Lecture note 2 (April 6)

Major Departures (modifications) of the new code

In the old code the definition of what or the lists of activities considered as commercial was meant to be **exhaustive**. If you are interested to carry out activities you might consider as commercial before the new code, of course you will be turned away. Mind you commercial activities are not **static** by their nature. Their progress in norm as well as in their technology almost makes inevitable the creation of new activities. If you take for example the internet, it took off in early 1990s. Mind you am not saying that they were nonexistent before this. In fact they used to be owned by the US department of defense, as far back as 1960s we had the internet. Now the internet has introduced new type of commercial activities that are carried out for gain.

My goal for now is to introduce you to the some of the changes made from the old code. Unlike the old code, the new code's list is meant to **be indicative or illustrative**. In other words if you come up with an activity you can carry out for profit you can request for registration and licensing so the ultimate decision falls in the hands of the concerned authority. Ministry of trade or some designated organ. That's one primary departure. When we look at article 5 of the old code, there is a list of about 20 activities which to be regarded as a trader. The question here is that for example if we leave commercial activities that came following the internet; even the traditional ones are not listed. One reason for this could be the fact that the code was drafted in a hurry. Since the original drafter was trying to come up with a comparative code that comprises laws not only from France but also from Syria, Germany and so on. And to the extent relevant, it used the Anglo American laws for commercial associations. Because of his death and the need to have the law it was proclaimed first as a decree and then became a proclamation even if it had many gaps. One of the problems was for instance if we look at business organizations there is a distinction between commercial civil organizations and commercial organizations. Such distinction is also found in the new code. But the relevancy of it is questionable because if we see its philosophical distinction as a civil company, traditionally in a continental legal system, provides professional services. Examples include accounting, auditing, medical services and so on. But, when this is one of it, in some places they will tell you there are a commercial activity and a noncommercial activity as well. There is however no distinction in terms of consequences starting from registration and licensing to an obligation to keep accounts specifically financial records, all of them are required to fulfill this. Deep down we do not have an answer as to their difference because of faulty drafting. The code tried for the commercial activities to be exhaustive. the drafter tried to include as many activities as he could. But there are some writings which indicate that the professor wanted to exhaustively list the activities considered as commercial at the time and then leave it to be open ended. But when we look at art.5 the activities are **exhaustive**. Thus the concerned authority will look at this list and turn you back

saying it is not listed. This is another point of departure that is rectified by the new code. In addition to adding the number of activities it also recognized activities done by the use of the internet. Since commercial activities are dynamic listing them exhaustively is not possible. What the new code did is thus to leave it open ended. Before the coming of this new code there were laws that made some activities as commercial activities such as the antitrust laws, law of licensing and registration. The antitrust laws added professional services and the like.

The other point is the lists in **article 6, 7 and 8 are expanded**. This are articles making a small scale artisan works as not making the person a trader even if those same works if done in a large scale made them a trader. Mind you there is a consequence in being labeled as a trader starting from keeping accounts to registration and licensing, to bankruptcy process and obligations on third parties, and also taxation. Thus those in arts 7, 6 and 8 being exempted from being a trader has its own effects. Activities done by artisans like fishing, constructions when done by artisans and on an artisan level they are exempted from being a trader. These are done in a household level.

Now about the consequence of being labeled as a trader one modification is in **the obligation of keeping accounting and financial record in art 69 and 70**. There is no unified authority to keep records accounting and auditing. This has its own consequences one of the most important one has to do with tax. In principle there is a proclamation called Financial auditing proc. No 847/2006. What the new code did is that it made it an obligation of every trader to keep accounts and financial records. It modified the task that used to be done in a piecemeal level. It gathered together and listed the primary principles and principal rules. The details are left to the respective proclamation and regulations that is issued regarding such matters. This is a significant departure. There is a consequence of keeping financial records and accounts and it requires it to be kept for a minimum of 10 years. There are consequences as registration to the primarily is fight information asymmetry. These financial records then serves as access to information primarily in dealing with third parties. You might explore how much of a debt that particular company or trader has before you invested your money on it or in case of security.

So you have arts 71 and 72 regarding whether or not these records serve as a proof for or against the trader. So any claim that might raise against him these financial records might be served as evidence or he might use it as a proof. These two provisions are new and show that financial records can serve as proof since claims are inevitable. The other is art 65 that puts a computer recording system that allows their use. It allowed keeping accounts in modern technologies. As we know we do not expect the old code to have this.

The other is **on registration and licensing**. Registration is more of an administrative task while what licensing does is provision of information. There are particulars that should be included in a registration especially more relevant with business organizations esp. Companies. These particulars especially starting from investors or third parties those who lent you money and other contractors they will trace your registration. As far as economists are concerned the producer has

more information thus the consumer to reduce the information gap. This is what you do to reduce information asymmetry since the other are found in antitrust laws. Thus in art 86-123 has made the laws that were found in a piecemeal level. Publicity was required by the old code to obtain legal personality. The rest of the matters are left to registration since they are prone to change. This is better than amending a code.

Licensing helps in administrative control. So it is primarily part of administrative law left to the administrative organ. This has been excluded from the new code to be dealt by administrative law. Book one deals with traders and businesses. A significant change is found in business organizations specifically companies. The new code still calls them 'Medebir' found from art 124-209. Before the coming of this code, significant elements were modified, repealed and were even replaced. For instance art 135-139 old code was replaced by 980/2008 about trade names the significant problem used to be these and some other articles were found in trade mark, articles discussing on how businesses acquire intellectual property. These were articles which had huge gaps. The other is provisions on pledges, business as incorporeal movable, securities the various types. With this regard business as they can be sold they can also be given as a pledge. There is a proclamation regarding this 1149/2008. Thus articles regarding business from art 175- 189 some were modified, repealed and replaced. The new code has avoided these scattered laws. The other is regarding trade mark and various intellectual properties. The old code has scattered laws with this regard which is fixed by the new code. Some of these were accumulated; some were fixed to retain their consistency. Of course there are separate proclamations about trademarks but the code tried to give them sense.

There are still drawbacks in the definition of business. As we have discussed earlier the primary element of business is good will. The protection of this, especially before the expansion of the Anglo American legal tradition was primarily, there is a law of unfair competition in the traditional legal system. It used to have only 4 articles basically it was all about the defamation of a good will. For example, misleading advertisement. These articles stated what unfair competition is, what constitutes it and basically defamation of a business. When it comes to the consequence of such behavior it takes you back to the court system with tort. Before the law of anti-competition the law with this regard was scant having only four articles. Because of this it was ended in terms of the activities regarded as anti-competitive behavior. The law had its own section in the proclamation. As we know there are two traditions with regards to the protection of good will. The primary element of business is trade mark, the face of it being trade mark. In the Anglo American tradition this notions are found in trade mark. You have to remember the justifications we have discussed about last class. The property based, legitimate expectation and the economic justifications. In economics there are three kinds of goods. The first one is search goods. Simply by looking at them, you can identify the defect by reasonable examination. No need of more investment, no need of significant search cost. The second is experience goods and services. It is different from the others in that they are discovered by examination once you consume them. Once you consume them you can understand the problem. Relatively there is less

potential problem that creates information asymmetry. The third and the most problematic is solver craven goods and services. These are mostly services of high quality. Unless you are trader, physician, you cannot get benefits. Basically standard model suggest fighting with this. The rational choice theory assumes for example in buying a used cars. They assume that we believe all of the cars are average in this situation. If we divide them in to three the one with 500 dollar, the other with 300 dollar and the clunkers with 100 dollar, then, they conclude that since the assumption is that the cars are average from the beginning no one will pay 500 or 300 for that matter. Ultimately the market will end up in the process with the clunkers the worst cars. But if you had information about the good character of the first cars you would have bought them. This shows how information asymmetry affects the market and the business. The reduction of search cost makes the market more competitive. Even if this all justifications are not efficient by their own we use them.

Unfair competition has been made part of anti-competitive laws.

Under the old code there used to be a law restricting businesses based on gender.

Lecture note 3 (April 13)

We know that in law there are physical persons and juridical persons. Now what does **professionall**y mean? Among other things you may think whether or not this requires training. For instance if we take sole proprietor does he need to attend a school of some sort? Now in general training is not required although there are some commercial activities that require certification. These are typically related to commercial services that one might provide as we shall see in the new code, are those services specially meant to assist other services. Traditionally these are carried out by partnerships specially limited partnerships.

At this stage you might not have the knowledge to give this example but when we look at both the continental and Anglo American legal traditions, partnerships are usually their behaviors that they choose for legislation legal tradition. These seems to be anticipated when the new code is revised. Now a sole proprietorship as I said except for certain type of commercial activities does not require to be certified educationally certified or otherwise certified**. Professional** means the individual ought to carry out that particular activity as a **source of livelihood.** That is one**.** There are of course exceptions to this. Secondly, it implies **repetition**. For example suppose as a student you go back and engage in the sale of certain product now the question is does that make you a trader. Or you carry out some sort of service let's say you engage in hair dressing activity. In principle the answer is **no.**

The other element in this particular term is **repetition aspect** it has to be carried out for certain period of time. Now the question one may raise is there are of course, suppose you have a professional club suppose selling products to its fans. Does that make them traders? This very issue was brought to litigation in European court of justice whether or not a football club can be considered to have been engaged in trade and basically commercial activity. Whether or not its primary purpose is entertainment. You may have also heard one particular famous case the Bosman case. It changed of course for footballers' the right to leave their club without payment which used to be the practice before. Now the court had to be turned as a primary issue whether or not the court had jurisdiction. Under the European court of justice you can only exercise jurisdiction if the activity in question falls within of course the treaty that you established union, practically an economic union. So the answer is if what the football clubs do is commercial therefore economic then the court can adjudicate the case. Now of course if their primary purpose is entertainment Bosman cannot proceed with his complaint. You only need to go through art 5 of the new and the old code.

The other primary test is whether or not the activity that a given person gives is body corporate or physical person is there a **profit motive**. Professionally and for gain. A profit motive is what sets apart cooperatives and other associations from traders. But of course you may come to find that professional associations, cooperatives sometimes may engage in any of the activities listed there. But that is not their primary motive or purpose of making profit. **The general rule is as long as what they carry on as primary activity and its purpose is not making profit they will not be considered as traders**. There are of course provisions that we shall see. So if you look at the proclamation on cooperatives their primary purpose is not making profits. The same goes to professional artistic associations and other associations which are largely governed by the civil code than the commercial code. If you look at art 4 it gives you an idea of those which are exempted from being traders even if they do the works stipulated in art 5. Now the question is what if they have shares in companies let's say what will be their status. We have another provision sub article 2 which makes the laws applying on trader to apply on them too. If you go through the old code one of the problems you will encounter is as to what happens to these types of associations who happen to have shares in company and membership interest in partnerships. What happens if a given company is a holding company that has a substantial amount of share in other company, does that make it a trader? The new code makes it clear that as far as holding companies are concerned it considers them as a trader. And the provisions applying to a trader are applicable to them too. Including keeping account books and registration. Sub article 3 also states that this provision apply to public enterprises. There are of course special provisions for public enterprises but the trend appears to be governed by the commercial code. Of course being in a special positions there are certain special provisions. I think there is separate course for public enterprise.

Now let's move on to some of the activities listed and you will find many of the activities are the same as the old but new developments in technology and economics have brought new

commercial activities. You will notice that these are new and anticipated. Leasing, those with large scale in sub 4, ware housing, those done other than partisans and the list goes on. But the list is not exhaustive but illustrative leaving a place for new developments. The administrative organs are the ones responsible to give licenses for emerging activities. An exhaustive list is mostly seen in continental legal systems. For instance in the case of a company the minimum capital, the company's minimum amount is stipulated by number but it has its own defects as we shall see in the future. Activities done by partisans are excluded from the list in art 6 meaning the provisions of traders does not apply to them. As a cross reference you can look at sub articles 4,5,31, 32, 33, 35. The obligation to keep accounts, registration and licensing and process of bankruptcy when it is warranted. The code basically states that they are done in small scale. The question that could be raised here is how we should govern jewelry houses. These issues largely are given to the discretion of the administrative organs. There is no law that states just because a person works only with his family and does not employ others he is exempted from being labeled as a trader. These are just indicators and they are not necessarily pure tests. The authority that is given the power of registration and control decides on such matters practically.

Art 8 exempts farmers who do small scale farming and animal breeding. Sub article 2 of this article also exempts those of persons, cooperatives and or such associations from being a trader if they do the activities found in sub article one.

Article 9 talks about holding companies these are when a company has a share in other company. Even for that matter two companies could have shares in each other's company. For this reason to be labeled as a trader, such companies don't need to carry out the activities listed in article 5 directly by themselves. It might not provide goods and services primarily. Companies that provide the same products and services selling the other's product still make them traders. But as we go along we will talk about the problems that follow this such as conflict of interest, and an interest to protect minority shareholders and the like.

Now something that should be noticed is in article 10 the issue of commercial and non-commercial business organizations. These are excluded from the new code. For example in France there are commercial companies and civil companies. Such distinctions are common in the continental legal tradition. Commercial companies are those which carry out activities listed in article 5. But civil companies are those involved with activities which have public interest aspect. Commercial services, Legal services, medical services it is assumed that commerce is not their primary interest in the continental legal system. As we have said earlier the code was drafted in a rush and has tried to assimilate laws from different countries. Thus they have not made the difference between the Anglo American and Continental tradition consistently. The difference between commercial and non-commercial organizations cannot be found exactly. The primary difference found in continental systems includes cases of licensing and registration where commercial organizations were obliged to obey. The second one is the case of accounting and insolvency where the commercial organizations are required to go through a bankruptcy process. Only commercial companies go through bankruptcy. The other issue is concerned with

the obligation to keep accounts or financial records. This has tax implication in itself. Civil or non-commercial companies are not required or are not largely required to go through such process. Now when we come to our laws there is **no difference as to the obligation of any professional services to be licensed and registered and to keep accounts of their yearly sales and buys**. This also serves for tax purposes by keeping account statements and books. Subsequent proclamations did not continue those distinctions. By the new code ordinary partnerships are not allowed to carry out commercial activities in art 5. General partnerships and limited partnerships in case of purpose and actual functions a share company that does not do the activities done by those it is left to operate as a sole proprietor. That is why there are many complicated provisions. Such gaps are found because the code was not consistent enough in following the traditions of the German and France model. In their case such partnerships as far as they are concerned are considered to provide professional services only and not a commercial one. From its start partnerships in general you won't find them as frequently as private companies and share companies. But ordinary partnerships are found in researches in the early 1960s. By excluding these the concept of limited companies is included that give those services privately. **Thus the old codes distinction of commercial and non-commercial is irrelevant and is not found in the new code.**

Now the next issue is with regards to who is carrying on a trade. There are distinctions as to carrying on business. the obvious one being with regards to capacity. Incapacity may stem from various sources age as minors this is subject to emancipation, judicially interdicted persons these are found in article 10. We also have legal interdiction this is when a person is prohibited from carrying on commercial activity. Well there are also provisions with regards to tutors appointed to this individuals can carry on trade which is also prohibited. Article 12 talks about the possibility of emancipation. The other question is with regards to third party's interest. Article 13 talks about a situation where this cannot be used as a defense where the minor has been registered as a trader by misleading the fact that he is a minor. This is because commercial register is the document that you refer to when in you enter into such transaction. In reality even if there is incapacity he cannot use it as a getaway from his obligations.

The other is about transactions made by married couple. Articles that talk about married couples have a reason behind. One is if it is not stated otherwise the transactions carried out by one of them is considered to be carried out jointly. Because there is a possibility of private property in matrimony. This is concerned with the common estate of the parties. The code then puts a notice requirement since it is one of the best signaling mechanisms. It has its own effect especially with regards to third parties. The traditional practice is to register such significant events and information such as this in the commercial register. One requirement of good faith is knowledge when the party knows of such disputes and carries the transaction any the question here becomes whether or not he can proceed with the argument that such information was not registered. This issues has an implication in that if the trade is owned jointly then the consequences will be faced equally by the parties not only the rights but also the obligations too. The other joint owner can

raise the fact that he objected the transaction from the beginning and that his interest in the matrimony should not be encumbered. The person transacting can face an argument if he knew about the objection before the transactions. If there is knowledge the third party cannot claim this right. Article 17 gives a way for the objecting spouse to set aside his objection if he thinks his objection will affect the interest of the family. This again has to be included in the commercial register. Article 18 makes it clear that if the third parties do not know of the objection the objecting spouse might be obliged to pay from their common or private property. But if the objection is included in the commercial register only the transacting spouse will be obliged to pay from his private property. Article 20 states that if the spouses cannot prove the fact that they work as an employee of the other spouse then any debt that is entered into by one will be paid. The reason for the objection is that the payment could extend to not only the common property but also the private property of the spouses. This fact should be included in the commercial register. A third party transacting in good faith will assume that the business is jointly owned. And when he is transacting the security is not only the common property of the spouses but also the private property too. The risk assessment of the third party will be affected by the amount of security the spouses have. Thus the argument that could be raised is that since one is only an employee only the transacting party's private property shall be taken as a security.

But since this is an essential issue why is registration not required. In law one of them is an employee of the other. In practice the business is considered to be the common property of the two. The one working as an employee should be the one who should prove the existence of such fact. The question here is doesn't the spouses notify the fact that the business is private property and not the common property of both. Usually it is expected to be objected by the non-transacting spouse. Thus it is expected to be notified by the non-transacting party saying this does not concern him/her.

The other is the right to trade. One thing they should have fixed was potential restriction as to capacity and potential problems that may rise in matrimony, marriage. It could have been designated as an exception in the provisions concerning right. Except for activities prohibited by law like unfair competition everyone has the right to engage in trading activities. Exception to this right includes incapacity. Article 22 stipulates that some might be prohibited from engaging in some activities by law. Some has been put as an illustration for example art.2. The article states about incapacity. This is why it is said that they should have been put together.

Especially for services those related with professional services, one requirement is starting from training and might also require supplication for competency. For example services of auditing and the like. But how does nationality clearly there is types of activities that are prohibited by the law to be carried out by foreigners. One restriction could be then is training and certificate. Something excluded from the new law is a distinction as to gender. We can take as an example of The Hindu joint family company. But still they cannot use this as an excuse to invalidate transactions they entered into claiming they were not allowed by law when they entered into it.

Article 24 states that commercial activities carried out by civic associations that are created not having a profit motive might be seen by laws.

We will move on to briefly address what business. In principle every trader has a business so what exactly is a business. What are the essential components of a business?

Business is an incorporeal movable which has other elements which are corporeal. We also talked about the importance of good will element. The other incorporeal movables including lease rights, intellectual properties, trade names, trade mark. And of course corporeal movables assembled for that particular business are deemed to be part of it.

A business manly consists of a good will. It also incorporates other incorporeal movables such as trade name and a special designation under which the trade is carried on trade mark. The right to lease the premise which the trade is carried on meaning the lease right. You may also carry on your own property. Patents and copy rights. As its corporeal elements it consists of equipment or goods. A good will results from the operation and creation of a businesses will vary according to the probable and possible relationship between him and third parties. This is the patronization aspect. When you look at the other sources for definition like black law dictionary, Of course it is the relationship between the trader and third parties. But is it only this? For instance some literature define it as primarily to know the amount of good will of a business the aggregate values of the corporeal and patent or copy right the trade name and the other rights aggregate value and the amount of the sale of the business there difference is the value of the business. These other elements still have their own market value. Their aggregate value and the sale of the business the difference between the amount and the sale is what the good will created. Some do not accept this definition claiming it to be a rough definition.

In any case one thing that you have to take is that commercial reputation is the prominent element in a business. A commercial reputation before you are able to be established, patronage comes when the customers trust you and when they are sure that they will come back and that they will patronize your product for a foreseeable future comes with a lot of investment in your time and capital in other words material investment. Once that patronage is established it is what increases the value of your business not the other elements as such. In order to protect good will we have anticompetitive laws as a mechanism of protection by the code. There are only four articles but what follows an unfair competition they are led back to tort laws. These are now compiled are included in an extended manner in a trade proclamation. Thus we will directly go to the trade practice and consumer protection proclamation. Actions that distort, put a barrier are not allowed. These are because it is against market principles. Thus the next part will be about business organizations. As we know her are new inclusions such as ordinary partnership which was controversial at first, **sole partnerships are new introduction**.

Lecture 4 (April 15)

In sole proprietorship in the particular commercial code will not be that desirable for difficult issues we raised as you remember. The idea is in sole proprietorship the distinction between the personal property and assets of the business basically the trade will not be made. So one way to go around this is to protect oneself from extended liability is to incorporate as a one firm or company. This was not possible in the old code. It is common to incorporate a sole proprietorship in US primarily for liability purposes. Of course it does some implications on tax.

Business

Under the new code of article 109, elements of business are listed down. You can see on your own. The primary element of business is goodwill. If you see legal dictionaries, good will is a commercial reputation in the sense that when customers are satisfied or relied on quality or sometimes practices. It is not uncommon also for establishing reputation for being affordable. So, it is a commercial reputation therefore you build by goods and services that are reliable, affordable or an acceptable quality to the customers. Now, article 106 (he was reading Amharic version) A business is an incorporeal movable consisting of all movable property brought together and organized for the purpose of carrying out any of the commercial activities in Art.5 of this Code. As provided under article 109(1) a business consists mainly of goodwill. Once you establish this commercial reputation, reliability, affordability, it takes a lot of cost, time and investment. Your expectation is that this individual customer would come back to your goods and services. As I told you, this is not an easy thing- it takes time, it needs investment. Once you built this commercial reputation, it possesses a huge value in a business. Most of the times in accounting sense, if you read literatures goodwill come through acquisition. Of course concerning sale, every business could be sold. Regarding its protection, there are provisions; we will briefly look at them.

Now, the primary element is therefore a commercial reputation you build- you reliably expect the customers to come back again and again. That is what goodwill is. This is not the only element, but the primary element. There are of course other incorporeal elements of business. Under article 109(2)(b), a tradename. This one is governed by separate proclamation. Trademark and other designation under which trade is carried out is another element. When you look at the Anglo-American legal system, there is a separate law regarding trademark. When you look at a particular trademark in general, it brings in your mind of practical type of product or services, the

reliability and quality it represents. It is not easy to establish this. That is why free market is unavailable. Trademark also has its own value. Many times, in other countries by using this designation unreasonably, they used to confuse customers which are unfair competition. This becomes the primary bone of contention.

I remember what happened in 1990's that there was a dispute between companies in China and USA concerning product origin. There is a company called Usa in china. USA claimed this as its product. Since both of them produce the same product, such point of contention may arise. For example Panassonic, Panasoanic; Sonny, Sunny… Basically trademark is based on goodwill. Even though it is a separate element of business, it has a strong attachment with goodwill. If the origin or source of the product confuses customers, it is unfair competition. There is a separate law that governs this.

Another element of business is intellectual property rights. Various patents, copyrights, so long as they acquired in relation to that particular business, are part of business. Most of the time, for example, chemical companies have many patents. A premise in which the trade is carried on is another element. The place where you carry out the business as long as you acquire it through lease and as long as you have lease right, it will be transferred with the business when the business is transferred. The business also includes corporeal elements such as equipment or goods. However, a mere existence of this corporeal element does not make the whole business corporeal. Claims- special rights attached to the business are also part of the business. Products and commodities are also part of business. But still the most important element of business is commercial reputation.

How you protect goodwill?

The new code has put a clear caption under article 113 and 114 how to protect goodwill. As provided under article 112, the goodwill results from the creation and operation of a business and is of a value which arises from relations between a trader and third parties who may require from him goods or services (art.112). This article tells you nothing. Of course commercial reputation is a value that emanate from a relation. If you are a producer, you are also a client for the customers. Goodwill is the name you built, by taking a long period of time. The product you supply should possess, not only reasonable price, but also standardized quality and the one that satisfy what the customers expects. These make it a well-established patronage. It requires time, cost, and much effort to build it up. It requires not only giving promise for customers, but also delivering the goods to them. After all these investment or after you establish this relationship, many researches have done. For example in behavioral economics, without taking in to account the market, there was steady price increment by producers to consistently over gain. The research was done to check whether the price in the market was sticky. In some cases there was 27% of price increment and because of this the clients have not started to seek other options. However, the market itself was not decisive. Such kind of price increment would inevitably affect your

pocket. The research shows that even significant sticky price increment didn't lead the customers to shift. This implies that commercial reputation has huge value. The fact that significant mark upping price wouldn't affect customers that much shows that once you establish this and as long as you protect this valuable patronage, you consequently profit from it in the business or any trade. Of course this research was done in behavioral economics. But still relevant even though may be biased.

So for the question how this goodwill is to be protected, for example there are commercial travelers to protect it as long as you paid them. There are also commercial agents like commission agency. They represent you and act on behalf of you. But when their contract terminate, they are prohibited from carrying out the same business to that of you in which they were carrying out in your name. There are provisions that prohibit this (article 53). If you lease out that place of business, can you run the same business in that place? No! There is again a provision that prohibit this. If you leased the business, you are not leasing only the premise, but also as long as that business is in lease you are not allowed to carry out that business. If you look at the articles, there is a provision that prohibit this (article 118). But here the danger it could create is the relationship between your business as a business and you as a trader are normally not such wide. Therefore if you leased out your business and start the same business in another place, who will the customers follow? They effectively know your trademark and tradename (which are called signal mechanisms). You supply the same service and the same goods to that of previous, though you changed your place. Then, chances are the customers or clients will likely follow you. Therefore, for this reason it is prohibited and considered as unfair competition. The relationship they built with you in long time is there even if the places of services are not changed. You build this reputation with persons, not with the business. After you sell it, you are not allowed to start the same business for 5 years (article 130). These are laws to protect good will. But there are difficulties. The old code itself provides only 4 or 5 articles regarding civilly unfair competition. In any case, in addition to this, there is also tortious liability. Of course this one is understandable since there is a separate proclamation. We will see. So we have these provisions. Read them on your own.

Article 113 had cross-referenced article 29, 38, 39, 53, 118, 130, 131, 166, and 167. Then, to protect the name you built from unfair exploitation by others, after you leased or sold it, there are commercial agents- basically commercial travelers and commission agents. Upon the termination of the contract, if there is conflict of interest at the time when they were in work, they can't run the same business. Is these the only ways to protect goodwill? No! This is the narrowest protection. We will see them next week. Now let's talk about justifications. Why we protect goodwill? Obviously the need to protect goodwill is that because of it is the most valuable element of any business and is the patronage you built. Traditional justification has been emerged as independent discipline in 1960's.

1) **Property-based justification**: you remember the value of property from the theory of State and Law. The traditional justification is based on the purpose needed to protect

property. Goodwill need to be protected like any other property is protected since you built it by taking long time. This is arguably a traditional justification.

2) **Legitimate expectation:** this one is emerged particularly in context of common law. Once a commercial reputation or patronage is established and if you able to connect the customers under particular goods and services to quality, affordability and reliability; and if they continue to patronize that particular product for secured period of time, that is how of course you come to establish this reputation. Therefore, if they, by relying on these, patronize them, this could establish legitimate expectation on their part. Specifically if you look at trademark, as I told you, it is a representation of goodwill. So, for example if you see various famous trademarks, what elicit to your mind is you expect the quality, reliability, and other desirable traits from that particular product. So, once established and legitimate expectation is created, we have responsibility to protect legitimate expectation of that public good. In other word, once you have a patronage and if you go to particular company to buy certain good, you expect to get the utility you have experienced in the past times. This is legitimate expectation. Therefore the consumers form legitimate expectation to what they associated with or built patronage for; and that expectation should be protected. So you have to know once property's quality, traits and so on. That is why common law protected it. This is traditional justification.
3) **Market competition based /standard model/ economic justification**: this has to do with information asymmetry. You do that because you have market to be competitive. You protect goodwill specially trademark because you want to ensure the market to remain competitive by their way or upon significantly decreasing search cost. Now you protect certain trademark to avoid its abuse. Once the reputation is established, if the customers under particular trademark, in the absence of other qualities, go to store to buy particular product they simply want to minimize search cost. You protect trademark or goodwill basically at least to significantly reduce your search cost. Search cost is the cost incurred related with to identify the information. We will come back to this. The information should be freely and equally available to both buyers and sellers. To have free competitive market, there shouldn't be barriers. That is to avoid disparity of information. In reality, the producers know much more than the consumers about their products. This is one disadvantage for consumers who go to market. They incur cost, including the price, to identify the quality, reliability and the potential side effect of the product. As you remember from the example of the second hand car. So in the presence of these, it is difficult to get free competitive market. To reduce this information asymmetry, protecting trademark or goodwill is important. So if you go to market to buy a particular good, first you select the good, you also ask them the price. This is opportunity cost. What caused this opportunity cost is lack of information on your part. Suppose however, you are using the Samsung product for long time. You know their brand. If you see the trademark of Samsung, you don't need search cost because you patronized this particular product. They established huge reputation with you. Therefore

in order to reduce significant search cost as long as possible, you need to encourage such things. So by avoiding search cost in such like, you can make the market efficient. As you remember there are many ways of transferring information. Trade mark is one of the signaling mechanisms. To reduce the disparity of information between producer and consumer there are various presumptions. This one is economic justification at least claimed by standard model. For example 9th American appeal security board, in Economics textbook, decided on this.

In addition to these, in consequence of protecting this commercial reputation there are economic incentives. The producer will have more incentive to produce more efficient and preferred products. Or he obliged to maintain the same quality and standards because had you not protected this commercial reputation, there couldn't have been such kind of incentive. Or again he supply more efficient product by investing. Then he control information asymmetry. So besides information asymmetry, he has economic incentive. This is the economic justification. Concerning sale, you can sell your business. You can also or mortgage it. You do this because it is a property. If you default, you can recover the business. The reasons why you protect goodwill or trademark is at least it significantly reduce search cost. One of the various methods of protecting market is through legislation. Market have both geographic and product aspect.

Lecture 5 (April 20)

Standard model

In law of economics the primary aim of standard model is supporting a healthy competitive behavior in a market. There are a number of assumptions this model makes.

1. **There must exist sufficiently large number of consumers and producer**. This ensures that producers are always price takers not setters. The market is supposed to determine the price. When you have large number of producers in a market chances are that single producer controls a significant market share that will let the price to be artificially managed. Therefore if a producer decides to increase the price of it cannot do so without losing its customers to its competitors. Mind you the reason why this is the case is because a single producer cannot take the fraction of the market. Producers therefore will be obliged to take the price. But when this fails the issue of market dominance will arise. So the assumption is you have sufficiently large number of producers and consumers so that no single producer can artificially increase price without putting into jeopardy its business.
2. **The availability of free entry and exit from the market both by producers and consumers.** Thus producers are free to exit and enter into the market without significant cost. A producer determines that a potential to make profit in the other market he should be able to leave this for the other market without significant cost. There should not be barriers for entry and exit. We will talk about various forms of barrier as we go through the proclamation. The most

common form of barrier are referred to as **sample cost**, these are costs you cannot recover when you decide to exit from a market. The machinery and the like can be recovered by sale or by hiring it but suppose one of the costs incurred for promotion cannot be recovered. This costs that cannot be recovered are prohibitive enough to not let you leave the market that serves as a barrier. Another possibility is competitors in that particular market may engage in various kind behaviors creating barriers. We can remember the example I have raised about the chocolate producers that is actually an intimidation. You may not be able to compete with such factories without going bankrupt. The same should also apply to consumers. If you are not able to switch from products, that poses a problem. Sometimes this might be difficult when for example the producer has a significant market power. There are such situations for example Kodak started producing photo copiers and printers. At that point in time the amount of time it was charging was unrealistically low. What it was doing was the printer and the copier used to be sold at a low price because it was gaining its profit from its cart rage. What it did was once you bought that hardware somewhere in time you will run out of a toner. But this product does not accept other cart rages other than that which is produced by Kodak. This is called **Locking in**. Back in the 70s standard oil had retailers at one point it decided to retail its products but it made a deal for with them to retail only its products. This is called **exclusive dealing**.

3. Product homogeneity.

When you talk about competition in a market you have determine whether or not producers are in the same market. There are two aspects to determine that the so called product aspect and geographical aspect. One aspect of determining they are in the same market is to identify their product is homogeneous. This is sometimes a difficult task but whether or not a product is **sufficiently substitutable** are the working criteria. If a price rise in one particular product leads the consumer to easily shift to another product that shows sufficient substitutability of the products.

4. The other assumption is **the existence of free and equal availability of information to both producers and consumers.**

In reality information does not come freely and consumers know about their products that consumers. There is always this disadvantage as to the consumers. When this is not achieved information asymmetry arises. The reason why consumers enter into search cost is the significant factor that goes into making choices based on the consumers taste or preference. Otherwise producers will impose their own taste and preference. We can take for example the issue of micro soft the case of tying or bundling. This way it is imposing its preference on you. Thus there has to be free entry and exit. When there is significant disparity among producers and consumers, consumers will incur cost.

5. **Producers are supposed to internalize not only benefit but also cost of production too**. This is essential if you want to achieve sufficient allocation of resources because scarce resources should be allocated to their best use possible. For example if a producer of a detergent how much soap is justified in a competitive market how much of this resource should be used to produce an additional unit of soap. A certain amount of detergent there is a large to be supplied in a competitive market. And when you force a producer to internalize not only its benefits but also the costs of making a given product, whenever producers are allowed to get away with avoiding certain amount of cost of producing a product the more of that product which is not

justified could be introduced. It will vary the principle of allocative efficiency. There are many other assumptions but we should pay attention to this for now.

The other issue is the instances of **market failure.**

1. The first instance of market failure is that the **concentration of market power in one or more producers** is a situation where the market is prone to abuse and will allow producers the chance to engage in anticompetitive behavior. So market power concentration the most extreme case being monopoly in fact unnatural monopoly. What happens is a producer or a couple of producers accumulate a significant share in the market. That will give them an opportunity to abuse the market abuse of dominance. The most extreme case is when you have single supplier. Unnatural monopoly is a single supplier this gives it a special opportunity to engage in anticompetitive practices including artificially manipulating prices. The simplest way to do that is to short supply or to create an artificial shortage. When you have limited number of goods and services in the market and valuable consumers' price will obviously increase. In other words when you have large consumers chasing limited number of products for a given product price will go up. So a monopoly can short supply and increase price giving it the opportunity to an unnatural profit. There are of course various instances of abuse of dominance but for you to abuse your dominant position you don't necessarily have to be a monopoly. Even when you have a significant number of producers for various reasons of course a handful of producers may have a significant amount of market share. As you remember MS was not by any means the only supplier in the market even there were producers with a better products in the market. But because it had a large market share it made its customers buy a product they do not want by bundling it with what they want. A significant market share is what gave him this power. There are various instances of abuse of power that driftly follow your relative market power. Or to engage in activities of price fixing, or refusal to deal or exclusive deal you need a significant market power. So artificial or manipulated market price needs huge power. As we remember the chocolate factory which excluded others by intimidation because it had the ability to continue in a market for a while by selling less than its cost of production. Refusal to deal in the case of HBO where the other producers requested to use its cable. On the face of it its refusal seemed justified but you can't deal like this in a free market. It had only the power to make them pay for its service. The same goes to one German company that operates that also had a carriage business. As it can't refuse court service it started paying its customers who are efficient by the name of incentive in terms of repayment annually. By reducing its cost it is making its own product more competitive and this is called **illegal rebate**. Intel also has faced such allegations. We should also remember the case of Heineken where it made an exclusive deal. Giving bars loans with low interest rate and a one year relief period provided that they will only serve its products. So abuse of dominance is a reflection of market power.

2. Another instance of market failure is a **disparity of information between producers and consumers**. As I said the principle is equal availability of information for the market to be competitive and efficient. In reality producers know about their products than consumers. Specially as I have said goods and services that have different behaviors are economically classified as search goods in which the chances of information being that problematic is that such goods only need a single reasonable examination bears all the necessary information. On the

other hand you have experience goods that need to be experienced to know about their quality, reliability potential adverse effects. In terms of information asymmetry seriousness of in ascending order experience goods and services are better next to the first. There are rather goods and services no matter how much you consume them you will not get enough information about them. Here we should remember about the information distortion created in a second hand car market. It is generally assumed by the buyers that the cars are average so they will only buy those with less prices. In case of such gap between the producers and consumers the market will fail to allocate scarce resource effectively.

3. The other instance of market failure is **negative externality the so called externality** in general. Positive externality is what we said before to have efficiency in the market producers shall internalize their costs as well as their benefits. In other words when they are pricing the entire cost must be factored. If you let them escape even a little portion of this cost the price will not retake the cost. Classic example is pollution which is a social cost. Before economists came up with this notion, social cost, they used to measure costs only in accounting terms. These include costs of raw materials, energy, tax and the like used to be unavoidable costs. If we have a soap producing company when the company dumps its wastes it has two choices. One is having to throw it in a river and the other is obliging the company to treat it. Treatment is expensive but relatively for free dumping it in a river is easy. But who burdens the utility reduction of this river. So we have to internalize these kinds of costs or tax them for it. For the amount of cost you have added (Euclidian test) will increase the cost of production and then eventually consumption of soap will decrease when the price increases. The production will also decrease. If you didn't oblige them to internalize this cost perhaps it could have produced another soap allocative efficiency is not justified. So the resource that is put at covering this cost would have been put at another place where it is needed thus allocative efficiency. Whenever there is negative externality and you as a state allow them to get away with allocative efficiency suffers. Undesired amount of given product will be put in the market.
4. The other is **public goods**. Is the purest form. The private sector is not interested to serve them. This is because public goods by nature are **non-rival** and **non-exclusive**. When it comes to these goods there is one entity that is at a good position to supply them the government. This is because it uses the mechanism of tax for financing. If we take for example higher education's engage in researches which turn out to be public goods. No private sector is interested to do such researches when they are done by the state. But these researches are used by the private when they engage in inventory activities.

Lecture note 6 (April 27)

We will go through the definition of consumer protection proclamation. When we look at the definition of the objective under article 3, it aims at protecting consumers and producers from anticompetitive behavior. When you ensure free and competitive market, the overall purpose is ensuring both productive and allocative efficiency. You protect efficient producers in the market by warning off anticompetitive behavior in the market. This also has advantage to consumers because it will ensure them that they have bought efficient goods and services and affordable ones. Article 3 is about objective.

Horizontal restraints: this is when there is competition between producers in the same market providing more or less the same goods or services. Art. 6 paragraphs 3 & 4 and 10 try to define this. It also defines what market is. You remember the case of plastic wrappers and aluminum foils. Sufficient substitution is enough, no need of perfect substitution. Market has a product aspect as well as geographical aspect. Sufficiently substitutable products as price moves upwards it causes consumers to easily shift to the other product. In such cases we could say there is sufficient substitutability even if this statement is an over simplification. Sub-rticle 3 states this substitution. If the products are not sufficiently substitutable we should not be talking about competition. The concept of geographic aspect is mentioned in the proclamation paragraph 4. It needs opinion of economic experts.

What are the instances of abuse of dominance? Market power does not necessarily mean dominance so it requires its own definition. This instance is mentioned in paragraph 10. For the purpose of sub article 2 of article 5(a) acts that are considered to be abuse are limiting production, hoarding or diverting, preventing or withholding goods from regular channels of trade. One example if you have a monopoly in the market one instance where you could gain unnatural profit is to short supply in the market. Hoarding also works to those who have sufficient market power.

The other is to supply products other than the natural channel of supply. You can take for example black markets. You can create shortage starting from production up to its supply if you have a significant market power.

Article 5(2) b. intimidating other competitors by making entry and exit hard is another instance. This scenario happens when a company has a power to stay in the market even by selling below the production cost. The other is by dominating raw materials for the production. This happens by making raw materials price to increase which increases the cost of production of your competitor. Here we shall remember the case of Warner brows.

Article 5(2)d. In case of **Refusal** to deal we shall remember the case of Kodak where I refused to sell for a distributor unless he agrees on some conditions. The conditions included to exclusively holding Kodak's products only or even if he holds others products it had to carry specific famous products of Kodak. Exclusive deal is not altogether prohibited this is seen in vertical restraints. We shall also remember the German company's case which used to provide port service. Take for example patents even if some consider it to be barrier this right, bears the question that can a patent holder prohibit others from innovating based on the protected product. This same issue is also found in vertical restraint.

The other instance is **price discrimination** under article 5 (2)f. The idea is that in a market operating by forces of demand and supply when price is decreased demand will increase. But only efficient producers will be able to continue operating in such markets. But as price increases demand will decrease and suppliers will increase. The thing is the situation where demand and

supply are at equilibrium the price is set here in a standard model. Price discrimination happens when as there are people with the ability to buy at this higher prices there are others who can't. So to make it efficient the idea is to provide both sides with the products. So inevitably price discrimination will happens. Article 5(2) g and h.

There are justifiable economic reasons under article 5(3). The first one is maintenance of quality and safety of goods and services. We will see this under vertical restraint. Another is leveling with prices or benefits offered by a competitor; and achieving efficiency and competitiveness.

Lecture 7 (May 4)

Vertical restraints

This is a scenario where the market actors dealing with in the same market in which they have vertical relationship. So under this scenario various restraints may be traced on the suppliers or producers in the particular market producers that rely on the actor's hierarchy to change. You can think of for example franchiser raising relationship in the contract that provides services and goods. Franchiser is a contract where you have multiple services that serve for by the terms and traditions regarding for example entities that you used to make for example 'Sanduch'. It is common feature all producers and suppliers have in the hierarchy. Now what sorts of restrictions that you may think of the dominant supplier in the market is for example a car manufacturer may impose restrictions on you. Whether or not you can charge prices (minimum resale price). What sorts of inputs you are allowed to use are set. Whether or not you can sell that manufacture to buy different manufacture. For example the standard oil forced its dealers to exclusively sell its products. Those who sell the products will receive certain percentage of sales as a rebate. Now you have article 5(2) h. it is a general provision. For example as I said, certain car manufacturer imposes and basically limits the number of dealers in certain geographical area. That particular dealer is basically a monopoly. The question often arises here is wouldn't you killing the competition while you are making a monopoly. Consumers are the one that would loser of. Can you say any justification for limiting the number of parties? There are also efficiency benefits as well if you have multiple dealers in certain market then they may limit capacity to compete in terms of the amount price they sell. There are also other efficiency gains as well. They may not necessarily attract their consumers by underpricing their product. But they also provide other products that may be more efficient by providing with credit sales or other purpose such as free services to the car maintenance. So you have this. How much limitation as to imposing minimum resale price say for example car. For example if you impose minimum resale prices it gives for others a potential gains. The dealers may not compete on price. But there are other areas where competition can takes place. Determining the price of certain car has its own advantage. They may follow other efficiency mechanisms. Even if they can't compete on price, they can compete on ways of payment like payment by installment or they may follow other new models or they also give free services like maintenance. Some don't agree with this kind of argument. How about a rebate. There is of course the so called **Illegal rebate**. For example if you carry exclusive

dealing basically retailers, 3% of their sale will be rebated to them as a bonus. What is wrong with it? They have popular product and when they ask retailers to supply, they are creating shortage of product. So by denying all together, they give priority only to those who retail their petroleum. On the one hand they have more popular and fictitious products; on the other hand they give priority for those who retail their products. Do you see any wrong? You have article 7(2)a and b.

Unfair competition is provided under article 8. Sub-article 1 is general one. Sub-article 2 is simply illustrative. No business person may, in the course of trade, carry out any act which is dishonest, misleading or deceptive, or cause harm or likely to cause harm to the business interest of the competitor. Acts of unfair competition are provided under sub-article 2. Sub-article 2(a) talk about confusion. Basically you can think of trademark. For example confusing packaging methods in which two products may be confused. Sub-article 2(b) about disclosure or use of information of another business person. You are familiar with trade secrets. Another form is patent or copyright. Under sub-article 2(c) it protects false or unjustifiable allegation that discredits another business person or its activities. False advertising is one example of this, if you discredit certain product to make it out of the market. For example if you establish a treatment by saying they are fetching that water to package it. Sub-article 2(d) is about comparing goods or services falsely or equivocally in course of commercial advertisement. For example if you openly broadcast advertisement on TV by saying my soap is better than others or by selecting certain soap and comparing it with yours. Sub-article 2(e) is about disseminating false information to customers or users about that product.

You have also provisions directly related with information asymmetry. You have article 14 particularly paragraph 1 & 2, 15 and 16. Every consumer shall have the right to: get sufficient and accurate information or explanation as to the quality or types of goods or services he purchase. He also has the right to buy goods and services on his own choice. Hence, suppliers can't impose their own tastes and preferences on you. Article 15 and 16 are provisions regarding one source of information in which producer or supplier is supposed to display information to potential customers. Let's get back to conservation of merge. Of course we will talk about them in relation to companies and partnerships. For now the reason why companies can't merge without prior approval by concerned body should be Fair Street forward. When two companies amalgamate, first they should notify to authority. Under article 9 it says no business person may enter in to agreement or arrangement of merger that causes or likely to cause a significant adverse effect on a trade competition. Mind you if you are allowing companies to merge, you are effectively eliminating competition at least by reducing the number of companies or business organization. The problem here is sometimes when companies merge, the two companies, at the same time acquire significant market power. First, the competitor will be reduced. Second, they potentially increase market power through amalgamation.

What a merger is provided under article 9(3). It could be occur where two or more business organizations previously having independent existence amalgamate; or where they pool the

whole or part of their resources for the purpose of carrying on a certain commercial activity. Another possibility is acquiring share, securities or assets of business organization; or taking control of management of business of another person by a person or group of persons through purchase or any other means. In the western, one can take over management to another company. There is possibility of multiple management. They may also buy management services. Then if the new company significantly or likely abuses the market, it is prohibited. However, if they carry on market power efficiently without abuse, it is not prohibited. At this stage this is enough since it is very wide. There are consequences like civil, administration, criminal sanctions. You remember tortious lability in unfair competition. See them all on your own.