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# Course Introduction

* Dear learners, this is a course on Business. This is the first time for you to deal with a law course. Thus, it is quite essential to familiarize you with the very concept of law as an introduction to the subsequent discussion. When you read different writings on laws, you may come across different definitions of the term “law”. Law is a term subject to various definitions. Though different definitions may be given to the term law, identifying a widely accepted definition of law seems to be essential. In an attempt to come up with a working definition resort shall be made to various writings pertaining to the concept. Although it can be said in simple terms that “law” is the body of rules to which person are expected to conform”, more other elements should be added to this definition so as to have a full-fledged one. It may be defined as rules of conduct that are imposed by a government authority and backed by sanction.

Business law is the area of law that governs relations of “persons” in business. It deals with legal aspects of business behavior. In this course the concept of personality, contract in general, contract of sale, agency and business organizations will be discussed. All the items in this course deal with the rights and obligations of “persons”. The concept person is going to be dealt with in somewhat depth manner. Therefore, before discussing rights and duties of persons, you must have some basic ideas on the concept. This shall be followed by “Contract”. The foundation of every business activity is contract. The provisions of “Contract in General” lay a foundation for other areas of business law. Then you will be dealing with law of Agency, special contracts and law of business organizations; respectively.

To have a clear understanding of the subject matter of the course you need to read the whole text very closely.

# Course objectives

# I. General Objectives

Generally, the course is designed to well acquaint you with the basic knowledge of the conceptual underpinnings law pertaining to business. As there exist no business activity that escapes from falling within the realm of law, a good knowledge of law in order to develop skills of problem solving and to enhance your personal competence to engage in business and its environs of the country in your future career is commendable.

# II. Specific Objectives

**After successful completion this Course, Specifically, you will be able to**

* understand the concept of law;
* discuss the role that law plays in business;
* supply yourself with legal knowledge in the area of business;
* identify a general idea on the rules governing agency;
* appreciate the legal relationships created in a contract of sale and the respective rights and duties of the parties to the contract of sale;
* Understand how contract of employment is created and terminated.
* have basic knowledge on the forms of business organizations under the Ethiopian law, formation of business organizations, requirements for the acquisition of legal personality, liabilities of business organizations; and
* solve theoretical and pragmatic problems arising in business activities by the norms pertinent laws

# UNIT ONE

# INTRODUCTION TO THE LAW

# Introduction

Albeit frequently mentioned concept, defining the term “law” is appears to be such a hard task. Black’s Law Dictionary tries to define law as rules of action which are issued by an authority and that have binding force accompanied by sanction or other legal consequence.[Garner; 2004: 900]It is known that you are familiar with the term in your day-to-day lives while many know a little about the nature and meaning of different branches of laws that are applicable in our legal systems. This chapter is aimed at introducing you with fundamental concepts about the law. Particularly, this chapter is devoted to deal with introductory remarks about the law with a special emphasis to the Ethiopian legal system.

# Unit Objectives

Dear learner, the following are the specific objectives sought to be achieved after the completion of this chapter.

* Appreciate different classifications of the law and understand various types of laws; particularly, you are expected to understand the meaning and scope of business law
* Familiar with the law making process under the Ethiopian legal system; and
* Understand the hierarchy of laws under the contemporary Ethiopian legal system having seen the meaning and effect of the notion of hierarchy of laws.
  1. Classifications of the Law

Needless to say that there are a number of scholars or jurisprudents that tried to come up with a definition for what the term “law” means. However, there is no agreeable definition so far since their definitions are diametrically opposite. Nor is possible to say there is an exact number of a classification of laws because of the differences in the criteria used or the methods employed by the scholars. We will look at two of these classifications hereunder; the first one is classifying laws as ***internationa***l vs. ***national***laws while the next is categorizing laws as ***public*** and ***private***.

* + 1. International and Domestic/ National Laws

1. **International Law**

Generally speaking, international laws are related with international institutions and organisations and their relations with States and individuals. Moreover, it is possible to say that international law is a branch of law that regulates the relations between/among States as well as citizens of different states. Thus, international law is applicable when a dispute arises between or among different countries. Besides, it could also be applicable in matters involving two or more persons from different countries.

*Example:*

*Issues involving the United Nations (UN) and its branches like the Security Council or regional organizations like the African Union (AU) are under the scope of international law.*

*On the other hand, international law could be applicable in the dispute arising from business transactions of a Chinese investor and an American contractor.*

The above cited example would be clear when we look at the classifications of international law. Basically, international law is classified in to public international law and private international law.

1. Public international law:is a type of international law that regulates the relations and transactions between states as well as the disputes involving two or more sovereigncountries. Moreover, it governs treaties concluded between two counties (bilateral treaties) as well as treaties signed among three or more counties (multilateral treaties). Finally, public international law deals with the organization and functions of international organizations.

*Example:*

*The border dispute and war between Ethiopia and Eretria was settled through the Algiers Treaty. That was a matter of public international law that involves two sovereign states, i.e. Ethiopia and Eretria. Similarly, the USA’s counter-terrorism war against Iraq and Afghanistan is regulated under public international law*.

1. Private international law/ Conflict of laws

Private international law (conflict of laws) is a type of international law that governs the relations between individuals from different nations. In other words, it is applicable on matters involving two or more individuals who are citizens of different countries.

*Example:*

*A Frenchman met an Ethiopian girl while he was in Djibouti for business trip in May 2005 where they fall in love and engaged. After a couple of months, they got married as per the dictates of Islamic or Sheri’a law in Mogadishu, Somalia. After two years of stay in Djibouti they moved to France. As a permanent residence, they chose Paris, the place where they bought a residential villa. Blissfully enough, they were glad to see their first baby shortly after they moved to France. In January 2014, they went to Dubai for summer vacation. Unfortunately, they had a serious fight and decided to get divorced while they were still in Dubai.*

*In the above hypothetical case there is an issue pertaining to whose family and /or property law is applicable; i.e. is that the law of Ethiopia, France, Djibouti, Somalia or Dubai (UAE), which is going to be applicable in the above case? Where shall they go to file a petition for divorce?*

*Therefore, it is private international law (conflict of law) that helps us answer the above questions. Or, such types of issues are entertained with the guise of private international law.*

1. **National Law**

National (domestic) law, also known as the law of the land,is a type of law whose applicability is limited to a single nation (country). For example, property law of Ethiopia and the criminal codes of China are considered as domestic (national) laws that are applicable in Ethiopia and China, respectively.

Unlike International law, which is applicable in two more countries, national law pertains to a particular nation. By the same token, national law’s applicability all over a country makes it different with local laws. It has to be noted that***local law*** is the law of a particular locality and not the genera law of the whole country.

*Example:*

*Various laws of USA are applicable only within the American territory since national laws are applicable only in that specific nation. For instance, the person who committed theft in Mexico will not be punished by the American criminal law since the laws of USA are not applicable outside America.*

*On the other hand, the family law of Tigray is not applicable throughout Ethiopia. It is not applicable in Hawassa or Adama since it is a type of local law that is applicable only in Tigray regional state*.

### 1.2.2 Public and Private Laws

A. Public Law

Public laws are branches of the law that are applicable to the state in its relations with its subjects. In other words, public laws govern the relationship between the government and citizens of a single nation (country). ***Constitutional law,Criminal Law***and ***Administrative Law*** are considered as typical examples of public laws. Let us briefly see the meanings of each of these types of public laws.

* Constitutional law: it is a branch of public law that defines the organization of the state, its fundamental rules, and form of the government, as well as the structure of the state and separation and limitations of powers.
* Administrative Law:it is another typical example of public law that regulates the operation of the executive power. Moreover, it deals with the formation, as well as the powers and responsibilities of administrative agencies.
* Criminal (Penal)law: It defines criminal acts (omissions), or offences, as well as criminal responsibilities. It also determines the respective punishments for each and every crime, which might involve different types of punishments including fines (payment of money), sentence (imprisonment) or capital punishment (death penalty) and measures.

B. Private law

Private laws regulate the acts of individuals, which are donein their private capacity, in a given state/ different states. Particularly, the disputes arising between two or more individuals in relation to their personal matters like property or marriage are resolved by private laws.

Examples include, ***Civil Law:*** which comprises of law of contract, law of succession, law of sales, property law; ***Procedural Law:***which governs the process of litigation, as well as ***Commercial Law:***that deals with traders and commercial business organizations, as well as acts of commerce including the law of insurance, negotiable instruments as well as law of traders and business organizations.

1. **Meaning and Features of Business Law**

Business law is a branch of private domestic/ national law that governs business transactions between two or more citizens of a nation.It is a broad area of law covering different types of laws and many different topics. It encompasses laws that are essential for forming, running and managing a business as well as making those help make business transactions. The following branches of laws are considered as the subject matters of business law.

* ***Law of contract****-*deals withformation, performance and nonperformance and remedies of contractual agreements
* ***Law of Sales****-* describes the meaning and nature of contract of sales as well as the rights and obligations’ of the buyer and the seller
* ***Law of Agency****-* deals with the types and natures of agency as well as the formation and extinction of obligations of agent and principal
* ***Law of Insurance-***comprises of the type, nature and formations of insurance contracts as well as the rights and obligations of the insurer and that of the insured
* ***Labor Law/ Employment Law****-* governs the meaning and formation of employment contracts together with the obligations and rights of the employee and employer.
* ***Law of Negotiable Instruments****-* deals with types and features of various commercial documents such as Bill of exchanges and Cheques.
  1. Making of Laws

***Dear learner:***

***Are you familiar with various branches of the government? What do you think are the fundamental responsibilities of each of these branches of the government? Do you know the principle of separation of powers?***

As you may recapitulate from the discussions in your civic and ethical education classes, different branches of the government have their own functions. That means, the legislative branches have the duty of making laws while the executive branch is entrusted with execution or implementation of laws made by the legislative branch. Similarly, adjudication or interpretation of laws is the power of the judiciary.

In principle, it is the legislative branch of the government which has the power to make laws. For example, the House of Peoples Representatives is has the primary duty to make laws in Ethiopia. However, as we will discuss under the next section, there are different types of laws that are made by the branches of the government other that the legislature. Thus, the law making process differs depending up on the type of the law or because of the nature/structure of the government organ that makes the law. Therefore, this section is devoted to deal with the law making process of the House of Peoples Representative in the Ethiopian legal system.

The first step is***initiation***where the council of ministers or members of the parliament request for the law to be made on specific area. The second stage is ***deliberation*** by the parliament on the importance of making such law. Then, the matter will be send to the legal affairs standing committee. If there is no a need for correction, the House of People Representatives shall ***ratify*** it and send it to the President (head of the state). After it is signed by the president, the speaker of the House of Peoples Representatives will number it and send it for publication. When it is ***published*** under the Negarit Gazette it becomes an official law of the land.

***Figure: The process of parliamentary law making in the Ethiopian legal system***

**Initiation**

**Deliberation**

**Standing Committee**

Numbered

Publication

**Signature**

Ratification

* 1. Hierarchy of Laws

It is natural to see discrepancies and conflicts among different laws of a nation. Whenever such types of inconsistencies exist, only one of the conflicting laws is going to be applicable. Therefore, the question as to which one of such laws should be applicable is answered with the concept of hierarchy of laws.

The principle of hierarchy of laws dictates that the law in the heir hierarchy shall be applicable whoever there are conflicting provisions of different laws. Hierarchy of laws has direct relation with the organ that made the respective laws. The law which is made by the legislative branch is in a higher hierarchy than the law made by the executive wing of the government.

***Dear students,***

***Do you remember the principle of supremacy of the constitution from your civic and ethical education classes? As you might remember, article 9 of the FDRE Constitution stipulates that the constitution is the supreme law of the land. What does the supreme law of the land mean?***

As it is clearly stipulated under the FDRE Constitution, the Constitution is the supreme law of the land whereby any law or practices that are contrary to the constitution are null and void. In other words, whenever there is conflict between the provisions of the constitution and any other law, the latter shall be discarded and could not be applicable. To put it differently, the FDRE Constitution is at the highest hierarchy of laws whereby all other laws are subordinate laws that are expected to be compatible with it.

The next in the hierarchy of laws are proclamation followed by regulations and directives. In the Ethiopian legal system, generally speaking, proclamations are made by the House of Peoples Representatives. On the other hand, regulations are enacted by the Council of Ministers whereas each Ministry makes directives. That means, proclamations are enacted by the law making organ of the government while the executive branch makes regulations and directives.

Therefore, the law at the lower hierarchy shall always be consistent and compatible with the law which is in higher hierarchy. Similarly, the law which is at the higher hierarchy shall be applicable in case of conflicts or inconsistencies of laws whereas the law at the lower hierarchy should not be applicable whenever it conflicts with the law at the higher hierarchy. The following figure would be illustrative of hierarchy of laws under the Ethiopian legal system.

***Figure: Hierarchy of Laws under the Ethiopian Legal system***

Constitution

Directive

Regulation

Proclamation

*Example:*

*Assume that the directive enacted by the Ministry of Education conflicts with the Higher Education Cost-sharing Council of Ministers Regulation (Council of Ministers Regulation No. 91/2003), then the latter shall be applicable since regulations are the higher hierarchy than directives. Similarly, if the above-cited regulation is inconsistent with the Higher Education Proclamation No. 650/2009, the regulation would not be applicable since regulations are at the lower hierarchy than proclamations. Finally, if proclamation no. 650/2009 is found to be inconsistent with the FDRE Constitution, it should be considered as null and void since the Constitution is the supreme law of the land.*

# Summary

The chapter dealt with some introductory remarks about the law. Particularly, it discussed the classification of laws in to international and domestic laws as well as private and public laws. The chapter has also dealt with various laws under each classification. Moreover, we tried to see, in brief, the meaning and nature of business law. Apart from this, the process of making laws by the legislative branch of the government has been discussed under this chapter. Thus, we looked at the whole process of law making from its initiation to its publication under the Negarit Gazette. Hierarchy of laws was the last section in this chapter where the hierarchy of various laws in the Ethiopian legal system was addressed.

# Self Test Questions 1

1. **Choose the Best Answer from the Alternatives**
2. Of the following, one is **not** the subject matter of business law
3. Family Law
4. Law of sales
5. Insurance law
6. Law of Agency
7. None
8. Which of the following branch of law is **not** a private national law?
9. Law of Contract
10. Law of Property
11. Criminal law
12. Property law
13. None
14. Which of the following is NOT a correct illustration?
15. Regulation – Council of Ministers
16. Proclamations- Council of Ministers
17. Directives – Ministries
18. Proclamations- House of Peoples Representatives
19. B&D
20. Which of the following deals with rules of litigation?
21. Property law
22. Procedural law
23. Criminal law
24. Substantive law
25. B&C
26. Which of the following is a right sequence of laws from the lower to the higher hierarchy?
27. Directive- Regulation- Proclamation- Constitution
28. Regulation- Proclamation- Constitution- Directive
29. Constitution-Proclamation- Regulation- Directive
30. Regulation- Proclamation- Constitution- Directive
31. None
32. Which of the following is TRUE about the law making process in Ethiopia
33. Initiation – Ratification – Deliberation – Publication
34. Publication – Deliberation – Ratification - Initiation
35. Initiation - Deliberation – Ratification - Publication
36. Initiation – Deliberation – Publication – Ratification
37. None
38. **Matching**

A B

1. Private international law A. Law of Contract
2. Public National law B. Citizens and the government
3. Public international law C. Regulate different countries
4. Local law D. Govern different citizens of a nation

E. Govern citizens of different nations

F. Property law

G. Land law of Oromia region

G. the Penal law of Ethiopia

# UNIT TWO

# LAW OF PERSONS

|  |
| --- |
|  |

**Introduction**

* Dear students! This is the second unit of the course on business law for non-law students. In this Unit, you will be dealing with the concept of personality. In so doing, the unit will be addressing the beginning point of personality. This shall be followed by an explanation on the concept of personality. The concept of personality is a fundamental one in law. One may even consider it as the most fundamental one as it provides for the definition of those beings or things, either natural or artificial, which will be bound by the law. Thus, it is quite imperative to learn on personality in somewhat depth manner as it lays down a corner stone for all subsequent discussions.

# Unit Objectives

**After successful completion of this Unit, you will be able to**

* discuss the concept of legal personality;
* explain the beginning point of personality;
* identify the types of persons; and
* discuss certain attributes of personality

## 2.1. The Concept and Nature of Personality

### 2.1. 1. Personality

* Dear students what do you understand by personality?

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

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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

###### 

* + 1. **The Nature of Personality**

The word "person" has a different meaning in law than the ordinary connotation of the word "human being". "Person" is a legal concept and we need to study the law to define and identify what do we mean by person and who are persons. A person is anything recognized by law as capable of bearing rights and duties. Only persons can undertake juridical acts. Juridical acts are undertakings that have protection of the law. “Person” is a legal concept that is conferred on human beings and entities by law. Thus, a person is anything that can have legal relations with each other.

There are two kinds of personality under the preview of law. These are Natural/ Physical and Legal/Artificial persons. Legal personality is an artificial or fictitious persons created by law in order to confer rights and corresponding duties. All entities recognized by law as capable of being parties to a legal relationship are legal persons. Thus, a legal person can be an association, an organization, a company, group of persons, government institution and etc. The state is recognized by law as a person. Provided that they are given personality by law, these entities are persons and can have legal relations with each other.

Acquisition of legal personality: Legal personality is an artificial or fictitious creation of law. Aartificial persons acquire legal personality in different mechanisms, including:

* Issuance of a particular legislation,
* Carrying out registration and conditions of publicity.

For instance, public offices will start to have personality upon the enactment of establishment proclamation or regulation with no other conditions attached to it. On the other hand, private business organizations have to be registered with a competent public authority in order to acquire legal personality. They should also comply with publicity requirements.

Once the entities get legal personality they are

* Recognized as equal before the law with the human person.
* Can perform juridical acts, bears a right and assume an obligation like the physical persons.
* Do have their own names and separate legal existence.
* Enjoy effects of personality by the help of physical persons that act through a representative capacity.
* Dear students, what are the attributes of legal personality?

**The following are some attributes of legal personality**

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

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

1. A legal person may sue or be used in its own name. To sue is to bring a legal action against another. If three people A, B and C form a company, after a company has satisfied the legal requirements for the acquisition of legal personality (after it has become a legal person), it brings legal actions (legal suits) against others in the name of the company, not in the name of A, B or C. Thus, there is a distinction between the liability of the company and the liability of individual persons forming it.

3). The same can be said about contractual relations that may be entered in to by a legal person. We have already seen that a legal person is an entity that can be a party to a legal relationship; therefore, a legal person can enter into contracts with another company or with a physical person (Human being). The rights acquired and liabilities incurred as the result of the contract, remains the rights or liabilities of the company. It is the company that is either the creditor or the debtor of a third party.

4). A legal person has an obligation to pay taxes on its property and any other income. We have already noted that a legal person may own property in its own name. Similarly, we know that a legal person may carry on business. In the same way that a physical person pays tax on his income, a legal person is also required to pay tax on any income it derives.

## 2.2. Natural Persons

### 2.2.1. Commencement of Personality

* **Dear students**, when does personality begin for human persons (natural persons)?

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

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

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

* **Dear students**, when do you think does personality begin?

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

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

Birth means a complete extrusion of the child from its mother’s womb. Whether the extrusion is natural or by an operation like the Caesarean, it makes no difference. Under the Ethiopian law, birth is sufficient in itself to confer personality. No other conditions are laid down in this respect. Once a human baby is born, it is a person.

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

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

* **Dear students**, under what condition does the interest of a baby in the womb be affected?

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

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

**Art. 842(1) First Relationship**

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

**Art. 843**

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

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

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

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

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

b) The child shall also be born viable

* **Dear students**, what does the term ‘viable’ envisage?

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

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

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| ☞ **Dear students, please take note of the following legal terms**  **Presumption** means a legal or factual conclusion drawn from the existence of certain facts.  **Rebuttable presumption** is a presumption that drawn from the proof of facts or circumstances and stands as established fact until a contrary fact is proved.  **Irrefutable presumption** is a presumption that cannot be proofed to a contrary fact. |

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

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

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

* **Dear students**, does it make any difference if the death of the baby is not natural?

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

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

* **Dear students!** Is the enjoyment and exercise of rights the same?

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

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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. The principle governing the holding of rights and duties is that as soon as personality begins, all rights and duties under the civil law are held by an individual even though the person may not exercise such rights personally. All persons enjoy rights without exception, but all persons do not have the same capacity to exercise rights. Some persons have a limited or a restricted capacity. Some persons are incapable of exercising rights.

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### 2.2.2. End of Physical Personality

Death is the only way through which personality can be completely brought to an end, apart from the case where death is established by the court as a result of procedure in order to have absence declared (Art. 172 C. C.).

**🏳 Activity 1**

Dear studentss read the following questions very carefully and give correct answers in the spaces provided.

1**.** Of the following one is not a person.

A. Sole private limited company D. All

B. Ethiopian Women Lawyers’ Association E. None

C. Ministry of Justice

2. For a merely conceived child to be treated as born, all except one shall be met.

A. Interest of the child. D. All

B. Being born alive. E. None.

C. Bing born viable.

3. As a rule when does personality (the capacity of holding rights) begin for human persons?

A. forty-eight hours after birth. D. All.

B. At the first point of conception. E. None.

C. At birth.

4. If a father dies, who is on the first line of relationship to succeed him?

A. Ascendants of the deceased (father and mother of the deceased).

B. Descendants (Children of the deceased).

C. Brothers and sisters of the deceased.

D. All.

E. None.

5. Which of the following is an attribute of personality?

A. Buying a house.

B. Discharging a debt.

C. Concluding marriage.

D. All.

E. None.

# SUMMARY

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

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

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

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## Self-Test Exercise 2

**Part I. True/ False item**

1. Personality is conferred only up on human persons.
2. Normally, a child is considered born only if he lives for forty-eight hours after birth.
3. Receiving donation by the Ethiopian Red Cross Society is an attribute of its personality.
4. The term “personality” refers to the capacity of holding rights and bearing the corresponding duties.
5. Death terminates personality of human persons.
6. The capacity of holding rights and exercising it is simultaneously conferred up on human persons.
7. Only persons are capable of holding rights and discharging duties.

**Part II. Give short answers.**

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

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

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# UNIT THREE

# LAW OF CONTRACTS IN GENERAL

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| General Overview |

* Dear students, this unit deals with the law of obligations. In doing so a brief highlight will be made on the sources of, types and sources of obligations. It would also confer about law of contracts specifically basic requirements for the existence of a valid contract, the effects of lack of essential requirements of contracts in particular and effects of contracts in general, non-performance, remedies for breach of contracts and issues affiliated with it will be treated in this unit.

# Unit Objectives

**After successful completion of this Unit, you will be able to**

* Identify the sources of obligations;
* Define the term "contract";
* Elucidate the difference and similarity of ‘agreements’ and ‘contract’
* Know the difference between legal and contractual obligations;
* Comprehend the four essential requirements for the existence of a valid contract;
* Confer the effects of a validly formed contracts; and
* Explain the remedies available following non-performance of contractual agreements.

## 

## 3.1. Sources of Obligation

Source of obligation indicates from where the obligation emanates. There are two sources of obligations. Obligations may arise either from the law or a contract.

1. **Law as a source of obligations**

Some obligations result from the direct operation of the law. This is to mean that the law itself sometimes imposes obligations on persons. Legal obligations are binding or enforceable on all persons. Legal obligations do not depend on the willingness of persons. Whether you like it or not, you must respect legal obligations.

The following instances explain obligations which make law their source:

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

* **Dear students,** how can an obligation emanate from a contract?

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1. **Contract as a Source of Obligations**

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

* **Dear students**, what is the difference between legal obligations and contractual obligations? (You can use the spaces left below to give your answers)

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

* **Dear students,** what is a contract?

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

* **Dear students**, how is the term contract defined under our law?

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

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The pertinent provision of the Ethiopian Civil Code which defines the term ‘contract’ is Art. 1675. It reads:

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

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

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| ☞ The definition of a contract contains the following elements.   1. An agreement; 2. Two or more persons; 3. Obligation; and 4. Proprietary nature. |

The first element in the definition is that a contract is **an agreement**. It is something willingly undertaken. Contract is not something imposed on. Nobody forces you to make a contract. You make a contract only if you are willing to do so. Accordingly, a contract is the result of free will of Contractants.

**Two or more persons**; Parties to a contract are always persons. They may be legal or physical persons. To a contract the persons shall be two or more parties. This excludes promise of a person for him/herself from the domain of contracts.

All contractual agreements **create obligations**. If no obligation is created in an agreement, that agreement is not a contractual agreement. The freedom of the parties is not limited to the creation of obligations. After creating obligations, contracting parties may want to **vary (change)** some terms of their obligations. They are free to do so. Obligations created by two contracting parties may be varied only by those two parties. Contracting parties can create and vary obligations freely. In addition, they can **extinguish** **obligations;** they can bring the obligations to an end totally by their agreement. Parties to a contract create obligations only as between themselves, without affecting the interest of a third party.

The obligation in a contract should bare **proprietary nature** that means it shall have a pecuniary effect. The obligation created aims at economic benefit not at social or moral values. For instance, ‘eder’, ‘debo’ , invitation for dinner, etc are not contracts for they basically meant to serve social or moral value.

Now it is safe to conclude that for an agreement to be a contract it has to meet the above mentioned criteria. If it fails to pass those tests it can be an agreement but not contract.

**🏳 Activity 2**

**Dear students read the following questions very carefully and give correct answers in the spaces provided.**

1. Which of the following is an obligation arising from the law?

A. Obligation to give military service D. All

B. Obligation to supply maintenance. E. None.

C. Obligation to pay taxes.

2. From the list which one is a contract?

A. Buying a pen. D. All.

B. Taking a taxi. E. None

C. Buying a house.

3. All except one make part of the definition of a contract.

A. Agreement.

B. Two or more parties. D. It is meant to create an obligation

C. Binding non-parties to an agreement. E. None.

4. Obligations of a proprietary nature means

A. Obligations devoid of market value. D. All.

B. Obligations having monetary value. E. None.

C. Things which are not amenable to physical appropriation.

5. In what respect do obligations emanating from the law are different from those of contracts

A. Obligations from the law are based entirely on agreement. D. All.

B. Obligations from the law are impositions. E. None.

C. Consent of a person to discharge an obligation is paramount.

## 3.2. Requirements for the Existence of Valid Contracts

1. **Formation of Contracts**

Dear students, did you remember the definitional elements of a contract, which distinguishes it from ordinary agreements, in Ethiopian law? It is not sufficient for contracts to be enforced for the mere fulfillment of definitional tests. All jurisdictions set their own respective essential conditions for a contract to produce effect i.e. to get legal protection.

* **Dear students**, what are the requirements for the existence of a valid contract in Ethiopia?

To grasp this point read the following provision of the Ethiopian Civil Code:

**Art. 1678 C.C.** - Elements of contract

*No valid contract shall exist unless:*

1. the parties are capable of contracting and give their consent sustainable at law;
2. *the object of contract is sufficiently defined, and is possible and lawful;*
3. *the contract is made in the form prescribed by law, if any.*

In line with the above provision of the Civil Code, no valid contract shall exist unless four essential conditions are satisfied. If these elements are not met the contract becomes invalid: Either voidable or void

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| ☞These basic or essential elements of contract are:  1) Consent  2) Capacity  3) Object; and  4) Form |

Let us see these essential requirements one by one.

**1. Consent**

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

**Art. 1679 C.C. Consent necessary**

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

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

* **Dear students**, how is consent expressed?

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

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There are two theories of consent of the parties: the ***objective*** and ***subjective*** theories**.**

The subjective theory of contract gives emphasis that the true intention of the parties can be only ascertained by whether each party subjectively intended to make the contract. This theory primarily focuses freedom of contracts. Proponents of this theory affirm that parties should not be liable beyond what was not intended during the conclusion of contracts.

On the other hand, objective theory holds that the true intention of the parties to a contract is to be ascertained from their ‘words and conduct’ rather than their unexpressed intentions. To ascertain whether parties consented to the terms of the contract it is only based on the declared will of the parts which are determined by analyzing external evidences. This theory focuses on security of contracts which in turn refutes the ability of humans to read the mind or the intention of another unless expressed.

Consequently, the Ethiopian law has adopted chiefly the theory of declaration without totally ignoring the subjective one. Therefore, the consent of the parties must be declared: the contract is completed when the parties have expressed their agreement. But if the consent of the parties is affected by any defects it is susceptible to invalidation.[[1]](#footnote-1)

Consent is expressed through offer and acceptance.

1. **Offer and Acceptance**

* **Dear students**, what is an offer? (You can use the spaces left below to give your answers)

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Offer expresses the willingness of the offeror to enter into contractual agreement regarding a particular thing. It is a promise which is conditional upon an obligation (to give something or to do something), a forbearance (to refrain from doing something) or return a promise that is given in exchange for the promise or its performance.

* **Dear students**, how can an offer be declared?

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

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Offer may be declared in writing, orally or by using sings (physical movement) or conduct.[[2]](#footnote-2) Social invitations or invitations to social affairs are not “offers” in the eyes of the law. An offer is a definite statement by one party called the offeror, of the terms under which he will contract. It typically consists of a promise or commitment by the offeror to give something, to do something or not to do something (to refrain from doing something) in the future.

The acceptance of social invitation, such as an invitation to go to dinner, does not give rise to legally binding contract. Likewise an extravagant offer of a reward made in the heat of excitement cannot be acted upon as an offer.

There are also some instances that appear to be “offers” but not offer in the legal sense. Ordinarily, a seller sending out circulars or catalogues listing prices is not regarded as making an offer to sell at those prices, but merely indicating willingness to consider an offer made by any person on those terms. This principle is also applied to merchandise that is displayed with price tags in store windows and to most advertisements. However, it must be noted that there are also implied terms. Although an offer must be definite and certain, not all of its terms need to be express. Some of the omitted terms may be implied by law.

The offer must be communicated to the offeree. Until the offer is made known to the offeree, the offeree does not know that there is something that can be accepted. To be effectively communicated the offer must be made verbally, or indicated by the actions of the offeror or authorized agent. If the offeree learns of the offeror’s intentions from some other source, no offer results because no offer has been communicated. In addition to intention to create a binding obligation, an offer must be definite and certain to be enforceable. If a vague or indefinite offer is accepted, courts will not enforce the apparent agreement against either party.

Very often, an invitation to negotiate is confused with an offer. There are also some instances (cases) that appear to be offers but not offer in the legal sense. There are cases called declaration of intention. In this regard, Art. 1687 of the Civil Code provides the following:

**Art. 1687**

No person shall be deemed to make an offer where:

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

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

Read the following provision of the civil code very carefully.

**Art. 1688**

* 1. Whosoever offers a thing for sale by auction shall be deemed to make a declaration of intention and not an offer.
     1. *In such a case, the contract shall be completed only when the thing is knocked down upon the last bid being made.*

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

**Acceptance**

So far, the discussion was on the rules relating to offer. Do we have similar rules governing acceptance?

On the other hand, an acceptance is unequivocal agreement of the other party, called the offeree, to the proposal stated by the offeror. When the offeror expresses a willingness to enter into a contractual agreement, the offeree has many choices: he may ignore, accept or reject the offer extended to him. Acceptance of an offer is a manifestation of one's agreement to the terms of the offer in a manner invited or required. It is measured by outward manifestation. Reservations or restrictions intended by one party shall not affect his agreement as expressed. The offeree must manifest his acceptance (his agreement to the proposal) in a manner that is clear. In other words, acceptance must be definite and certain. The offeror is entitled to know whether the offeree accepts the offer.

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

* **Dear students**, how do you express your acceptance?

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

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In the absence of a contrary requirement, an acceptance may be indicated by an informal Ok; by a mere affirmative nod of a head, or by performing the act called for. Acceptance of an offer can also be shown by conduct. But it must be clear that the offeree intended to accept the offer. An offer may be accepted only by the person to whom it is directed. If anyone else attempts to accept it, no contract with such a person arises. If the offer is not directed to a specified individual, but to a class of persons, any person within that class can accept it. If the offer is made to the public at large, any member of the public may accept it (public promise of rewrd)[[3]](#footnote-3).

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

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

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

* **Dear students**, when does the exceptional case under Art. 1684 come in to application?

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

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Likewise Art. 1684 deals with the cases where the offeror and the offeree have pre-existing business relation/s. There are two conditions to be met so as to apply the aforementioned provision. These are:

1. The offer to extend the contract must have been made in a special document (a document prepared for the purpose of making an offer); and

2. The offeror must specify the time within which he expects the response of the other. If the offeree does not respond within a reasonable period of time, the offer shall be deemed to have been accepted.

* **Dear students,** When does an offer terminate?

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

a) Revocation b) counter – offer

c) Rejection d) lapse of time

e) Death, disability or declaration of absence of either party.

1. **Revocation**

* **Dear students**, how and when can an offer be terminated?

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

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

But there is very important question that should be answered: when does revocation become effective? Is it when the letter of revocation is dispatched (mailed), or is it when the letter is accepted by the offeree? There are two theories: the theory of dispatch and the theory of reception.

According to the theory of ***reception***, a letter or telegraph revoking an offer to a particular offeree is not effective until it is received by the offeree. It is a revocation neither at the time it is written by the offeror nor even when it is mailed or dispatched. On the other hand, the ***dispatch*** theory states that revocation is effective only up to the time the letter is mailed or dispatched. The second theory (dispatch theory) is supported by Art.1692 (1) of the Ethiopian Civil Code.

1. **Lapse of time**

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

1. **Counter offer**

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

1. **Rejection**

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

1. **Death, disability or declaration of absence of either party**

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

1. **Defects in consent (vices of consent)**

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

**Mistake**

According to Art. 1696 of the Civil Code a contract may be invalidated where a party gave his consent by mistake.

* **Dear students**, what do you understand by the term mistake?

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

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

* **Dear students**, when is mistake considered to be decisive or fundamental?

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

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

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

Under the Ethiopian Civil Code, mistakes relating to the motives of the parties and arithmetical errors are the only mistakes considered as non-fundamental.[[4]](#footnote-4) Arithmetical mistake are errors in computation (calculation), typing errors, etc. Motive is something you have in mind. You may have a purpose for making a given contract. As long as your motive is not communicated to the other party, it does not affect his interest.

**Fraud**

**? Dear students**, what is fraud?

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

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

**Art. 1704. Fraud**

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

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

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

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

**Duress**

**🖎 Dear student,** what is duress?

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

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

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

**🖎 Dear student**, is the list under Article 1706(1) exhaustive?

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

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

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

**🖎 Dear learner**, What is an imminent danger?

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

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

**🖎 Dear learner**, What about the ‘seriousness’ of a danger?

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

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

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

**Art. 1707**

1. A contract may be invalidated on the ground of duress not withstanding that duress was exercised by a person other than the party who benefited by the contract.

**Art. 1708 - Threat to exercise a right**.

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

A person is usually not guilty of duress when the act or threat is to do something the person has a legal right to do. For instance you have a right to threaten the other party with a legal suit if he owes you something. Threat to exercise your right does not constitute duress unless you have obtained an excessive economic advantage there from.

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

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

**2. Capacity**

The second essential element for the validity of a contract is the capacity of the parties. It is the essence of a contract that there should be at least two parties and the contract involves the meeting of two minds. Contracting parties, therefore, must possess the faculty of giving their consent. To undertake any juridical act, an act that have legal effect and protection of the law, requires capacity.

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

**🖎 Dear student**, who are capable persons?

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

Capacity is presumed. Every party to a contract is presumed to have contractual capacity until the contrary is proved. According to Art. 198 of the civil code *“Every physical person is capable of performing all the acts of civil life unless he is declared incapable by the law.”*

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

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

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

**a) Minority**

Art.198 of the Ethiopian civil code and Art.215 of the Revised Family Code defines a minor as a person of either sex who has not attained the full age of eighteen years. Minors are treated differently by the law than adults when it comes to capacity to contract. Minors are given special protection under the law. For their own protection, minors are restricted in their freedom to contract.

**🖎 Dear learner**, why does the law protect minors?

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

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

The following provisions are reproduced from the Ethiopian Civil Code.

**Art. 199**

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

**Art. 313 - Principle**

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

**Art. 314 - Application for nullity**

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

**Art. 318 - Mere statement of majority**

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

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

**b) Insanity and Infirmity**

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

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

**🖎 Dear learner**, Who is an insane person?

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

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**Art. 339 – Definition**

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

An insane person is one who, as the result of insufficient development of mind or as the result of mental disease or senility, is not capable to understand the consequences of his actions. To determine the effect of insanity on the juridical acts of persons, the law classifies insanity into Notorious and non-notorious. A person is deemed to be notoriously insane where; by reason of his mental condition he is an inmate of a mental hospital or of a nursing home for the time for which he remains an inmate.

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

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

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

Non- notorious insanity does not give rise to the invalidation of a contract as of right. In order to avoid a contract, the insane person or his tutor is required to show that at the time of contract he was not in a position to give consent free from defects.The fact that the juridical act of a notoriously insane person is not binding on him does not mean that he is also free from extra contractual liability. He is liable extra contractually as though he were of sound mind.

**c) Judicial Interdiction**

**🖎 Dear learner**, what is judicial interdiction?

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

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Judicial interdiction is the withdrawal of a person’s legal capacity by the order of the court to protect his interest, or the interest of his presumptive heirs. Judicial interdiction may also be pronounced in the case of a person who is unable through permanent disability to govern himself or to administer his estate (Art. 340 and 354 and 351 civil code). A distinction must be drawn between judicial interdiction and legal interdiction. According to Art.380 of the civil code, a Person interdicted by law is one from whom the law withdraws the administration of his property as a consequence of a criminal sentence passed on a person. Judicial interdiction may be demanded by the insane person himself, by his/her spouse, by any relative by consanguinity or affinity or by public prosecutor as it is indicated under Art.353 of the Ethiopian civil code.

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

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

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

3.3. Object of a Contract

**🖎 Dear Student!** what do you think is an object of a contract?

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

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**Art. 1711 - Determination of object**

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

Object of contract means obligations undertaken by the contracting parties. Contracting parties are free to create and to determine the nature (terms and conditions) of their obligations, termed as freedom of contracts. Nobody shall determine a contractual obligation to the contracting parties as it is also clear from the reading of the Art.1675 defining the term ‘contract’. But their freedom is not absolute. There are restrictions and prohibitions provided by law. Contracting parties cannot violate public policy in determining their obligations. They cannot create obligations against the moral values of the society.

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

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

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

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

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

* The object of a contract must be possible to be performed at the time of conclusion. A contract shall be of no effect where the obligations of the parties or of one of them relate to thing or fact which is impossible and such impossibility is absolute and insuperable. For example, suppose that A entered in to a contract with B. The obligation that A assumed to discharge is to deliver the moon in consideration for a price which is agreed to be one million birr. You cannot imagine performance of a contract the obligation of which one of the parties assume to discharge is not possible. Parties to a contract may undertake impossible obligations, something that cannot be carried out. This may be the result of superstitious beliefs. Whatever the reason, if the obligation is absolutely impossible, the contracting parties demand the contract to be declared void. Void contracts are contracts with no legal recognition from the beginning: ‘void abinitio’.
* The object of contract must be lawful.

Where the obligations of parties or of one of them are unlawful or immoral, the contract is void. The relevant provision of the Ethiopian civil code is Art. 1716. The object of contract must be lawful. If the object of the contract is not lawful, the contract shall have no effect. You know that contracting parties are free to determine their obligation. But that does not mean that they may contract entirely as they wish. The formation, purpose and performance of contract must be lawful. Contracting parties have no right to violate the moral standards of the society and laws of the state under the veil of conclusion of contracts.

1. **Form of a Contract**

Contracting parties have a freedom of choosing the form of their contract unless the law specifies or parties agreed a special form for certain contracts (Art.1719). Where a special is expressly prescribed or agreed such form shall be observed failure leave the contract with no effect but a mere draft. Most contracts are oral. Many are made by telephone. Others are made and carried out in a single face to face conversation.

**🖎 Dear Student**, what are the types of contracts required to be made in a special form?

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

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

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

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

**Art. 1723 - Contracts relating to immovable**

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

**Art. 1724 - Contracts with a public administration**

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

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

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

**🖎 Dear Student**, what are preliminary contracts?

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

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**Art. 1721 - Preliminary contracts**

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

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

**Art. 1722 - Variations**

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

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

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

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

**Effects of Contracts**

**🖎 Dear Student**, what do you think are the effects of validly formed contracts?

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

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

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

## Interpretation of Contract

**Art. 1733 - Limits of interpretation.**

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

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

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

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

A contract is to be enforced according to its terms. The court must examine the contract to determine what the parties intended during conclusion of the contract. The court must give effect to their intention. It is the intention of the parties as expressed in the contract that must prevail. The impression of one contracting party has no effect unless communicated to the other.

* Where the provisions of a contract are not clear, the common intention of the parties must be sought. The general conduct of the parties before and after the contract shall be taken into consideration. This means that it is by studying the history of the contract (negotiations, discussion before the contract) that one can determine the common intention of the parties.
* The contract should be considered as a whole. The provisions of a contract shall be interpreted through one another. Each provision shall be given the meaning required by the whole contract.
* Provisions capable of two meanings shall be given the meaning to render them effective rather than the meaning which would make them void. The court must give a meaning to make the contract valid.

* The word debtor means a person who makes performance. In cases of doubt, a contract shall be interpreted against the party who stipulated the obligation or against the party who drafted the contract. This interpretation is also called strict interpretation. This rule applies in contracts of adhesion, such as insurance policy (insurance contract) where one party stipulates conditions of contract in advance.

**Activity 3**

**Dear students read the following questions very carefully and give correct answers in the spaces provided.**

1. Which one of the following is not an essential condition for the existence of a valid contract?

1. Form B. Consent C. Object D. Capacity E. None

2. One of the following contracts shall be made in written form so as to sustain validity.

* 1. Contracts concluded for the sale of 100 sacks of teff.
  2. Contracts entered in to with the Ministry of Education
  3. Contracts of guarantee
  4. B and C
  5. A and B

3. What vice vitiates consent of a contracting party?

A. Mistake D. All.

B. Duress. E. None.

C. Fraud.

4. A contract which is made in written form shall:

A. Be attested by at least three witnesses. D. All.

B. Be signed by the contracting parties. E. None.

C. Be always registered.

5. For a valid contract to exist its object shall:

A. Be sufficiently defined. D. All.

B. Be possible to perform. E. None.

C. Be lawful and moral.

## Performance of Contracts

**🖎 Dear Student!** How do contracting parties perform their contract?

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

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

**Art. 1740** - Performance by whom

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

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

**🖎 Dear Student!** Who shall receive performance?

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

**Art. 1741** - Payment to whom made

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

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

**Art. 1743** - Payment to unqualified person

1. Payment to a person unqualified to receive it on behalf of the creditor shall not be valid unless the creditor confirms it or such payment has benefited him.
2. *Payment shall be valid where it is made in good faith to a person who appears without doubt to be the creditor.*

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

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

**Art. 1745** - Identity of the object

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

**Art. 1747** - Fungible things

1. Unless otherwise agreed, the debtor may choose the thing to be delivered where fungible things are due.
2. The debtor may however, not offer a thing below average qualify.

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

Where the debtor had undertaken to deliver a fungible thing, the applicable rule is different. Fungible things mean a class of things, which has within that class, different qualities but serve the same purpose. Wheat is the name of a class. There are different varieties, qualities within this class of wheat. Where the contract mentions only the name of a class the obligation of the debtor (seller) is not the same.

**🖎 Dear Student!** Where and when Performance shall be made?

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

**Art. 1755** - Place of payment

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

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

**Art. 1756** - Time of payment

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

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

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

**Art. 1758(1)** Transfer of risk

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

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

**Non-Performance of Contracts**

**🖎 Dear Student!** What is non-performance?

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

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

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

**Art. 1772:** A party may only invoke non-performance of the contract by the other party after having placed the other party in default by requiring him by notice to carry out his obligations under the contract.

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

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

**🖎 Dear Student!** What are the cases where default notice is not necessary?

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

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

**Art. 1775**

Notice need not be given where:

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

In all the above cases, the creditor need not give notice to the debtor. If a party who had undertaken not to do something violates his agreement, the injured party can exercise his right without giving notice. Secondly, where the contract was agreed only to be performed within a given period of time, the creditor can institute action without giving notice upon the expiry of the period. Third is ‘anticipatory breach of contract’ which implies breach of contract before due date. If your contracting party informs you in writing that he is not going to deliver or pay, you don’t have any reason to wait for the due date because you already know his intention. The last case is the result of your agreement. If you agree at the time of contract to avoid notice, your agreement is respected.

**🖎 Dear Student!** What are the remedies for non-performance of contractual agreements?

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

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

a) Require the enforcement of the contract, or

b) Require the cancellation of the contract,

c) Cancel the contract unilaterally, and

d) Require that damages caused to him by non-performance be made good.

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

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

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

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

**b)Cancellation of a Contract**

**🖎 Dear Student!** What do you think is cancellation of contract?

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

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

**c) Damages (Monetary Compensation)**

Compensation may be awarded to the injured party independently or in addition to other remedies. Compensation may be ordered as an adequate (sufficient) remedy by itself. If a contract is cancelled, there is something that the other party loses. Therefore, compensation may be ordered even if the contract is cancelled. If a contract is enforced (if specific performance ordered), there is a time gap between due date and the time of enforcement. There is also a possibility that the creditor may lose something. Accordingly, the purpose of compensation is to re-establish that balance that was disturbed by non-performance. Compensation is not awarded whenever a contract is breached. It is awarded only when the non-performance has caused the creditor to suffer some economic loss.

**🖎 Dear Student!** Is there any case where by compensation may not be paid by the non-performing party? (You can use the spaces left below to give your answers)

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

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

**🖎 Dear Student!** What is force majeure?

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

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

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

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

1. The unforeseeable act of a third party for whom the debtor is not responsible.
2. An official prohibition preventing the performance of contract.
3. A natural catastrophe such as an earthquake, lightning or floods.
4. International or civil war.
5. The death or serious accident or unexpected serious illness of the debtor. Illness that existed at the time of contract is not force majeure. That is the meaning of “unexpected serious illness.”

The following shall not be deemed to be cases of force majeure unless agreed in advance:

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

It has to be remembered that force majeure relieves the debtor from pay compensation for delay or non-performance but he/she has to perform his obligation as per the contract.

**Activity 4**

**Dear students read the following questions very carefully and give correct answers in the spaces provided.**

1. Who shall bear the costs in performing contractual obligations?

* + 1. The creditor C. both the debtor and creditor
    2. The debtor D. None

2. When is serving default notice to the non-performing party not necessary?

1. When it is agreed in the contract that it is not necessary.
2. When the debtor has declared in writing that he would not perform his obligation
3. When the obligation assumed is to refrain from doing certain acts.
4. A and B
5. All

3. One of the following does not describe non-performance of contractual agreements.

1. X undertook (agreed) to deliver 50 sacks of sugar, but only half of it was delivered at the agreed time and place.
2. Y failed to provide raw materials, in line of their agreement, to a creditor shoe factory.
3. Z declined to sale the items in his shop at the price labeled up on them.
4. A and C
5. None

4. Damages or monetary compensation is ordered only when:

A. The debtor fails to perform an obligation due to his fault.

B. Failure of the debtor to perform an obligation is not attributable to *force majeure*.

C. Non performance is due to foreseeable acts of the debtor.

D. All

E. None.

5. Risk of loss or damage of a thing which is made the subject matter of a contract may pass to the creditor when either of the following takes place.

1. When the thing is delivered to the creditor.
2. When the debtor fails to deliver the thing in line with terms of their agreement.
3. When the creditor fails to take the handing over of the thing in pursuance to their agreement
4. B and C
5. A and C

# SUMMARY

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

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

Interpretation is a process whereby uncertainties in the words of contract are resolved. Provisions of contract are interpreted only if they not clear. When interpretation becomes necessary, contracts must be interpreted in accordance with good faith, to give affect to the common intentions of the parties, by reading the whole contract. It must also be interpreted in a manner that favors the debtor and a party who does not benefit from the contract.

Contractual obligations must be carried out as agreed. Contract may be performed by the debtor in person or by a third party. Payment may be made to the creditor or his agent. Payment to unauthorized person does not release the debtor. If the debtor is in doubt as to who should be paid, he can refuse payment and can deposit the amount with the court. The debtor must deliver the exact thing. Delivery of a different thing does not release him. In the case of fungible things, the debtor may choose the exact thing to be delivered, but must choose a thing of an average quality.

Place and time of performance may be agreed. If not agreed, legal provisions shall apply. Risk of loss or of damage to the thing passes from the debtor to the creditor when the thing is delivered. If the creditor is in default for not taking the thing, risk of loss may pass before delivery. Variation of contract is the right of the contracting parties. Courts of law may vary contracts only under very few exceptional cases provided by law.

Non-performance is a breach of contract or violation of agreement or failure to perform. When a party does not carry out his obligations under the contract, the other party may exercise his right arising out of non-performance. But before exercising his right, he must put the non-performing party in default by giving notice. Notice is a necessary measure before going to court. If the debtor does not carry out his obligations within the time limit fixed in the contract, the next step is the institution of a legal action. When you institute a legal action, the court may make different orders. It may order specific performance cancellation of contract or award compensation to the injured party. These are the effects of non-performance or remedies for non-performance. Specific or forced performance is ordered only if the performance of the debtor is important to the creditor and only if the enforcement does not affect the personal liberty of the debtor. Cancellation of contract may be with or without the decision of the court. A contract may not be cancelled unless fundamental provision of a contract is breached. Monetary compensation may be ordered where the non-performance (breach) has caused the other party to lose something economically. A party who fails to perform his obligations under the contract is liable to pay compensation. The debtor is released only if his non-performance is the result of force majeure.

# SELF- TEST EXERCISES 3

**Part I. True/False item.**

1. For mistake to be invoked as a ground of invalidation, it must be both fundamental and decisive.

2. Contracts that one can make with a public administration shall always be made in written

form.

3. The respective obligation of contracting parties is its object.

4. Written form is the only valid way by which a contact is concluded.

5. For a court to order specific (forced) performance, it shall be of special interest to the creditor

and shall not affect the personal liberty of the debtor.

**Part II. Give short answers.**

1. X declared to his friend B that he is going to give 50000.00 birr to Y (his other friend). The

moment this declaration was made Y was not around. Was there any contractual relationship between Y and X?

2. Distinguish between contractual and social obligations.

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

4. What is the difference between subjective and objective theories of consent? Which one is adopted by the Ethiopian contract law?

5. Explain interpretation of contracts in your own words.

6. Compare and contrast obligation emanates from law and agreements.

7. Discuss the difference between legal and contractual remedies of non-performance.

# UNIT FOUR

# Law OF AGENCY

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|  |

# Introduction

Agency is a relationship based up on an express or implied agreement by which one person, the agent, agrees to act for another person, the principal, in negotiating and making contracts with third parties. Agency relationship is a fiduciary relationship which results from manifestation of consent. It is created in different ways. It can be created by contract or by operation of law, or even by decision of a court of law.

# 🏳 Unit Objectives

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

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

## 4.1. Definition and Scope of agency power

### Definition

**🖎 Dear learner!** What is agency?

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

**Article 2199**- Definition

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

Though the above provision seemingly indicates that agency power emanates from the agreement of the parties, it does not mean that contract is the only source of agency power. The civil code under its Article 2179 clearly states that the main sources of agency power are two: the law and contract. The authority to act on behalf of another may result from agreement. In this regard, an agency relationship is created by mutual consent of two parties. It is a relationship where two persons have agreed that one of them is to act on behalf of the other to effect contractual, personal or commercial transactions with a third party.

**🖎 Dear learner!** What elements do you note from the above Article defining agency?

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

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**🖎 Dear learner!** what elements do you note from the above Article defining agency?

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

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

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

**b**. Capacity- All the parties to the contract of agency must be capable persons in the eyes of the

law. They must have contractual capacity to enter in to a binding contract.

**c**. Object- Object here means obligations undertaken by the contracting parties. Thus, the

obligations of all the contracting parties to the contract of agency must be sufficiently defined.

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

Principal- agent relationship may also be created by ratification.

**🖎 Dear learner!** What is ratification?

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

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

Read the following civil code provision.

**Article 2190**: Abuse or lapse of power

1. *Contracts made by an agent in the name of another outside the scope of his power may be ratified or repudiated at his own option by the person in whose name the agent acted.*
2. *The provisions of sub-article (1) shall apply where the agent acted under an authority which had lapsed.*

**Article 2192**: Effect of Ratification

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

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

**🖎 Dear learner!** Who are the parties to the agency relationship?

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

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There are three persons that are involved in the contract of agency; the agent, the principal and the third party. The agent is a person who makes contracts for and on behalf of another person. The principal, on the other hand is a person that authorizes the agent to represent him and to act in his name. The third party is a person that enters in to a contract with the agent.

Even though three persons are involved only two of them are contracting parties. The agent is not a contracting party because he simply serves as a tunnel via whom the interest of one party passes to the other.

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

**🖎 Dear learner!** How can agency power emanate from the law?

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

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

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

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

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

A contract that exists between a salesman and a trader is a contract of employment. But the very fact that a salesman is placed in the store empowers him to represent the trader for the purpose of selling and receiving goods. A salesman may demand that goods sold by him are to be paid to him, unless payment is to be made to a special account. However, a salesman may not demand payment outside the store unless so expressly authorized or unless he produces a receipt signed by the trader.

**🖎 Dear learner!** Who may be a principal?

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

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

**🖎 Dear learner!** Who may be an agent?

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

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There are two arguments regarding the capacity of a minor. Some people argue that all parties to

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

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

**🖎 Dear learner!** What is the form of contract of agency?

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

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

**Article 1719**: Form of Contract

* 1. Unless otherwise provided, no special form shall be required and a contract shall be valid where the parties agree.
  2. *Where a special form is expressly prescribed by law, such form shall be observed.*

**Article 2200**: Form of agency

1. *Authority may be conferred upon an agent either expressly or impliedly.*
2. *Where the act to be performed by the agent is under the law to be made in a prescribed form such form shall be complied with in conferring authority upon the agent.*

🖎 Dear learner! What do you observe from the reading of these two provisions of the civil code? (You can use the spaces left below to give your answers)

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

🖎Dear learner! what should the object of their contract be?

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

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

Read the following civil code provision very closely.

Article 1716 - Unlawful or immoral object.

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

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

4.2 Scope of Agency power

🖎 Dear learner! What power or how much authority does an agent have?

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

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**Article 2180**- Scope of the power of attorney

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

**Article 2202** of the Civil Code: Scope of Agency.

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

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

A fundamental rule of law of agency is that the principal is only liable in contract for the authorized contracts of an agent. Whether the agent received the power expressly or impliedly, the effect is the same. The act of the agent performed within the scope of his authority binds the principal.

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

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| **🖎 Dear learner!** Under what conditions do you think is apparent authority holds the principal to third parties? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Read the following provision which is reproduced herein below.

**Article 2195** (c): Liability of the principal

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

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

Read the following civil code provision very carefully.

**Article 2202 (2)**

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

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

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

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

**Article 35** of the commercial code: Powers of Manager.

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

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

**Article 2203**: General Agency.

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

**Article 2204**: Acts of management

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

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

**🖎 Dear learner!** What about special authority?

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

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**Article 2206**: Authority of special agent.

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

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

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

* 1. Unauthorized Agency

🖎 Dear learner! When do you think unauthorized agency occur?

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

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An unauthorized agency occurs where a person who has no authority to do so undertakes with full knowledge of the facts to manage another person’s affairs without having been appointed an agent. Where the agent has acted beyond his power or without authority, the principal may be held liable in accordance with the principles governing unauthorized agency.

Article 2257: Unauthorized Agency.

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

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

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

Article 2264- Duties of the principal

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

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

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

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

**Activity 7**

**Dear learners read the following questions very carefully and give correct answers in the spaces provided.**

1. The act of the agent obliges the principal to third parties except;

A. When the act is made within the scope of agency power. D .All

B. When the act is made in the name of the principal E. None

C. When the act is made in the name of the agent.

2. If the agent acts without a due authority;

A. At the option of the principal, the act may either be ratified or repudiated.

B. The agent is held liable to third parties.

C. The principal is held liable to third parties.

D. A&B

E. All.

3. Agency power can emanate from;

A. Contractual agreements; D. All.

B. The law E. None

C. Decision of courts of the law.

4. Under an unauthorized agency;

A. The principal has given authority before the act is undertaken.

B. The principal’s interest shall require management of his affairs.

C. The principal shall ratify the act done to his benefit.

D. B&C

E. All.

5. Of the following acts one does require specific authorization for the agent to validly act.

A. Bringing or defending court action. D. All.

B. Selling of perishable goods. E. None.

C. Leasing a house for a period of two years.

## 4.3. Duties Of The Agent And The Principal

### 4.3.1. Duties of the Agent

🖎 Dear learner! what do you thick is the duties of the agent towards his principal?

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

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**a. Duty of Strict Good Faith**

***Article 2208*** *Civil Code: Strict good faith.*

1. *The agent shall act with the strictest good faith towards his principal.*
2. *He shall disclose to his principal any circumstance which would justify the revocation of the agency or a variation of its terms.*

🖎 Dear learner! what do you understand by the term “strict good faith?”

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

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The act of the agent performed within his authority is legally binding on the principal. Therefore, the principal places a great trust and confidence in an agent. The agent may not intentionally or negligently act. The relationship between the agent and the principal is not that of a mere debtor and creditor. It is a relationship of trust and confidence. The agent is held to a high standard of honesty. The most important obligation the agent assumes is the obligation to be loyal to the principal. Loyalty may not be defined with precision. It depends much upon the accepted standards in the community. The agent must refrain from placing himself in a position that may encourage conflict between his interests and those of the principal. The agent must put the interest of the principal ahead of his own interest.

**Article 2209** (1): Effect.

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

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

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

**🖎 Dear learner!** What do you think are the sources of these confidential information?

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

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

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

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

**b. Duty to Account**

**Article 2210**: Accounts

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

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

**c. Duty of Diligence**

**🖎 Dear learner!** what standard of care is expected from an agent in discharging his duty?

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**Article 2211**: Diligence required of an agent

1. *The agent shall exercise the same diligence as a bonus pater familias in carrying out the agency as long as he is entrusted therewith.*
2. *He shall be liable for fraud and for defaults in the performance of his duties.*

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

**d. Duty to Perform Personally**

**Article 2215**: Delegation of authority

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

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

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

**Article 2215 (3)** - Delegation of authority

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

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

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

**Article 2264** Civil Code

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

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

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

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

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

**Art. 2209** of the Civil Code

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

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

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

4.3.2. Duties of the Principal

**🖎 Dear learner!** What are the duties of the principal?

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

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**a. Remuneration**

**Article 2219** Civil Code

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

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

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

**b. Duty to Reimburse the Agent**

**Article 2221** - Diligence required of agent.

1. *The principal shall advance to the agent the sums necessary for carrying out the agency.*
2. *He shall reimburse outlays made and expresses incurred by the agent in the proper carrying out of the agency.*

🖎 Dear learner! What is reimbursement?

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

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When the principal appoints an agent, he is required to advance or to give to the agent money necessary for the execution of the agency. It the principal has not advanced the necessary money, the agent may be forced to spend his own money in the interest of the principal. In such a situation, the principal is under duty to reimburse, that is, repay the agent for any expense necessary for the proper discharge of the agency. An agent has a right for reimbursement. But there is a limitation to his right. To get back his money, the expenditure must be reasonably spent. If the expenditure was due to the misconduct or negligence of the agent, he is not entitled for reimbursement. Moreover, the agent may not recover disbursements made on illegal purposes.

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

c. Duty of Indemnity

Article 2222 Civil Code- Liabilities and damages

1. *The principal shall release the agent from liabilities which incurred in the interest of the principal.*
2. *He shall be liable to the agent for any damage he sustained in the course of the carrying out of the agency and which was not due to his own default.*

🖎 Dear learner! What are the two duties of the principal in the above provision?

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

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

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

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

**Liability of the Principal and the Agent**

**🖎 Dear learner!** When the principal is held liable to third parties?

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

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Read the following civil code provision very closely.

**Article 2189** Civil Code: Complete agency

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

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

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

**Article 2206 (2)**

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

**Article 2190**– Abuse or lapse of power

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

2. The principal is liable to third party if he ratifies the contract made by the agent outside the scope of his power. Unless he ratifies such contracts, he is not liable. There is no obligation of ratification. It is optional. If he is not interested, he has another option of repudiation. If the principal repudiates the contract the agent is personally liable to the third party. According to Article 2192 Civil Code, where the contract of the agent is ratified, the agent shall be deemed to have acted within the scope of his power. Under Article 2206 (2) of the Civil Code, the principal may be liable in accordance with the principles governing unauthorized agency.

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

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

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

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

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

**Article 2189 (3)** of the Civil Code provides:

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

🖎 Dear learner, what is the substance of this provision?

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

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

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

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

**🖎 Dear learner!** When is the agent held liable to third parties?

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

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

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

**🖎 Dear learner!** When is the principal jointly held liable with the agent?

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

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The following provision is pertinent with the case at hand.

**Article 2195** - Liability of principal.

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

1. *Where he informed a third party of the existence of the power of attorney but failed to inform him of the partial or total revocation of such power; or*
2. *Where he failed to ask the agent to return the document evidencing the power of agency and failed to seek a judicial decision to the effect that such document was revoked; or*
3. *Where he caused in any other manner, in particular by his statements, behavior or failure to act, a third party to believe that the person with whom he was dealing was authorized to act on behalf of the principal.*

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

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

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

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

4.4 Termination of Agency power

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

**a.** **Revocation**

**🖎 Dear learner!** What is revocation?

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

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Revocation is the withdrawal of the power of the agent.

1. *The principal may at any time restrict or revoke, as regards third parties, the authority he gave to the agent to make contracts in his name.*
2. *Any waving of such rights shall be of no effect.*

*Article 2226 Civil Code*

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

**Article 2228** - Plurality of principals.

1. *Where the agent has been appointed by several principals for a common affair, the revocation of the agent may be effected only by all the principals.*
2. *One of the principals may not without the others consent to revoke the common agent unless such revocation is founded upon a just motive.*

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

**b. Renunciation by the Agent**

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

**Article 2229** - Renunciation of agent

*(1) The agent may renounce the agency by giving notice to the principal of his renunciation.*

*(2) Where such renunciation is detrimental to the principal, he shall be indemnified by the agent unless the latter cannot continue the performance of the agency with out himself suffering considerable loss..*

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

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

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

**Article 2230** Civil Code

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

**Activity 8**

**Dear learners read the following questions very carefully and give correct answers in the spaces provided.**

1. What are the causes for termination of agency power?

A**.** Death of the agent. D. All.

B. Revocation by the principal. E. None.

C. Renunciation by the agent

2. What are the notable duties of the agent?

A. Duty of diligence. D. All.

B. Duty to account. E. None.

C. Duty of strict good-faith.

3. When are the agent and the principal jointly held liable to third parties?

A. When the agent acted with a lapsed authority and is repudiated by the principal.

B. When the principal revokes power of attorney with out informing third parties of this fact.

C. When the agent acts beyond the scope of his power.

D. All.

E. None.

4. Who is held liable if the agent, acting within the scope of his authority, defrauds third parties?

A. The agent himself. D. The third party

B. The principal. E. None.

C. Both of them.

5. One of the following does not fall within the realm of duties of the principal?

A. The duty to account. D. The duty to remunerate

B. The duty to reimburse E. None.

C. The duty to indemnify.

# SUMMARY

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

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

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

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

**Self-test exercises 4**

**Part I. True/Fe item.**

1. Decision of a court of law is one of the sources of agency power.

2. Ratification of agency power means approval of a prior authorized act of an agent.

3. Contract of agency which confers power to purchase a house in the name and on behalf of the

Principal shall always be made in written form.

4. As compared to the general agent’s, special agent has a narrow scope of authority.

5. It is the agent who shall be held liable for the acts of any person whom he appointed without

Authorization.

**Part II. Read the following questions very carefully and answer the questions that follow in the given spaces**.

1. When does the act of an agent bind a principal to third parties?

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

possibilities deal with the instances).

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3. What kinds of acts require specific authorization?

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4. X authorized Y to undertake all his activities (affairs) in Merkato area here in Addis by

representing him as he will not be around for the coming six months.

4.1. What kind of agency power is conferred up on Y?

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4.2. What sort of activities can validly be undertaken by the agent(Y)?

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# UNIT FIVE

# CONTRACT OF SALE

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|  |

# Introduction

Sales is a contract. As a contract the basic or essential requirements for the existence of a valid contract must be satisfied in the sale contract. The provisions of sale contract shall apply to the sale of goods or corporeal chattels or movable things.

# 🏳 Unit objectives

**After successful completion of this Unit, you will be able to**

* explain how sale contract is formed;
* define sale;
* explain the meaning of corporeal chattels;
* identify the obligations of the seller and buyer;
* learn that delivery may be made in different ways;
* distinguish and explain the two ways of transferring ownership; and
* Note that only the owner or his agent may transfer ownership by contract

## 5.1. Formation of Contract of Sale

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

### 5.1.1 Contract of Sale

**🖎 Dear learner!** What is a sales contract?

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

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

What are the elements of this definition?

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

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

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

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

**Article 2267** – Corporeal Chattels

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

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

**🖎 Dear learner!** what are corporeal chattels?

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

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

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

Basically, Sales is a contract whereby the seller delivers a thing and transfers its ownership to the buyer. But what does term “a thing” mean in that definition? A “thing’ is subject matter of sales contact. The “thing” as the subject matter of sales contact refers to corporeal chattels or corporeal movables and the intrinsic parts or elements immovable which can be separated and transferred as corporeal movable.

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

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

**🖎 Dear learner!** To what does the term “thing” refer?

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

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

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

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

**Activity 5**

**Dear learners read the following questions very carefully and give correct answers in the spaces provided.**

1. To what do provisions of sale contract relate?

A. Immovable things. D. All.

B. Land and buildings. E. None

C. Ordinary movable things.

2. What distinguishes contract of sale from other forms of contracts?

A. The involvement of money as a medium of transaction. D. All.

B. The involvement of two parties E. None..

C. The existence of reciprocal obligations.

3. Parties to a contract of sale are:

A. Donor and donee D. All

B. Buyer and seller E. None

C. Pledgor and pledgee

4. Of the following one is not a corporeal chattel.

A. An ox D. All.

B. A chair. E. None.

C. A car.

5. An intrinsic element of an immovable property refers to?

A. Trees. D. All.

B. Crops. E. None.

C. A marble to be extracted.

**5.2. Performance of contract of sale**

**5.2.1: Obligations of the Seller**

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

**a) Obligations to deliver the thing**

**🖎 Dear learner!** what is delivery?

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

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

**b) Obligation to Transfer Ownership**

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

**Article 1184** of the Civil Code states that:

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

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

**c) Obligation of Warranty**

**🖎 Dear learner!** what is warranty?

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

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**Article 2287** of the Civil Code

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

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

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

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

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

The following civil code provision is also pertinent.

**Article 2282** of the Civil Code

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

**🖎 Dear learner!** what is the element of this warranty?

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

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

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

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

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

**🖎 Dear learne**! What is the obligation of the seller under this warranty?

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

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

**🖎Dear learner!** what are the remedies available to the buyer in the case of non-conformity?(You can use the spaces left below to give your answers)

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

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

**🖎 Dear learner!** when do you think is the thing delivered considered to be defective and thus hold the seller liable under the warranty obligation?

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

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

**Article 2289** .Warranty Against Defects

The warranty shall become effective where:

*a. the thing does not possess the quality required for its normal use or commercial exploitation; or*

*b. the thing does not possess the quality required for its particular use as provided expressly or*

*impliedly in the contract, or*

* + 1. *the thing does not possess the quality or specifications provided expressly or impliedly in the*

*contract.*

If the thing delivered is defective or if there is breach of warranty against defects, the buyer may exercise his right against the seller. He can bring an action against the seller. In order to claim his right arising out of warranty provisions on the condition that the buyer has met the duty of examining the thing with out delay.

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

**🖎 Dear learner!** Is there any period of time provided for under the law within which an action should be brought?

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

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

## 5.2.2: Obligations of the Buyer

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

**a. Payment of Purchase Price**

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

**🖎 Dear learner!** how could price of a thing be determined?

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

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Price of a thing could be determined in different ways.

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

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

**b. Taking Delivery**

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

# 5.3. Common Obligations of the Buyer and the Seller

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

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🖎 Dear learner! what are these common obligations?

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

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

**a. Expenses**

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

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

**b. Preservation of the Thing**

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

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

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

**c. Transfer of Risks**

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

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

# 5.4:Non-performance of contract of sales

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

Article 2329. Non-performance of obligation to deliver.

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

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

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

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

# b. Cancellation of Sale Contract

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

**🖎Dear learner!** what are the instances under which cancellation of a contractual agreement is ordered? (You can use the spaces left below to give your answers)

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

**c. Damages (Monetary Compensation)**

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

**🖎 Dear learner!** when could a court grant monetary compensation?

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

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

**🖎 Dear learner!** what is the amount of damages to be paid to the injured party?

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

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

**Article 1799** of the Civil Code, Normal amount of damages

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

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

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

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

**Article 2365.** Thing having no current price

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

In cases of anticipatory breach of contract, damages shall be calculated having regard to the market price of the thing on the last day of the period fixed in the contract for the performance of the contract. In the case of delay in the payment of price, the buyer shall pay interest at the legal rate, or a high contract rate, if there was any.

**Activity 6**

**Dear learners read the following questions very carefully and give correct answers in the spaces provided.**

1. One of the following is not obligation of the seller.

A. Making effective delivery of a thing. D. All.

B. Warranting against dispossession E. None.

C. Transferring ownership right.

2. Transfer of ownership right means;

A. Transfer of the right to use the thing. D. All.

B. Transfer of the right to dispose the thing. E. None.

C. Transfer of the right to collect the fruits that the thing accrues.

3. Specific or forced performance of contract of sale is ordered when;

A. It is of special interest to the buyer.

B. As long as it does not affect the personal liberty of the seller.

C. What the seller undertakes to deliver is easily available on the market.

D. A &B.

E. None.

4. Who would bear expenses for making contract of sale?

A. The buyer.

B. The seller.

C. Both of them

D. None.

5. Preservation of the thing is an obligation of:

A. The buyer.

B. The seller.

C. Both of them

D. None.

# SUMMARY

Contract of sale is a contract. Like other contractual agreements it needs to meet all the essential conditions for the existence of a valid contract. This is to mean that a contract of sale shall be made by capable persons. Consent of the contracting parties, that is to say, the buyer and the seller, shall be free from defects. The object of their contract or their respective obligations shall be sufficiently defined, possible to perform and shall also be lawful and moral. A contract of sale made without complying with the above requirements will lose effects before the law. A contract of sale is different from other contractual agreements in that it calls for exchange of goods for a price expressed in terms of money.

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

Non-performance of sale contract produces certain effects: forced performance, cancellation of contract and monetary compensation. Specific performance is an order requiring the defaulting party to carry out the obligation according to the specific terms agreed upon. To demand specific performance, the buyer must show that the performance of the seller is of a special interest to him. That means forced performance is not ordered whenever requested by the buyer. The seller can also demand forced performance when the buyer has not paid. The buyer and seller may cancel sale contract on different grounds, the buyer may move the court to cancel the contract when the compulsory date for delivery has expired, when the whole ownership is not transferred and when the thing delivered is defective.

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

# SELF-TEST EXERCISES 5

**Part. I True/False item.**

1. Warranty against non-conformity is the buyer’s obligation.

2. A sale contract may relate to a thing belonging to a third party.

3. Risk of loss or damage to the thing passes to the buyer up on delivery.

4. Warranty is a guarantee made by the seller on the thing he/she/it sells.

5. It is the buyer’s obligation to bear expenses for the making of a sale contract.

6. What makes contract of sale different from service contract is that the main material to

produce a thing is supplied by the seller himself.

7. If X gives his sewing machine to Y to enable the latter to use the thing for the coming five

years in return for 6000.00 birr, this transaction can be considered as a sale contract.

**Part II. Answer the following questions in the spaces provided.**

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

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

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

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# UNIT SIX

# Employment and Labour Law

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**Introduction**

Employment and Labour law is the body of laws which address the legal rights of, and restrictions on, workers and their employers. As such, it mediates many aspects of the relationship between trade unions, employers and employees. There are two broad categories of labour law. First, collective labour law relates to the tripartite relationship between employee, employer and union. Second, individual labour law concerns employees' rights at work and through the contract for work. This chapter tries to give students a general insight of individual labour relation from its formation to termination.

# 🏳 Unit Objectives

**After successful completion of this Unit, you will be able to**

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| * identify the essential definitional elements of employment relation * spell out the grounds for termination of contract of employment * identify the items of minimum employment conditions * enumerate the respective legal consequences for lawful and unlawful terminations |

## 6.1. Sources of regulation

There are three types of legal regimes regulating employment relation in Ethiopia. These are:

1. Employment relations in private organizations and public enterprises.
2. Civil servants who are working in federal and government agencies.
3. The other covers a wide range of employees who are not covered by the above two legal regimes and governed by independent legislations. These include military, police force, judges, public prosecutors, higher government officials, etc.

As a matter of business law, this chapter is limited to the first group of employment relations. The central statute regulating employment relation in the private sector in Ethiopia is the Labour Proclamation, adopted in 2003 (Labour Proclamation No. 377/2003) and most recently amended in 2006 (Labour (Amendment) Proclamation No. 494/2006).

**6.2. Scope of legislation**

The Labour Proclamation is generally applicable to employment relations based on a contract of employment between a worker and an employer. However, it does not apply to the following employment relations arising out of a contract of employment.[[5]](#footnote-5)

* Upbringing, treatment, care or rehabilitation;
* Educating or training, other than as an apprentice;
* Persons holding managerial posts who are directly engaged in major managerial functions and who give decisions within the power delegated to him/her by law or the employer;
* Personal service for non-profit-making purposes;
* Persons such as members of the armed forces, members of the police force, workers of state administration, judges of courts of law, prosecutors and others whose employment relationship is governed by special laws; or
* Persons who perform an act, for consideration of payment, at his/her own business or professional responsibility under a contract of service

## 6.3. Contracts of employment

Employment relation is established through a contract of employment and it shall be deemed formed where a person (the employee) *agrees, directly or indirectly, to perform work for and under the authority of another (the employer) for a definite or* *indefinite period or piece work in return for wages*.[[6]](#footnote-6)

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| **🖎 Dear learner!** What elements do you note from the above Provision? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

According to this article, there are four basic elements of employment relation. Let us try to examine these elements of the definition.

1. Agreement: agreement is the basis for employment relation and this automatically excludes forced labor from the ambit of employment relations. Hence a person cannot be compelled to enter into an employment relation.
2. Personal performance of work: the employee is committing him/her/self to render personal service for the benefit of the employer. The employee, as of right, cannot delegate third parties to perform the job in his/her behalf.
3. Duration of employment:  a contract of employment could be entered into either for definite period (for six months, for one year etc), or for indefinite period (i.e. for the life of the company), or for a specific assignment (to unload sacks of grain from a truck).
4. Wage: The employer will be expected and required to pay wage to the employee. Hence employment relation is not a pro bono service. On the contrary, it is a service in return for wages. The mode of payment for wage could be in cash or in kind though ordinarily payment is effected through cash. As regards to the interval of payment, it could be in daily, weekly, bi-monthly, monthly etc.

# 6.4 Form of contract of Employment

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| **🖎 Dear learner!** What should be the form of contract of employment to be valid? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

The labour law regime in principle does not require any special form for contractual validity.[[7]](#footnote-7) This means employment relation may be formed in many ways. It may result from a simple oral agreement between two individuals, or it may be created by a detailed written contract. What matters is the existence of agreement between the employer and employee and fulfillment of other elements discussed above. A contract of employment shall specify the type of employment and place of work the rate of wages, method of calculation thereof, manner and interval of payment and duration of the contract.[[8]](#footnote-8)

If the contract is concluded in writing, according to article 6 of the labour proclamation, it shall specify the following:

1. the name and address of the employer;
2. the name, age, address and work card number, if any, of the worker;
3. the agreement of the contracting parties; and
4. the signature of the contracting parties.

# 6.5 Length of employment

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| **🖎 Dear learner!** Can you list the type of employments with regard to its duration? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

As regards to duration, as mentioned above in the definition, a contract of employment could be entered into either for definite period, for indefinite period, or for a specific assignment. Unlike marriage, which is, in principle, is a lifelong engagement; there is no as such lifelong contract of employment. However, the Ethiopian Labor law clearly stipulates, in article 9 of the proclamation, any contract of employment shall be deemed to have been concluded for an indefinite period (permanently) except for the cases   provided under Article 10 of the proclamation. The cases where contract of employment for definite period (temporary) or a specific work is allowed are the following:

* + the performance of specified piece work for which the employee is employed;
  + the replacement of a worker who is temporarily absent due to leave or sickness or other causes;
  + the performance of work in the event of abnormal pressure of work;
  + the performance of urgent work to prevent damage or disaster to life or property, to repair defects or break downs in works, materials, buildings or plant of the undertaking;
  + an irregular work which relates to permanent part of the work of an employer but performed on irregular intervals;
  + seasonal works which relate to the permanent part of the works of an employer but performed only for a specified period of the year but which are regularly repeated in the course of the years;
  + an occasional work which does not form part of the permanent activity of the employer but which is done intermittently;
  + the temporary placement of a worker who has suddenly and permanently vacated from a post having a contract of an indefinite period;
  + the temporary placement of a worker to fill a vacant position in the period between the study of the organizational structure and its implementation.

A person may be employed for a probation period for the purpose of testing his suitablity to a post in which he is expected to be assigned.[[9]](#footnote-9) When the employer and employee agree to have a probation period, the agreement shall be made in writing and cannot exceed forty five (45) consecutive days (not working days).[[10]](#footnote-10) What makes probationary employment different is, during the agreed time of probation both the employer and employee are legally entitled to terminate the contract of employment without good cause.

**6.6 Minimum working conditions**

Unlike most contractual engagements where the parties to the contact are left alone to determine the terms of their contractual relation, employment relation has its bench marks (the so called minimum working conditions) below which the terms of the contract may not stipulate.

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| **🖎 Dear learner!** List the minimum working condition an employee is legally entitled under Ethiopian labour law? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

1. **Working time**

**Hours of work**

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| **🖎 Dear learner!** How long a worker is obliged to work per day and per week? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Article 61 provides that normal working hours shall not exceed 8 hours a day or 48 hours a week (Article 61). Workers are entitled to a weekly rest period of 24 non-interrupted hours in a period of 7 days. Unless otherwise agreed, according to article 70 of the proclamation the weekly rest should be on Sunday, but another day may be chosen for certain services.

**Overtime**

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| **🖎 Dear learner!** What is overtime work? Can an employer order a worker to worker for extra hours whenever s/he wants? (You can use the spaces left below to give your answers) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Any work exceeding the normal working time of 8 hours a day or 48 hours a week is overtime. Overtime work is in principle prohibited. Overtime is only permissible for up to 2 hours a day, or 20 hours a month, or 100 hours a year, and only in the following exceptional circumstances listed in Article 67:

* Accident, actual or threatened
* Force-majeure
* Urgent work
* Substitution of absent workers assigned on work that runs continuously without interruption

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| **🖎 Dear learner!** Do you think the rate of payment for overtime is equal to the normal working hours? (You can use the spaces left below to give your answers) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

The rate of payment for overtime work is more than the rate in the normal working hour. The proclamation defines the overtime payment in Article 68 (1). The overtime payment ranges from a rate of one and one quarter (1 ¼) of the ordinary hourly rate (from 6 a.m. to 10 p.m.) to two and one half (2 ½) on public holidays.

1. **Paid leaves**

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| **🖎 Dear learner!** What is annual leave? What is the length of annual leave of an employer with 10 years’ service? (You can use the spaces left below to give your answers) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Any worker is entitled to uninterrupted annual leave with pay. As per Article 77, the annual leave in no case be less than14 ‘*working days’*, plus one working day for every additional year of service. Article 76 forbidden to pay wages in lieu of the annual leave.

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| **🖎 Dear learner!** What is the difference between working days and consecutive days for the purpose of computing annual leave? (You can use the spaces left below to give your answers) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Sick leaves and public holidays are also items of minimum working conditions. Where a worker is rendered incapable of work owing to sickness he shall be entitled to a sick leave of up to six months per year.[[11]](#footnote-11) The payment for the period of sick leave is:

1. For the first one month with 100% of his wages;
2. For the next two months with 50% of his wage;
3. For the next three months without pay.

Public holidays observed under the relevant law are also non working days and at the same time paid holidays.[[12]](#footnote-12) An employee who works on a public holiday is entitled to the double of his or her ordinary hourly wages.[[13]](#footnote-13)

1. **Maternity leave and maternity protection**

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| **🖎 Dear learner!** What are the leaves a pregnant employee is entitled? Do you think there are prohibited work patterns for pregnant employee? (You can use the spaces left below to give your answers) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Article 35 of the Constitution of Ethiopia grants the right to maternity leave with full pay. A pregnant employee is not permitted to perform where it could be hazardous to her or the child's health.[[14]](#footnote-14) Night work is not generally prohibited, nor shall she be assigned to overtime-work. Moreover she shall not be given an assignment outside her permanent place of work and be granted time off for medical examinations.[[15]](#footnote-15)

Female employees are entitled to maternity leave, which is to start from 30 days prior to due date of birth (pre natal), and end not less than 60 days after birth of the child (post natal). Maternity leave is classified as paid leave.[[16]](#footnote-16) A nursing employee does not enjoy special legal protection.

1. **Safe and Healthy working conditions**

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| **🖎 Dear learner!** Whose duty is to maintain safe and healthy working condition? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

An employer shall take the necessary measure to safeguard adequately the health and safety of the workers.[[17]](#footnote-17) (Article 92) Corresponding to the obligation of the employer a worker is also duty bound to make proper use of all safeguards, safety devices and other appliance furnished for the protection of his health or safety and for the protection of the health and safety of others.[[18]](#footnote-18)

1. **Termination of contract of employment**

In Ethiopia there are three ways to terminate a contract of employment.

1. By the operation of the law,
2. Agreement between both parties
3. Unilateral termination or termination by either the employer or employee

**Termination by the operation of the law**

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| **🖎 Dear learner!** Can you list scenarios that will automatically terminate employment relationship? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

In some instances specifically prescribed by the law, contract of employment will be automatically terminated. According to article 24 of the labour proclamation, a contract of employment may be terminated by law on the following grounds:

1. Expiry of the period or on the completion of the work where the contract of employment is for a definite period or piece work;
2. Death of the worker;
3. Retirement of the worker in accordance with the relevant law;
4. When the enterprise ceases operation permanently or due to bankruptcy or for any other cause; or
5. Where the worker is unable to work due to partial or permanent incapacity.

**Termination by the agreement of both parties**

The parties (employer and employee) may terminate their contract of employment by agreement. Yet, a waiver by the worker of any of his/her rights under the law has no legal effect. In addition, the termination by agreement is effective and binding on the worker only where it is made in writing.[[19]](#footnote-19)

**Unilateral termination**

This is the case where either the employer or the employee unilaterally calls for the termination of contract of employment. These take two forms.

1. Termination of contract of employment by the initiation of the worker (resignation)
2. Termination of contract of employment by the initiation of the employer (dismissal)

**Resignation**

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| **🖎 Dear learner!** What is resignation? And how an employee can legally resign? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Generally a worker can terminate the contract of employment (resign) giving prior notice of fifteen days.[[20]](#footnote-20) The worker may also terminate his/her contract without notice for good cause (constructive dismissal) such as in the following cases:

* Where the employer has committed against him/her any act contrary to his/her human dignity and morals or other acts punishable under the Penal Code;
* In the case of imminent danger threatening the worker’s safety or health, the employer, having been made aware of such danger, failed to act within the time-limit in accordance with an early warning given by the competent authority or appropriate trade union or the worker him/herself to avert the danger;
* If the employer has repeatedly failed to fulfil his/her basic obligations towards the worker as prescribed under the LP, collective agreements, work rules or other relevant laws.

Where a worker terminates his/her contract of employment for the above reasons, he/she must inform the employer, in writing, of the reasons for termination and the date on which the termination is to take effect.[[21]](#footnote-21) However, the worker’s right to terminate such contract lapses after fifteen working days from the date on which the act occurred or ceased to exist.[[22]](#footnote-22)

**Dismissal**

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| **🖎 Dear learner!** What is dismissal? And how an employer can legally dismiss a worker? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

A contract of employment may only be terminated, at the employer’s initiative, where there are grounds connected with the worker’s conduct or with objective circumstances arising out of the worker’s ability to do his/her work or the organizational or operational requirements of the enterprise.[[23]](#footnote-23) In this case, the dismissal may be summary dismissal (without notice) or ordinary dismissal (with notice).

**Termination of the contract of employment without notice (summary dismissal)**

A contract of employment shall be terminated without notice on the following grounds only.[[24]](#footnote-24) If any of the following things happen the employer is entitled to terminate the employment of a worker without being required to give the employee a notice period (i.e. from one to three months period based on the workers service period).

1. Repeated and unjustified tardiness despite warming to that effect,
2. Absence from the work without good cause for a period of five consecutive working days or ten working days in any period of one month or 30 working days in a year,
3. Deceitful or fraudulent conduct in carrying out his duties having regard to the gracing of the case,
4. Misappropriation of property or fund of the employer,
5. Producing a work output below the qualities and quantities agreed which, despite the potential of the worker is persistently,
6. Responsibility for brawls or quarrels at the work place,
7. Conviction for an offence where such conviction renders him incapable for the post which he holds,
8. Responsibility for causing damage intentionally or through gross negligence to any property of the employer or to another property which is directly connected with the work of the undertaking;
9. Intentionally commit in the place of   work any act which is endangers life and property
10. Take away property from the work place without the express authorization of the employer
11. Report for work in a state of intoxication
12. Except for HIV/AIDS/ test, refuse to submit himself for medical examination when required by law or by the employer for good causes.
13. Refuse to observe safety and accident prevention rules and to take the necessary safety precautions
14. Commission of other offences stipulated in a collective agreement as grounds for terminating a contract of employment without notice.
15. Absence from work due to a sentence of imprisonment passed against the worker for more than 30 days;

Where an employer terminates a contract of employment because of the above reasons, he shall give written notice specifying the reasons for and the date of termination within 30 days. The right of the employer to terminate the contract due to the above provisions lapses after 30 working days from the date that the employer has knowledge of the ground for the termination.[[25]](#footnote-25)

**B. Termination Of Contract Of Employment With Notice (ordinary dismissal)**

The following are sufficient grounds for the termination of a contract of employment with notice.[[26]](#footnote-26)

1. The worker’s manifested loss of capacity to perform the work to which he has been assigned or his lack of skill to continue his work,
2. If the worker, for reasons of health or disability, permanently, is unable to carry out his obligations under the contract of employment,
3. The worker’s unwillingness to move to a locality to which the undertaking moves,
4. When the post of the worker is cancelled for good cause and the worker cannot be transferred to another post.

The notice of termination by the employer shall be handed to the worker in person.  Where it is not possible to find the worker or he refuses to receive the notice, it shall be affixed on the notice board in the work place of the worker for ten consecutive days.[[27]](#footnote-27)

**Period of Notice**

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| **🖎 Dear learner!** What is notice period and how long it should be? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Period of notice means the number of days the employer should give for the worker before the termination of the contract. This Period of notice ranges from one to three months based on the period of service of the worker.[[28]](#footnote-28)

1. One month in the case of a worker who has completed his probation and has a period of service not exceeding one year,
2. Two months in the case of  a worker who has a period of service a above one year to nine years,
3. Three months in the case of a worker who has a period of service of more than nine years,
4. To months in the case of a worker who completed his probation and whose contract of employment is terminated due to reduction of work force.

**Reduction of workers**

The other ground of dismissal in Ethiopia is Reduction of Workers. Reduction of workers can be made when the following requirements are fulfilled.[[29]](#footnote-29)

1. Fall in demand for the products or services of the employment resulting in the reduction of the volume of the work and profit of the undertaking & there by resulting in the necessity of the reduction of the work force,
2. A decision to alter work methods or introduce new technology with a view to raise productivity resulting in the reduction of the work force,
3. Any event which entails direct and permanent cessation of the worker’s activities in part or in whole resulting in the necessity of a reduction of the work force.

Reduction of workforce is said to occur when the above grounds occur, and affect a number of workers representing at least ten percent of the number of workers employed or, in the case of an undertaking where the number of employees is 20-50 a reduction of workers affecting at least 5 employees over a continuous period of not less than 10 days can be made. In this case, the employer in consultation with the trade union or its representative shall give priority of being staying in job, for those workers having higher rate of productivity and best skills. In the case of equal skill and rate of productivity, the workers to be affected first by the reduction shall be in the following order.

* Those  having  the shortest term of service in the undertaking,
* Those who have fewer dependants,
* Those who are disabled due to an employment related injury in undertaking,
* Workers’ representatives,
* Expectant mothers,

**6.7. Remedies in case of unjustified dismissal**

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| **🖎 Dear learner!** What remedies are available for illegally dismissed worker? (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

A worker who intends to challenge the validity of his or her termination must file a submission before a regional first instance court.[[30]](#footnote-30) If the termination proves to be unlawful, the proclamation gives the choice of remedies.  The court may:

* Order the employer to reinstate the employee from any date not earlier than the date of dismissal.
* Order the employer to pay compensation to the employee.

The primary remedy in respect of an unlawful termination is to order reinstatement or re-employment.[[31]](#footnote-31) In the event that the employee does not wish to be reinstated or re-employed or the circumstances are such that a continued employment would be either intolerable or no longer reasonably practical and would give rise to serious difficulties, the court may award compensation rather than reinstatement/re-employment, even in cases the worker wishes to be reinstated.[[32]](#footnote-32)

The compensation will be paid in addition to the severance payment. There are, however, certain limits on compensation. The compensation will be hundred and eighty times the average daily wages and a sum equal to the remuneration for the appropriate notice period in the case of an unlawful termination of permanent worker, and a sum equal to the wages that the worker would have obtained until the lawful end of his contract.[[33]](#footnote-33)

Compensation to be paid by the worker who has terminated his or her contract contrary to the provisions of the Proclamation shall not exceed fifteen days wages of the worker.[[34]](#footnote-34)

## Summary

Employment and Labour law is the body of laws which address the legal rights of, and restrictions on, workers and their employers. The central statute regulating employment relation in the private sector in Ethiopia is the Labour Proclamation, adopted in 2003 (Labour Proclamation No. 377/2003) and most recently amended in 2006 (Labour (Amendment) Proclamation No. 494/2006). The Labour Proclamation is generally applicable to employment relations based on a contract of employment between a worker and an employer. Employment relation is established through a contract of employment and it shall be deemed formed where a person agrees, directly or indirectly, to perform work for and under the authority of another for a definite or indefinite period or piece work in return for wages. The labour law regime in principle does not require any special form for contractual validity. As regards to duration a contract of employment could be entered into either for definite period, for indefinite period, or for a specific assignment. The law provides for minimum working conditions to employees. These include limited working time, paid annual, sick and public holidays leave, pregnancy and maternity leave, maintaining safe and healthy working conditions. Ethiopian labour law is also characterized by regulating how an employment relation can be legally terminated. In this regard, it specifically lists the grounds to dismiss an employee and the remedies available for an employee whose employment is terminated illegally, which are reinstatement or compensation.

## Self test Questions 6

**Choose the best answer**

1. Which of the following employment relations is not excluded from the application of Labour Law?
2. Upbringing, treatment, care or rehabilitation;
3. Apprenticeship
4. Personal service for non-profit-making purposes;
5. Managerial employees
6. All
7. None of the above
8. A contract of employment may be terminated by the operation of the law on one of the following grounds:
9. Expiry of the period or on the completion of the work where the contract of employment is for a definite period or piece work;
10. Death of the worker;
11. Retirement of the worker in accordance with the relevant law;
12. When the enterprise ceases operation permanently or due to bankruptcy or for any other cause; or
13. Where the worker is unable to work due to partial or permanent incapacity.
14. All
15. An employer can not dismiss an employee without notice when:
16. Repeated and unjustified tardiness despite warming to that effect,
17. Misappropriation of property or fund of the employer,
18. Responsibility for brawls or quarrels at the work place,
19. The worker’s unwillingness to move to a locality to which the undertaking moves,
20. The period of notice for an employee who has seven years of service is:
    1. One month
    2. Two months
    3. Three weeks
    4. Three months

**True or false**

1. A worker, as of right, can delegate third parties to perform the job in his/her behalf.
2. A contract of employment should be in writing to be valid.
3. Any contract of employment shall be deemed to have been concluded for definite period of time.

**UNIT SEVEN**

**LAW OF INSURANCE**

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# Introduction

Insurance is an economic device by which a possible but uncertain risk of suffering a financial or economic loss resulting from loss or damage to property, incurring civil liability, illness or accident or death of the insured person is transferred from the person bearing it to another person, called the insurer, for consideration. It may also be defined as a contract whereby one person, called the insurer, agrees to pay compensation or the agreed amount of money to another, called the insured or the beneficiary, against payment of a certain amount of money, called premium, where the insured property is lost or damaged, or where the insured liability is incurred or where the insured person falls ill or sustains bodily injury or dies.

# 🏳 Unit Objectives

**After successful completion of this Chapter, you will be able to**

* discuss the definition of insurance;
* explain the requirements for the formation of a valid contract of insurance;
* describe the requirements for the establishment and operation of an insurance business;
* identify the significance of insurance; and
* differentiate the basic principles governing insurance contracts;
  1. **Definition of Insurance**

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| * Dear learner what do you understand by insurance?   (You can use the spaces left below to give your answers)  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ |

Insurance is a cooperative economic device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to insure themselves against that risk. This means that insurance provides a pool to which many persons contribute a certain amount of money called the premium, and out of which the insurer compensates the few who suffer losses.

Insurance can be understood in various ways. Firstly, from the point view of an individual it serve as a risk transfer mechanism or an economic device whereby a person, called the insured/assured transfers a risk of a possible financial loss resulting from unforeseeable events affecting property, life or body to a person called the insurer for consideration. Secondly, from the point of view of the insurer, insurance is a mechanism through which a risk is distributed among the group of persons who are exposed to the same type of risk, i.e., persons who bear the risk of suffering a financial loss as a result of events affecting property, life or body.

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

### Definition and Nature of Contracts of Insurance

A contract of insurance is a contract whereby one party undertakes, in return for a consideration called a premium, to pay to the other party a sum of money on the happening of a certain event (death or attainment of a certain age, or injury) or to indemnify the other party against a financial loss arising from the loss or damage to property or from incurring civil liability.

The party which promises to pay a certain amount of money to, or to indemnify, the other party is called the insurer (sometimes called the assurer- in cases of insurance of persons and the under writer in cases of marine insurance and the party to whom such protection is given is called the insured (or the assured). 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.

Art 654 of the Commercial Code of Ethiopia defines insurance as follows:

“Insurance (policy) is a contract whereby a person, called the insurer, undertakes, against payment of one or more premiums, to pay to a 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 in which one person called the insurer, agrees to pay the agreed amount of money or compensation to another person, called the insured, or the beneficiary where the insured property is lost or destroyed ( in cases of property insurance), or where the insured person incurs civil liability (in cases of liability insurance) or where the insured person dies or suffers bodily injury or falls ill (in case of insurance of persons). The insurer undertakes this obligation for consideration, called premium payable by the insured person.

Sub Art(2) of the same article provides that 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, sub Art(3) provides that a contract of insurance may also be made in respect of human person's life, body or health in which the insurers 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, it must fulfill the following requirements: (i) there must be an agreement between the parties (ii) the agreement must be supported by consideration, (iii) the parties must be capable of contracting (must have capacity), (iv) the consent of the parties to the agreement must be free from defects, and (v) the object must be legal or the object must not be illegal and immoral.

Although a contract of insurance resembles, to a certain extent, a wagering or gambling agreement whereby the insurer bets with the insured that his house will not be burnt and giving him the odds of its value, it is a legal and enforceable contract with important economic and social purposes.

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| * **Dear learner**, what are the requirements for the existence of a valid insurance contract? |

Note: Wagering or gambling agreements are considered void in almost all legal systems. For instance, Art 713(2) of the Commercial Code of Ethiopia provides that games and gambling shall not give rise to valid claims for payment unless they are related to activities enumerated under Art 714, such as stock exchange speculations, sporting activities and lottery or betting authorized by the government.

A contract of insurance differs from a contract of wagering or gambling for the following reasons:

1. The object or purpose of an insurance contract is to protect the insured against economic losses resulting from a certain unforeseen future event, while the object of a wagering or gambling agreement is to gamble for money and money alone.
2. In an insurance contract, the insured has an insurable interest in the life or property sought to be insured. In a wagering or gambling agreement, neither party has any pecuniary or insurable interest in the subject matter of the agreement except the resulting gain or loss. This is the main distinguishing feature of a valid contingent contract as compared to a wagering agreement.
3. A contract of insurance (except life, accident and sickness insurances) is based on the principle of indemnity. However, in a wagering agreement there is no question of indemnity, as it does not cover any risk.
4. A contract of insurance is based on scientific calculation of risks and the amount of premium is ascertained after taking into account the various factors affecting the risk. In a wager, there is no question of any calculation what so ever, it being a mere gamble.

### Distinguishing Characteristics of Insurance Contract

Insurance contracts are subject to the same basic law that governs all types of contracts. However, a special body of law has developed around legal problems associated with insurance.

Insurance contracts have the following distinct legal characteristics that make them different from other contracts.

An insurance contract is aleatory rather than commutative. Aleatory contracts have a chance element and an uneven exchange. Under an aleatory contract, the performance of at least one of the parties is dependent on chance. An aleatory contract also involves an uneven exchange: one of the parties promises to do much more than the other party. Depending on chance, one party may receive a value out of proportion to the value that is given. For example, assume that Semira pays a premium of Birr 500 for birr 100,000 of homeowners’ insurance on her home. If her home is totally destroyed by fire shortly thereafter, she would collect an amount that greatly exceeds the premium paid. On the other hand, a homeowner may faithfully pay premiums for many years and never suffer a loss.

In contrast, other commercial contracts are commutative. A commutative contract is one in which the values exchanged by both parties are theoretically even. For example, the purchaser of a real estate normally pays a price that is viewed to be equal to the value of the property.

Although the essence of an aleatory contract is chance, or the occurrence of some fortuitous event, an insurance contract is not a gambling contract. Gambling creates a new speculative risk that did not exist before the transaction. Insurance, however, is a technique for handling an already existing pure risk. Thus, although both gambling and insurance are aleatory in nature, an insurance contract is not a gambling contract because no new risk is created.

An insurance contract is a unilateral contract. A unilateral contract is a contract in which only one party makes a legally enforceable promise. In this case, only the insurer makes a legally enforceable promise to pay a claim or provide other services to the insured. The term “unilateral” means that courts will enforce the contract in one direction only: against one of the parties; in this case, the insurer after the insured has paid the premium for coverage, the insured’s part of the agreement has been fulfilled. Under these circumstances, the only party whose promises are still outstanding is the insurer. Although the insured must continue to pay the premium to receive payment for a loss he or she cannot be legally forced to do so /compare Art 666/4/ of the Commercial Code/. However, if the premiums are paid, the insurer must accept them and must continue to provide the protection promised under the contract.

In contrast, most commercial contracts are bilateral in nature. Each party makes a legally enforceable promise to the other party. If one party fails to perform, the other party can insist on performance or can sue for damages because of the breach of contract.

An insurance contract is a conditional contract. This means the insurer’s obligation to pay a claim depends on whether or not the beneficiary has complied with all policy conditions. If the insured does not adhere to the conditions of the contract, payment is not made even though an insured peril causes a loss. Conditions are provisions inserted in the policy that qualify or place limitations on the insurer’s promise to perform.

The conditions section imposes certain duties on the insured if he or she wishes to be compensated for a loss. The insurer is not obligated to pay a claim if the policy conditions are not met. Typical conditions include payment of premium, providing adequate proof of loss, and giving immediate notice to the insurer of a loss. For example, under a homeowner’s policy, the insured must give immediate notice of loss. If the insured delays for an unreasonable period in reporting the loss, the company can refuse to pay the claim because a policy condition has been violated.

In property insurance, insurance is a personal contract, which means the contract is between the insured and the insurer. Strictly speaking, a property insurance contract does not insure property, but insures the owner of property against loss. The owner of the insured property is indemnified if the property is damaged or destroyed. Since the contract is personal, the applicant for insurance must be acceptable to the insurer and must meet certain underwriting standards regarding character, morals, and credit.

Since a property insurance contract is a personal contract, it normally cannot be assigned to another party without the insurer’s consent. If property is sold to another person, the new owner may not be acceptable to the insurer. Thus, the insurer’s consent is normally required before a property insurance policy can be validly assigned to another party. Since the general rule states that one cannot be forced to contract against one’s will, the right of the insured to assign the policy is dependent on the consent of the insurance company. Otherwise, the company could not be legally bound in a contract with an individual to whom it would never have issued a policy originally, and one in which the nature of the risk is altered substantially. For example, let us say that an automobile owner decided to sell his or her car to a 17-year-old boy. If it were possible to assign the insurance policy to the boy without the consent of the insurance company, the company would then be forced to deal with a person with whom it would not have dealt. The assigned policy will be legally binding only with the written consent of the insurance company. / Compare the provisions of Arts 672, 673, 660 of the Commercial Code/

In contrast, a life insurance policy can be freely assigned to anyone without the insurer’s consent because the assignment does not usually alter the risk and increase the probability of death. Compare Arts 696-698 of the Commercial Code.

The insurance contract is said to be a contract of adhesion, i.e., whose terms and conditions are not the result of negotiations between the parties, and one party has to agree to the terms and conditions prepared by the other. In such types of contracts, ambiguities or uncertainties in the wording of the agreement will be construed against the drafter- the insurer. If the policy is ambiguous, the insured gets the benefit of the doubt. This principle is due to the fact that the insurer had the advantage of writing the terms of the contract to suit its particular purposes and the insured has no opportunity to bargain over conditions, stipulations, and exclusions. Therefore, the courts place the insurer under a duty to make the terms of a contract clear to all parties. In the absence of doubt as to meaning, the courts will enforce the contract as it is.

The general rule that ambiguities in insurance contracts shall be construed against the insurer is reinforced by the principle of reasonable expectations. The principle of reasonable expectations states that an insured is entitled to coverage under a policy that he or she reasonably expects it to provide, and that to be effective, exclusions or qualifications must be conspicuous, plain, and clear.

### The Requirements to Carry on Insurance Business

* **Dear learner,** how can an entity begin insurance business?

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Art 656 of the Commercial Code provides that the law shall determine the conditions under which physical persons or business organizations may carry on insurance business. Therefore, we have to refer to other parts of the commercial code and other laws to find out as to who may undertake insurance business and the conditions under which it may be undertaken.

Accordingly, Art 513 of the code provides that banks and insurance companies cannot be established as private limited companies, i.e., a private limited company cannot engage in banking, insurance or any other business of similar nature. Similarly, Art 6(1) of the Licensing and Supervision of Insurance Business Pro No 86/1994 provides that no person may engage in insurance business of any type unless it applies to and acquires a license from the National Bank of Ethiopia for the particular class or classes of insurance. Furthermore, Art 4(1) and Art 2(3) of the same proclamation provide that such person has to be a share company as defined under Art 304 of the commercial code.

According to this article, a share company is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company. The capital of the company to be established as an insurance company must be wholly owned by Ethiopian nationals and/or business organizations wholly owned by Ethiopian nationals, and it must be established and registered under Ethiopian law and must have its head office in Ethiopia.

These requirements / conditions in effect prevent foreigners from engaging in insurance business and foreign banks from opening branches and operating in Ethiopia. The most probable reason for this position is the need to protect infant domestic insurance companies which do not have the desired financial strength, knowhow and human resources to be able to compete with foreign banks which have superior capacity in these areas.

The other condition that a person must fulfill to obtain a license relates to the minimum capital of the company, i.e., it must have a minimum capital of 3 million Birr if it is applying for license to undertake general insurance business i.e., insurances other than insurance of persons, and 4 million Birr if it is applying for a license to undertake long term insurance business, i.e., insurance of persons and 7 million where the application is to undertake both classes of insurance. Such capital has to be paid up in cash and deposited in a bank in the name of the company to be established as an insurance company.

### Significance of Insurance

Insurance as a mechanism of transfer of risk has great economic and social benefits to the individual insured, his family and the country in general. The following are some of the major benefits.

## Indemnification for Losses

Payment of compensation by the insurer for losses permits individuals and their families to be restored to their original financial position after a loss has occurred. As a result, they can maintain their financial security. Since they are restored either in part or in whole after a loss occurs, they are less likely to seek financial assistance from relatives and friends. It also allows businesses to remain in business and employees to keep their jobs, suppliers will continue to receive orders, and customers can still purchase the goods and services they desire. Businesses and families who suffer unexpected losses are restored or at least moved closer back to their previous economic position. The advantage to these individuals is obvious. The society also gains because these persons are restored to production and tax revenues are increased. In short, the indemnification function contributes greatly to family and business stability and therefore is one of the most important social and economic benefits of insurance.

## Reduction of Worry and Fear

Another benefit of insurance is that it reduces worry and fear, both before and after loss. For instance, if family heads have life insurance for adequate amount to cover the future needs of their families, they are less likely to worry about the financial security of their dependents in the event of their premature death. Persons insured for long-term disability do not have to worry about the loss of earnings if a serious illness or accident occurs. Property owners who are insured enjoy greater peace of mind since they know that they are covered (they would be compensated) if loss occurs to their property.

## Source of Investment Funds

The insurance industry is an important source of funds for capital investment and accumulation. Premiums, which are collected by the insurer in advance, usually at the time of conclusion of the contract and other funds which are not needed to pay for immediate losses and expresses, can be loaned to businesses or invested in manufacturing, real estate... sectors. These investments increase the society's stock of capital goods and promote economic growth.

Insurance, through compensation of losses, also encourages new investment. For instance, if an individual knows that his or her family will be protected by life insurance in the event of premature death, his or her and the family's financial resources are protected by various types of property insurances, he/she may be more willing to invest savings in a long-desired project such as a business venture, without feeling that the family is being robbed of its basic income security. In a way a better allocation of resources is achieved, i.e., idle funds/deposits are used for a more productive purpose. As insurance is an efficient device to reduce risk, investors may also be willing to enter fields they would otherwise reject as too risky, and the society benefits from increased services and production.

## Means of Loss Control

Although the main function of insurance is not to reduce loss but merely to spread/distribute losses among members of the insured group, insurers are nevertheless vitally interested in keeping losses at a minimum. Insurers know that if no effort is made to prevent or minimize occurrence of insured risks, losses and hence premium would have a tendency to rise. It is human nature to relax vigilance when they know that the loss will be fully paid by the insurer.

The following illustrations are some of the areas in which insurance companies play a very important role in loss prevention and control:

* Development of fire safety standards and public education
* Programs
* Recovery of stolen properties
* Investigation of fraudulent insurance claims and thereby deterring intentional destruction of property and life
* The insurance industry also finances programs aimed at reducing premature deaths, accidents and illness.

## Enhancing Credit

Insurance enhances a person's credit, i.e., it makes the borrower/debtor a better credit risk because it guarantees the value of the borrower’s collateral/mortgage or pledge/, and gives the creditor /lender greater assurance that the loan will be repaid. For instance, when a house is purchased on credit provided by a lending institution, the lender normally requires a property insurance on the house before the mortgage loan is granted. The property insurance protects the lender's financial interest if the property is damaged or destroyed.

* 1. **Basic principles of Insurance**

There are certain fundamental principles (or characteristics) more or less common to all classes of insurance business.

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* **Dear learner**, briefly discuss what principle of utmost good faith is? \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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### Principle of Utmost Good Faith

The general rule of ‘caveat emptor’ (let the buyer beware), which applies to ordinary trade contracts, does not apply to insurance contracts. Insurance contracts are contracts of utmost good faith. Accordingly, it is the inherent duty of both parties to a contract of insurance to make full and fair disclosure of all material facts relating to the subject matter of the proposed insurance. It is so because insurance shifts risk from one party to another. A material fact for this purpose is a fact, which would affect the judgment of a prudent insurer in considering whether he would enter into a contract at all or enter into it at one premium rate or another. For example, in life insurance suffering from a disease like asthma or diabetes is a material fact whereas having occasionally a headache is not a material fact.

Although the duty of utmost good faith applies also to the insurer, for example, he must not urge the proposer to effect an insurance which he knows is not legal or has run off safely, but this duty rests highly on the insured because he knows or is expected to know more about the subject-matter. The proposer must disclose all material facts truly and fully. There should not be any false statement or half-truths or any silence on a material fact. This applies to all material facts whether considered by him as material or not and whether known to him or not. The proposer is expected to know every circumstance, which in the ordinary course of business ought to be known by him. He cannot rely on his own inefficiency or neglect.

The duty to make a full and true disclosure continues until the contract is concluded, i.e., until the proposal of the insured is accepted by the insurer, whether the policy is then issued or not and it is not a continuing obligation. Thus, any material fact coming to his knowledge after the conclusion of the contract need not be disclosed. However, the duty to disclose revives with every renewal of the old policy or alterations in the existing policy.

The following types of facts are not required to be disclosed by the proposer, i.e., the non-disclosure of them shall not be fatal to the contract:

Any fact that diminishes the risk

1. Any fact that is known or presumed to be known to the insurer
2. Any fact which is of public knowledge or which relates to the law of the country
3. Any fact as to which information is waived by the insurer.

If the principle of utmost good faith is not observed by either party, the contract becomes void able at the option of the party not at fault, irrespective of whether the non-disclosure was intentional or innocent. Of course, in case of innocent misrepresentation the premium is refundable on the avoidance of the contract.

### Principle of Indemnity

The second fundamental principle is that all contracts of insurance are contracts of indemnity, except those of life and personal accident insurances where no money payment can indemnify for loss of life or bodily injury. In case of marine and fire insurances, the insurer undertakes to indemnify the insured for loss or damage resulting from specified perils. In case of loss, the insured can recover from the insurer the actual amount of loss, not exceeding the amount of policy. If there is no loss under the policy, the insurer is under no obligation to indemnify the insured. The purpose of indemnity is to place the insured, after a loss, in the same position he occupied immediately before the event. Under no circumstances, is the insured allowed to benefit more than the loss suffered by him.

It must also be noted that indemnity is linked with ‘insurable interest.’ If a one-fourth co-owner gets the full property insured, he shall be indemnified to the extent of his interest or share only in the case of total destruction of the property insured.

However, there are instances, in which the principle of indemnity does not apply, i.e., the insurer does not have the obligation to compensate the insured person. One such instance is where the object or liability is under-insured. Under-insurance occurs where the amount of guarantee /sum insured agreed upon in the policy is lesser than the actual value of the object or the amount of potential liability of the insured. In such cases, the insurer’s obligation is to pay the amount of guarantee/ sum insured, rather than compensation of the insured (Art 679).

The other such instance is related to insurance of persons, where the parties freely fix the amount of guarantee and is payable regardless of the actual damage sustained where the risk materialized. This is mainly because it is generally accepted that human life or limb cannot be valued in terms of money and are irreplaceable and the insured or beneficiary who receives it cannot be considered to have made a net profit out of the insurance. (Art 689)

### Proximate Cause

The next principle of insurance is that the insurer is liable only for those losses which have been proximately caused by the peril insured against. In other words, in order to make the insurer liable for a loss, the nearest, immediate, or the last cause has to be looked into, and if it is the peril insured against, the insured can recover. This is the rule of proximate cause/ causa proxima. / Insurers are not liable for remote causes and remote consequences even if they belong to the category of insured perils. The question as to which is the causa proxima of a loss, can only arise where there has been a succession of causes. When a result has been brought about by two causes, you must, in insurance law, look to the nearest cause, although the result would not have happened without the remote cause. The law will not allow the assured to go back in the succession of causes to find out what is the original cause of loss.

According to Art 663, the insurer shall guarantee the insured against risks specified in the policy. In other words, the insurer shall compensate or pay the sum insured only where the loss or damage to the property or death or injury to the person is caused by a risk or risks specifically agreed upon in the policy. So, to be able to determine whether an insurer is liable to pay compensation or the sum insured, we have to establish that the loss or damage or death or injury resulted from risks or perils covered by the policy since all insurance contracts clearly specify the risks and perils for which the insurer shall be responsible (i.e., risks covered by the policy) and those for which the insurer shall not be responsible.

However, there are certain risks which are considered by the law as covered risks and those which are excluded. Accordingly, Art 663(2) provides that losses or damages due to unforeseen events, including acts of third parties, and those resulting from the negligence of the insured are considered as covered risks unless the parties exclude them clearly. While losses or damages resulting from the intentional action or inaction of the insured such as the intentional destruction of the property by the insured himself or a third party who is acting upon the instruction of the insured are considered as excluded risks. The law excludes intentional damages even where the parties might have agreed that such losses or damages are covered. This is a public policy principle since such acts shall affect the national economy and violate the purpose of insurance as a means of transferring potential but uncertain (as to time and extent) risks. Such acts even constitute a criminal offence punishable under the criminal law. / Art 659 of the Criminal Code of Ethiopia. /

Furthermore, Art 676 of the Commercial Code excludes from coverage, in all property insurances, risks arising out of international or civil wars unless the insurer, in a separate agreement, undertakes to cover them, because losses or damages caused by wars may be catastrophic and beyond the financial capacity of insurers.

Where the object insured is lost or totally destroyed or the person insured dies or is injured as a result of a risk or peril not agreed upon in the policy or excluded by the policy or the law, the policy shall terminate as of right, and the insurer shall not incur any liability. /Art 677, 711/

### Insurable Interest

Consistent with the concept of insurance as a means of indemnifying an insured against a loss, is the corollary that insurance should not provide an insured with the means of showing a net profit from the event insured against. One rather rough-hewn method of enforcing that corollary is the doctrine of insurable interest.

The Ethiopian Insurance Law does not sufficiently incorporate the principle of insurable interest. Art 675 of the commercial code, which is applicable to property insurances, is the only provision that deals with the subject. According to this provision any person who has a direct economic interest arising from property rights, such as ownership, usufruct or use right or indirect economic interest, arising out of contracts such as mortgage or pledge may insure such property to protect his interests.

However, the rules governing liability insurance and insurance of persons fail to incorporate rules on the principle of insurable interest which is considered as a mandatory requirement for the validity of contracts of insurance. Hence, we shall try to discuss the principle based on the law and experience of other countries.

Insurable interest means some proprietary or pecuniary interest. The object of insurance is to protect the pecuniary interest of the insured in the subject matter of the insurance and not the material property as such. A person is said to have an insurable interest in the subject matter insured where he will derive pecuniary benefit from its existence or will suffer pecuniary loss from its destruction. Insurable interest is thus a financial interest in the preservation of the subject matter of insurance. A purely sentimental interest or a non-monetary benefit will not cause an insurable interest. Accordingly, a creditor has an insurable interest in the life of the debtor but a son has no insurable interest in the life of his mother who is supported by him.

‘Insurable interest’ is an essential pre-requisite in effecting a contract of insurance. The insured must possess an insurable interest in the subject matter of the insurance at the time of contract. Otherwise, the contract of insurance will be a wagering agreement which shall be void and unenforceable.

In the case of marine insurance, it is not essential for the assured to have an insurable interest at the time of affecting the insurance but the assured must have insurable interest at the time of loss of the subject matter insured.

### Doctrine of Subrogation

The doctrine of subrogation is a corollary to the principle of indemnity and as such, it applies only to property insurances. According to the principle of indemnity, the insured can recover only the actual amount of loss caused by the peril insured against and is not allowed to benefit more than the loss he suffered. In case the loss to the property insured has arisen without any fault on anybody’s part, the insured can make the claim against the insurer only. In case the loss has arisen out of tort or fault of a third party, the insured becomes entitled to proceed against both the insurer as well as the wrongdoer. However, since a contract of insurance is a contract of indemnity, the insured cannot be allowed to recover from both and thereby make a profit from his insurance claim. He can make a claim against either the insurer or the wrong doer. If the insured chooses to be indemnified by the insurer, the doctrine of subrogation comes into play and as a result, the insurer shall be subrogated to all the rights and remedies of the insured against third parties in respect of the property destroyed or damaged.

The following points are worth noting in connection with the doctrine of subrogation:

1. This doctrine will not apply until the assured has recovered a full indemnity in respect of his loss from the insurer. If the amount of the insurance claim is less than actual loss suffered, the assured can keep the compensation amount received from any third party with himself to the extent of deficiency, and if after full indemnification there remains some surplus he will hold it in trust for the insurer, to the extent the insurer has paid under the policy.

2. The insured should provide all such facilities to the insurer that may be required by the insurer for enforcing his rights against third parties. Any action taken by the insurer is generally in the name of the insured, but the cost is to be borne by the insurer.

3. The insurer gets only such rights that are available to the insured. He gets no superior rights than the assured. As such, the insurer can recover under this doctrine, only that which the assured himself could have recovered.

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Art 683 of the Commercial Code provides that the insurer that has compensated the insured for the financial losses he has suffered because of loss of or damage to property have the right to substitute the insured and to proceed against the third party who caused the damage. This provision transfers to the insurer all the rights and remedies that are available to the insured against the party responsible for the loss or the damage to the property. The extent of right of subrogation of the insurer is limited to the amount of money it has paid to the insured. Therefore, where the insurer has not fully compensated the insured for the losses he has suffered, as in the case of under insurance, both the insurer and the insured may proceed against the third party who is responsible for the loss or damage. The insurer for the amount it has paid and the insured for damage he has not received compensation.

However, the insurer may not exercise its right of subrogation against certain group of people. Art 683/3/ provides that the insurer cannot proceed against ascendants, descendants, and employees, agents of the insured and against persons living with him. This restriction on the right of insurer is not totally acceptable and is not based on legally justifiable grounds.

As the insured does not have remedy against his minor children, his employees and agents who caused damage to the property while performing their duties and while acting within the scope of their power/ Art. 2130, Art 2222/, the restriction on the right of the insurer is based on acceptable legal ground and appropriate. However, preventing the insurer from proceeding against the ascendants and descendants of the insurer who are not his dependants and who may have their own businesses, for instance, does not seem to be legally explainable.

### Risk Must Attach

The next principle of insurance is that for a valid contract of insurance the risk must attach. If the subject-matter of insurance ceases to exist (e.g. the goods are burnt) or the insured ship has already arrived safely, at the time the policy is effected, the risk does not attach, and as a consequence, the premium paid can be recovered from the insurers because the consideration for the premium has totally failed. Thus, where the risk is never run, the consideration fails and therefore the premium is returnable. It is a general principle of law of insurance that ‘if the insurers have never been on the risk, they cannot be said to have earned the premium.’

The risk also does not attach and therefore the premium is returnable where a policy is declared to be void ab-initio on account of some defect, e.g., assured being minor or parties not being ad-idem. But where a policy is void because there is no ‘insurable interest’ premium paid cannot be recovered because in that case it amounts to ‘wager’, except in the case of marine insurance where the assured is not required to have insurable interest at the time of entering into the contract. In addition, the premium cannot be recovered where the insurer on grounds of fraud avoids the policy by the insured.

Art 682/1/ of the commercial code provides that contracts of insurance concluded in respect of goods, which are already lost, damaged, or destroyed, or in respect of goods, which are no longer exposed to a risk, shall be of no effect. The premium paid in respect of such contracts shall be refunded to the insured, as the insurer was not bearing the risks as it would have under normal circumstances, i.e., in cases of valid contracts, provided that the insured, at the time he purchased the policy, was not aware of the loss, or damage or destruction of the object, nor of their safe arrival at the warehouse.

### Mitigation of Loss

When the event insured against occurs, for example, in the case of a fire insurance policy when the fire occurs, it is the duty of the policyholder to take steps to mitigate or minimize the loss as if he were uninsured and must do his best for safeguarding the remaining property. Otherwise, the insurer can avoid the payment for loss attributable to the negligence of the policyholder. Of course, the insured is entitled to claim compensation for the loss suffered by him in taking such steps from the insurer.

### Doctrine of Contribution

Like the doctrine of subrogation, the doctrine of contribution also applies only to contracts of indemnity, i.e., to property insurances. Double insurance occurs where the same subject matter is insured against the same risk with more than one insurer. If two different policies are taken from the same insurer, it is not a case of double insurance. It will be termed as ‘full insurance.’ Under double insurance, the same risk and the same subject matter must be insured with two or more different insurers. In the event of loss under double insurance, the assured may claim payment from the insurers in such order as he thinks fit, but he cannot recover more than the amount of actual loss, as the contract of property insurance is a contract of indemnity.

The doctrine of contribution states that ‘in case of double insurance all insurers must share the burden of payment in proportion to the amount assured by each. If an insurer pays more than his ratable proportion of the loss, he has a right to recover the excess from his co-insurers, who have paid less than their retable proportion.’

Thus, the essential conditions required for the application of the doctrine of contribution are:

* + - 1. There must be double insurance, i.e., there must be more than one policy from different insurers covering the same interest, the same subject matter and the same peril which has caused the loss.
      2. There must be either over-insurance or only partial loss. If the amount of different policies is just equal to the value of the subject matter destroyed, the different insurers are liable to contribute towards the loss up to the full amount of their respective policies and as such, the question of contribution as between themselves does not arise.

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### Reinsurance

An insurer assuming larger risk from the direct insurance business may arrange with another insurer to off load the excess of the undertaken risk over his retention capacity. Such arrangement between two insurers is termed as ‘reinsurance.’ Thus, by the device of reinsurance the original insurer transfers part of the risk to the reinsurer. Payment made by the ceding insurer (called original insurer or reinsured) to accepting insurer (called reinsurer) for the assumption of the risk by the latter is termed ‘reinsurance premium.’

A reinsurance contract does not affect the original insurer’s contractual obligation to the insured under the original contract of insurance. Moreover, in the absence of any privity of contract between the reinsurance and the originally insured person, the latter cannot have any remedy against the former. It is worth noting that since a contract of reinsurance is also a contract of indemnity, the reinsurer, before paying the money, must make sure that the sum originally insured has been paid by the ‘original insurer’ (or the ‘re-insured’). Of course, after paying the money in proportion to the risk transferred to him, a reinsurer becomes entitled to the benefits of subrogation.

If for any reason, the original policy lapses, the reinsurance also comes to an end. Furthermore, if the original contract is altered without the consent of the reinsurer, the reinsurer is discharged. Hence, a policy of reinsurance is co-extensive with the original policy.

### Third Party Interests in Liability Insurance

Liability insurance originated solely as a protection for the interests of the insured against loss suffered through liability to third parties. It began in the area of employers’ insurance against loss through liability to employees for work related injuries. And currently, third party insurance is also introduced to the vehicles caused damage to any person during their drive. Since indemnification of the insured was the sole function of the insurance, the injured third party could not bring a direct action against the insurer even after obtaining a judgment against the insured. Even the insured could not bring action on the policy until he had sustained an actual loss by payment of the judgment debt to the third-party. If the insured happened to be insolvent and judgment proof, no claim could arise under the policy.

**Summary**

Insurance is a merge of an institution and policy in which formation insurance contract has specific requirements while undertaking insurance business differs from the contract. Insurance from the point view of an individual is risk transfer mechanism or an economic device whereby a person, called the insured/assured transfers a risk of a possible financial loss resulting from unforeseeable events affecting property, life or body to a person called the insurer for consideration. From the point of view of the insurer, insurance may be defined as a mechanism through which a risk is distributed among the group of persons who are exposed to the same type of risk, i.e., persons who bear the risk of suffering a financial loss as a result of events affecting property, life or body. We can further clarify this definition through the following example.

The Unit discusses the subject matter based on The Commercial code of Ethiopia 1960. It includes discussion on the definition of insurance, the requirements for the formation of a valid contract of insurance; the requirements for the establishment and operation of an insurance business; the significance of insurance; and the basic principles governing insurance contracts.

**Self test Question 7**

1. Clearly show the definition and nature of Contracts of Insurance.
2. Verify the distinguishing characteristics of contract of insurance.
3. Pin point the legal requirements that should be fulfilled to carry on insurance business.
4. Cleary show the significance of insurance in relation to indemnification for losses, reduction of worry and fear, source of investment funds, means of loss control, enhancing credit
5. Clearly discuss what principle of indemnity is.
6. What do we mean by proximate cause in relation to insurance?
7. What do we mean by insurable interest?
8. Briefly discuss doctrine of subrogation.
9. Pin point what doctrine of contribution is.
10. Discuss what third party interests in liability insurance are.

# UNIT EIGHT

# LAW OF BANKING AND NEGOTIABLE INSTRUMENTS

# Introduction

This chapter is composed of two parts; law of banking and law of negotiable instruments. Under the first part we will deal with the meaning and significance of banking as well as various types of banks and their respective functions. The second part is devoted to discuss with negotiable instruments. Under this part, the meaning and types of negotiable and instruments will be discussed while special emphasis is given to commercial instruments. Besides, the section covers issues like types, natures and means of transfers of commercial instruments.

# Unit Objectives:

Up on the completion of this chapter, you are expected to;

* Understand the meaning and significance of banking
* Differentiate various types of banks and their functions
* Know the meaning and types of negotiable instruments
* Appreciate various types of commercial instruments
* Being familiar with how commercial instruments are issued and transferred
  1. Law of Banking
     1. **Definition**

The business of banking is easily defined and understandable from what it do. So, it can be defined by law and custom as it involves in the issue of notes payable on demand intended to circulate as money when the banks are banks of issue; in receiving deposits payable on demand; in discounting commercial paper; making loans of money on collateral security; buying and selling bills of exchange; negotiating loans, and dealing in negotiable securities issued by the government, state and national, and municipal and other corporations.

Bank is the institution whose purpose is making banking or administering the banking business. Thus, the law of banking regulates the banking system on the establishment of bank and operation banking business. Specifically, it regulates the detail requirements to establish bank; types of banks and their respective and specific functions; the various types of banking dealing with respect to their customers.

Banks can be classified into two groups based on their purpose of establishment and function. These are commercial banks and central or national banks. Commercial banks are the main type of banks involve in banking activities listed above in the definition part. Central or national banks are often responsible for formulating and implementing monetary and credit policies, usually in cooperation with the government.

Some institutions often called banks, such as finance companies, savings banks, investment banks, trust companies, and home-loan banks, do not perform all the banking functions described above and are best classified as financial intermediaries. Their economic function is that of channeling savings from private individuals into the hands of those who will use them, in the form of loans for building purposes or for the purchase of capital assets. These financial intermediaries cannot, however, create money (i.e., credit) as the commercial banks do; they can lend no more than savers place with them.

Banks run business by lending money and collecting interest. To do so, they have to acquire the minimum money to establish and run banks. In additions, they make money by using depositors’ money for long term loans. They pay depositors less interest than they receive from borrowers, and that difference accounts for the bulk of their income.

* + 1. **Economic Significance of Banks**

Although banks have many role, their primary role is to take in funds-called deposits-from those with money, pool them, and lend them to those who need funds. They are intermediaries between depositors (who lend money to the bank) and borrowers (to whom the bank lends money). As such, they create money for large scale investments. They also play a vital role in international and national payment system. They are also a means of money payments from employers to employees or from tax payers to government.

Banks encouraging savings by providing an incentive to save through payment of interest on deposits/savings and providing safety and security. Saving is also an important source of investment and the improvement of the living standards of the society.

Banks are the main institutions as a source of money lending for investment, which in turn is a base for the development of a nation by enhancing productivity, job creation, increase export or/and substitute importation and a means of foreign currency earning or/and saving. They encourage and help the development of certain sectors of an economy (like agriculture or industry as the country wishes to promote) by providing loans with low interest rates compared to other loans and allocating higher amount of loans.

Banks are important institutions to stabilize financial system of a nation by implementing monitory policy and save from inflation, deflation, and the like problems. They can also contribute for a balanced development of different parts of a country by opening branches in rural areas.

In their small scale lending, banks can benefit individuals and families by providing money for their provisional need. They also provide for small scale investment and mercantile businesses. They have great importance a day to day activity of individuals by making business transactions in the country payments easier, safer and cheaper. Payment through banks also avoids the risk of loss or theft of money. Generally, as a source of money and means of transaction, banks facilitate the economic activities of societies and benefit them from the fruits of saving and lending money for various purposes.

Central or national banks harmonize the banking business by regulating the banking system.

* + 1. **Types of and Functions of Banks**

1. Central/National Banks

g Central or national banks are operated for the public welfare and not for maximum profit. They are entrusted with the power of regulating the size of a nation‘s money supply, the availability and cost of credit, and the foreign-exchange value of its currency. Regulation of the availability and cost of credit may be nonselective or may be designed to influence the distribution of credit among competing uses. The principal objectives of a modern central bank in carrying out these functions are to maintain monetary and credit conditions conducive to a high level of employment and production, a reasonably stable level of domestic prices, and an adequate level of international reserves. They have also other functions like acting as fiscal agent of the government, supervising the operations of the commercial banking system, clearing checks, administering exchange-control systems, serving as correspondents for foreign central banks and official international financial institutions, and, in the case of central banks of the major industrial nations, participating in cooperative international currency arrangements designed to help stabilize or regulate the foreign-exchange rates of the participating countries.

Central banks traditionally regulate the money supply by expanding and contracting their assets. An increase in a central bank‘s assets causes a corresponding increase in its deposit liabilities (or note issue), and these, in turn, provide the funds that serve as the cash reserves of the commercial banking system—reserves that commercial banks, by law or custom, must maintain, generally in a prescribed proportion of their own deposit liabilities. As banks acquire larger cash balances with the central bank, they are in a position to expand their own credit operations and deposit liabilities to a point where the new, larger cash reserves no longer produce a reserve ratio greater than the minimum set by law or custom. A reverse process occurs when the central bank contracts the volume of its assets and liabilities.

1. Commercial Banks

Unlike central or national bank, a commercial bank’s purpose is mainly making profit.

They accept and deposit money. In their turn, they provide loans while guaranteed with security or collateral. Loans can range from personal or household use to huge investment projects.

They function as agents or representatives of their clients. These functions include collecting cheques, drafts, bill of exchanges; make payments for their clients; pay insurance premiums of their customers; purchase and sell securities, shares and debentures on behalf of their customers; transfer money payments. They are also important institutions in providing lockers for valuable assets (like precious jewelry, documents), give reference, sell and purchase foreign exchanges and facilitate foreign trade, issue letter of credit.

It is required to hold only a fraction of its deposits as reserves; it can use some of the money on deposit to extend loans. When a borrower receives a loan, his checking account is credited with the amount of the loan; total demand deposits are thus increased until the loan is repaid. Modern commercial bank also offers a wide variety of additional services to its customers, including savings deposits, safe-deposit boxes, and trust services.

1. Saving Banks

A savings bank is a financial institution that gathers savings, paying interest or dividends to savers. Saving banks assemble the capital of the community, conserve the idle wealth, and having aggregated it into sizable funds, loan it to business enterprisers. They add to the peace and comfort and available consumption of society by providing a safe outlet for the funds of those who have the will and capacity to save but do not have the ability either to use the funds industrially themselves or to invest them with safety and profit. They also promote thrift more than any other financial institution. The prudent investment of interest and accumulated principal, which together constitute saving, lessens profligacy, provides against the adversities of old age and sickness, helps the thrifty to buy a home and to enjoy better living conditions, builds up independence and stability of character, and improves the social and political life of the community.They are the intermediary of people with surplus and those who are with shortage of money.

1. Investment Banks

Investment banks are financial intermediaries that perform a variety of services. They specialize in large and complex financial transactions such as underwriting, acting as an intermediary between a securities issuer and the investing public, facilitating mergers and other corporate reorganizations, and acting as a broker and/or financial adviser for institutional clients.

The operation of investment bank is by purchasing all of the new security issue from a corporation and selling the issue in smaller units to the investing public at a price sufficiently high to cover expenses of sale and leave a profit.

1. Development Banks

These banks are national or regional financial institutions designed to provide medium- and long-term capital for productive investment, often accompanied by technical assistance, in less-developed areas. Underdeveloped countries launching national development strategies were keen on accelerating the pace of growth of productivity and per capita GDP. This was the obvious requirement for alleviating poverty and reducing the development gap with the developed countries. To realize this goal, they consider industrialization to be an important prerequisite of national development and thus the efforts of the majority of development banks are directed toward the industrial sector though some are also concerned with agriculture. Whenever commercial banks are unable to cover the financial interests of the economy, development banks are ideal to fill the gap. They may be publicly or privately owned and operated, although governments frequently make substantial contributions to the capital of private banks. The form and cost of financing offered by development banks depends on their cost of obtaining capital and their need to show a profit and pay dividends.

1. Islamic Banking

Islamic banks operate banking activity with the principles of Islamic law (*Sheria*). There are certain restrictions stemmed from moral and ethical values of the Islamic law (like collection and payment of interest (*riba*) and investing in businesses that are considered contrary to its principles or *harem*). These banks run their banking activities with respect to these and other limitations.

* 1. Law of Negotiable Instruments
     1. Meaning and Types of Negotiable Instruments

The Ethiopian Commercial Code of under Article 715(1) 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.”* From this definition we can discern the following basic points about negotiable instruments. First, a negotiable instrument is a document that represents a right. In other words, there is some kind of right that is stipulated under any negotiable instrument. Such a right is usually payment of money that emanates from contractual relationships.

Besides, such a right could not be transferred without the document which makes the right inseparable from the document. Most of all, it is implicitly provided under the above definition that transferring rights is the primary aim of negotiable instruments. The Commercial Code of Ethiopia categorizes negotiable instruments into three main types, i.e., Commercial Instruments, [Transferable] Securities and Documents of Title to Goods.

1. **Transferable Securities**

Transferable securities are negotiable instruments incorporating rights for payment of money arising from loans provided to the government. This happens when any person buys bonds or treasury bills. For instance, many Ethiopians have bought bonds for the Grand Renaissance Dam. That means, through such bonds they have entitled to receive repayment of the money they spent on the bonds together with interest. Therefore, it is possible to mention government bond as an example for transferable securities.

1. **Documents of Title of Goods**

Documents of Title of Goods are negotiable instruments stipulating one’s ownership rights over goods that are being transported or goods which are warehoused. Thus, such documents help the owner to receive goods or claim things back from the warehouse. For instance, if DDU wants to buy books for its libraries from abroad, the first thing to do will be to deal with book sellers, and pay the prices that are agreed on. Then, the books would be shipped to Djibouti port. Unless the university has a document *(bill of lading)* that stipulates its ownership over the books, it is not possible to take delivery of such books from the shipping agencies.

1. **Commercial Instruments**

As it is stipulated under article 732 of the Commercial Code of Ethiopia *“Commercial instruments are negotiable instruments setting out an entitlement consisting in the payment of a sum of money.”* Depending on various factors includingthe market, the amount of money to be paid, the country, the level of understanding and trust between the two parties, the commercial usages in the line of business, restrictions and regulations of the country where the payment has to be made, the necessity to finance the sale of the goods and costs involved, the parties in any transaction could chose among several methods of payment including a payment into an open account, cheque, Draft, guarantee of payment issued by a bank, Documentary Collections or Letter of credit. (J. Keizer H. Wevers: 175)

* + 1. Commercial Instruments

The Commercial Code of Ethiopia recognized a number of commercial instruments namely; ***Bills of exchange, promissory notes, cheques, travellers cheques*** and ***warehouse goods deposit certificates***. Under this section we are going to deal with three of these documents; bill of exchange, cheque and promissory notes.

1. Bill of Exchange and Cheque

*Bill of Exchange* is a commercial document prepared by a person ordering another person to pay some amount of money for the beneficiary. The following definition illustrates what *Bill of Exchange* means.

*“The Bill of Exchange, commonly referred to as the* ***draft*** *or the* ***bill,*** *is an unconditional order in writing, signed and addressed by the* ***drawer*** *(the exporter usually) to the* ***drawee*** *(the confirming bank or the issuing bank usually), requiring the drawee to pay the drawer a certain sum of money at sight or at a fixed or determinable future time.”* (J. Keizer H. Wevers, 175)

Therefore, a Bill of Exchange (a Draft) is an unconditional order in writing by one person up on another for the payment of a certain some of money. To put it differently, it is, like other negotiable instruments, payable absolutely and unconditionally after it has been presented (by the payee) and accepted (by the drawee).

Cheque, on the other hand, is defined as *“a document with which the holder or the person designated in the cheque is able to draw money from the account of the person involved.”* To put it in other words, Cheques are prepared by the person who has a saving account in a bank. The main aim of Cheques is such a person ***(drawer)*** will order banks to pay some beneficiary (beneficiaries), who is also known as a ***payee,*** an amount of money that is going to be deducted from his account.

***Dear learner; do you understand the meanings of drawer, drawee, and payee from the above definitions?***

The drawer is the party who issues the draft and to whom the payment is made. It is the person who prepared the document and issues unconditional order against another person. On the other hand, the payee (beneficiary) is the one who is entitled to or is going to take the payment. Finally, there is the drawee, the party who owes the money or agrees to make the payment and to whom the draft is addressed.

Therefore one of the similarities between bill of exchange and Cheques is the existence of three parties; drawer, drawee and payee. However, in case of cheques the drawees are always banks or financial institutions. That means, cheques are always issued against banks or similar other financial institutions like saving and credit associations. In other words, cheque is a bill of exchange drawn on a bank.

***Figure I. A: A Simple Format of Bill of Exchange***

**Bill of exchange (1)**

**Date: 8/12/2015 (2)**

**Hawassa**

**To: Challa Belete (3)**

**Pay (4) Mr. Fisseha Gemechu (5) Br. 1,000 (one thousand birr only)(6) on 12/12/2015 (7)**

**Bsadh**

**Belachew Dagne (8)**

***Figure I.B: A Simple Format of a Cheque***

**ABC Commercial Bank ABC Commercial Bank ABC Commercial Bank ABC Commercial Bank ABC Commercial Bank**

**Cheque (1)**

**Date 08/12/15**

**Mekelle(2)**

**To: ABC Commercial Bank**

**Main Branch**

**Mekeele(3)**

**Pay (4) Mr. Yassin Hassen (5) Br. 50, 000 (Five thousand Birr Only) (6) on 15/12/15 (7) at the permanent residence of the payee**

**~~FiyoKas~~**

**Fiyori Kahssay(8)**

***Dear learner:***

***Do you see the similarities between the figures? Can you point out the main differences between these two documents?***

As you might witness, there are plenty of similarities between these two negotiable instruments. Particularly, both instruments should encompass the following mandatory and optional requirements.

1. Name of the instrument- it is the name of the commercial instrument. In the above figures, it is “Bill of Excahnge” and “Cheque” which is written on the top of the papers.
2. Date and place of issuance – the place and time of issuance (when and where the drawer prepared the document). Date and places of issuances are stipulated as follows; **Date: 8/12/2015, Hawassa and Date 08/12/15 , Mekelle**
3. Name of the drawee - the name of the person who is to pay. As you can see from the figures, “Chala Belete” and “ABC Commercial Bank” are drawees of the Bill of Exchange and Cheque respectively.
4. Unconditional order – the drawer shall use the term “pay” instead of phrases like “would you please pay” , “would you mind if you pay” or “please pay”
5. Name of the payee- the name of the person to whom or to whose order payment is to be made. Fisseha Gemechu and Yassin Hassen are payees in the above documents.
6. Amount of money- in figure and words **For instance, in the above bill of exchange it is expressed as Br. 1,000 (one thousand birr only). However, in the Cheque it says Br. 50, 000 (Five thousand Birr only) obviously there is a difference between the amount written in figure and words.** Whenever there is inconsistency between the two, the amount stipulated in words will be acceptable. Thus, the amount of money to be paid in the above Cheque will be five thousand birr.
7. Date and place of payment – if the drawer fails to provide date of payment, the document would not be treated as a void document. Rather, the document will be considered as an ***on demand*** instrument.
8. Signature Name of the drawer- The signatures of Fiyori Kahsay and Belachew Dagne are examples.
9. **Promissory Notes**

Unlike bill of exchanges and cheques, there are only two parties in the case of promissory notes; these are the ***promisor*** and ***promisee.*** Threfore Promissory Note is a document whereby one of the parties (the promissor) gives an unconditional promise to pay a sum certain in money to another party (the promisee). The following figure with give you a hint about what could promissory notes look like.

***Figure II. A Typical Example of Promissory Notes***

**Promissory Note(1)**

**Date 15/12/2014**

**Addis Ababa(2)**

**I promise to pay (3)Miss Hanna Alazar or order (4)Br. 50 (fifty birr only) (5) on 1st January 2015(6) in Bahir Dar(7).**

**Nejat A**

***Nejat Ali(8)***

**Illustration**

1. Name of the Instrument
2. Date and place of Issuance
3. Unconditionalpromise to pay
4. Promisee – the name of the person, to whom or to whose order payment is to be made or a statement that the note is payable to bearer
5. Amount of payment
6. Time of payment;
7. Place of payment;
8. Signature of (the promisor)- the person who issues the instrument (maker)
   * 1. Bearer, Demand and Order Instruments

***Dear learner: are you familiar with these terms? In the Ethiopian official paper money (notes) there is a phrase which says “payable to the bearer on demand” (ላምጪው እንዲከፈል ህግ ያስገድዳል፡፡.)What do you think it means?***

1. **Bearer Instruments:**

We call documents bearer when the instrument says “pay the bearer” or “pay to the holder” instead of mentioning the name of the beneficiary. In case of bearer instruments, the holder or the person who is in the possession of the instrument is considered as the beneficiary. In other words, the drawee shall pay the person who approaches him for payment as long as he has the instrument at his hand.

1. **On Demand (At Sight) Instruments:**

Demand instruments are documents by which there is payment whenever the beneficiary claims for payment. We call instruments demand when the document explicitly says “on demand” or “at sight”. Besides, the document is still demand whenever the drawer fails to mention the date of payment. In cases of demand instruments, the drawee is duty bound to pay the beneficiary by the time he is asked for payment.

1. **Order Instruments:**

Contrary to bearer instruments, in the case of order instruments there is a specific beneficiary whose name is mentioned in the document. In case of order instruments the payee can take the money or order the payment for another person. Therefore, when the document encompasses a phrase which says “…or order”, it is an order instrument. The document is still an order instrument even if there is no such kind of phrase as long as there is a specified beneficiary under the document. But the drawee could say “not to order” where the beneficiary becomes the one whose name is mentioned in the document.

Examples:

**Bill of Exchange**

**Date 11/11/11**

**To: Yusuf Ibrahim**

**Pay to Mr. Yafet Abrham Br. 10 (Ten Birr Only)**

**~~Amira Ab~~**

**Amira Abdella**

**Bill of Exchange**

**Date 11/11/11**

**To: Yusuf Ibrahim**

**Pay to the bearer Br. 10 (Ten Birr Only) on demand**

**~~Amira Ab~~**

**Amira Abdella**

***Figure II. B.A Figure II.B.B***

**Bill of Exchange**

**Date 11/11/11**

**To: Yusuf Ibrahim**

**Pay Mr. Yafet Abrham or order Br. 10 (Ten Birr Only) on 12/12/12**

**~~Amira Ab~~**

**Amira Abdella**

**Bill of Exchange**

**Date 11/11/11**

**To: Yusuf Ibrahim**

**Pay to Yafet Abrham not to order Br. 10 (Ten Birr Only) on 12/12/12**

**~~Amira Ab~~**

**Amira Abdella**

***Figure II.B. C Figure II.B. D***

From the above documents II.B. A is a bearer instrument as it is clearly shown in the figure. Similarly, it is a demand instruments since the document explicitly says “on demand”. Similarly, II.B.B is also a demand instrument since there is date of payment stipulated in the document.

On the other hand, figure II.B.C is an order instrument since there is a clear stipulation while II.B.B is also an order instrument since there is a specific beneficiary. However, Figure II.B.D is not an order instrument since it clearly says “not to order”.

* + 1. **Endorsement**

**Dear learner: do you remember the difference between “bearer” and “order” instruments that we have discussed above? What do you think is their difference with respect to transfer of rights?**

One of the typical features of negotiable instruments is transferability whereby these documents must be readily transferable from one person to another. In case of bearer instruments, ***simple delivery*** of the document amounts to transfer of a right together with the document. The reason is that anyone who possesses bearer instruments is considered as a beneficiary. Therefore, if a person simply delivers a bearer instrument to another the latter is considered as a payee or beneficiary by the mere fact of his/her possession of the document which says “pay the bearer/ holder”.

On the other hand, such transfer of rights could only be achieved through ***endorsement*** followed by***delivery*** of the documentwhenever the document is an order instrument. ***Endorsement*** is a process of writing the name of the endorsee on the back of the instrument with the instrument with the intent to transfer the right. There are various types of endorsements that are recognized under different legal systems. Let us have a brief look at each of these types of endorsements based on the following example.

**Bill of Exchange**

**Date 11/11/11**

**To: Birra Ahmed**

**Pay Mr. Hadush Abrham or order Br. 10,000 (Ten Thousand Birr Only) on 12/12/12**

**~~Amira Ab~~**

**Azmeraw Bekele**

1. **Ordinary Endorsement:** It consists of the signature of the transferor (endorser) with or without the word “pay”, the name of the endorsee and the date of endorsement. For instance, if Mr. Hadush (Payee) wants to transfer his right to Miss Ahlam Yunus through ordinary endorsement, he shall write the following on the back of this document;

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Pay Miss Ahlam**

**Hadush A**

**15/11/11**

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. **Endorsement-in-Blank** : In this case the endorser simply puts his signature without mentioning the name of the endorsee. That means, the payee has shown his intent to transfer his right to unidentified beneficiary. If he wanted to transfer the right through endorsement-in-blank, Mr. Hadush should simply put his signature on the back of the instrument like this;

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Hadush A**

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Starting from this time (after Mr. Hadush puts his signature), anyone who holds the document (the bearer) is considered as an endorsee (beneficiary). In other words, the document becomes a bearer instrument after it is being endorsed in blank. To put it differently, endorsement-in-blank automatically changes *order* instruments to *bearer*.

1. **Partial Endorsement:** This occurs when the endorser transfers only part of his right to another person. The following “endorsement” could be an illustration for partial endorsements.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Pay Miss Ahlam Br. 5,000**

**Hadush A**

**15/11/11**

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

However, such type of endorsement is invalid under our legal system since from the very begning we said that in case of negotiable instruments, rights contained in such instruments cannot be transferred separately from the document. Thus, Mr. Hadush could not separately transfer the right (the Br. 5,000). Thus, endorsement should be made to the full value of the instrument, i.e., endorsement for part of the value of the instrument is not possible, and partial endorsements are generally invalid.

1. **Conditional Endorsements:** These types of endorsements exist when the endorser puts some kind of condition with the endorsement. See the following example;

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Pay Miss Ahlam if she get married by the date of payment**

**Hadush A**

**15/11/11**

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

In this case, the right of Miss Ahlam is subjected to a stringent condition, which is getting married. In other words, if she wants to stay single, she is not entitled to the right. However, this type of endorsement is also invalid since our law stipulates that the rights on negotiable are transferred or paid unconditionally. Because of that, we can say that conditional endorsements are invalid endorsements.

**Summary**

Under this chapter we have discussed with the meaning and economic significance of banking. Moreover, various types of banks and their distinct features as well as fundamental functions have been dealt with in the chapter. On the other hand, the meaning and types of negotiable instruments was the other theme of the chapter. Particularly, the chapter dealt with commercial instruments, namely bill of exchanges, cheques and promissory notes. Together with this, the chapter discussed the nature and special features of the instruments accompanied by notes on how the rights, stipulated on these documents, are transferred.

# Self Test Questions 8

1. **Look thoroughly at the following document and answer questions 1-5**

|  |
| --- |
| XXXXXXXXX  Date 15-5-2015  To: Hagos Kahsay  Pay Mr. Gemechu Regassa Br.10 (Ten Birr Only) on 16-5-2015  ~~Desta~~  Desta Gize |

1. What is the negotiable instrument depicted above?
2. Bill of Exchange
3. Promissory Note
4. Cheque
5. Treasury Bill
6. Could not be known
7. Who is the Drawer of the document?
8. Hagos Kahsay
9. Gemechu Regassa
10. Desta Gize
11. The bearer
12. A&D
13. Who is the drawee in the instrument?
14. Hagos Kahsay
15. Gemechu Regassa
16. Desta Gize
17. The Beneficiary
18. C&D
19. When will be the date of payment?
20. On 15-3-2015
21. On demand
22. Whenever the payee claims
23. B&C
24. It is not known
25. Which of the following is **NOT** true about the document?
26. It is an Order instrument
27. It is a bearer instrument
28. It is demand instrument
29. It is invalid document since there is no date of payment
30. None
31. **Write short answers for the following questions**
32. Discuss the fundamental functions of at least three types of banks that we have discussed in the chapter
33. Write at least three economic significances of banking
34. Briefly discuss the three types of negotiable instruments
35. Briefly discuss the basic differences between bill of exchanges, cheques and promissory notes
36. What does someone mean when he say bearer, order and demand instruments?

**UNIT NINE**

# LAW OF BUSINESS ORGANIZATIONS

|  |
| --- |
|  |

**Introduction**

Dear students, you have discussed contract in general and some special contracts in previous chapters. Business organizations are entities arising from special contract which is termed as partnership agreement. They are familiar part of everyday life; mainly where free market economy prevails. Business organizations run the supermarkets from which we buy our foods and attires; they supply the water, gas, and petroleum products we depend on; they publish the books and newspapers we read. In Ethiopia, most, if not all, of the business organizations are legal entities which have firm-names and head office; they can acquire rights and incur liabilities, and can sue and be sued under their firm names. Business organizations, from a legal viewpoint, are undertakings with more than one member, having assets distinct from the private assets of the members and a formal system of management, which may or may not include members of the organization. This chapter explains to you the definition, formation, basic features and types, and dissolution of business organization.

# 🏳 Unit Objectives

**After successful completion of this Chapter, you will be able to**

* define business organization;
* explain a partnership agreement;
* describe legal personality and attributes of legal personality;
* differentiate the basic types of business organization; and
* distinguish between limited and unlimited liability of business organizations.
  1. Definition of Business Organization

**🖎** What is a business organization?

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

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Article 210 of the Commercial Code defines a business organization as “any association arising out of a partnership agreement.” Pursuant to Article 211 of the Code, A partnership agreement is “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 thereof ,if any.”

Article 223 reads “A business organization shall have no legal existence nor personality until all the provisions of this Code relating to publicity have been complied with and registration is published in accordance with Art. 87 of this Code.”

A cumulative reading of Articles 210 and 223 reveals two important aspects of business organizations, namely the contractual and institutional ( or, organizational) aspects. According to article 210 a business organization is an association stemming from a contract known as “partnership agreement.” Article 223 suggests that even if a business organization emanates from a partnership agreement, the mere fact of concluding a valid partnership agreement is not enough to create a business organization at law. It needs additional aspect to be complied. In the words of Everett F. Goldberg, “[a] business organization has an institutional aspect with an existence dependent upon, but separate from, the partnership agreement.”

* 1. Basic features of Business Organization

The first feature, initial plurality of membership, distinguishes the business organization from the business owned by one man; in the latter case the trader can do as he pleases with its assets, since he is personally liable for debts and obligations incurred in connection with the business.

The second feature, the possession of distinct assets, is essential for two purposes: to identify the assets to which creditors of the organization can resort to satisfy their claims (though in the case of some organizations, such as the partnerships they can also compel the member to make good any deficiency), and to make clear what assets the managers of the organization may use to carry on business for the member’s benefit. The assets of an organization are brought in directly by its members by way of contribution. Contributions may be made in cash, kind, and service in all forms of business organizations other than the Share Company or private limited company.

The third essential feature, a system of management, varies greatly. In a simple form of business organization the members are entitled to participate in the management, and each member has an equal voice in management decisions.

The fourth feature, business organizations are affected by the legal environment in which they operate. Accordingly, two aspects of the Law of Business Organizations should be noted. First, the law facilitates various combinations of labor, capital and management. Certain business or economic goals may be better served by one organizational form than another. The second noteworthy feature of the Law of Business Organizations is that each form of organization imposes varying degrees of legal formalities on its participants. Further, one’s business relationship may have different legal consequences, depending on which organizational form is selected.

* 1. Formation of Business organization

Generally, any business organization must be formed by a contract known as partnership agreement. Article 211 of the Commercial Code defines the partnership agreement as “a contract whereby two or more persons intend to joint together and to cooperate undertake to bring together contributions for the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising out thereof.”[Emphasis added]

* + - 1. The partnership agreement
  1. A Partnership agreement is a contract

The partnership agreement is a contract concluded between at least two persons who wish to carry on an enterprise in an organized manner. Thus, the partnership agreement, being a contract, is subject to the Civil Code provisions governing contracts in general, in addition to the pertinent provisions of the Commercial Code. Accordingly, in order for a contract to be a valid partnership agreement, the parties to it must fulfill the substantive and formal conditions set down by Article 1678 et seq of the Civil Code. That, is, the parties must be persons, physical or juristic, having capacity to enter into contracts. They must also give their free consent. Besides, their business objects must be sufficiently defined, lawful and moral, and possible. Furthermore, a valid contract has to be made in the required form, if any. Article 214 of the Commercial Code provides that “formation of any business organization other than a joint venture shall be of no effect unless it is made in writing” Under this sub-topic we see also about the case of two people: Persons incapable to carry on trade and spouses.

* + 1. Persons Incapable Under the Civil Code

The validity of a partnership agreement is affected by the incapacity of a party to it in the same way as in any other contract. In this regard, the Commercial Code contains a few provisions that supplement the Civil Code.

Article 11(1) prohibits persons incapable under the Civil Code from carrying on any trade. Sub-article(2) of the same provides that if an incapable person carries on a trade, any of his acts related to the trade may be invalidated in accordance with the pertinent civil code provisions. The provisions of article 11 also apply mutatis mutandis to the incapacity of a party to become a member of a business organization in which one has the status of a trader. A general partner in a commercial general partnership or commercial limited partnership is deemed to be a trader.

Article 12 prohibits the tutor of a minor or an interdicted person from carrying on a trade in the name and on behalf of the minor or interdicted person, except in the cases provided in article 288 of the Civil Code. The effect of this provision is to preclude the tutor from joining, in the name of a minor or an interdicted person, a business organization which would make the minor or interdicted person a trader. According to Article 288 of the Civil Code, a tutor may carry on commercial, industrial or other enterprises forming part of the estate of the incapable if is so instructed by the family council. Also under article 276 of the Revised Family Code, the tutor shall do so if is enjoined to do that by a court. The family council or the court, as the case may be, must instruct the tutor whether to liquidate or to keep them going, having regard to the time for which the tutorship is to last, the abilities and potentialities of the tutor, and the interest of the incapable.

Article 13 provides that emancipated minors may not carry on a trade unless authorized in writing by the family council.

Beware that protection of the addressee is the purpose of the rules on incapacity. The law extends protection also to third parties against the risks of having dealings with incapables and thereby promoting security of commercial transactions. Pursuant to Article 14, minority cannot be set up against third parties where a minor who carries on a trade got himself entered in the commercial register as though he were of age. According to Article 15, judicial interdiction does not affect third persons unless notice of the incapacity is entered in the commercial register.

* + 1. Spouses

As per Article 16, married couples may become members of a business organization as if they were not married. A spouse may object in the interest of the family to the other spouse’s becoming a member of a business organization which bestows upon the latter the status of trader. The effect of such objection is to limit the trading spouse’s liability for business debts only to the extent of his personal property. As long as such debts are normally considered to be of the marriage, and, thus, recoverable against the personal property of each spouse and the matrimonial regime, such objections do not preclude the trading spouse from becoming a member of the business organization. The objections can be set up against third parties if only entered in the commercial register.

(b) Two or more persons, physical or juristic, can be parties

Generally, nothing prevents a business organization from becoming a member of another business organization. An association may not become a general partner of a commercial general partnership or commercial limited partnership, since, pursuant to Article 25, it “ may not carry on any trade.” Whether it may become a member of another business organization depends on whether it thereby acquires as one of its purposes the making of profits. If it does, it may not become such a member. Nevertheless, noting seems to prevent an association from joining a share company or private limited company as a means of investing extra funds or acquiring more funds to carry out its legitimate purposes.

The minimum requirement of two persons is true for all business organizations except the share company, for which there must be at least five. The automatic effect of the operation of the rule on the minimum number of persons who can enter into the partnership agreement is the exclusion of sole proprietorships from the Law of Business organizations. Put differently, one person cannot form a business organization by himself.

On the other hand, a question arises as to the maximum number of persons who can be members of a business organization. There is no general limit on the maximum membership size of business organizations, except in the private limited company where it is fixed at fifty.

(c) Intent to Join Together and Cooperate

For a partnership agreement to be valid, the parties to it must have had the intention “to join together and to cooperate.” In effect, this is to mean that the parties to the partnership agreement acted in the way they did with a view to forming a business organization. In addition, they must have intended to collaborate on an equal footing though they all need not intend to participate in the management and control of the business organization. The degree of collaboration expected from members varies from one form of business organization to another.

(d) Contributions

The parties must undertake to bring in contributions in order that a contract subsists as a valid partnership agreement. Contributions can be made in cash, kind, or services. In all business organizations, except in a share company or private limited company, they should be made in cash or kind. Capital contribution includes intangible property. Cases in point are copyrights, utility models, patents, trademarks, service marks, and trade secrets, including debts owed to and the use of property belonging to the contributor.

(f) For the purpose of carrying out economic activities

The objective of the parties to a valid partnership agreement must be to engage in economic activities. The formulation under article 211 which stipulates that “activities of an economic nature” is so broad that it would appear to cover almost any profitable human endeavor, provided that it is possible, moral and lawful. At this stage, it has to be pointed out that economic activities include, but not limited to, all of the commercial activities mentioned under Article 5. However, you should bear in mind that all non-economic activities are excluded outright by virtue of the above-mentioned requirement.

(g) Participating in the profits and losses arising out thereof

Every party to the partnership agreement must have the intention to share in the profits and losses. Profits and losses will be distributed between the members in the proportion stipulated in the partnership agreement. In the absence of such stipulation, every partner shall have an equal share in the profits and losses, irrespective of his contribution [Article 252 (1)]. Any stipulation giving all the profits to one partner or relieving one or more of the partners of his share in the losses is null and void (Article 215).

1. Publicity

A further formality requirement imposed on the parties to a valid partnership agreement is publicity. According to Article 219(1) of the Commercial Code “any business organization other than a joint venture shall be made known to third parties.” The policy consideration behind the publicity requirement is to protect third parties. Members are required to bring to the attention of the public that they have formed a business organization. This requirement is unique to partnership agreements, as distinct from other contracts, because the very existence of the business organization depends on its fulfillment.

Publicity consisted in cumulative fulfillment of the requirements relating to publication of notice, deposit of documents, and registration in the commercial register [Articles 220-224, Com. C.]. However, Proclamation No.376/2003 does away with the first element of publicity, namely publication of notice. Article 2(2) of the same provides that “Business organizations shall acquire legal personality by registering in the commercial register without being publicized in a newspaper as provided for under Article 87,219,220,223, and 224 of the commercial code for their establishment and amendments to their memorandum of associations.”

* 1. Legal Personality of Business organization and its Attribute

As far as the law is concerned, it is not only human beings who count as persons. In some cases, the law creates artificial persons, such as bodies corporate under public law, associations, cooperative societies, and business organizations, which are dealt with legally as if they were people; this is called having legal personality. Only when an entity has legal personality can it have legal rights and duties. A human being has legal personality from the beginning to the end of his life. Article 1 of the Civil Code provides that “the human person is the subject of rights from its birth to its death.” In addition to individuals, groups of people can have legal personality. They are broadly called business organizations, and they allow the law to treat the group as separate from the individuals who operate or own it. Article 210(2) of the Commercial Code stipulates that “any business organization other than a joint venture shall be deemed to be a legal person.” Legal personality, therefore, is a device whereby groups of people such as business organizations become the subject of rights and duties.

Attributes of Legal Personality

(a) Capacity. The fundamental importance of legal personality is that an entity with legal personality is capable of enjoying, as opposed to exercising, rights. Business organizations are, pursuant to Article 22 of the Commercial Code, expressly invested with the capacity to “carry on any trade in accordance with the provisions regulating such trade.” Nevertheless, no express rule exists pertaining to the capacity of business organizations to carry out other activities and to enter into juridical acts in general.

With respect to scope of the capacity of business organizations with legal personality, we can put forward the following argument by drawing on the general rules for physical persons as well as associations provided in Articles 192 and 454(1) of the Civil Code respectively. Business organizations with legal personality should be capable of performing all the acts of civil life consistent with their nature unless declared incapable by law.

Since a business organization is basically a combination of individual members and initial capital, the members would be co-owners of the property if the organization does not have a separate legal existence. Any liability incurred, in the normal business practice, by one or more of the members in their name shall rest with them. However, if the law bestows upon the organization legal personality, it may acquire right of ownership over the property and incur liability in its name. Furthermore, it can litigate legal proceedings in its firm-name. Also, it is primarily liable on its property, income & taxable activities.

(b) Firm name. Another attribute of a legal person is name. The name of a business organization, firm-name, is chosen by the members in pursuance of the rules governing firm-names. The Commercial Code contains specific requirements for names of all business organizations except an ordinary partnership. The name of any business organization other than the ordinary partnership must indicate the form of organization: whether it is- “General partnership,” “ share company,” etc. Besides the firm-name of a general partnership should include the names of at least two partners and the name of a limited partnership may only consist of the names of the general partners. A share company and private limited company may be operated under assumed names chosen freely, provided that they do not offend public morals and the rights of third parties.

(c) Head Office. The head office of a business organization is the place where its principal organs of administration and management are situated. The legal effects of the place of its head office are the same as those of residence for the physical person. The significance of the location of its head office figures prominently in procedural matters in particular in relation to judicial jurisdiction and service of process. Moreover, it determines nationality of the business organization under consideration.

(c) Nationality: The general principle concerning bodies corporate whose head offices are situate abroad is that they have such nationality as is given to them by the laws of that country. Consequently, a legal person with its head office in Ethiopia is presumably of Ethiopian nationality in spite of the absence of an express provision. As can be gathered from a reading of Articles 545-549 of the Civil Code in conjunction with Articles 555-560 of the Commercial Code, the formation or operation of a business organization and its enjoyment of rights in Ethiopia depend upon the following three factors; the place where its principal business purpose is situate, and the country under whose law it is formed.

A business organization with its head office in Ethiopia is subject to Ethiopian law with respect to its formation and operation. An organization with its head office abroad is subject to Ethiopian law if it is formed in accordance with Ethiopian law or if its principal business object is in Ethiopia. An organization formed abroad (and, presumably, with its head office and principal object of business abroad) must register in Ethiopian offices.

* 1. Forms of Business Organization

🖎 What do the different forms of business organizations look like?

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

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Though the main classification 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:

1. Ordinary partnership
2. Joint venture
3. General partnership
4. Limited partnership
5. Share company
6. Private limited company
7. **Ordinary Partnership**

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

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

A party who contributes a property has the same obligations of a seller, that is, to deliver the thing, to transfer ownership and to warrant the buyer against defects.

Where property is contributed, the risks shall pass to the partnership in accordance with provisions relating to sale.

1. **Joint Venture**

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

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

1. **General Partnership**

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

1. **Limited Partnership**

The limited partnership is basically the same as general partnership. But there is one exception. In limited partnership, there are two types of partners. One or more of its members have limited liability. General partners in limited partnership have unlimited liability. A limited partnership has a firm name.

1. **Share Company**

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

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

A share company shall not remain in business for more than six months after the number of members is reduced to less than five.

1. **Private Limited Company**

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

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

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

* 1. **Liability of Business Organizations**

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

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

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

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

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

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

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

**Criminal Liability:**

Criminal liability of Business organization or juridical persons represents formal public disapproval and condemnation because of the failure to abide criminal law and resulted with more severe penalties because than the civil liabilities discussed above. An entity can be held liable for its wrongful acts by virtue of two legal principles:

**1. Vicarious liability:**

The legal principle of **vicarious liability** applies to hold one person liable for the actions of another when engaged in some form of joint or collective activity. The general rule in the criminal law is that there is no vicarious liability. This reflects the general principle that a crime is composed of both an *actus reus*(commission or omission) and a *mens rea* (intention) pursuant to Articles 23, 58 and 59 of the Criminal codeand that a person should only be convicted if he, she or it is directly responsible for causing both elements to occur at the same time. Thus, the practice of holding one person liable for the actions of another is the exception and not the rule in criminal law. In the criminal law, **corporate liability** determines the extent to which a corporation as fictitious person can be liable for the acts and omissions of the natural persons it employs. It is sometimes regarded as an aspect of criminal vicarious liability. A company can be vicariously liable to many offences of strict liability and negligence for the acts of its employees in the course of their duties.

**2. Direct liability:**

The idea that a company is a legal person that could sue and be sued in its own name, has given way to the law maker superimpose its individualistic conception of criminal liability to legal persons. The acts of individuals who had committed the offence are identified with the company itself. In such circumstances the company as well as the individual could be criminally liable.

**Art 34/4 of the Criminal Code Meaning of Juridical Person/Corporation:**

For the purpose of the applicability of Art 34, "juridical person" means a body which has

governmental or non-governmental, or public or private structure and includes any legally recognized institution or association set up for commercial, industrial, political, religious or any other purpose.

**Principles relating to Criminal liability of Corporations Under the Criminal Code of Ethiopia: Art 34**

A juridical person, other than the administrative bodies of the State is punishable, where it is expressly provided by law, in any of the following capacities (Art.34/1):

1. Principal criminal,

2. An instigator or

3. An accomplice

**Essentials to attach criminal liability to juridical persons:**

A juridical person shall be deemed to have committed a crime and punished as such if the following essential elements of such commission are established:

* 1. One of its officials or employees commits a crime as a principal criminal, an instigator or an accomplice,
  2. In connection with the activity of the juridical person
  3. With the intent of promoting its interest
  4. By an unlawful means or by violating its legal duty or by unduly using the juridical person as a means.

**Punishment in case of juridical persons:**

* 1. Fine under sub-article (3) or sub-article (4) of Article 90 of this Code; and
  2. Suspension or closure or winding up of the juridical person may be ordered where necessary
  3. Individual liability on the officials or employees of the juridical person may be additionally imposed for their personal criminal guilt.

# SUMMARY

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

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

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

# SELF- TEST EXERCISES

**Answer the following questions in the given spaces.**

**Part I. True/ False item.**

1. The main purpose behind formation of business organizations is to generate profits.

2. A business organization is an association arising out of a partnership agreement.

3. All members of a partnership agreement shall make contributions in kind.

4. It is possible for an individual person to form (create) a business organization alone.

5. A partnership agreement shall be reached only by persons having given their consent to be bound by the agreement.

**Part II. Short answer**

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

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2. An ordinary partnership is made to be one of the six forms of business organizations which the Ethiopian commercial code recognizes. Yet, it is different from other kinds of business organizations in that it does not share the features with which the other business organizations are characterized. So, can we take ordinary partnership as a business organization proper? Why/ why not?

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

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11. The Civil Code of Ethiopia, (1960)
12. Labour Proclamation No 377/2003
13. The Commercial Code of Ethiopia, (1960)
14. Vanderlinden Jacques , The law of physical persons, (1969)

1. See Art.1696 and the following of the Civil Code of Ethiopia, 1960 [↑](#footnote-ref-1)
2. See Art.1681of the Civil Code of Ethiopia, 1960 [↑](#footnote-ref-2)
3. See art. 1689 of the Ethiopian Civil Code, 1960 [↑](#footnote-ref-3)
4. For more details See also Art.1701 of the Ethiopian civil code, 1960 [↑](#footnote-ref-4)
5. Arts.3(2) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-5)
6. Arts.4 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-6)
7. Arts.5 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-7)
8. Arts.4 (3) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-8)
9. Arts.11(1) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-9)
10. Arts.11(3) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-10)
11. Arts. 85 (1) & (2) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-11)
12. Arts. 73 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-12)
13. Arts. 74 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-13)
14. Arts. 87 (2) to (6) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-14)
15. Arts. 88 (1) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-15)
16. Arts. 88 (3) & (4) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-16)
17. Arts. 92 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-17)
18. Arts. 93 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-18)
19. Arts. 25 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-19)
20. Arts. 31 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-20)
21. Arts. 32 (2) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-21)
22. Arts. 33 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-22)
23. Arts. 26 (1) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-23)
24. Arts. 27 (1) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-24)
25. Arts. 27(3) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-25)
26. Arts. 28 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-26)
27. Arts. 34 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-27)
28. Arts. 35 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-28)
29. Arts. 28(2) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-29)
30. Arts. 137 & 138 (1)( b) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-30)
31. Arts. 43 (1) & (2) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-31)
32. Arts. 43 (3) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-32)
33. Arts. 43 (4) of Labour Proclamation No. 377/2003 [↑](#footnote-ref-33)
34. Arts. 45 of Labour Proclamation No. 377/2003 [↑](#footnote-ref-34)