods;
- on outbreak of international or civil war; or
- The debtor's death or unexpected serious accident or illness

On the other hand, the following cases can never constitute defense of force majeure under our law;

- strike or lockout occurring in the debtor's factory,
- an increase or decrease in the price of raw materials necessary for the performance of the contract, or
- The passing of new law that makes the debtor's obligation more onerous

3.7. Extinction of Obligation

Having appreciated the formation and effect of contract, it is worth discussing extinction of obligations. As we have seen in the definitional element of contract, contract is an agreement made between two or more persons as between themselves to create, vary or *extinguish* obligations of proprietary nature. This shows that there is a contract to extinguish the existing obligations like creation and variation. In this regard, the normal cause of extinction of obligations is the performance of the contract, as Article 1806 of the Civil Code states. Article 1807 of the Civil Code lists the other modes of extinction. Accordingly in addition to performance of contract; invalidation, cancellation, termination, novation, set off, period of

limitation of a contract, and merger are grounds of extinction of obligation. Each way of extinction of obligations are discussed here in under.

1. **Performance of contract**

Performance of obligation 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.

2. **Invalidation of a contract**

Invalidation of a contract is related with the problem in the formation of the contract. It happens when there is defect in the formation of the contract. If a party that is incapable concludes a contract or if one of the parties concludes the contract without having the legally required consent, the contract is subjected to rescission at his/her request. Thus, invalidation of contract is making an effective contract ineffective when it has a problem in its formation. Its effect is restitution of contracting parties in their previous position. That means parties would go back to the position they had before the conclusion of the contract (Art 1815).

3. **Cancellation of a contract**

Cancellation on the other hand is making a contract ineffective when there is non-performance. Cancellation of a contract is one effect of contract in that the contract is formed within the legally provided requirements. When one of the contracting parties fails to perform the contract, the other party might cancel the contract as one remedy of non-performance of the contract. Like invalidation of contract, the effect of cancellation of a contract is restitution or reinstatement.

Here one point that needs to be noted is whether it is in the case of invalidation or cancellation, restitution is not always possible. Acts done in performance of the contract shall not be invalidated where such invalidation is not possible or would involve serious disadvantage or inconveniences (Art 1817). When reinstatement is become impossible or inconvenient, the alternative is payment of damages or compensation.

4. Termination of Contract

Termination of contract is making the contract ineffective starting from the time of termination of the contract. As discussed above, invalidation and cancellation have retroactive effect. They go back and wipe out everything that has been performed. Termination on the other hand has no retrospective effect rather it have prospective effect. If a contract is terminated, the part that is already performed remains intact or valid. However, once it is terminated, it shall not produce any effect as of the date of termination (Art 1819(2)).

Termination of contract can be either, bilateral (by the agreement of both the contracting parties), unilateral by one party, or judicial (by court order). Unilateral termination is made either by the effect of agreement when such unilateral termination clause is provided in their contract and when a condition that entitles unilateral termination is fulfilled. Cancellation can also be made when one of the parties requires to that effect.

5. Remission of debt

Remission of debt is voluntary release of debtor of his obligation by the. If the debtor has received a release from the creditor, his obligations are extinguished. Art 1825 of the civil code states that;

> *Where the creditor informs the debtor that he regards him as released, the obligation shall be extinguished unless the debtor forthwithinforms the creditor that he refused his debt to be remitted.*

6. Novation

Novation is substitution of an existing obligation by new obligation in its nature or object (Art 1826). The new obligation shall be different from the substituted obligation either by its object or nature. Mere difference without substantial change either in the object or in the nature does not amount to novation; rather it is variation in fact.

7. Set-off

Where two persons owe debts to one another, set-off shall occur and the obligations of both persons shall be extinguished. A party, who is a creditor in one of the transactions, may be a debtor in another transaction. Assume that A owes B birr 10,000 birr in one transaction and B owes A birr 10,000 birr in another transaction. The two parties can then set-off their debts and

extinguish their obligations. Parties may set-off their obligations, instead of performance by both. Set off usually applies to monetary obligations.

8. Merger

Merger happens when the position of creditor and debtor becomes the same (Art 1842). There are different reasons for merger between debtor and creditor. Successions, formation of partnership are among the juridical acts, which result in merger. Merger makes the debtor and creditor the same person. Assume A borrowed 5,000 birr from his father; however, if his father died before collecting the debt from his son, A. Then A is the only successor of his father. Here we can say that A becomes the owner of the property of his father including the 5,000 Birr. It is not feasible for A making payment to himself. The position of A merged with that of his father.

9. Period of limitation

A period of limitation is a duration (period) within which a legal action must be brought before legal organs. The law demands people to exercise their legal rights as soon as possible. If they do not invoke their rights and demand remedies within the time specified by law, they are likely to lose their rights to sue the persons that might have violated their rights. This happens by application of period of limitation.

The law of contract provides the maximum period of limitation for contractual claims. The maximum duration is ten (10) years for all kinds of issues such as remedies for non-performance or invalidation for defective contracts. Therefore, whatever your contractual right is you must take it to court before 10 years period (Art 1845). The period of limitation run from the day when the obligation is due or the right under the contract could be exercised (Art 1846).

Summary

Contract is an agreement whereby two or more persons as between themselves create, vary or extinguish obligations of a proprietary nature. It is created by mutual assent of the parties that is evidenced by a contractual offer and acceptance. If there is a circumstance that vitiate the validity of consent, the contract become subject to invalidation. Accordingly, mistake, fraud, duress, and unconscionable contracts vitiate the consent of the parties and leads to invalidation of the contract in the court of law by application of the party whose consent is vitiated.

Obligations undertaken by the parties required to be sufficiently defined, possible for human being, lawful, and moral to form valid contract. No special form is required to conclude a contract. However, when the law imposes a certain formality requirement or if the parties so require, the contract must be in written form. Accordingly, contracts relating to immovable, contracts to which a public administration is a party, contracts that last for a longer period of time, a preliminary contract that has to be concluded in the form of the main contract required to be in written form. Written contracts must be signed by contracting parties, attested by at least two witnesses, and in some cases, they may be alternatively authenticated by a public authority.

The general effect of a validly concluded contract is its legal enforceability. Once parties have created a contract, they are obliged to comply with the terms. The breach of contractual terms would entail a legal liability. If a party totally fails to carry out the obligation, if he makes fundamentally defective performance, or makes a delayed performance, there is non-performance of contract. In cases of non-performance, the Ethiopian law allows the creditor to demand remedies such as specific performance, cancellation, and damages/compensation.

Lastly, contractual obligations extinguished by the occurrence of certain factors: performance, invalidation, set-off, remission, merger, termination, and cancellation are causes for extinguish of contractual obligations under Ethiopia law. Right holders are required to take legal actions as soon as possible if they think that their legal rights are violated. The the maximum period of limitation is 10 years for contractual claims.

Exercise

1. Identify important elements in the definition of contract and elaborate them

2. Discuss the circumstances at which the consent of contracting party become defective

3. Discuss the remedies available for contracting parties in the case when one of the party breach a contract

4. Identify and elaborate the causes of extinguish of obligation under Ethiopia law

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5. Distinguish the difference that exist among invalidation, cancellation and termination of contract

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Chapter Four

LAW OF SALE

Introduction

Dear students, law of sale are a special kind of contract. So requirements of formation of contract discuss in the last chapter are apply for it. This unit appreciates the subject matter and scope of sale contracts. In discussing the subject matter of law of sales, the goods and price will be emphasized discussed. Various forms of obligations born by the buyer and the sellers under the Ethiopian law of contract of sale will be considered. Remedies available for the parties in sale contracts in the case where the other party breaches the agreement will also discussed.

Unit objectives:-

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

- Explain how sale contract is formed
- Identify the obligation of the buyer and seller
- Explain how delivery is made in the contract of sale
- Define and explain what warranty mean in contract of sale
- Identify common obligations that parties to a contract of sales have to discharge
- Identify and explain remedies available for non-performance of sale contract

4.1. Formation of sale Contract

Dear students, what is sale and how do you define a sale contract?

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Contract of sale has been defined under Article 2266 of the civil code as follow,

> *A contract of sale is a contract whereby one of the parties, the seller, undertakes to deliver a thing and transfer its ownership to another party, the buyer, in consideration of a price expressed in money, which the buyer undertakes to pay him".*

According to the above definition, the following are essential elements of of sales contract.

a) ***Contract of sale is a contract***: Contract of sale is a special kind of contract. As a contract, it is regulated by general contract provisions and it must satisfy the basic requirements for the existence of a valid contract. Thus, the parties must be capable, that is they should not be minor, insane and infirm, judicially interdicted person, or legally interdicted person. Contract

of sale is, like any other contract, formed when the parties express their agreement on the subject matter of the contract and its price. That is to say, the contract of sale is completed when the parties have expressed their consent to the terms of the contract. Thus, to say there is consent an offer made by one of the parties must be accepted by the other in a way that fulfills the requirements provided under general contract provisions. The object of the contract shall also be sufficiently defined, lawful, moral and possible. Sale contract must also be made in the form prescribed by law, if any.

b) **Two Parties:** There must be at least two distinct parties to a contract of sale, as a person cannot buy his own goods. These two distinct parties are the buyer and the seller. The seller is the person who assumes the obligation to deliver a thing while the buyer is the person who assumes the obligation to pay money as a price.

c) **Delivery and Transfer of ownership:** The owner of the thing must agree with the other person to deliver and transfer ownership of the thing. A mere agreement to transfer possession cannot be termed as a contract of sale. The seller must transfer or agree to transfer ownership so that contract of sale is concluded.

d) **The Thing:** The subject matter of contract of sale must be "things." The word thing shall refer to goods. As far as goods are concerned, Art 1126 says verbally "All goods are movables or immovable" Although all goods are movables or immovable, the subject matter of sale contract are only movable goods or corporeal chattels. Immovable goods are not the subject matter of sale contract.

e) **The price;** a contract of sale must involve consideration in return for transfer of ownership. Consideration normally connotes reciprocal obligation of the parties assumed in the contract in the form of money.

4.2. Performance and Obligation of Parties to sale contract

As performance of sales contract refers to carrying out of the obligations assumed by the contracting parties, analyzing the obligations of the seller, obligations of the buyer and common obligations of the seller and buyer imposed on the parties by the custom, good faith and the provisions of the law is be necessary to understand performance of sales contract.

4.2.1. Obligation of the seller

The obligation of the seller bears normally those imposed by the contract itself. The law also imposes certain obligations up on the seller either because of the silence of the contract or due to

the mandatory nature of the law. These obligations are the obligation to deliver, the obligation to transfer ownership, the obligation to warrant the buyer against dispossession defects and non-conformity to the contract and related obligations. Failure to perform these obligation amounts to non-performance.

4.2.1.1. Obligation to deliver

The characteristic obligation of the seller is to deliver the thing sold. Delivery generally refers to transfers of possession willingly. Delivery takes place in accordance with the contract and the default rules of the law. The obligation of the seller to deliver the thing includes the obligation to deliver the agreed amount as well as the obligation to deliver the thing at an agreed time and place.

Delivery can be conducted in different modes. These modes of delivery can be actual delivery, constructive delivery, and symbolic delivery. Actual delivery is the physical handing over of the thing directly to the buyer or his representative. Constructive delivery does not involve physical handing over of the thing to the buyer. It is when the seller is to remain in actual control of the thing after the conclusion of the contract (Art 1145). Symbolic delivery on the other hand is similar to constructive delivery in that it does not effect the physical handing over of the thing sold. However, it is different from constructive delivery as it involves the physical handing over of other things that represent the things sold. For example, if the seller gives the key of the store to the buyer, he makes symbolic delivery. Similarly, giving bill of lading to the buyer is a symbolic delivery.

4.2.1.2. Obligation to transfer ownership

The seller shall take the necessary steps for transferring to the buyer unassailable rights of ownership over the thing. Ownership is the widest right that may have on a corporeal thing. The seller shall do whatever he could do to make the buyer an owner.

Ownership transfers upon transfer of possession and Possession transfers upon delivery. Thus, the necessary step to be taken by the seller to transfer ownership is to deliver the thing to the buyer in any of the modes of delivery discussed above.

However, delivery alone does not transfer ownership. The seller must be the owner of the thing sold. It is the basic principle of property law that *a person can transfer no greater right in property than he himself possesses.* For example, if Mr. A steals a mobile phone from B and sells

it to C, C has no greater title to the watch than A possessed. Transfer ownership includes the obligation to have a good title. Thus, a non-owner cannot transfer ownership.

The rule that holds a person can transfer no greater right than his own suffers an exception. That is, this rule does not apply in certain cases. This exception is possession in good faith. The principle of possession in good faith holds that a person who in good faith enters for consideration into a contract to acquire ownership of a corporeal chattel will become owner of that corporeal chattel by virtue of this good faith when he takes possession of such chattel. Good faith is honesty in fact in the transaction. However, there are cases under the law where possession in good faith cannot serve as a defense. That is, there are certain movables whose ownership cannot be acquired by acquisition in good faith. These are;

1. **Special Movables that Require Registration of Contract**: in order to transfer the ownership of certain special movables, registration of the contract is a requirement. The ownership of movables such as motor vehicles, ships, airplanes and TV cannot be acquired by possession in good faith.
2. ***Public Domain (Public Property)***: Property belonging to the state or other administrative bodies shall be deemed to form part of the public domain where it is directly placed or left at the disposal of the public or it is destined to a public service (Art 1445).
3. ***Stolen property*** - A person who has bought a stolen thing cannot acquire the ownership of such thing (Article 1165).

4.2.1.3. Warranty

Warranty/guaranty is a contractual promise by the seller regarding the quality, character, or suitability of the goods he has sold. Art 2287 of the civil code states that;

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

Warranty is classified into express warranty and implied warranty.

What is the difference between implied and express warranty?

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Express warranty: it is created when the seller makes an express statement of facts or a promise to the buyer concerning the goods that become part of the bargain. A seller of a TV for instance may say, “I will give one year’s warranty for ordinary performance of the TV.” If the

thing does not work as the seller said expressly, the buyer could go back to the seller and ask for maintenance, or any other remedy. An express warranty may be oral or written.

Dou you think that all statements of quality or performance declared by the seller warranty statements?

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The buyer should be cautioned that not all statements result in warranty claim. It is only genuine statements of facts by the seller, which are considered declarations giving rise to express warranty obligations. Sellers often exaggerate the merits of the goods they are trying to sell. The making of statements such as "the best quality ever made" or "made for the best" or "the choice of the generation" is known as sales talk, or puffing. Such declarations should not be considered as warranty statements. They are merely personal opinions or judgments of value, and buyers are not justified in relying on them. The buyer should make independent investigation of his own. As the old principle has it, "let the buyer beware" i.e. the buyer should be careful. If he is negligent in buying the goods and in checking out their qualities, probably the law will not help him.

Implied warranty: it is the responsibility imposed by law on the seller for the quality of goods he sold. It arises whether or not the seller has made express promises as to the quality of the goods. The seller knows better about the property than the buyer. The buyer may not have the knowledge and expertise to check the quality of the property he buys. In majority of the cases, he must rely on what the sellers or suppliers tell him about the property. As a result, the buyer's position became worse, relying on people who simply want money from him. Therefore, the law intervened and started to improve the position of the buyer.

What are warranties imposed by law under the Ethiopia law?

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The Ethiopian law of warranty provides three heads of (implied) warranties: these are warranty against dispossession, warranty against defect, and Warranty against non-conformity

- **Warranty against dispossession:** As provided under Art 2282 of the civil code, the seller required to warrant the buyer against any total or partial disposition which he might suffer in consequence of a third party exercising a right he enjoy at the time of the contract. Thus, the

element of this warranty is that, first; the seller must have a valid title on the thing, second, the seller must have a right to transfer title to the buyer, and lastly, the seller shall not be dispossessed totally or partially. Thus, if the third parties succeed in taking the property from the buyer due to the right they had while the property was with the seller, the buyer has a remedy against the seller based on warranty against dispossession.

- **Warranty against defect:** The seller shall guarantee to the buyer that thing sold conforms to the contract and is not affected by defects. There are three cases of this warranty under the law. These are; one, where the thing does not possess the quality required for its normal use or commercial exploitation. Two, where the thing does not possess the quality required for its particular use as provided expressly or implied in the contract. Three, the seller has the duty to give warranty against defects where the thing does not possess the quality of specification provided expressly or impliedly in the contract. Under these circumstances, there is a breach of contract against defect and the seller has a legal duty to give warranty.
- **Warranty against non-conformity:** Where a description of the goods or a sample or model is made part of the contractual agreement, there is a warranty that all the goods supplied shall confirm to the description, Sample or model that is provided in the contract. It is the rule under the law that the thing delivered must be the same with what the parties agreed. If there is any discrepancy, the buyer may claim based on warranty against non-conformity. Four cases are considered under the law to be bases for claim of warranty against non-conformity. These are; first delivery of part only of the thing, delivery of greater or lesser quantity than they agreed, delivery of a different thing ,and delivery of a thing with different species.

4.2.2. Obligations of the buyer

As stipulated under Art. 2303 of the civil code the main obligations of the buyer under the contract of sale are the obligation to pay price and the obligation to take delivery of the thing sold.

4.2.2.1. Obligation to Pay Price

The price is the amount of money that the buyer undertakes to pay to the seller in consideration of a thing. The obligation is usually discharged quite easily by a cash payment. However, as the economy develops and the importance of commercial transaction rise, sophisticated means of

payments also appear. For instance, cheques, bank accounts, special banking facilities, credit card payments or even payment in foreign currencies are modes of paying the price.

Art 2304(1) of the Civil Code reads, "The obligation to pay the price shall include the obligation to take any step provided by the contract or by custom to arrange for or guarantee the payment of price." In a sense, the buyer must arrange the actual payment of price and so undertake all the relevant formalities to transfer the money through orders to the bank. The place of payment is in principle that fixed in the contract. Where the contract is silent, payment is made at the address of the seller, which implicitly means his business address. In cases of simultaneity, price is paid at a place where the thing is delivered.

4.2.2.2. Obligation to take delivery of the thing

The buyer must take necessary steps to complete the delivery. Article 2313 provides that:

> *The buyer shall, after delivery, take such steps as may be necessary for completing the delivery of the thing.*

These necessary steps include the obligation to go to the place of the business of the seller and physically receive the thing from the seller or to keep the buyer's store opened if delivery is to be made at the buyer's place. It also includes the duty to accept the thing when the place of delivery is at the residence of the buyer when the thing does not suffer from any defects. The buyer may take deliver by only telling the seller to keep the thing on his behalf. This is the case where the buyer takes delivery through constructive mode of delivery.

4.2.3. Common Obligations of the Seller and the Buyer

The obligations of the contracting parties are not limited to the above obligations. They have some obligations in common like obligation to pay expenses, obligation to preserve the thing and obligation to bear unpreventable risk of loss and deterioration.

4.2.3.1. Expense

There are different expenses involved in sale contract, which may be borne by the seller or by the buyer. The noticeable expenses here are those of forming the contract, delivery, transport, payment, custom duties, and expenses because of change in business address of a party.

The law provides that the expenses of delivery (that includes counting, measuring and weighing costs), transport (where delivery is carriage-free), customs duties linked to a delay caused by the

seller, and those incurred due to the change in business address by the seller, are all borne by the seller(Art 2317). The buyer on his part bears the expenses of the contract of sale itself, expenses for payment, expenses after delivery and expenses of transport where thing is sent to other place than that of delivery.

4.2.3.2. Transfer of risk and Preservation of the thing

Article 2325 (1) indicates that risk is transferred to the buyer from the day when he is late in paying the price. Transfer of risk connotes that the buyer shall pay the price notwithstanding that the thing is lost or its value is altered. The fact that the risk is transferred against the buyer does not mean that the seller can throw the property out. After delivery of the thing, the ownership transfers to the buyer. Although risk might be transferred to the buyer, the seller has the obligation to preserve the thing and if the thing is damaged for lack of preservation, the seller will be liable for the damage.

In cases of constructive delivery, the thing belonging to the buyer may remain in possession of the seller. The same is true when the buyer is late in taking delivery or in paying the price. In these circumstances, the seller should preserve the thing belonging to the buyer at the buyer's expense (Art 2320).

4.3. Non-performance of a Sale Contract and its remedy

Dear students, as discussed in previous unit, non-performance of a contract refers to the failure of the contracting parties to discharge their obligation. Accordingly, contract of sale is said to be non-performed or breached when either the buyer or the seller or both fail to carry out their obligations under the contract.

As sale is a special type of contract, and therefore remedies found in the general rules of contracts such as forced performance, cancellation and damages, will apply, *mutates mutandis*. However, before resorting to the remedies of non-performance, parties in sale contract, which requires such remedies, shall put the other contracting party in default.

4.3.1. Forced Performance

Dear student, you have to recall your reading on forced/special performance of general contracts (Unit 3). Specific performance is awarded only if it is of a special interest to the creditor and if it

can be carried out without affecting the personal liberty of the debtor (Art 1778 cum Art 2329 civil code).

4.3.2. Cancellation

Dear students, you already have some ideas about cancellation of contract under unit 3. The question of cancellation arises when a contract is breached. The same rule applies here. As a rule, parties have to seek cancellation of the contract from a judicial body. All the same, they can unilaterally declare cancellation in exceptional circumstances. There are a couple of reasons attributable to the buyer's claim of cancellation and there are other sets of reasons for cancellation raised on the part the seller. There are also reasons available to both parties. The expiry of the compulsory date fixed for delivery, non-transfer of the whole ownership to the buyer and defect of the good delivered against which the seller warranted the buyer, could be reasons for cancellation of the contract by the buyer. Impossibility in performance of an obligation also entitles the respective party to cancel the contract.

Where contract is cancelled for any of the above grounds, the parties are released from their obligations under the contract. Where a party has performed his obligation in whole or in part, he may claim the restitution of what he had supplied including the expenses incurred. Restitution is the return by a party of things he has taken under the contract from the other party. If the seller is to refund the price, it must include interest from the day of reception. If the buyer is to restore the thing to the seller, it includes profits derived from the thing.

4.3.3. Damages or compensation

In addition to forced performance and cancellation, compensation is also among the remedies for non-performance of sales contract. Compensation because of non-performance is recommended to put the victim of non-performance in a place he would have been had the contract been performed.

Summary

Sale is an exchange mechanism that has the purpose of passing title from the seller to the buyer for a price. Sale is a contract and, as a contract, those essential requisites necessary for validity of contracts are applied for sale contracts. Consent of parties, capacity, object, and form should always be observed when concluding a sale contract.

The normal effect of every contract is performance. Sale contract is no exception on this regard. Performance is realized through the imposition of certain obligations on both the seller and the buyer. The parties to the contract of sale have their own respective obligations to discharge. The most noticeable obligations of the seller in sale contract are delivery, transferring ownership, providing warranties. The main obligations of the buyer on the other hand are paying the price, taking delivery of the thing, and other obligation contractually imposed upon him.

Transfer of risk, expenses, and preservation of the thing are common obligations of the buyer and the seller. These obligations may be borne by either of the parties depending on differences in time, nature and other attending circumstances.

If one of the parties under sale contract fails to perform his obligation, the other party may seek remedy from the court. These remedies are particularly forced performance, cancellation, and damages or compensation.

Exercise

1. Ato Bitew and Ato Dagne conclude a contract between themselves. Ato Bitew gave Ato Dagne ox and Ato Dagne in return gave Ato Bitew Horse. Do you think that a contract of sale exist between these individuals? Why/why not?

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2. Discuss;
    i. Obligation of the buyer to the seller

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    ii. Obligation of the seller to the buyer

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iii. Common obligations of the buyer and the seller

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3. Discuss the remedies the buyer have when the seller breach the contractual agreement

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UNIT FIVE

LAW OF AGENCY

Introduction

Dear students, in daily business and private commercial transactions, people are often and for commercial viability, efficiency and expedient are frequently represented by others in commercial and business transactions. This representation is so called agency. Agency is the fiduciary relation that involving trust and confidence between two persons so that one shall act on the behalf and subject to the control of the other. Thus, in this unit, you will study the way agency relationship is created, right and obligation of the parties and its legal effect as between the parties and the way the relationship is terminated.

After having completed the study of this unit, you will able to:

- Appreciate ways of creating agency relationship
- Explain the legal capacity of the principal and agent
- Distinguish between agency by contract and agency by law
- Elaborate the scope of agency
- Identify the respective obligations of the agent and principal
- Explain the ways of terminating agency

5.1. Definition of Agency

What is agency?

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Sometimes, a person may not be able to do a given task by him herself. A person at a far distance may carry business activity by employing someone to represent him/her. This representation of third party on one own behalf is so called agency. Agency is the way a person does legally binding act by the instrumentality of another person. Simply agency is the way a person does legally binding act by the instrumentality of another person. It is a fiduciary relation that exists between two persons so that one shall act on the behalf and subject to the control of the other. Fiduciary relation means that the relationship is one involving trust and confidence.

In this regard, Art. 2199 of the civil code define agency as follow;

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

People get satisfied when they perform their task by their own. There is an adage that strength this statement in our community that says "*Yalebalebetu Aynedim Esatu*". A person is the best manager of his affairs. But there are different reasons why one cannot /will not perform his/her task by his/her own.

Could you illustrate some of reasons, which obliged a person to employ an agent?

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One cannot be master of all activities. For instance, an accountant may not be able to define himself in a court of law when sued. Sometimes a person may not be able to find himself/herself in more than one place at a given time. If you also remember your law of persons, legal persons act through physical persons. In another scenario, a person may not like to act him/herself to avoid contact with some people. Still others may want to act through another because they like to take rest etc. Hence, in all these cases the person needs to employ a representative what so called agent.

5.2. Sources of Agency

As provided under art. 2179 of the civil code, the authority to act on behalf of another may derive from law or contract. Accordingly, the authority of an agent is the power of agency, which the agent acquires by the operation of the law or by a contract concluded between the agent and the principal to this end.

5.2.1. Agency by the operation of law

In most cases, civil matters are left to individuals. However the law takes the gap-filling role for the interest of the public. An agency relationship by operation of law is implied regardless of express or implied intention of the parties.

When agency arises out of law the law has some justifications. Obviously, agreement between the principal and the agent is lacking. There is no consent to the agent's acting as an agent. Here the law intervenes and for reasons of policy, it treats one person as an agent of another without any agreement between them. The reasons why such relationships are considered to arise differ. The Ethiopian law recognizes agency by the operation of the law in the following instances.

- **Legal incapacity**: As you may remember from your discussion in unit two, incapable persons such as minors, judicially interdicted persons and legally interdicted persons cannot perform juridical acts by themselves. They exercise their rights and duties only through guardians and/or tutors. The law obliges the court to appoint a guardian and/or a tutor for these kinds of persons. The guardian and/or the tutor act on the behalf of incapable person not because of prior agreement but because the law has given them the authority to do so.
- **Cohabitation**: cohabitation occurs in family relationships, as between husband and wife. For example, suppose one spouse purchases certain basic necessities and charges them to the other spouse's charge account. The law often regards the latter as liable for payment of the necessaries, either because of a social policy of promoting the general welfare of the spouse or because of a legal duty to supply necessaries to family members.
- **In emergency situations**: The law encourages the curbing of an emergency by recognizing persons who have no agency authority to contract with others to act on the behalf of other persons anyway due to the emergency. For example, a rail-road engineer may contract on behalf of his employer for medical care for an injured motorist hit by the train. Such a situation is referred to in Ethiopian law as *unauthorized agency*, which we will deal with later on.

In some situation, a person may not be able to manage his property or business due to different causes. It may be due to illness or absence. And any interested party may not available to manage the property of that person. So the court may appoint an agent to administer the property. The person appointed by the court is called a curator. The curator is an agent the same to other cases of agency but the only difference is that he is appointed by the court and the court limits of the power of the curator. The law requires the curator to inform to the principal his appointment.

5.2.2. Agency by Contract

Agency that is derived from a contractual relationship is the most usual kind of agency. Accordingly, for many authors consent is the basis of the law of agency and it explains why the agent can represent the principal.

The preliminary agency relationship is contractual in nature, and the parties to such contract can define the scope of the authority of the agent and are free to determine the details of their engagement. As articulated under Art.2199 of the civil code Agency is;

> *A contract where by a person, the agent, agrees with another person, the principal, to represent him and to perform on his behalf one or several legally binding acts''*

What are the elements that that you can identify in the above definition?

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The elements of agency contract as defined above discussed as follow.

Agency is a contract…. This implies the consensual nature of agency. As agency is a contract the rules of contract law apply to formation of a valid agency. Article 1678 of the Civil Code provides elements that need to be fulfilled to have a valid and binding contract.

Accordingly, the principal and the agent must consent and their consent must be free from the vices in consent. It is also necessary to have full contractual capacity in order to be the agent of another person or the principal giving authority to another. Although the relationship of principal and agent is normally based on mutual consent, the agreement, as a rule, does not have to be in any particular form.

Unless the law requires, the contract of agency need not be made in writing or registered. If the act the agent is to perform is required to be in writing, the agency as well must be established in writing. If the juridical act can be performed orally, the agency created orally is valid. For example, as we said under form requirement in chapter three, an insurance contract must be made in writing. If the principal wants to authorize someone to be his agent and thereby

conclude a contract of insurance on his behalf, he must give the authority in writing.

The object of the agency must also be sufficiently defined, possible, moral and legal. The scope of authority of an agent is determined by the contract of agency. The obligation one owes to the other shall be sufficiently defined. This means the authority given to the agent shall be clearly stated in the contract of agency. If there is any ambiguity as to the powers of an agent, the contract of agency cannot be enforceable. The promise the agent or the principal makes shall be humanely possible, moral, and lawful. If the agent or the principal promises to do an act or to make a representation that all humanely impossible, immoral or illegal the contract of agency has no effect.

Agency requires at least these persons. These persons are given a specialized name by the law here: the agent and the principal. The principal is the represented and the agent is the representative. The principal is the person whose affairs are to be performed by another person. He/she is the one who acts through another person. This latter person who represents the interest of another in the agency relationship is the agent.

Agency is created to represent the principal and to perform on the latter's behalf one or severally binding act; Agency is aimed at the agent acting on behalf of the principal, not on behalf of the agent himself. If the agent acts for his benefit that does not establish agency. In the making, agency is established when it is intended that the agent acts to the benefit of the principal. There are three relationships involved in an agency relationship. These are: one, the relationship established between the agent and the principal. This relationship is called the internal relationship. Two, the relationship between the agent and the third parties. Three, the relationship between the principal and the third party. The latter relationship is established only when the agent and the third party relationship is lawfully established.

5.3. Scope of Agency

What power does the agent have?

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The scope of the power assumed by the agent is determined by the contract-giving rise to agency. In this regard Art 2180 of the civil code states that;

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

Yet, the scope of the agency assumed by the agent might not be expressly determined by the contract. In the latter case, it is determined by the nature of the transaction to which the agency relates (Art. 2202). The scope of agency conferred on the agent may be either special or general as provided by Art 2202(2) of the Civil Code.

5.3.1. General Agency

General agent is one authorized to contract all the business of the principal or all of the principal business of a particular kind at a particular place. Such type of agency is conferred in general terms. Usually, it is expressed in terms like "all my affairs", "anything related to my property", "any affairs which I am called to perform" etc.

The scope of such authorities conferred in general terms is limited only to the management of the said affairs. It is confirmed under Art. 2203 that;

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

General agency relates to preservation/maintenance of those affairs/ rights of the principal. A person, conferred with agency in general terms is only empowered to sustain the rights of the principal and is not empowered to perform acts of disposing the rights of the principals. These acts of the agent are said to be acts of management.

What are acts of management?

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The law has unequivocally listed down those acts, which are named acts of management under Art. 2204. These are:

- Acts done for the preservation of maintenance of property;
- Leases for terms not exceeding three years
- The collection of debts
- The investment of income;
- Discharge of debts

As articulated under sub art 2 of Art 2204, the following acts are also acts of management in terms of preserving the rights of the represented. These acts are acts of dispositions, a close look at these activities reveals that the purpose of conferring power to conduct these activities for an agent protects the loss of the rights of the person represented. Hence, these acts are acts of management. These acts are;

- sale of crops;
- the sale of goods intended to be sold; and
- The sale of perishable commodities and other similar acts are categorized as acts of management.

5.3.2. Special Agency

Special agency is an agency with express and specific authority given to the agent. Some acts under the law require special authority. A special agent is a person who is given power by the principal to act in a particular transaction. Articles 2206(1) of the civil code specify that;

> *Special agency confers upon the agent authority only to conduct the affairs specified by the agreement and their natural consequences according to the nature of the affair and usage.*

Sub Art 2 of the above provision list out the following affairs that require special authority.

- Selling or mortgaging real estate
- investing capitals
- Sign bills of exchange
- effect a settlement and consenting to arbitration
- Making donations, bringing or defending an action.

Performance of these and similar other acts must be conferred upon the agent expressly and specifically. If they are not given so, the agent cannot carry out these acts.

Special agency is an authority different from general agency in that it empowers the agent to dispose the rights of the person represented. Sometimes, this authority is named as act of disposition.

5.4. Authorities of an Agent

The authority of the agent is the power within which the agent can act with the effect of making the principal liable with third parties. Here, we are not referring to the content of the authorization (which we have just seen above), but to the external manifestation of the authority. It is provided under Art. 2206(2) that anything that the agent does in excess of that authority will not affect the principal either to benefit or make him liable unless his act is ratified by the principal. If the agent acts outside his authority, he may be liable to his principal for breach of the contract of agency or otherwise; or to the third party for breach of warranty of authority.

There are two varieties of authorities to act through another. These are actual authority or as it is (real authority) and apparent authority.

5.4.1. Actual authority

Actual authority is the authority that in fact the agent has been given by the principal under the agreement or contract. It produces the normal effects of agency relationship. Actual authority exists in two forms: express and implied Art. 2206. Express authority is specifically created and limited by the terms of the agreement or contract that give rise to the agency relationship. It is express when it is given by express words such as when the principal authorizes the agent to deliver a truck of a specified type to a third party in a given time and place. Implied authority on the other hand is one implied from the nature of the business that the agent is authorized to transact in express terms. It is important for the carrying out of the authority expressly granted. For example, where an agent is empowered to conclude a written and registered sales contract with a third party, it can be implied that this agent is empowered to buy a pen, a piece of paper, or sometimes to employ an expert to prepare a written contract when required by the law.

5.4.2. Apparent authority

Apparent authority is not an authority arising from the consent of the principal whether express or implied according to the rules discussed in the preceding section. This authority does not exist in reality, but it arises as a matter of law out of the presumed position of the parties in the eyes of third parties and these third parties assume that the agent has authority to act on the behalf of the principal. The scenario of apparent authority (where there is no authority at all in reality) must, therefore, be distinguished from implied authority (where authority indeed exists).

Under the Ethiopian law, apparent authority does not, in principal result in the effects of agency. Yet, it does not mean that apparent authority does not result in the liability of the principal towards the third party and the agent is free from liability. When the agent has acted with an apparent authority, both the principal and the agent are liable towards the third party with which the agent has acted.

As stipulated under Art. 2195 the following cases give rise to apparent authority.

- Where the principal has informed a third party of the existence of the power of attorney but failed to inform him of the partial or total revocation of such power;
- Where the principal failed to demand the return of a document evidencing power of attorney, if any;
- Where the statement, behavior has made third parties believe the existence of authority.

5.5. Modes of Representation

While the agent acts on behalf of the principal, the way he approaches third parties may be different. From the viewpoint of the knowledge by third parties of the situation, the Ethiopian law has acknowledged two modes by which the agent may represent the principal. These are disclosed and undisclosed agency relationships.

5.5.1. Disclosed agency

Undisclosed agency is the mode of representation in which there is no disclosure of the fact that the front person is acting on behalf of another person Art 2197(1). That is neither the fact that he is acting on behalf of another person nor the name of another person is made known to the third party contracting. Therefore, the agent acts on his own name and he is acting on his own behalf. The latter is inferred from the situation where the third party is not aware of the fact that the agent is acting to the benefit and on behalf of another. Here an internal relationship (the actual authorization) between the principal and the agent exists, but externally third parties believe that the agent is acting on his own behalf.

There is however, a difference in the effects of these sorts of agency relationships especially as regards relation with third parties, and we now look into the effects of each of such agency engagements.

5.6. Effects of Agency

Once a contract of agency is formed, it produces various distinct legal effects. The effect regarding liability relationships among the various parties involved in agency vary depending on the modes of authorization discussed.

- **Actual authority-disclosed agency**: it create complete agency that produces a direct legal bond between the principal and third party. The agent functioning under such a circumstance is merely facilitates the transactions and does not personally enjoy rights or bear duties arising from the transaction he has undertaken with third parties. He simply steps out of the legal bond, and it is the third party and the principal who are personally indebted to each other. Neither the third party nor the principal can make a personal claim against the agent regarding the transactions created. The agent is not answerable for the performance of the contract he has concluded with third parties. The principal and third party are legally obliged to one another for the performance of the obligation.
- ***Undisclosed agency:*** In this scenario**,** legal bond is created between the third party and the agent. The agent is authorized to represent the principal, but third parties do not know the fact that he is an agent. So, the law recognizes a liability relationship between the agent and third party. However, the internal liability relationship the agent has with the principal remains intact. Thus, the agent recovers duties he has personally borne vis-à-vis third parties through his rights from the principal, and he discharges the rights he has personally enjoyed vis-à-vis third parties through his duties from the principal. The principal and the third party cannot personally claim from each other, but they can claim from each other, through subrogation, the rights, and duties they each possess vis-à-vis the agent by replacing themselves to the positions of the agent. They exercise against each other not the rights they personally have with regard to each other but those of the agent.
- **Apparent authority**: Transactions undertaken in apparent authority may or may not create a direct legal bond between the principal and the third party depending on circumstances. The principle is that where an agent acts with apparent authority (such as where he undertakes with lapsed or revoked authority, or else where he acts exceeding the authority he is given), the principal will not be liable and only the agent is held liable to third parties. But, exceptionally the principal is held liable together with the agent in the following cases, as provided in Art. 2195 of the Ethiopian Civil Code

a) Where the principal has informed a third party of the existence of the power of attorney but failed to inform him of the subsequent partial or total revocation of such power;
b) where the principal failed to demand the return of a document evidencing power of attorney, if any;
c) Where the statements or behavior of the principal has made third parties believe in the existence of authority.

However, in the above circumstances, the principal may exempt the agent from liability through the ratification of the agent's actions in apparent authority. In other words, ratification has the effect of assimilating the liability of the principal to the normal liability that results from the combined consideration of actual authority/disclosed agency scenarios. The whole transaction thus creates a direct legal relationship between the third party and the principal. But in cases other than those making the principal jointly and severally liable with the agent, the principal has the option of repudiation. Repudiation refers to the power of the principal to reject (disapprove) acts that the agent performs in apparent authority where the principal cannot be held liable, and this has the effect of making the agent bear the whole liability towards the third party.

5.7. Rights and Duties of Parties to the Contract of Agency

As a relationship, agency imposes obligations among the parties involved in the relationship. The obligations are dependent on the agreements made, the law and by such incidental effects as are attached to the obligations concerned by custom, equity and good faith (Art 1713). It is impossible to list all the duties/obligations within an agency relationship. Hence, below we are going to discuss only the main obligations of each of the parties to the contract of agency.

As duties and rights are correlative, duties of an agent are rights of the principal and duties of an agent are rights of the agent. Therefore, we are not going to study the rights of the parties on the one hand and duties of the same on the other.

5.7.1. Duties of an agent

Duties of the agent to a contract of agency arise either from agreement (express or implied) or from law. The promises an agent makes to his principal are his duties, the promises may depend upon the interest of the principal and an agent. We cannot mention all the conceivable duties of an agent. The following are the main duties the agent.

- **Duty of notification: -** It is a maxim in agency law that all that the agent knows, the principal knows. Thus, it is only logical that the agent be required to notify the principal of all matters that come to his attention concerning the subject matter of the agency. What the agent actually tells the principal is not relevant; what the agent should have told the principal is crucial. Under the law of agency, notice to the agent is notice to the principal, and the agent should observe this duty.
- **Duty to follow Instruction of the principal:** The principal when appointing an agent may prescribe certain mode of representing. As the agents serves as a messenger of the principal he/she has to follow whatever the principal says. If the agent ignoring the instruction given and follows his own way, he/she may be liable for losses or damages that may happen on the representation

- **Duty of care and diligence:** The agent shall make the representation in a way the interest of the principal demands and only to safeguard the interest of the principal. The agent when representing a person shall take due care and diligence. Article 2211 demands the agent to make the representation as a good father.
- **Duty to account:** The agent has to give all the money or property that he receives under the guise of agency. The agent cannot enjoy a secret benefit from the representation. He can enjoy only the legal remuneration in accordance with the terms of the contract.
- **Duty of strict good faith**: The agent should represent only the interest of his principal. His interest shall not be involved in the transaction. If the agent represents interest of anyone other than the interest of his principal, the principal may invalidate the contract (Article 2187).
- **Duty to be performed personally:** The agent has to execute the agency personally. The agent is a delegate and cannot delegate someone to represent the principal represent the principal. The principle is a delegate cannot delegate. This general rule has, however, exceptions. The exception are;
    a) If the principal consents to the delegation, the agent is free to appoint someone that may represent the principal.
    b) If unexpected danger preventing representation by the agent happens or where the agent by himself cannot execute the agency, he may delegate someone. Say, for example, the agent fall sick and could not communicate to the principal in ignorance of his/her place or address.

c) In some circumstances, the agent may lack expertise to discharge a given representation by him/her self. In such as case, the agent may delegate someone to execute the representation. An architect, for example, may employee a mechanical, electrical engineers, or a plumber to execute a given task.

5.7.2. Duties of the Principal

The principal like the agent has some contravening duties towards the agent. These are:

- **Remuneration**: - Agency may be made upon consideration or gratuitous basis. The duty of remuneration thus comes into the scene under Ethiopian law where the parties expressly stipulate in their contract. The duty to pay remuneration is exceptionally demanded when the agency services are professional or where it is customary to pay remuneration for the concerned agency services. However, even in these latter cases, parties can expressly exclude the payment of remuneration.
- **Duty to Advance Money**: - The agent may need money to run the representation of the principal. These may include for example transportation and similar costs. According to article 2221 of the Civil Code, the principal shall advance to the agent the sums necessary for carrying out the agency. This would constitute all expenses that the agent needs to make in the discharge of his functions including transportation costs and the principal is expected to forward these outlays in advance.
- **Duty of reimbursement**:- The money advanced by the principal may not be sufficient to run the affairs of the principal or the principal might not have advanced money for the agent. In such cases, the agent may employ his own money or money from other persons. These outlays/expenses incurred by the agent need to be reimbursed (Art. 2221).
- **Duty of indemnification and compensation**: - Subject to the terms of the agency agreement, the principal has the duty to indemnify an agent for liabilities incurred because of authorized and lawful acts and transactions. For example, if the agent, on the principal's behalf, forms a contract with a third party and the principal fails to perform the contract, the third party may sue the agent for damages. In this situation, the principal is obligated to compensate the agent for any costs incurred by the agent because of the principal's failure to perform the contract. The principal shall also compensate for any non-contractual damages sustained by the agent in the course of performing his agency duties.

- **Agent's Lien right**: The principal may not discharged his obligation of paying remuneration, expense, damage, or liability payments. In such a case, if the agent is in possession of goods belonging to the principal, then the agent is entitled to exercise a lien on such goods and retain possession of them until the principal has satisfied the due claims of the agent (Art. 2224).

5.8. Termination of Agency Relationship

An obligation does not usually remain indefinitely. It comes to an end for different reasons. Agency is not different from this general principle. It comes to an end for different reasons. One cause to extinguish agency relationship is termination. Termination of agency is possible to arise from two sources: by the act of the parties and the law. Act of the parties could mean either agreement by the two parties or by unilateral declaration from one of the parties.

5.8.1. Termination by act of the principal or the agent

- **Agreement:** Agreements/contracts are not only entered into to create obligation but also to extinguish obligations as well (Art. 1675). The principal and the agent may agree to terminate a relationship that exists among them. "A contract may terminate where the parties so agree" (Art. 1819 via the bridge Art. 1676.) upon agreement, nothing is impossible to assume except those prohibited by law (usually by public laws and mandatory private law provisions).
- ***Revocation:*** It is a unilateral declaration on the part of the principal to terminate the exiting agency-principal relationship (Art 2226). It occurs when the principal gives notice of termination of the authority to the agent.
- **Renunciation (Repudiation);** a counter right granted to the agent is the right to renounce the authority he had acquired. It is a declaration made by the agent to terminate agency relationship that existed with the principal. Similar to revocation, it is a unilateral declaration Art 2226.

5.8.2. Termination by Operation of the Law

Agency relationship may be ended by operation of law. Article 2232 of the Civil Code states unless otherwise agreed, a contract of agency shall terminate by the death of the principal or where he is declared absent, becomes incapable or is adjudicated bankrupt. Upon death, personality ends for all legal purposes and therefore the agency as a legal affair is out rightly terminated. Declaration of absence has the effect of death, and therefore kills legal personality for all legal matters including agency. Declaration of incapacity also puts an end to agency

relationships because, as we repeatedly said, the personal exercise of all juridical acts requires capacity. Absence of capacity entails absence of a juridical act such as agency. Bankruptcy on its part impoverishes the economic status of a person. Agency relates to economic matters and a person with no assets is not worthy of economic transactions.

Summary

Agency is the fiduciary relation that exists between two persons so that one shall act on the behalf and subject to the control of the other. While agency is the fiduciary civil relationship between the principal and the agent, its primary purpose is to confer on the agent the authority to transact with third parties.

Contract is the main source of agency relationship. Even though the the contract is the main source of the agency relationship, the law intervenes, in the absence of formal agreement between parties, in certain cases for reasons of public policy and to fill-in the gap created by the difficulty. Cohabitation, representation of legal incapacity, unauthorized agency, and curators are some of instances at which the law intervene and create agency relation between the parties.

An agent could be a general agent or special agent. General agency is the case where the power of agency is fixed in general terms, without detailed authorization. Agency expressed in general terms only confers upon the agent authority to perform acts of management (i.e. administrative or maintenance functions). Special agency on the other hand, confers on the agent authority only to conduct the affairs specified by the contract of agency. These acts are acts of disposition such as alienation or mortgage of real estate, investment of capital, signing of bills of exchange, making donations, and bringing or defending lawsuits etc.

Agency produces various distinct legal effects. In disclosed agency relationship, a direct legal bond is created between the principal and third parties. However, in an undisclosed agency scenario, the agent is deemed to have acted on his own behalf and legal bond in this case is created between the third party and the agent.

There are some respective rights and duties as between the principal and the agent. Duties of the agent arise from the contractual stipulation made by the parties and from the law's role to fill the gaps created by the contract. These duties include duty of notification, duty of loyalty, duty of diligence, and duty of non-delegation. On the other hand, a principal has obligations of remuneration, duty to advance money, duty of reimbursement and duty of compensation.

Agency can be terminated by operation of the law (the death, declaration of absence, incapacity or bankruptcy of either of the parties) and by the actions of the parties (revocation or renunciation).

Exercise

1. Identify and explain sources of agency relationship

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2. When the agent is directly liable for third parties?

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3. Distinguish
    a. General agency and special agency

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    b. Disclosed agency and undisclosed agency

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4. Discuss:
    i. The obligation of the agent to his principal

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ii. The obligation of the principal to the agent

5. Discuss the different ways in which an agency relationship may be terminated

UNIT SIX
INTRODUCTION TO COMMERCIAL LAW

Introduction

Dear students this is the last unit of this course. The unit comprises three different bodies of law. The first part deals with the law-governing traders and business organizations in Ethiopia legal system. Accordingly, this section gives you an idea on what is meant by traders and business organization. Based on that idea, you will study about other items relating to business organization.

The second part deals with insurance. Insurance law as a means of transferring a risk from insured to the insurer in Ethiopia legal system is defined. Moreover, fundamental issues and principles pertaining to insurance law in Ethiopia legal system will be dealt.

The last part is all about negotiable instruments. The businessperson daily comes in contact with documents like cheque, bond, bill of exchange etc. these documents are negotiable instruments which serve as a substitute for money. Thus, this part introduces you with different forms of negotiable instruments recognized in Ethiopia and the rules regulating them.

Objectives

After successful completion of this unit, you will be able to;

- Define traders under Ethiopia law
- Describe obligations of traders
- Identify the forms of business organization under Ethiopia law
- Distinguish between limited and unlimited liability of business organizations
- Describe the significance of insurance transactions
- Identify fundamental principles regulating insurance
- Explain the nature of negotiable instruments
- Distinguish between different forms of negotiable instruments

6.1. Law of traders and business organization

6.1.1. Traders

Who are traders? Do you think that any person who sells things for profit is just trader?

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Businesses are operated by persons, whether physical or juridical. However, sole businesses or sole proprietorships can only be run by physical persons. Physical persons who operate a sole business are referred to as traders. Article 5 of the Ethiopia commercial code defines the trader. This provision defines traders as;

> *Traders are persons who professionally and for gain carry on any of the activities mentioned in article 5. (Dear student please refer long lit activities of Art 5 of the commercial code).*

What are elements in the above definition?

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Thus, as per the above provision, a physical person becomes a trader if and only if the following requirements are met.

- ***Engaging in business professionally;*** one who operates a business has to do so professionally. The profession requirement refers to something different from the standard lexical meaning of the word "profession" or "professional." In its lexical meaning, profession defined as "a calling requiring specialized knowledge and often long and intensive academic preparation." It is not in this sense our law uses the term. Rather, it is in the sense of a principal calling, vocation, or employment that the Code makes use of it. To say that the business that is being operated by a certain person has to be her principal calling is, in effect, to say that she who operates a business as a pastime or in her leisure does no be counted as a trader.

- **Operating business**: a physical person becomes a trader if and only if she operates a business/enterprise. The requirement of the existence of a business has not been made as explicit under Art 5. Despite its inexplicitness, the business requirement can be read into Article 5 without difficulty. This is so for two reasons. First, one cannot be a trader without operating a business or an enterprise. Second, though it has been contended that the business requirement is implicit in the fact of being trader, it is submitted that a conjunctive reading of Articles 125(1) and 5 render it explicit. Article 125(1) stipulates, "Every trader operates a business." From this, it appears that there is no trader who does not operate a business.

- **For gain or profit**: a person who engages in trading activity professionally does not become a trader unless she does so for profit. Thus, not all persons who operate a given task for profit may be necessarily regarded as traders. For example, persons who engage in agricultural production, cattle breading, fishery and persons who operate activities ***at the level of handcrafts*** are not treated as traders even if they derive profits out of their activities, and they don't have the rights and duties of traders. This shows that the type of activity, not necessarily a profit generating one, is considered for categorizing a professional pursuer as a trader or not.

- ***Carry out one or more of the activities listed in Article 5 of the Commercial Code.*** The business objects of a trader has to be carry out one or more of the activities listed in Article 5 of the Commercial Code. The list in Article 5 was meant to be exhaustive. However, it has been broadened by subsequent legislations like the Commercial Registration and Business Licensing Proclamation No. 67/97, as amended, the Re-enactment of the Investment Proclamation No. 280/2002, as amended, and the Trade Practice Proclamation. The said laws redefined the scope of the enumeration of commercial activities under Article 5 of the Commercial Code. For instance, such activities as higher education, health, and construction are included. In addition to studying the list of activities that are being opened for traders, it is also important to examine the definition of trader in these laws.

6.1.1. Obligations of traders

Can you guess the obligations that a person who engaged in trading activity may have?

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Traders have certain obligations not borne by non-trading persons. The law imposes on the traders the following obligations.

a. Obligation to keep books and accounts

Article 73 of the commercial code requires traders and commercial business organizations to keep books and accounts. Keeping books and accounts is beneficial to both the trader and the government. Books and accounts are admissible evidences for activities of a trader: For all questions or issues connected to the business or fruits of trade operated by the trader books and accounts are admissible evidences. In other cases, a document written by a person cannot be taken as evidence in a way supporting the trader. Books and accounts may also be produced as evidence in favor of the government: Article 72 of the commercial code states that books and accounts may be taken as evidence against the party who kept them. If the trader denies a business profit he has earned, the authorities may produce the books and accounts as against the trader.

b. Obligation to be registered

Every trader and commercial business organization before commencing the activity of trade shall be registered). The law has established three kinds of registers: a commercial register managed by regional bureaus of trade and industry, commercial register managed by the ministry of trade and industry, and a central commercial register. The place of first (principal) registration depends upon the place where the business license was acquired. If the trader has business license from any one of the regional offices, it will be registered there. If a trade has business license from trade and industry bureau of Amhara, he/she will be registered in Bahrdar.

Import and export activity, hospital, business colleges and similar activities are fields in respect of which the Ministry gives business license. If a certain person establishes hospital in Desie, he/she principally will be registered not in Bahrdar but in Addis-Ababa at the Office of the Registration in the Ministry of Trade and Industry.

c. The Obligation to have Business License

Every trader and commercial business organization (except the joint venture) before commencing the commercial activity should have business license. This is the rule;

exceptionally, however, certain persons may operate commercial activity even without having a business license. Regional bureaus of trade and industry may exempt certain group of traders to operate commercial activity even without having a business license. Somali region, for example, exempts traders operating a commercial activity at a capital of birr 5000 and below from the obligation to acquire business license.

6.2. Law of business organization

There are two basic forms of doing business, i.e. individually (sole trader) or through establishing business organization. Article 210 of the Commercial Code defines a business organization as;

> "Any association arising out of a partnership agreement"

A partnership agreement on the other hand, defined under Article 211 of the Code as;

> *"a contract where by two or more persons who intend to join together and to cooperate undertake to bring together contribution for the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising out there or ,if any."*

Accordingly, a business organization is a contractual association of two or more persons who undertake to bring in contribution with a view to carrying out an economic activity. Business organization is a contract in the strict sense of the term. As a contract, multilateral instrument, it should satisfy all the legal requisites we raised on general principles of contract law and it produces all the effects of a contract. It binds together the cooperators and contributors and it is backed by the sanction of law for enforcement.

As a contract again, two or more persons are needed and this means that a single person cannot establish a business organization in Ethiopia. Parties to the partnership agreement should be willing to work together for common goal. The extent of collaboration depends on the nature of the business organization. The persons also undertake to make contributions that later constitute the business organization. The kind of contribution may depend upon the interest of the parties and the need for investment in the business organization. Cash contributions are the obvious

modes. But in kind contributions, or even skill (knowledge), are possible in so far as they are susceptible to monetary valuation.

Business organizations are established for carrying out activities of economic nature and the partnership agreement should reveal this. That is to say, persons organize themselves in the form we are talking about to strengthen their economic power, to collect more profit. In other words, a business organization cannot be established for purpose other than profit making. The contracting parties further undertake to participate in both the profit and the loss that arise out of their operation, as the case may be. The contract cannot exclude members from either the profit or loss or both.

6.2.1. Forms of Business organization in Ethiopia

Though the main classification of business organization is between partnerships and companies, partnerships can be further broken down into four legal forms: ordinary partnership, joint venture, general partnership, and limited partnership. Companies comprise of two legal forms, namely, Share Company and private limited company.

Totally, there are six legal forms of business organizations provided for in Article 212 of the Commercial Code: these are discusses here in under;

1. **Ordinary partnership**

An ordinary partnership is one of the various forms of partnerships. The major distinction between an ordinary partnership and other partnership forms is that commercial business organizations cannot adopt this form of business organization. Article 213(2) provides that;

> *"Where a commercial business organization is created in the form of an ordinary partnership or where the form of the organization is not specified, the commercial business organization shall be deemed to be a general partnership."*

Thus, though an ordinary partnership is defined as a business organization, it is not known as Commercial business organization and is not authorized to undertake trade activities. If it carries out a trade activity, it will automatically be considered as a general partnership.
Even if ordinary partners cannot engage in commercial activities (i.e., those listed in Art.5), it

can carry out any other economic activities which the ordinary partnership may legitimately carry out are virtually unlimited.

2. Joint Venture

This organization is usually formed with relatively small number of person or for a limited purpose for a short period. Two or more partners often join to work on a project that each could not handle separately. The project may be too large, too expensive, or too complicated for one of them, but manageable if they work together. For instance, large dams, bridges, and office buildings may be built by joint ventures who combine their resources for the single project only. These people may not want to have permanent partnership by going through the ordinary procedure for establishment of other forms of partnership especially the procedure of registration that may take time and involve expenses.

Joint venture agreement has its own special features. These are:

- It is not made known to third parties. Where it is made known to third parties, it shall be deemed, insofar as such parties are concerned, to be an actual partnership, to be regulated under general partnership. Therefore, the partners should be careful in keeping the secret of their association.
- it need not be in writing and registered
- It does not have legal personality.
- The manager is known to third parties. He shall be fully responsible for the liabilities of the joint venture.
- Every partner shall deal with third parties in his own name.

3. General partnership

General partnership is the typical partnership form. Partners in a general partnership, as per article 280(1) of the Code are,

> *"Personally, jointly, severally and fully liable as between themselves and to the partnership for the partnership firm's undertakings."*

Thus, the partners are personally, jointly, severally, and fully liable as between themselves and to the partnership for the partnership firms undertaking. General partnership has no minimum capital requirements. It is left to the partners to decide on the amount of the capital to be contributed.

The management and administration of the company is determined by the agreement concluded by the partners in the memorandum of association. The memorandum of association can also provide voting procedures in which the partners make their decision as to the assignment of shares.

The name of the partnership consists of the names of at least two of the partners followed by the words "General partnership".

4. **Limited partnership**

The limited partnership is the same as general partnership. However, the difference is, in a limited partnership there are two types of partners namely, general partners who are liable personally, jointly, and severally and limited partners who are only liable to the extent of their contribution.

A limited partnership is managed by the general partners. Limited partners are not allowed to participate in management. Otherwise, they are to be held jointly and severally liable for all the debts and obligations of the company. However, they can require to be presented with a copy of the balance sheet and are entitled to inspect the books of the firm.

A limited partnership must consist of the names of the general partners followed by the words “Limited partnership". Where a limited partner allows his name to be included in the firm's name, he shall be liable to third parties in good faith as though he were a general partner.

5. **Share Company**

Share Company is characterized by an acquisition of capital from a relatively wider segment of the society. It is a public company whose capital is fixed in advance and divided into shares and where liabilities are met only by the assets of the company. The share company is fundamentally different from the forms of business organization. All of its member enjoy limited liability. The shares are freely transferable and the public may be invited to subscribe.

The establishment of Share Company requires at least five persons and there is no maximum as to the number of partners. Subject to the laws provided for the establishment of banks, the capital of the company shall not be less than 50,000 Birr.

6. Private limited company

Private limited company is the most popular form of company in Ethiopia. One reason is that it is particularly well adapted to small and medium–sized business and currently, the Ethiopian business is at these stages. The other point is that it is hybrid of Share Company and partnership. On one hand it is limited liability, its member's liability is limited to the extent of their contribution, on the other hand, shares are not freely transferred to the outsiders. Thus, this company is middle way between Share Company and partnership.

Private Limited Company may be formed to pursue any purpose or to carry on any activities, however, it may not take banking, insurance, and similar activities, such business must be carried out by Share Company (Art 513). Like share company, private limited company is always of commercial nature even if it intends to carry on civil activities.(Art 10(2) and 510(2)commercial code).

Share Company and private limited company always have limited liability. It means that members are not liable personally to the debt of organization. Ordinary partnership, general partnership, and general partners in limited partnership have unlimited liability. It means members may be held liable for a debt of the organization, if the organization fail to pay the debt.

6.2. Insurance Law

What is insurance?

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Insurance is an idea of the people, for the people and by the people. At a very basic level, it is some form of protection from any possible financial losses. it is is "the collective bearing of risk". What brought insurance into being was popular concern for future uncertainty. Man wanted to protect their hard-earned property from uncertainty and this simple requirement was given a shape with the innovation and improvement of insurance policy.

Man has always been in search of security and protection from the beginning of civilization. The urge in him lead to the concept of insurance. The basis of insurance was the sharing of the losses of a few amongst many. At this time, insurance companies are in hurry to eat the cake of insurance business and the insurance business has been increased at every level of the society.

According to the Ethiopian Commercial Code, a code governing Insurance policies, an insurance policy is defined as;

> *"A contract whereby a person called the insurer, undertakes against payment of one or more premium to pay to person, called the beneficiary, a sum of money where a specified risk materializes".*

According to this definition, insurance is a contract between two or more persons. The party, which promises to pay a certain amount of money to, or to indemnify, the other party is called the insurer. The document containing the terms and conditions of the contract of insurance is called the policy, and the insured is therefore, also referred to as a policyholder.

A contract of insurance is a type of contingent or conditional contract. It is a contract in which the performance of the obligation arising there from by the parties or one of them is dependent upon the condition or contingency agreed upon by them. Accordingly, as the obligation of the insurer/assurer to pay compensation or the agreed amount to the insured or the beneficiary is dependent upon materialization of the risk or risks specified in the policy.

A contract of insurance may be concluded in relation to "damages" covering risks affecting property or arising out of the insured person's civil liability. These types of insurance are generally referred to as indemnity insurances, in which the insurer's obligation is to pay compensation, which is always equal to damage. Similarly, a contract of insurance may also be made in respect of human person's life, body, or health in which the insurer's obligation is to pay the amount agreed upon (the sum insured). This is a type of insurance in which the principle of indemnity or compensation is not applicable since human life or body does not have a market value, hence the name Non-indemnity insurance.

Thus, a contract of insurance, as a contingent contract is a perfectly valid contract, and the general principles of the law of contract apply equally to such a contract. Hence, to be valid,

there must be an agreement between the parties, the agreement must be supported by consideration, the parties must be capable of contracting (must have capacity), the consent of the parties to the agreement must be free from defects, the object must be legal or the object must not be illegal and immoral as well the agreement must be in written form.

6.2.1. Fundamental principle of insurance

Insurance is actually a form of contract. Even though insurance is governed by the insurance Policy signed among the signatory parties and the pertinent Insurance laws of the country, the basic insurance principles of the country will also be considered as parts of an Insurance Policy. Hence, there are certain principles that are important to ensure the validity of the contract.

1. **The principle of utmost good faith**

The principle of utmost good faith is mostly discussed in the context of the duty of the insured towards the insurer, though it is equally applicable to the insurer's duty towards the insured. A person who applies for insurance is usually given an application form containing questions about the nature of risk. Insured is deemed to have known all the facts of the subject matter of insurance. The insurer decides to accept or not to accept the application (offer) based on the information given. Therefore, the insured must disclosed all material facts in his knowledge (Art 667). The duty of disclosure of material facts continues throughout the contract and the insured should advice the insurance company wherever change occurs in the property insured.

2. **The principle of insurable interest**

Insurable interest is the pre-requisite for insurance. The insurer must have some pecuniary interest in the subject matter of the insurance. The subject matter of the contract must provide some financial gain by existing for the insured (or policyholder) and would lead to a financial loss if damaged, destroyed, stolen, or lost. The insurer need not necessarily be the owner of the insured property but he must have some vested interest in it (Art 675). It could be, mortgagee, trustee, bailee, and lessee. It is worth mentioning that it is the principle of insurable interest that distinguishes insurance from gambling or wager agreements.

3. **Principle of indemnity/compensation**

The main objective of insurance is placing the insured in the same financial position as was just before the loss. This principle is clearly stated in article 678 of the commercial code. This

principle is based on the idea that insurance is a system for distributing loss. It is not a mechanism of generating profit. The insurance company promises to compensate the policyholder for the loss up to the amount agreed upon in the contract. For instance, if your car is inured for 500,000 birr but damages are only 100,000 birr. You get 100,000 birr not the full amount.

The commercial code of Ethiopia clearly stated that contract for the insurance of an object is a contract for compensation. Thus, insurances like fire and marine insurance are contracts of indemnity.

However, in case of life insurance, the economic value of a human life cannot be measured precisely before death. It could in fact be unlimited. Life insurance is not a contract of indemnity.

4. **The principle of subrogation/substitution**

This principle says that once the compensation has been paid, the right of ownership of the property will shift from the insured to the insurer. It prevents the insured of collecting the twice of the same loss at first instance, and wrong doer would escape liability at second. So, let us say you are in a car wreck caused by a third party and your file a claim with your insurance company to pay for the damages on your car and your medical expenses. Your insurance company will assume ownership of your car and medical expenses in order to step in and file a claim or lawsuit with the person who is actually responsible for the accident.

5. **The principle of contribution**

This principle applies if there is more than one insurer. It is an extension of the principle of indemnity, which allows proportional responsibility for all insurance coverage on the same subject matter. For instance, imagine that you have taken out two insurance contracts on house so that you are covered fully in any situation. Let's say you have a policy with Abay insurance that covers 30,000 birr in the house damage and a policy with Niyala insurance that cover 50,000 birr in the house damage. If your house damage that causes 50,000 birr worth of damage. Then about 19,000 birr will be covered by Abaya insurance and 31,000 birr by Niyala insurance.

7) The Principle of Loss Minimization

In an uncertain event, it is the insured's responsibility to take all precautions to minimize the loss on the insured property. Insurance contracts should not be about getting free stuff every time something bad happens. Therefore, a little responsibility is bestowed upon the insured to take all measures possible to minimize the loss on the property.

6.2.2. Types of insurance

Under Ethiopia commercial code, there are three types of insurance. They are insurance of object, insurance of liability and insurance of person.

1. **Insurance of object**

Insurance of object is a property insurance as designed to protect the insurable interest in that object or property against a specific risk. It is a broad area that may include burglary, robbery, theft, fire, automobile insurance etc. The subject matter of this type of insurance is property interest (i.e. preservation of a thing having money value). Its main purpose is to put the insured in the same financial position after the occurrence of the risk as he/she enjoyed before it materialized. The insured does not allowed to make profit from insurance. In this regard, Article 678 commercial code states that;

> *"A contract for the insurance of an object is a contract from compensation. The compensation shall not exceed the value of the object insured on the day of the occurrence.*

2. **Insurance of person**

Insurance of persons is a kind of insurance engagement confined on the welfare of a person him/herself. The subject matter of insurance of person is a human person's welfare. the ***nature*** of the insurance is contractual but not of indemnity. Its scope is the kind of risk on the life either death, illness or injury of the person to be covered with payment of sum amount of money in the form of back up to the damage by the insured him/herself or a third party beneficiary who might be dependent of the insured. It regards neither the property interest not a kind of liability he /she owes to a third party. The subject matters is the insured person him/her self the personal welfare. According to the Commercial Code, since insurance of persons is not considered to be a contract for compensation, the amount insured may be freely fixed and shall be due regardless of the damage suffered by the insured. In addition, the rule of subrogation in no case applies under

insurance of persons.

3. Insurance of liability

Liability insurance protects against tort liability, including, however, tort liability assumed by contract. A tort is a legal injury or wrong to another that arises out of actions other than breach of contract, in which courts will provide a remedy by allowing recovery in an action for compensation. The main purpose of insurance of liability is bringing the insured back of his/her financial position, which he/she was before making the third party material or moral, damage good. In other word, its objective is safeguarding the insured from material loss caused because of discharging civil liability.

The sources and types of tort liability fall could be:

- Fault based liability: Liability for one's own faults--negligent driving, professional malpractice, false imprisonment by an individual, defamation, and so on
- Vicarious liability: liability due to the behavior of persons answerable, like employees
- Strict liability: for instance, liability for loss resulting from defective products and liability resulting from ownership of property

Insurance of liability for damages should be understood as distinguished from insurance of objects in that in the latter case the risk feared has the effect of diminishing the economic status of the insured resulting direct damage to the property interest against a thing upon which the insured has material benefit that can be assessed in money terms.

6.3. Some remarks on law of negotiable instrument(commercial paper)

What are negotiable instruments?

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The word negotiable means ‘transferable by delivery’ and the word ‘instruments’ means a written document by which a right is created in favor of a person. Thus, the term negotiable instrument literally refers to a document containing rights that can be transferred by delivery.

Similarly, Article 715(1) of Ethiopian Commercial Code of 1960 defines the term negotiable instruments, as any document incorporating a right to an entitlement in such a manner that it is not possible to enforce or transfer the right separately from the instrument.

The requirements for negotiability of these instruments are be in writing, signed by the maker or the drawer, be an unconditional promise or order to pay, state a fixed sum of money, be payable at sight (on demand) or at a fixed date. They are payable to order or to bearer, unless it is cheques which is always to order.

Negotiable instruments serve as a substitute for money. Their principal aim is to reduce those risks that would unduly impair the marketability of commercial paper. The rights that could be incorporated in negotiable instruments may be rights for payment of money arising out of various contracts (e.g. cheques, bill of exchange, and promissory note). Such rights may also arise from ownership in companies or loan made to the government or to a share company (e.g. share and bond). The rights that are incorporated in negotiable instruments may be rights to receive goods under voyage or deposited in a warehouse (e.g. A bill of lading, a truck way bill and an airway bill).

When we say the nature of negotiable instruments, they have the following four basic characteristics.

- Inseparability of the instrument and the right it embodies. The right can neither be enforced nor transferred without the instrument
- The instrument and the right which it embodies are capable of being transferred by delivery, either with or without endorsement according as to whether the instrument is in favor of order or bearer.
- The person to whom the instrument is negotiated or transferred can sue on it in his/her own name.
- The person to whom a current and apparently regular negotiable instrument has been negotiated, who takes in good faith and for value, obtains a good title to it, even though his transferor had a defective title or no title at all.

6.3. Types of Commercial Instruments

Dear students, do you guess types of negotiable instruments or commercial paper recognized under Ethiopia law?

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Art 732(2) of the commercial code state that;

Bills of exchange, promissory notes, cheques, traveler's cheques and warehouse goods deposit certificates shall be deemed to commercial instrument under this code.

Here let us briefly examine only the first three types of negotiable instruments.

- **Bills of Exchange**

Bills of exchange are negotiable instruments incorporating an unconditional order, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum in money to or to the order of a specified person.

Bills of exchange, therefore, involve an order to pay money rather than a promise to pay money. The person issuing the order is the drawer, the person ordered to pay is the drawee and the person who receives the payment is the payee.

- **Promissory Notes**

A promissory note is defined as a document incorporating an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person or to bearer. This, definition implies that promissory notes are promise to pay money and they are only two parties i.e., the maker of the promise and the payee to whom payment is effected.

It is important to note the following distinctions between bills of exchange and promissory notes, i.e. a promissory note contains promise to pay whereas a bill of exchange contains an order to pay. The maker of promissory note is always primarily liable and its liability is the same as the acceptor of a bill of exchange, but in case of drawer of bill of exchange once the bill is accepted

he is only liable as surety in the event of dishonoring of bill of exchange. The concept of acceptance is not applicable to promissory notes unlike bills of exchange that may be accepted. Finally, promissory notes involve two parties only as opposed to bills of exchange that under normal circumstances involve three parties.

- **Cheques**

A check is the most widely used form of commercial instrument. It is bill of exchange drawn on a bank and payable on demand. The check is an unconditional order in writing, addressed by one person, the drawer, to a banker, signed by the drawer, requiring the bank to pay, on demand, a sum certain in money to or to the order of specified person or to bearer.

The following are the main differences between checks and bills of exchange. A check is always drawn on a banker and is always payable on demand while a bill of exchange may be drawn on any one and may be made payable on demand or at fixed or a determinable future time and a check can be crossed in several ways but bills cannot be crossed. Acceptance is not necessary for a check since it is payable on demand as opposed to bills of exchange which may be made payable at fixed or determinable future time presentment for acceptance may be necessary.

Summary

Traders are persons who carry on trading activities professionally and for gain. Traders have certain obligations not borne by non-trading persons. They are generally required to be registered, to obtain business license and to keep books and accounts.

Business organization is a grouping of businesspersons that comes out of the partnership agreement. The Ethiopian law recognizes ordinary partnership, general partnership, limited partnerships, Share Company, and private limited companies as forms of business organizations. Partnerships are associations of persons and the personality of members does greatly matter. Partnerships will have their own legal personality upon registration and publicity. But such personality is greatly dependent on the mutual understanding between the partners so much so that the withdrawal of one partner may cause the dissolution of the partnership as a whole. Companies on the other hand are associations of capital and the personality traits of shareholders are not important to the existence of the company. What is needed is capital and not persons. The basic virtue of the company form is the full recognition of limited liability.

Law of insurance is a social security scheme that developed because of the existence of risks. It is a contract whereby a risk is transferred from an insured to an insurer. As a contract, it is subject to the rules of ordinary contract law. Among other requirements, a contract of insurance must be made in writing this is because the law says that the contract should be supported by a written document called an insurance policy.

There are different fundamental principles regulating insurance. The major ones are the principle of utmost good faith, the principle of insurable interest, the principle of indemnity and the principle of subrogation. While all of these principles are applicable to insurance of object and liability insurance, the last two principles are not applicable to insurance of person.

A negotiable instrument is a special but simple document that gives the possessor a right to the entitlement as expressed in the instrument by the presentment of the instrument to the debtor. The instrument is said to be negotiable because it can be transferred from one person to the other by mere delivery or, sometimes, by endorsement. Bills of exchange, promissory notes, cheques, traveler’s cheques, and warehouse goods deposit certificates are recognized as negotiable instrument under Ethiopia law.

Exercise

1. Discuss the conditions at which a person who engaged in a certain activity to be regarded as trader under Ethiopia law

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2. Enumerate and briefly explain forms of business organization recognized in Ethiopia legal system

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3. Distinguish Private Limited Company and Limited Partnership

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4. Discuss at least 4 basic principles, which regulate insurance law in Ethiopia

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5. What is a negotiable instrument? What is its importance for the business?

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