

# Law of Sales and Security Devices

Teaching Material

**Prepared by:**

**Gadissa Tesfaye  
&  
Mebrathom Fetewi**

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## **PART ONE – LAW OF SALES**

### **Chapter One**

#### **Introduction**

An overall understanding of the law of sales is a condition to avoid ambiguity in the detailed discussion of the course. It can shade light on the general nature of the subject matter, the transactions under its ambit, its function and relevant general information about the course. Accordingly the introductory chapter is intended to give general information about the course of law of sales.

The general information about the law of sales will give emphasis on the subject matter, scope and function of law of sales. In discussing the subject matter of law of sales the goods and price will be emphasised discussed. Different classifications of goods and their recognition under the Ethiopian law of contract of sale will be considered. Price expressed in money as a subject matter of law of sales will also be discussed.

In addition to the subject matter of law of sales the scope and function of law of sales will also be discussed. In discussing the function and scope of law of sales social interaction which is regulated by law of sales and its very purpose of facilitating movement of goods will be addressed. Regulating, gap filling, encouraging optimal performance and reliance will also be discussed as functions of law of sales.

Therefore, upon the successful completion of this chapter you are generally expected to

- recognize the subject matter of law of sales
- delimit the scope of law of sales
- list the functions of law of sales
- put the role of law of sales and sales contract in the society

## 1.1. The Subject matter of law of sales

As knowing the subject matter of law of sales is of paramount importance in understanding the general nature of law of sales contract, existing goods, goods belonging to third parties, future goods, contingent goods, and price as a subject matter of law of sales will be discussed. Thus, upon successful completion of this section, you will be able to

- list the type of goods and show their difference
- analyze the relationship between these goods and the formation requirement of sales contract
- analyze the relationship between price and the formation requirement of sales contract
- analyze the requirements for the formation of general contract and contract of sales in light of the subject matter of law of sales

Law of sales is a branch of business law that regulates the relationship between the buyer and seller of goods. It is a collection of rules pertaining to the formation, performance and breach of contract of sale. It imposes certain duties on the buyers and sellers the breach of which gives rise to remedy. When the dispute between buyer and seller result in litigation before the court of law, the court applies law of sales and general contract provisions to adjudicate the dispute. Article 1676 of the civil code clearly indicates that the general contract provisions are applicable to contracts including contract of sale in a way they do not contradict with special provisions.

Principally the subject matter of sale is “goods”. Goods are generally things such as chair, desk, electricity which can be appropriated by human beings. Although goods can be classified differently, goods can be classified into existing goods, future goods and contingent goods. Although there is no such classification in the Ethiopian law of contract of sales Article 2266 and 2267 shows that it is corporeal chattels which are under the ambit of contract of sale.

In addition, goods price is also the subject of law of sales. The parties must define the subject of their dealings with precision. The subject of contract of sale, according to Article 2270, could be existing thing, future thing or things belonging to third party.

*Art. 2270. - Subject of sale.*

*(1) A sale may relate to an existing thing belonging to the seller.*

*(2) A sale may also relate to a future thing which the seller undertakes to make for delivery to the buyer.*

*(3) It may also relate to a thing belonging to a third party.*

### **1.1.1 Existing goods**

Existing goods are goods, which have physical existence. In addition to physical existence, the goods should be in the seller's ownership or possession when the contract is concluded. It does not matter that the thing is in possession of third party. The owner is considered to have general property right to sell the goods. Article 2270 of the civil code in its sub article (1) and (3) obviously connotes that existing goods belonging to the seller and belonging to third parties can be subject of contract of sales.

Existing goods can also be classified into specific and unascertained goods. Specific or certain goods are goods identified and agreed upon at the time of conclusion of the contract.

In contrast, unascertained goods are goods which are not separately identified or ascertained when the contract of sale is concluded. Although they are not separately identified unascertained goods shows goods defined by description.

### **1.1.2 Goods belonging to third party**

The seller may sell the thing that belongs to the third party at the conclusion of the contract. Things belonging to third parties are existing goods. Bailee and pledgee sell the thing that belongs to the bailor or pledger. The seller shall have actual control of the thing to be sold and in the examples given above, both the bailee and pledgee have actual control over the thing. Although the goods can belong to third party, that third party shall have the ownership or possession of the goods to be sold. As possession does not necessarily mean actual control, a person who does not have possession but has actual control may conclude sales contract. Even a person who is not the owner and who does not have actual control can also conclude sales

contract whose subject belongs to the third party. An agent can be the best example of this when he agrees to sell a thing which is under the ownership and possession of the seller.

### **1.1.3. Future goods**

Future goods are goods which do not exist at the time of the contract or are not in the hands of the seller although they do have material existence. Goods to be produced manufactured or acquired by the seller after the formation of the sale contract are termed as “future goods”. Concerning this, Article 2270 (2) clearly states “a sale may relate to a future thing which the seller undertakes to make for delivery to the buyer”.

If for example Mr. Belay agreed to sell milk but the milk, which his cow may yield during the coming year, is an illustration of future goods, which did not have material existence at the time of the conclusion of the contract of sale.

If Mr. Belay agreed to sell two kilos of coffee which will be delivered to him after one month, the subject of contract of sale is said to be future good which has material existence but not yet in the hand of the seller.

### **1.1.4. Contingent goods**

There are also special future goods, which are called contingent goods. Contingent goods are future goods which the seller acquires depending on an uncertain contingency. The specialty with contingent goods is that the seller may or may not acquire the goods depending on the condition.

Can the parties make non-existent goods the subject matter of contract of sale?

The answer seems negative. The subject matter of contract sale must only be existing thing, future thing or things belonging to third party. Thus, if Naol agreed to sell to Becky his tape recorder, which was destroyed by fire yesterday, their contract is null and void. To begin with it might be said that the object of the contract is impossible. A contract whose object is impossible is said to be void contract. In addition it is moot if, mistake of the existence of the object can be

valid ground to invalidate the contract. Doctor Girma in their commentary on general contract under the Ethiopian law has put inexistence of the object of the contract to make the contract invalid for the object is impossible and there is mistake as to the existence of the object of the contract.

However, contrary position seems to exist under Article 2326 that deals with things under voyage. This provision transfers risk, even when the thing does not exist at the time of the conclusion of the contract. Risk is transferred in cases where the seller did not and should not have known that the thing was damaged or perished. Transferring risk for a thing, which does not exist at the time of the conclusion of a contract, connotes the formation of a contract even when the thing does not exist. Then this might lead us to conclude that sales contract may relate to things which do not exist at the time of the formation of the contract as is indicated under things under voyage.

In addition to goods price expressed in the form money is also the subject matter of contract of sale. The parties to the contract of sale must specify the price of the thing sold. If the parties do not determine the price of the thing or if the price of the thing is not determinable, there is no contract of sale. The parties may make the price determinable by referring to the arbitration of the third party according to Art.2271.

*Art. 2271. Price estimated by third party*

*(1) The price may be referred to the arbitration of a third party.*

*(2) There shall be no sale where such third party refuses or is unable to make an estimate.*

According to this article, to say that a contract of sale is formed the party must specify the price in their contract or refer to the arbitration of the third party. And the price referred to the arbitration of the third party must be determined as agreed. Otherwise, there would not be formation of the contract of sale. However, it should be noted that if the price is determined in a way it can be easily ascertained by judicial interpretation as in Articles 2305 – 2308 of the civil code, the formation of the contract cannot be questioned.

For example, Aden agreed to buy a used computer from Bushra for satisfactory price without determining the price of the computer. Thus, Eden agreed to pay the price determined by Guled who is a mechanic. Aden has taken delivery of the computer. Unfortunately, Guled died before he determined the price in a car accident. Thus, there is no contract of sale in this hypothetical example as the arbitrator is unable to determine the price of the used computer. However, Aden agreed to pay a price usually charged by the seller, it can be determined by referring article 2307.

? Can the parties refer the determination of the price to the market force? For example, can the party agree that the price would be the market price to be determined at some future date?

In some jurisdictions, for example in India, the parties may refer the price to be determined by a magazine which contains a list of items and their price and which is published regularly. The same is true in Ethiopia. For example, in Ethiopia, Ethiopian Tea and Coffee Authority, announces the price of coffee through Ethiopian Radio. Thus, the parties can agree that their price is the price to be announced by Ethiopian Tea and Coffee Authority. Still, there will be no contract of sale if the authority fails to announce the price on radio. It is not necessary that the third party be a natural person.

Price of the thing sold can also be determinable when the thing has a current price or market price or when the seller normally deals in the thing sold. In such situation, the price would be the market price or the price normally charged by the seller.

## **1.2. Function and scope of law of sales**

Having seen the subject matter of law of sales, it is worth discussing the function of law of sales and its scope of application. In discussing the function and scope of law of sales, the role which the law of sales plays, the transactions which are under the ambit of law of sales and the things or goods which can be and cannot be subject of law of sales will be discussed. Hence this sections aims at acquainting you with

- The ability to identify what the function of law of sales is

- The ability to demarcate the function of law of sales in governing transactions
- The ability to list major functions of law of sales

Generally, the function of law is fashioning the social behavior in a desired manner. In so doing laws are categorized into different subject matters trying to regulate certain social behaviors in a desired manner. As one category of laws on the basis of subject matter, law of sales does have function, which aims at shaping the social interaction in certain area of contractual relationship. That contractual behavior is generally encouraging sales contract in a way it is in light with public policy. It does also provide gap filling provisions in case the contracting parties should fail to agree on all the terms of the contract.

As it is known the society does not produce all kinds of goods that it consumes and it does not provide all the services by itself. It produces some goods and obtains the rest through trade. In primitive society, people used to barter one kind of goods for another. With the emergence of modern money, people began exchanging goods by using money as medium of transaction. As a result, the agreements to exchange goods through the medium of money and the rules regulating these agreements emerged. These agreements are contracts of sale and the rules regulating them are Law of sales.

Law of sales contract, therefore, governs and helps the movement of goods from the original maker to the final user to fulfill social wants. The movement of goods from the original maker to the ultimate user through the marketing process is under the ambit law of sales contract.

Law of sales as a law of contract is expected to have different functions such as regulating the contract. It can regulate the contract by providing mandatory requirement in the definition, formation, performance and remedies and other issues of sales contract. In its regulating role, it takes social interest, public policy into consideration. Accordingly, when the law of sales provides mandatory regulating rules the parties cannot set the rule aside.

It also fills the gap, which might result from on imperfect nature of a contract. As it is known contracting parties cannot predict all the contingencies, which would happen subsequent to the



formation of the contract. As the contracting parties may not agree on the term for which there is no agreement, the law of sales plays a role by filling the gap by providing gap-filling provisions.

It also creates conducive environment for optimal reliance by encouraging change of behavior on possible and probable performance with greater benefit of change of behavior and entitling compensation. It also discourages excessive reliance by using different ways of assessing compensation.

Protecting optimal performance by allowing alternative remedies of non-performance of sales contract is also one of its functions. The remedies are, however, required to be in a way they do not erode certainty and security of transaction and demote cooperation.

The subject matter of contract of sale delimits the scope of contract of sales. The subject matter of law of sales is things. However, all things are not subject of contract of sale. Things, which cannot be appropriated by human beings, cannot be the subject of contract of sale. The thing must be a corporeal chattel pursuant to Article 2267 (1) of the Civil Code. Corporeal chattels are things that have a material existence and can move themselves or be moved by man without losing their individual character. Cumulative reading of 1226 and 1227 connotes that things, which are under the category of goods, are corporeal chattels. Things, which are not corporeal chattels, are not subject of sales would be logical conclusion of the above premises. For example goats sheep, refrigerator, watch, book, pen etc are corporeal chattels while sun moon and stars are not corporeal chattels although they are things.

Intrinsic elements and accessories of corporeal chattels are also under the ambit of contract of sale. Clear connotation of Article 1131, which says, "*Unless otherwise provided, right on or dealings related to, goods shall apply to all intrinsic elements thereof*" is testament for the inclusion of intrinsic elements of a subject of sales. Article 1135 also shows that in the absence of clear indication rights on or dealings with regard to certain goods is also applicable to the accessories.

However, some corporeal chattels are excluded from primarily being subject to contract of sale according to Article 2267 (2) of the Civil Code. They are called special corporeal chattels. For examples, airplanes and ships are special corporeal chattels. When the special provisions dealing with the special corporeal chattels are silent, provisions of sales contract and general contract can be applied.

? Can land, building and incorporeal claims such as shares and stocks be a under the scope of contract of sale?

Some things are not corporeal chattels although they can be appropriated by man. Immovable can be appropriated but they are not corporeal chattels as they cannot move by themselves or be moved without losing their individual character. Although the possibility of being appropriated makes them goods, they are not subject to contract of sale for they are not corporeal chattels. The immovable goods under the civil code of Ethiopia are goods such as building and land. In fact, land is not subject to any form of exchange, by which ownership is transferred, as it belongs to the state, nations, nationalities and peoples of Ethiopia pursuant to Article 40 (3).

Things attached to land such as trees, crops and plants are also considered to be corporeal chattels once they are subjected to juridical acts for their separation from the land expressly or implicitly as to the connotation of article 1133(2) of the civil code. Although they are immovable by destination for they are destined to be part of an immovable, they are considered to be movables once they are subjected to juridical acts.

Incorporeal rights, pursuant to Art 1128, in securities to bearer and claims are assimilated to corporeal chattels in the absence of contrary stipulation. Although they do not have material existence, the provision has clearly provided under the title of security to bearer that claims and other incorporeal chattels embodied in securities to bearer to be presumed as corporeal chattels. However, it must be born in mind that such kind of things are not corporeal chattels. It is only by presumption that such goods are assimilated. Intangible things like intellectual property, shares and stocks are also subject of contract of sale corporeal chattels by analogical interpretation, albeit the applicability of special provisions.

Actionable claims, which can be enforced by legal action or suit like debts, are also included under corporeal chattels in certain legal system. The sale of goods act of India of 1930, which was amended in 1963, is an example of such legal systems where actionable claims are subject matter of law of sales contract. Whether such claims are included under the provision of sales contract of Ethiopia might raise a question. Be that as it may, this does not mean that only law of sales is applicable on such incorporeal chattels. Sales contract is applicable if and only if there is no special and contrary provision.

Natural forces, which have economic value like electricity, are also assimilated to movables once they are mastered by man and put to their use. These natural resources are required to be subjected to appropriation by human beings. Unless they are under the control of human beings or are appropriated, transfer of possession and then ownership will not be possible.

It is also moot if business can be subject matter of sales contract. Business can consist of corporeal and incorporeal chattels. Business may consist of corporeal chattels like chairs, tables, television, tape computer and incorporeal chattels like copy rights, patent rights. It actually mainly consists of good will. Having seen what business is, it is questionable if business can be governed by contract of sale.

Accordingly, movable goods including things like cars, stocks and shares, goods like trade mark, copy rights, patent rights, water, gas, and decree of a court of law are regarded as corporeal chattels either by assimilation or by definition. They can be subject of sales contract provided that there is no special contrary provision.

- ? Do you think that money is a goods and under the scope of law of sales? Why? Why not?
- ? Assume someone sold older rare coins. Can the transaction be considered as sales contract and can the coin be treated as goods?

### **1.3. Summary**

It is worth understanding that law of sale is a branch of business law which regulates the relationship between the buyer and seller in a transaction called sales contract. It is a collection of rules with principal subject matter of goods. Goods can be existing goods, future goods, goods belonging to third parties and contingent goods.

Law of sales contract plays an overriding role in helping the society to make exchange as the society cannot produce all what it wants and need by itself. In addition to this law of sales regulates market, fills contractual gaps, encourage optimal cooperation and performance among its other functions.

The scope of law of sales is limited by its subject matter. Its subject matter is corporeal chattels, intrinsic elements and accessories of corporeal chattels. Special corporeal chattels may sometimes be governed by other special laws. Although immovable is not under the scope of application of law of sales, things like trees, crops and plants on a land can be under the ambit of law of sales.

Actionable claims, natural forces which can be used by human beings and business can be the subject matter of law of sales although it might be arguable to the contrary.

### **1.4. Review Questions**

- 1) Do you think that a contract concluded by a person who is not an owner is a valid contract of sale?
- 2) Discuss the difference between existing goods, goods belonging to third parties, future goods and contingent goods.
- 3) Discuss the function of law of sales.
- 4) Are actionable claims subject of contract of sale? Why or why not?
- 5) Are all things subject matter of law of contract of sale? Why /why not?
- 6) Is business subject matter of contract? Explain.
- 7) Discuss the application of general contract provisions on contract of sale.
- 8) Discuss the application of general contract and sales contract provisions on the sale of special movables.

- 9) Assume Ato Belay has the right to get one fifth of his father's property? Can he sell his share before the partition and can such transaction be under the jurisdiction of law of sales?
- 10) Ato Alemu has use right over the business of Zufan. Can his transfer of this right be subject matter of law of sales?

## **Chapter Two**

### **Contract for Sale of Goods**

#### **Introduction to the chapter**

In discussing contract for sale of goods a detailed discussion will be made on the main body of law of sales. In doing so 2.1 will be allotted to the definition formation and other related issues. Then performance of contract of sales of movables, transfer of risk under contract of sales of movables, non - performance and its legal effects, remedies in case of non – performance, contracts allied to sale, contract for sales of immovable will be discussed in the various sections of this chapter.

Accordingly, upon the successful completion of this chapter students are expected to:

- have a general understanding of the law of sales
- know the importance of performance of contract
- know the obligation of the parties
- understand the ways by which risk is transferred
- know the meaning of non-performance
- show the normative aspect of remedies of non-performance of contract of sale
- list and distinguish the contracts allied to sale and various forms of contract
- know the special application in the case of sale of immovable

#### **2.1. Definition, formation, and other related issues in the contract for sales of movables**

In discussing contract for the sale of goods definition, formation and other related issues will be discussed. In defining law of sales first a comparative analysis will be made with reference to different definitions forwarded by different scholars and different legal systems. The definition of law of sales in the Ethiopian civil code will be presented. Accordingly the general definition of law of sales will be discussed compared with the definition of the term under the Ethiopian law of sales and with each element of the term. Upon successful completion of the chapter on the formation of contract of sales, you are expected to:

- forward different definitions of contract of sale
- pinpoint the distinguishing features of the definitions
- define contract of sales in the civil code
- analyze the terms in the definition of sale in the civil code
- analyze the definition of sales in light with the definition of contract of the general contract provisions
- List the elements for the formation of contract in general
- state the elements for the formation of contract of sale
- analyze the elements for the formation of contract in general and contract of sale
- state the peculiar elements for the formation of contract of sale
- be able to give grounded legal advice as to whether there is valid contract of sales

### **2.1.1 General definition of contract of sales**

So far there is no universally accepted definition of sales contract. The definition of sales contract differs from legal system to legal system. The Roman law which is considered to be the origin of civil law legal system, for example, defined sales as "a contract by which one person becomes bound to deliver a subject to another with the view of transferring the property in consideration of money" this definition seems to include the basic elements. Accordingly sales contract shall be

- a contract
- include a thing as a subject of sale
- consideration expressed in money
- deliver with the purpose of transferring ownership

According, to the Roman law in the absence of the elements, the existence of sales contract is questioned. The French law being similar with the Roman law has also defined sales verbally as: "Sale is a contract by which the one binds himself to deliver a thing and the other to pay for it" Even though this definition has incorporated the three elements that is one party, obligation to deliver a thing and obligation to pay for it, obligation of transferring ownership is for example excluded.

The Napoleon code, which reproduces the traditional meaning under Article 1582 and 1603, shows that the render obligates him to deliver the thing and warrant it. Although the definition doesn't clearly show transfer of ownership and who the render is, Roman times don not have such

obligation; the obligation of the render to transfer ownership can be inferred from Article 1599. Hence transfer of ownership is an element of the meaning of sales in the napoleon code unlike the French one.

The German code on the other hand clearly includes the obligation to deliver the thing and procure ownership under Article 433. There seems to be difference in the definition of the Napoleon code and German code in clearly stipulating the obligation to deliver.

The uniform sales act termed sale of goods as "agreement whereby the seller transfers the property in the goods to the buyer for a consideration called the price". It is not untrue to assert that the requirements of sales of goods in the modern common law have been enshrined under this definition. The uniform commercial code also defines sales as consisting of passing of title from the seller to the buyer. Thus, it is worth noting that neither delivery nor payment is necessary in contract of sale of goods in present sales.

Normally an agreement to sale and contract of sale are different in that agreement to sell does not include conveyance while contract of sale includes conveyance as an intrinsic element of its. In an agreement to sale, the contracting parties agree to sell a certain thing for specified price without making delivery an element of their contract.

Sales contract is generally defined as a "contract whereby one person who is called the render, obligates himself to transfer to another the ownership of a thing, while the other who is the buyer, obligates himself to pay to him its value in money". This definition seems to give the idea of modern sale.

### **2.1.2. Definition of contract of sales in Ethiopia**

Sale is one way by which rights are assigned under the Civil Code of Ethiopia. There are different ways by which rights are assigned in addition to contract of sale. Sale has been defined under Article 2266 of the civil code as '*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’.*

The essential characteristic of sale lies in the obligation of the seller to deliver and transfer ownership and in the obligation of the buyer to pay a price. Other obligations of the parties are consequential in the sense that they are implied into the contract (by law), unless clearly excluded by the agreement of the parties.

Contractual obligations are different from one another both in their nature and effect. For example, in the English law of contracts, obligations are divided into two: conditions and warranties. Conditions are essential terms of the contract and hence determine the nature of the contract. On the other hand, warranties are not essential terms and do not determine the nature of the contract. Moreover, in English law, it is only breach (non performance) of an obligation, which can be characterized as condition that results in the cancellation of the contract. If one of the parties fails to perform one of his obligations and the obligation is a warranty, then the remedy of cancellation is not available as a remedy to the other party.

Ethiopian law is apparently similar to English law of contracts, at least in terms of the above distinction. This is because, under Ethiopian law, it is only fundamental non-performance that results in the cancellation of the contract. Non-performance is fundamental only when it affects the essence (essential terms) of the contract. Non-performance related to a minor obligation of the debtor is remedied by specific performance or damages but not by cancellation. From this one can learn that contractual obligations are different from one another both in their nature and effect. Similarly it is only certain obligations that determine the nature of a given contract. Others may be incidental or non-determinative.

The definitional Article which provides two obligations of the seller and one obligation of the buyer is not intended to deal with all the obligations. The buyer and the seller have additional obligations. For example, the seller, according to Article 2273, has the obligation to warrant against partial or total dispossession and against defects and non-conformities. A question as to why these obligations are not mentioned in Article 2266 may be raised.

This is because the two sets of obligations are different in their nature and effect. The first set of obligations of the seller stated in Article 2266, determine the nature of the contract. That is to mean, in any contract, if the obligation of one party is to deliver a thing and transfer ownership and the obligation of the other is to pay a price, expressed in terms of money, that contract is considered as a contract of sale. That means these obligations are preconditions for the existence of contract of sale.

On the other hand, the other set of obligations stated in Article 2273 are not essential obligations. The parties can for example expressly agree that the seller does not have the obligation to make such warranties. The contract, however, does not change its nature. It is still a contract of sale. However, unless expressly and completely excluded by the parties, the seller has the obligation to warrant against partial or total dispossession and against defects and non-conformities. Hence, we can call these obligations as incidental, or non-essential or implied or consequential obligations. In a contract of sale, the obligations that are stated under Article 2273 are known as incidents of sale. Whereas those stated in Article 2266 are essential; in their absence, the contract could be anything but not sale. There are other essential elements of the definition of sales contract. Consider the following.

#### **2.1.2.1. It is Contract**

Among the elements of the definition of sale its being contract is one. Contract of sale is a special kind of contract. The parties should comply with the essential conditions for the validity of contracts in general. Thus the parties must be capable, that is they should not be minor, insane and infirm, judicially interdicted person, or legally interdicted person.

There must be an offer and acceptance for the formation of sales contract. The consent of the parties, which is expressed through offer and acceptance, should also be free from defect. Mistake, fraud, duress, unconscionable nature of the contract undue influence renders contract of sale invalid. The obligations of both the buyer and the seller must be defined, lawful and possible. If the parties to the contract of sale fail to comply with these requirements the contract would be invalid.

The fact that contract of sale is a contract does not, however, mean that it does not have peculiar natures to which the coverage of general contract is not enough. Contract of sale has certain peculiar characteristics different from the definition of general contract. Such peculiarity can be inferred from the definition. Accordingly, one of its peculiarities is that it must be concluded between two parties, which are called the seller and buyer.

#### **2.1.2.2. Two Parties**

There must be two distinct parties to a contract of sale, as a person cannot buy his own goods. But this does not mean that the parties to the contract of sale are only two individuals. Two persons is the minimum requirement. Thus, if Boron, Becky, and Naol jointly own a refrigerator, they can sell it to Anatoly, Becken, Haweny and Na'ansy. Boron, Becky, and Naol are sellers and have to discharge the obligation of the seller jointly. Similarly, Anatoly, Becken, Haweny and Na'ansy are buyers and they should jointly pay the price and take delivery of the refrigerator.

These two distinct parties are the buyer and the seller. The seller is the person who assumes the obligation to deliver a thing while the buyer is the person who assumes the obligation to pay money as a price. If, for instance, students of a hostel take meals with a mess run by themselves on cooperative lines, there is no contract of sale as there is no buyer and seller. This is because the students are joint owners of the meals they are consuming. The generally assumed fact is that every student is consuming his own goods on the basis of the understanding that he has to restore what he has consumed to get the mess to continue to provide meals for its members.

However, this does not mean that no sales contract may exist among joint owners with respect to the thing they own jointly. If, for example, Ato Merga and Ato Alem own a house jointly, Ato Alem may sell his share and such juridical act is under the definition of sales contract and both parties can be considered as buyer and seller. What should be born in mind is that whether, in the later example, the joint owners are “part owners” with divisible share in the house.

Sometimes there might be contractual transaction concluded by one party with himself. An agent may possibly sell his car for himself pursuant to Article 2188 although it is subjected to

cancellation by the principal. It is questionable if it can be sale contract with the meaning of article 2266 of the civil code.

### **2.1.2.3. Delivery and Transfer of ownership**

The owner of the thing must agree with the other person to deliver and transfer ownership of the thing. A mere agreement to transfer possession cannot be termed as a contract of sale. The seller must transfer or agree to transfer ownership so that contract of sale is concluded. This essential characteristic distinguishes many contracts from contract of sale. For example, in the contract of letting and hiring the owner (the lessor) of a thing delivers the thing to the other person (the lessee) but ownership is not transferred. For example, Mr. X hires a horse with its cart from Mr. Y at 20 Birr per day for a week. Mr. X takes the horse and used it for transporting certain goods from one place to another. Mr. Y (the owner) did not transfer the ownership to the Mr. X (the lessee) and he did not agree to transfer ownership. In cases of contract of bailment, the owner (the bailor) also delivers the thing to the other person (the bailee). Nevertheless, the owner does not transfer ownership to the bailee. This is because transfer of possession by delivery transfers ownership although transfer of possession does not necessarily show transfer of ownership.

### **2.1.2.4. The Thing**

The definitional provision also puts “things” as an essential element of sale. The subject matter of contract of sale must be “things”. Normally all things cannot be subject matter of sales contract if they cannot be appropriated by human beings. Someone who agrees to sell a moon cannot be said to have concluded contract of sale for the thing is not good because it cannot be appropriated. The word thing shall, accordingly, refer to goods, as it is only goods, which can be possessed and owned.

As far as goods is concerned, there is no direct meaning of goods in the Ethiopian civil code. Be that as it may, the meaning of “goods” can be inferred from different Articles as of 1126. Art 1126 says verbally “All goods are movables or immovable” Although all goods are either movables or immovable all movables or immovable may not be “goods”

Article 1127 of the Civil Code gives the meaning of movables under the title of corporeal chattels. According to this provision, things which have material existence and can move themselves or be moved by themselves without losing their individual character” are said to be corporeal chattels. Assimilated incorporeal chattels are also included under things.

If the corporeal chattel is to be manufactured or produced by the person who undertakes to deliver the thing, the main materials for the production of the thing shall be provided by the seller. If the party who is going to receive delivery provides the necessary materials for the production or manufacturing of the thing it is said to be contract of service. The party who is delivering the thing is giving his service not a thing. Article 2269 of the civil code is destined to connote the difference between contract of service and sales contract.

#### **2.1.2.5. The Price**

In addition to goods consideration expressed in terms of money is also an essential element of the definition. The consideration for contract of sales must be in cash. This consideration in cash is price. The apparent peculiarity of sales contract from the general contract is the presence of consideration as its element. Thus, a contract of sale must involve consideration in return for transfer of ownership. Consideration normally connotes reciprocal obligation of the parties assumed in the contract.

If consideration is required to exist there shall be corresponding obligation and one obligation shall have inducement role on the other corresponding obligation. If there is no consideration, it is a contract of donation not a contract of sale. The basic difference between contract of donation and contract of sale is that in donation there is no consideration while in contract of sale there is consideration.

The price to be paid and the goods to be delivered shall exist as obligation of the buyer and seller. They shall also have inducement relationship, as consideration is one element of sales contract. If the consideration is in kind it is a contract of barter not a contract of sale. Thus, it is essential that money be used as a medium of exchange. Barter in which goods are to be exchanged for goods is not sale albeit its being moot if it is contract at all. There must be price in

terms of money. However, this does not take as to the extreme that negotiable instruments like bills of exchange or check cannot be used.

? Can you say there is a contract of sale if the party agreed that part of the price should be paid in kind?

Abebe sold his Acer® desktop computer to Belete. According to their agreement Bekele would deliver two 21 inch Sony® TV sets and 1500 Birr as a consideration for the computer. Abebe has taken delivery of the TV sets and Belete has also taken delivery of the Computer.

? Is there contract of sale between Abebe and Belete?

Sale and agreement to sell are treated separately in certain countries albeit both might be included in contract of sale. Contract of sales is sometimes considered to be a generic term including sale and an “agreement to sell”. Sale refers to contract of sale where the goods are transferred to the buyer immediately at the time of the conclusion of the contract. It is referred to as an “absolute sale”. A contract where transfer of an ownership right is effected immediately, exemplifies such a contract. Although delivery might be made in the future sale is an executed contract if the agreement is sale or absolute sale.

Agreement to sell is on the other hand an agreement where transfer of right of property is effected at a future time or after the fulfillment of certain conditions. It is an excluder contract. There is no transfer of property right at the time of the formation of the contract the conveyance of property takes place later following the formation of the contract.

Such distinction has not been clearly provided in the Ethiopian Civil code. The definitional provision of Ethiopian law of contract seems to deal with contract of sale in the context of an agreement to sell; sale implying immediate conveyance of property creating jus in rem i.e. right to enjoy goods against the whole world seems to be excluded.

The definition of general contract and the definition of the contract of sale are evident. As sales contract is a contract, the definition of contract is applicable on it. Accordingly; as a contract is “an agreement whereby two or more persons as between themselves create vary or extinguish obligation, the obligations created by sale is also between the contracting parties. In addition to this Article 2266 of the civil code connotes one contracting party undertakes to discharge his obligation towards the other contracting party. This implies that sale under Ethiopian civil code is an excluder contract.

In addition, there is also an agreement which looks like an agreement to sale that is promise of sale. However, promise of sale is an agreement where one party gives his word to sell a certain thing for a certain price. But, this is not a contract of sale strictly speaking. The contract of sale is to be concluded later not at the time of promise of sale. The promise of sale is preliminary contract for sales contract.

### **2.1.3. Formation of contract of sales**

Having seen a general introduction to contract of sales and its definition, it is worthy discussing the formation of contract of sale. In discussing the formation of contract of sale a comparative analysis will be made between the elements in the general contract provisions and provisions in the law of sales. In addition, the peculiar elements of the formation of sales contract will be analyzed and discussed.

Contract of sale is, like any other contract, formed when the parties express their agreement on the subject matter of the contract and its price. That is to say, the contract of sale is completed when the parties have expressed their consent to the terms of the contract. Thus, to say there is consent an offer made by one of the parties must be accepted by the other in a way that fulfills the requirements provided under general contract provisions. The parties must define the subject of their dealing with precision and their agreement shall be in special form when such form is necessary.

As a contract, a sales contract is regulated by general contract provisions. The requirements for the formation of contract should be complied with. Generally for the formation of contract offer and acceptance are indispensably required. Either the buyer or the seller shall propose to enter

into a contract with specified terms if accepted by the offeree. The buyer or seller to which proposal to enter into a contract has been made should also express his assent without reservation.

Even though contracting parties might make invitation to treat, no contract of sale can be formed by mere invitation to treat in the absence of offer and acceptance by which the consent of the buyer and seller is expressed. The pretence of the parties is not again a sufficient formation of the contract of sale. The consent shall be free from defect and the parties shall have intention to be bound.

The object of the contract shall also be sufficiently defined, lawful, moral and possible pursuant to Art.1714, 1715, 1716 provisions of the civil code. The object of the contract of sale is principally delivering the thing and paying the price. The thing can be an existing thing belonging to the seller or third party or it might be a future thing. What is mandatorily required is that the thing to be delivered shall be sufficiently defined, lawful moral and possible.

The corresponding obligation assumed by the buyer is payment of price. Price as a requirement of consideration has been put in a way that creates peculiarity in contract of sale. Sufficient definition of the price shall enable the courts ascertain the price. However, lack of sufficient definition to that effect does not make the contract subjected to invalidation as it is provided under Article 1714. Article 2271 of the civil code fills the possible gap. However, if the parties do not determine the price of the thing, and if the price not is determinable, there is no contract of sale. The parties shall make the price at least determinable by referring to the arbitration of the third party according to Art.2271.

*Art. 2271. Price estimated by third party*

*(1) The price may be referred to the arbitration of a third party.*

*(2) There shall be no sale where such third party refuses or is unable to make an estimate.*

According to this Article, to say that a contract of sale is formed the party must specify the price in their contract or refer to the arbitration of the third party. And the price referred to the



arbitration of the third party must be determined as agreed. Otherwise, there would not be formation of the contract of sale.

For example, Aden agreed to buy a used computer from Bushra. But they could not determine the price of the computer. Thus, Aden agreed to pay the price determined by Guled who is a mechanic. Aden has taken delivery of the computer. Unfortunately, Guled died in car accident before he determined the price. Thus, there is no contract of sale in this hypothetical example as the arbitrator is unable to determine the price of the used computer.

? Can the parties refer the determination of the price to the market force? For example, can the party agree that the price would be the market price to be determined at some future date?

In some jurisdictions, for example in India, the parties may refer the price to be determined by a magazine which contains a list of items and their price and which is published regularly. The same is true in Ethiopia. For example, in Ethiopia, Ethiopian Tea and Coffee Authority, announces the price of coffee through Ethiopian Radio. Thus the parties can agree that their price is the price to be announced by Ethiopian Tea and Coffee Authority. Still, there will be no contract of sale if the authority fails to announce the price on radio. It is not necessary that the third party be a natural person.

Price of the thing sold can also be determinable when the thing has a current price or market price or when the seller normally deals in the thing sold. In such situation, the price would be the market price or the price normally charged by the seller.

In addition to what has been said, formal requirement is also an intrinsic element of contract of sale when it is provided either by their agreement or by law. It can be inferred, therefore, that no special formal requirement is peculiar for contract of sale.

## **2.2. Performance of contract of sales of movables**

Definition, formation, and other affiliated issues in the contract for sales of movables have been discussed so far. Having made these considerations, discussion on performance of sales contract will be made. As performance of sales contract refers to carrying out of the obligations assumed by the contracting parties, analyzing the obligations of the seller, obligations of the buyer and common obligations of the seller and buyer imposed on the parties by the custom, good faith and the provisions of the law is necessary to understand performance of sales contract..

Upon successful completion of the chapter on the performance of sales contract, students are expected to

- advise parties on the obligations of the buyer
- advise parties on the obligation of the seller
- advise parties on common obligation of the parties
- differentiate warranties and conditions
- differentiate express and implied warranty
- differentiate the incidental obligation related to the principal obligation

### **2.2.1. Obligations of the seller**

The seller has certain obligations which shall be performed. The seller assumes certain obligations under the contract of sales. These obligations are the obligation to deliver, the obligation to transfer ownership, the obligation to warrant the buyer against dispossession defects and non-conformity to the contract and other obligations. Failure to perform these obligation amounts to non-performance. In addition to these obligations the seller does have shared obligations with the buyer.

#### **2.2.1.1. Obligation to deliver**

The seller assumes certain obligations under the contract of sale. These obligations are the obligation to deliver, the obligation to transfer ownership, the obligation to warrant the buyer against defects and non-conformity to the contract and other obligations imposed on him by the contract of sale and gap filling provisions pursuant to Article 2273 of the Civil code. Failure to perform these obligations amounts to non- performance of sales contract.

The characteristic obligation of the seller is to deliver the thing sold. Delivery generally refers to transfers of possession willingly. Delivery takes place in accordance with the contract and the default rules of the law. It consists of handing over in not only the principal subject of the contract but also its accessories. The thing to be delivered shall, however, be the agreed thing in quantity and type.

*Art. 2274. - Essence of obligation.*

*Delivery consists in the handing over of a thing and its accessories in accordance with the contract.*

A) **Modes of Delivery:** Delivery can be conducted in different modes. These modes of delivery can be actual delivery, constructive delivery, (*constitutum possessorium*), *traditio longa manu*, *traditio brevi manu* and symbolic delivery. Different legal systems may apply different modes of delivery and modes of transfer of ownership.

Actual delivery is the physical handing over of the thing directly to the buyer or his representative. Actual delivery is the most frequently used mode of delivery. Article 1140 of the civil code shows the possibility of actual delivery by entitling the party to whom delivery is made the actual control over the thing.

Constructive delivery (*constitutum possessorium*) does not involve physical handing over of the thing to the buyer. It is employed when the thing is already in possession of the buyer; when the thing is to remain in possession of the seller after the contract of sale or where the thing is in the possession of the third party and the buyer decided to keep the thing with that third party. For example, X has hired his horse to Y and Y is using the horse for driving a cart. If X agrees to sell this horse to W and decides to keep the horse with Y, there is constructive delivery made by X.

Constructive delivery under Ethiopian laws refers to delivery when the seller is to remain in actual control of the thing after the conclusion of the contract. Article 1145 shows things which are certain and things pertaining to generic species which have been individualized are deemed to have been transferred when the holder declares that he detained the things on behalf of the

new possessor. This provision clearly shows the possibility of transfer of possession by constructive delivery although the seller can be holder.

Sometimes delivery when the buyer is in possession of the thing to be sold is termed as *traditio longa manu*. *Traditio longa manu* does not again show actual handing over of the thing. The seller points out the buyer where the thing is and makes it ready to be taken. The buyer can take the thing whenever he/she pleases. On this mode of delivery actual handing over of the thing is not possible for any reason at the time of conclusion of the contract. As temporary hindrance of actual handing over does not affect possession right pursuant to Article 1142 and possessor may exercise his right indirectly pursuant to Article 1141, the possibility of *traditio longa manu* can be inferred from these provisions.

Delivery when the things are in the possession of the third party is sometimes termed as *traditio brevi manu*. In *traditio brevi manu* the conclusion of the contract is the way of delivery. This mode of delivery is effected when the buyer has been in actual control of the thing before the conclusion of the contract. This avoids unnecessary repeated retaking back of the thing which has been in the hand of the buyer and sold to the buyer. Since there is possibility of actual control of the thing by the buyer before the conclusion of the contract, the application of *traditio brevi manu* also seems to be indisputable. It is indeed impractical to give subject of sale, which has been in the hands of the buyer, to the buyer and re-take it.

Symbolic delivery is similar to constructive delivery in that it does not effect the physical handing over of the thing sold. But it is different from constructive delivery as it involves the physical handing over of other things that represent the things sold. For example, if the seller gives the key of the store to the buyer, he makes symbolic delivery. Similarly, giving bill of lading to the buyer is a symbolic delivery.

The obligation of the seller to deliver the thing includes the obligation to deliver the agreed amount as well as the obligation to deliver the thing at an agreed time and place.

**B) Quantity to be delivered:** The seller has to deliver the agreed quantity of things. If the seller delivers in excess or in short of the agreed amount, there is non-performance of contract. The buyer may accept or reject the things delivered at his discretion. If the buyer accepts the quantity that is less than the agreed amount, he has to pay the agreed price for quantity delivered but he cannot require additional delivery. In cases of excess quantity, the buyer has to pay a contractual price of the quantity delivered.

The parties to the contract of sale, according to Article 2275, may agree on delivery of “about certain quantity” of specified goods. In such case there is a possibility of delivery of a thing, which is determined by gap filling provisions, where the seller has the discretion to decide the exact quantity to be delivered. However, the seller has no duty to determine the exact quantity if the stipulation about certain quantity was made for the sole interest of the buyer. Accordingly, this benefit might be given to the buyer where ‘it appears from the circumstances that such stipulation has been included in the contract in the sole interest of the buyer’. For instance, imagine that Fitsume is celebrating a graduation ceremony. He invited 50 persons to the ceremony. Since Fitsume was not sure about the number of persons who would show up, he ordered around 60 bottles of soft drink from Lelisa. In this case, we understand from the circumstance that Fitsume should determine the exact quantity.

? The parties to the contract of sale agreed to deliver “about certain quantity” of specified goods. Can the seller deliver the quantity as large as he wishes or as small as he wishes?

The difference between approximate quantity and actual quantity delivered, whether the decision is made by the seller or buyer, should not exceed ten percent in cases of the whole cargo or five percent in other cases. For example, if Awash agrees to deliver about 400 Kilograms of sugar to Yared, he cannot deliver less than 380 kilograms or more than 420 kilograms as five percent of 400 kilogram is 20 kilograms.

**C) Time and Place of delivery:** The seller cannot deliver the thing whenever and wherever he likes. He must observe the provisions of the law and that of the contract. The seller should

deliver the thing sold at agreed time. Failure to deliver at such time amounts to non-performance of the contract. However, the parties may fail to specify the time of delivery or the date of delivery cannot be inferred from the will of the parties, the seller shall deliver the thing as soon as the buyer requires him to do so according to article 2276.

It must be born in mind; however, that delivery shall be made immediately is meant to show that delivery of the thing shall be simultaneous with the payment of the price unless there is contrary agreement. If the parties agreed on the time of payment of the price, but fail to specify time of delivery, the seller should deliver at the time of payment of the price as per Art.2278. The seller may in such case retain the thing until payment is made.

Where the parties have agreed that delivery shall take place during a given period, it shall be for the seller to fix the exact date of delivery unless it appears from the circumstances that it is for the buyer to do so. Regarding this Article 2277 provides as follows:

*Where the parties have agreed that delivery shall take place during a given period, it shall be for the seller to fix the exact date of delivery unless it appears from the circumstances that it is for the buyer to do so.*

For example, if the seller agreed to deliver the thing sold between July14 and August 16, he has to make delivery during this period. However, the buyer determines the exact date where circumstances may give such power to determine the exact date of delivery to the buyer. For example, if Y agrees to deliver a wedding cake between June 6 and 19 to X, it is clear from circumstances that X needed the cake on the day of his wedding. Thus, it is X who should decide the exact date according to Article 2277 because Y has no interest in the date of delivery and for that matter Y does not know the date of wedding.

As far as place of delivery is concerned, unless otherwise agreed, the seller shall deliver the thing at the place where, at the time of the contract, he has his place of business or, failing such, his normal residence. On the other hand, where the sale relates to a specific thing and the parties know the place where such thing is at the time of the contract, the seller shall deliver the thing at

such place. The same is true where the contract relates to fungible things selected from a stock or a specified supply or to things, which are to be made or produced in a place known to the parties at the time of the contract.

#### **2.2.1.2. Obligation to Transfer ownership**

The seller shall take the necessary steps for transferring to the buyer unassailable rights of ownership over the thing. Ownership transfers upon transfer of possession. Possession transfers upon delivery. Thus, the necessary step to be taken by the seller to transfer ownership is to deliver the thing to the buyer in any of the modes of delivery discussed in the previous section.

However, delivery alone does not transfer ownership. The seller must be the owner of the thing sold. It is the basic principle of property law that a person can transfer no greater right in property than he himself possesses. For example, if Kebede steals a watch from Degu and sells it to Boron, Boron has no greater title to the watch than Kebede possessed. Thus a non-owner cannot transfer ownership. This principle is called *nemo dat quod non habet* in Latin. Thus the obligation to transfer ownership includes the obligation to have a good title.

The rule that holds a person can transfer no greater right than his own suffers an exception. That is, this rule does not apply in certain cases. This exception is possession in good faith. The principle of possession in good faith holds that a person who in good faith enters for consideration into a contract to acquire ownership of a corporeal chattel will become owner of that corporeal chattel by virtue of this good faith when he takes possession of such chattel. Good faith is honesty in fact in the transaction. The buyer is in good faith when he purchased the thing with an innocent belief that the seller is an owner.

#### **2.2.1.3. Obligation to warranty title, defects, and non – conformity**

The obligation of the seller to warrant is extended to warranty of dispossession, defect, and non-conformity. Warranty is a contractual promise by the seller regarding the quality, character, or suitability of the goods he has sold. Warranty is classified into express warranty and implied warranty.

Express warranty is created when the seller makes a statement of facts or a promise to the buyer concerning the goods that become part of the bargain. The seller who gives an opinion or recommends the goods does not create an express warranty. Whether a statement made by a seller is interpreted as an opinion or as an express warranty often depends on the relative experience and knowledge of the buyer and the seller. If the seller deals in the types of goods he is selling and the buyer does not deal in such goods and knows little about them, a statement by the seller about the quality or character of the goods might be interpreted as an express warranty. On the other hand, if the buyer is a dealer in such goods and has had experience and knowledge similar to that of the seller, the same statement might be interpreted as an expression of an opinion.

In negotiating, a seller may use descriptive terms to convey to the buyer an idea of the quality or characteristics of the goods. Similarly a seller might use pictures, drawings, blue prints or technical specification or in some cases a sample or model.

Implied warranty is responsibilities imposed by law on the seller for the quality of goods he sold. Implied warranty arises whether or not the seller has made express promises as to the quality of the goods.

Implied warranties are imposed on the seller in the interest of promoting higher standards in the market place for the following three reasons. First, the buyer commonly has little or no opportunity to examine goods carefully before making a decision to buy them. This might result in information asymmetry. Secondly, the buyers are often not in a position to test the goods to determine their quality prior to buying them due to complexity and the nature of many goods. Lastly, the seller or manufacturer of such goods is in a much better position to make a thorough examination or test of the goods to determine their adequacy and quality. The obligation of the seller to warrant dispossession, defect and non-conformity can in certain circumstances be set aside by the agreement of the parties.

**A) Warranty of dispossession:** Warranty against dispossession has been provided as an obligation of the seller in 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. In addition to assuring the buyer that the seller is a rightful owner the obligation to transfer ownership includes the obligation to transfer unassailable rights over the things.

The seller may be an owner of the thing sold. His title to the thing is not defective. However, the seller may never encumber the thing sold with some rights of third parties; chief among such encumbrance is pledge and liens. If the seller transfers ownership over the thing encumbered with pledge or liens, the seller fails in his obligation to transfer unassailable rights over the thing according to Art. 2281 which provides that:

*The seller shall take the necessary steps for transferring to the buyer unassailable rights over the thing.*

To perform his obligation of transferring unassailable rights, the seller is duty bound to warrant the buyer against total or partial dispossession. Warranty against dispossession is an implied warranty which does not depend upon the agreement of the parties. But this implied warranty against dispossession is not effective in the following legal limits. These legal limits are when the buyer is aware of the threat of dispossession, when the parties excluded or restricted warranty against dispossession, when the buyer fails to join the seller in the proceeding against him and when dispossession is due to the act or contribution of the buyer.

The awareness of the buyer about the threat of dispossession is among the limits of warranty of dispossession. The buyer may sometimes know that there is a possibility that a third party would dispossess him. For example, the buyer may know that the thing has been given as a security for loan. Where, at the time of the contract, the buyer knows that he risks dispossession, the seller shall not warrant the thing unless he has expressly undertaken to do so. Since it is implied warranty, the presumption is that the parties know that there is warranty of dispossession. If the knowledge of the buyer is established, however, the implied warranty shall not be considered. If the buyer is aware of the risk of dispossession he is expected to have taken advantage of the risk in their negotiation to enter in a contract of sale.

Even though the buyer is aware of the dispossession, warranty shall be due where dispossession is due to the falling in of a pledge made by the seller. The basic reason for favoring warranty against dispossession while the buyer knows the risk is the role of the seller in avoiding dispossession by performing the obligation for which the thing is pledged.

Relieving the seller from warranting dispossession owing to falling of the thing in pledge directly implies that the seller will not discharge his obligation secured by pledge. Failure to discharge the obligation may not affect the seller at least in his interest in the pledged property.

Exclusion or restriction of warranty against dispossession is also another limit of warranty of dispossession. The parties exclude the warranty against dispossession when they agree that the seller would not be responsible if the third party dispossesses the buyer. Contracting parties can exclude or restrict the above warranty which emanates from the law. But the law provides some mandatory and gap-filling provisions regarding an agreement to exclude or restrict the legal warranty against dispossession:

*Art.2284. \_\_ provisions excluding or restricting warranty.*

- (1) Provisions which exclude or restrict the warranty shall be construed restrictively;*
- (2) Unless otherwise expressly agreed, such provisions shall impose on the seller the obligation to return the price to the buyer, in whole or in part, in cases of dispossession; and*
- (3) A provision excluding or restricting the warranty shall be of no effect where the seller has intentionally concealed that a third party had a right on the thing or dispossession is due to the act of the seller.*

In addition to the aforementioned grounds, the failure of the buyer to join the seller in the proceeding against him is also another limit of implied warranty of dispossession. Third parties may sue the buyer. In such case, the buyer must inform the seller that he had been sued. The seller may raise objections in the court and may win the case. He shall, therefore, join the seller as a party to the proceedings instituted against him in due time. However, if the seller is not joined in the proceedings without any fault on his part, he shall be released from his warranty

where he can show that the proceedings might have had more favorable issue, had he been joined in due time.

Finally, when dispossession is due to the act or contribution of the buyer, dispossession of warranty is limited. If the dispossession is due to the buyer, for example, the thing is attached by the creditor of the buyer and sold by auction according to the order of the court. The seller will not warrant such dispossession. When the dispossession is also due to the act of the buyer, the seller is released from his warranty. If the buyer acknowledges the right of a third party outside judicial proceedings or he has entered into a compromise with such a third party, he may not avail himself of the warranty given by the seller. He can however be benefited from warranty if he can show that the latter could not have prevented dispossession.

*B) **Warranty against defects in the thing:** The seller shall guarantee to the buyer that the thing sold conforms to the contract and is not affected by defects in addition to the warranty of dispossession. There are circumstances where the seller gives an express warrant against defect. When a seller uses descriptive terms and the buyer takes them into consideration while making the purchase, the seller has expressly warranted that the goods he delivers will meet that description. Express warranty can be given in a limited manner. Where the seller has warranted during a specified period, certain qualities or the good working condition of the thing, it shall be sufficient for the buyer to inform the seller of the defect before the expiry of such period.*

It must be born in mind that the fact that the seller has given express warrant does not necessarily mean that he has the obligation to warrant. If the seller can prove that the buyer knew of the defects at the time of the contract, he is not liable on his warranty against defects. According to Article 2295(2) *Express warranty given by the seller is void where the buyer knew of the defects in the thing at the time of the contract.* To have a valid express warranty, the warranty must relate to the defects that the buyer does not know during the conclusion of contract.

The seller does not only warrant for what he has expressly warranted but also for warranties he is presumed to have undertaken by implication. Implied warranties are imposed by law and arise only under certain circumstances and they can be excluded or restricted by the parties as they are not absolute.

What shall be taken into consideration is that exclusion or restriction is of no effect when the seller has fraudulently concealed from the buyer the defects in the thing according to Article 2297 which provides that:

*Any provision excluding or restricting the warranty shall be of no effect where the seller has fraudulently concealed from the buyer the defects in the thing.*

The other limitation on implied warranty is the gross negligence of the seller. The seller is not liable on a warranty against defects which are so obvious that the buyer could overlook them only as a result of gross negligence. However, the warranty holds the seller who has expressly declared that the thing was free from defects or has expressly warranted certain qualities albeit the presence of obvious defects.

The seller who can prove that the buyer was not in gross negligence but in knowledge of the defect can, however, be relieved of his warrant liability whatever their agreement is. Express warranty while the buyer is cognizance of the defect does not have effect and for stronger reason implied warranty while the buyer is cognizance of the defect relieves the seller from warranty liability.

All defects are not warrantable. Certain defects are warrantable and others are not warrantable. A warrantable defect for which warranty shall become effective according to Article 2289 is where the thing:

- *Does not possess the quality required for its normal use or commercial exploitation;*
- *Does not possess the quality required for its particular use as provided expressly or impliedly in the contract; (warranty of fitness for particular use)or;*
- *Does not possess the quality or specifications provided expressly or impliedly in the contract (warranty of fitness specified in the contract)*

Warranty of fitness for normal use obliges the seller to deliver goods that are fit for the ordinary purpose. For example, a person of normal weight who buys a chair should be able to sit on it without it collapsing. The chair should also withstand other things people commonly do with

chairs, such as occasionally standing on them or dragging them across the floor. If the chair fails to have such qualities, it is believed not to have the quality required for normal use.

Warranty for commercial exploitation exists when the goods are of such quality and in such condition that a reasonable man would accept them under the circumstances of the case in performance of his offer to buy those goods. Thus, to be fit for commercial exploitation the goods must be such as are reasonably saleable under the description by which they are known in the market. For example, Becky bought a tape recorder from Natoly. If Natoly could not resell the tape recorder to another seller, the tape recorder is not fit for commercial exploitation. If Ato Dawit agrees to sell four cans of Nido milk and if it is unsealed, it is not possible to resell. Therefore it does not possess the quality required for commercial use.

Warranty of fitness for particular purpose is made to the seller when the seller knows the particular purpose for which the buyer needs the goods and knows that the buyer is relying on the seller to select goods suitable for that purpose. For instance, a person goes to the shop and tells the shop owner that he needs a scissors that will cut cloth. If the shopkeeper knows the buyer is depending on him to pick a suitable pair of scissors, there is warranty that the scissors selected are fit for the buyer's need.

Warranty of fitness to specification provided in the contract is available when the thing is described in the contract. In this case, the thing that may serve normal use or particular use may not comply with the specifications in the contract. For example, the seller agrees to deliver a table which is 3 meters long, two meters wide and one meter high. If the seller delivers a table with a width of three meters, the seller is liable on warranty even though the table serves the need of the buyer.

*C) **Warranty against non-conformity:** A seller, in addition to warranty against dispossession and defect, has the obligation to warrant against non-conformity of the thing. Non-conformity can be warranted as of article 2287 if it is warrantable non-conformity and Article 2288 has given positive meaning of warrantable non-conformity.*

Warrantable non-conformities: The thing is deemed not to conform to the contract where the seller delivered to the buyer part only of the thing sold or a greater or lesser quantity than he had

undertaken in the contract to deliver or the seller delivered to the buyer a thing different from that provided in the contract or a thing of a different species as per Article 2288(1) which provides that:

*The thing shall not be deemed to conform to the contract where:*

*(a) The seller delivered to the buyer part only of the thing sold or a greater or lesser quantity than he had undertaken in the contract to deliver; or*

*(b) The seller delivered to the buyer a thing different to that provided in the contract or a thing of a different species.*

For example, if the seller agrees to deliver 500 kilograms of sugar, the seller breaches the warranty against non-conformity if he delivers a thing different from that provided in the contract or a thing of different species. For example, if the seller agrees to deliver a Sony TV set, he breaches the warranty against non-conformity when he delivers a tape recorder or JVC TV set as tape recorder is a different thing and JVC TV set is a thing of different species.

There are certain preconditions and limitations which affect the liability of the seller for warranties of defect of the thing and non-conformity. The time when defects are to be considered, examination of the thing by the buyer, notification of defects, period for suing on a warranty, are among the conditions which affect the effectiveness of warranty.

Time when defects are to be considered is one of the preconditions and limitations on which the liability of the seller depends. The conformity with the contract and the absence of defects is to be ascertained having regard to the conditions of the thing at the time of the transfer of risks. Where there is no transfer of risks because of the cancellation of the contract having been declared or the replacement of the thing having been required, then regard is to be given to the time when the risks would have been transferred, had the thing been in conformity with the contract. As an exception, however, the seller is held to his warranty if the non-conformity or the defects occur at a later date and are caused by the seller or a person who he is liable.

Examination of the thing by the buyer is also another condition on which the liability of the seller depends and it is the duty of the buyer to examine the thing. The buyer should examine the thing without delay as soon as he has the opportunity. Unless otherwise agreed, the examination is to be carried out in accordance with the usages of the place of examination. Where the buyer intends to avail himself of the results of the examination, he shall in due time invite the seller or his representative to attend such examination, unless the thing is likely to perish.

The buyer must examine the thing as soon as he has an opportunity and notify the defects or non-conformity without delay to the seller to avail himself of warranty. Failure to notify the existence of defects may also result in loss of rights of the buyer unless there is a latent defect, i.e. a defect that cannot be disclosed at the time of examination, in the thing. Where the examination discloses non-conformity with the contract or a defect in the thing, the buyer shall without delay give notice thereof to the seller. In notifying the defect, the buyer shall indicate its nature in accordance with custom and good faith. Where the buyer has not notified the seller, he may no longer avail himself of the non-conformity or defects unless the seller admitted their existence.

Where a defect which could not be discovered by the normal process of examination, is subsequently discovered the buyer may avail himself of such defect where he notifies the seller as soon as he discovers it. The seller who has intentionally misled the buyer may not avail himself of the fact that the notification of defects has not been sufficiently precise or made in due time.

In addition to the above mentioned conditions, there is also period of limitation for suing on a warranty. The buyer must sue the seller within one year from the date of notification of the defects or non-conformity to the contract except when the seller misled the buyer. The parties may provide in their agreement a period exceeding two years for suing on warranty but they cannot lessen this period to less than two years. In this regard, article 2298 provides that:

*(1) The buyer shall, under pain of losing his right, bring proceedings on a warranty against defects within one year from his having given notice to the seller, unless the seller intentionally misled him.*

*(2) The parties may not shorten this period.*

*(3) Where specified qualities or the good working condition of the thing have been warranted by the seller for a specified period, the time within which the buyer may bring proceedings shall be reckoned from the day when this period has expired*

Where specified qualities or the good working condition of the thing have been warranted by the seller for a specified period, the time within which the buyer may bring proceedings shall be reckoned from the day when this period has expired.

After the expiry of the above period, the buyer may no longer avail himself of the defect or non-conformity. However, where he has not paid the price and he notified the defect or non-conformity in due time, The buyer may, however set off against the demand for payment a claim for reduction in price or damages.

In a sale of fungible things, the seller may replace defective things by new ones within the period provided for in the contract. In a sale of goods to be manufactured or produced by the seller on the specifications of the buyer, the seller may put right the defects within a reasonable time, even after the expiry of the period fixed for delivery, provided that the delay causes the buyer no substantial inconvenience or expenses. But this will not affect the right of the buyer to claim damages.

**D) Other obligations of the seller:** The seller does have other accessory obligations as provided in the gap filling provisions. Other obligations of the seller relate to handing over of documents and insurance. If it is customary for the seller to hand over to the buyer documents concerning the thing sold, the seller shall, in addition to delivery, hand over such documents. The documents shall be handed over as carefully and quickly as possible at the place fixed in the contract or provided by custom. The buyer shall not be bound to accept the documents unless they conform to the contract.

Where the seller must know from the circumstances that carriage insurance is the custom and where the seller is not bound to contract such insurance himself, he shall provide the buyer with



the necessary information to enable him to contract insurance, where the buyer requires such information from him.

### **2.2.2. Obligation of the Buyer**

The main obligations of the buyer under the contract of sale are the obligation to pay price and the obligation to take delivery of the thing sold. These are the conditions of contract of sale with the exclusion of which no contract of sale can be made. The contract of sale may also include some other obligations such as obligation to cover expenses of delivery which are not an intrinsic element of the definition as they are warranties. The buyer must appropriately discharge all obligations under contract to avoid suit on non-performance of contract of sale. In this regard, article Art. 2303 provides that:

*(1) The buyer shall pay the price and take delivery of the thing.*

*(2) He shall be bound by any other obligation imposed upon him by the contract of sale.*

#### **2.2.2.1. Obligation to pay price**

The buyer has the obligation to pay the price and take delivery of the thing. The price is the amount of money that the buyer undertakes to pay to the seller in consideration of a thing. It is the cost at which a thing is bought.

The obligation of the buyer to pay price includes the obligation to take any steps provided by the contract or by the custom to arrange for or guarantee the payment of price, according to Art 2304. For example, the contract of sale may provide that the buyer should pay the price in check. In this case the buyer must open account in bank and deposit money in the bank from which he orders payment to the seller. Thus, the buyer fails in his obligation to pay price if he does not open an account in a bank. The parties to the contract may agree that the buyer would pay the price after delivery of the thing provided the buyer gives security to the seller. In such case, the buyer's obligation to pay price includes the obligation, for example, to give surety.

In many kinds of business, there are customs and practices of the trade that are known by people in the business. Applying these customs and practices in light with providing gap filling rules

considering hypothetical contract that is the contracting parties would assume these customs and practices had they been cognizant of the gap. The buyer has, accordingly, the obligation to pay in accordance with the custom and arrange for or guarantee the payment of the price. For example, assume that the custom in purchase of pharmaceutical products the buyer has to transfer the purchase price through the bank to the seller. In such case, the buyer should take step to transfer the money through the bank.

According to Article 2304 (2), the obligation of the buyer to pay price also includes the obligation to accept bills of exchange, to open credit account and to provide bank security.

Parties to sales contracts frequently fail to regulate price or leave gaps which might result in unresolved dispute. In such cases, the provision of the Civil Code determines the price in some instances by its gap filling provisions. Such circumstances relate to the absence of fixed price while the price is based on weight of the thing when the thing; has market price, when the buyer accepts excess quantity, when the time and place of payment is not agreed.

? How do you see the validity of a contract whose object (price) is not specifically stated?

A) **Price determined by weight:** According to Art 2305, if the parties determined the price based on the weight of the thing, the price should be based on net weight rather than gross weight and the new weight is taken into account in the event of doubt. For example, if the seller agrees to deliver 20 quintals at 520 Birr per quintals, he has to deliver a quintal containing 100 Kilograms excluding the weight of the container.

B) **Things at current price:** If the thing sold has a market price and the parties did not agree on the price of the thing, the buyer should pay the market price. If the seller normally sells the thing and there is no agreement on the price of the thing, the buyer should pay the price normally charged by the seller. In both cases, the place and time of delivery should be considered. For example, if the place of delivery causes the buyer to incur extra expenses, that expense should be

included in the price. Likewise, the price should be increased in proportion to the duration of delay in paying price, when the sale is on credit.

**C) Quantity greater than agreed:** The seller should deliver the quantity of the thing agreed upon in the contract. Where the seller delivers a quantity greater than that provided in the contract, the buyer may accept or reject the excess quantity as he pleases. If the buyer, on the other hand, accepts the quantity in excess, he should pay a price increased in proportion to the quantity delivered to him. For example, A agreed to deliver 10 quintals of sugar to B at 500 Birr per quintal. Instead A delivered 15 quintals. B has an option to accept or reject the additional 5 quintal. If he accepts, he should pay 500 Birr for each additional quintal.

**D) Place of payment:** If no place is fixed in the contract, the buyer should pay the price at the address of the seller. However, if the contract provides that the price is paid when the thing or documents are handed over, when the price is paid at the place where, under the contract, such thing or documents are to be handed over.

#### **2.2.2.2. Obligation to take delivery of the thing**

The buyer must take necessary steps to complete the delivery according to article 2313 which provides that:

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

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

### **2.2.3. Common Obligations of the Seller and the Buyer**

In the preceding discussions, we have discussed the respective obligations of seller and buyer. The obligations of the contracting parties are not limited to these obligations. They have some obligations in common like obligation to pay expenses, obligation to preserve the thing and obligation to bear unpreventable risk of loss and deterioration. The common obligation of the parties will accordingly be dealt with.

#### **2.2.3.1. Obligation to pay expenses**

The contract of sale may not involve expense when it is an instance sale. For example, when you buy a jacket, you pay the price and take the jacket. You have concluded a contract of sale but you did not incur expenses. However, when contract of sale involves a lot of money, the parties usually make their contract in writing. In such case the conclusion of contract involves certain expenses like advocate's fee for drafting the document incorporating the agreement, expenses for typing, printing and photocopying the document.

Sometimes the conclusion of the contract may involve brokers. The remuneration paid to the brokers is an expense of the contract. When the contract of sale involves expenses, the buyer should cover such expense.

The obligation of the buyer to pay price sometimes involves expenses like charges by the bank when the money is to be sent to the seller through the bank according to the contract. The obligation to pay price like obligation to open credit account and the obligation to provide bank security are always accompanied by expenses. In addition to expenses of payment and expenses of contract the buyer bears the expenses of transportation when the goods sold is to be taken to other places than place of delivery. It can be safely concluded that the buyer bears the following expenses:

- Expenses of a contract of sale;
- Expenses of payment;
- Any expense arising after delivery;

- Expenses of transport where the thing sold has to be sent to another place than the place of delivery and if the delivery is not to be carriage free;

Under the discussion dealing with common obligation of the parties, there are certain obligations of the seller. The seller bears the additional expenses incurred by the buyer as a result of changing his residence after the conclusion of contract pursuant to Art 2315.

The seller shall pay such transportation expenses when the delivery of the thing is carriage-free as per article 2318. The buyer should bear expenses after delivery like expenses for loading a cargo pursuant to 2317. Where transport of the thing is interrupted by an event beyond the control of either party, the additional transport expenses shall be borne by the party who bears the risks.

The seller should bear the expenses of delivery where delivery involves expenses. The expenses of delivery including the expenses incurred for counting, measuring and weighing of the thing sold.

Where import customs duties or other duties charging the imported thing are to be paid by the seller and such duties increase after the contract is made, such increase shall be added to the price. Where, however, a delivery bearing such duties has been delayed by the act of the seller or of a person for whom the seller is liable, the additional duties shall be paid by the seller whenever the buyer can show that the increase would not have been due, had the delivery been made at the time fixed in the contract or provided by law. Whenever there is a decrease in customs duties, the price shall be reduced accordingly.

### **2.2.3.2. Obligation to preserve the thing**

In addition to bearing expenses, both the buyer and the seller should preserve the thing which has been sold. After delivery of the thing, the ownership transfers to the buyer. In cases of constructive delivery, the thing belonging to the buyer may remain in possession of the seller. The same is true when the buyer is late in taking delivery or in paying the price. In these circumstances, the seller should preserve the thing belonging to the buyer. The seller should not

neglect the goods. The seller's duty to ensure the preservation of the thing is at the buyer's expense. In preserving the goods the seller may incur expenses as when the seller hires a guard for the purpose of keeping buyer's goods or when the seller keeps the buyer's good in warehouses at his own cost. The buyer should then refund the seller according to Article 2320 of the Civil Code. When the buyer fails to do so, the seller has also the right to retain the thing until the buyer indemnifies him for the expenses he incurred in preserving the thing.

Although risk might be transferred to the buyer, the seller has the obligation to preserve the thing and if the thing is damaged for lack of preservation, the seller will be liable for the damage. Article 2325 (1) indicates that risk is transferred to the buyer from the day when he is late in paying the price. Transfer of risk connotes that the buyer shall pay the price notwithstanding that the thing is lost or its value is altered. This is however true if the loss or alteration of the value of the thing is not attributable to lack of preservation of the seller who is in actual control of the thing.

The buyer has also the obligation to preserve the thing at the seller's expense where the thing sold has been received by him and he intends to refuse it either owing to defect or non-conformity. Article 2324 (2) dictates that risk will not be transferred to the buyer even after delivery and the seller is in actual control if he has cancelled the contract, require cancellation or require replacement of the thing. We can infer from this that if the thing which is in the actual control of the buyer is lost or damaged, it is the seller not the buyer who shall cover the price of the thing.

However, if the loss or damage is attributable to the noncompliance of the obligation to preserve the thing by the buyer, the buyer will be liable to cover the price of the thing. Even though risk is not transferred to the buyer, his obligation to preserve the thing in his actual control makes him liable.

The seller and the buyer may relieve themselves of the obligation to preserve the thing by consigning or selling it in accordance with the provisions of the title of this code relating to 'contracts in general' (Article 1779-1783). If for example Ato Yehiya sold 100 kilos of bananas

to Ato Waq jira and the buyer died before accepting delivery, Ato Yehiya may be authorized to sell bananas and deposit the money if the person who shall receive performance is not known or refuse to accept.

### **2.3. Transfer of risk under contract of sales of movables**

Like the performance of contract transfer of risk is also of paramount importance in the contract for the sale of goods. As a result this section will deal with the meaning of risk transfer, effect of risk transfer and the ways by which risk is transferred. Upon completing this section students should be able to:

- Provide the justification of risk transfer
- define what risk transfer is
- put the effect of risk transfer

#### **2.3.1. General**

Risk is the liability of loss or deteriorations of a thing sold. The thing sold may be damaged, destroyed or lost during transportation. Floods, tornadoes or other natural catastrophes may destroy it. As a result allocating risk some times requires transfer of risk from the seller to the buyer. General principle of economic analysis of contract tells us that risk shall be borne by the person who is in a better position of avoiding the risk or shared when none of the parties is in a batter position of avoiding the risk. Therefore the laws dealing with risk transfer are normatively required to take into consideration the efficient risk allocation.

The effect of risk allocation is that the person who bears the risk is to cover the value of the thing which has been damaged or lost. Thus, the basic principle, which is provided regarding transfer of risks in the sale of goods, is that, the buyer shall pay the price notwithstanding that the thing is lost or its value altered where the risks are transferred to him Article 2323 which provides as follows:

*Where the risks are transferred to the buyer, he shall pay the price not withstanding that the thing is lost or its value altered.*

The risks shall be transferred to the buyer from the day when the thing has been delivered to him in accordance with the provisions of the contract or of this code. The risk is transferred upon delivery notwithstanding that the thing delivered does not conform to the contract, where the buyer has not cancelled or required the cancellation of the contract or required that the thing be replaced.

Risk transfers from the seller to the buyer in the following cases.

- Delivery
- Delay of buyer
- Handing over to carriage

The risk transfers to the buyer when the seller delivers the thing to the buyer in any of the modes of delivery. According to Article 1758 of the Civil Code the debtor bears the risk till delivery is made according to the contract. This provision shows that risk is transferred upon delivery and it follows the principle which says *res peri demino* or risk perishes to the owner or risk follows to the ownership.

This way of risk transfer seems to be based on the assumption that when the thing is delivered the person to whom the thing is delivered is in a better position of avoiding the risk and shall accordingly bear the risk.

Be that as it may, there are circumstances where the risk is not transferred upon delivery. The buyer must accept the thing to assume its risk of loss or deterioration. The buyer usually accepts when the thing conforms to the contract or when the thing suffers from no defects. The buyer rejects the thing if it does not conform to the contract or if it is defective when he required the seller to replace the non-conforming things or defective things. Therefore, delivery transfers risk to the buyer only when the thing conforms to the contract. If the thing does not conform to the contract, there must be failure to reject the thing or acceptance of the thing so that delivery transfers risk.

Even though it is generally said that delivery transfers risk, there are circumstances where risk transfers without the delivery of the thing. Sub Article (2) of article 1758 shows that risk is



transferred to the creditor even if there is no delivery if the creditor is in default for not taking delivery.

Sales contract provisions have also provided, in addition to delivery, failure of the buyer to take delivery of goods transfers risk from the seller to the buyer even in the absence of delivery. The risks shall also be transferred to the buyer from the day he is late in paying the price pursuant to Article 2325 although being late in paying the price might result in delay to take delivery. This is an exception to the principle which declares that risk perishes to the owner and in light with risk follows hands.

In addition to delay certain additional conditions are attached when it involves fungible things. Where the sale relates to fungible things, the delay of the buyer shall not transfer the risks to him unless the thing, clearly designated for the performance of the contract, has been especially allocated to the buyer and the seller has sent notice to the buyer to that effect. Where fungible things are of such a nature that the seller cannot set aside part of them until the buyer takes delivery, it shall be sufficient for the seller to have performed all the acts necessary to enable the buyer to take immediate delivery. Therefore, the general conditions upon the fulfillment of which risk transfers to the buyer owing to delay in taking delivery of fungible things are:

- The thing must be designated for the purpose of delivery that is the thing must be identified from other things
- The thing must be allocated to the buyer, that is, identification alone is not enough.
- The notice of designation and allocation must be given to the buyer. Thus, default notice alone is not enough.

### **2.3.2. Special arrangement by the parties – term of shipment**

In addition to delivery and delay of the buyer, handing over of the thing to the carriage also transfers risk in the case of a thing under voyage. Where the sale relates to a thing under voyage, the risks shall be transferred to the buyer from the day when delivery has taken place by the thing having been handed over to the carrier. This is special arrangement where the thing is delivered before the conclusion of the contract. Such transfer of risk allows transfer of risk before the

conclusion of the contract. Article 2326 says that where the subject of sale is under voyage (being transported) the risk shall be transferred to the buyer upon delivery by handing over to the carrier. Delivery or handing over of a thing which is under voyage is effected before the conclusion of the contract because it is after delivery the thing can be called things under voyage. Effectuated delivery transfers risk and delivery is before the conclusion of the contract means risk is transferred retroactively.

Hence, it is not illogical inference to say the effect of contract of sale comes before the conclusion of contract. However, it is the effect which follows the cause not the cause which comes after effect. In addition to this mistake as to existence of a thing impossibility delivery before the conclusion of contract can also be a challenge for such transfer of risk as risk depends on validly formed contract.

For example some number of mobile apparatus was handed over to a carriage on September 7 and a contract of sales for the things under voyage was concluded on September 20. At the conclusion of the contract, however, the things under voyage was destroyed. In this case the risk is transferred to the buyer as of September 7 that it is when the things were handed over.

In this case leave alone risk transfer, the formation of valid contract is at issue for the buyer may invoke mistake as to the existence of the contract. It might also be said that there is no contract since the object of the contract relates to impossible object because non-existing object before the conclusion of contract is said to be impossible object.

Risk is not transferred in a situation where at the time of the making of the contract the seller knew or should have known that the thing had perished or was damaged. This seems to get its justification from allocating risk to the person who is in a better position of avoiding the risk and the seller who has knowledge or is reasonably expected to know is in a better position to avoid the risk by not entering the contract.

However, even though the seller does not know or should not have know, there seems not tenable justification to make the buyer bear a risk for a thing which did not exist at the time of the conclusion of the contract or was perished before the conclusion of the contract.

Special consideration is made when there are provisions relating to expenses and the goods are shipped in common. As far as a provision relating to expenses is concerned, any provision relating to expenses stipulated by the parties, especially a provision whereby expenses are to be borne by the seller does not in itself transfer the risks.

As far as goods shipped in common is concerned, the risks shall be allocated to each of the buyer in proportion to his share from the day when delivery has taken place by the goods after being handed over to the carrier, where the seller has sent to the buyer the bill of exchange or other document showing that the shipment has taken place.

## **2.4. Non - performance and its legal effects**

Having discussed transfer of risk in section three, non-performance and its legal effects will be discussed. Under non-performance of contract and its legal effects a discussion will be made on the meaning of non-performance and provisions from which the meaning of the term can be inferred will be analyzed. The purpose of remedies of non-performance as its legal effect will be dealt with. The precondition of default notice as a legal effect of non-performance will then be discussed, along with its purposes. After studying this section student should be able to:

- Identify whether certain discrepancy between the agreement and the actually performed act is tantamount to non-performance.
- List the pre-conditions of remedies of non-performance
- State the time when default notice can be given
- List the circumstances where default notice is not necessary

### **2.4.1 Meaning of non-performance**

Non-performance of a contract refers to the failure of the contracting parties to discharge their obligation. Contracting parties assume obligation which emanates from the express agreement of

the contracting parties, from the incidental effects of the contract and from the gap filling provisions. When the contracting parties do not comply with these obligations it can be said that there is non-performance of the contract.

Even though the definition of non-performance of contract has not been made in the civil code different provisions imply failure to discharge these assumed obligations according to the agreement or with trivial discrepancy. Article 2329, 2331, 2332, 2333 are among the provisions from which the meaning of non-performance of contract can be inferred.

Contract of sale is said to be non-performed or breached when either the buyer or the seller or both fail to carry out their obligations under the contract. Usually both parties to the contract for the sale of goods perform the obligations they agreed to in the contract. Occasionally, however, one of the parties to a contract may fail to perform his obligations for different reasons. A buyer, for instance, may fail to pay a purchase price at the agreed place or time or fail to take or receive delivery. Similarly, a seller may change his mind and refuse to deliver a thing sold or a buyer while enjoying a thing purchased may be disturbed by a third party claimant, or the thing delivered may be defective.

There is also non-performance of contract when a party not only fails to discharge his/her obligation but also fails to accept performance specially delivery. Article 1779 gives remedy for non-performance by refusal to accept the thing. It can be inferred from this provision that refusal to accept without good cause is non-performance of the contract.

#### **2.4.2 Legal effects of non-performance**

Among the basic functions, which are carried out by contract law, providing remedies for non-performance of contract is the most important one. Party would be reluctant to enter into a contract in the absence of legal remedy for non-performance of contract. The purpose of contract law dealing with non-performance of a contract is avoiding the deterrence effects of non-performance on the parties for fear that their contract may not be performed.

The legal remedies for non-performance protect the concern of the party whose interest is affected by non-performance. The interest, which might be effected by non-performance of the contract, is the benefit, which could have been gained, had the contract been performed. Accordingly; the remedies are supposed to provide the party with the benefit of the performance of the non-performed or to put the party whose interest is affected by non-performance in a place he would have been had the contract been performed.

In addition to the party whose interest is affected by non-performance; the party who fails to perform is required to be protected, in the contract law dealing with non-performance. The cost incurred, as remedying of non-performance should not exceed the reason by expected remedy of that specific non- performance, the party shall be protected from untreatably excessive cost of remedy of non-performance.

The general purpose of general contract in providing remedies of non-performance is not peculiar to contract of sales. The purposes, which are required to be met, shall also be secured in contract of sales.

The non-performance of the obligation in contract of sales begs striking a balance between the interest of the party who fails to perform and the party for whom the contract is not performed. Taking these interests into account most countries apply forced performance, cancellation and compensation of damage as a remedy of non-performance. Applying these remedies can be considered legal effect of non-performance of contract of sale.

Under Ethiopian law of contract and contract of sale, before resorting to the remedies of non-performance, a contractant that requires such remedies shall put the other contracting party in default, This effect of non-performance of contract of sale, along with the manner of its application, is provided in Articles 1772 to 1775 as a pre-condition of remedies of non-performance of contract.

*Art. 1772. – Notice necessary.*

*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 obligations under the contract.*

The connotation, enthroned in this provision is that, default notice is a pre-condition for the remedies of non- performance putting the party who failed to perform in due time incorporates certain purposes. The special provisions of sales contract also provide default notice as a condition for the remedies of non-performance when the date for performance is not compulsory according to 2338(2) and 2348(2) considering its importance. Articles 1773 has been, therefore, provided referring to the forms and time of notice

*Art. 1773. – Form and time of notice*

*Notice shall be by written demand or by any other act denoting the creditor's intention to obtain performance of the contract.*

*Notice may not be given unless the obligation is due.*

There is no any mandatory formal requirement of default notice. It shall, however, denote the intention of the creditor requiring performance. This intention can be expressed in either written form or any act capable of depicting that an unequivocal expression of intention shall be made.

Default notice cannot be made before the time of the performance of the contract. It shall be made when the obligation is due. In addition, the default notice shall include the time for performance upon the expiry of which the creditor will not be accepting performance.

The time, for which performance shall be made and upon the expiry of which performance is not accepted, is required to be put and be reasonable according to Art. 1774. Such reasonableness shall be determined taking into account the nature and circumstance of the case. Such circumstance might include whether the party has the object of obligation at hand. Whether it is to be manufactured in the future and the time for its manufacturing shall be considered.

It has also been stated that the buyer must notify the seller his intention to require forced performance, within a short period according to Article 2331(1). Thus, the buyer cannot require forced performance for unlimited period whether he has a particular interest or not. The buyer may also fix a reasonable period to the seller for making the defects or non-conformity good.

Despite the fact that notice is a pre-condition for someone to resort to remedies of non-performance there are cases where the remedies can be applied without putting the other party in default. Article 1775, 2338 provides cases when remedies can be applicable without default notice.

When the obligation is assumed to be discharged within fixed period of time and that period expires, there is no need for notice. Compulsory date for delivery as of 2338 can be the best example where default notice is not important. Such non-performance cannot be rectified by performance following notice once the time expires. A debtor, assuming the obligation of selling birthday cake or selling soft drinks which has market price need not be put in default, if he fails to perform his obligation. The contract can be performed only before the date of the birthday expires and the soft drink can be obtained in replacement.

Anticipated non-performance when the debtor declares not to perform the obligation in writing also excludes the pre-condition of notice to rectify non-performance. Reminding someone who declares not to perform has no any tangible effect for he knows the non-performance and he has already refused to do so.

In addition to this exclusion of notice for failure to discharge obligation, express stipulation in the contract also have parties apply directly the remedy of non-performance. When the obligation is not discharged in due date and express agreement excluding notice is stipulated in their contract, the effects of non-performance become applicable without notice.

## **2.5. Remedies in case of non – performance**

After putting the debtor in default or if notice is excluded as discussed above, the party to whom performance is required to have been made, may apply to the remedies of non-performance

provided under Article 1771. The remedies of non-performance is accordingly aimed at discussing the different alternative and cumulative remedy of non-performance, the pre-conditions to require and apply each remedies and the guidelines and ways of applying these remedies.

This section is therefore aimed at enabling students

- to list the remedies of non-performance of contract of sale
- to list the cumulative and alternative remedies of non-performance of contract of sale
- to state the conditions upon the fulfillment of which the remedies can be effected
- to specifically put the ways of assessing compensation
- effect of the remedies of non-performance of contract of sale

The remedies for non-performance of obligations in a contract of sale are structured in such a way that the various possibilities are provided with respect to each of the remedies. These remedies have been provided under Article 1771 of the general contract provisions as effect of non-performance of contracts verbally as:

- (1) Where a party does not carry out his obligations under the contract, the other party may, according to the circumstances of the case, require the enforcement of the contract or the cancellation of the contract or in certain cases may himself cancel the contract.*
- (2) He may in addition require that the damage caused to him by non-performance be made good.*

According to Article 1771, the remedies for non-performance of contract of sale are:

- Forced (specific) performance
- Cancellation of the contract
- Damages

The objective of these remedies is to put the party aggrieved by non-performance in the same position as if the contract has been performed so that certainty, security of transaction and optimal cooperation is secured.



### 2.5.1 Forced Performance

Forced performance is one remedy of non-performance of contract of sale. Forced performance, as the term implies, is to have the contractant carry out the contractual obligations unwillingly in compliance with the order of the court. Forced performance can be applied as, either specific performance or substituted performance. Forced performance begs the role of court for its implementation. Specific performance is not, however, ordered for the mere reason that it is required by the party. Certain requirement shall be fulfilled in order that the court orders specific performance.

*Art. 1776. – Specific performance.*

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

Two criteria are put, in this provision to order specific performance. Indispensably the creditor shall have a special interest and the personal liberty of the debtor shall remain intact. These requirements protect the debtor from violation of his right to liberty in civil case. In addition to these conditions of the general contract, in sales contract forced performance can be required when certain failures happen that is when a there is failure to deliver, when there is non-conformity or defects, and non-payment of price.

The presence of special interest can be inferred from the importance of the obligation required to be discharged towards the creditor and its possibility of being discharged otherwise. Accordingly, the buyer cannot require forced performance in all cases of non-performance of the obligation to deliver unless the following conditions are fulfilled. First, the buyer must have a particular interest in the thing sold pursuant to Article 1776 and 2329 which provides that:

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

Article 2329 provides ‘where the thing has not been regularly delivered, the buyer may demand the forced performance of the contract where it is of particular interest to him’. The buyer should

have a particular interest, no possibility of purchase in replacement and should notify within a short period. The buyer cannot demand the forced performance of the contract where the sale relates to a thing in respect of which a purchase in replacement conforms to commercial practice or such purchase can be effected by him without inconvenience or a considerable expense. The buyer shall lose the right to demand the forced performance of the contract where he fails to inform the seller, within a short period after he has ascertained the delay, of his intention to demand such performance. This period is estimated with particular strictness where the date fixed for the performance of the contract is a compulsory date.

Unlike the general contract in the sales contract provision, the requirement of leaving the liberty of individual intact is not provided as a condition. This is because in sales contract there cannot be a circumstance where the liberty of individual is affected. What is done is only attaching the property of the party who failed to perform the contract.

The seller may demand forced payment when the buyer fails to pay the price pursuant to Article 2333. Forced performance is the only option where the thing is delivered to the buyer and it cannot be returned as the buyer has already assigned, transformed or the thing is destroyed due to the fault of the buyer. The seller cannot require forced performance when the thing is not delivered to the buyer and the seller can make compensatory sale according to the custom of the market. Compensatory sale is possible when the thing can be sold to other persons.

The buyer has a particular interest in the thing sold when no other thing except the thing sold to him satisfies his need. For example, Guyo wants to buy a horse for in order to participate in a regional horse competition. He bought a horse that was a champion in the national horse competition from Galgalo. Thus, Guyo has a particular interest in the horse he bought.

To give additional example of this, in obligation of supplying electricity assumed by corporation can be of special importance as such service is not of trivial advantage rather of paramount importance and such service cannot be given by other party.

Secondly, the buyer must not have any possibility of purchase in replacement. In this regard Article 1778 reads:

*Art. 1778. – Fungible things*

*Where fungible things are due, the creditor may be authorized by the court to buy at the debtor's expense the things which the debtor assumed to deliver.*

Where the fungible things are due the debtor may have substituted performance be made upon court authorization to buy the thing at the debtors expense. If Ato Shewa fails to perform his obligation of delivering 100,000 of sugar in due time, the creditor may buy the agreed amount of sugar from the market upon court authorization. The price of the sugar would then be covered by the debtor.

Article 2330 also provides that:

*The buyer may not demand the forced performance of the contract where the sale relates to a thing in respect of which a purchase in replacement conforms to commercial practice or such purchase can be effected by him without inconvenience or considerable expense.*

The buyer cannot require the forced performance if the market usage is to buy the thing from another seller. For example, Becky agreed to buy a 14 inch *Sony*® TV set from Natoly who deals in TV sets and another electronic goods. Becky cannot require forced performance if it is the custom of the market that the buyer should obtain the good from other seller. Even if it is not a custom in the market, the buyer should obtain the TV sets from other sellers if he could do that without incurring considerable expenses or inconvenience. Thus, if the buyer cannot obtain the thing in the same market it is inevitable that he will incur considerable expenses. For example, the buyer incurs considerable expense if he had bought the thing in Dire Dawa and if that thing cannot be found except in Addis Ababa. When the buyer incurs such an expense he may require it in the form of compensation.

It must be born in mind that the buyer may not be awarded with forced performance if the non-performance is owing to dispossession even though the buyer has a particular interest and the

liberty of the seller cannot be affected. This is because contract including contract of sale creates an obligation between the contracting parties only. Forced performance in case of dispossession affects not only the contracting parties but also third parties who have better title than the contractant. Ordering forced performance results in negative externality (affecting third parties). Article 1952 (1) shows that contract shall have effect only on contracting parties. Article 1675 also indicates that a contract can have effect “as between” the contractants.

The buyer may require forced performance in case of non-conformity or defects. The buyer who has regularly given notice of the defects may require the seller to deliver new things or the missing part or quality of the things where the forced performance of the contract may be demanded. He may require that the defects be made good by the seller within a reasonable time where the sale relates to a thing which the seller has to make or produce on the specifications of the buyer and where such defects can be made good. Where the buyer’s right to decide later as to the form, measurements or other details of the thing is reserved in the contract and he has failed to give such specifications within the time fixed in the contract or on the expiry of a reasonable period of time notified to him, the seller may himself make the specifications according to the requirements of the buyer as he knows them. The seller shall inform the buyer of the specifications of the thing where he has determined them and fix him a reasonable period of time for giving different specifications. Where the buyer fails to give his specifications within such time, the specifications made by the seller shall be binding.

Non-payment of price might also be remedied by forced performance. Where the buyer fails to pay the price, the seller may demand payment unless the sale relates to a thing in respect of which a compensatory sale is imposed by custom.

### **2.5.2 Cancellation of contract of sale**

The other remedy for non-performance of the contract of sale is cancellation. There are conditions and effects of cancellation. There are two kinds of cancellation under law of sales. Cancellation is the action by which contracting parties make an already formed contract ineffective. Cancellation of contract is made in response to non-performance. Cancellation presupposes the presence of contract. They are judicial cancellation and unilateral cancellation.

Cancellation by the court, upon the request by party who is aggrieved by non-performance, is judicial cancellation. Sometimes the party is empowered to cancel the contract and it is called unilateral cancellation follows.

### **2.5.2.1. Cancellation by Court**

Cancellation of a contract can be made by court action. The party who requires cancellation as a remedy for non-performance shall bring action to effect. Article 1784, deals with cancellation of contract by court action as a remedy for nonperformance of a contract, and is provided as:

*Art. 1784. – Cancellation of contract by the Court*

*A party may move the court to cancel the contract where the other party has not or not fully and adequately performed his obligations within the agreed period of time.*

A party whom assumed an obligation has not been performed, not been fully and adequately performed, can have the court cancel the contract. The party requiring cancellation shall be in a position to perform or shall have performed his obligation unless he can be benefited from time limit.

The court does not cancel a contract when an action is brought to this effect simply because there is non-performance of a contract. The court shall consider the good faith of the parties. Mandatory Article 1785 has put the importance of good faith to guide the court in deciding whether are not to order cancellation or not in the following words:

*Art. 1785. – Good faith.*

- (1) In making its decision, the court shall have regard to the interested of the parties and the requirements of good faith.*
- (2) A contract shall not be cancelled except in cases of breach of a fundamental provision of the contract.*
- (3) No contract shall be cancelled unless its essence is affected by non-performance and it is reasonable to hold for such reason that the party requiring cancellation of the*

*contract would not have entered into the contract without the term which the other party has failed to exacted being included.*

Article 2340 also shows that the court shall not cancel the contract of sale unless there is a fundamental breach and if the breach can be made good with in a period of time fixed by the contract. According to this provision, where the seller delivers the thing at a place other than that where he is bound to make delivery, the court shall not cancel the contract on the application of the buyer unless the manner in which the contract was enforced constitutes a fundamental breach of contract. The contract may not be cancelled where the breach can be made good by the seller within such a period of time as is fixed by the contract or by law. The court is required to consider the interest of the parties and requirements of good faith. The party requiring cancellation shall be affected in a way his interest is not secured by the non-performance.

Assume Ato Kahadi enters into a contract with Ato Tamagn. In the contract, Ato Tamagn agreed to deliver the thing in Addis at Kahadi's domicile. Later for Ato Kahadi has been a resident of Mekelle, Ato Tamagn delivered the coffee at Ato Kahadi's residence in Mekelle. Ato Kahadi requires cancellation for non-compliance of place of performance. The court shall not invalidate such contract, as the non-compliance of place of performance does not affect his interest.

Cancellation by court shall be ordered in cases of only fundamental breach. Note that it is fundamental breach which can obviously affect the interest of the party. For example, A enters into a contract where he will make a table out of oak but he made the table out of a piece of metal. The contracting party of A requires cancellation. The court shall cancel the contract for there is a fundamental breach of contract provision.

Breach of fundamental provision should be seen in light of the effect it results in. The interest of the party requiring performance shall take the decisive nature of the non-performance. Cancellation shall be effected if the essence of the contract is affected. Whether the party requiring cancellation would have entered into the contract of sale without the term, which the other party failed to perform, shall be considered.

Mesebo Cement Factory enters into a contract with XY Company. The XY Company undertakes to deliver necessary materials at the head office of the company in Addis. XY Company delivered the raw material in Mekelle where cement is produced. Mesebo Cement Factory would have entered, into the contract had it known the way of performance as it had been.

As the seller can require cancellation when the thing is not delivered in the place where it should have been delivered, cancellation can also be required when the whole ownership is not transferred to the buyer pursuant to 2341. The contract may be cancelled where, as a result of a defect affecting his title, the seller has not procured for the buyer the thing free from all rights belonging to third parties. The contract, however, may not be cancelled where the buyer, on buying the thing, knew of the encumbrance. In addition, the contract may not be cancelled where the right with which the thing is encumbered is of small importance and it appears that the buyer would have bought the thing, had he known of the encumbrance.

The seller may also require cancellation of the contract when there is default in taking delivery according to Article 2349. 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 where the failure of the buyer justifies the fear that he will not pay the price or it appears from the circumstances that taking delivery was an essential stipulation of the contract.

Court cancellation can be required when there are contracts for successive deliveries as is provided under Article 2351 of the Civil Code. Where, in contracts for successive deliveries, by reason of the non performance or the defect of one of the performance due by a party, the other party is justified in fearing that the future performance will not be made or will be affected by defects, such party, may require that the contract be cancelled for the future. The buyer may also require the cancellation of future deliveries or deliveries already made, or both, where he proves that, by reason of their connection, these deliveries are of no use to him without those which have not been made or were affected by defects

### **2.5.2.2. Unilateral cancellation**

In addition to court cancellation, parties, who are aggrieved by non-performance of a contract, may opt to cancel it unilaterally, as provided under the law. Unilateral cancellation can be made by the party without going to court if there is a unilateral cancellation clause, expiry of time limit, impossible performance, anticipated nonperformance, dispossession, partial delivery, defect, non-payment of price, impossibility of performance and anticipatory breach.

The buyer and the seller do have different conditions which entitle them to the power of canceling the contract and some common ones. The parties are also required to take into consideration whether the breach of contract affect the essence of the contract in unilaterally canceling the contract of sale. Article 1786 provides the possibility of unilateral cancellation by cancellation clause in a contract.

*Art. 1786. – Cancellation by a party. – 1. Under the contract*

*A party may cancel the contract where a provision to this effect has been made in the contract and the conditions for enforcing such provision are present.*

Contracting partners are free to the extent of stipulating a clause that permits unilateral cancellation when a certain condition is fulfilled. Stipulating cancellation clause helps to avoid going to court to effect cancellation. It can also serve to avoiding delay and back log. In addition to agreement expiry of certain period of time can also lead to unilateral cancellation according to Article 1787.

*Art 1787. – 2. Expiry of time limit*

*A party may cancel the contract where the other party has failed to perform his obligations within the period of time fixed in accordance with Art. 1770, 1774, or 1775 (b).*

This provision makes cross-reference to the provisions upon the expiry of which a unilateral cancellation is legally possible. The expiry of period of grace, period put in default notice and the expiry of a fixed period of time in which the debtor shall perform the obligation having to the nature of the contract, and the party unilateral cancellation of contract.



In light of this general contract provision, the expiry of a compulsory date for delivery entitles the buyer the power to cancel the contract unilaterally pursuant to Article 2338(2). The date fixed for delivery is deemed to be compulsory date where the thing has a market price on markets to which the seller can apply to obtain it. The date fixed by the seller or the buyer, where it is for either of them to fix such a date within a period of time provided in the contract, shall also be deemed to be a compulsory date. Where the date fixed for delivery is not a compulsory date, the court may grant the seller a period of grace within which he shall perform his obligations. The buyer may, under the same circumstances, grant the seller an additional period of time fixed in a reasonable manner and inform him that he shall refuse the thing upon the expiry of this period. The contract shall be cancelled as of right where the seller fails to deliver the thing within such additional period.

Where the period fixed by the buyer is not reasonable, the seller may, within a short time, inform the buyer that he shall only deliver the thing upon the expiry of a reasonable period. Failing such declaration, the seller shall be deemed to accept the period of time fixed by the buyer.

Non-payment of price as of 2333 may make the seller cancel the contract when an express stipulation is put to that effect. The seller may forthwith declare the cancellation of the contract in case of non-payment of the price where this right has been expressly given to him by the contract of sale. Failing an express stipulation, the seller may cancel the contract on the expiry of a reasonable period fixed by him in the notice placing the buyer in default, where the sale relates to things which are quoted on the stock market or have a current price or where this right has been expressly given to the seller by the contract. The seller may also declare the cancellation of the contract upon the expiry of the period of grace, where the court has granted such period to the buyer.

Moreover, failure to make specifications within specified time can entitle the power of unilateral cancellation. Where the buyer has reserved in the contract the right to decide later on the form, measurements or other details of the thing and he fails to give such specifications at the date

agreed as being compulsory or upon the expiry of a reasonable period granted to him by the seller, the seller may declare the cancellation of the contract.

Impossibility of performance is also another way where unilateral cancellation is possible pursuant to Article 1788 and 2352

*Art. 1788. – 3. Performance impossible*

*A party may cancel the contract even before the obligation of the other party is due where the performance by the other party of his obligations has become impossible or is hindered so that the essence of the contract is affected.*

It must be born in mind that impossibility of performance in Article 1788 is different from object impossible provided in Article 1715. Article 1715 refers to an obligation which is impossible before the formation of the contract and that is why it affects the formation of the contract.

Article 1788 refers to an obligation which becomes impossible after the formation of the contract. The impossibility shall affect the essence of the contract in order to carry out unilateral cancellation, as non-performance is required to affect the essence of the contract to affect it.

In addition to the aforementioned provisions Article 2352 of the civil code connotes that either the seller or the buyer can cancel the contract unilaterally where the performance of the obligation of the other party became impossible or when one of the parties inform another, party that he would not perform the contract.

For example, Adem agreed to sell his ox to Bushra. According to their contract, Bushra will take delivery and pay the price after ten days. On the third day, the ox died. Bushra can unilaterally cancel the contract. If the ox is alive and Bushra told Aden before delivery date that he would not pay the price of the ox, Adem can unilaterally cancel the contract.

For example Muger Cement Factor enters into a contract of sale assuming the obligation to deliver 1000 tone in consideration to 1,000,000 of cement to Surconstruction. Later Muger

assured that Surconstruction is declared bankrupt and cannot pay the price. The cement factory came across damage, which hinders it to produce the agreed amount of cement.

Anticipated non-performance unequivocally expressed by the refusal of the contracting party pursuant to. Article 2353 and 1789 has been put to add clarity to the possibility of unilateral cancellation this way:

*Art. 1789. – 4. Party refusing performance*

- (1) A party may cancel the contract where the other party informs him in an unequivocal manner that he will not carry out his obligations under the contract.*
- (2) The party who intends to cancel the contract shall place the other party in default and the contract shall not be cancelled where the party in default produces within fifteen days securities sufficient to guarantee that he will perform his obligations at the agreed time.*
- (3) Notice shall not be required and the contract may be cancelled forthwith where a party informs the other party in writing that he will not perform his obligations.*

When there is an indication that the party would not perform the contract, the other party shall put him in default and cancel the contract. If the party who protests cancellation can provide security guarantying his payment within fifteen years, the contract shall remain effective. However, if the contractant showed that he would not perform in writing immediate cancellation of the contract can be made without any default notice.

Dispossession of the subject of sale entitles the buyer the power of unilateral cancellation pursuant to Article 2342. The contract shall be cancelled as of right where the buyer is totally ousted from the thing and the seller is bound to warrant the buyer against dispossession. The contract may be cancelled where the buyer is partially ousted from the thing. The contract may however not be cancelled where dispossession only affects a part of the thing of minor importance and it appears that the buyer would have bought the thing, had he known that he would be dispossessed of such part.

Partial delivery also gives similar power to the buyer. According to Article 2343 where part of the thing only has been delivered or does not conform to the contract, the buyer may not cancel the contract for the whole unless it appears that he would not have entered into the contract, had he known how it would be executed. In case of delay in the delivery of part of the thing, the buyer may cancel the contract for the whole notwithstanding that the remaining part of the thing is delivered subsequently, where the date of delivery constituted a compulsory date for the whole. Where the buyer is not entitled to cancel or require the cancellation of the contract, he may cancel it partially or require that it be partially cancelled and confine himself to paying a price proportionate to the value of such part as has been duly delivered to him.

In addition to what has been seen delivery of defective thing or partially defective thing can lead to unilateral cancellation. The contract may be cancelled where the thing is affected by a defect against which the seller warranted the buyer. The contract may however not be cancelled where the defect is of small importance and it appears that the buyer would have bought the thing, had he known of the defect pursuant to Article 2344.

Article 2345 also connotes that where the sale is of several things at a time or of collection of articles and only some of them are defective, the contract may be cancelled with regard to such defective things or articles only. The buyer shall in such case pay to the seller a price proportionate to the value of the things or articles, which have been delivered to him free from defects. The contract however, may not be cancelled for the whole where the defective thing or article cannot be separated, without considerable inconvenience to the buyer or seller, from those which are free from defects. The cancellation, which relates to the principal thing, shall extend to accessories notwithstanding that they have been sold for a separate price.

Generally, there are certain conditions and effects of cancellation. The effects and conditions of cancellation are the ambiguity of the intention of the other party in delayed performance, effect of cancellation on price and profit, expenses, outlays, transformed things and when restitution is not possible.

In case of delay the other party can assure the intention of the other party according to Article 2354. Where a party, being late in the performance of an obligation which constitutes an essential stipulation of the contract, asks the other party whether he still consents to the execution of the contract, the contract shall be cancelled as of right where the other party does not answer within a short time.

Where a contract is cancelled, the parties shall be released from their obligations under the contract, without prejudice to such damages as may be due. If a party has performed his obligations in whole or in part, he may claim the restitution of what he has supplied including expenses incurred. On the other hand, if both parties have performed their obligations, each of them may refuse the restitution due by him until the other party has effected his obligation.

The effect of cancellation on price and profit has been stipulated under Article 2356. Accordingly, whenever the seller is required to refund the price, he shall in addition pay interest on such price calculated from the day of payment. The buyer shall restore, in addition to the thing, the profits he has derived therefore.

Where the thing cannot be returned in its previous condition, however, the buyer shall retain the right to require or declare the cancellation of the contract or to avail himself of cancellation already declared where the thing or part thereof has perished or been damaged without this being due to his own act or that of a person for whom he is liable. He shall in particular retain this right where the thing has been damaged as a result of an examination made by him in accordance with custom. The contract may not be cancelled where the buyer is unable to restore the thing because he has assigned or transformed it or it has perished or been damaged by his act.

Transformation of thing also makes reinstatement impossible. where the thing is transformed, the buyer shall retain the right to require or declare the cancellation of the contract where: (a) the thing or part thereof has been transformed by him before he was able to discover the defect of which he avails himself to require or declare the cancellation of the contract; or (b) the alteration of the thing is of no importance.

As regards outlays made by the buyer on the thing, the provisions of the Chapter of this code relating to 'unlawful enrichment' shall apply (Articles 2168-2178). The buyer may only claim from the seller the payment of these outlays in the case of dispossession where he is unable himself to be indemnified by the third party by whom he is dispossessed.

Abebe has for example sold his TV to Ato Chala and Ato Chala has fixed a certain known problem of the TV. If the contract is cancelled then Abebe is duty bound to cover the expenses of repairing the TV.

### **2.5.3. Compensation**

In addition to forced performance and cancellation, compensation is also among the remedies for non-performance of sales contract. Compensation because of non-performance is recommended to put the victim of non-performance in a place he would have been had the contract been performed. Most scholars of economic analysis of law are ardent proponents of this purpose of compensation.

Any one enters into a contract to get benefit not to be in the same position of his before the formation of the contract. If the law does not either enforce the contract or have the party given a remedy that puts him indifferent between performance and non-performance of the contract, the contracting party would be reluctant to enter into a contract. And this would in turn affect security of transaction.

On such analysis scholars of economic analysis of law agree on the efficient nature of perfect expectation damages that is a compensation which puts the contracting party at the place he would have been had the contract been performed. The relevant general contract provisions and special sales contract are also expected to be in light with this purpose.

In light with this Article 1771(2) has permitted damage to be required in addition to the other remedies put in Sub-article (1). Reading this provision in light with Article 1790 shows that compensation can be both alternative and cumulative remedy of non-performance of a contract.

Article 2360 also supports the aforementioned general contract provisions by allowing claiming of damages whether the contract is cancelled or upheld.

The concept of perfect expectation damages is enshrined in these provisions. Only enforcement of a contract may not put the victim of non-performance in a place he would have been had the contract been performed. Because the failure of the party to perform in due time may negatively affect the victim of non-performance and may make him incur cost of court litigation.

Only cancellation may not also put the victim of non-performance in the place he would have been, had the contract been performed. Therefore, allowing damage and enforcement or damage and cancellation together gets its justification from the need to put the contracting partner in a place he would have been, had the contract been performed.

Where the contract of sale is not cancelled, the amount of damage is fixed in accordance with the provisions of general contract law pursuant to Article 2361. This provision seems to connote that the provisions of contract of sale is applicable in other cases. However, general contract provisions are also applicable when it is relevant even in case of cancellation and compensation pursuant to Article 1676. Accordingly, the preconditions of compensation which are not covered by sales contract are also to be governed by general contract provisions.

#### **2.5.3.1. Conditions for compensation**

The remedies of non-performance do not ignore the interest of the party who failed to perform although the absence of fault does not relieve the party, who fails to perform, from making good the damage. The preconditions for damage owing to non-performance are aimed at protecting the interest of the other party. Therefore, there are certain excuses for the non-performing party one of which is force majeure.

*Art. 1791. – Damage when to be made good.*

*(1) The party who fails to perform his obligations shall be liable to pay damages notwithstanding that he is not at fault.*

*(2) He shall not be released unless he can show that performance was prevented by force majeure.*

This provision shows that non-performance is not excusable although the party is not at fault except for force majeure. The fact that party is not at fault does not mean that he is not in a better position of avoiding the risk.

This is because of non-performance whose ground is neither of force majeure nor fault, is a foreseeable event. Its foreseeability puts the party with duty of performance in a better position of avoiding the risk. Accordingly, the party in a better position of avoiding the risk shall bear it.

Putting force majeure as an excuse for performance is also justified by equal position of the parties to avoid the risk. Force majeure is not foreseeable. The absence of foreseeability put neither of them in a better position of avoiding risk

Putting force majeure as an excuse for performance is also justified by equal position of the parties to avoid the risk. Force major is not foreseeable. The absence of foreseeability put neither of them in a better position of avoiding risk.

Knowing force majeure as an excuse of non-performance, it is worth noting what force majeure is. An attempt to define force majeure has been made under Article 1992. Instance of force majeure and absence of force majeure have been put under Article 1993 and 1794 to add clarity on Article 1792

*Art 1792. – Force majeure.*

*(1) Force majeure results form an occurrence which the debtor could normally not foresee and which. Prevent him absolutely from performing his obligations.*

*(2) Force majeure shall not exist where the occurrence could normally have been foreseen by the debtor or where it renders more onerous the performance by the performance by the debtor of his obligation.*



Force majeure has been put under the determination of objective standard of foreseeability. An occurrence, to be force majeure, shall absolutely prevent the performance and not be foreseen by a reasonable person.

Article 1793 has provided examples of force majeure

*Art. 1793. – Cases of force majeure*

*The following occurrences may accordingly the circumstances, constitute cases of force majeure.*

- a) the unforeseeable act of a third party for whom the debtor is not responsible; or*
- b) an official prohibition preventing the performance of the contract; or*
- c) a natural catastrophe such as an earthquake, lightning or floods; or*
- d) international or civil war; or*
- e) the death or a serious accident or unexpected serious illness of the debtor*

It must be born in mind that Article 1793 illustratively puts examples of force majeure. Accordingly, by analogical interpretation, other case of force majeure can be included.

The same holds true for Article 1794 that illustrates the absence of force majeure.

*Art. 1794. – Absence of force majeure.*

*Unless otherwise expressly agreed, the following occurrences shall not be deemed cases of force majeure:*

- (a) a strike or lock-out taking place in the undertaking of a party or affecting the branch of business in which he carries out his activities; or*
- (b) an increase or reduction in the price of raw materials necessary for the performance of the contract; or*
- (c) the enactment of new legislation whereby the obligation of the debtor become more onerous.*

There are certain exceptions where force majeure does not relieve the parties from paying compensation. The party who fail to perform a contract may be excused for non-performance on certain grounds. In addition to his failure to perform, the party may also fail to notify the other party about his non-performance to avoid further loss. In such case the party who tends not to

perform is in a better position of avoiding certain loss. Article 1797 is put in order to avoid such loss by imposing duty of notifying the creditor about nonperformance.

Article 1797 provides a warning that his failure to notify the other party of the reasons, which prevents him, from performing can result in taking the benefit of excuse off him. Although non-performance is attributable to force majeure, the party who failed to notify is liable to the damages owing to his failure to notify.

The other exception of exclusion of damages when non-performance is owing to force majeure is, if the other party is put in default. Although force majeure relieves the party who failed to perform his obligation, his being put in default changes such situation of the debtor.

Although performance is hindered by force majeure, if performance had been possible before the default notice, the party would be liable to pay damages for non-performance.

Illustration: The compulsory date of the obligation of A was March 1, he was put, in default March 5, the force majeure occur on March 10, A is liable to make the damage good since force majeure occurred after the debtor was put in default.

### **2.5.3.2. Assessment of compensation**

As far as the assessment of compensation is concerned the provisions starting Article 1799 till 1805 of the general contract shall be, as gap filling provisions, applicable in a way they do not contradict with special provisions provided in provisions of contract of sale. When the contract is cancelled there are ways of assessment of compensation in things that have current price, purchase in replacement, special circumstances, things that have no current price, anticipatory breach and in dispossession in the special sales contract provisions and general contract provisions.

**A) Things having a current price:** - Article 2362 in principle depicts that where the contract is cancelled and the thing has a current price, damages equal to the difference between the price fixed in the contract and the current price as on the day the right to declare the cancellation of the contract could be exercised or on the day following the day the contract was cancelled by the

court or as of right. In addition, regard shall be given to the normal expenses of a purchase in replacement or compensatory sale. The price to be taken into account shall be that on the market where the buyer or seller would, in the normal course of business, buy or sell the thing to which the contract relates.

This is in line with Article 1799 (1), which reads, “*Damages shall be equal to the damage which non-performance would normally have caused to the creditor in the eyes of a reasonable person.*”

Sub Article (1) of this provision orders objective standard to be employed in assessing damage. The damage is assessed as a damage which non-performance would normally cause in the eye of a reasonable person. That is why the difference between the price fixed in the contract and the current price is taken into account in assessing the damages.

According to this provision actual damage which has been actually incurred may not be awarded. If the loss which has been actually incurred is more than the loss which is reasonably assessed (normal damage), the normal damage which has been assessed by taking into account a reasonable man's standard would be paid. This provision excluded an actual damage which is not foreseeable and which is the result of excessive reliance. Accordingly; the party who excessively relies on buying in excess of price in the normal course of business is not compensated to that extent. The law orders only normal damage to be made good.

**B). Purchase in replacement:-** Where the buyer has effected a purchase in replacement or the seller has effected a compensatory sale according to Article 2363, the price paid for such purchase or obtained from such sale shall be taken into consideration in calculating the amount of damages. Such amount may be reduced where the other party proves that the purchase in replacement or compensatory sale has been effected in bad faith or in abnormal business conditions.

Article 1802 in line with the above concern provides the duty with its consequence of reduction of compensation verbally as:

*Art. 1802 – Duty to limit the extent of the damage.*

- (1) The party who invokes nonperformance shall take all reasonable measures not involving inconvenience or heavy expenses to limit the extent of the damage caused.*
- (2) Where he fails to take such measures, the other party may invoke such failure to require that the amount of damages be reduced.*

The party who is entitled to claim compensation may have a chance to reduce the damage by buying for a lesser amount without considerable inconvenience. At least if he buys more than the normal business the compensation is reduced for he failed to discharge his duty to limit the extent of damage.

**C). Special circumstances:** - Article 2364 and 1808 order greater damage as an exception to the normal damage. Damages shall be equal to the prejudice actually caused where the party who suffered such prejudice shows that, at the time of the making of the contract, he had informed the other party of the special circumstances by reason of which the prejudice caused is greater. The same is true where the party shows that non-performance is due to the other party's intention to harm, gross negligence or grave fault.

**D). Thing having no current price:-** Article 2365 and 1799 provides that if the thing has no current price, damages shall be equal to the prejudice which non-performance would normally cause to the creditor in the eyes of a reasonable person. Damages shall be equal to the prejudice actually caused where the party informed the other party of the special circumstances by reason of which prejudice is greater, or where the party shows that non-performance is due to the other party's intention to harm, gross negligence or grave fault.

**E). Anticipatory breach of contract:-** In cases of anticipatory breach of contract, damages shall, where the thing has a current price, 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 obligation. Where no period has been fixed in the contract, damages shall be calculated having regard to the market price of the thing on the day when the right to declare the cancellation of the contract could be exercised. Damages however, may not exceed the price actually paid for a previous purchase in

replacement nor the difference between the price fixed in the contract and the price actually received for a previous compensatory sale.

**F). Dispossession:-** Where the buyer is dispossessed of the thing, the seller shall, without prejudice to other damages, reimburse him the judicial and extra-judicial expenses of the proceedings he had to institute, with the exception of the expenses he could have avoided by informing the seller of the proceedings. This compensation is not expected to be perfect expectation damage as it does not consider the opportunity he has lost and does not award him with the expense of buying such thing.

## **2.6. Contracts allied to sale (various forms of contract)**

### **2.6.1. Overview**

There are contracts which are similar to sales contract with certain unique applications. These contracts have certain unique application in their formation, in transfer of risk, obligation of the parties, and other associated issues.

Having discussed the various remedies of non-performance therefore, various forms of sales and contracts allied to sale specifically sale of cattle and other living things, Sale by sample, Sale on trial, sale by installment, sale with ownership reserved, sale with right of redemption, sale with obligation to forward, sale by auction, under various forms of sales and barter contract, hiring sale and contract of supply under the contracts allied to sales will be discussed.

Generally, corporeal chattels are the subject matter of various forms of sales and contracts allied to sales. Accordingly, when the special provisions dealing with the special corporeal chattels are silent, provisions of sales contract and general contract can be applied as discussed in scope and function of law of sales. Their similarity and difference with contract of sale and among themselves will be discussed in dealing with each special contract. After studying this section students are expected to:

- Differentiate between the contract of sale and various forms of sales and contracts allied to sales
- Differentiate each various forms of sale and contracts allied to sales

- State the peculiar nature of the various forms of sale contracts allied to sales

### **2.6.2. Various contracts**

As indicated above, various forms of sales and contracts allied to sale specifically sale of cattle and other living things, Sale by sample, Sale on trial, sale by installment, sale with ownership reserved, sale with right of redemption, sale with obligation to forward, sale by auction, under various forms of sales and barter contract, hiring sale and contract of supply under the contracts allied to sales will be discussed in the following sections.

**A) Sale of cattle and other living animals :-** Sale of cattle and other living things is one the various forms of sales. This special form of sales has certain peculiar characteristics of which the obligation of the seller is one. The seller has the obligation to warranty against contagious diseases and defect. On making delivery, the seller shall guarantee that the animal sold by him does not suffer from any of the diseases which are listed in Article 2369. And any contractual stipulation contrary to this is of no effect. But the presence of such contractual obligation does not affect the very existence of the contract although the obligation to warrant is characterizing obligation of the contract.

Giving no effect to contrary stipulations is against the freedom of contract because the parties do not have the right to agree as they like. This limitation on the freedom of contract of the parties seems to be justified on the protection of the party against information asymmetry. However, this limitation seems to overlook the possibility of agreement of parties with full knowledge. For example someone might be willing to buy an animal with such disease for research.

This is one difference between sale of cattle and other living things on one the hand and contract of sale on the other. In contract of sale leave alone express exclusion of warranty, the knowledge of the buyer about the defect denies the buyer protection.

As far as warranty against defects is concerned, warranty shall be due by the seller where the animal sold is affected by a defect such that it is not fit for the purpose to which it is destined by its nature or under contract. The parties may by express provision in the contract exclude with regard to a given defect the warranty is due.

Likewise, the parties may extend the warranty and provide that the seller shall warrant that the animal possesses a given quality. In this case the parties are free to agree in the way they like and this shows that the obligation to warrant against defect is not characterizing obligation.

Where the obligation of the parties is not discharged the contract can be cancelled pursuant to Article 2373. Where the animal suffers from a contagious disease or is affected by a defect for which warranty is due under the law or the contract, the buyer may require that the sale be cancelled.

When the contract is cancelled there are certain circumstances where compensation is ordered pursuant to Article 2375. The seller shall make good the damage caused to the buyer where: (a) the seller has expressly guaranteed that the animal was not affected by the disease or defect by reason of which the sale is cancelled; or (b) the seller is shown to have known, at the time of delivery, of the disease or defect by reason of which the sale is cancelled.

Such protection is also extended when the animal is lost as of Article 2374. Where the animal sold dies in consequence of a disease or defect for which warranty is due or of a fortuitous event caused by such defect, the loss shall be borne by the seller who shall refund the price he received.

It is not only the buyer who is protected as the seller is also protected in sale of cattle or other living things. Article 2326 shows that the buyer shall lose his rights against the seller where he fails to cause the disease or defect to be ascertained by experts and to inform the seller of such disease or defect within the time fixed in writing by the parties. Where no time has been fixed, the buyer shall lose his rights where he fails to cause the disease or defect to be ascertained by experts and to inform the seller of such disease or defect within thirty days from the animal having been delivered.

**B) Sale by sample:-** In addition to sale of cattle and other living things sale by sample is also another form of contract of sale. Sale by sample refers to a contract where an example of the thing to be delivered is given to the buyer.

In a sale by sample or pattern, the qualities of the thing shall conform to those of the sample or pattern. Where there is discrepancy between the sample and the manner in which the thing is described in the contract, the sample prevails. And if there are differences but no discrepancy, the thing shall combine the qualities of the sample and those of the description.

The basic difference between sale by sample and sale contract is that in sale by sample there is warranty indicating that the example given is the same as the thing to be delivered. The sample may not necessarily be the subject of sale. But the thing given as a specimen or sample shall be in conformity with the subject of sell.

Accordingly, the party to whom the sample was entrusted shall have to prove that the sample exhibited is identical to the sample received. There is no sale by sample or pattern where the seller proves that the sample or pattern was only presented to the buyer by way of information without any undertaking as to conformity.

**C) Sale on trial:** - In sale on trial acceptance is required to be within a certain period of time or a reasonable period. Here, it can be inferred that sale on trial is one indication of an offer with time limit for acceptance. Hence, Article 2380 connotes that where the sale has been made upon trial, the buyer shall, within the period fixed in the contract, declare whether he accepts or refuses the thing. The seller is duty bound by the contract until the expiry of the fixed period of time pursuant to Article 1690 of the civil code.

If no period is fixed in the contract, the seller may give the buyer a reasonable period of time to decide. It is questionable if the buyer can have a remedy for his reliance when the seller reneged his promise and entered into another contract. Such problem can be solved by applying general contract provision article 1691 which dictates that where acceptance is late in an offer without time limit, the offerer shall forth with inform the offeree (buyer) his intention not to be bound by his offer. This might be again result in a controversy as to what time is reasonable time.

Within the aforementioned time the buyer may show his acceptance either by keeping silent or by implication. Where the buyer fails to inform the seller of his decision within the above period,



the sale shall be deemed to be concluded where the thing has been delivered to the buyer so that he may try it. This mode of acceptance is contrary to the general contract provisions.

? How do you think should the contradiction between the general contract and sale on trial be resolved?

According to the general canon of interpretation and Article 1676 (2) of the Civil Code special provisions shall prevail over general provisions. The provisions on sale on trial shall be applied as general contract and sales contract provisions shall not affect special provisions of sale on trial. The thing shall be deemed to be refused in the contrary case.

In addition to acceptance by silence acceptance can also be made by implication as provided under article 2382. The sale is deemed to be concluded where the buyer pays without reservation all or part of the price or dispose of the thing otherwise than is necessary to try it. Acceptance by implication is, for stronger reason, more substantial than acceptance by silence.

As far as risk transfer is concerned, Article 2383 shows that risks shall be borne by the seller notwithstanding that the thing has been delivered to the buyer, as long as the buyer has not accepted it. This is in line with the principle which dictates that risk perishes to the owner contrary to risk follows hands.

**D) Sale by installments:-** In sale by installments the seller has certain options as stated under Article 2384. According to this provision, where the thing has been sold and delivered on the condition that the price will be paid by installments and the buyer is in arrears with one of the part payments, the seller may proceed to recover the unpaid installments or, where such right has been expressly reserved to him, declare the cancellation of the contract.

Art.2385 shows that where the contract is cancelled, the seller and the buyer shall return the payments, which they have made to each other. The seller may, however, claim a fair rent and an indemnity for the wear and tear of the thing. Any stipulation imposing more onerous obligations on the buyer shall be of no effect.

Exigibility of balance is limitation on the seller to exercise his rights. Article 2386 dictates in connoting the limitation that where the exigibility of the balance of the claim has been stipulated in the case of default of payment of an installment, the seller may not avail himself of this stipulation unless the buyer is in arrears for two consecutive payments representing together not less than one tenth of the price of the sale. Any stipulation imposing more onerous obligations on the buyer shall be of no effect. Although the parties may stipulate such obligation, it will be void without affecting the very existence of the contract.

**E) Sale with ownership reserved:-** Sale with ownership reserved is a contract where the seller delivers the thing to the buyer without transferring ownership unlike the contract of sale where ownership is required to be transferred. In a contract with ownership reserved, the rights of third parties might be negatively affected and result in negative externality.

For example Degef might buy a car from Yidnekachew who has got it because of sale with ownership reserved from Abebe. If the real right of the Abebe is given priority, the right of third party (Degef) who has bought it might be affected.

To protect third party, Article 2387 has been provided connoting that a provision whereby the seller reserves to himself, until payment of the price, the ownership of a thing the possession of which has been transferred to the buyer shall not affect third parties unless it has been entered in a public register kept for this purpose at the place where the buyer resides. Where the third party who has acquired the thing is bankrupt, such provision shall not affect his creditors except on the conditions laid down in the commercial code. Whether the third party for whom protection is extended is required to be in good faith or not has not been provided.

And protecting a party in bad faith seems to be absurd. If for example the third party has bought the car knowing that it belongs not to the seller but to a third party, he shall not be protected although he is a third party.

The way risk is transferred is also an important issue worth discussion. Article 2388 dictates that the risks are born by the buyer from the time the thing is delivered to him. Although the seller is

still the owner, risk is transferred to the buyer upon delivery or risk follows hands. This is in line with the principle that delivery transfers risk and against the principle that dictates risk perishes to the owner.

Article 2389 dictates cancellation of sale with ownership reserved and its consequences. Where the sale is cancelled, the seller shall return to the buyer all partial payments, which he had received. He may however claim a fair rent and an indemnity for the wear and tear of the thing. Any stipulation imposing more onerous obligations on the buyer shall be of no effect.

**F) Sale with right of redemption:-** Sale with the right of redemption is a contract where the buyer has the right to re-take the subject of sale unlike the contract of sale. The seller may reserve to himself the right to redeem within a given period of time the thing which he sold to the buyer pursuant to Article 2390. In sales contract, however, the seller may have the chance to retake the thing sold provided that the contract is valid. Such contract might have a negative impact on certainty and security of transaction as the buyer might lack certainty on the thing he has bought.

Article 2391 has been put to attenuate such negative impact by providing limitation on the time of redemption. The period for exercising the right of redemption may not exceed two years. It shall be two years where a shorter period has not been fixed. The contracting parties are free to shorten the period of limitation of redemption by agreement unlike period of limitation in general contract provisions pursuant to Article 1855.

The buyer who buys a thing with the right of redemption has certain limitation to protect the right of the seller. The buyer may, according to Article 2392, not assign the thing to which the right of redemption extends. But this will not affect third parties unless the clause providing for redemption has been entered in a public register kept for this purpose at the place where the buyer resides.

The seller does not have the freedom to take what he has sold without limitation as it might have negative impact on the buyer. Article 2393 has extended protection to the buyer by imposing obligation on the seller. The seller who exercises his right of redemption shall refund the buyer

the price, which he had received, and the expenses of the contract of sale. Unless otherwise agreed, the provisions of the chapter of this code relates that to unlawful enrichment shall apply as regards the expenses incurred by the buyer on the thing.

**G) Sale with the obligation to forward the thing:-** Sale with obligation to forward occurs when the seller is duty bound to convey the thing to the buyer. Article 2394 which deal with care of transport, states that where the seller is bound by the contract to forward the thing, he shall make, on the usual conditions and by the usual means, the contracts of carriage necessary for the thing to be actually forwarded to the place fixed in the contract of sale.

Where the contract of sale implies the carrying of the thing, the delivery shall, unless otherwise agreed, be effected by the handing over of the thing to the carrier as of Article 2395. This mode of delivery is actual handing over of the thing. Where the seller uses his own means of transport or means of transport hired by him for the purpose of effecting part of the carrying, delivery shall be effected by the handing over of the thing to the carrier with whom the contract of carriage is made on behalf of the seller. Where the thing is to be carried by successive carriers and the seller is bound by the contract of sale to enter into one or more contracts of carriage covering the whole transport, delivery shall be effected by the handing over of the thing to the first carrier.

Article 2396 which deal with thing not intended for the execution of the contract indicates that where the thing handed over to the carrier is manifestly not intended for the execution of the contract, by reason of an address written thereon or otherwise, the duty to make delivery shall not be deemed to have been carried out unless the seller gave notice of the transport to the buyer and sent him, where appropriate, a document describing the thing.

As far as delivery in carriage by water is concerned Article 2397 states that where the carrier to whom the thing is handed over is required to carry the thing by water, delivery shall be effected by the thing being put on the board or by the ship according to the terms of the contract.

The seller may postpone the forwarding of the thing until he is paid, where the contract of carriage does not give him the right to dispose of the thing under voyage. But the seller cannot

do so, where it has been agreed that delivery would take place at the place of arrival or the price is to be paid after delivery. Where the seller has forwarded the thing because he had the right to dispose thereof after the beginning of the voyage, he may, until the price is paid, object to the thing being handed over to the buyer at the place of destination.

Where a bill of lading or other document has been issued which permits to obtain the delivery of the thing or the possession of which is necessary to be able to dispose of the thing, the payment of the price may only be demanded against transfer of the document provided by the contract or by custom. In such case, the buyer may not refuse to pay the price on the ground that he was not able to examine the thing. The obligation to transfer the documents shall be deemed to be an essential provision of the contract where the document is a bill of lading or any other document which permits to obtain the delivery of the thing or the possession of which is necessary to be able to dispose of the thing.

Where, after having forwarded the thing, the seller comes to know that the buyer has been declared insolvent, he may object to the thing being delivered to the buyer notwithstanding that the buyer is already in possession of the bill of lading or any other documents which permits to obtain the delivery of the thing. The seller may not object to the delivery where it is required by a third party regularly in possession of the bill of lading or the above mentioned document. In such case, the seller may not object to the delivery unless the bill of lading or other document contains reservation regarding the effect of its transmission or he can show that the holder, in acquiring the bill of lading or other documents, knowingly acted to the detriment of the seller.

Where the thing has been forwarded to the buyer and placed at his disposal at the place of destination, the buyer shall, if he intends to refuse the thing, take possession thereof on behalf of the seller where he can do so without payment of the price and without inconvenience or considerable expense. But this is not the case where the seller is present at the place of destination or there exists at such place a person qualified to receive the thing.

Regarding examination of the thing: where a thing is forwarded, the buyer shall examine it at the place of destination. Where the thing is re-dispatched by the buyer without transshipment and where the seller, at the time of the making of the contract, knew or should have known of the

possibility of re-dispatching, the examination shall be postponed until the thing arrives at its new destination.

**H) Sale by auction:-** Sale by auction has certain peculiar features one of which is its formation. As far as the formation of contract in the case of sale by auction is concerned, the contract of sale shall be concluded by the auction, which the seller or the auctioneer makes of the thing. The person who conducts the auction shall be deemed to be entitled to knock down the thing to the highest bidder, where the seller has expressed no contrary stipulation. The auctioneer does not have the right to refuse for the highest bid.

Sometimes it is questionable if there is last bid before the knocking down of the thing. A clear clarification has been put under the obligations of bidder in Article 2404 which indicates that the bidder shall be bound by his offer on the terms of the conditions of sale. Unless otherwise provided, he shall be released where a higher bid is made or his offer is not accepted immediately after the usual calls.

For example an auctioneer who is conducting an auction may not refuse to accept the highest bid from the other bidders although the auctioneer believes that the proposed price is much less than what he expected.

The obligation to pay is required to be in cash pursuant to Article 2405. Accordingly, unless otherwise provided in the conditions of sale, the bidder shall be bound to pay cash. The seller, who is not paid cash or according to the conditions of sale, may unilaterally cancel the contract forthwith,

Obligation of warranty due by the seller has been imposed under Article 2406 in that in a public and voluntarily sale by auction, the seller shall give the same warranty as in ordinary sales. In compulsory auctions, the seller shall not give warranty except in the case of fraud on his part.

Article 2407 has also provided obligation of warranty due by the disdainer. Accordingly, he at whose request the auction takes place shall warrant the conformity of the thing with the

description given of it in the conditions of sales. He shall also be liable for any fraud he may commit.

**I) Barter contract:-** Barter is one of the contracts allied to sale. Barter is a contract where a thing is exchanged for a thing. Certain scholars do not consider it is a contract for it leaves no obligation to be discharged.

Be that as it may it has been treated as a contract under Ethiopian laws. It differs from contract of sale in some respect. One of the differences is that there is no price to be paid in consideration of a thing to be delivered. One of the basic difference concerns their subject matter in that price is subject matter of law of sales but not a subject matter of barter contract.

Each of the exchangers shall, as regards the things subject to the exchange, have the same rights and obligations as a seller. The exchanger who is bound by the barter contract to pay a balance shall, as regards the payment of such balance, have the same obligations as a buyer. This is one way by which the general contract and sales contract provisions can be applied.

The other peculiarity is sharing of expense. Unless otherwise agreed, the exchangers shall share equally in the expenses of the barter contract since there is no buyer and seller in contract of barter. The provisions applicable to contracts of sale shall for the remainder apply to barter contracts. In addition to law of sales general contract provisions are also applicable to barter contract if they are relevant in a way they do not contradict with law of contract of sale and barter provisions.

**J) Transfer of rights other than ownership:-** In addition to barter transfer of rights other than ownership is also among the contracts allied to sales. This is transfer of rights without the right to dispose the thing. The bare ownership is within the owner. Transfer of rights other than ownership includes transfer of usufruct and incorporeal rights. One of the basic differences with contract of sale is lack of obligation to transfer ownership.

**i. Transfer of usufruct:** - Transfer of usufruct is transfer of the provisions applicable to contracts of sale apply where a person transfers for consideration the usufruct of a thing. The obligation of the seller to transfer ownership of the thing is in such case replaced by the obligation to transfer the usufruct of such thing.

**ii. Transfer of incorporeal rights:** - The provisions applicable to contracts of sale shall, as far as possible and without prejudice to the provisions of special laws, apply where a person transfers for consideration an incorporeal right. Copy rights, business as it constitutes mainly good will can be under this provision. The transfer of choices in action is subject to the general provisions of the law of contract. It is, accordingly, questionable if transfer of actionable rights is under this provision.

**K) Hiring sale:-** Regarding sale, as provided under Article 2412, the provisions applicable to contracts of sale apply where the parties have described their contract as one of hiring a thing, if it has been provided that the tenant of the thing will become the owner thereof upon payment of a given number of installments. However the following points should be given prior consideration.

The risks are borne by the tenant from the time when the thing has been delivered to him. Here the mode of delivery does not necessarily mean actual handing over. What is required to be taken into consideration is only delivery. However, it must be born in mind that ownership is not transferred accordingly the principle of transfer of risk is risk follows hands.

On termination of contract Article 2414 connotes that the tenant may at any time terminate the contract by returning the thing to the lessor. But sale contract is not subjected to termination upon the choice of one party.

As far as cancellation of the contract is concerned the general contract provisions can be applied. Especially Article 2415 connotes that where the contract is cancelled, the lessor shall return to the tenant the rents, which he has collected. He may only claim a fair rent and an indemnity for the wear and tear of the thing. Any provision imposing more onerous obligations on the tenant is of no effect. This is without affecting the formation of the contract.



**L) Contract of supplies:-** The definition of contract of supply has been provided under Article 2416 as “A contract of supplies is a contract whereby a party undertakes for a price to make in favor of the other party periodical or continuous deliveries of things”.

Article 2417 shows lack of sufficient definition about the quantity to be delivered does not affect the contract in its formation. Where the quantity to be supplied has not been fixed, the supplier shall supply such quantity as corresponds to the normal needs of his contracting party, having regard to the time when the contract was made. If the parties have only fixed a maximum and a minimum limit for the whole of supplies or for each delivery, the person with whom the supplier contracted may fix, within these limits, the quantity to be supplied to him. If the quantity is to be fixed according to his needs, the person with whom the supplier contracted shall take all he needs, notwithstanding that this quantity exceeds the minimum fixed in the contract.

Lack of sufficient definition as to the price does not also affect the formation of the contract. Article 2418 states that where supplies are to be made periodically, the price for each delivery is, failing an express provision in the contract, fixed in accordance with the provisions of the law governing ordinary sale.

Article 2419 provides a gap-filling rule concerning time of payment. Accordingly, where supplies are to be made periodically, the price is due at the time of each delivery. Where supplies are to be continuous, the price is due on the usual maturity dates.

Article 2420 states that the time fixed for the various performances is considered to have been fixed in the interest of both parties. If the party entitled to the supplies is allowed to fix the time when each performance shall be made, he should inform the supplier of such time by giving him a reasonable notice.

If one of the parties fails to carry out his duties regarding a given performance, the contract may be cancelled where non-performance is of importance and capable of destroying the confidence in the regularity of the performance of future obligations. The supplier may only cancel the

contract or suspend its performance after having given reasonable notice to his contracting party. Any provision to the contrary shall be of no effect pursuant to Article 2421.

Concerning preference clause Article 2422 and 2423 goes on to say, that a provision whereby a person undertakes to get supplies in preference from a given supplier, should he need certain kinds of goods, shall not be effective for more than three years. It shall be reduced to three years where it has been made for a longer period. A person who entered in such kind of undertakings should inform the supplier of the terms offered to him by third parties. In such cases, the supplier should, under pain of loss of right, declare within the time fixed in the contract or within a reasonable time whether he intends to avail himself of the preference clause.

When there is exclusive clause binding the client, Article 2424 fills the possible gap by providing that if a provision has been made in a contract to the effect that a person shall supply himself exclusively with certain things from a given supplier, such person may not receive from third parties supplies of the things of the nature provided in the contract. Unless otherwise agreed, such person may not himself manufacture or produce things of the nature provided in the contract.

When there is an exclusive clause binding the supplier Article 2425 also takes the gap filling role and shows that if it has been agreed that the supplier should supply his products to a given person only, the supplier may not, in the area provided in the contract and during the currency of the contract, directly or indirectly supply third parties with goods of the nature provided in the contract. If the contracting party has undertaken to develop, in the area provided in the contract, the sale of the things, which have been reserved to him, he shall be liable where he fails to carry out this obligation, even if he sold the minimum quantity provided in the contract.

As far as termination of contract is concerned, if the duration of the contract of supplies has not been fixed in the contract, each party may terminate the contract by giving notice as provided in the contract or, where not provided, reasonable notice. The reasonableness of the time shall be assessed considering the position of the parties in supplying it to others and in obtaining the thing to be supplied from others.

## **2.7. Contract for sales of immovable**

Having discussed contract for sale of goods, a discussion on sale of immovable is necessary to understand the peculiar nature of sale of immovable in the formation performance and other related issues. In doing so general overview of sale of immovable, validity requirement and performance of sale of immovable will be discussed. In discussing the general overview, applicable laws, the subject matter of sale of immovable and other related issues will be discussed. In discussing the validity requirement for the sale of immovable, the elements of the sale of immovable along with the general elements of contract will be dealt with. Then the obligation of the contracting parties to the sale of immovable will be analyzed in the performance of sale of immovable.

Upon the completion of this section, students are expected to acquire the following legal skill:

- Pinpoint the subject of law of sale of immovable
- Differentiate between movables and immovable
- Identify whether all immovable are subject of law of sales
- List the validity requirement for the sale of immovable
- Give correct legal advice as to the validity requirement of sale of immovable
- State the peculiar obligations of the buyer and seller in relation to the sale of immovable.

### **2.7.1. General overview**

Sale of immovable deals with sale of land, building and immovable by destinations which are considered to be immovable. Sale of immovable is contract of sale where the subject matter of the contract is immovable properties. Immovable properties are goods which cannot be moved or move by themselves contraries reading of Article 1127 and land and building are the immovable according to Article 1130 of the civil code. A contract of sales where the object of the contract is immovable according to the definition of the civil code is said to be sale of immovable.

However, it shall be born in mind that land is not subjected to sale as an individual cannot have ownership over land. The right to ownership of land is vested in the nation's nationalities and peoples of Ethiopia pursuant to Article 40 (3) of the constitution. This provision clearly prohibits

sale or any other means of exchange. This shall, however, be understood along with its exceptions where the peasants can possess the land, pastoralists may use for free grazing and investors can use it with pay.

The general contract provisions are applicable to the contract of sale of immovable for, discussed, earlier general contract provisions are applicable to all contracts regardless their nature. Sales contract provisions are also applicable to contract of immovable pursuant to Article 2894. Article 2894 also says *“Those provisions in the Title of this code regarding “Contracts relating to the assignment of rights” which apply to contracts of barter, assignment of rights other than property and hire purchase shall apply to contracts relating to immovable.”*

Although general contract and sales contract provisions are applicable to sale of immovable, a certain special treatment is provided under the provisions dealing with sale of immovable. Article 2875 goes on to say verbally *“Without prejudice to the provisions of the following Articles, the provisions of the Title of this Code regarding ‘contracts relating to the assignment of rights’ shall apply to the sale of immovable”*. What we can infer from this is that the provisions of sales contract are applicable in the elements for the formation of the contract of sale of immovable, performance of the contract, non-performance of the contract and its remedies and other relevant areas where these provisions.

### **2.7.2. Various requirements for the validity of the contract**

The validity of contract of sale of immovable requires the validity requirements provided in the general contract and contract of sale of corporeal chattels as it is contract and the provisions of law of sales are applicable on it. There are, however, additional or peculiar validity requirements which are worthy discussing here in this chapter.

Lesion has been put not to have any effect on the validity of contract. Accordingly, a sale of an immovable may not be rescinded by the buyer or the seller on the ground of lesion. However, this shall be seen in line with the general contract provisions dealing with unconscionable contracts. If the unconscionable contract is backed up by circumstances which result in unequal bargaining power of the contracting parties, the contract will be invalidated automatically

pursuant to Article 1710 (2) of the civil code. If for example one of the contracting parties is in necessity, has business inexperience, in certain position which puts him in unequal bargaining power, and the contract is a lesionary contract, it is subjected to invalidation by the party whose consent is vitiated.

The other validity requirement is existence of the immovable. The immovable shall exist so that the contract of sale of immovable is validly formed. Such inexistence makes it different from sale of immovable. To give an example a contract whereby one of the parties undertakes to deliver to the other party a house, a flat or another building which does not yet exist, is a contract of work or labor relating to immovable and not a contract of sale.

This actually seems to be sales contract as sales contract may relate to things which do not exist. However, this is not true in case of immovable. An immovable is not subject of sale and when the contract is for the delivery of a flat or another building it is not sales contract. Nor is it sale of immovable. The basic difference is the presence of service or labor, its relation to immovable and the inexistence of the thing to be delivered.

Another requirement is form of contract as it has been put under Article 2877. Accordingly, a contract of sale of an immovable shall be of no effect unless it is made in writing. This is in line with the general contract provisions which order that contract relating to immovable to be in written form. Article 1723 clearly connotes that contracts relating to the immovable shall be in written form and registered.

The other requirement is registration in registers of immovable property as stated under Article 2878. The contract shall be registered in the registers of immovable which is termed as “masreja na wul mezgeb kifli” It is however, questionable if it is, strictly speaking, validity requirement. The provision which on goes to say “*The sale of an immovable shall not affect third parties unless it has been registered in the registers of immovable property in the place where the immovable sold is situate*”, seems to connote that lack of registration does not affect the formation of the contract but the effect of the contract on third parties. It will have effect on the contracting parties even though it is not registered and absence of registration only affects the

effect of the contract on the third parties. Had it been a void contract specifying its effect on third parties would have been unnecessary.

Another possible interpretation of this provision is that the provision is giving emphasis on the registration in the place where the immovable is situated. Normally registration is compulsorily required and this assertion can be backed up by Article 1723 which orders registration for contracts relating to immovable. The place where registration can be made might be the place where the immovable is situated or any other place. If it is not registered in the place where the immovable is situated, it will not have effect on third parties but it will have effect on the contracting parties. If it is not registered at all, however, it is considered to be a void agreement.

This argument gets support from Article 2881 that deals with registered rights and burdens. The buyer shall be deemed to know all the rights and burdens affecting the immovable, which has been registered in the registers of immovable property in the place where the **immovable is situate**. In this respect, the buyer may not avail himself of the provisions concerning the warranty against eviction, unless the seller has warranted that such rights of third parties did not exist. Such warranty may only result from an express provision in the contract of sale. The buyer may avail himself of the provisions concerning the warranty against eviction where the immovable is attached and sold at the request of a creditor who has a mortgage or an antichresis. He can also avail himself if registration is in another place other than the one where the immovable is situate.

Registration in the case of hire purchase also seems to be in line with this argument as provided in Article 2895. In the case of a hire purchase, the hire purchaser may register in the registers of immovable property in the place where the immovable is. These provisions seem to indicate the importance of the place where the immovable is situated. Therefore, the exclusion of its effect on third party while making it effective for the parties and the requirement of the place where the immovable is situated in case of hire purchase can be said to emphasize the place of registration.

In practice if a contract related to immovable is not registered it is not considered to be a contract in the courts of Tigray. Most lawyers also believe that registration is a mandatory validity

requirement. In relation to this contracts which are made secretly for any purpose is not considered to be contract at all for they are not registered if they have to be simulated ones.

Colossal controversy has also been made as to whether registration is validity requirement or not in the Federal Court judges and lawyers. For example in a civil case C.No. 37869 between Appellants Habte Zurga and Kebebush Deberka and Respondents Mullushawa Tefere and Zewdnesh Belay Federal high Court decided that “ *a contract of sale of an immovable property need only comply with the requirements that it be made in writing, signed by all the parties to the agreement, and be attested by two witnesses. The requirement of registration is not a requirement as to form and is imposed for the protection of third parties not privy to the agreement.*”

This decision of the High Court was also reversed by the Federal Supreme Court Cassation Bench as it has been put in Cass.F.No.21784. In its decision the court said” *a contract of sale of immovable shall have no effect unless it is registered with a court or notary. The provisions of 1723 and 2878 are not mutually exclusive. Article 1723 lays down the special form which a contract of sale of an immovable has to follow in order to acquire validity. Art. 2878 imposes the additional requirement of registration in the register of immovable properties once a valid contract of sale has been entered into.*”

A similar position has also been held and the same decision has also been given in a similar case whose main issue is whether registration is validity requirement as it can be referred in F.No.21448 Federal Supreme Court Cassation decision.

Even though Ethiopia is among the Civil law Legal System where court decisions do not bind other courts, Article 2(1) of Proclamation 454/1997 cassation court decision has a binding effect on any Federal and State Courts. Be that as it may, entertaining the different controversies is of greater importance for legal education.

Regarding this, one of the strongest counter arguments to the cassation decision is that of Ato Mekebeb’s article that deals with formal requirement of immovable requirements. Mekbeb

Tsegaw has provided detailed argument against the cassation court decisions showing that registration is a validity requirement. He has said that Article 1723 (1) has put the requirement of registration and he added that the Amharic version is in line with the cassation court's decision.

In interpreting by seeking the intention of the legislature, he has said that the function of courts was neither registration nor authentication at the time of legislation and nor was any organ with such function. In such circumstance, the intention of the legislature was not making registration validity requirement.

He has supported his argument by the comment of Professor George Krzeczunowicz quoting his comment as "lack of registration with court or notary of the written contracts contemplated by this article does not affect their validity between the parties (1720 (3)).

After asserting the presence of at least difference at most contradiction between Article 1723 (1) and 2877, the writer maintains the position that *lex specialis derogate generalis* canon of interpretation shall be applied.

### **2.7.3. Performance of contract of sale of immovable**

Peculiar application in sale of immovable is also observed in the obligation of the parties. Obligation of the seller to Cooperate under Article 2879 of the Civil Code is one of these. The seller shall furnish to the buyer all the documents necessary to enable the buyer to cause the transfer of the immovable to be registered in the registers of immovable property. Such obligation shall be deemed to be an essential stipulation of the contract of sale. The absence of this stipulation affects the very formation of the contract. This is an essential condition of sale of immovable without which such contract is not said to be contract of sale of immovable.

In line with the obligation to cooperate, the seller has also the obligation to disclose information about the encumbrances on the immovable pursuant to Article 2880. The seller shall declare to the buyer the rights which third parties have on the immovable sold where such rights may be set up against the buyer independently of a registration in the registers of immovable property. The contract may compel the seller to declare to the buyer the rights which third parties have on the immovable notwithstanding that such rights are entered in the registers of immovable property.



Concerning sale of immovable belonging to others, the provisions concerning the warranty against eviction shall apply where the sale relates to an immovable which, in whole or in part, did not belong to the seller. The buyer may avail himself of the provisions relating to the warranty against eviction without waiting until he has been evicted. He may accordingly require the cancellation of the contract or other remedies of non-performance. He may not avail himself of such provisions where, at the time the court is to make its decision, such eviction is no longer to be feared.

An exception to the rights of warranty has been provided with regard to persons who have Right registered and persons who have rights of recovery. The buyer is presumed to know all the encumbrances if such rights of third parties are registered pursuant to Article 2881. In cases where the rights are registered the buyer may not be benefited from warranty of eviction unless the seller expressly agreed to warrant against eviction owing to the registered rights.

Unless otherwise expressly agreed, the seller shall not be liable in damages to the buyer where the latter is evicted by a person who avails himself of a legal right of recovery on the immovable sold.

However, if the seller is totally evicted the exception suffers an exception of exception. In case of total or partial eviction of the buyer, the seller shall refund to the latter, in addition to the price and the expenses of the contract, all the expenses incurred by him in altering the immovable.

The seller shall guarantee the area of the immovable sold where such area has been indicated in the contract. This obligation of warranty is actually in line with the agreed term of the contract. It is if the contracting parties indicate such area that the warranty is due. Such indication is not necessarily required to be express. An implied indication can also result in such obligation of warranty.

As of Article 2889 entitled Rights of buyer, *where the true area is smaller than the one which has been indicated, the buyer may require that the price be reduced accordingly. He may require*

*the rescission of the contract where the true area is smaller by at least one-tenth than that which has been indicated or where it renders the immovable unsuitable for the use which the buyer intended to make of it and such use was known to the seller.*

Such discrepancy has been considered as non-performance of the contract and the contract can be cancelled. The term rescission seems not to be a right word as it refers to invalidation of a contract and the term is employed in the provision to connote cancellation.

Here the contract can be made ineffective if there is a fundamental breach of contract and the fundamental nature of such breach is known to the seller. The knowledge of the seller is necessary when the buyer wants it for a particular use. If it is of no significant importance reasonably, the trivial discrepancy does not result in rescission.

The action of the buyer based on the warranty of area shall be subject to the same conditions and be instituted within the same time as an action based on the warranty against defects. This is to refer to the time when warranty for smallness of an area is due. This shall take into account the time when the risk is transferred subject to the exceptions.

The seller may not require an increase of price where the true area is larger than that indicated in the contract. The provisions of Sub-Art (1) shall not apply where the error of the seller is due to fraud on the part of the buyer. Thus it is questionable if the contract can be invalidated. When the contract is made owing to the fraud of the buyer, the contract can be invalidated by referring to the general contract provisions. Optionally the seller can require increment of the price of the additional area.

It is questionable if this holds true for a fraudulent act of third party. Generally contract made by a fraudulent act of third party results in an invalid contract. This is not an exception for fraudulent act in the area of immovable. But if the contract is upheld whether increment of the price is due is moot. It might be argued that if a contract which is formed by fraudulent act of third party can be invalidated, for stronger reason the seller shall have the right to require increment in the price of the additional area. Therefore, the provision should be interpreted in a

way it allows increment when there is a fraudulent act which might result in invalidation of the contract.

However, the buyer might prefer invalidation to increment and he does not actually have the power to require invalidation as it is only the seller, being cheated, can require the invalidation of the contract. Imposing the duty of increasing the price of the additional area would be against freedom of contract. Accordingly, it should not be interpreted in a way that erodes the freedom of the contracting party who does not have the power to invalidate the contract.

By presumption the buyer of an immovable is deemed to have a particular interest in the specific performance of the contract. The importance of this presumption is that he may, accordingly, demand such execution. The buyer is not duty bound to accept compensation as a remedy of non-performance as it can be made when the buyer does not have a special interest in the specific performance of the contract.

There is, however, period of limitation for specific performance. The buyer shall lose the right to demand the specific performance of the contract where he fails to demand it within one year after he has ascertained the delay of the seller. This period of limitation is for the specific performance not for remedies of non-performance of the contract. The buyer can resort to the other remedies of non-performance.

As far as sale with right of redemption is concerned the seller may, in the contract of sale, reserve to himself the right to purchase the immovable from the buyer during a certain period. The provisions of the Title of this Code relating to “Joint ownership, usufruct and other rights in rem” concerning the promise of sale shall apply to such stipulation.

## **2.8. Summary**

Contract of sales does not have universally accepted definition although it might have a working definition in different legal systems. Article 2266 has defined sales contract in terms of the obligation of the seller to deliver and transfer ownership and in terms of the obligation of the

buyer to pay a price. Contract, seller and buyer, the thing, the price, have also been provided as elements of the definition.

In its formation in addition to all the requirements for the formation of contract, consideration has been put as peculiar requirement. In performance of the contract of sale the seller and the buyer have certain obligations imposed by law custom, good faith. The obligations of the seller are delivery, transferring ownership, warranty, handing over of documented and insurance. The seller also has the obligation of paying the price and taking delivery. The obligations to pay expenses and preserve the thing are also common obligations of the parties. In law of sales the crucial issue of risk transfer has been provided to be effected by delivery, delay of buyer and handing over of the thing to carriage.

The gap filling provisions of contract of sales in non-performance of the contract provide various remedies to protect security of transaction. After the precondition of default notice is complied, a party may require forced performance, cancellation, cancel the contract by him/her self and /or require compensation depending on the circumstance.

various forms of sales and contracts allied to sale specifically sale of cattle and other living things, Sale by sample, Sale on trial, sale by installment, sale with ownership reserved, sale with right of redemption, sale with obligation to forward, sale by auction, under various forms of sales and barter contract, hiring sale and contract of supply under the contracts allied to sales are among the most similar juridical acts with contract of sales. Be that as it may they all have their own peculiar features.

Although sale of immovable is not strictly under law of sales and has its own peculiar features, general contract and sales contract provisions can be applied depending on the circumstances. Immovable as subject matter creates one peculiar feature. In addition to that unconscionable sale of immovable has been said to be valid. The existence of the immovable has also been put as a validity requirement. Furthermore formal requirement is a validity requirement with great deal of controversy whether registration is validity requirement.

## 2.9. Review questions

1. Does lack of sufficient definition affect the formation of contract of sales? Why/ why not?
2. What is the difference between conditions and warranties in common law legal system?
3. Is there such a distinction in Ethiopian law of sales?
4. Discuss the limits of warranty of dispossession.
5. Can a party who does not bear risk have the obligation to preserve a thing? Why/why not?
6. Discuss nemo dat quad non habet in light of transfer of ownership by sales contract?
7. W/ro Semira bought a pledged car for a certain amount of money from W/ro Danayit being informed that the car is pledged. How is the obligation of warrant of W/ro Danayit against dispossession owing to pledge? How would be the obligation of warranty against defect if the car was defective and such defect was known by the buyer?
8. What is the element of the definition which distinguishes sales contract from lease and donation?
9. What is the difference between sale and agreement to sale? Does Ethiopian law of sales show such a difference?
10. What are the preconditions of the remedies of non-performance of contract?
11. Why do you think is default notice necessary?
12. What are the remedies of non-performance of contract?
13. Discuss whether the remedies are alternative or cumulative remedies.
14. List the various forms of contract of sale and contracts allied to sales, along with their peculiar natures.
15. What is the difference in the formation of general contract and sale of immovable with reference to lesion as elements of contract?
16. What is the very purpose of formal requirement? Argue if registration is a formal requirement pursuant to the provisions of the Civil Code.
17. How is delivery effected in sale of immovable?

## Chapter Three

### International sales contract

#### **Introduction to the chapter**

Having seen the contract for sale of goods, it is important to discuss the circumstances when the contracting parties are Ethiopians or when their contract is considered to be an international contract of sale. Most of the issues in the international sales contract are a question of private international law. The basic issues related to an international sale contract is the court which has jurisdiction, the applicable laws and other related issues of conflict of law.

In an international sales contract, the basic concern of this reading material will be the applicable laws, the court which have jurisdiction in certain international contracts and the application of internationally applicable laws by Ethiopian courts.

#### Objectives of the chapter

By the end of this chapter, students are expected to:

- Define the term international sales contract;
- recognize how courts having jurisdiction over international sales contract are determined;
- To distinguish international conventions applicable in international sale of goods;
- Detect whether signing to conventions has binding effect on the states and its citizens;
- To detect the circumstances by which these international conventions can be applicable in Ethiopian courts;

An international sales contract is concerned with sales contract between a seller and a buyer, which can be from different countries. International sales contract is a concern of conflict of laws. In light with this the laws, which govern international sales, contract, the court having jurisdiction and other issues of conflict of law are relevant. Be that as it may it is worthy discussing certain laws or conventions, which are applicable to international sales contract, which might be concluded by Ethiopian traders.

CISG (Convention on International Sales of Goods), UNIDROIT Principles as Principles of European Contract Law and Model Contracts are designed to facilitate and promote international trade by making uniform laws, which result in legal certainty and predictability. Several countries have already adopted CISG. Ethiopia is not, however, among these countries although this does not mean that Ethiopian traders are not to be affected by it. Ethiopian traders enter into sales contract not only in Ethiopia but also outside Ethiopia. Certainly the application of CISG, UNIDROIT Principles will be more probable when Ethiopian trades are involved in contracts outside Ethiopia.

There might also be circumstances where this principle might be of help even in domestic affairs. Freedom of contract also allows parties to choose the applicable law even though the parties are Ethiopian or the contract is made in Ethiopia.

Accordingly, the application of CISG and UNIDROIT in international sales contract and domestic contracts will be discussed as of CISG and UNIDROIT is possible when

- the rules of conflict of law orders the application of;
- there is *lex mercatoria* or trade usage; and
- the parties agree the application of CISG.

### **3.1. The application of CISG (Convention on International sale of Goods) on international contracts**

CISG was signed in Vienna in 1980 and became effective on January 1, 1988. It is one of the international conventions that is gaining worldwide acceptance. It is a result of the work of UNCITRAL, a commission of the United Nations empowered with synchronization of international trade laws of the world by removing legal barriers in international business. The commission comes up with uniform rules of law on significant subjects such as agency, arbitration, leasing, international sales, and others. In maturing and promoting the CISG, the UNCITRAL is not doing something new rather implementing prior aspirations of the international society.

In 1930 the International Institute for the Unification of Private Law (UNIDROIT) determined to advance with the preparation of a uniform law on the international sale of goods under the auspices of the League of Nations. Its inception is traced to the report of Professor Ernst Rabel which advocated the importance and practicality of unification of laws. Ernst Rabel not only initiated the drafting of an international uniform law of sales, but also established the fundamentals for consequent process in his comprehensive comparative study on sales law. Consequently, two uniform laws were adopted in 1964 by a diplomatic conference at The Hague, (ULIS) and (ULFIS) dealing with the international sale of goods and the formation of contracts for international sales respectively.

The two Hague conventions were applied by courts and in extrajudicial settlements. The two conventions were believed to be inclusive in their substantive application. Be that as it may, the extent of application of these two uniform laws was restricted essentially for they were ratified by few Western European Countries and hence failed to receive substantial acceptance outside Western Europe. 28 states were present at the Hague Conference. These states also signed the Final Act. Four additional countries sent observers. In the end, however, only nine states ever ratified the Conventions, which came into force on 18<sup>th</sup> August 1972. “It was especially disappointing that the Hague Conventions were not ratified by some of the signatory states such as France and the United States which had exercised a considerable influence on the formulation of their rules”.

The other reason, strictly associated to the negative belief of the developed countries which believed is that it favored the sellers of manufactured goods in the industrialized nations as these countries were not represented in the drafting process at the Hague Conference. Therefore, if the two Hague conventions are applied, either judicially or in arbitration, it is only in the context of transactions between parties from these small number of member states.

Four years after the adoption of The Hague conventions, in 1968, UNCITRAL engaged in the mission of unifying international sales law. This is considered as an extension of the past since UNCITRAL did begin with the Hague conventions as a basic threshold intending to create an



international sales law acceptable to as many countries as possible. These efforts resulted in the emergence of CISG.

Developed in such a way, CISG has four parts. Part I deals with the Convention's scope of application and its general provisions. Part II provides the provisions governing formation of contracts. Part III provides the substantive rules for the sales contract itself. And finally Part IV provides the obligations of the contracting states. A state may partly adopt part II or III together with part I. This was in response to a request made by the Scandinavian countries. This is also incorporated in Article 92 verbally as: "a Contracting State may declare at the time of signature, ratification, acceptance, approval or accession that it will not be bound by Part II of this Convention or that it will not be bound by Part III of this Convention" and it goes on to say: "a contracting State which makes a declaration in accordance with the preceding paragraph in respect of Part II or Part III of this Convention is not to be considered a Contracting State within paragraph (1) of article 1 of this convention in respect of matters governed by the Part to which the declaration applies".

Though the convention is about contracts for international sale of goods, it does not govern every aspect of any kind of contracts for sale between every contracting party. On the other hand, the scope of application of the convention is limited in some four aspects as it is provided in the first six articles. These aspects defining the scope of application of the Convention's are personal, territorial, temporal and material aspect".

### **3.2. The application of UNIDROIT principles on international contracts**

The UNIDROIT Principles were published in 1994 by the intergovernmental agency of International Institute for the Unification of Private Law, known as UNIDROIT. Characterized by some as "a significant step forward in the globalization of legal thinking," these principles represent a new approach to international trade law.

The UNIDROIT Principles are characterized by some as an expression of the modern *lex mercatoria*. The UNIDROIT Principles as a whole clearly do not (yet) represent absolute usages, nor do they merely lay down doctrines and rules which are generally accepted at an international

level; they also provide solutions which, even if they still represent a minority view, are perceived to be better suited to the special needs of international trade.

The UNIDROIT Principles may be used for three different purposes. One is as the *lex contractus* chosen by the parties; the second is as a means of interpreting and supplementing the applicable domestic law, and as a means of interpreting and supplementing existing international uniform law instruments.

### **3.3. The case for using CISG and UNIDROIT principles in Ethiopia**

There are circumstances where CISG and UNIDROIT Principles are applied in Ethiopia. The application of CISG and UNIDROIT Principles in Ethiopia with respect to international contracts is based on two grounds: the first is freedom of contract and the other is rules of private international law. As it has been put there might also be circumstances where CISG and UNIDROIT principles are used in domestic contracts although it is believed not worth discussing now.

In examining situations where understanding of CISG and UNIDROIT Principles is imperative for those connected to Ethiopian legal system, it is worth seeing it in light with its scope of application and the conditions upon the fulfillment of which CISG could be applied to international contracts in Ethiopia.

There are three basic conditions that limit the scope of application of CISG. The cumulative satisfaction of the three conditions results in “direct and automatic application of CISG with the effect of displacing the various system of contract law of its member states in their entirety”.

The first is what is known as the ‘internationality’ requirement provided in Article 1 of CISG, which stipulates that “this convention applies to contracts for sale of goods between parties whose places of business are in different States: (a) when the States are Contracting States; or (b) when the rules of private international law lead to the application of the law of a Contracting State”. “Therefore, neither the nationality of the parties or their civil or commercial character nor the location or intended place of delivery of goods is not relevant in determining the application

of the CISG” according to certain scholars like Ahmad Azzouni. What is considered is the place of business of the parties not the parties.

And most importantly, it “extends the application of the CISG further to contracts involving parties from non-contracting states when the rules of private international law lead to the application of the law of a contracting state”. Here it should be noted that there are possibilities of avoiding this by making reservation at the time of ratification or exclusion of CISG by the contracting parties. According to Article 95, “any state may declare at the time of the deposit of its instrument of ratification, acceptance, approval or accession that it will not be bound by Subparagraph (1) (b) of Article 1 of this convention”. “The US has made such a declaration on the grounds that the application of Article 1 (1) (b) would lead to their own law being displaced more often than that of the non-contracting state”. “Germany responded to this declaration by the United States (and other countries) with its own reservation that it assumes no obligation to apply when the rules of private international law lead to the application of the law of a Party that has made a declaration to the effect that it will not be bound by sub paragraph (1) (b) of Article 1”. What is more, Article 6 provides, “the parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions”. This does not however allow unilateral exclusion of the application of the convention. Whatever the proposal of one party is the formation of the contract will in the first place be determined by the convention. It can only be excluded if the application of these policies and principles are excluded by agreement of the parties, nevertheless their application as an initial matter is inevitable.

Among the essential conditions for the application of CISG, the subject matter of the contract is one condition. CISG applies exclusively to contracts for the sale of goods. This condition is stated in Article 1 and also clarified under Articles 2, 3, 4 and 5. Article 2 excludes goods bought for personal, family or household uses, if the seller has the information. Sale by auction, under authority of law, or of securities, vessels, or electricity is also among the excluded transactions.

Moreover, “the impossibility to determine for certain kind of sales if they are of a national or of an international character, also the possible conflict that may occur with respect to other

international instruments, which also regulate the same objects as those falling into the scope of the CISG”, and “the fact that in many countries the sale of some or all of the items listed in Article 2 is governed by special rules reflecting their special nature, determined either because of the purpose of sale (goods bought for personal, family or household use), or the nature of the sale (sale by auction, on execution or otherwise by law), or the nature of the goods (stocks, shares, investment securities, negotiable instruments, money, ships, vessels, hovercraft, aircraft or electricity)” partly explain the exclusions made in Article 2.

Article 3 provides that, “contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production” and the provision goes on to say “this Convention does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labor or other services” This provision distinguishes contract of sale of goods from contracts for the supply of services, in cases where in a given situation the obligation to provide services is mixed with the obligation to provide goods.

Article 4 also limits the ambit of CISG by saying, “this Convention governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. In particular, except as otherwise expressly provided in this convention, it is not concerned with: (a) the validity of the contract or any of its provisions or of any usage; (b) the effect which the contract may have on the property in the goods sold”. Moreover Article 5 excludes the liability of the seller for death or personal injury caused by the goods to any person.

The third condition for the application of CISG is provided in Article 100 (1) of CISG: “this convention applies to the formation of a contract only when the proposal for concluding the contract is made on or after the date when the Convention enters into force in respect of the Contracting States referred to in subparagraph (1) (a) or the Contracting State referred in subparagraph (1) (b) of article 1”. The principle of non retroactivity has been provided in Article 100 of CISG to protect stability and foreseeability

Having seen jurisdiction when the application of this convention in international contract in Ethiopia is concerned, it is a well recognized principle in private international law that determination of applicable law is not connected with determination of the court having jurisdiction on the matter. Article 7 of the Inter-American Convention on the Law Applicable to International Contracts partly provides, “selection of a certain forum by the parties does not necessarily entail selection of the applicable law”. And Article 5 of the same provides partly, “this convention does not determine the law applicable to the agreement of the parties concerning arbitration or selection of forum”. These indicate that Ethiopian court may have jurisdiction on the matter but the applicable law may be CISG or UNIDROIT Principles.

The condition in which Ethiopian courts assume judicial jurisdiction over international transactions has been provided by Sedler as observed from the practice. According to him, Ethiopian courts might assume jurisdiction in three different kinds of situations. The first is when the defendant in dispute is an Ethiopian national or domiciliary. The second instance is where the contract which is the subject matter of the dispute has occurred in Ethiopia. The third ground is when the parties consent to that effect.

Even though Ethiopia does not have codified rules on the choice of law, general observation can be made about the possible principles and rules that would help courts determine the applicable law based on some of the findings of scholars on the subject and the new draft proclamation on private international law.

First, courts will have to see if the parties to any international contract have made “effective

choice” of the applicable law. In the absence of effective choice by parties, the following options may be forwarded. The first is the LEX LOCI CONTRACTUS – the law of the place where the contract is concluded, which may sometimes be fortuitous and thus not advisable. In addition to that determining the place where the contract was formed might be difficult to determine when there are different rules in the formation of the contract. For example Ethiopia follows the theory of dispatch as can be remembered in contract one course. When an Ethiopian enters into a contract with someone whose country adheres to the theory of reception, determining the place where the contract was formed can be difficult.

The second is, the LEX LOCI SOLUTIONS – the law of the place the contract is to be performed. And the third solution is the law of the state with which the contract has substantial connection or otherwise termed as the "proper law of the contract".

After applying the rules of private international law, the applicable law may be the law of a Contracting State or Non-Contracting State. If it is the law of a contracting state, then CISG may be applied on the condition that the three cumulative essential conditions mentioned earlier related to the requirement of internationality are proved to exist in given case.

This could have been different had Ethiopia ratified the CISG. In that case, the court would directly go to Article 1 and other relevant articles to see whether CISG could be applied. But since Ethiopia has not ratified CISG, Ethiopian courts are not expected to apply it. Therefore, the first thing that they would do is to apply their rules of private international law with the hope of determining the applicable law. If the rules of private international law point to the law of a Contracting State, then they will be engaged in another factual determination. Whether CISG is the applicable law for the given case shall then be ascertained.

In cases where CISG is applied by the Ethiopian courts, UNIDROIT Principles can also be used in order to supplement the CISG. Moreover, just as CISG can be applied when it is chosen by the contracting parties in Ethiopia, UNIDROIT Principles can also be applied. The other possibility for the application of CISG and UNIDROIT Principles is as an expression of *lex mercatoria* by

arbitral tribunals in Ethiopia. Pursuant to Article 1713 of the Ethiopian civil code, which provides that contracting parties are bound not only by the express provisions of their agreement but also by such incidental effects as may be attached to it considering trade usage, custom and good faith, CISG and UNIDROIT can be referred to. Determining what practices are considered trade custom and usage may be, for a very strong reason, giving attention to such documents.

On top of the above discussed possibilities, CISG and UNIDROIT Principles may be applied as a draft for contracts. This involves incorporating part or all of the provisions into their contract. Obviously, here the court applies the provisions as it applies the terms of the contract. “This is not exactly a choice of law clause unless the parties chose the law of a Contracting State, having the state’s implementation of the CISG in mind. Instead it is to be viewed as a drafting technique which uses the provisions of the CISG as a kind of model contract”.

Generally, an international contract occurs when a contract involving parties which have business place in different countries are involved. In such case the parties might apply a law of their choice provided that their choice is sustainable at law. In the absence of such choice certain international documents like CISG and the supplementing document of UNIDROIT can be applied upon the fulfillment of certain conditions. The conditions relate to when rules of conflict of law orders the application of these documents, when there is *lex mercatoria* or trade usage; and when the parties agree on the application of CISG.

### **3.4. Summary**

An international sales contract is a contract which is made between contracting parties who are in different countries. CISG, UNIDROIT Principles as Principles of European Contract Law and Model are among the applicable laws in international sales contract. The very purpose of these instruments is to facilitate and promote international trade by making uniform laws, which result in legal certainty and predictability.

Having passed through different historical phenomena, the convention on the international sale of goods has four parts. The scope of application of the Convention and its general provisions, formation of contracts, the substantive rules for the sales contract, and the obligations of the contracting states are respective parts of the convention and the scope of application of the convention is limited in some four aspects.

The UNIDROIT Principles being characterized as an expression of the modern *lex mercatoria*, may be used as the *lex contractus* chosen by the parties, as a means of interpreting and supplementing the applicable domestic law, and as interpreting and supplementing existing international uniform law instruments.

The circumstances where CISG and UNIDROIT principles can be applied in Ethiopia is by dint of freedom of contract and rules of private international law. Ethiopian courts can also have jurisdiction over international contracts when the defendant in dispute is an Ethiopian national or domiciliary, when contract which is the subject matter of the dispute has occurred in Ethiopia and when the parties consent to that effect. When CISG is applied by the Ethiopian courts, UNIDROIT Principles can also be used in order to supplement the CISG.

### **3.5. Review questions**

- 1) What is the purpose for which the international sale of goods comes in to existence?
- 2) What is the role of UNIDROIT principles and CISG in international sale of goods?
- 3) Discuss the four parts of CISG.
- 4) Does signing CISG result in a mandatory application of the convention?
- 5) Discuss internationality requirement in light of Article 1 of CISG.
- 6) What is subject matter of CISG?
- 7) Do you think that there are circumstances where Ethiopian law of contract and law of contract of sales may be applied in international sales contract?



## **PART TWO – LAW OF SECURITY DEVICES**

### **Introduction to Part Two**

Welcome to the second part of Law of Sales and Security Devices. As you may have observed in your study of Law of Sales in the first part of the material, the grand objective of Law of Sales and Securities is to facilitate the smooth running of commercial transactions which are indispensable for the creation of one economic community as an objective set by the FDRE Constitution. In dealing with the law of sales, you have studied various rules, principles and concepts which regulate commercial transactions in the area of sales of goods. In this second part of the material you will study another area of law, i.e. law of security devices. This law also has at the same objective as above, i.e. facilitating commercial transactions. However, the nature and content of this law is different from law of sales. The commercial relations emphasized in this law is not sales of goods, rather it is the relation between creditors and debtors in the performance of various obligations with special attention to loan system.

The law of security devices consists of four chapters. The first and the last chapters deal with preliminary issues which are important for the overall understanding of the law. The core part of the law is addressed in the second and third chapters. The first chapter deals with preliminary issues which aim at giving the students the general picture of the nature and content of law of security devices. The points to be discussed here are the definition, importance and nature of securities in general as well as the principal types of securities. Under chapter two, one of the principal types of securities, i.e. *pledge* will be addressed. Various aspects of pledge like: definition, nature, subject matter, requirements for its creation, the relation between the parties to the contract of pledge and the extinction or enforcement of pledge will be discussed in this chapter.

Chapter three deals with another principal, in fact the most important, type of securities i.e. *mortgage*. Like the previous chapter, the discussion starts by introducing students to the meaning, subject matter, nature and importance of mortgage. The essential legal requirements for the creation and enforcement of mortgage are also discussed in detail. The chapter also addresses other aspects of mortgage like the types of mortgage, effects of mortgage on the parties involved and extinction or enforcement of mortgage.

The fourth chapter deals with '*other types of securities*'. In the strict sense of the term, 'security' refers to either personal security (surety) or property securities (pledge or mortgage). However, antichresis (special type of mortgage), lien rights, right of redemption, etc also possess the nature of securities in the broad sense of the term. In fact antichresis is one of the principal type of securities, but the question is 'can it be considered as an independent type of security or simply mortgage with certain modification; is it really prevalent intoday's business relations?' Hence these points will be discussed in Chapter Four in a way that incites students for further investigation into the issue.

As the law of security devices is based on special contracts (guarantee, pledge, mortgage, and others), the general principles and guidelines from the provisions of contracts in general are applicable. Hence, your knowledge of *the law of contracts in general* is important. Read all the four chapters carefully and attempt to solve the questions included in the exercises as well as self-check review questions.

### **Objectives - General**

Upon successful completion of this part of the material you should be able to:

- ✓ Define and discuss the contracts to secure performance of various obligations and the basic nature and importance thereof;
- ✓ Identify and apply the essential preconditions for valid formation and effectiveness of contracts for security of transactions;
- ✓ Effectively deal with the rights and duties of the parties involved in the contracts for security of transactions;
- ✓ Apply special laws applicable to the relation between banks and their debtors;
- ✓ Apply relevant provisions of the law in solving legal problems that may arise from various securities for commercial transactions;
- ✓ Draft valid security contracts, i.e. contract of guarantee, contract of pledge and contract of mortgage.

## Chapter One

### General Introductory Issues

#### Introduction to the chapter

Before going into the detailed discussion of the principal types of securities, their various aspects and *modus operandi*, it is better to have a general picture of securities. Despite the distinction among various types of securities based on their nature, subject matter and requirements in the creation of each type of security, they all share some common features. These common features of securities will be addressed in this chapter through the discussions on the definition of securities, importance and nature of securities as well as various types of securities with their distinctive features.

#### Objectives of the chapter

After successfully completing the study of this chapter, you should be able to:

- define securities in general and various types of securities
- explain the importance of securities in the relation between creditors and debtors in general and the loan system in particular
- identify the basic characters of securities
- enumerate the principal types of securities and their distinguishing characters.

#### 1.1. Definition of Securities

Before dealing with the various aspects of security like their importance, basic characters, and principal types of securities, it is important that students be clear with the meaning of security itself. Accordingly, read the following definitions given by different writers and try to grasp the essence of the definitions/meaning of security. To start from dictionary definition, Black's Law Dictionary provides that security is:

1. *Collateral given or pledged to guarantee the fulfillment of an obligation; esp., the assurance that a creditor will be repaid (usu. with interest) any money or credit extended to a debtor.*
2. *A person who is bound by some type of guaranty SURETY (A person who is primarily liable for the payment of another's obligation).*

In his *Treatise on Civil Law*, the M. Planiol also provides definition of "Security Contracts" as: *"those contracts intended to protect creditors against the insolvency of their debtors. Insolvency is the state of a debtor whose liabilities are greater than his assets."*

### **Exercise**

Answer the following questions before reading the next paragraph.

1. *What do you understand about the meaning of security from the above two definitions? Can you explain the meaning of security in your own language?*
2. *What basic feature of securities do you understand from the definitions?*
3. *How do you explain the importance of securities both for the creditor and the debtor?*

One important point from the above definitions is that security is an undertaking (either personally or through property) to assure/guaranty the creditor that the debt will be paid or the obligation will be performed to the satisfaction of the creditor. It is all about providing the creditor with an alternative remedy/solution in case the debtor fails to pay the debt or to fulfill his obligation. Other points that may be understood from the definitions are:

- *security is created principally for the benefit of the creditor; however, the debtor also may be considered to have, at least, indirect benefit (e.g. getting loan easily),*
- *security arises, most of the time, from contract between the creditor and the debtor or third party,*
- *security can exist only if there is a debt to be paid or obligation to be performed etc.*

If you have difficulty understanding the above points from the given definitions, do not worry we will have further discussion on these points in the subsequent sections and chapters.

## **1.2. Importance of securities**

Consider the following questions and try to appreciate the messages intended to be conveyed by the questions.

*Do you think securities are important in the relations between creditor and debtor? Why?*

*Can you give any specific reason why securities are important? For whom, do you think, are they important? For the creditor? For the debtor? For the society in general?*

**Read the following paragraphs in light of the above questions.**

Generally speaking, from the very purpose for the creation of securities, they are designed to facilitate the relations between creditor and debtor. Securities play a great role in smoothing the relation between the debtor and his creditor. The question is how do they serve this purpose? It is by assuring the creditor that the debtor will pay the debt or perform his obligation to the satisfaction of the creditor; if the debtor fails to pay or discharge his obligation, then the security right of the creditor will be enforced to satisfy the claim of the creditor. This substantially reduces, if not avoid, the possible damages and inconveniences which may ensue from the non-performance by the debtor.

For the better understanding of the importance of securities, one may look at the situation of parties involved in the operation of security system – principally the creditor and the debtor. To start from the creditor, naturally the creditor has a general right to be paid by proceeding against all the assets of the debtor. However, the creditor may be exposed to the danger of non-payment or non-performance because of various acts of the debtor in relation to his assets. Consider the following extract from Planiol and identify the principal dangers to which the creditor is exposed. Try to understand also which of the dangers can be avoided by creating security rights in favour of the creditor. Note that the material written by Planiol is a commentary on the basis of French Code Civile which has served as the principal material source for our Civil Code. Accordingly, the following extract is helpful in understanding the importance of securities in our legal system, but do not forget that the provisions of law referred to in the extract below are the provisions of the French Code Civil although it may not be so difficult to find provisions with similar content under our Civil Code.

**Source: M. Planiol: *Treatise on Civil Law*, (footnotes omitted)**

*SECURITY CONTRACTS GENERAL*

*1. UTILITY AND VARIETY OF SECURITY CONTRACTS*

**2308.** *Definition*

*“Security contracts” are those intended to protect creditors against the insolvency of their debtors. Insolvency is the state of a debtor whose liabilities are greater than his assets.*

### **2309.** Enumeration

*These contracts are four in number: suretyship, pledge, antichresis, and the constitution of a mortgage. The effect of all four is to afford the creditor a guaranty or security. To understand their utility one must consider the situation of the creditor in the absence of any special security.*

### **2310.** Dangers to which Creditor are Exposed

*One already knows that the effect of obligations is to give the creditor a pledge on the patrimony of his debtor (Art. 2092 and above Nos. 179 and following). The debtor can compromise this pledge in four different ways:*

- (1) By his negligence. He can lose the rights which belong to him for example by permitting prescription to run against them. The law has provided for this in Art. 1166, by giving to the creditors the action in subrogation or oblique action which permits them to exercise his right in his place and thus save their pledge (supra, Nos. 280 and following)*
- (2) By a fraud. He can cause the fraudulent disappearance of all or a part of his assets, either by putting his property in the name of a third party, or by alienating it by donation or sale. The law here has provided a means to prevent this by the paulian or revocatory action (Art. 1167 and above Nos. 296 and following)*
- (3) By alienation not fraudulent:*
- (4) By the contracting of new debts.*

*Against the last two dangers, no direct measure can be taken by the law: the conduct of the debtor is licit in both cases. When the dissipation of the property is not fraudulent the alienations made by the debtor are valid the paulian or revelatory action cannot be exercised. The act is therefore binding on the creditor. This is what is meant when it is said that the creditors are the universal successors of their creditors [debtors]. They have a right on his*

*patrimony, but a right vague and general which does not prevent them from being subject to the effects of all the acts done in good faith by their debtor; all the variations which change the composition of his patrimony at the same time changes the composition of their pledge: all that which goes out of the patrimony of the debtor leaves the gage of the creditors; it is to that extent lost for them.*

*The same reasoning may be applied to the formation of new credits: all the creditors are equal and treated the same. It follows therefore that in case of insolvency as there is not enough to pay everybody each can only receive a dividend, a percentage of what was due him. This is the effect of the great law of competition which is established in these terms by Art. 2093: "The property of the debtor is the common pledge of his creditors and proceeds thereof is distributed between them ratably." The procedure of distribution by contribution is the means of arriving at this proportional division between creditors, when all the property of the debtor is sold and not suffice to pay everybody (supra, No. 191). In the case of merchants, this general liquidation of the patrimony of the debtor has been particularly constituted under the name of bankruptcy (supra, No. 193). They say then that they pay the creditors pro-rata ...*

*This last danger is quite as serious as the preceding and perhaps it is more frequent in practice: there are more debtors who become insolvent by the unrestrained augmentation of their liabilities than by the wasting and destruction of their assets.*

### **2311. Protection Against Danger of alienations**

*Two different means are employed:*

- (1) Dispossession. The debtor is dispossessed of property which is given to the creditor to keep as security. This is system of the ancient mancipation fiduciaire of the Romans, of the ancient pignus, the pledge or surety of*

*the moderns. The creditor possessing the property of his debtor is certain that the property will not be alienated without his consent, but that involves a great inconvenience, the debtor being deprived of the possession of his property, is prevented from working; the exploitation of the land suffers from it, etc.*

*(2) Mortgage. One can, without dispossessing the debtor confer on the creditor a real right on the property subjected to his guaranty; this right permits him to seize the property into whatever hands it may pass; this is what is called right of pursuit. It is the proceeding employed in the mortgage.*

### **2312.** *Protection against the Competition of other Creditors*

*Against this danger there are three ways of protecting the creditor:*

*(1) The Joining of a Second Debtor as Guarantor of the First.*

*The second debtor is called the surety. This was a usage very extensively resorted to in ancient times but much less frequently today (infra Nos. 2314 and 2323). By thus taking two debtors the same debt instead of one, the chances of payment are multiplied.*

*(2) Exceptional Dispensation of the Law of Completion. This results from a disposition of the law which, as a special favor, permits the creditor to be paid before the others: he is thus withdrawn from the effect of the competition above mentioned under No. 2310. This is what the Romans called *privilegium*; we say more willingly right of preference. We still have a certain number of privileges which correspond absolutely to the original notion: these are the general privileges.*

*(3) Creation of a Real Right for the Benefit of the creditor. We can finally reach the same result, which is to assure the creditor preference over the others, by giving him real right on one or several pieces of property belonging to the debtor. This real right on one or several pieces of property belonging to the debtor. This real right can be indifferently a*



*pledge or a mortgage. BY the mere fact of its existence, this real right exempts the creditor from the law of competition: a real right is binding on all, against other creditors as well as against subsequent transferees. Thus the same right of pledge or mortgage which gives the creditor the right of priority against third party purchasers equally gives him a right of preference against other credits.*

Basically, the point in the note is that the creditor wants to be sure that he will be paid or that the obligation will be performed since the debtor may alienate his property and reduce his capacity to pay or he may enter into a new obligation thereby increasing the number of creditors which will, in turn, result into tough competition among creditors for the satisfaction of their claims. Hence, securities serve the purpose of ensuring the creditor that he will be paid and if not, the creditor will have resort to his security right, i.e. demanding the surety to pay (if it is personal security), or activating the sale of pledged or mortgaged property (if it is real security) and satisfy his claim in priority to other creditors, if any, of the same debtor.

The importance of securities is not only for the creditor, but also for the debtor and even the society in general. It is obvious that the debtor who offers security will have better access to loan than a debtor who requests a creditor for extension of loan without offering any security. Hence, securities provide the debtor with better access to loan or any other opportunities. Securities are important also for the society in general, in the broader sense of the role of securities in assisting business activities. To be more specific, it is true that various business activities, specially in developing countries, are financed through loan system. It is equally true that the loan system cannot function well without security system. The creditors or lending institutions will be more willing to loan money for various individual only if the re-payment of the loan is secured. Stated otherwise, individuals having different skills, talents, and profession can have access to capital to change their gifts into productive economic activity which may contribute significantly to the economic development of the country.

Read also the following paragraphs from a book and try to appreciate the place of securities in various commercial transactions.

**Source: Davidson Knowles: Business Law, Principle and Cases in the Legal Environment, 8<sup>th</sup> edition.**

### ***The Need for Security***

According to an old song "love makes the world go round" while this may be true love does not provide much help in the business environment. Indeed from a business perspective credit may be what makes the business world go round. Creditors extend credit with the expectation that they will be repaid with interest. Generally the interest rate charged will, to some extent reflect the risk the creditor believes he or she is assuming. The greater the risk assumed by the creditor the higher the cost of the credit demanded of the debtor. Debtors realize that they will be expected to pay for the use of credit but they would prefer to receive as much credit as they need while paying as little for that credit as possible.

Security interests in general and secured transactions in particular can be used to help both parties in such credit situations. The creditor is given "security" in the form of a claim against asset of the debtor thus reducing the risk faced by the creditor. With this lowered risk the creditor is willing to extend credit to the debtor at a lower cost. The debtor, in turn is given credit at a lower cost without much if any additional risk. Admittedly the debtor has granted the creditor rights against one or more assets of the debtor in the event that the debtor in the event of a default with or without any security interest.

There are numerous types of security interest that can be used. Many homeowners acquire a mortgage loan to purchase their homes granting the lender a security interest against the home and the property as security for the loan. Many automobile loans involve retention by the lender to take physical possession of the securing asset until such time as the loan is repaid a method

*referred to at common law as a pledge. In this chapter we will address curd transactions as they are defined-and restricted-by Article 9 of the UCC. This article has recently been amended and the amendments were significant. The revised Article 9 went into effect January 1, 2001 in most states.*

*You can see the revised Article 9 and official Comments to the article at [www.law.cornell.edu /topics/ secured\\_transactions.html](http://www.law.cornell.edu/topics/secured_transactions.html).*

### **1.3. Nature of Securities**

The purpose of this section is to introduce students to the distinguishing features/characters of securities. The most important distinguishing character of securities to be discussed here is that securities by their nature are accessory or secondary rights. Accessory rights are those rights the existence of which is conditioned upon the valid existence of another right referred to as primary right. Consider the following paragraph about accessory rights written on the basis of information from a book.

**Source: Sir Thomas Erskine Holland, K.C: *Elements of Jurisprudence*, 13<sup>th</sup> ed. (2006)**

*Rights in general are referred to as accessory if they don't have independent existence or if they are not created for their own sake. In other words, if a right doesn't bring an independent benefit to the owner of the right or if it simply assists the enforcement of another principal right, then the former is referred to as accessory right. In the words of the above referred writer, "one of the great divisions of rights distinguishes those where that act is due for its own sake, from those where it is made due merely on default of another act." Hence the division of certain rights as principal (primary) and the others as secondary (accessory) indicates that the former group of rights is enforceable by themselves independently while the enforceability of the later group depends on the failure to enforce the principal rights. Therefore, primary rights are available for the owner of the right and enforceable for their own sake while accessory rights are made available merely in substitution for the primary rights*

*the exercise of which has failed for various reasons. In other words, we need the accessory rights just to ensure the enjoyment, by the owner, of principal rights. There would be no reason for securities to exist unless there is primary obligation the performance of which is ensured by creating security rights. Accordingly securities are accessory as they can not exist or can't be enforced in the absence of the principal right/obligation the performance of which is secured by the creation of securities. Generally, securities are created as an alternative remedy for the creditor in case the debtor fails to perform the principal obligation.*

This accessory nature of securities can be seen from various angles. In the first place as it has already been discussed, without valid primary obligation no security can exist. Secondly, the enforcement of securities is conditioned upon the failure of the debtor to discharge his obligation. In other words, securities can be enforced only after ascertaining the failure of the debtor and in order to ascertain the failure of the debtor we need to wait for the due date of the principal obligation. Hence, securities stay inactive until the due date of the secured obligation. Thirdly, if the primary obligation is extinguished for what so ever reason, it automatically results in the extinction of securities which have been created to ensure the performance of that obligation. Securities by their nature cannot survive the extinction of the obligation for the security of which they are created.

In conclusion, the creation of securities, whatever its type may be, presumes the existence of a valid primary obligation which the creditor expects to be performed; the execution of securities presumes the failure of the debtor to discharge his obligation; a reason which brings about extinction of primary obligation will at the same time result in the extinction of securities. This accessory character of securities will be addressed in the discussion on each type of securities in the subsequent chapters.

## 1.4. Types of Securities

Dear students, in this section, we will discuss the different types of securities, the basic feature and content of each type of security, the distinction among different types of securities, and the importance of each type of security.

Depending on their nature, content, and effects, securities are classified in different forms in different legal systems. In accordance with the classification adopted in our legal system, we have two principal types of securities. The first is personal security, which is also referred to as surety. This is the type of security in which case the security right of the creditor is against human person called *guarantor*. The guarantor undertakes, in terms of money, towards the creditor, to perform the primary obligation in case the debtor fails to perform it. The second type of security is real (property) security. This is the case where security right of the creditor is against property or a thing. Under this type of security, the right of the creditor will be enforced against the thing on which he claims to have security right; it is not against person unlike the case of personal security.

Real securities, in turn, are classified into two. The first is security against movables which is referred to as pledge in many legal systems including ours but also called as *pawn*, *bailment*, etc in other legal systems. The second type of real security is the case where the security is created against immovables principally. This type of security is called as mortgage in most of legal systems. Mortgage may, sometimes, change to 'another' form of security i.e. *antichresis* if there is a special arrangement between the creditor and the debtor. Antichresis is, therefore, a special type of mortgage which will be addressed in the last chapter of this material.

An important point that students should note is the fact that the above classification does not automatically exclude other types of rights which may, in certain circumstances, be considered as securities. The principal examples of such rights may be lien rights in various relations, sale with ownership reserved, right of redemption and others. This is also a point which will be discussed in the last chapter.

Another important point here is that the first principal type of security (personal security – surety as described above) is a part of contracts in general since the relevant provisions of surety (1920 – 1952) are found in the part of the civil code dealing with general contracts. Accordingly, it is treated under the course *Contract II* which, we will assume, you have already taken. Therefore, we will not have direct discussion on contract of guarantee and its mode of operation. In the next chapters we will deal only with real securities. However, don't forget that surety is one of the actively working type of securities in day to day business transactions. What is more, some of the provisions of suretyship are highly relevant in the functioning of other securities (real securities). Therefore, students who register for this course are strongly advised to read provisions of suretyship and have basic knowledge of its essential contents.

All the same, read the following extract taken from Planiol which will give you an overview of the types of securities, their utilities, the distinctions among securities and the likes. While reading the extract, try to answer such questions as:

- Is there any essential difference between the classification given by Planiol and the classification which exists under our civil code?
- What are the essential points of distinction between (a) personal and real securities (b) different types of real securities – pledge and mortgage?
- What advantages and disadvantages or specialties, in general, are there in each type of security?

**Source: M. Planiol: *Treatise on Civil Law*, (footnotes omitted)**

## **2. DISTINCTION BETWEEN PERSONAL AND REAL SURETIES**

### **2313. Definition**

*The security of the creditor comes sometimes from another person who obliges himself towards him to pay in place of the debt or if the latter fails to do so and sometimes from the property of the debtor subject either in mass or individually to his particular security to the exclusion of the creditors. In the first*

case it is said that the creditor has a personal surety; in the second that he has a real surety.

## **A. PERSONAL SURETIES**

### **2314. Their Antiquity**

The system of personal sureties is the most ancient known. It is the system practiced by the ancient Romans and the barbarians. It is quite naturally in use among poor populations, where the debtors can rarely offer to their creditors' real sureties.

### **2315. Their Insufficiency**

The use of personal sureties augments the chances of payment of the creditor by augmenting the number of his debtors but it in no way modifies his rights either against the debtor or against the other creditors or against third party purchasers of his property. He remains as to each of them, a chirographic creditor so that if he happens to be unfortunate the creditor may well not be paid although he had several sureties. This has been the experience for a long time. Thus for practical purposes sureties are always preferred.

However, in commercial law, the importance of personal sureties has persevered because of the rigor of the executory proceedings against the defaulting debtor. This importance has still further increased since the establishment of commercial companies engaged in banking operations. An obligation assumed by these companies has, for the creditor, the value of a surety of the first order, and it is often resorted to, under the name of bank suretyship.

### **2316. Present Status**

Formerly there were many varieties of personal sureties. The Romans practiced the *sponsio*, the *fide-promissio*, the *fidejussio*, and the *mandatum pecuniae credendae*; the last two alone survived up to the end. In our ancient

law different varieties were used of which the principal one was the plevine, obligation of the plègee. In our modern law all these ancient forms merged in a single one, suretyship.

However suretyship is not the only form of personal security which can today be pointed out: solidarity, and to a lesser extent, indivisibility play the same role.

## **B. REAL SURETIES**

### **2317. Their Number**

Since the system of fiduciary alienations was abandoned, the number of real sureties has been reduced to two: the pledge and the mortgage.

### **2318. Effect of these Sureties**

In these two systems the creditor provided with the security, no longer has to fear the effect of alienations made by his debtor, whether he possesses and detains the thing (pledge creditor) or whether he has the right of pursuit, that is, the right to seize it in the hands of third persons in case it is alienated (mortgage creditor). To these two kinds of creditors provided with securities, the chirographic creditors (cedulaires or ceduliers creditors in the ancient language) who have an ordinary title of credit (chirographum cedula), are opposed. The latter are sharply distinguished from the others: they are relegated to an action purely personal against the debtor, while the first two categories possess, in addition to this action which belongs to every creditor, a real action (mortgage or pledge).

### **2319. Superiority of the Mortgage**

Of all the securities which have been invented in favor of creditors, the most perfect is certainly the mortgage. Here is an enumeration of its advantages:

(1) It has not as has the pledge, the inconvenience of dispossessing the debtor. By the mortgage the creditor acquires neither the ownership nor



even the possession of the thing which is given to him as security: the latter remains entirely, in fact and in law, at the disposition of the debtor but the creditor can obtain it by requiring its restitution from any person either from the debtor or from a third person who detains it as owner, as soon as his debt becomes due, should he elect to make use of his right to be paid: when that day arrives, he takes the thing and sells it, as if it were his pledge. Thus, it can be said that the mortgage is a deferred pledge in which the taking of possession by the creditor is not immediate.

(2) It is not as was the Roman privilege, reduced to a simple right of preference. The right of preference which it gives, resulting from its real nature, is accompanied by the right of pursuit.

(3) Finally, it has, compared to suretyship, all the advantages of real sureties over personal sureties.

### **2320. Why the pledge has survived**

In view of all the qualities of the mortgage one may ask why the pledge has not disappeared, and why all the securities of the creditor do not reduce themselves to two forms: the mortgage on the one hand and the surety on the other.

It is because the pledge has still a usefulness of its own. The mortgage offers perfect security every time that one does not have to fear the material disappearance or the conversion of the thing: for example it may be used as desired for immovables and ships.

But for corporeal movables which the debtor can easily conceal or transfer to third persons, the mortgage is lacking: the creditor does not find a safe guaranty except in the system of pledge which materially dispossesses the debtor. That is why the pledge is still practiced along with the mortgage.

### **2321. Specialization of the pledge and the Mortgage**

*Originally, that is to say in the Roman legislation, the pledge and the mortgage could be used indifferently in connection with the same objects for movables as well as for immovables; the Romans allowed the mortgage of movables, and their "pignus" could be constructed on houses and on land as well as on movables.*

*Today it is otherwise. The mortgage (save with rare exceptions) cannot be established except on immovable and the pledge can never be established except on movables. The two great forms of real security in antiquity have therefore become specialized; they have been adapted to various situations, according to the nature of each, and they divide the domain which formerly was common to both: the pledge has appeared insufficient. Moreover it has disappeared everywhere by the effect of a natural selection. But that is not true, except in modern times the very ancient French law for a long time practiced the pledge of immovables. See the thesis of M. Fred. Peltier, *Du gage immobilier dans le très ancien droit français*, Paris, 1893.*

## **1.5. Summary**

In the preceding chapters, we discussed the definition of securities in general, the basic elements of the various definitions; the importance of securities in facilitating various commercial transactions and contributing to the development of the economy; the essential and common features of various securities, for example, that all securities are accessory to the principal obligation to be secured; the principal types (classification) of securities into personal and real securities, the basic distinction between the two, the further classification of real securities into pledge and mortgage and the basic distinctions between the two. Students are expected to remember these points as they are indispensable for better understanding of the issues to be addressed in the next chapters.

## **1.6. Review Questions**

1. Provide a more general and workable definition of securities after putting together essential elements from various definitions given by different scholars.
2. What core importances of securities can you identify?
3. Give a list of the essential features which are common to all types of securities.
4. Put in diagram the major classifications of securities and provide the principal points of distinction among various types of securities.

## Chapter Two

### Pledge (Security on Movables)

#### Introduction to the chapter

In this chapter, we will discuss various aspects of pledge ranging from creation up to the execution or extinction. The components of the discussion in this chapter are, among others, the definition of pledge, its subject matter, the nature and requirements for the validity and the validity and effectiveness of pledge. We will discuss also the relations between the parties to the contract of pledge before the due date as well as after the due date of primary obligation. The parties to the contract of pledge are the creditor (technically called *Pledgee*) and the debtor or third party who furnishes the pledge on behalf of the debtor (technically called *Pledger*). These parties have certain rights and duties which arise from the contract of pledge before the due date and also after the due date of the principal obligation. Hence, we will discuss these rights and duties of the parties.

#### Objective of the chapter

By the time you complete the study of this chapter you should be able to:

- define contract of pledge,
- identify things which can be given as pledge,
- understand and handle issues relating to valid creation and execution of contract of pledge,
- Understand the rights and duties of the parties to the contract of pledge and resolve issues which may arise therefrom.

#### 2.1. Definition of Pledge

The understanding pledge and, hence, its definition, content, purpose, mode of creation and its effect, varies from one legal system to the other and from time to time, i.e. from the old Roman '*Pignus*' to the modern conception of pledge. The definition of pledge also has gone through a long process of development which has contributed to the refinement of the definition of pledge and its elements. However, common understanding and uniform definition of pledge seems to be still lacking. This is true because, for one legal system pledge is simply a special type of

bailment, while it is a lien right for the other legal system. Scholars also have their own point of emphasis while defining pledge. Read the following definitions of pledge taken from various books and try to identify the basic elements of the definitions and points of emphasis in each definition.

**From: *Black's Law Dictionary*, 8th ed. 2004**

Pledge is “A security interest in personal property represented by an indispensable instrument, the interest being created by a bailment or other deposit of personal property for the purpose of securing the payment of a debt or the performance of some other duty.”

**From: *Mercantile Law*, 5<sup>th</sup> ed. by MC Kuchhal (1999)**

“The baiment of goods as security for payment of a debt or performance of a promise is called ‘pledge’. The bailor in this case is called the ‘pawnor’. The bailee is called the ‘pawnee’.”

**From: *Treatise on Civil law*, Vol. II Part II , by M. Planiol (1939)**

“Pledge is a contract by which the debtor himself, or a third person, remits to the creditor a movable object to serve him as security. Pledge is a contract at the same time productive of obligations and creator of a real right.”

**From: *The Elements of Jurisprudence*, 13<sup>th</sup> ed. by Sir Thomas Erskine Holland, K.C. (2006)**

Pledge may be defined as:

“a right *in rem*, realisable by sale, given to a creditor by way of accessory security to a right *in personam*. It follows from this definition that the pledge-right subsists only as long as the right ‘in personam’ to which it is accessory; that the right extends no further than is necessary for the sale of the thing pledged, not to its use or possession; and that the realisation of the value of the thing by sale puts an end to the title of the original owner.”

All the above definitions are reproduced not to deal with the critical analysis of each definition. We will have a critical analysis of the definition under our law. Here, the intention is to enable the students to compare the definitions, analyse them and try to work out a more comprehensive definition and to be familiar with the overall purpose and nature of the relations in contract of

pledge. The above definitions, in general, address various aspects of pledge like the purpose of the contract of pledge, the nature of the relation under contract of pledge, the indication about rights and duties of the parties, etc. Please answer the following questions after reading the definitions.

- ✓ Who are the parties to the contract of pledge?
- ✓ What kinds of objects can be pledged and who can offer the object for pledge?
- ✓ What is the principal purpose of pledge?
- ✓ What is the basic nature of contract of pledge?
- ✓ What basic rights and obligations do you expect to arise from contract of pledge?

The above questions are important not only while dealing with above definitions, but also in your study of Ethiopian law of pledge and while reading the extracts from various books which have been provided at the end of this chapter.

Now let us look into the definition of pledge and its various elements under the Ethiopian law of pledge. Read the following provision from the Ethiopian Civil Code.

*Art. 2825 - Definition*

*A contract of pledge is a contract whereby a debtor undertakes to deliver a thing, called pledge, to his creditor as security for performance of an obligation.*

**After reading the provision, can you answer the following questions?**

- ✓ What is the source of pledge, can it arise from provision of law or can it be created by decision of the courts?
- ✓ Who can give an object as a pledge?
- ✓ What is the basic obligation that the pledgor has to assume for the contract of pledge to be created validly?
- ✓ What kind of object can be delivered as a security under contract of pledge?
- ✓ What is the principal purpose of concluding contract of pledge?

To answer the above questions, consider the following components of the definition.

Contract of pledge is: **a)** a contract, **b)** the debtor, **c)** undertakes to deliver, **d)** a thing, **e)** to his creditor, **f)** as security for performance of an obligation.

**a – Pledge is a contract ... (What is the source of pledge?)**

The first component of the definition is that *contract of pledge is a contract*. This is an important point as it shows that in our legal system, the only source of pledge is contract. In other words, unless there is a clear agreement between the parties with the purpose of creating pledge, there is no way for pledge to exist. It arises only from express contract which has to fulfill certain requirements of law for its validity. Consider the following exercise.

***Exercise 1***

Mr. Jarso borrowed Birr 10.000 from his friend Mr. Bacha to be paid after one year. Recently, Jarso planned to go to his locality to visit his family and entrusted his video camera to Bacha for safe custody. Two months later, Jarso came back and requested Bacha to give back the camera thanking him for the safe custody. However, Bacha refused to give back the camera stating that he will keep the camera as pledge to secure the payment of the money on the due date. ***Can he claim the right of security on the camera?***

***Exercise 2***

Mr. Aleyu borrowed birr 5000 from his neighbor Mrs. Nani to up-grade his hotel. To ensure that he will pay the money after six months, he gave an automatic fruit mixer as a security under contract of pledge. A month later Aleyu realized that the money was not sufficient and requested Nani to lend him another birr 5000 to be paid after one year. She agreed to lend the money but this time nothing was said about security for the payment of the second loan. On the due date of the first loan, Aleyu paid the money and requested for the return of the fruit mixer. However, Nani refused to return the mixer claiming to keep it as a security for the second loan which is not yet due. ***Is the act and claim of Nani lawful?***

In both of the above hypothetical cases the creditors (Mr. Bacha and Mrs. Nani) cannot claim to have security right since there is no express contract of pledge to that effect. In the first case, the

simple fact that certain property belonging to the debtor falls under the possession of the creditor by chance or for a different purpose does not entitle him to claim security right on the property even if he has lawful claim from the debtor. Because, pledge, as a security, may arise only from contract pursuant to Art. 2825 of the Civil Code.

In the second case also the mere fact that there is a preceding contract of pledge to secure the payment of specified loan does not automatically entitle the creditor to claim security right on the same property for the payment of another loan extended to the same debtor. The creditor may be entitled to continue in the possession of the object as security for the second loan only if they vary the existing contract of pledge before the due date of the first loan or if they conclude a new contract of pledge to secure the payment of the second loan. In the absence of such arrangements the creditor is bound to return the property to the owner upon the discharge of secured obligation and can not claim security/priority right for the payment of another debt in accordance with Arts. 2845(1) and 2858(2) of the Civil Code which provide as follows:

**Art. 2845 - *Return of pledge***

*(1) The creditor shall return the pledge to the pledger or to the person designated by him, if the contract of pledge is extinguished by payment of the debt or for any other reason.*

**Art. 2858 - *Limitation of creditor's rights***

*(2) The pledgee may not enforce his priority right arising out of the contract of pledge beyond the maximum amount specified therein. The pledgee may not enforce his priority right to obtain security for another debt, even if incurred subsequently to the contract of pledge, owed to him by the debtor or pledger.*

In conclusion, the point here is that a creditor can enjoy security right as a pledgee only if there is a clear contract of pledge which entitles him to this right. Hence, the only source of pledge is contract unlike the case of mortgage which may arise either from the provisions of the law or judgments of courts or arbitral tribunals which will be discussed in the next chapter.

**b – ...the debtor ... (Who may deliver the object as a pledge? Who can be a pledger?)**



In accordance with the definitional article, Art. 2825 of the Civil Code, it seems that the appropriate person to deliver the object is the debtor because, it says that *pledge ... is a contract whereby the debtor...* However, from the facts of the real world as well as the provisions of the law, it is clear that the pledged property may be delivered by either the debtor himself or a non – debtor third party on behalf of the debtor. Consider the following case.

### ***Exercise 3***

Mr. Hamza requested his employer Mrs. Muna to extend a loan of birr 10,000. Muna agreed to extend the loan but only if Hamza can deliver certain property as security. Hamza is worried that he does not have any property sufficient to secure the loan but he knows that his friend Jambo has a gold ring worth birr 15,000. ***What do you advise Hamza?***

The solution here is what the law has clearly provided. That is, Hamza can approach his friend Jambo to help him in getting the loan by offering the gold ring as security. If he manages to convince Jambo, then the contract of pledge may be concluded between the employer (pledgee creditor) and Jambo (third party pledger) to secure the debt of Hamza (the debtor). This is what Art. 2826 of the Civil Code clearly provides it reads as follows.

Art. 2826 -

*A contract of pledge may be made between the creditor and a third party to secure the debt of another person.*

In general, the point here is that it is not only the debtor who may deliver the pledged property as the definitional article says, but also a third party may deliver the object and be considered as a pledger.

***C - ...undertakes to deliver...***

From the reading of the above phrase in the definitional article, it is understandable that the basic obligation to be assumed by the pledger in the creation of a contract of pledge is *undertaking to deliver* rather than *actual delivery* of the property. That is, for the contract of pledge to come into

existence, undertaking by the pledger to is sufficient. In other words, actual delivery of the object is not a precondition to say that a valid contract of pledge has been concluded. Actual delivery and immediate transfer of possession is not a requirement under the law. Please consider the following example.

#### ***Exercise 4***

Mr. Achalu is looking for a job and he came to Mrs. Ayantu - an owner of a factory. She agreed to employ him but asked for some kind of guarantee up to the value of birr 10,000 to secure his competence and damage caused by his negligence or fault. Achalu also agreed to deliver his digital video camera but informed her that the camera is under the possession of third party for the time being. They reached an agreement that the camera will be delivered to the creditor after a month and concluded contract of pledge accordingly. ***Is the contract of pledge in this case valid? When does the contract of pledge start to exist?***

As stated above, it is an undertaking to deliver which is necessary for the creation of pledge. Hence, in the above case, Achalu has undertaken to deliver the camera after one month. Therefore, we can say that a valid contract of pledge started to exist one month before the date of actual delivery. This is an important point because if we say a contract of pledge cannot exist without actual delivery of the pledge or a valid contract of pledge exists only as of the date of actual delivery, in the above case the creditor cannot bring action for possession in case the debtor fails /refuses to deliver the camera one month after the conclusion of contract of pledge. However, in the above case the creditor can bring action for possession against the debtor if he fails/refuses to deliver the camera since our law considers “*undertaking to deliver*” as an important requirement for contract of pledge to come into existence. Therefore, in case of refusal failure by the debtor to deliver the pledge as he has undertaken. The remedy for the creditor is found under Arts. 2825 of the Civil Code, as stated above, and Art. 2842 (1) which provides the creditor with the right to bring action for possession in the following words.

Art. 2842 - *Action for possession*

(1) *The pledgee may bring actions for possession in respect of the pledge.*

**d - ... a thing ... (what kind of object can be pledged?)**

Here also in light of the definitional article it seems that every thing that has an economic and financial value can be pledged because, the definitional article says that ... *a debtor undertakes to deliver a thing* I hope, you know from your study of property law, 'a thing' refers to every thing whether corporeal or incorporeal, movable or immovable which can be appropriated and put into economic use. Hence, the word 'thing' refers to at least movables and immovables. However, it is not much difficult to understand from other provisions in the law of pledge that it is only movables that can be given as pledge in our legal system.

Here, it is also important to note that movable is understood in its broad sense. That is, it refers not to only movable objects but also to various forms of rights and claims on movables. Read the following article in order to see that the appropriate subject matter of pledge is only movable objects and different forms of claims and rights which are capable of being transferred separately.

*Art. 28 29 - Pledge*

*(1) The pledge may consist of a chattel, a totality of effects, a claim or another right relating to movable property.*

*(2) It must be capable of being sold separately by public auction.*

From the reading of the above article you may understand that pledge relates to either movable things themselves or claim and rights on movables (you will study pledge of claims and rights under a separate section of this chapter). But one important point here is that the pledged movable should be capable of being sold/transferred by public auction as provided under Art 28 29(2) above.

**? Can you give an example of objects which cannot be sold/transferred by public auction?**

Consider a public official or any other individual who has been entrusted with the custody of certain movable object (say ornaments) which forms part of a public domain. If such person borrows certain money or assumes certain obligation and gives the said movable object as a security for the performance of his obligation, the security right cannot be valid since the

objects/properties forming part of a public domain cannot be sold in anyway. You may refer to what you have studied under property law, specifically Art. 1454 of the Civil Code.

In conclusion, it is not everything which can be pledged but only movables or rights and claims relating to movables which are capable of being sold separately.

**e - ... to his creditor... (Who may be the possessor of pledged property?)**

In the definition, it is stated that the debtor undertakes to deliver a thing called pledge *to his creditor....* Of course, in principle the pledged property will be delivered to the pledgee-creditor and he is considered as a lawful possessor who can bring even possessory action to protect his possession – (See Art. 2842(1). However, in some exceptional situations the pledged property may be delivered to a third party custodian who will keep the thing under his custody on behalf of the pledger and pledgee - creditor. This possibility has been clearly provided under the law. Read the following article.

Art. 2831 - *Possession by an agreed third party*

*(1) The parties may agree that the pledge be delivered to a third party acceptable to them both.*

*(2) The rights and duties of such third party shall be prescribed by the provisions relating to the bailment of goods or warehousing.*

? Can you think of a situation in which it is appropriate to deliver the pledge to a third party custodian?

***Exercise 5***

Assume that Mr. Mekbib borrowed birr 2000 from his friend Mr. Hagos. When he was asked to provide security, Mekbib offered a *TV set* as a surety under contract of pledge. However, Mekbib knows that the creditor (Hagos) never stays at home because of the nature of his business and he has ten children. Hence, he foresees the possibility for his *TV set* to sustain damage. ***What do you advise him?***

**Or**

Assume that in the above case the value of the TV set is 4000 and Mekbib borrowed another birr 1000 from Mr. Gutu to whom the same *TV set* is given as security. The two creditors (Hagos and Gutu) could not agree as to who should possess the *TV set*. ***What will you advise him?***

As you can read from the above article, in both cases it may be delivered to a third party who will keep the thing in the interest of the debtor and the secured creditors. Therefore, even if the pledged property has to be delivered to the creditor in principle, there is a possibility for the object to be possessed by third party custodian. Read the following paragraph written by Planiol regarding possession by third parties and its utility in facilitating the relation between a pledger and several pledgee creditors claiming security on the same property.

***Possession of the pledge by the Intermediation of a Third person***

*It is not necessary that the creditor himself be the one to receive the pledge and to preserve it. This can be done by a third person, who will be the depositary of the pledge for the pledge. All that the law requires is that the thing pledged does not remain in the possession of the debtor.*

*This arrangement is frequently employed in commercial transactions where general warehouses store great quantities of merchandise which are almost always subject to pledges. The advantage here is, in the first place, that the creditor is free from the surveillance of the pledge and of the responsibility which goes with it but there is still more to it is the only method which permits the pledging of the same thing successively to several persons. It is therefore a very useful scheme in the case of things of great value sufficient to satisfy several creditors at one time.*

**f – ... as a security for the performance of an obligation... (The accessory nature of contract of pledge)**

The last phrase in the definitional article provides that contract of pledge may be concluded and the property may be delivered to the creditor *...as a security for the performance of an obligation....* This phrase clearly shows that contract of pledge is accessory to some principal

obligation which a creditor expects to be performed at a certain date in the future. In other words, the only purpose of pledge is to secure the performance of an obligation. Therefore, it is reasonable to conclude that pledge comes into picture or may exist only if there is an obligation the performance of which is to be secured by the pledge. Without the existence of any principal obligation, pledge may not be created for it does not have any other purpose except securing the performance of an obligation.

**Note:** when we say that primary obligation should exist, it is not a requirement that the obligation should actually exist on the date of conclusion of the contract of pledge. It may be an obligation which we are certain to exist in the future. Read the following article.

*Art. 2827 – Debt guaranteed*

*A contract of pledge may be made in order to guarantee a future or conditional debt.*

Moreover, pledge is accessory right not only because it presumes the existence of a primary obligation but also it extinguishes if the primary obligation it secures is extinguished by any reason including performance. See Art. 2845(1) and 2849 of the Civil Code. In addition, the enforcement/execution of pledge is conditioned on the non-performance of the obligation it secures.

For a better understanding of the accessory nature of pledge, first you remember what we have discussed in the previous chapter about nature of securities in general; second, you read the following paragraph taken from a book.

**Source:** Sir Thomas Erskine Holland, K.C. *The Elements of Jurisprudence*, 13<sup>th</sup> ed. (2006)

*The 'iura in re aliena' which have hitherto been considered are given with a single purpose. Their object is to extend the advantages enjoyed by a person beyond the bounds of his own property. But there is also a right of the same class which is given, not with this object, but for merely subsidiary purpose of enabling the person to whom it is granted to make sure of receiving a certain value to which he is entitled; if not otherwise, then at all events by means of the right in question. The other rights in re aliena enable the person entitled to them*

*to enjoy the physical qualities of a thing. This right, which is known as pledge merely enables a person who is entitled to receive a definite value from another, in default of so receiving it, to realize it by eventual sale of the thing which is given to him in pledge.*

*The right of sale is one of the component rights of ownership, and may be parted with separately in order thus to add security to a personal obligation. When so parted with, it is a right of pledge, which may be defined as 'a right in rem, realisable by sale, given to a creditor by way of accessory security to a right in personam.' It follows from this definition that the pledge-right subsists only as long as the right 'in personam' to which it is accessory; that the right extends no further than is necessary for the sale of the thing pledged, not to its use or possession; and that the realisation of the value of the thing by sale puts an end to the title of the original owner. The thing pledged need not be property of the person who is liable personally. Although it is usually a physical object, it may also be a 'ius in re aliena,' including even a right of pledge or a right 'in personam,' in which last case the realisation of its value may take place rather by receipt of payment than by sale.*

*The objects aimed at by law of pledge are, on the one hand, to give the creditor a security on the value of which he can rely which he can readily turn into money and which he can follow even in the hands of third parties; on the other hand, to leave the enjoyment of the thing in the mean time to its owner, and to give him every facility for disencumbering it when the debt for which it is security shall have been paid.*

To conclude this section, the definition of pledge has gone through a long process getting more and more comprehensive from time to time. The definition of pledge envisages, among others, the parties to the contract of pledge, the subject matter of pledge, the nature and purposes of

pledge, etc. In our legal system also the definition of pledge has been given under Art. 2825 of the Civil Code. However, this article seems not to be comprehensive enough to give us a more general and sufficiently elaborative definition of pledge. This deficiency in the definitional article, however, may be substantiated by close reading of other articles in the same law of pledge. Therefore, it is possible to get a better definition of pledge by reading provisions like Arts. 2825, 2826, 2829, 2831. You may consider the following statement after reading the above articles.

*Contract of pledge is a contract whereby a debtor or a non-debtor third party undertakes to deliver a movable thing called pledge to his creditor or third party custodian as the case may be in order to secure the performance an obligation.*

## **2.2. Requirements for a valid creation of contract of pledge**

At the beginning, it is important to note that a contract of pledge is ‘a contract’. That is, although pledge is special type of contract, the rules, principles and requirements applicable in the conclusion of contracts in general are binding on the parties to the contract of pledge. Accordingly, both the pledger and the pledgee should give their free and full consent, they should be capable of performing juridical act (concluding contract) in the eyes of the law, the object of their contract should be clear lawful and morally acceptable, and they should comply with prescribed form, if any. All these are general requirements and applicable to every contract. Here, the main issue we are going to discuss is the requirements specific to the contract of pledge and how the above general requirements are reflected in the creation of a contract of pledge.

### **2.2.1. Formality requirements – specification of maximum claim and written form**

Specification of maximum claim and written form are the requirements which the law prescribes to be fulfilled in order for valid contract of pledge to exist. These are mandatory requirements to be fulfilled in the conclusion of contract of pledge under the pain of nullity of the contract if not fulfilled. Clear specification of the obligation itself and the maximum amount of the part of the obligation which is secured by conclusion of the contract of pledge is the first important and mandatory equipment here.



Close reading of Art.2828(1) shows that whatever the value of the secured obligation may be; whether the contract of pledge is made in the written form or not, as the case may be, the maximum amount of the debt guaranteed should be specified in the contract of pledge itself. What do you understand by the phrase *the maximum amount of the debt guaranteed*? Consider the following exercise.

### ***Exercise 6***

Mr. Getu approached his employer Mr. Gutu for the loan of birr 10,000. Mr. Gutu agreed to extend the loan but only if Mr. Getu can provide security for the payment of the loan after a year. Mr. Getu could not find any other property to offer as security except a gold ring worth birr 5000. Mr. Gutu then said any way give me the gold ring for the time being, I will give you the money, but you have to look for another additional security. Accordingly, they agreed and the loan was granted, the gold ring was delivered to the creditor. ***What amount of the debt do you think is guaranteed?***

In the above case, it is not the whole debt the payment of which is guaranteed. It is only 5000 which is secured debt. Hence, the question is ‘what does the law want to be specified? Is it the maximum value of the obligation (10,000) or is it the amount of the debt guaranteed (birr 5000). Obviously the part of the debt which is not guaranteed doesn’t have any thing to do with the contract for security (contract of pledge) What is important here is the maximum of the amount guaranteed or the maximum of the amount for which the creditor is given priority and protected as such. It is not the maximum of the claim of the creditor. Regarding the specification of the principal obligation itself, what is important is that the nature and the content of the obligation has to be clearly provided in order to meet the requirement that the object of a contract has to be clearly defined (Art.1714 of the Civil Code).

The main point here is, if a third party, for example, undertakes to deliver a movable thing under a contract of pledge to secure the performance of unspecified obligation that exists between the creditor and the debtor, such a contract of pledge shall not have any legal effect. Consider where in such contract of pledge the third party, for example, simply states: ‘I hereby voluntarily

undertake to deliver my DVD player as a pledge to secure the payment of loan between the creditor Mr. Baraki and the debtor Mr. Tamiru.’ In Such case the principal obligation secured itself cannot be identified since it is not precise enough to be identified in the words of Art. 1714 of the Civil Code. Therefore, in the contract of pledge what we expect to be specified for the contract to be valid is the nature, content and identity of the secured primary obligation and the maximum part of such primary obligation which is secured by concluding the contract of pledge.

The second formality requirement is with written form. As you may understand from Art. 2828(2), the law requires the contract of pledge to be made writing upon certain condition. The condition is if the maximum amount guaranteed, as discussed above, exceeds 500 Ethiopian birr. Hence, the written form becomes a form prescribed by law only if the amount guaranteed exceeds birr 500. Note that the amount referred here also is not the maximum of the claim of the creditor, but it is the maximum part of such claim which is guaranteed by the pledge contract. This is very important to ascertain whether the creditor is secured for his total claim or only some part of it. This, in turn, conveys the message that whatever the value of the security (the object) may be we cannot assume that the creditor is secured for the totality of his claim. Consider this exercise.

### ***Exercise 7***

A debtor borrows birr 20,000 from each of three different creditors which makes up the total amount of his debt birr 60,000. All of the three creditors demanded security consecutively. However, the debtor had only a movable property with the value of birr 30,000 to provide as security. Since he wants the creditors to be entitled to equal protection (security), he concluded a contract of pledge with the first creditor clearly stating that he is secured only for the payment of birr 10,000 out of the 20,000. He concluded different contracts of pledge with the second and the third creditors in the same manner.

On the due date of all the three obligations, it is easy to ascertain the maximum amount for which each creditor is guaranteed. But, if only the maximum claim of each of the creditor (20,000) is specified in the contracts of pledge concluded with each creditor, we cannot provide the creditors with equal protection as it was intended by the parties. This seems to be a reason

why the law wants the maximum amount guaranteed to be specified rather than the maximum claim of the pledge i.e. creditor. All the same, the second requirement is that if the amount guaranteed exceeds birr 500, the contract of pledge has to be supported by a written document. Otherwise, the contract shall not be valid in the eyes of the law without fulfilling a form prescribed by law. The non-compliance with such requirement renders the contract to a mere draft than full fledged contract of pledge in the words of Art.1720 of the Civil Code. Moreover, students should remember that in cases where certain contract is required to be made in the form prescribed by law there are additional requirements in duding the requirement and that the contract should be duly signed by the parties to the contract, that there should be at least two witnesses from the reading of Art. 1727 of the Civil Code.

### **2.2.2. Transfer of Possession**

Transfer of possession is another important requirement which has to be fulfilled in order for the security right (pledge) itself to be an enforceable right. Without or before transfer of possession, which is effected through delivery of the movable thing either to the creditor or third party, the creditor can not claim to be an secured creditor. He remains to be ordinary creditor until he takes the possession of the pledge. The requirement for transfer of possession basically demands that the pledge has to be dispossessed of the pledged property. He should not continue to possess the property after giving it as security under contract of pledge. The debtor should relinquish the possession of the pledged property into the hands of appropriate person, either the creditor or third party.

Transfer of possession is made a requirement principally because of the nature of the thing subject to pledge i.e. movable. As you may remember from your discussion of property law, whosoever is in possession of movable things is presumed to be an owner and can transfer the thing as owner to a third party in good faith (a purchaser, a creditor, etc). Once the thing is transferred to such third party in ownership or as a pledge, the security right of the previous creditor cannot be enforced. This is because the creditor cannot follow the movable property in the hands of third party in good faith since the law gives priority to the protection of such third party who has the actual possession of the thing as an owner or pledge-credit or any other right.

Therefore, once the contract of pledge is concluded the possession of the thing should not remain in the hands of the debtor. The thing has to be transferred to the creditor or custodian.

An important question here is “when should the debtor be dispossessed of the pledged property for the contract of pledge to be valid?” Is it exactly on the date of the conclusion of the contract of pledge or can they postpone the transfer of possession for a certain day in the future? Let us have an exercise of a hypothetical case.

Mrs. Mitike took a loan of birr 20,000 from Siket Bank to be paid after a year. The creditor bank demanded security before handing over the money to the debtor (Mitike). She informed the bank that she has a food processing factory and she can give one of the machines in the factory as a security. She also told the bank that there is a product under process and she cannot deliver the machine immediately. However, she promised to deliver the machine after some fifteen days and in the meanwhile she will look for another machine to hire, which will replace the pledged machine upon delivery. The bank was convinced and they concluded a contract of pledge on the same date of loan and agreed to transfer the possession of the machine after two weeks. ***Is the contract of pledge valid before the date of actual delivery of the pledge?*** Read the following two provisions of the Civil Code before solving the above case.

**Art. 2832 - Debtor's Possession**

- (1) The furnishing of a pledge without dispossession of the debtor may be made in such cases only as are expressly provided by law.*
- (2) In all other cases, the contract shall be of no effect where it stipulates that the pledge shall remain with the debtor.*

**Art 2852 - Effect on Third Parties**

- (1) The contract of pledge shall not affect third parties unless the pledge is in the possession of the pledgee, or the person designated for the purpose by the parties, at the time when the pledgee invokes the contract.*
- (2) The contract of pledge shall be of no effect where at that time the pledge is still in the debtor's possession or it has returned to his possession with the pledgee's consent or*

*it is in the possession of a third party from whom the creditor cannot demand its return.*

The two important requirements under the above provisions are the following. Under Art. 2832, the law principally requires the parties not to exclude the transfer of possession totally by stipulating that the pledge remains with the debtor. If there is a stipulation which states that there will be no transfer of possession and the pledge remains with the debtor, then the contract of pledge shall be of no effect. The possibility for the contract to be effective with no transfer of possession at all may be provided only by law. You can consider Art. 2830 as an example of such law which provides for an exceptional circumstance where a contract of pledge may be effective even if there is no transfer of possession of the pledge. This is when the thing subject to pledge cannot be disposed without a document of title and such document of title has been delivered to the creditor. This is because in such cases the possession of the thing itself and the possession of the document are equivalent and it suffices for the creditor to possess the documents. The examples of such goods are goods on board ship, which will be evidenced by issuance of bill of lading, goods warehoused, which will be evidenced by issuance of voucher, etc. In conclusion, the basic requirement of the law here is that the parties should not, by their agreement, exclude the transfer of possession. However, the law doesn't prohibit the transfer of possession to be effected on certain day in the future after conclusion of the contract of pledge.

The second important requirement regarding transfer of possession is provided under Art. 2852 of the Civil Code. The cumulative reading of the two sub-articles clearly shows that the security right of the creditor will be effective, both against the pledger and the third parties in general, only if it is under the possession of the creditor at the time he claims the enforcement of the contract of pledge. A creditor who does not have possession of the pledge cannot claim the enforcement of contract of pledge. Hence, an important requirement for the creditor is to have possession of the pledge on the day he invokes the contract of pledge which is, in principle, either on or after the due date of the secured obligation. Therefore, it is sufficient for the creditor if can take possession at any time before the due date. Actual delivery and transfer of possession on the date of conclusion of the contract of pledge is not a requirement. Remember what we have

discussed in the section dealing with the definition of pledge regarding the issue of *undertaking to deliver*.

Hence, in the above hypothetical case, the agreement that the possession will be transferred after fifteen days may not make the contract invalid since they did not absolutely exclude the transfer of possession. The law seems to advise the creditor to take possession as soon as possible for the effective protection of his security right. But, it is not mandatory requirement to take possession on the date of conclusion of the pledge contract although it is important for the effective protection of his security right.

However, for a creditor who is looking for an advice as to the most appropriate time the transfer of possession should be effected for the best protection of his security right, we have to advise him that he had better take the possession on the date of conclusion of contract of pledge. This is because, once the debtor transfers the pledge to a third party, the creditor loses his priority right on the thing. But, the transfer of possession on the date of conclusion of the contract does not seem to be a validity requirement.

One last point about transfer of possession is that though it effectively protects the right of the creditor, this requirement seriously affects the right of the debtor as he cannot make use of the thing or exploit it in any manner as long as the thing is under possession of the creditor. Moreover, the creditor also cannot make use of the pledge in any way which shows that this requirement takes the pledged property out of commercial transactions thereby affecting its economic utility. Hence, transfer of possession is considered as one of the demerits of pledge when compared to other types of securities. Consider the following paragraph from Planiol which may indicate the undesired effect of transfer of possession

### ***Necessity of a permanent dispossession***

*The dispossession of the debtor is very annoying for him. Before the mortgage came into being an attempt was made to palliate this inconvenience by a very simple scheme: the pledgee after having received the thing restored it to its proprietor by means of fictitious lease "nummo uno" or by a contract giving*

*him only a precarious possession. In that lay a danger for third persons: since the thing is remaining in the hands of the debtor, it afforded him a fictitious credit which he could again (and quite uselessly) be pledged by him. The present law forbids this practice: the thing should be placed in the possession of the creditor and remain there (Art.2076).*

However, in our legal system in order to mitigate this undesired effect of transfer of possession, the creditors are advised to focus on movables which can be represented by documents since in such cases the physical possession of the thing may remain in the hands of the pledger. Secondly, the law has adopted mechanisms whereby the debtor is entitled to exercise certain rights even if the thing is under possession of the pledgee. He is entitled to such rights as re-pledging, disposing, releasing the pledge by paying even a premature debt, etc which we will discuss in the next section.

### **2.3. Rights and Duties of the parties to the contract of pledge**

As we have already discussed, pledge arises from the contract between the pledgee and the pledger. In as much as it is a contract, it gives rise to the rights and duties for the parties. Inherent to the nature of contracts in general, the rights of one party is the duty for the other party and vice versa. Accordingly, all the rights of the pledgee give rise to duty for the pledger and the rights of the pledger are duties for the pledgee. Hence, it is possible to see that there are a number of rights and duties for the parties which include, among others, the duty of the pledger to transfer possession as the pledgee has the right to have possession of the thing, the duty of the pledgee to return the thing upon the extinction of the primary obligation as it is the right of the pledger to get back his thing, etc. However, in the following paragraphs, we will focus on the principal rights and duties of the parties as emanating from the contract of pledge.

#### **2.3.1. Rights and Duties of the Pledger**

As we have already discussed elsewhere in this material, the pledger may be either the debtor himself or third party on behalf of the debtor. This pledger, as an owner of the pledge, has certain rights which he reserve on the pledged property. He has also certain duties which arise from the contract of pledge. We will discuss the principal rights and duties of the pledger as follows.

## **I. Rights of the pledger**

### **a. Right to Retain Ownership**

It is obvious that the contract of pledge is concluded with the view to making use of full right of ownership on the pledged property in satisfying the claim of the creditor. In short, the right of the secured creditor under contract of pledge pertains to full right of ownership on the pledge. However, the security right of the creditor is an accessory right which will be enforced only after the due date of the secured obligation in case the debtor fails to perform it in the manner agreed. Hence, the law does not want to seriously restrict the right of ownership on the basis of accessory right. Moreover, if we stop the debtor from exercising his right of ownership, this will seriously affect the property right of the debtor as he has already lost the possession of the pledge because of the requirement of transfer of possession. Accordingly, the law clearly provides that the pledger retains right of ownership on the pledged property and can exercise this right of ownership in a way it does not affect the security right of the creditor.

? Can you give examples of the principal rights that the owner/pledger can exercise after pledging the property? What are the rights that he cannot exercise because of the restriction which arises from the contract of pledge? Consider also the following exercise before answering the above questions.

### ***Exercise 8***

Mrs. Bune has a new grinding mill which has not been installed and has not started functioning yet. She was in need of some money and took a loan of birr 20,000 from Rural Microfinance Institute to be paid after one year. The new mill was given as a security for the payment of the loan and was delivered to the creditor. ***What possible rights can Mrs. Bune exercise on the property even if it is not under her possession?*** Read the following provision of the Civil Code which may help you in appreciating the rights the owner can exercise and the restrictions imposed.

Art. 2834 - ***Ownership of pledge***



- (1) The pledger shall retain his rights on the pledge, save for the restrictions arising out of the contract of pledge.*
- (2) He may dispose freely of his rights and may in particular alienate the pledge or re-pledge it subsequently.*

As you may understand from the reading of the above provisions, the pledger retains full right of ownership on the pledge and can exercise certain rights inherent to the right of ownership. Hence, in our previous exercise Mrs. Bune can exercise her right of ownership in various ways. For example, she can dispose the thing in favour of third parties and the third party can acquire full right of ownership on the property irrespective of the fact that the thing is under possession of the creditor. She can also give the same property as security for another debt as far as it does not affect the right of the previous creditor. The exercise of these rights may appear as practically difficult since the thing is under the possession of the creditor and subject to security right. But, consider the above exercise again in order to see how it is possible to exercise these rights.

In the previous exercise, assume that Mrs. Bune, the owner of the grinding mills, finds a buyer who is looking for grinding mills. He offered her a price of birr 18,000 for each mill. The buyer also stated that he can take possession of the mills after one year as he wants the mills as part of the factory he is going to open one year later. Accordingly, they agreed on the price and the manner of payment. That is, birr 16,000 was to be paid to the owner immediately, and birr 20,000 to the owner after actual delivery of the mills or to the creditor in case the owner (the debtor) fails to pay the loan for which the mills were given as security.

The idea under the above illustration is that the debtor can dispose the thing freely and the creditor cannot, for example, challenge the contract of sale in the above case. The only thing is that the disposition made by the debtor (owner) should not affect the security of the creditor. That is, the owner cannot transfer the ownership of the pledge to a buyer who wants the thing immediately and request the creditor to hand over the thing to the buyer. If the buyer wants the property immediately the arrangement they can have is paying sufficient part of the price to the creditor and release the thing.

Moreover, the debtor in the exercise of ownership can enter into another contract of pledge with respect to the same property to provide another creditor with security right. In other words, he can create several pledges on the same property. Hence, in the above case Mrs. Bune can borrow another loan like birr 10,000 and give the same mills as security. If any dispute arises between the creditors regarding, for example, the possession of the pledge, the thing can be delivered to a third party custodian in accordance with Art. 2831 of the Civil Code. If the thing is sold to pay the debts of the creditors and the proceed is not sufficient to cover the claim of all the creditors, he who enters into contract of pledge in the first place shall be paid first in accordance with Art. 2860 of the Civil Code to be discussed later on.

### **b. Right to take back the thing by discharging the secured obligation at any time**

Here the right to which the debtor is entitled by law is the right to take back his property by discharging the debt guaranteed at any time even before the due date. He has an absolute right to claim the return of the property by discharging the guaranteed debt. This right is absolute as it cannot be restricted even by agreement. In the previous case, hence Mrs. Bune can claim the return of the mills by paying the debt if the buyer of the mills wants them immediately.

This debtor is provided with this right probably for two principal reasons. First, as we have repeatedly stated contract of pledge is accessory contract and so is the security right of the creditor. Hence if the secured obligation is discharged sufficiently, there is no reason why the thing remains under the possession of the creditor. The only claim of the creditor on the pledged property is just to ensure the payment of the secured obligation. Once his claim is satisfied he has to give back the thing to the owner. Second, as stated above the debtor is entitled to dispose the thing. Hence, if the buyer wants the thing immediately, the debtor can take back the thing and deliver it to the buyer by discharging the debts guaranteed. Read the following provision of the Civil Code which is relevant to the above discussion

#### **Art.2837 - *Premature payment of the debt***

- 1. The pledger may at any time demand the return of the pledge by paying the debt secured by it.*
- 2. Any stipulation to the contrary shall be of no effect.*

The above discussed rights are the principal rights reserved by a person who pledges his property. But still there are other rights to which the pledger is entitled. The following is a brief summary of these rights.

First, as repeatedly stated the debtor has the right to get back his property upon the discharge of the secured obligation. This right is substantiated by the accessory nature of pledge which cannot survive the extinction of the secured obligation either by payment or for any other reason. This can be seen from the reading of various articles like Arts. 2845(1) and 2849 of the Civil Code. Second if the pledge is to be sold, the debtor failing to perform the obligation, he (the pledger) has a right to apply to the court for the restriction of sale to the part of the property which can satisfy the claim of the creditor specially when the thing is divisible by its nature (consider a contract of pledge where the pledger has given a Television worth birr 4,000, a video camera worth birr 5000, a C.D player worth birr 8000 and a photo camera worth birr 2000 to secure a debt of birr 10000). In such case the debtor can claim the restriction of the sale only to the property which can pay the creditor sufficiently thereby saving force of the property from sale (Art. 2855 of the Civil Code).

Third, once the pledge is sold, the pledger has a right to get any balance of the proceeds after the secured creditor is paid sufficiently. This right also seems to emanate from his right of ownership. Because after the claim of the creditor is settled the balance of the proceeds, if any, is the value of the capital which belongs to the owner of the thing. Accordingly, it should be handed over to the owner of the thing. You can read this from Art. 2859 (2) of the Civil Code.

## **II. Duties of the pledger**

### **a. Duty to deliver the thing**

The first duty of the pledger which we have already discussed elsewhere is the duty to transfer possession. As you remember from our previous discussion the possession of the thing has to be transferred either to the creditor or to a third party custodian one way or the other it is the duty of the pledger to deliver the thing and transfer possession of the thing to the appropriate the person,

creditor or third party. This dispossession of the pledger is necessary for the effective protection of security right of the creditor.

### **b. Duty to cover cost of preservation**

When considered in general terms, both the pledgee and the pledger have interest in the preservation of the thing. On the part of the pledger, he is the owner of the thing and if the thing sustains any damage the harm is to the owner, because, the damage to a thing is actually damage, to the owner as it affects the capital (value) of the thing. On the part of the pledgee, the strength of his security right depends on the value of the thing. In other words, the value of the security right of the creditor corresponds to the value of the thing. Whenever the thing deteriorates and loses value as such it reduces the security right of the creditor. The probability to be paid first shrinks since the deterioration of the thing causes loss of value which represents the extent to which the pledgee is secured.

Therefore, both parties are interested in the preservation of the thing and they have to take part in the preservation of the thing. The pledgee has an immediate possession of the pledge and he is presumed to have (daily information about the condition of the thing). He knows directly what is happening to the thing. Hence he is expected to preserve the thing even by incurring expenses if necessary. However, the pledger shall reimburse the pledgee for the cost of preservation since the duty to preserve a thing is actually the duty of the owner of the thing. In conclusion, the pledger has to cover the cost of preservation which might have been reasonably incurred by the pledgee but the pledgee - creditor has to undertake immediate preservation of the thing. Read Art.2835 of the Civil Code.

### **? What if the creditor fails to preserve the thing in the way he expects to preserve it?**

Obviously the pledger can demand the pledge to be delivered to a third party who may preserve the thing in a better way. Again, it is the right of the debtor to demand the thing to be delivered to third party in case the pledgee abuses his right i.e. fails to preserve the thing although he is legally entitled to the possession of the thing (see Art.2836 of the Civil Code).

### **2.3.2 Rights and Duties of the Pledgee**

As you may have already understood, the contract of pledge is concluded principally for the benefit of the pledgee. This is true because the driving cause for concluding a contract of pledge is just to provide the pledgee with the security right. Hence, the pledgee derives, from the contract of pledge, various rights together with certain duties. We will discuss the principal rights and duties of the pledgee as follows.

#### **I. Rights of the pledgee**

##### **a. Right to possess the pledged property**

As we have already discussed under the section on the transfer of possession as a requirement in the creation and execution of pledge the pledgee creditor should take the possession of the pledge. You know that a creditor who does not have possession of the thing cannot in any way demand enforcement of his security right. He cannot claim to be given priority in the payment of the obligation. This clearly shows that it is the right of the creditor to take possession and retain the pledge under his control until the debt is paid.

The creditor is considered as the lawful possessor of the pledge and can bring even possessory action to protect his possession. Any third party even the pledger may try to intervene with or usurp the possession of the creditor. As a lawful possessor, the creditor is entitled to protect his possession in every manner that a possessor can protect his possession lawfully. More specifically, he can use a reasonable and proportional force or he may bring possessory action for the cessation of the interference or restoration of his possession. You may refer to your course on Law of Property (Arts. 1148 and 1149 of the Civil Code) or even in the law of pledge Art. 2842 (1) of the Civil Code.

The pledgee is entitled to this possession even if the thing does not belong to the pledger. That is, even if it is delivered to him by the pledger without being the owner of the thing, the pledgee is legally entitled to retain the possession of the thing and exercise his security right that he derives from the contract of pledge. As long as the pledgee concluded the contract of pledge with the pledger in good faith or innocently and take the possession of the thing even if the thing has a real owner different from the pledger, the pledgee shall not be forced to give back the thing to

the true owner. He can enjoy his security right as if the pledger is the owner of the thing. Solve the following exercise by making use of articles that follows.

### ***Exercise 9***

Mr. Nega rented a bread baking machine from Mr. Teka for one month. In the meantime, Nega wanted to expand his business and borrowed birr 5,000 from Mr. Takele to be paid after six months. To secure the payment of the money, Nega delivered to the creditor (Takele) the bread baking machine which he rented from Teka (third party). Upon the expiry of one month, Teka came to Nega claiming the return of the machine. Mr. Nega responded that he has given the machine as security and he is willing to pay a rent for additional five months. The owner of the machine (Teka) gets angry and comes to the creditor threatening him to return his property.

***What will be your solution to the dispute between the creditor and the owner of the machine?***

Read the following provisions which may help you in settling the dispute between the creditor and the owner of the pledged property.

#### **Art 2843 - *Third party's claim to the pledge***

*The pledgee may exercise the rights deriving from the contract of pledge notwithstanding that the pledge has been delivered to him by a person who was not authorized to dispose it.*

#### **Art. 2844 - *Exception***

- 1. The owner of the pledge may take it back where he shows that the pledgee knew or should have known, on the making of the contract, that the other party was not authorized to pledge the thing.*
- 2. He may also take the pledge back by discharging the debt secured by it.*

As it is clear from the facts of the case and the above provisions, the creditor is entitled to retain the thing under his control irrespective of the fact that it is delivered to him by the debtor who is not able to dispose it. The principal justification seems to be that the thing is movable and any

body who is in possession of a movable is presumed, by law, to be the owner thereof. Read Art. 1193, which you studied under property law. Hence, the creditor is entitled to assume the debtor who possesses the thing is the owner and accept the thing as a pledge trusting this presumption of the law. Therefore, in the above case, Mr. Teka can not force the creditor to give back the thing although he is the real owner of the thing.

? An important question here is ‘is there any remedy for Mr. Teka who is the true owner of the thing?’ Read the above provisions of the Civil Code again which may be relevant to answer this question.

In the first place, it is the duty of Mr. Teka (the owner) to know to whom he is giving his property. However, Mr. Teka is not without any remedy. He may take back his property upon the fulfillment of certain condition. The first condition is that he has to prove the bad faith of the creditor. We say that the bad faith of the creditor has been proved when it is proved that the creditor, at the time of contracting or taking possession of the pledge, has full knowledge that the thing does not belong to the person who is giving it as a pledge. If the true owner of the thing can prove the bad faith of the creditor this way, he can take back his property Art. 284(1). Second, the owner of the property can take it back by discharging the obligation of the debtor which is secured by the property. Of course, in this case it is clear that the owner of the thing who has discharged the debt of another person (the debtor) is entitled to legal subrogation in proceeding against the debtor for re-imburement. If the above two are not possible, the third solution may be proceeding against the debtor in case he fails to pay the secured debt and the pledge is sold.

### **b. The right to collect fruit**

If the pledged property by its nature produces fruit, the law entitles the creditor to the full right of ownership on the fruit. The reason seems to be that the thing produces the fruit, presumably, because of good preservation and investment by the creditor who is having the possession of the thing. Another reason may be that sometimes, because of its nature, it may be inconvenient to keep the fruits or deliver them to the pledger timely (*E.g.* Think of a cow given as pledge and its milk to be collected daily). Whatever the reason may be the pledgee is entitled to collect the fruit

and enjoy it as an owner from the reading of Art 2841(1). However, the pledgee is entitled to the ownership of fruit not for free. The value of the fruits he collected will be used to settle the claims of the creditor which includes, the cost of custody and preservation of the pledge, the interest if the debt is interest bearing (contractual or legal), and lastly the capital of the principal debt itself.

### ***Exercise 10***

Hashim planned to go to America but does not have sufficient money to cover the cost of transportation. He approached his uncle Kassim requesting him to cover the cost of transportation i.e. birr 10,000. Upon delivery of the money, Hashim promised that he will come back after a year and pay the money. To secure the payment he gave five cows to his uncle (the creditor). Six months later, three of the cows gave offspring (calves). Mr. Kassim incurred birr 3000 for the grass he has been feeding the cows, for their medication etc within the one year time. In their agreement, they clearly provided that there is no interest to be calculated on the principal claim. On the other hand, Mr. Kassim has collected for six months milk which approximately amounts to birr 3500 from the three cows in addition to the calves. Now, Hashim is back home after one year and willing to pay the money but he knows that Mr. Kassim has been collecting and making use of the fruits. *How would you settle the issue if they come to you seeking for solution as to how much money Hashim is expected to pay?*

As it has been already stated, the pledgee is entitled to collect and own the fruits but the value of the fruits shall be used in setting the claims of the creditor. Hence, in the above case, if the value of the three calves is, let us say, birr 3000, the pledgee has already collected milk worth birr 3500. The total value of fruits is, therefore, birr 7500. He has incurred birr 3000 for preservation and his principal claim is birr 10,000. Hence, the total claim is birr 13000. Therefore, Hashim should pay the only difference, i.e.  $13000 - 7500 = 5500$ . Note that had the value of the fruits been greater than the total claim of the creditor, he is answerable to the debtor for the surplus.

### **C. Right to be paid first (Priority Right)**

This is the principal right which is a real expression of security right. This right of priority exempts the secured creditor from competition with other creditors who claim payment from the



same debtor. It is a right which will be exercised on the proceeds from the sale of the pledged property upon the failure of the debtor to perform (pay) his obligation. We will have a separate section on the manner of sale of the pledge. The present discussion is based on the assumption that the debtor has failed to discharge his obligation and the pledge has been sold by fulfilling the requirement of the law. *What is the right of priority then?*

It is the right to be paid from the proceeds of sale of a pledge prior to or in preference of other creditors who claims payment from the same debtor. The secured creditor does not compete with other creditors and is not subject to the rule of proportional payments even in situations where the assets of the debtor are not sufficient to pay all of his debts. Consider the following exercise and the provisions that follow.

### ***Exercise 11***

Mr. Edget owns a car worth birr 80,000 and a house worth birr 100,000. Recently, he decided to be involved in a business by opening a factory. For this purpose, he took a loan of birr 60,000 from Siket Commercial Bank pledging a car. After establishing the factory, he faces shortage of money to start production and approached his two friends Mr. Shifa and Mrs. Zinet to extend him loan. Each of them gave him birr 80,000 without even demanding security. A year after, Mr. Edget's factory caught fire and turned to ash. He is found insolvent as his liabilities are greater than his assets. Hence, all the three creditors appeared claiming the payment. The car was sold for birr 80,000 and the house was sold for birr 110,000. The claim of the three creditors together is birr 230,000 while the total asset is birr 180,000. ***How are you going to effect payment of the creditors?*** Read the following provisions first.

#### **Art. 2857 - *Priority rights***

- 1. The pledgee may be paid out of the proceeds of the sale of the pledge before all other creditors.*
- 2. In addition to the debt specified in the contract of pledge, the pledge shall secure the contractual interest and legal interest on the debt and the expense incurred for the custody, preservation or sale of the pledge.*

Art. 2858 - Limitation of creditor's rights

- 1. The pledgee may not enforce his priority right arising out of the contract of pledge beyond the maximum amount specified therein.*
- 2. The pledgee may not enforce his priority right to obtain security for another debt, even if incurred subsequently to the contract of pledge, owed to him by the debtor or pledger.*

An obvious point about the above case after reading the articles is that the secured creditor has a right to claim to be paid before all other creditors as it is clearly provided under Art. 2857 above. Hence, the bank will be paid first from the proceeds of the sale of the car; the Bank will be paid the principal claim, i.e. birr 60,000 and if there is interest (contractual or legal) and cost of preservation also. The Bank is entitled to be paid such claims before other creditors claim payment from the proceeds of the sale of the car. However, note that there is a restriction on the priority right of the creditor. That is, the creditor will be paid first only the claim which is secured by express contract of pledge as you can understand from Art. 2858. For example, in the above case if there is another loan like birr 10,000 that the debtor has taken from the Bank subsequent to the contract of pledge concluded to secure the previous loan i.e. birr 60,000, the creditor can not claim to be paid the second loan prior to other creditors. Regarding payment of such unsecured claims, the creditor will have equal right with other creditors pursuant to Art. 2839(1) of the Civil Code.

## **II. Duties of the Pledgee**

We have stated elsewhere that the rights of the pledger constitute the duties of the pledge in general terms. However, let us consider some basic duties of the pledgee as a person possessing the property which belongs to another person - the pledger.

### **a. The duty to preserve the thing**

At this stage it should be clear that both the pledger and the pledgee are interested in the preservation of the thing. However, now we are concerned with the duty of the pledgee to preserve the thing

Because of his right to possess the thing the pledge will be the under physical control of the pledgee unless the thing is put under the custody of a third party in an exceptional situation. Hence, as a person with a physical control of the pledge, the pledgee knows the condition of the pledge i.e. whether the pledge is deteriorating and losing value or whether it is in a good condition, etc. The pledgee is in a better position to check the state of the pledged property. That is why the law provides that the duty to preserve the pledged property is the duty of the pledgee although he is entitled to the reimbursement for the cost of preservation by the pledger. The duty of the pledgee to preserve the thing can be read out from the following provisions.

**Art. 2835 - *Cost of maintaining and preserving the pledge***

*The pledger shall reimburse the pledgee for expenses incurred in maintaining and preserving the pledge.*

**Art. 2845 – *Return of Pledge***

*(2) Until the pledge is returned, he shall be liable for the loss of or damage to the pledge in accordance with the provisions of Article 2720.*

**2847 - *Loss or deterioration of the pledge***

*If the pledge has been entrusted to his keeping, the pledgee shall be liable for its loss or deterioration as provided in Article 2710 and 2721 of the civil code.*

The first article provides that an immediate or direct duty of preservation is the duty of the pledgee but he is entitled to the reimbursement by the pledger for the cost of preservation. The other articles clearly provide that the pledgee has a legal duty to undertake a reasonable preservation of the pledge. The articles also clearly provides that if he fails to discharge this duty of preservation, as a result of which the pledged property sustain damage or deteriorates and loses value, the pledgee is responsible/answerable to the pledger. The pledgee is responsible not only for his/her failure to preserve the pledge but also for the damage caused by the acts of persons for whom he is responsible. In conclusion, the pledgee is assimilated to a bailor in

discharging the duty to preserve the pledge. You may read the following articles to which the above reproduced articles make cross reference.

**Art. 2720 – *Loss or deterioration of the chattel – 1. Gainful custody***

- (1) Where he receives compensation for taking charge of the chattel or he is authorized to make use of it or he in a way derives benefit from it, the holder shall be liable where the chattel is lost or deteriorates after he has received it.*
- (2) He shall also be liable for any loss or deterioration caused by person whom he has authorized to make use of the chattel, even temporarily.*

**Art. 2721 – (2) *Limits of Liability***

- (1) The holder shall not be liable only where shows that the loss or deterioration was due to force majeure.*
- (2) He shall not be liable where he can show that the loss or deterioration was due to decay, dilapidation or other defect of the chattel.*
- (3) He shall not be liable where the deterioration is due to the normal and authorized use of the chattel.*

? An important question from the above provisions is ‘what if the pledgee fails to preserve the thing in the way he is required by law?’

If thing has sustained actual damage (deterioration or loss of value) because of the failure by the pledgee to make a reasonable preservation, it amounts to breach of legal duty which may be considered as commission of fault. Hence, he will be responsible to a pay compensation for damage caused by his faulty act. Moreover, if the pledgee fails to preserve the thing while the thing is under his possession, it may be considered as abuse of right to possess and the pledger may demand the pledge to be given to a trustee. Read Art. 2836 of the Civil Code.

**b. The duty not to use the thing**

Although the pledge is entitled to the possession of thing as well as collection of the fruit, he is not as of right entitled to use the thing. His possession doesn’t give rise to the right to use the

thing. He may be entitled to use the thing only under two exceptional circumstances. Read the following provision and try to identify the circumstances in which he may use the thing.

Art. 2840 - *Use of the pledge*

*The pledgee may not make use of the pledge without the pledger's consent, except where such use is necessary for its preservation.*

As you can understand from the above provision the pledge is not entitled to make use of the thing in principle. This restriction seems to be justified by the fact that the right to use is highly prone to abuse. However, the pledgee may use the thing under two circumstances: first, with the full consent and permission of the pledger; second, if making use of the thing is necessary for its preservation.

? Can you give any example of a thing which we cannot preserve without using the thing itself?

The answer to the above question is very much important since the pledgee may use the thing under the pretext of use for preservation. If the pledgee uses the thing under the guise of use for preservation, the restriction not to use the thing will be ineffective. Hence, we have to clearly identify the types of things which we have to be necessarily used for their preservation. An important example may be things with special quality; the quality which may be lost unless practiced regularly. Specific example may be animals which we use for special purposes, like horses specially trained for competition which may forget its special quality for competition. Therefore, it is only in such exceptional situation that the pledgee can use the thing for its preservation.

**c. The duty to return the thing upon extinction of the secured obligation**

Now, it should be clear that the only right of the creditor on the pledged property is the right to possess the thing until the secured obligation is discharged. Once the secured obligation is discharged, there is no reason why the creditor may retain the possession of the thing. The discharging of the secured obligation results in the extinction of pledge and the pledger can exercise full ownership without any restriction which may arise from the contract of pledge. This

duty of the pledgee to return the pledge can be understood from Arts. 2845(1) and 2849 of the Civil Code.

## **2.4. Execution of pledge - Sale of pledge**

Sale of pledge is the means to the execution of the security right of the pledgee. It indicates that the debtor has failed to discharge the secured obligation. Hence, the execution of a pledge takes place through sale of the pledged property after ascertaining that the debtor has failed to discharge the secured obligation. Accordingly, we will discuss sale of pledge assuming that the debtor has failed to perform the secured obligation.

Like the preservation of the thing, both the pledger and the pledgee have interests to be protected during the process of sale of pledge. Regarding the interest of the pledgee, the extent to which he is given priority depends on the amount of proceeds collected from the sale of the pledge. If the proceeds from the sale of the pledge are not sufficient to cover the payment of his claims, he will turn to be ordinary creditor; he will take equal position with unsecured creditors. On the other hand, the pledger is also interested in the process of sale since he is entitled, as an owner, to the balance remaining after settling the claims of the secured creditor. Therefore, the process of sale of pledge should be as reasonable and fair as possible to strike the balance of the two interests.

? What do you think are the rules and procedure to be observed in order to make the sale of a pledge reasonable and fair to the parties?

### **2.4.1. In cases of ordinary creditors - General**

The principal provisions of law intended to serve the above stated purpose of balancing the interests of the parties are Arts. 2851, 2852, 2853/54/55/56 of the Civil Code. An over all consideration of these provisions shows that the law principally aims at protecting the pledger. The reason is that from the very beginning the debtor or pledger is in a disadvantaged position. That is, as a person looking for a loan he may not be on equal position of bargaining with the creditor. In the same way, at the time of sale of pledge the thing is under the possession of the pledgee and the pledger may not be as such interested in looking for the maximum possible price

of the thing. The pledgee may simply focus on satisfying his claim turning blind eyes to the interest of the pledger in getting the at most possible price of the thing. The strong interest of the pledger deserving protection by law is plain, specially where the value of the thing is greater than the secured obligation.

Accordingly, in the above enumerated provisions the law fixes certain rules and procedures which the pledgee has to comply with while processing the sale pledged property. These rules and procedures, among others are: 1<sup>st</sup> The pledgee is not entitled to undertake a private sale of the thing; he cannot, even under contract of pledge, demand the debtor to give him the power to immediately sell the thing on private sale when the debtor fails to discharge his obligation (such agreement between the pledger and pledgee is possible only after the due date of the obligation), 2<sup>nd</sup> The pledgee can apply to the court for the sale of thing only if it is under his possession at the time he applies for the sale of the thing (execution of the pledge contract), 3<sup>rd</sup> he has to ascertain, by giving default notice that the debtor has failed to discharge his obligation, 4<sup>th</sup> he can cause the sale of pledge only by court order or through a neutral third party, in case the thing has price quoted on market, 5<sup>th</sup> he may be required to restrict the sale of the pledge only to the part of the pledge which can sufficiently satisfy his claim, 6<sup>th</sup> he has to hand over to the pledger any amount of proceeds in excess of his secured claim. All these are rules and procedures that the pledgee has to observe while processing the enforcement of his security right. If he breaches any of these rules and procedures, the enforcement of security right may not be valid and the pledger can bring action against the pledgee for any damage he sustained.

The pledgee is required to observe the above rules and procedures because of the fact that our Civil Code adopted, under the above enumerated articles, the concept of *judicial foreclosure*. This is the type of foreclosure whereby the pledgee is entitled to enforce his security right only by court order and under the supervision of the court. This is the type of foreclosure which tries to balance the interest of both the pledgee and the pledger. For a better clarity and detailed understanding of foreclosure, please read the following two extracts from different materials.

#### **2.4.2. In case the creditor is a bank – Special Protection**

Before reading the following extracts, students should note that the above stated rules and procedures which the creditor has to observe are applicable in our legal system only if the creditor is not banks. In cases where the creditor is a bank, there is a special law which regulates the execution of security rights when. In other words, banks, as creditors, are not expected to observe the rules and the procedures under the Civil Code to the extent these rules and procedures are repealed by the special law applicable to banks. This special law is Proclamation No 97/1998, a proclamation which is issued to provide for properties mortgaged or pledged with banks. An important point introduced into the Ethiopian Law of Securities by this proclamation is the concept *the power of sale foreclosure*. The power of sale foreclosure is the concept whereby the creditor and the debtor are legally entitled to conclude an agreement which entitles the creditor to acquire ownership of the property or sale the property privately without a need to apply to the court to secure an order for sale foreclosure.

Hence, as you can understand from the above paragraph, creditor banks are entitled to a special protection whereby they are relieved from court procedure. Creditor banks are given this special protection because of the practical problems they are facing in the enforcement of securities. That is, the long procedure and requirement to be observed in case of foreclosure by order of courts is seriously endangering the profitability of banks. From the very nature of their business, in order for banks to make profit, they should be able to extend loans to those who need it and collect it back without delay. That is the only way they can collect a good amount of interest which makes the greatest part of the profit of the banks. If the banks have to struggle for say a year or more in collecting the loan they have given to individuals, their profitability will be seriously affected. This special protection of banks is further justified by the practical situation in our courts where enforcement of securities may be delayed for a number of years for various reasons. Therefore, banks are legally freed from the rules and procedures which require creditors to apply to courts for the enforcement of securities.

? However, what is the fate of the protection of a debtor to what he is entitled in case of judicial foreclosure?



This question may be answered by reading the said proclamation where it is provided that the creditor bank is responsible for any damage caused to the debtor if the debtor can show that the creditor bank sold the property for an unreasonably lower price which affects the interest of the debtor. Yet, an important question is whether the proclamation has provided for detailed rules which protect the interest of the debtor. For further explanation on the above issue and detailed discussion on the importance and shortcomings in the proclamation, the student is strongly advised to read the following extracts. The first extract is an article written by Samson Assefa, a Legal Advisor in the Commercial Bank of Ethiopia and the second extract is from an undergraduate thesis written by Aytenew Debebe, Faculty of Law, Haramaya University, 2008 (unpublished)

## **2.5. Extracts for Further Reading**

**Source: An article by Samson Assefa, Legal Advisor at Commercial Bank of Ethiopia (Commercial Bank of Ethiopia, Newsletter)**

## **FORECLOSURE AND OTHER MECHANISMS TO REALISE SECURITES**

### **A. LOAN PERFECTING MECHANISMS (INTERNATIONAL PRACTICES)**

*There are several mechanisms of realizing the security of a loan based on the methodology used to secure the underlying asset. Foreclosure and repossession are the most known methods of liquidating that the debtor fails to effect the payment in accordance with the terms of the loan contract.*

*Presently, a kind of foreclosure system is placed in Ethiopia by proclamation No. 97/98.*

*To have a better idea on loan perfecting mechanisms and principles, this essay tries to summarize the different types and models of foreclosure and other loan perfecting mechanisms with a view to assisting better understanding of Ethiopian Foreclosure System.*

### **I. FORECLOSURE**

*Foreclosure procedure is one of the mechanisms used in a financial institution as a means of liquidating a security held in a bank when debtors fail to effect repayment of their loan. Globally, there are various foreclosure procedures that*

are practiced by banks and financial institutions based on their empowering legal instrument. The following modalities are used more frequently.

### **1. Strict Foreclosure**

*“Which is a judicial procedure that by terminating the mortgagor’s equity of redemption gives the mortgagee absolute title to the mortgaged real estate without a sale of the property”. In this procedure the principal stages of implementation are:*

- *The Bank (mortgagee) brings action before a court seeking a decree of the court for strict foreclosure*
- *The court orders the payment of a debt within a certain period.*
- *In default of payment within the above specified period of time the debtors’ equity of redemption shall be barred forever and foreclosed.*

*The net effect of this procedure is to give bank the ownership of the collateral without any sale of the property. (This procedure is not included in the collateral law of Ethiopia)*

### **2. Power of sale Foreclosure**

*“It is a foreclosure based on terms in a mortgage/pledge contract giving a mortgagee/pledgee bank or third party the power to sell the mortgaged property upon default without resorting to judicial proceedings by foreclosure; by an out-of-court procedure”*

*Recently, Ethiopian foreclosure rules are roughly similar to this foreclosure. The authority to foreclose basically emanates from the contract of mortgage or pledge. For instance, terms in the contract drafted in the following manner could give rise to the power of sale foreclosure:-*

*“If a borrower fails to discharge the debt in accordance with this security contract and the loan contract attached herewith, the Bank shall have a right to sell mortgaged or pledged property by auction upon giving a prior notice of 30 day and to transfer the ownership to the buyer in accordance with the law”*

*Such terms give authority to the Bank as an agent to execute the sale of the property in accordance with the foreclosure procedure and auction rules.*

### **3. Judicial Foreclosure**

*Judicial Foreclosure is “a legal procedure in which a court orders real estate to be sold to enforce the mortgaged/pledged right under the mortgage/pledge”*  
*The principal stages of the procedure can be summarized as follows:*

**3.1** As soon as the date fixed for payment passed, the mortgagee/pledgee brings action before the appropriate court in order to get a decree of the court for sale.

**3.2** The court, by appointing a person to supervise the sales procedure, shall order the sales to be carried out by public auction.

**3.3** If there is any surplus it shall be returned to the mortgagor/pledgor or any person entitled to it.

## **II. WARRANT OF EXECUTION**

### **(Country experience: Poland)**

In the Polish legal system, the privileged position of Banks for debts collection, based on a special regulation (within the Banking Law) releases bank from an obligation to apply to the court for the "performance clause" and authorizes banks to issue their own warrant of execution, which has got as equal power to seize goods or money as the court's decree. The banking warrant of execution is issued by a bank upon the audience from its books or other documents proving the existence of valid claim/debt due for payment.

To start the executions procedure, the default of the debtor has been sufficient to issue a warrant of execution, which is simply the Bank's declaration, stating - on the grounds of its books or other/equal documents that the debt exists and has been valid and mature. The bank has also privilege to choose the way of execution by the bailiff of the court (according to the code of civil procedure for execution in administrative way). The debtor has no right to protest against the procedure chosen by the Bank. Otherwise the debtor can legally defend himself against the Banking Execution, Started by his Bank and the right has been granted to him by the Banking law. He can start the opposite procedure making the counter execution request to the state court, to show that amounts are lower or that there is a possible deduction of both counter-claims. Consequently, the court is obliged to stop the Banking execution if the debtor applies for, until the claim is settled during the routine court's procedure.

Normally, the sale is done with due regard to the interest of those who secured their property for the debt.

## **III. REPOSSESSION**

Repossession is typically used to perfect loans that are granted against the security of motor vehicles. Here the Banks are required to have a title interest on the underlying motor vehicle.

This situation takes place when Banks finance the purchase of motor vehicles. Initially Banks establish themselves as owners or co-owners of the vehicle that they hold as collateral for their credit facility.

When the debtor fails to pay the loan (defaults) as per the terms of the contract, the following process shall be undertaken:-

- 1) The Bank establishes that the loan is in default and has very little probability to work out.
- 2) The Bank authorizes a repo-man by written order (a staff skilled with the collection of motor vehicles) to locate and seize the motor vehicle.
- 3) The repo-man brings the vehicle to the impound facility.
- 4) The Bank notifies the borrower to redeem the vehicles within a certain period of time (normally thirty days)
- 5) Following the expiry date of the redemption period, the Bank sells the vehicle by auction to pay off the loan.
- 6) Any proceeds over the loan amount and interest penalties and storage charges, etc. are remitted to the borrower.

#### **IV Forced Bankruptcy (Liquidation)**

This is a method that allows Banks to collect a debt when their collateral is short of the debt portfolio exposure. Banks may institute a case of bankruptcy in the capacity of a creditor. In this cases debtor may have sufficient readily convertible assets that might help the Bank to collect its debt fully. This mechanism allows Banks to settle their debt secured by Mortgage from other assets without the requirement to liquidate the underlying mortgaged asset. This procedure might also be very attractive, when the chattel is very specialized such as single manufacturing equipment or when the mortgaged/pledged property is overvalued or when its liquidation market is found to be very small.

#### **B. Salient Features of Ethiopian proclamation**

In light of the above loan perfecting mechanisms, proclamation No. 97/1998 contemplates a foreclosure rules that are close by nature for a power of sale foreclosure procedure.

The proclamation actually amended only two provisions of the Civil Code: Articles 2851 and 3060. Basically, the proclamation expands the freedom of

contract between the Bank and the mortgagor/pledgor. The two contracting parties (the Bank and Mortgagor/pledgor) which were previously prohibited to agree upon the sale of pledged mortgaged property without a need to go to the court are now allowed to get into agreement of this nature Article3 of the proclamation summarizes this freedom of contract in the following manner:

“An agreement authorizing a creditor bank with which a property has been mortgaged or pledged and whose claim is not paid within the time stipulated in the contract, to sell the said property by auction upon giving a prior notice of at least 30 days to the debtor and to transfer ownership of the property to the buyer, shall be valid”

The whole purpose of this proclamation is meant to cut short the trial and execution process of courts that might be undertaken to enforce a contractual agreement upon selling the mortgaged or pledged property. The only responsibility that is put on the Bank is to follow the rules of auction as they are specified in Articles394 - 449 of the Civil Procedure Code - assisted by the registrar.

However, when this proclamation is translated into practice a number of problems and loopholes are to be faced. These among other things include:-

- A) Co-operation of relevant executive organs: (i.e. police, registrar, etc).
- B) Appraisal/estimation of the property to be sold.
- C) The ambiguity of the proclamation:-
  - i. On the second auction procedure
  - ii. On the capital gain tax implementation
  - iii. On Mortgaged/pledged property take over right of the Banks.
  - iv. On the rights and responsibilities of the registrar.
- D) Lack of adequate market.
- E) Lack of public awareness of the procedure.

As it is a new phenomenon for Ethiopian legal system, certain practical problems are definitely expected. However, the banks should set out to improve the Process through joint consultation and standardization in all aspects of its application. Banks are also expected to cooperate in creating awareness of the public and the executive organs through different workshops and seminars. The internal procedure of each bank must also be assessed from time to time in order to improve the procedure in such a way that the interests of all parties be accommodated based on the principles of a common sense and fairness.

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- 3) Jozzezaska, Anna, Essay on Banks Prerogative for Debt Collection (Unpublished, National Bank of Poland, 1996)
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**Source: An undergraduate thesis by Aytenev Debebe, Faculty of Law, Haramaya University, 2008 (unpublished)**

### 1.1 Definition of Foreclosure

The meaning of the term foreclosure does not remain the same at all times. With the development of law and corresponding changes in procedure to enforce creditors' security, the term acquired different definitions.

Originally, foreclosure was defined as "a legal means by which a mortgagor loses his right to redeem his property." (The Encyclopedia America, Int. ed. Vol. 11, 1995). From this definition we can understand that foreclosure means only the depriving of the mortgagor's right to redeem or to regain his property.

It is also defined as "a legal proceeding by which a mortgagor's right to a mortgaged property may be extinguished if the borrower fails to meet his obligations agreed in the mortgage." (The New Encyclopedia Britannica, 15<sup>th</sup> ed. Vol. 4) In this definition, we can see that the mortgagor loses all his right in his property, including the right to regain his property when he fails to meet his obligations agreed to in the mortgage. This definition better describes the essence of foreclosure in which it put the condition upon which the mortgagor will lose his rights.

H.C. Black has also defined foreclosure as "a procedure by which mortgaged property is sold on default of mortgagor in satisfaction of the mortgage debt." (Black's Law Dictionary, Revised 6<sup>th</sup> ed. 1991). One can learn from this definition that foreclosure is a procedure that entitles a mortgagee to have the secured property sold and obtain the amount of his debt from the proceeds of the sale.

But all of the three definitions are not exhaustive in describing the presently and widely exercised foreclosure, in which the role of courts is minimal, i.e. power of

sale foreclosure. This foreclosure power arises from the agreements entered between mortgagor and mortgagees.

## **1.2 Types of Foreclosure**

As was stated above, the term foreclosure has been or is applied to different procedures which bar the mortgagor's rights in the mortgaged property, where the debtor fails to discharge his obligation as prescribed in the contract.

The commonly used types of foreclosure are:

- I. Strict foreclosure,
- II. Judicial sale foreclosure and
- III. Power of sale foreclosure.

To have a better understanding of the concept of foreclosure, and to be able to identify the type of foreclosure introduced into our legal system, it is necessary to briefly discuss each of the above mentioned types of foreclosure.

### **I. Strict Foreclosure**

Strict foreclosure is a procedure by which the secured party elects to keep the property in full satisfaction of the debt. [The Uniform Commercial Code, Art. 9.505(2)]. By this the absolute title to the mortgaged property is vested in the mortgagee.

For a mortgagee to avail himself of this mode of foreclosure, he will file a bill for strict foreclosure whereby a decree will be obtained for the payment of the mortgage debt within a short period of time. (American Jurisprudence, Mortgage, 2<sup>nd</sup> ed. 1971). The decree obtained from the court, expressly providing that all rights, title and interests of the debtor shall be vested forever unconditionally in the mortgagee, will suffice to make complete the transfer of title to the mortgagee. Since the decree cuts off permanently all possibility of redemption and since this will penalize a mortgagor who accidentally fails to pay even a very insignificant portion of the debt, strict foreclosure is regarded as harsh and inequitable. (Corpus Juris Secundum, Mortgage, Vol.59, 1949). This method of foreclosure does not give the mortgagor the chance to get the value of the property in excess of the debt since it vests the absolute title in the mortgagee without any sale. In effect, the mortgagee is not required to pay the balance, if any. And hence, in some jurisdictions, it has been forbidden by law. (Corpus Juris Secundum, Mortgage, Vol.59, 1949).

## **II. Judicial Sale Foreclosure**

Judicial sale foreclosure is a procedure by which the mortgagee takes an action for the sale of the mortgaged property and application of the proceeds of the sale to the mortgaged debt. (Corpus Juris Secundum, Mortgage, Vol.59, 1949). Once such is brought and if the court is convinced by the claim of the mortgagee, it will order the sale of the mortgaged property at a reasonable price and usually by auction; and the proceeds of the sale applied to the payment of the debt and if there is any surplus, it is paid to the mortgagor or other junior creditors. (George E. Osborne, Hand book on Mortgage, 19151). This method of foreclosure is advantageous in that it avoids multiple actions for deficiency judgment; meaning, where the proceeds of sale is not sufficient to cover the whole debt, the mortgagee may obtain the deficiency judgment without reopening the foreclosure measured by the difference between the debt and the sale price. . (George E. Osborne, Hand book on Mortgage, 19151).

This judicial sale foreclosure is observed in our legal system. Especially, prior to 1997 before the enactment of the proclamation for power of sale foreclosure, the practice revealed that it has been serving as a sole method of foreclosure used by banks and other creditors. However it is the best method of determining conclusively the rights of all interested parties, it is complicated, time consuming and costly since it involves a long series of judicial proceeding.

## **III. Power of Sale Foreclosure**

Power of sale foreclosure was a clause commonly inserted in mortgage contracts, giving the mortgagee the right and power, on default of the debtor, to sell the mortgaged property without going through a judicial proceeding; to satisfy the creditor out of the proceeds of sale, return the surplus, if any, to the mortgagor or such other persons as may be necessary. (Harold Flusk, Business Law Principles and Cases, 2<sup>nd</sup> ed. 1970). To this end, the power of sale must be expressly conferred on the mortgagee by the terms of the mortgage. Moreover, for the mortgagee to sell the mortgaged property there shall first be failure of the debtor to meet his obligations according to the contract. In addition, giving default notice to the mortgagor, of the mortgagee's intent to exercise the power is a condition precedent that must be complied with and the sale must be by auction preceded by advertisement of sale. (American Jurisprudence, Mortgage, 2<sup>nd</sup> ed. 1971).

This method of foreclosure avoids the long and tiresome stages in judicial foreclosure since it is an out of court proceeding. However, it fails to establish as stable title as does judicial sale, since the title acquired is not based on a judicial proceeding; sanctioned by court order.



Power of sale foreclosure is introduced to our legal system in 1997 by Proclamation No. 65/97 expressly allowing banks to enter into an agreement to sell collateral mortgaged without invoking the aid of court of law. Presently we observed this method of foreclosure in proclamation No. 97/98 (hereinafter the proclamation) which repealed the latter proclamation. In this paper we will concentrate on this method of foreclosure in force and the possible intricacies that may follow.

### **1.3. Overview of Experience in other Legal systems**

#### **1.3.1. In the United States of America**

In the USA, all the three types of foreclosure are applied, but the most commonly applied methods are judicial and power of sale foreclosure; whereas strict foreclosure is being considered as an outdated and permissible only in few states. (Gibson and others, Real Estate Law, 3<sup>rd</sup> ed)

As regards judicial foreclosure, it is the exclusive or generally used method of foreclosure in majority of states and is available in all by virtue of express statutory enactment, since it is the best method of determining conclusively the rights of all interested parties and consequently of producing a stable title. (American Jurisprudence, Mortgage, 2<sup>nd</sup> ed. 1971).

Under power of sale foreclosure; the manner, time and place of the sale is determined by the parties in the instrument giving such power, and by statutory regulations which lay down minimum standards to be adhered to. Since the whole process is out of reach of the courts supervision and as such it is exposed to abuse, it is hated by potential purchasers and some states expressly prohibited by a specific legislation (American Jurisprudence, Mortgage, 2<sup>nd</sup> ed. 1971).

The last method which is still applicable in a few states of USA is strict foreclosure. The reason why its application declined at a higher rates is that, it highly penalizes the mortgagor and it makes the security transaction assume a character of sale. (Lassalle Extension University, American Law and Procedure). This is highly harsh and inequitable since it cuts off permanently all possibility of redemption even for insignificant portion of the debt, in which the debtor may accidentally fail to pay.

To summarize, the general trend in USA is that, the application of strict foreclosure is almost dying, whereas judicial and power of sale foreclosure have greater acceptance and still applied widely in many states.

#### **1.3.2. England**

*In England, the most commonly used method is statutory power of sale. It is almost similar to power of sale foreclosure in that it is an out of court procedure. However, unlike power of sale foreclosure, in statutory power of sale, the power does not arise from the contract of the parties, but from the law. The law states that there is an implied power of sale mortgages in the absence of an express provision to the contrary and out of court sale by its use is the common method of foreclosure. As regards strict foreclosure, it is applied by the mortgagee as an alternative in case he does not want to use his statutory power of sale.*

*Finally, judicial foreclosure is the least practiced of all forms of foreclosure in England. It is usually applied either upon a choice of the mortgagee or upon the discretion of the court. (G.C. Cheshire, The Modern Law of Property, 9<sup>th</sup> ed.)*

*Generally, in England though the mortgagee can choose any of the three forms of foreclosure, he can apply statutory power of sale or strict foreclosure in the absence of express prohibition in the contract of mortgage.*

### **1.3.3. France**

*In France there are two types of foreclosures in force; judicial and no-judicial foreclosure. (<http://www.sellforeclosure.asp>). A foreclosure that arises from court action is the judicial foreclosure. The mortgage deed or trust does not have a power of sale clause. Therefore, the mortgagee or another lien holder must take the borrower in default before a court to recover the unpaid balance of the debt.*

*By contrast, a non-judicial foreclosure is one which a foreclosure can be completed outside the court system. By this real property can be sold under power of sale in mortgaged deed or trust that in default. But the mortgagee is unable to obtain a deficiency judgment. (<http://www.sellforeclosure.asp>). Thus, the only practiced forms of foreclosure in France are judicial and power of sale foreclosure whereas strict foreclosure is not recognized.*

## **1.4. Justifications for the Introduction of power of Sale Foreclosure under Ethiopian Law**

*Before considering the specific reasons that necessitated the introduction of power of sale foreclosure, it is necessary to discuss the civil code provisions of Art. 2851 (1) and 3060 (1). When the legislature issued proclamation No. 65/97 and repealed it by proclamation No. 97/98, it was in a conception that the two provisions prohibit creditors and banks from entering into an agreement empowering them to sell pledged or mortgaged properties by an out of court procedure. But this conception is not based on the spirit of the law, rather only*

dependent upon the practice of banks which were realizing their security interest only using judicial proceedings. It is based on this misconception that legislature issued the foreclosure proclamation.

Both provisions of the civil code declare that, any agreement for the sale of pledged or mortgaged properties held as security without complying with the formalities required by law, shall be of no effect. The purpose of this prohibition is to forbid agreement that leave aside the formalities that the law requires to be fulfilled while a sale is conducted. One clear formality that needs to be complied is to give prior notice to the debtor, where he does not carry out his obligation under the contract. And in effect, any agreement authorizing a pledge or mortgagee to sale the collateral without giving default notice to the debtor shall be of no effect. The requirement of notice also is not left aside by the proclamation, rather it is extended to a minimum of 30 day; and the selling procedure is referred to the civil procedure code which was previously in force.

This being the spirit of the law, the legislature understood in a way that the law intended to prohibit from the very outset any agreement empowering creditors to sell the property. Therefore, by way of conclusion, it can be said that even prior to the coming into force of the foreclosure proclamation, the civil code does not prohibit entering into contracts for selling of pledge or mortgaged properties complying with the formalities required by law.

Having said this on the provisions of the civil code, now it is time to consider the reasons necessitated the introduction of the proclamation which allows an agreement that empowers banks to sell properties mortgaged or pledged with them.

First, if banks are to use judicial foreclosure as procedure to collect money from defaulter, they must exhaust all the long and series of steps of the procedure which is time taking and costly as it involves; "Filing of foreclosure application, service of process, hearing of the parties, the issuance of decree, notice of sale, actual sale which may be effected after two auctions, probably an application by the debtor to have the sale set aside, confirmation or setting aside of the sale, determination of the rights to any surplus, if any, and another long proceeding for deficiency judgment, if any, etc.". The cost, complication and time needed for this procedure may be aggravated in case an appeal is brought at any stage of the proceeding. It is not difficult to appreciate the effect of this long procedure in our judicial system where there are fewer benches and judges compared to the large number of cases. The preamble of the proclamation which is meant to show the importance of the law makes the above problem explicit when it says: "Where as it takes rather too long a time to obtain a judgment, from courts of law, fore sale of property mortgaged

or pledged with banks to subsequently have it exacted .. it is necessary to amend the civil code

Concerning the sale of property pledged or mortgaged with banks, the other reason that necessitated the issuance of the proclamation is revealed by the second paragraph of the preamble of the same proclamation saying: "Whereas, consequently, banking business thriving on interest payment on loans it provides from public money received in form of saving deposits or acquired from other sources, ... has been adversely affected; it has been necessary to promulgate this proclamation"

The money power of banks depends considerably upon the money they borrow by way of deposits from the public. In order for banks properly collect the money they lend to debtors. If banks are to use to use court procedure to collect the money from the debtors, banks will not be able to collect money in due time. This delay will force banks to remain interest payers for depositors which could otherwise be covered by interest on loans extended to borrowers, had the latter settled their debt in due time. This will paralyze the power of banks. The rationale behind the issuance of this proclamation is also justified by the need to avert this danger.

Last but not least, in modern economy, banking activity is the pillar of the economic life of a nation. Banking activity helps largely to finance various business undertakings and development schemes. If the money lent to borrowers is to remain for long under the control of few borrowers other potential ; borrowers will not have a chance to borrow when they need; which ultimately affects the free economic policy of a country. This problem is magnified by the proclamation in paragraph three of its preamble as: "Whereas, to create a conducive environment for economic growth or development by enabling banks to collect their debt from debtors efficiently and thereby promoting good business culture, it is necessary to promulgate this Proclamation," Therefore, if banks are to play a role they are expected to play in the economy and to promote good business culture by supplying interested borrowers with adequate and fair loan, an efficient mechanism that helps to collect their money from debtors should be devised. The issuance of the proclamation is justified to achieve the above objectives.

The detail of the law and its limitations are going to be discussed in the coming chapter.

## **THE RIGHT OF CREDITOR BANKS TO SALE FORECLOSURE AND IT'S LIMITATIONS**

### **2.1. TIME AND CONDITIONS PRECEDENT TO EXERCISE THE POWER**

#### **2.1.1 Time Precedent**

A power to sale contained in the pledge or mortgage contract, continues to exist during the life of mortgage. This does not, however, imply that creditor banks holding securities are empowered to sale at any time until the debt secured is due according to the contract and the debt or is in default. The right to foreclose and sale shall not be enforced and it remains a suspense condition.

In addition, time of commencement of exercising the power may be barred by limitation. When we see the proclamation, it does not specify the period in which banks must exercise the power of sale. But one can not draw a conclusion from the silence of the law that banks can exercise their power of sale at any time. Rather we should make a search into the provision of general contract law. Article 1845 of the civil code provides a period of limitation for the enforcement of all obligations to be ten years, unless provided by another law. However, article 1850 of the same declares that a creditor whose claim is secured by pledge may exercise his security right notwithstanding that the claim is barred. Therefore, it can be said that since the proclamation does not provide any period and since ten years period of limitation is inapplicable to security rights arising from pledge, banks power of sale of pledged properties continues so long as the pledge exist. In case of rights arising from mortgage, it is different from that of pledge when article 1850 of the code restricts itself to make the ten years period of limitation inapplicable to pledge contracts. The intention of the legislator seems that the rights arising out of mortgage contracts are subject to article 1845. But this is not sufficient inference to conclude that all contracts of mortgage are subject to the ten years period of limitation, and the law has a gap in this respect.

#### **2.1.2. Conditions Precedent to Exercise the power**

##### **I. Default notice**

Default notice is a legally required condition to be complied with by a creditor before invoking the non-performance of the obligation according to the contract (see Art. 1772 of the Civil Code on Contracts in general). In mortgage or pledge contracts, as these are also contract, the power of sale does not become exercisable until notice requiring the payment of debt or part there of for at least thirty days after such service as it is provided by the proclamation. Accordingly, before selling the collateral mortgaged/pledged, bank shall call upon the debtor to discharge the obligation and give him due notice that upon default, it will sale the property. The minimum thirty days notice is arguable as it is reasonable period the argument stems from the fact that since notice is

required to be given to debtors with a view to enable them to raise the money needed to discharge their obligation within the given period.

## **II. Estimation of the Floor Price of the property for the First auction**

The other necessary prerequisite to exercise power of sale foreclosure is appraisal of the property to be sold. When appraisal of the property, all necessary care has to be taken so that a fair price may be obtained to prevent sacrificial sale of the debtor's property. Accordingly, before the first sale by auction, the property must have an appraised value and there cannot be sale for less than this value. [See Art. 428(1) of the Civil Procedure Code]. Whenever the highest bid at the first auction does not reach the sum equal to the appraised value, a second auction will be held. By the second auction, however, any bid which is the highest is taken to be the saleable price of the property without reference to the appraise value. In connection with appraisal of the property, the issue bothering both the banks and the debtors is 'who should appraise the property?'

Although the law required that the property to be sold must have an appraised value, it is silent as to who should appraise it. While the proclamation allowed banks to sell by auction the property mortgaged with them, it neither provides as to who should appraise the property nor it forbid banks to appraise it. From this silence a reasonable inference that can be made is that banks are allowed to appraise the property.

But is it proper to give the banks the green light that they can appraise the property they are going to sell or acquire by it's appraise value should the first auction fail. If banks are allowed to appraise the property, they may be only concerned with their own interest and under estimate the value of the property with the consequence that the property of the debtor be sacrificed. In addition, banks may intentionally under estimate with the motive that, they themselves will acquire at the under estimated price if the two auctions failed. Therefore, to properly protect the interest of the debtors, it is necessary that appraisal be made by a disinterested third party other than banks.

## **III. Notice of sale (Advertisement)**

After the debtor is placed in default and the floor price is estimated, what follows is advertising the auction sale. The main rationale behind notice of sale by auction stems from advising the public as regards an auction to be conducted so that potential bidders may be present at the sale who may offer a good price thereby protecting the debtor by guaranteeing him at least the true value of the property. The advertisement shall not be restricted to only advising the public as to the sale, rather it should go beyond that, in that it should be given in a manner designed to attract the public attention by making

the property to be sold as attractive as fairness demands. (Black's Law Dictionary, Revised 6<sup>th</sup> ed.1991).

The proclamation does not describe the content and manner of advertisement but it does refer to the civil procedure provision. The proclamation requires that Art. 394-449 of the civil procedure code shall be applicable *mutantis mutandis* while the bank is exercising the power. According to these provisions of the civil procedure code, the notice of sale shall specify the following elements:

- the property to be sold and the estimated value thereof,
- any encumbrance for which the property is liable,
- the amount for the recovery of which the sale is to be conducted,
- the terms and conditions of sale and manner in which and time within which the purchaser need to pay the purchase price, and
- Every other thing which is material for the purchaser.

The civil procedure code, while mentioning the above requirements, failed to say anything as regards the frequency of the publication of the advertisement. It simply suggests that while the bank is conducting the sale, it shall cause the proclamation of sale to be made. In the absence of clear provision, the reasonable conclusion that can be drawn is that the bank is obliged to advertise the sale at least once.

Regarding the time after which the bank may exercise the power of sale, the civil procedure code to which the proclamation makes reference, provides after publication, the sale may not be conducted until after the expiration of at least thirty days in case of immovable and of at least fifteen days in case of movable properties starting from the date of publication.

## **2.2. Selling the Property**

Once the debtor fails to discharge his debt and the bank, which held the property by way of security, complies with the conditions precedent for the exercise of power of sale, the bank can now sell the collateral.

As to how the sale is to be conducted, Art. 3 of the proclamation make it clear that the sale shall be conducted by public auction. This may be due to the fact that the private sale does not protect the interest of the debtors since it is prone to abuse; whilst sale by auction is considered as reliable safeguard for the interest of the debtor by guaranteeing him the true value of his property.

### **2.2.1 Sale by Auction**

Although the proclamation requires banks to sell the property only by auction, neither the proclamation nor any other law defined what auction is. Thus, in order to know its meaning, we are obliged to use its ordinary definition. Black's

Law Dictionary defines auction as "a sale of property to the highest bidder." There are three basic elements in this definition; first there should be a property to be sold which is the subject matter of the auction; second the sale must be affected to the highest bidder; and to get a highest bidder, there should be competition among bidders which shows the third element that is the publicity of the sale. Now the question is whether these elements are reflected in our law.

Art. 1688 of the civil code discloses that the subject matter of sale is a thing, meaning property when it says "whosoever offers a thing for sale by auction shall be deemed to make a declaration of intention". The element of highest bidder is also impliedly included in Art. 1688(2) when it dictates "... the contract shall be deemed to be completed only where the thing is knocked down upon the last bid being made". The last bid shall be implied to mean the highest bid. Art. 428 of the civil procedure code also tell us the sale of the thing shall be effected to the highest bidder. Thus we can conclude that the element of highest bid is observed in our law. Therefore, we can safely say that although our law does not give the definition of the term auction, the basic elements of the term are included impliedly in auction provisions of the civil code and civil procedure code.

### **2.2.2. The Minimum Number of Bidders for a Valid Auction**

While the proclamation requires banks to conduct sale by auction, it does not answer the question of minimum number of bidders and neither any other law answered it. For auction sale to be effected, there should a highest bidder. And this presupposes the presence of successive increased bids. This is possible only when there is attendance and competition among bidders. In the presence of one bidder alone, one cannot think of a highest bid as one cannot compete with him self. Hence, we can conclude that for a valid auction to exist, more than one bidder shall appear and offer for sale. Otherwise in the presence one bidder alone, where competitive bidding cannot be expected, it will be a fallacy to say that auction is conducted.

### **2.2.3 How Auction shall be conducted?**

While banks are conducting the sale by auction, all aspects of the sale must be commercially reasonable with due diligence and prudence which may be expected from a provident owner. [The Uniform Commercial Code, sec. 9.505). Besides, in the exercise of power of sale, banks must strictly comply with the requirement of Art. 394-449 of the civil procedure code to which Art.6 of the proclamation refers.

According to the Procedure Code, the bank may conduct two successive auctions. In the first auction, the bank may sell the property if at least a bid is



offered equal to the floor price. If the highest bidder in the first auction is below the floor price specified, the bid will be rejected. Failing of the sale of the property in the first auction either for non appearance of any bidders or a bid equal to the floor price, a second sale by auction may be held. In this auction, unlike the case of the first auction, there is no any estimated floor price, and the highest bid will be accepted and the bank will effect the sale by such bid whatever its amount may be. If the second auction too fails due to non appearance of bidders, the bank is not allowed to conduct an extra third auction; instead the bank will take over the property at the floor price set for the auction as provided in the Amendment the Proclamation which is made by Proclamation no. 216/2000.

#### **2.2.4 Can the Auctioneer Bank bid for the property?**

Whether the banks exercising their power of sale can participate in the auction is a controversial issue. There might be some who argue that banks can participate in the auction, as there is no any provision that deprive the banks of their power to purchase. The proclamation that armed banks with power of selling the property do not expressly state whether the banks can participate in the auction. However, it makes a reference to the application of Art. 431 of the civil procedure *mutantis mutandis* which clearly provides that no auctioneer shall bid for the property. This reveals that banks cannot bid for the property. Moreover, when the bank is selling the property, it is assuming a double character; on one hand, it is an agent of the debtor, and on the other hand, it is an auctioneer of the sale of the property in which it is striving for the settlement of its own debt. In the law of agency, one agent cannot make a contract of sale with itself [Art. 2188(2) of Civil Code]. In our case, the bank shall not sell the property to itself and upon noncompliance it may result in setting aside of the sale. Therefore, in the presence of Art. 431 of the civil procedure code and the agency provisions of the civil code, one cannot say that banks can bid for the property.

#### **2.3. Defective Sale and Remedies available to the victims of the Sale**

In the event banks exercise their power of sale, they might fail to comply with the formalities prescribed for the sale by auction of properties. In such cases the sale may cause damage to the mortgagors or other competitive secured creditors. The US Commercial law has set stringent rules upon the secured party's liability for failure to comply with the rules of selling the property. In the event the secured party acts in a commercially unreasonable and impermissible fashion, the debtor and presumably other junior creditors may institute an action for the sale be set aside. In such case, the liability is the difference between the amount actually received from the sale and the amount that would have been

received had the sale been in accordance with the requirements of the law. (The Uniform Commercial Code, sec. 9.507)

Art 6 of the proclamation suggests the bank, while exercising its power of sale, must act in compliance with the formalities that are laid down under the civil procedure code. If not, the bank shall be liable for any damage it causes to the debtor in the process of selling by auction in violation of the rules prescribed. But the effect of defective sale is different in pledge and mortgage. In case of pledge, the defective sale does not entitle the pledgor or any other person to have the sale set aside. This can be understood from Art 435 of the civil procedure code when it says 'no irregularity in publishing or conducting the sale of movable property shall vitiate the sale.' But any damage caused by the defective sale can be redressed by compensation. As regards defective sale of mortgaged property, unlike the case of pledged ones, the sale can be set aside. In order for sale to be set aside, the aggrieved party has to show, in addition to the defect in the sale that he has sustained substantial damage as a result of the sale.

After dealing with the analysis of selected cases to show the practical problems in the execution of security rights through the power of sale foreclosure, Aytenew provides the following recommendations at the end of his paper:

In view of the problems raised the writer forwards the following recommendations.

- The foreclosure law does not have any provision as to who should appraise the floor price of the property for the first auction. Hence, it is suggested that the proclamation should be amended with the view to incorporate a provision that specifies a disinterested third party appraiser of the property to be sold by a bank.
- Since the proclamation does not define the concept of auction, the issue whether one bidder is adequate for a valid auction to exist remains unresolved. It is therefore, submitted that the proclamation should be amended to add a provision defining the concept based on its essence of competitive bidding.
- Also, the proclamation does not resolve the issues like the period in which banks can exercise their power of sale, and the frequency of publications of notice of sale or advertisement. It is therefore, imperative that the proclamation should be amended so as to resolve these procedural issues.
- Finally, even if the proclamation has released banks from instituting court action for the sale of collaterals, the opposite procedure where the

*lending bank would be a defendant is possible and it can be started by the mortgager or pledger. When such application against the bank is admitted by the court the bank will go back to the unwanted and lengthy court procedure. To tackle this problem, special benches should be established to give immediate decisions on complaints either for compensation or setting aside of the sale.*

### ***Questions for Attention***

While reading the extracts, try to give attention to the line of argument adopted by the writers.

Consider such issues as:

- From the reading of the extracts and the proclamation itself, do you think the proclamation provides for sufficient guidelines which may assure the protection of the interest of the debtor?
- What is the line of argument adopted by Samson?
- Is Samson emphasizing on problems arising from the shortcomings in the proclamation rather than the defective/unreasonable sale by the banks?
- What is Aytnew arguing for?
- Is Aytnew arguing that the permission of agreement between creditor and debtor empowering the creditor to sale the property without going to court as allowed by the proclamation is not strictly prohibited even under the Civil Code? Hint; consider the section of the extract dealing with the justification for introduction of the power of sale foreclosure.
- Is Aytnew focusing on the shortcomings in the proclamation or simply condemning banks for undertaking defective sale which affects the right of the debtor?
- What are the basic solutions forwarded by the two writers regarding the problems they have identified as might have been caused either by the gaps in the proclamation or by the unwarranted sale by the banks?

In the following couple of pages you have short notes taken from various books which will enable you to compare and contrast the Ethiopian law of Pledge with that of other legal systems, both common law and civil law systems. You may focus on points for

attention as provided under each extract. The first extract is from common law system while the second is from the civil law tradition.

❖ **Note: While reading the following extract, you are advised to give attention to the following points:**

- The definition of pledge and its essential elements,
- The basic similarities and difference between pledge and bailment, and how this is reflected in our law of pledge,
- The principal rights and duties of the parties, i.e. pledgee and pledgor, and its comparison with rights and duties of parties in the similar position under our law specially regarding the points like:
  - \* extent of priority and lien right of the pledgee,
  - \* acquisition of additional security for the loan extended to the same debtor after the creation of pledge to secure previous loan,
  - \* the right of the pledgee to sell the pledge, its requirements and limitations,
  - \* the rights and duties as well as protections to which the pledgor is entitled as an owner of the thing pledged
- A person who can create a valid pledge and in what circumstances can pledge be created,
- Solve also the question that follow the note and check how much they are relevant in understanding and solving similar situations in our legal system.

Note that the issues addressed in the extract may not be in the same order as the issues addressed under our civil code. Hence, you may need to take into account various provisions of the civil code at the same time.

**Source:** (M C Kuchhal, *Mercantile Law*, 5<sup>th</sup> revised edition, 1999) (Footnotes Omitted)

## PLEDGE OR PAWN

### Definition

"The bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'. The bailor in this case is called the 'pawnor'. The bailee is called the 'pawnee' " (Sec. 172)

**ILLUSTRATION:** A borrows Rs 100 from B and keeps his watch as security for payment of the debt. The bailment of watch is called a pledge.

Thus a pledge is only a special kind of bailment. Here goods are deposited with a lender or promisee as security for the repayment of a loan or performance of a promise. Otherwise, like bailment, a pledge also involves only a transfer of possession of goods pledged. The ownership remains with the pledgor. The general interest remains in the pawnor and in the goods pledged. The pledgee or pawnee has only a special interest in the goods pledged. The general interest remains in the pawnor and wholly reverts to him on discharge of the debt. Further, like bailment, a pledge is concerned with only movable goods, The movable goods include any kind of goods, valuables and documents of title e.g., railway receipt, bill of lading., etc (Morvi Mercantile Bank vs Union of India). Even a savings bank pass book issued by post office (which must accompany any withdrawal) may be pledged (J. & K. Bank vs Tek Chand)

### Distinction between Bailment and pledge

1. As to purpose. Pledge is the bailment of goods for a specific purpose i.e., to provide a security for loan or for the fulfillment of an obligation, whereas there is no such purpose in case of bailment. A bailment is for a purpose other than the above two, e.g, for repairs, safe custody. etc.

2. As to right of sale. In case of pledge, the pledgee has a right of sale (of the goods pledged) on default after giving notice to the pledgor but there is no such right of sale to the bailee in case of bailment. The bailee may either retain the goods or sue the bailor for non-payment of his dues.

3. As to right of using the goods. In case of pledge, the pledgee has no right of using the goods pledged, while no such restriction, exists for a bailee in case of bailment if the nature of transaction so requires..

### Rights of Pawnee

1. Right of retainer (Sec. 173). The pawnee has the right to retain the goods pledged until his dues are paid. He has the right to retain the goods pledged until his dues are paid. He has the right to retain the goods pledged, not only for payment of the debt or performance of the promise, but for the interest due on

the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged. Thus this right may be termed as the pawnee's right of 'particular lien.'

2. Right of retainer for subsequent advances (Sec. 174). When the pawnee lends money to the same debtor after the date of the pledge without any further security, it shall be presumed that the right of retainer over the pledged goods extends even to subsequent advance. The presumption can be rebutted only by a contract to the contrary. It will be noticed that although a pawnee has a 'particular lien' only, but this Section allows him to track his subsequent advances to the original debt in the absence of any agreement to the contrary.

3. Right to extraordinary expenses (Sec. 175). The Pawnee also has the right to recover from the pawnor extraordinary expense incurred by him for the preservation of the goods pledged. But he cannot retain the goods, if such expenses are not paid. He has only a right to sue the pawnor for recovery of such extraordinary expenses.

4. Right to sue the pawnor or sell the goods on default of the pawnor (Sec.176). Where a pawnor makes default in the payment of the debt or performance of the promise, the Pawnee may exercise either of the following rights.

- a) He may bring a suit against the pawnor for the recovery of the amount due to him and retain the goods pledged as a collateral security or
- b) He may himself sell the thing pledged, after giving to the pawnor a reasonable notice of his intention to sell.

In connection with the alternative right of sale, the following points must be noted.

- (i) The requirement of a reasonable notice is a statutory obligation and cannot be waived by agreement. A sale without notice is void, notwithstanding any contract to the contrary.
- (ii) The pawnee cannot sell the goods to himself and if he does so then such a sale is void as against the pawnor and the pawnor can recover the goods on paying the amount due.
- (iii) If the proceeds of such sale are insufficient to meet the full claim of the pawnee, he may recover the balance from the pawnor, but if there is surplus, he must pay it over to the pawnor.

### **Duties of Pawnee**

Pledge being a special kind of bailment, the duties of a pawnee are just like a bailee. Thus a Pawnee's duties may be enumerated as follows:

1. To take reasonable care of the goods pledged
2. Not to make any unauthorized use of the goods pledged
3. Not to mix the goods pledged with his own goods.

4. Not to do any act in violation of the terms of the contract of pledge and of the provisions of the Contract Act. For example, he should not sell the goods pledged without a reasonable notice to the pawnor.
5. To return the goods pledged on receipt of his full dues.
6. To deliver any accretion to the goods pledged e.g. bonus shares must also be delivered where shares form the subject-matter of pledge. The accretion remains the property of the pawnor (M.R. Dhawan vs Madan Mohan)

### **Rights of Pawnor**

1. Enforcement of pawnee's duties. The duties of the pawnee are the rights of the pawnor. The pawnor can, therefore, enforce by suit all the duties of the pawnee (enumerated above) as his rights. For example, if the pawnee makes an unauthorized sale (without giving the notice as required under Section 176), the pawnor can file a suit for redemption of goods, treating the sale as void (of course after depositing with the court the full amount due) or for damages for conversion.

Similarly, the pawnor has a right to receive the pledged goods back along with accretion, if any, on making the payment on stipulated date, and so forth.

2. Defaulting pawnor's right to redeem (Sec 177). A pawnor, who defaults in payment of the debt amount at the stipulated date, has a right to redeem the debt at any subsequent time before the actual sale of goods pledged. Thus an agreement that the pledge should become irredeemable, if it is not redeemed within a certain time, would be invalid. Of course, the pawnor redeeming after the expiry of the specified time must pay to the pawnee, in addition, any expenses which have arisen from his default.

### **Duties of pawnor**

The more important duties of pawnor are follows:

1. To compensate the pawnee for any extraordinary expenses incurred by him (Sec.175)
2. To meet his obligation on stipulated date and comply with the terms of contract.

#### **Pledge by Non-owners**

The owner of goods can always make a valid pledge, but in the following cases pledge made by non-owners will also be valid:

1. **Mercantile agents** (Sec. 178) A mercantile agent means an agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or sell goods or to

consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods (Sec.2 (9) of the Sale of Goods Act)

A mercantile agent who is, with the consent of the owner, in possession of the goods or the documents of title to goods (e.g. railway receipt or bill of lading) can make a valid pledge of the goods while acting in the ordinary course of business of a mercantile agent. Such a pledge will be valid even if the agent had no actual authority to pledge, provided that the pawnee acts in good faith and has not at the time of the pledge any notice that the pawnor has no authority to pledge (Sec.178).

It must be noted that a person in bare possession of goods cannot make a valid pledge. For example, a servant to whom goods are entrusted by his master during his (master's) absence cannot make a valid pledge. Similarly, a person entrusted with goods for a specific purpose cannot pledge the goods, e.g. goods held for safe custody or under a contract of hire cannot be pledged.

**2. Person in possession under voidable contract** (Sec. 178-A). A Person having possession of goods under a voidable contract can make a valid pledge of the goods, provided the contract has not been rescinded at the time of the pledge and the pledgee has acted in good faith and without notice of the pledgor's defect of title. For example, where A purchases a ring from B by exercising coercion and pawns it with C before the contract is rescinded by B, the pledge is valid. C will get a good title to the ring and B can only claim damages from A.

**3. Pledgor having limited interest** (Sec. 179). Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest. Thus, a person having a lien over the goods may pledge them to the extent of his interest. For example, A delivers a suit length to B, the tailor master, for making a suit and agrees to pay Rs 1,500 as sewing charges. B pledges the suit with C for Rs 3,000. The pledge is valid to the extent of B's interest in the suit, namely, Rs 1,500 (sewing charges). A can, therefore, recover the suit only on paying Rs 1,500 to C, the pledge (Thakurdas vs Mathura Prasad)

**4. Seller in possession of goods after sale** [Sec.30 (1) of the Sale of Goods Act]. A seller, left in possession of goods sold, is no more owner of the goods, but a pledge created by him will be valid, provided the pawnee acted in good faith and had no notice of the sale of goods to the buyer. The original buyer can obtain damages from the seller but cannot recover the goods from the pledge.

**5. Buyer in possession of goods under an "agreement to sell"** [Sec. 30 (2) of the Sale of Goods Act]. Where a buyer under an 'agreement to sell' wherein the goods to become the property of the buyer on fulfillment of certain condition or on expiry of some time, obtains possession of goods with the seller's consent before



the payment of price and pledges them, the pledge is valid, provided the pledgee acted in good faith and had no notice of the pledgor's defect in title of the goods pledged. It may be mentioned that under an 'agreement to sell' the ownership remains with the seller until the 'agreement to sell' becomes a 'sale' by the fulfillment of agreed condition.

**ILLUSTRATION.** A agrees to buy a car if his solicitor approves and obtains possession of the car and pledges it. The pledge is valid, although at time of pledge A was not the owner and later on also he does not become owner as the solicitor disapproves the purchase.

6. **Co-owner in possession.** Where there are several joint owners of goods, one of the co-owners in sole possession thereof with the consent of other co-owners may make a valid pledge of the goods.

### TEST QUESTIONS

1. Define pledge and distinguish between pledge and bailment. When will a pledge made by a non-owner of the goods be valid?
2. Define pledge, and state the respective rights and duties of pawnor and pawnee.

### PRACTICAL PROBLEMS

Attempt the following problems, giving reasons for your answers:

1. A pledges with B jewels worth Rs 60,000 and borrows Rs 30,000 at 12 percent interest per annum. Promising to repay the amount and redeem the jewels within a year. B, having apprehension about the safety of the jewels, because of increasing burglaries in the town, not only insures the jewels but also buys a strong safe at a cost of Rs 800, there being no safety vault in that town and keeps the jewels in that safe.

Now, when A comes to repay the loan B claims the amount due for principal and interest, cost of insurance and cost of the safe. But A admits liability only for principal and interest. Decide?

[**Hint.** B is entitled to recover from A the amount of the principal and the interest plus the cost of insurance and of the safe. There is no dispute so far as the amount of principal and interest is concerned. As regards cost of insurance and of the safe, it should be noted that under Section 175, B, the pawnee is entitled to these expenses also as they have been incurred for the preservation of the goods in the given circumstances.]

2. B handed her jewellery to M to value it and tell her what advance he could make on them, it being agreed that M was to keep the jewellery as security if he made the advance. On the same day M pledged the jewellery with A, a pawnbroker, who advanced £1,000 in good faith. Four days later, M advanced

£500 to B on the security of her jewellery. Subsequently on coming to know of the transaction between M and A, B paid the amount she had borrowed and sued A for the recovery of the jewellery contending that when M advanced the money, no valid pledge could arise as there was no delivery of goods in pursuance of the contract and M had already parted with the possession of the goods by pledging them with A. Will B succeed? Give reasons.

[**Hint.** No, B will not succeed as the pledge is valid. The facts in the instant case are similar to *Blundell vs Atten* (1921, 3 K.B. 233). In that case it was held that the pledge was valid. Delivery made four days before was a good delivery for the purpose of creating a pledge, whenever that pledge was created. "Delivery of possession and advance need not be simultaneous and a pledge may be perfected by delivery before or after the advance is made" (*Lallan Prasad vs Rahmat Ali*, A.I.R 1967. SC, 1322).] B would have succeeded had she made the payment of £500 along with interest to A instead of M because the pledge in between M and A was valid only to the extent of M's interest in the jewellery, namely, £500 (amount of advance to B). Of course, on making the payment to M, B has a right to sue M for the redemption of her Jewellery.)

❖ **Note:** Read the following short note on various aspects of pledge. You may focus on the following questions while reading:

- What is the historical background of pledge and the understanding about pledge (securities on movables) when looked into from various angles and its development in the Roman, German, English and French legal systems?
- What is/are the merits and demerits of pledge as a security?
- How do you compare and contrast pledge in foreign legal systems with the pledge as it is incorporated in the Ethiopian Civil Code in light of the following points:
  - \* essential features, mode of creation and operation of pledge
  - \* the essential requirements for the valid creation and effectiveness of pledge
  - \* types of properties against which pledge can be created

Note that if you have sufficient understanding of the extract, you should be able to provide the basic summary of the extract in general and clear points which should provide answers to the above points in particular.

**Source:** (K.N Ryan, *Introduction to Civil Law*, 1962) (Footnotes Omitted)

## **A. Securities over Movables**

(a) **Possessory Securities.** The pledge is a form of security over movables known both to the common law, and to the civil law of France and Germany which corresponds in structure to the Roman law *pignus*. The creation of a pledge over chattels involves the agreement of the parties to constitute it and delivery of the chattels. The Code Civil requires the agreement to be evidenced by a formal document (Arts. 2074-5 C.C.); failure to observe this requirement has the effect that the pledge creditor obtains no preferential rights. Written agreement is not, however, necessary in either English or German law. The delivery of possession may be actual or symbolic; but fictitious delivery by *constitutum possessorium* does not suffice in German law.

The effect of creating a pledge is that the creditor obtains possession of the chattel so as to hinder any disposition of the chattel by the debtor, and to enable the creditor to obtain satisfaction of his debt from it by selling it. Roman law at first gave the creditor a right of sale only if this had been agreed between the parties, but later there was an implied right of sale unless it was excluded. The Code Civil prohibits private sales; the creditor must obtain a judicial decree directing sale by auction or forfeiture (Art. 2078 C.C.). The B.G.B. on the other hand accords the creditor a right of private sale, but hedges it round with stringent provisions designed to protect the debtor (Arts. 1228-48 B.G.B.). In English law, "a contract of pledge carries with it the implication that the security may be made available to satisfy the obligation, and enables the pledged in possession (though he has not the general property in the thing pledged, but a special property only) to sell on default in payment and after notice to the pledgor, although the pledgor may redeem at any moment up to sale".

The possessory liens of English law are another form of possessory security. There is nothing in the civil law which corresponds exactly to them as a class, though many of the situations where a lien arises by operation of law or by trade usage are ones where the civil law also is concerned to protect the creditor. Thus the code civil recognizes "special privileges" in favor of innkeepers, carriers, and persons who have expended money to preserve a movable (Art. 2102 C.C.); and a statutory pledge arises in German law in favor of an innkeeper and an entrepreneur who has manufactured or improved movables (Arts. 204, 647 B.G.B.), though the emphasis on possession is not so marked as in the common law.

(b) **Hypothec Securities.** In Roman law, hypothecs could be created or could arise by operation of law over either movables or immovable. The only form of real security over movables known to Germanic law, on the other hand, was the pledge. The Reception led to the introduction of the hypothec over movables, but as a result of the principles which regulated the transfer of movable property, it afforded no genuine security to the creditor at all. The bona fide purchaser of a chattel from the debtor took the chattel free from the creditor's hypothec. This rule was expressed in the maxim that "movables cannot be followed by hypothec". This maxim is incorporated in the code civil (Art. 2119 C.C.); but code went further and provided that only immovable could be hypothecated.

Nevertheless, movable hypothecs have been reintroduced into France by subsequent legislation. Inter alia, growing crops, hotel equipment and manufacturer's stock in trade may be hypothecated so that the farmer, hotelier or manufacturer can obtain credit without the economic dislocation which would result from a transfer of possession of the objects hypothecated. Hypothecs may also be created over boats and airships by registration of the hypothec.

In English law, the non-possessory liens and charges may be classified as hypothecs. This includes in particular maritime liens, bottomry and respondent bonds, and equitable liens. The civil and commercial codes do not always refer to hypothecs in relation to situations which give rise in English law to such liens or charges, but the creditor is generally privileged upon some basis. For example, the equitable lien of the unpaid vendor finds its counterpart in the special privilege imparted to the unpaid vendor by Art. 2102 (2) C.C.; a German statute of 1940 enables a "ship-hypothec" to be created by registration; and the German Commercial Code regulates in detail the security by way of bottomry.

(d) **Transfer Securities.** From a commercial viewpoint a pledge is not a satisfactory form of security over movables in all circumstances. A pledge requires delivery of possession of the res [thing] to the creditor, with the consequences that the debtor loses the use of the res until the money is repaid, and the creditor is bound to retain in good condition a chattel from which he can in general derive no benefit except its value as a security. French law has remedied this defect by reviving the hypothec over movables in certain cases. German law, on the other hand, has followed the English method of the bill of sale. In the security transfer (Sicherungsübereignung) the title to the res is transferred to the creditor, who undertakes to retransfer it when the debt is paid.

## **2.6. Summary**

The following are some of important points that have been addressed in the present chapter on law of pledge. The definition of pledge and its essential elements were discussed in the first section. The general definitions of pledge were reproduced for your consideration. The analysis of definition as provided in our law, its elements, and the shortcomings have been provided in detail. The essential requirements for a valid creation and effective enforcement of a contract of pledge also have been discussed in the chapter. As pledge results in rights and duties for the parties, the principal right and duties of the pledger out and the pledge have been pointed and discussed. The chapter also deal with the conditions for execution of pledge and the different modes of application adopted based on who is the pledge creditor. Note the execution through court proceeding, its justifications, and implications; the independent execution by certain pledge creditors (Banks), its justifications and implications as well. The chapter, lastly, provides extracts from various sources which, we believe, are important to evaluate the Ethiopian law pledge in light of the experience in other jurisdictions.

## **2.7. Review Questions**

Answer the following questions after reading the chapter.

1. How do you state the general definition of pledge? Can you enumerate the essential elements of the definition?
2. What do you think are the shortcomings in the definition provided by the Ethiopian law of pledge? How do you supplement the shortcomings if any?
3. Discuss the essential requirements for a valid creation and effective enforcement of pledge and the importance of these requirements.
4. Enumerate the principal rights of the pledgee creditor and the a pledger debtor (third party). What are the duties attached to the enjoyment of these rights?
5. Describe the execution of pledge through court proceeding, and the execution by the pledgee (Banks). Discuss the problems in these modes of execution and the possible ways out.

## **Chapter Three**

### **Mortgage (Security of Immovables)**

#### **Introduction to the chapter**

In this chapter we are going to consider another principal type of real security – mortgage. Mortgage is generally a relation between a creditor and his debtor or a third party on behalf of the debtor whereby immovable property or in some cases, special movable property is given as a security to guarantee that the debtor will perform his obligation on the due date and sufficiently. Mortgage has various aspects which, among others, include: definition, subject matter, essential nature and the requirements for a valid creation of mortgage, types of mortgage, various effects of mortgage on the parties to the mortgage including third parties, and the process of enforcement of mortgage. We will discuss these principal aspects of mortgage in the present chapter.

#### **Objectives of the chapter**

After completing the material in this chapter, the student should be able to:

- define mortgage as distinguished from other types of securities,
- explain the basic/distinguishing features of mortgage in comparison to other types of securities,
- list down and implement the principal requirements for the valid formation and operation of mortgage, and engage in drafting of valid contract of mortgage,
- enumerate the principal types of mortgage together with their purposes,
- handle/resolve issues which may arise from the relation between the mortgagor and the mortgagee on the one hand and their relations with third parties on the other hand,
- effectively deal with issues involved in the enforcement of mortgage under the general law of security as well as special laws applicable only to certain creditors like banks.

#### **3.1. Definition, subject matter, and essential features of mortgage**

This section is designed to introduce students to the most important type of security Mortgage. In this section you will have the discussion of general introductory points like the definition, subject matter, and basic features of mortgage as it is understood by different legal scholars.

### 3.1.1. Definition

The definition of mortgage, its nature and purpose as well as the essential preconditions for its formation, are all affected by the understanding of the society at different level of development of legal systems. For example, in the early Roman law, *hypothec security* (in old times equivalent to security over property, and through passage of time used as substitute term for mortgage) is known in general terms without making any difference between security on movables and security on immovable. However, later on in the major legal systems of the world, i.e. civil law and common law, fundamental distinction between securities on movable & securities on immovable regarding their importance & effects have developed. Even the understanding of scholars varies at different stage of the development of jurisprudence. In the modern legal systems, while security on movables is referred to as “pledge” and is regulated by an independent regime of law, security on immovable is given a different name as “mortgage” and is subject to essentially different rules, regulations and requirements.

All the same, for better understanding of mortgage as being different from other forms of securities, it is important to consider certain definitions given by scholars. Accordingly, in Black’s Law Dictionary it is provided that mortgage is a conveyance of title to property that is given as security for the payment of debt or the performance of a duty and that will become void upon payment or performance according to the stipulated terms. At least two important points can be drawn from this definition.

The first point is that mortgage is principally the conveyance (delivery) of title to property given as a security, i.e. it shows that the title to the property has to be transferred to the creditor temporarily until the date of payment of debt or performance of the obligation. The second important point in the definition is that mortgage extinguishes upon payment or performance of the obligation. This, of course, shows one of the accessory features of mortgage (in fact it also applies to other types of security also) which is one of the essential characteristics of mortgage.

To consider one more definition, Marcel Planiol, in his comment on the French Civil Code, provides that *mortgage is a real security which without presently dispossessing the owner of the property hypothecated, permits the creditor at the due date to take it over and have it sold, in*

*whosoever hand it is found and to get paid from the proceeds by preference to the other creditors.* From the above definition it is not difficult to understand the following basic points. Firstly, mortgage is a real security, i.e. the right that creates relation between a person (creditor) and a thing (the property given as security); and the right that can be enforced against everybody in the world. Secondly, the phrase *...without presently dispossessing the owner of the property...* means that creation of mortgage doesn't result in dispossession of the debtor thereby allowing him to use, enjoy, administer or do any thing he wants to do with his property. Thirdly, the phrase *...permits the creditor at the due date to take it over and have it sold...* indicates that mortgage by its nature entitles the creditor to exercise his security right only if the debtor fails to perform his obligation at the due date. Hence, before due date mortgage is not enforceable. Lastly, the definition provides for the principal rights of the mortgagee creditor. These are: the right to follow the property and satisfy his claim in whosoever hand the property may be found (the right of pursuit), and the right to be paid (to satisfy his claim) from the proceeds of the sale of the property in priority to other creditors (the right of preference).

Regarding the definition of mortgage in our legal system, there is no any provision dedicated to the definition of mortgage. However, it is possible to understand the essential features of mortgage, as stated in the above definition, from different provisions dealing with various aspects of mortgage as we are going to discuss it in the next sections (sections 3.2.1 up to 3.2.4 below).

### **3.1.2 Subject matter of mortgage**

In this section, we are concerned with the question “what can be subjected to mortgage?” History shows that at the early stage of development of the concept itself, mortgage could be created on any form of property whether immovable or movable. However, through an increasing development of the essential difference between pledge and mortgage as real securities and the distinction between movables and immovables, mortgage is created principally against immovable in the present days.

Our law also provides that mortgage principally charges immovable together with its intrinsic elements and accessories. However, our law also provides some exceptional situations where



special type of movables may be mortgaged. You can see this by closely reading Art. 3047 (2) of the 1960 Ethiopian civil code together with some provisions (Arts. 171ff from the 1960 commercial code where the law provides that business, which is special movable and subject to registration, can be mortgaged . Read also the following sub-section (3.1.2.2)

### **3.1.3. The Essential Characteristics of Mortgage**

The essential characteristic of mortgage we are going to discuss under this section may not be peculiar to mortgage. Some of these essential features may be shared by other types of securities. Hence, the essential features to be discussed in this section are those which may help in making distinction between mortgage and other real rights or rights in rem (those rights which create relations between a person and a thing). The principal characteristics are provided as follows.

#### **3.1.3.1. It is a real right**

Here the point is that mortgage is one of the rights which create relation between the creditor and the mortgaged property. It entitles the mortgagee creditor to exercise his security right against the property wherever the property may be. The following quotation from an article written by *Montejo (attached at the end of this chapter)* may explain this nature of mortgage in a better manner.

*“[Mortgage] is called ‘real’ because it consists of direct and immediate power over property or real estate. Unless the property belongs to a third party, the right holder can make his power effective regardless of the person holding it. It is real because it falls upon real property, which, as any real right of guarantee, secures the fulfillment of an obligation through the concession of direct and immediate power over some one else’s property.”*

Hence, while enforcing his right as a mortgagee, the creditor proceeds against the property encumbered with the right of mortgage; not against anybody.

#### **3.1.3.2. It is created against immovable**

In the old times, it is claimed that mortgage could be created on any form of property whether immovable or movable. However, through an increasing development of the essential difference between pledge and mortgage as real securities, at present, mortgage is created principally against immovable. More specifically, the writer quoted above also states that *the mortgaged*

*property must be alienable and immovable ..., it should be a property or a real right [like usufruct], which can be alienated and registered in the public registry ...*

In fact, in our law also it is provided that mortgage principally charges immovable together with its intrinsic elements and accessories. However, some exceptional situations where special type of movables may be mortgaged is not excluded in our legal system. A close reading of Art. 3047 (2) of the 1960 Ethiopian civil code together with some provisions (Arts. 171 ff from the 1960 commercial code indicate that business, as special movable which is subject to registration, can be mortgaged .

### **3.1.3.3. It is accessory to the principal obligation**

As was discussed in the section dealing with nature of securities in general, certain rights are referred to as accessory if they don't have independent existence or if they are not created for their own sake. In other words, if a right doesn't bring an independent benefit to the owner of the right or if it simply assists the enforcement of another principal right, then the former is referred to as accessory right. Accordingly, mortgage is one of accessory rights as it can not exist or can't be enforced in the absence of the principal right/obligation the performance of which it secures. Generally, mortgage is created as an alternative remedy for the creditor in case the debtor fails to perform the principal obligation.

The accessory nature of mortgage may be better explained by the following statement from the above quoted article: *A mortgage is considered as accessory because it is issued as a way to guarantee a principal obligation. In this way, all what affects the principal obligation, will also affect the mortgage.* Consider also the following statement by M. Planiol: *The mortgage, being the simple guaranty of a credit, follows the fate of the latter and can't subsist without it. The existence of a mortgage implies the existence of a creditor, whom it secures.*

In summary, it can be said that, obviously the existence of mortgage or any accessory right presupposes another principal right without which an accessory right can not exist or would be unnecessary. Stated otherwise, the extinction of the principal obligation for whatsoever reason, results in the extinction of the accessory right - mortgage. The enforcement of accessory right is

conditioned upon the failure of the debtor to perform his obligation. If the debtor performs his obligation sufficiently and duly, there will be no way (reason) to enforce the mortgage; above all, the most important point is that the creation of accessory rights, especially mortgage, doesn't result in dispossession of the debtor or prevention of the debtor from using, enjoying, and managing his mortgaged property.

Generally, it is because of this accessory nature or secondary importance of mortgage that it does not seriously affect the mortgaged property or the status of the debtor. The debtor will not be dispossessed of the property; he is entitled to continue using, managing, and creating all possible rights in favor of other third parties. It is possible to see that the accessory character of mortgage has been recognized in our law also when we consider the caption as well as the content of the following provisions of the 1960 Ethiopian civil code. Under the Ethiopian law of mortgage that deals with the extinction of mortgage, it is possible to see that the existence of mortgage depends on the existence of the principal claim. The cumulative reading of the first two provisions in the said section [Art 3109(1) and 3110(a)] of the civil code shows that registration of mortgage and protection of the creditor as such exists only as far as the claim exists. Consider the full message of the provisions:

***Art. 3109 – Principle***

*(1) A mortgage is extinguished if the registration of the mortgage is cancelled in the registers of immovable property.*

***Art. 3110 – Grounds for cancellation***

*Any interested party may require the registration to be cancelled where:*

*(a) the claim secured by the mortgage is extinguished;*

In other words, if the claim for the security of which the mortgage is created extinguish for any reason, then the extinction of the principal obligation guaranteed by mortgage is a sufficient cause for cancellation of mortgage which, in turn, results in extinction of mortgage.

Regarding the rights retained by the debtor on the mortgaged property, under the paragraph dealing with the right of the mortgagee to follow the immovable, the content of provisions like

Art. 3084 and Art.3088 of the civil code shows that the debtor (mortgagor) retains the possession, enjoyment and the power to create all real rights on his immovable after giving it in mortgage. This also shows that mortgage is accessory in its nature and doesn't as such affect the prerogatives of the owner on his property. This accessory nature of mortgage is recognized in other legal systems. In French law, a similar idea and in English law an understanding which is not very much different from the idea discussed above prevails. This is true from the following statements made by Planiol: "The accessory character of the hypothec [a Spanish word equivalent to mortgage in the present time] is also strictly maintained in French law. If the obligation to pay is void or is extinguished, the hypothec is also void or terminated, and hypothec passes with the debt secured." In English law also equivalent understanding exists where lien and charges (substitute terms for mortgage) are considered as a mere shadow, so to speak, cast by the debt upon the property of the debtor.

### ***Exercise 12***

*From the above two articles you can understand that if the secured principal obligation is extinguished, then it results in the extinction of mortgage which is created to secure the performance of such obligation. But, what do you think may be the reasons for the extinction of the secured obligation?*

#### **3.1.3.4. Indivisibility of mortgage**

The indivisibility of mortgage is one of the essential characters although it is not exclusive to mortgage. Almost all securities, by their nature, are indivisible. Indivisibility is reflected in two principal ways. The first is that even if the debtor pays a portion of the claim, he is not entitled, as of right, to claim the proportional reduction of the value of mortgage. The unpaid part of the claim shall be secured by the total value of the original mortgage. Therefore, even if the claim may be discharged in divided form, mortgage continues as undivided until the claim is paid in full. The second reflection of indivisibility is that for various reasons the immovable subject to mortgage may be divided, for example, among heirs. However, the mortgage over the divided immovable continues as undivided. That is, the mortgage continues to apply in its undivided form to each part of the divided immovable. Each part will be encumbered with the total value of mortgage for the payment of the total claim.

In our law also the same position as above has been adopted in the sense that mortgage is indivisible even if some part of the claim is discharged or the property itself is divided. The provisions of the Ethiopian civil code under Art 3055(3) and Art 3087 are relevant in this case.

***Art. 3055 – Reduction of claim***

- (1) Where the debtor has discharged one fourth of the debt, he may apply for the entry in the register to be corrected accordingly.
- (2) The creditor shall give his consent to the correction.
- (3) The fact that part of the debt has been discharged does not enable the debtor to require that part of the immovable mortgaged to be released

***Art. 3087 – Indivisibility of mortgage***

- (1) A mortgage is indivisible.
- (2) Where part of the immovable mortgaged is alienated or such immovable is divided, each part shall secure the full payment of the debt.

The former article provides that if the debtor discharges  $1/4^{\text{th}}$  of the secured claim, he can claim the correction of the registration regarding the reduction of the amount of the principal claim secured; i.e. he doesn't have the right to claim the release of the immovable in proportion to the reduced amount of principal claim. He can claim only the correction of the maximum amount secured. The later provision clearly states that if the mortgaged property is divided for whatsoever reason, the mortgage shall continue to apply on each part as undivided. Therefore, the indivisibility of mortgage is irrespective of the payment of the claim partly or division of the property.

**Exercise 13**

Mrs. Habiba has two buildings worth birr 80,000 and birr 60,000 each and situated next to each other under the same title deed. She is operating a restaurant in the first building while she has opened a supermarket, a boutique, and a cafeteria, in the second one. Mrs. Habiba borrowed birr 100,000 from a bank for the security of which the two buildings are mortgaged. On the due date,

she could pay only 50,000 and the date of payment was extended by agreement for one year. Now, Mrs. Habiba is claiming the release of the first building arguing that the value of the second building itself is sufficient to cover the unpaid loan. *Is she legally entitled to claim the reduction of the value of mortgage or release of one of the two buildings? Why or why not?*

Assume that Mrs. Habiba died before paying the remaining debt. Her two children effected the partitioning of her estate whereby each of them received one building and other properties. *Can any of the two heirs claim the building they have received to be free from the claim of the mortgagee creditor (the bank)? Why?*

If you have clearly understood the above discussion, the answer to the above questions is no. The first question relates to the first aspect of indivisibility of mortgage, while the second question relates to the second aspect of indivisibility of mortgage. If you fail to get the full answer, please read the above discussion again.

### **3.2. Importance of mortgage**

In this section, we are concerned with the utilities of mortgage as a security device. The issue here is ‘what makes mortgage preferable to other forms of securities?’ Mortgage has been recognized as the most effective and economic type of security for various reasons. The utility of mortgage is affirmed by Planiol in this statement: *Of all the securities which have been invented in favor of creditors, the most perfect is certainly the mortgage*. One may ask why mortgage is this much important? In the first place, like all other real rights, it entitles the creditor to proceed against property in case the debtor fails to pay the claim. That is, the creditor does not proceed against human being in which case there may be every form of resistance

Mortgage provides perfect protection not only because his right is against property, but also he can proceed against the property in whosever hand it may be. The second importance of mortgage, the point which is more relevant to the issue in this chapter, is that it does not, in anyway, result in the dispossession of the debtor. In other words, it does not affect the power of the debtor to possess, use, collect fruit, improve, manage, create rights for others or even dispose

the property. The debtor, even after the creation of mortgage, is entitled to all these prerogatives as an owner. Planiol puts the advantage of mortgage for the debtor in the following words:

*“It [mortgage] has not, as has pledge, the inconvenience of dispossessing the debtor. By mortgage, the creditor acquires neither the ownership of nor even dispossession of the thing which is given to him as security; the latter remains entirely, in fact and in law, at the disposition of the debtor...”*

Therefore, it is possible to conclude that mortgage not only secures the creditor in a better and effective manner but also allows economic utilization of the property as the debtor is entitled to continue in the possession, use, enjoyment or generally reasonable exploitation of the thing in the manner he thinks fit.

The above stated importance of mortgage has also been recognized in our law as it can be understood from the cumulative reading of the various provisions of the Ethiopian civil code such as Arts. 3059, 3081, 3084, 3088 which in general provide for the rights to which the mortgagee creditor is entitled as well as the rights reserved by the debtor. This will be discussed in a more detailed fashion in the last section of this chapter.

### **3.3. The essential requirements for the creation and enforcement of mortgage**

In the previous sections we have looked at the various aspects of mortgage including its definition, subject matter, essential features and importance. In this section we will turn to another aspect of mortgage, i.e. the essential preconditions for its formation or effectiveness. Accordingly, the point of focus in this section will be the formal and substantial requirements in the formation and operation of mortgage. Regarding the formality requirement, form, as defined in Black’s Law Dictionary, refers to “the legal and technical manner or order to be observed in legal instruments or in the construction of legal documents or processes”. In the following subsection we will consider the major requirements.

#### **3.3.1. Written form**

One of the most important manner or order to be observed in constructing legal documents is obviously, making the document in writing. This is the principal form to be fulfilled by various legal documents as prescribed by law. For various reasons, the written form of documents

governing various relations is highly recommended and prescribed by law in such relations. To mention some of the reasons, the written form clearly shows the intention of the parties to be bound by the relation they have created. If the parties reduce their words into writing and put their signature, this can be taken as a strong expression of their intention to be party to the relation and to be bound by it. Moreover, in case any dispute arises between the parties during the course of their relation, it will be easy to prove the terms and contents of their relations only if they have a written document which can serve as evidence. Therefore, because of the above stated and other importance various laws prescribe certain relations to be governed by written documents.

Mortgage is one of such relations between the creditor and the debtor which is required to be made in writing. This is because of the huge capital or money which it guarantees and the nature of property (immovable which has multifaceted economic value) it affects. In our law also the same understanding as above was recognized. Art. 3045 (1) of the civil code clearly provides that mortgage shall have a legal effect only if its creation is evidenced by a written document. This is a form prescribed by law and its non fulfillment makes the relation legally ineffective as the failure to observe a form prescribed by law results in the ineffectiveness of the relation (Remember the discussion on Contracts in General regarding the effect of failure to observe a form prescribed by law).

### **3.3.2. Registration**

Registration is one of the most important requirements in the effective operation of mortgage. Whether registration is simply a formal requirement or it is an essential precondition for the validity of mortgage itself depends on the approach taken by specific legal system. However, in most legal systems, starting even from the Roman time, registration is considered as one of the preconditions for the existence of the right itself.

All the same, whatever its status may be, registration guarantees two principal rights in the security of the creditor. *The first* is the right of priority in payment. That is, the right to be paid first from the proceeds of the sale of the immovable in case there are other creditors of the same debtor who are trying to enforce the payment of independent claim. *The second* is the right to follow the mortgaged immovable in the hands of third parties who acquire the thing subsequent



to registration of mortgage. The creditor can enforce his security right irrespective of the fact that the thing has been transferred to any third party provided that he registers his right of mortgage prior to the transfer. The above two rights secured by registration are often referred to as *the right of preference* and *the right of pursuit* respectively. Registration also serves the purpose of publicity. That is, it notifies all third parties what kind of rights and encumbrances already exists on the immovable. By registration, third parties will be able to know what kind of effective rights they can have on the thing and who can create these rights lawfully on the concerned property.

Coming to the position of our law, registration is one of the essential preconditions for the valid existence and effectiveness of mortgage. It is evident from the reading of Art. 3052 that mortgage starts to be effective only as of the date of registration. Moreover, the elements of security right of the creditor as discussed above (*right of preference* and *right of pursuit*) are also clearly recognized in our law. The cumulative reading of Arts.3057, 3059(1) and (2), 3081 and 3085, 3089 of the civil code shows that the creditor who registers his right of mortgage duly will be given priority in the payment of his claim. Such a creditor is also entitled to attach the thing in the hands of every third party while enforcing his security right. In other words, his priority right applies against other creditors as well as all third parties whose right is registered after the registration of mortgage.

### **3.3.3. Ownership**

Full ownership of the mortgaged property is a special capacity that has to be fulfilled by the person who is creating mortgage in favour of the creditor. This requirement basically mean that the debtor (mortgagor) is required to be the full owner of the immovable against which he is creating mortgage. It demands to be an owner in order to create mortgage lawfully. The basic reason for this requirement is that eventually the enforcement of mortgage entails the transfer of ownership to third party in order for the creditor to satisfy his claim from the proceed of the sale. That is why, in the words of Planiol, the creditor must be careful in checking whether the person who offers him a mortgage guaranty is really the owner.

This requirement of ownership has been strictly recognized under our law. Close reading of articles 3049 and 3050 of the civil code clearly indicate that unless the person is the owner who

is entitled to dispose the thing at the time of creation of mortgage, the mortgage can not be valid and enforced as such. An important point here is that even if the mortgagor acquires full right of ownership later on after creation of mortgage, this fact does not rectify the defect in the mortgage and it remains to be of no effect. Here, one may raise a question: what if the debtor has the right of ownership but it is common ownership like between spouses or what if the debtor is given the power of attorney to dispose the thing but not to mortgage it? This is an issue solved by various special laws. For example, consider Arts. 68 & 69 of the Revised Family Code which requires consent of both spouses for the creation of valid mortgage even if the property is registered in the name of one of the spouses. Also, consider Art. 2205 (2) of the Civil Code in the law of agency which requires a special agency for an agent to create valid mortgage on the property of the principal. Any way, our law is so strict regarding ownership that even if the debtor (mortgagor) acquires full right of ownership on the thing mortgaged after creating the mortgage, it doesn't validate the mortgage.

#### **Exercise 14**

Assume that Mr. Galdo is in possession of a will written by his father who died months ago. Mr. Galdo is expecting the liquidation of his father's succession to be closed soon. Mr. Galdo knows that he has been given a house under the provision of the will. He could not wait for the closure of the liquidation and borrowed birr 50,000 from a bank. He showed the document of will in which he is given full right of ownership on the house, but waiting for the closure of liquidation to register the house in his name. The bank agreed and they a concluded contract of mortgage.

*Can this contract of mortgage be valid if Mr. Galdo acquires full right of ownership, six months later, in accordance with the provision of the will?*

#### **Exercise 15**

Mrs. Shemsia has been living in a house for the past 13 years. She occupied the house when it was abandoned by a foreigner who left Ethiopia all of a sudden. She is quite sure that she will acquire full right of ownership after two years since she has been preserving/maintaining the house and paying taxes pertaining to ownership in accordance with the requirement of acquisition of ownership by usucaption. Recently, she entered into contract of mortgage on the house with a creditor from whom she has borrowed birr 80,000. *Do you think that the mortgage*

***will be valid if she acquires full right of ownership after two years through the registration of the house in her name?***

In both the above cases, in short, the law clearly states that the mortgagor should have full right of ownership on the immovable mortgaged before or on the date of creation of mortgage. Otherwise, the mortgage cannot be valid even if the mortgagor acquires full right of ownership soon after the creation of the mortgage. (See Arts. 3050 & 3051 of the civil code). Therefore, the contracts of mortgage in the above cases cannot be valid in any way. The mortgage remains as invalid even if it is certain that the mortgagors will acquire right of ownership in the near future.

### **3.3.4. Specification of the maximum claim secured by the mortgage**

Another requirement to be discussed is that the maximum claim secured by the mortgage has to be clearly specified in the document (contract) creating mortgage. The specification of maximum claim the payment of which is guaranteed has two principal purposes. The first is that it informs all third parties (other creditors, purchaser etc...) to know the maximum value of encumbrances on the thing. Secondly, it enables the debtor to create another mortgage on the same immovable in order to take additional loan from other creditors also. To make it clearer in the words of Montejo in his article referred above:

*...when the mortgage is issued the value of the property must be established in a definite way. Thus, any interested person will know, easily, safely and at any time, the maximum value of the obligation. Besides it will be guaranteed that the owner is entitled to transfer the property or acquire new resource through the imposition of other minor mortgages.*

The requirement of specification has been recognized under our law as one of the mandatory preconditions the non fulfillment of which makes the mortgage invalid. This can be read from Art. 3045 (2) of the civil code. Hence, to conclude in the words of Planiol:

*“The mortgage already existing should leave free and visible the portion of the asset value that they don’t absorb. All this excess should remain disposable in order to get new loans or new debts. On this point the interest of the debtor coincides with that of the creditor, because he is satisfied by the same means; the right of the first mortgagee creditor should be limited by the special character of the mortgage and made known to third persons by publication”*

### **3.4. Types of Mortgage**

Based on its source, mortgage may be divided into three principal types. These are: Legal Mortgage (where the source of mortgage is provisions of law), Judicial Mortgage (where the mortgage arises from the decisions of the courts), and Contractual Mortgage (where mortgage is created by lawful agreement between the mortgagor and the mortgagee).

The first two types of mortgage are designed by law in order to serve specific purposes recognized by law. Consider the following brief sub-sections.

#### **3.4.1. Legal Mortgage**

Legal mortgage is the case the mortgage rights for certain creditors arise from the provisions of the law itself without any agreement between the creditor and the debtor. In cases of legal mortgage the purpose of the law is to provide a special protection to certain creditors. We can see this by looking into the principal beneficiaries of legal mortgage where the law aims at according special protection. For example, as you can read from Art. 3042 of the civil code, an owner who sells his immovable is entitled to legal mortgage on the immovable he has sold as far as he is not paid the full price of the property. This is because, he is transferring to the buyer full right of ownership once and for all. Hence, he deserves to be paid full price as he is losing right of ownership on an exceptionally important property. Co-heirs also have the same protection since they are entitled to legal mortgage against immovable put in the share of another co-partitioner. If one of co-heirs is entitled to payment of compensation by the co-partitioner in case the latter is dispossessed of any property put in his share or held liable for the payment of any debt arising from succession, he can demand the payment of compensation against another co-heir by exercising his right of legal mortgage on the immovable put in the share of such co-heir.

#### **3.4.2. Judicial Mortgage**

This is the case where the right of mortgage for the creditor is provided by decision making organs, principally Courts and Administrative Tribunals. In the case of judicial mortgage, the purpose of the law seems to be ensuring the better enforcement of decisions rendered by courts or various arbitral tribunals. As, you all probably know, the toughest of all the stages in legal proceedings is execution of judgments. This is true because the judgment – debtor naturally

evades the execution of judgment against his property by disposing it or changing the ownership into another's name or by any other means. Hence, the law clearly states that courts or arbitral tribunals may ensure the execution of their decisions or awards by creating judicial mortgage against one or more of the immovables belonging to the judgment – debtor. You may read Art. 3044 of the civil code for the full message of the point.

### **3.4.3. Contractual Mortgage**

The third type of mortgage, the most prevalent in various forms of business transactions, is contractual mortgage. Contractual mortgage arises from clear/express agreement between the mortgagor and the mortgagee by fulfilling all the requirements as discussed above. Please read Section 3.3 which deals with the essential requirements for a valid creation of mortgage.

Lastly, an important point worth mentioning is that whatever its type may be, mortgage can have a legal effect only if it is duly registered. In other words, mortgage, whether created by law or judgment of courts or by agreement, has to be registered in order to have any legal effect. Hence, the beneficiaries of legal mortgage as well as judicial mortgage are required to register their mortgage in order to be protected as a mortgagee. This point is clear from Art. 3052 of the civil code which provides that mortgage, *however created*, shall produce legal effect only as of the day it is registered. Therefore, the requirement of registration applies to all types of mortgages.

### **3.5. Effects of Mortgage**

Like any contractual relations, the creation of mortgage results in rights and duties for the parties to the contract of mortgage. It will have a legally binding effect on the parties if it is created by fulfilling the requirements of the law. It may even affect the interest of third parties in certain circumstances. Now, what are the principal effects of mortgage on the parties to a mortgage contract as well as on third parties (including other creditors of the same debtor) who may have various relations with the mortgaged property one way or the other? We will discuss these effects of mortgage in light of the rights of the creditor, (mortgagee), the rights of the mortgagor, and the status of third parties in the operation of mortgage system.

### **3.5.1. The Relations between the Parties to Mortgage**

Our discussion in this and subsequent sections will focus on contractual mortgage as it is the most prevalent type of mortgage; even the provisions of the civil code on mortgage principally deal with the case of contractual mortgage. In the following sections you will study the effects of mortgage in light of the principal rights and duties of the parties to mortgage as it indicates the relations between the parties

#### **3.5.1.1. The Rights of the Creditor (mortgagee)**

One of the principal effects of mortgage is the right it creates for the creditor. Of course, mortgage itself is principally created to provide an alternative right (remedy) for the creditor in case the debtor fails to perform his obligation. Hence, the creditor derives two principal rights from mortgage. The first is the right to be paid from the proceeds of the sale of the property, in priority to any other creditor. This right is referred to as *the right of preference or priority in payment*. The second right of the creditor is the right to follow the property in the hands of third parties whose right is registered after the registration of the mortgage. This right is referred to as *the right of pursuit*. One important point about the rights of the mortgagee is that even if at the due date of the secured obligation the security right (mortgage) becomes ineffective (the mortgaged immovable may be totally lost or its value may not satisfy the whole claim of the creditor, etc.), the creditor is still entitled to proceed against other properties of the debtor as an ordinary creditor, i.e. on equal footing with creditors whose claim is not secured. In other words the loss of security right in no way entails the loss of the principal right. The above stated principal rights of the creditor are provided in Art. 3059 of the civil code as follows:

#### ***Art. 3059 – Principle***

- (1) Where the immovable is attached by the creditors of the mortgagor, the mortgagee may demand to be paid, out of the proceeds of the sale of the immovable, in priority to any other creditor.*
- (2) Where the immovable has been sold by the mortgagor, the mortgagee may attach it in the hands of the purchaser whose rights have been registered subsequently to the registration of the mortgage.*
- (3) The mortgagee shall in addition have all the rights of an ordinary creditor.*

*Now, let us look into the rights of the creditor as stated above.*

### **3.5.1.1. (A) The Right to be paid first (priority right)**

The priority right of the creditor is reflected in two principal ways. These are: the extent of priority (what are the claims covered by the priority?), and the property to which the priority right applies (the principal immovable, its intrinsic elements and accessories, improvements, and various compensations which may be paid in the event of loss of the immovable, etc.)

To say a few words about the extent of priority, first let us have a summary of the importance of registration as discussed in the previous section. It is a requirement under the general contract itself (Art.1723) and mandatorily under Art. 3052, that a creditor is required to register his right for the effective protection of his right as a secured creditor. A creditor can demand to be paid in priority to any other creditor of the same debtor (with due regard to Arts. 3081 & 3082) or any other third party who acquires rights in rem over the immovable mortgaged, only if he registers his right of mortgage before such third parties register their rights. Registration is not as such an ordinary requirement; the registration of the right of mortgage has to be made before third parties acquire/register any type of right in rem over the property mortgaged. To appreciate the importance of registration, please read Arts. 3057, 3059 (1) & (2), 3081/82, 3085 and 3088/89. An important issue here is, assuming that a creditor has duly registered his right of mortgage, “what is the extent (limit) of his priority right?” or “What claims of the creditor are covered by the priority rights and paid in the first place as such?”

Obviously, the first claim which the creditor can demand to be paid in priority to other creditors is the principal claim itself or the capital of the claim (see Art. 3076). This seems to be reasonable since the main reason for the creditor to enter into a contract of mortgage itself is to ensure the payment of the primary claim. Secondly, the creditor can also demand to be paid in priority the contractual interest to be calculated on the principal claim as can be understood from Art 3077(1). However, since interest is accessory claim which depends on and is derived from the principal claim itself, the right of other creditors should not be prejudiced by the priority of secured creditor for payment of interest. Hence, the law limits preferential payment of interest to the amount of interest calculated for the time not exceeding two years, see Art. 3077 (2) & (3). As a result, if there is an interest that has been calculated in excess of two years time, then as

regards the payment of such interests the creditor will assume the position of an ordinary creditor i.e. he can't claim to be paid such interest in priority to other creditors.

The third claim of the creditor which is covered by preferential payment is necessary expenses incurred for the preservation of the immovable and insurance premiums due by the debtor but which have been paid by the mortgagee. Here, in principle the duty to preserve the immovable is the duty of the owner (mortgagor). However, the debtor (mortgagor) may not be financially capable to preserve the thing. At the same time, it is obvious that the extent of the security of the creditor depends on the value of the immovable; hence, he has essential interest in the preservation of the immovable. Accordingly, the creditor may, in such situation, take over the preservation of the thing in which case he is entitled to be paid the cost of preservation in priority. In addition, there may be an insurance policy (concluded to insure the risks of damage against the immovable) which may terminate unless the premium is paid. In this case also if the immovable is insured, then creditor's security right extends also to the compensation paid in case the immovable is lost because of the materialization of insured risk; read Arts. 3069 of the civil code and Art. 684 of the commercial code. Hence, in conclusion, if the mortgagee creditor incurs costs in such cases (for preservation or for the payment of premium) then he can claim to be paid in priority to other creditors. Cost of proceeding for the attachment of the immovable, and legal interest (which will be calculated over the sum of principal claim + the agreed interest on the principal claim + necessary expenses + insurance premium), are the last claims which the creditor can demand to be paid preferentially.

Another aspect of priority right is the property to which the priority right applies/extends. In the first place, the priority right of the creditor applies to the immovable itself. When we say the immovable, it obviously includes the intrinsic elements from which the immovable is made and some objects which may be fixed to the immovable as accessories. Assuming your knowledge of intrinsic elements and accessories from your study of property law, any thing which may be considered, by its nature or by agreement, either as intrinsic element or as accessory shall form part of the mortgage; read Art.3065 of the civil code. However, an important point here is that the mortgagor may transfer some of the intrinsic elements or accessories to third parties separately from the immovable itself. Now, the question is, can the mortgagee creditor challenge



such acts of transfer, by the mortgagor, of intrinsic elements or accessories to third parties? In other words, can the mortgagee claim the attachment of the transferred intrinsic elements or accessories in the hands of the third party who acquired it independent from the immovable?

The law clearly provides, under Art. 3065, that the creditor cannot follow the intrinsic elements or the accessories in the hands of third party. This is because the intrinsic elements and the accessories, when independently considered, are principally movable and any body who acquires movables in good faith is entitled to legal protection as such. Hence, the mortgagee creditor cannot proceed against such third parties if the mortgagor transfers some of intrinsic elements or accessories to the third parties. This can be read out from Art. 3065 of the civil code.

However, the transfer of intrinsic elements or accessories separately from the immovable obviously reduces the value of the immovable and this in turn affects the security right of the mortgagee. Hence, the law provides alternative remedy for the mortgagee whose security right has been reduced by the transfer of the intrinsic elements and accessories of the mortgaged immovable. The remedy is that the creditor can demand the debtor to provide another property which can replace the intrinsic elements or accessories transferred to third parties. If the debtor cannot provide such property, the creditor has a right to demand immediate performance of the part of the principal claim which turns out to be unsecured because of the reduction in the value of the mortgaged immovable which resulted from the transfer of the intrinsic elements or accessories. These remedies may be based on Arts. 3065, and 3073 – 3075.

On top of the immovable, its intrinsic elements, and accessories, the law considers the priority right as extending to improvements that may be made to the mortgaged immovable. For example if a two – room house is mortgaged and later on the mortgagor adds another two rooms resulting in the increase in the value of the house from 30,000 to 50,000; the security right of the mortgagee also increases together with the increase in the value of the house since improvements on the mortgaged property is considered as part of the priority right of the mortgagee.

Another property to which the security right extends is the rent which may be collected from the mortgaged immovable. As has been stated elsewhere, unlike the case of pledge, in the case of

mortgage, the mortgaged immovable remains under the possession of the mortgagor. Accordingly, he is entitled to use it, he may give it in usufruct or he may lease it out for a third party. Moreover, he is entitled to the benefits he may collect from the immovable before the due date of the secured debt. However, once the due date of the secured obligation arrives, the debtor failed to pay it, and the immovable is attached to satisfy the claim of the creditor, any rent collected after the attachment of the immovable forms a part of the property to which the priority extends and, hence the creditor will have priority right on such rents too.

The last important point regarding the priority right is that the priority right of the creditor applies even against other creditors who claim security right on the same immovable. But, in case all the competing creditors are secured creditors, the priority right shall be enforced on the basis of the date of registration. Hence, the creditor who registers his mortgage first shall be paid first. The applicable rules in such case are provided under Arts. 3081 – 3083 of the civil code.

#### **3.5.1.1. (B) The right to follow the property**

Another important right of the creditor is the right to follow the property in the hands of a third party who acquires it after the registration of the mortgage. This right is sometimes referred to as *the right of pursuit*. As we have already seen, mortgage is a real right in the sense that the security right of the creditor is against the mortgaged immovable and he can apply for the enforcement of his security even if the immovable is in the hands of a third party who acquired it after the registration of the mortgage. This right has been clearly provided under Art. 3089 of the civil code which provides that the right of the creditor, in such cases, shall be enforced by disregarding all the rights of third parties which have been created and registered after the registration of mortgage. An issue that may be raised here is: What is the fate of such third party whose right has been disregarded in the enforcement of the right of secured creditor? We will come to this issue later on.

#### **3.5.1.2. The Rights of the Debtor (Mortgagor) on the Property after the Creation of Mortgage**

In the previous section we have dealt with the various aspects of mortgage namely, its essential features, preconditions for its valid formation, rights of the creditor, and the likes. Our discussion on these aspects of mortgage clearly indicates how much mortgage may or may not restrict the

right of the debtor on the mortgaged immovable. In this section we will consider the principal rights reserved by the debtor after creating the mortgage. Read the following paragraphs carefully to understand the situation of the debtor after giving his immovable as security under contract of mortgage.

In the first place, the accessory nature of mortgage shows that mortgage is the right of the creditor which will be enforced only if the debtor fails to perform the obligation. Until then the debtor continues to possess and exercise his right of ownership on the thing. In addition, one importance of mortgage as stated above is that it doesn't necessarily result in the disposition of the debtor of his mortgage property. This, in turn, allows the debtor to exploit his property in the manner he thinks fit even after giving it as a mortgage. Finally, registration of mortgage and specification of the maximum value secured by the mortgage are also to the advantage of the debtor. That is, registration indicates that the right of mortgagee is protected by the registration of mortgage. Hence, the creditor is not entitled to and it is unnecessary for him to take the possession of the property. This indirectly allows the debtor to exploit his property even during the term of mortgage. On the other hand, specification of maximum claim secured also enables the debtor to create another additional mortgage or other real rights on the property as far as its value can be sustained. These rights reserved by the debtor are expressed by Planiol in the following way:

*The debtor already derives great advantage from the rules which springs from the nature of the mortgage itself, since he keeps the possession and the enjoyment of his property, and even keeps the free exercise of his rights as owner, being still able to dispose of the thing, to alienate it, and to grant new rights of mortgage.*

Generally, all the aspects of mortgage are designed and implemented in a way that enable the debtor to make economic use of the property even after the creation of mortgage. The same approach is found in our law. Among others, Arts.3084 and 3088 of the civil code envisage that the debtor is entitled to create or enjoy all possible rights on the mortgaged immovable. The law is so strict that his powers, as an owner of the thing, to create every right for others or even to dispose the thing can't be restricted even by express agreement between the debtor and the creditor. In general, the law nowhere provides for the restriction of the right of the mortgagor to enjoy his ownership even after the creation of mortgage. This is so because the creditor is

protected and entitled to the enforcement of his security right through due registration of his mortgage.

### **3.5.2. The place of third parties in the mortgage relations**

As you may have noticed from our previous discussions, the mortgaged immovable may be transferred to a third party buyer as the law itself allows the mortgagor to do so; or the immovable itself may belong to a third party who mortgages it on behalf of the debtor. Hence, both the buyer and the third party mortgagor may be considered as third parties with respect to the principal relation between the debtor and the creditor. Now, the question is: “what is the fate of the third party who acquires rights in rem (e.g. ownership, servitude, usufruct, etc) subsequent to the registration of mortgage or the third party who mortgages his property for the debt of another person?” First let us consider the case of the buyer of mortgaged immovable. In the previous discussions we have seen that the debtor has full right to transfer the immovable to a third party buyer even after mortgaging it. On the other hand, we have also seen that the creditor who registers his right of mortgage duly is entitled to proceed against the immovable even if it is in the hands of third party. An obvious conclusion from this is that it is the duty of third party, before entering into contract of sale, to check what rights have been already created and registered on the immovable subject to the pain of being ousted from the immovable. You may still raise a question: *“Is there any protection for such third parties who are ousted from the immovable by the secured creditor or should we exclude them just by sticking to the fact that the creditor who is dispossessing such third party registered his right of mortgage first?”*

The law doesn't leave such party totally helpless and the third party is provided with some remedies stipulated under Arts. 3090, 3091, 3093, 3094, 3095 & 3097. Note that such remedies should be exercised without prejudice to the right of secured creditor; in fact, that is why the law attaches, to each of the remedies, some preconditions to be fulfilled by the third party before exercising the remedies. The first remedy is provided under Art. 3090. This is a remedy which the third party can invoke against the secured creditor (mortgagee) himself. The provision states that the third party assumes the position of the guarantor and then makes use of any rights or defenses available for a guarantor. Art. 3090 refers to Art. 1920<sup>ff</sup> of the civil code i.e. defenses for the guarantor. If the buyer of mortgaged immovable can show that the primary obligation is

invalid owing to the incapacity or mistake on the part of the debtor (Art. 1923), or that the primary obligation has been extinguished for whatsoever reason (Art.1926 [1]), or that the primary obligation has been extinguished through substituted performance (Art.1927), or that the primary obligation has been varied or date of its payment has been extended... then, he can defend himself against the mortgaged creditor. Moreover, the third party buyer can demand the mortgagee to proceed against other assets of the debtor if he fulfills the following preconditions cumulatively: He has to raise this defense prior to the debtor's declaration of bankruptcy [Art 1935(2)]; he has to indicate other assets of the debtor which are free from any litigation and possible to be attached [Art. 1936(2)]; he has to advance sufficient money to proceed against the assets or properties of the debtor, consider [Art. 1936 (1)]. The third party can demand also the mortgagee to proceed against the debtor within six weeks where the primary obligation has fallen due [(Art. 1938)]. Then, if the creditor fails to proceed against the indicated assets or against the debtor himself as indicated above, it seems possible that the third party can invoke Art. 1937 and 1938(2) to relieve himself of an obligation to surrender the immovable to the secured creditor - mortgagee.

Generally, the law considers the buyer of mortgaged immovable as a guarantor who can raise all possible defenses and defend himself against the action brought by the creditor who claims to have security right on the immovable. A very serious challenge against this protection of the third party buyer is that it changes the real right of the creditor to the personal right as the creditor is going to face all the defenses which may be raised against a creditor who proceeds against his guarantor.

The second remedy for the third party is provided under Art. 3093. Here, the idea is that if the third party can't avail himself of Art 3090 then the creditor (mortgagee) has the right to follow the property in the hands of such third party. Assuming that the immovable has been attached and sold in the hands of the third party buyer, this third party has a right to claim compensation, from proceeds of the sale, for the improvements that he has made on the immovable. He has also a right to become the owner of fruits that he has collected from the immovable prior to the attachment of the immovable in his hands (Art3093). Moreover, the third party is not liable for any loss or deterioration of the immovable unless the loss is because of his own fault or

negligence and unless the loss occurs after he has been informed that a proceeding has been instated for the attachment of the immovable. In such cases the fault or negligence of the third party seems to be against the creditor and hence the third party is liable for the loss or deterioration of the immovable.

The other possible remedy of the third party is the right to bring action for warranty against the debtor. By the time the immovable is attached in the hands of the third party, he can proceed against the debtor demanding the debtor to give guarantee that he will perform his primary obligation or at least he will return the price which has been paid to him by the third party. Hence, this is a right to demand security from the debtor that the third party will not be dispossessed of the immovable. If the third party is dispossessed, he has the right to be subrogated to the right of the creditor (Arts 3095 & 3097). The third party may pay the debt on behalf of the debtor before attachment of the immovable with the consents of the creditor to accept payment by the third party, but after attachment even without the consent of the creditor. Read Arts. 3095, 3097 & 1971 of the civil code. If he pays the debt, the third party cannot be said to assume the position of the debtor. Hence, merger can't be invoked against him.

The next point at issue is the position of third party mortgagor, i.e. where the immovable is given as security by a third party on behalf of the debtor. The law refers to such third party as guarantor under Arts. 3105 – 3108. Basically this third party is not liable for the payment of primary debt. It is only because of his good faith or because of his good relation with the debtor or the creditor that he is securing the debt of another person, i.e. the debtor. Hence, the liability of such third party should be limited. Accordingly, the law provides that the maximum liability of the guarantor (third party mortgagor) is limited to the immovable that he has given as security. In other words, if the value of the immovable that the guarantor has given as security cannot settle the whole claim of the creditor can proceed against the debtor himself or his property for unsettled part of the claim. Other properties of the guarantor are not liable under Art. 3105. He is deemed to have bound himself only for the value of the immovable which he has mortgaged and not his other properties.

Moreover, the third party mortgager can avail himself of all the defenses /remedies that we have stated above for any third party who acquires the immovable mortgaged from the debtor (Art. 3107). Hence, pursuant to Art. 3106 he can avail himself of the provisions of Arts. 3090ff. This right is, however, without prejudice to Arts 3107 & 3108. Read these two provisions together with Art 3094 & 3098.

An important point which should be emphasized here is the effects of these remedies on the nature, importance, and enforcement of real securities. As stated above in case of the remedies for the buyer of mortgaged immovable, these remedies for the third parties tend to affect the nature and importance of real securities, specially mortgage since the buyer of mortgaged immovable or third party mortgagor can raise against the mortgagee all the defenses available for a guarantor. The mortgagee creditor may face all the challenges as though his security is guarantee (personal security) while the creditor might have purposely chosen real security by calculating the importance and easily enforceable nature of securities on properties.

Regarding the above point one may consider a real case decided by one of the courts in Dire Dawa. In that case, husband and wife borrowed some amount of money from a bank. They were requested to provide security and they approached their neighbor to offer her house as security. The neighbor agreed to mortgage her house for the security of the debt of the couples and contract of mortgage was concluded between the bank and the owner of the house – the neighbor. On the due date, the debtors (the couples) failed to pay the money and the bank started the process of executing its mortgage right on the house. However, the third party mortgagor – the neighbor, applied to the court for the injunction of the sale process arguing that debtors (the couples) have another property which can be sold to cover the debt. The court accepted the argument and ordered the court to stop the process of sale of the house and to proceed against the property of the debtors situate in Addis.

Of course, the court enforced what the law says under Art. 3106 of the civil code. But, the point is that, had the mortgaged immovable been the property of the debtors the argument that the mortgagee should proceed against other properties of the debtors may not be acceptable. Hence, in the above case the mortgagee had to argue with the third party mortgagor and could not directly enforce the mortgage right because of the remedies the law provides for the third party

mortgagor. Therefore, if the creditor has to face challenges from the buyer of mortgaged immovable or third party mortgagor, it is difficult to see the benefit of real securities. Note also that the debtor is legally entitled to transfer the mortgaged immovable (Art. 3084 of the civil code) or to make use of mortgage offered by third party (Art. 3105 of the civil code) while the third party buyer and the third party mortgagor are also entitled to challenge the mortgagee by raising the above stated defenses.

### **3.6. Extinction of mortgage**

Extinction of mortgage is another point which needs consideration. In principle, as its existence and effectiveness should be evidenced by registration, the extinction of mortgage also should be evidenced by cancellation of the registration. Hence, cancellation of the registration is the main proof of extinction of mortgage – Art 3109. Cancellation may be sought from the court if the principal claim is extinguished or settled for one or the other reason (see Art.3110). Another important ground for cancellation is where the creditor renounces his right of mortgage as provided under Arts. 3110 (b) and 3112 (1). But, note that the renunciation of the mortgage doesn't amount to renunciation of the principal claim since the mortgage is simply to secure the payment of the principal claim [see Art. 3112 (2)]. Another important ground for cancellation is when the creditor makes the subrogation impossible. Where the mortgagor is not the debtor himself but third party on behalf of the debtor, such third party mortgagor has the right to be subrogated to the right of the creditor as can be understood from Arts. 3106 cumulative Arts. 3095 & 3097. Hence if the creditor makes this subrogation impossible the third party mortgagor has a right to demand cancellation of the mortgage. Read also Arts. 3113, 3114 & 3115 & 3116.

The last point about mortgage is regarding the sale of mortgage. Similar to the case of pledge, sale of mortgage is the first and the most important step towards the enforcement of security right of the mortgagee. However, the sale and enforcement of mortgage is not different from that of pledge as discussed in the previous chapter. This is true if you consider the provisions of the civil code dealing with mortgage where no detailed rules have been provided regarding the sale of mortgage except some general principles under Arts. 3060 – 3063. Hence, the student is advised to refer back to the discussion on the sale of pledge in the previous chapter.



### **3.7. Summary**

In this chapter we have considered a lot of important points on various aspects mortgage. To remind you some of these points: we have considered the definition of mortgage, the properties subject to mortgage, and the basic features of mortgage that it is real security, it is accessory to the principal obligation, and it is indivisible by its nature. We have also considered the importance or utilities of mortgage as compared to other securities, the essential requirements for the valid creation and operation of mortgage like the written form, registration, full ownership of the property by the mortgagor, specification of maximum value of the secured obligation. The principal types of mortgage depending on the source also have been discussed as including legal, judicial, and contractual mortgages. The chapter contains also a detailed discussion on the effects of mortgage as reflected through the rights and protections provided for the mortgagee and the mortgagor, and the place of third parties in the mortgage relations. Lastly, the execution of mortgage as well as the extinction and its reasons are also discussed.

### **3.8. Review Questions**

1. State the definition of mortgage and explain the essential elements contained in the definition.
2. What are the basic characters and utilities of mortgage as compared to other forms of securities?
3. Enumerate the principal requirements for the valid creation of mortgage and explain the importance and the effects of non fulfillment of each of these requirements.
4. Discuss the principal types of mortgage, their distinctions, and specific purposes of each of them.
5. Critically analyze the rights and protections to which the mortgagee and the mortgagor are entitled, and the place of third parties in mortgage relations.
6. Explain how mortgage may be executed and the principal reasons for the extinction of mortgage.

## **Chapter Four**

### **Other ‘Security Devices’**

#### **Introduction to the Chapter**

This is the last chapter of the material. In this chapter, we will address various forms of contractual relations which, one way or the other, serve the purpose of securing the performance of certain obligation. The law does not clearly consider these contractual or legal relations as constituting security and address them as such. That is why the title of the chapter is put in quotes. Hence, an important question which the students should keep in mind through the discussion in this chapter is: ‘Are these relations created to secure the performance of an obligation; stated otherwise, do these relations really constitute security devices?’ This question is left open for the students to make further investigation and develop their own opinion by making use of their knowledge of the principal securities discussed in previous chapters. Hence, we will give you only general indications in the following paragraphs.

The main relations to be addressed in this chapter are: Antichresis (as provided under Arts. 3117<sub>ff</sub>), Assignment of rights (as provided under Arts.1962<sub>ff</sub>), Sale with ownership reserved (as provided under Arts. 2387<sub>ff</sub>), Sale with the right of redemption (as provided under Arts. 2390<sub>ff</sub>), Lien rights in various circumstances (laws).

It is also important to note that the case of Antichresis is not subject to the question stated in the first paragraph. There is no doubt that antichresis can be created only to secure the performance of a given primary obligation. The main reason why the case of Antichresis is included in this chapter is that when you consider the nature, creation, and effects of antichresis, it is similar to and serves the same purpose as mortgage except some minor differences. Hence whether it constitutes separate type of security may be questionable. In general, the main objective of this chapter is to motivate the students to make further investigation whether the above referred relations really constitute security devices.

## Objectives of the chapter

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

- give definition of antichresis,
- explain the essential features, and effects of antichresis,
- describe the differences between mortgage and antichresis,
- explain those contractual or legal relations which are allied to security devices,
- critically evaluate whether these relations are created to serve as securities.

### 4.1. Antichresis

In the following sub-section we will consider the major aspects of antichresis such as: the definition of antichresis, the basic requirements for the creation of antichresis, the essential characters of antichresis and its utilities, the distinction of antichresis from other securities, specially mortgage.

#### 4.1.1. Definition

Antichresis has been defined under our laws as ‘... a contract whereby the debtor undertakes to deliver an immovable to his creditor as a security for the performance of his obligations.’ You can see the essential elements of the definition of antichresis from the above statement provided under Art. 3117 of the civil code. The first is that antichresis is a contractual relation between the debtor and the creditor. This signifies that antichresis arises only from contract. It cannot be created in any other way unless there is clear contract between the debtor and the creditor with an intention to create antichresis. Second, antichresis can be created only against immovable. Third, the principal purpose of antichresis is to secure the performance of an obligation. The fourth and the most important one is that the immovable will be delivered to the creditor.

#### Exercise

Evaluate the above definition of antichresis in light of your knowledge about pledge and mortgage from discussions in the previous chapters.

The above stated definition and the essential features of antichresis, which will be discussed later on, indicate that antichresis is simply a special type of mortgage. The subject matter, the

requirements for creation, and the main purpose under contract of antichresis is not different from that of mortgage except for some differences which are introduced to serve certain purpose.

#### **4.1.2. Creation**

The requirements for creation are almost similar to those which we have discussed in the case of mortgage. As you can read from Art. 3118 of the civil code, all the requirements for the valid creation and effectiveness of mortgage shall apply to contract of antichresis. Hence, it should be in the written form, it should specify the maximum claim secured by the contract of antichresis, the person (the debtor) who provides antichresis as a security needs to have full right of ownership on the immovable, the contract of antichresis should be registered duly (Read Art. 3129). However, note that there are certain differences even regarding the creation and effects of antichresis as you can read from the following section.

#### **4.1.3. Distinction between antichresis and mortgage**

The most important difference is that in case of ordinary mortgage, there is no transfer of possession of the immovable mortgaged and it remains in the hands of the debtor. But in case of Antichresis the possession of the mortgaged immovable will be transferred to the creditor, see Art. 3117. To this extent there is similarity between pledge and antichresis. However, unlike the case of pledge, in case of antichresis, the transfer of possession to the creditor will entitle him to the right to make use of the mortgaged property. As you all know, in the case of ordinary mortgage the creditor doesn't take the possession of the immovable let alone using the immovable. It is this transfer of the immovable which changes the relation between the debtor and the creditor, from ordinary mortgage to special type of mortgage (antichresis). That is, before transfer of possession of the immovable or once the immovable returns to the possession of the debtor, then the contract of antichresis remains to have the same effect as mortgage (Read Art.3121 of the civil code).

Once he takes possession, the creditor is entitled to use the immovable. The use that the creditor derives from the immovable replaces the interest to be calculated on the principal claim, see Art. 3124 of the civil code. No other additional interest can be calculated on the principal claim on top of the use the creditor drives from the immovable. But, can we say that always the use that

the creditors derive from the immovable mortgaged is proportional to the interest that could have been calculated on the principal claim?

The second principal difference is that the creation of antichresis has to be necessarily supported by contract. Antichresis can't be inferred from the conduct or any prior relation between the debtor and creditor or from the provisions of the law. There should be clear agreement for the creation of antichresis in accordance with Art. 3119 of the civil code.

In conclusion, except the above stated differences, you can see from the provisions on antichresis that it is essentially similar to ordinary mortgage for its creation, registration, effect, and extinction. You can even see that like all other securities, antichresis also has accessory character from the reading of Art. 3128. The principal reason why the creditor and the debtor push one step forward and concludes contract of mortgage in the form of antichresis is to stop the calculation of interest on the principal claim by entitling the creditor to have possession of the immovable and make use of it in place of the interest.

#### **4.2. Affiliated Cases**

As we have indicated in the introduction to the present chapter, there are certain relations which, at least indirectly, have the purpose of securing the performance of an obligation. Consider the following statements. **1.** A creditor who, for consideration, assigns his right to another person shall guarantee the existence of such right at the time of assignment (Art. 1964 of the civil code). **2.** Any person (seller) who sells a thing and delivers it to a buyer may reserve the right of ownership on the thing to himself until the payment of the full price of the thing (Art. 2387 of the civil code). **3.** Any person (seller) who sells a thing and delivers it to a buyer may reserve to himself the right to buy back the thing within a certain period of time (Art. 2390 of the civil code). **4.** Any person who has been serving as an agent of another person (the principal) is entitled to keep the possession of all the objects of the principal which has come under the possession of the agent to carry out his agency. Now, the question is, can we consider all the above cases as security devices although the law does not address them separately as such?

### **4.3. Summary**

In chapter four, we have been considering some issues which are accessory to the principal types of securities. The main issue intended to be addressed is whether security relations are limited only to the principal types of securities as discussed in the preceding chapters or there are other forms of relations which take a form of security. In dealing with this issue, the present chapter has considered antichresis as a security relation attached to mortgage with some special features; assignment of rights, sale with ownership reserved, rights of redemption and others also in light of the general nature of securities and the significance of these relations as security devices.

### **4.4. Review Questions**

1. What basic characters, do you think, are shared between principal types of securities and the “securities” as discussed in chapter four?
2. What do you think is the principal purpose of creating antichresis as distinct from the ordinary mortgage?
3. Do you think that there are some basic features missing in case of securities discussed in chapter four to be considered as fully constituting security devices?

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