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**Title: The Legal Framework for Business Bailout in case of
Economic Distress in Ethiopia**

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DECLARATION

I, the undersigned, hereby declare that this is my original work, has not been presented for a degree in any other university or institution and that all sources of materials used for the thesis have been duly acknowledged.


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Acronyms

LAMAC: Liability and Asset Management Corporation

SOEs: State Owned Enterprises

AGOA: Africa Growth Opportunity Act

FFD: failing firm doctrine or defence

FDRE: Federal Democratic Republic of Ethiopia

SLC: substantial lessening of competition

Us: United States of America

CCLP: competition law and policy working paper

EU: European Union

FSB: Financial Stability Board

ATSSSA: Air Transportation Safety and System Stabilization Act

BGI: Brasseries et Glaciers Internationals

UN: United Nations

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Abstract

The thesis seeks to fill a crucial gap on different types of bailout legislation that exist in Ethiopia such as Liability and Asset Management corporation Establishment council of ministers Regulations No.483/202: the failure to create preconditions for dealing with future bailouts. Establishing express, ex ante conditions for providing aid would temper business risk-taking, protect taxpayers, and establish bounds to bailouts. This thesis argues that the key to limiting moral hazard is to follow approach that delineates clear contours and conditions for aid. The thesis also calls for revision of loophole on the Establishment and Operation of Ethiopia Deposit Insurance Fund council of ministers Regulations No. 482/2021. The regulation requires liquidation or closing of an insured bank to pay insured depositors but this requirement clearly contradicts with the very essence of bailout. The thesis also argues that conditions or requirements that helps to identify other form of bailout i.e. failing firm doctrine is not provided on the FDRE Trade Competition and Consumers Protection Authority Merger Directive Number 1/2016.

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the Study

Where economies face financial pressure, countries may adopt a variety of measures to prevent the impact of the crisis and bailout is the major one. The 32nd president of the United States, Franklin D. Roosevelt used this term for the first time during the Great Depression and the New Deal, when he noted at the US Congress in 1932 that “they should purchase some additional stock, if I may use the term, to bail out the Government’s investment in the home loan banks.”¹

Bailout has been described differently by Different legal scholars. Those who view bailout broadly define bailout as a form of government assistance designed to prevent enterprise failure.² According to them bailouts can be provided in a number of different ways.³ Assistance may be provided to a failing business or enterprises facing financial distress through special tax breaks. It may also be provided in the form of exemptions from the need to comply with burdensome regulation, and finally, bailouts may be provided through trade restrictions, tariffs, and quotas on foreign imports. Such measures reduce competition and provide domestic companies a larger market share and the ability to raise prices.⁴ From narrow viewpoint bailout is defined as an ex post government transfer (a loan, loan guarantees, cash, or other types of consideration) into a distressed entity that aim to stop financial panic, to prevent the collapse of the private enterprise or industry and to restore its stability.⁵ It also includes those cases where a government nationalizes a business for a time period usually until business is restructured and then re-privatized.⁶

The need for a bailout often arises from economic distress which come out of a financial crisis, or national emergency that particularly affects certain industries.⁷ Governments

¹ Roosevelt, Hearings of the senate committee on banking and currency, 1932, in Zimmer, on the trial of “bailing out” (Sept. 30, 2008); Federal Home Loan Bank system, summary US Fed. Gov.

² Cheryl D. Block, “Overt and Covert Bailouts: Developing a Public Bailout Policy”, *Indiana Law Journal*, vol. 67 (1992), p.951

³ See Ibid

⁴ See Ibid

⁵ Virág Blazsek, *Banking Bailout Law a comparative study of the United States, United Kingdom and the European union*(2021), Routledge Research in Finance and Banking Law, p. 1

⁶ See Id., p. 3

⁷ Wex definitions Team, *Bailout*, Legal Information Institute, bailout, Primary tabs, accessed from (<https://www.law.cornell.edu/wex/bailout>) last visited on May 2020

provide bailouts in order to ensure continued survival of the entity being rescued under difficult economic circumstances.⁸ A company that has a large workforce may receive a bailout because the economy could not withstand the substantial increase of unemployment that would occur if the business failed.⁹ The government in these cases steps in to prevent the insolvency of institutions that are needed for the smooth functioning of the overall markets.¹⁰

Bailout is the most common mechanism of rescuing business in developed countries. However, until this time the practice of bailout in Ethiopia is small in numbers and it applies for limited event. To mention some legislative measures taken by the government which appears to have bailout features includes **1**, to prevent default or to restore State Owned Enterprises (SOEs) already in default, the government establishes the Liability and Asset Management Corporation (LAMAC) under Regulation No. 18/1997.¹¹ This enables bailout decisions to be subject to the law. But the legislation does not address principles and the criteria to be met for well-considered and successful bailing out. These undoubtedly create a challenge to protect taxpayer money and state funds. **2**, Another bailout program available to eligible merger applicants would be failing firm doctrine. The failing firm doctrine is enshrined in article 20.3B(1) of the Merger Directive number 1/2016,¹² where it is listed as one of the factors to be considered when determining whether or not a merger will likely to have adverse effect on the public interest. **3**, The Ethiopian Deposit insurance regulation requires deposit insurers to pay yearly contribution and the initial premiums to the Ethiopian Deposit Insurance Fund the fund will serve as source for paying out for depositor in the case of insurance even.¹³ Furthermore, the government shall make contributions of 2 million birr to the fund.¹⁴ Additionally if at any time, resources of the Fund fall short of its liabilities, such shortfall will be covered by bailout funding by government when the shortfall induces systemic crisis in the financial system.¹⁵

Most of the time legislative measures help to avert the breach of the existing laws, using taxpayer money without prior lawful authorization, lack of transparency and distortion of

⁸ The Economic Times Definition of Bailout, , (<https://economictimes.indiatimes.com/definition/bailout>) last visited on 14 January, 2022,

⁹ See Wex definitions Team, May, 2020, supra note 7

¹⁰ See Ibid.

¹¹ Council of ministers regulations to provide for the establishment of Liability and Asset Management Corporation, 2021, Regulation No .483, Neg. Gaz. Year 27, no.13

¹² FDRE Trade Competition and Consumers Protection Authority Merger Directive Number 1/2016

¹³ Establishment and Operation of Ethiopia Deposit Insurance Fund council of ministers Regulations No. 482/2021

¹⁴ Ibid

¹⁵ Ibid

competition.¹⁶ Building upon the existing literature, this study will evaluate whether the legislation on these issues considers the approach of the most advanced and successful bailout system.

1.2. Statement of the Problem

Business sectors are essential part of the economy of one country. So it is beneficial to the government of a country as well as its people to ensure that financially troubled businesses that contribute to the economy and society are given a second chance. There are various ways of achieving this objective. Making some amendment on laws that exempt the business from complying burdensome regulation, nationalizing a business or financially assisting the struggling companies are the major ways that can help the business to trade profitably by stable and viable concerns.¹⁷

Currently various businesses which exist in Ethiopia are affected by different factors. The following are some of the major ones:-

On January 2, 2022 the United States of America has cut Ethiopia out of a duty free trade programme, the Africa Growth Opportunity Act (AGOA). The suspension from this trade benefits threatens the country's industrial parks which manufacture textiles, leather and leather products and other goods. Due to this removal huge number of workers which are employed in these sectors also face the risk of losing their jobs. Ethiopia's decades-long and relatively successful efforts to lift itself from poverty, build a viable manufacturing industry, create jobs for its youth, and progressively disassociate itself off aid through trade would all be jeopardized.¹⁸

The most difficult challenge faced by businesses in our country is associated with foreign currency shortage. Ethiopia is currently experiencing a severe foreign currency shortage which is limiting investment and commercial activities, increasing inflation and lowering the country's overall economic activity.¹⁹ The foreign currency reserve is lower than it should be and the manufacturing industry frequently struggles to obtain foreign currency permits for

¹⁶ See Virág Blazsek (2021), supra note 5 p.1

¹⁷ Ratidzo Sharlene Dzvimbob, "SHOULD THE ZIMBABWEAN COMPANIES ACT MOVE AWAY FROM JUDICIAL MANAGEMENT AND ADOPT BUSINESS RESCUE?", University of Cape Town, SEPTEMBER 2013, p 1

¹⁸ Mamo Mihretu, Don't Remove Ethiopia's AGOA Trade Privileges, FP ARGUMENT, An expert's point of view on a current event. Accessed from(<https://foreignpolicy.com/2021/10/13/ethiopia-agoa-trade-biden-abi-dont-remove-eligibility/>) last visited on OCTOBER 13, 2021, 7:35 AM

¹⁹ Kennedy Abebe, Foreign Exchange Crunch Now, Then, Tomorrow, Addis Fortune, Vol 18 ,no 905, Sep. 02,2017 (<https://addisfortune.net/columns/foreign-exchange-crunch-now-then-tomorrow/>) last visited on May 1,2023

raw materials and capital goods imports.²⁰ This problem has a detrimental impact on production, thereby slowing down the overall performance of the country's economy.²¹

As stated above, those incidents which occurred in the country affect the business environment in general and financial capability of the businesses in particular. So in order to reduce this impact and to rescue the businesses, the government should have Bailout program.

United Nations categorized Ethiopia as least developed country with highest external debt.²² So it is fair to say that the country can't spend money to save private business sector from collapse. But in respect of state owned enterprise, Government of Ethiopia has been involved in almost every sector of economic activity and when this businesses faces distress it uses mostly public money to bail them out.²³

Another alternative form of Bailout to eligible merger applicants would be failing firm doctrine (here after shall be referred to as "FFD"). Given the unprecedented economic devastation brought about by the lack of foreign currency and AGOA sanction, the failing firm doctrine may be raised more often by merging parties in the near future. So to prevent economic hardship from threatening the firms or industries viability there should be proper legal framework that gives effect to this special relief from regulatory requirements

In addition to FFD and debt servicing, another mode of government assistance which may also identifies as bailout is deposit insurance. This program covers a liability to a customer or depositor for which the business enterprise would otherwise be liable. The Ethiopian deposit insurance legislation may possibly realize the objectives of the deposit insurance. However the legislation has certain limitation that refutes the very essence of bailout.

Even though, Ethiopia has taken some steps towards regulating the financial and nonfinancial support of businesses by the government in challenging time, but as this thesis will seek to demonstrate, with the exception of Deposit Insurance Regulation Ethiopian bailout legislations (specially Liability and Asset Management corporation Establishment regulation and merger directive) lacked certain conditions and fundamental principles that the legislator should have considered when designing bailout law.

²⁰ See Ibid

²¹ See Ibid

²² United nations, UNCTAD, the least developed countries report 2020, P.x

²³ Liability and Asset Management corporation Establishment council of ministers Regulations No. 483/2021

This thesis is devoted on an analysis of principle and preconditions for financial and nonfinancial bailout applied by other jurisdiction but are overlooked by bailout out laws in Ethiopia.

1.3. Research Questions and scope

The thesis aims to answer the following questions

1. How does and how should Ethiopian government decide when to bailout a firm or industry in financial distress?
2. What kind of standards or criterion's should be incorporated on Ethiopian bailout legislation for well-considered and successful bailing out?
3. What lessons could Ethiopia draw from international experiences to improve of the already existing legal framework of bailout?

This thesis takes a general outlook of the issues. As long as it fits for the purpose other alternative scheme for rescuing the business will be subject of discussion. The thesis also endeavours to highlights the best practices of other jurisdiction concerning bailout program and bailout regulation.

1.4 Significance of the study

The finding of this study enables readers to grasp the necessary information with respect to the existing regulatory frame work of bailout of businesses in case of economic distress. Further, the outcomes of this research will provide important inputs for those who desire to conduct further study in the area. This study will also help to reconstructs a legal framework that might better serve the countries present and future economic crisis situation.

1.5. Objective of the Research

1.5.1. General Objective

The general objective of the paper is to assess and evaluate the legal framework for bailout program in case of economic distress in Ethiopia.

1.5.2. Specific Objectives

The specific aim of this study is in order to

- To identify the concept and essence of bailout program and bailout regulation

- To analyse the principle and preconditions of bailout applied by other jurisdiction but are overlooked by bailout laws in Ethiopia
- To provide a way forward on how to address challenges of bailout regulation in Ethiopia

1.6. Research methodology

The study is a doctrinal research type by using literature reviews based on qualitative research methodology. In the research process official and mandatory legal frame works of Ethiopia, Ethiopian economic policy and interviews will be used as a primary data while text books, journals, scholarly articles, survey of selected foreign experiences case study, newspaper, government records and data, and official government statements and letters and statements in internet will be used as a secondary source.

1.7 Limitation of the study

This research is limited to study of certain preconditions and fundamental principles that the legislator should have considered when designing bailout laws in Ethiopia. In conducting this research it was hard to find domestic literature that directly connected to bailout regulation. In addition to this the competition authorities' refusal to furnish documented cases in relation to merging parties' notifications of merger and the finding of the authority on proposed merger makes the analysis of the issue to be challenging.

1.8 Literature review

At the domestic level it is hard to find literature that directly connected to bailout regulation. This lack of literature could be because of the actual instances that the government responded by bailout is recent.

Solomon Abay, on his article "Designing the Regulatory Roles of Government in Business", discusses the issues that arise in connection with role of government regulation in the economy. He also analyzed the specific nature of government regulation through different theories. From those theories the most suitable for this topic are utilitarian theory and The School of Neo-Institutional Law and Economics. The utilitarian theory (neo-classical political economists) argued that government regulation can only be justified if it improves the satisfaction of a society than would result in its absence.²⁴ As is known, Bailout

²⁴ Solomon Abay, " Designing the Regulatory Roles of Government in Business: The Lessons from Theory, International Practice and Ethiopia's Policy Path", *Journal of Ethiopian Law*, vol. 23 No.2 (December 2009) p.75

regulation plays key part for recovering businesses which faces financial difficulties. So, one can deduce that this kind of regulation is supported by utilitarian theory. The School of Neo-Institutional Law and Economics assumed individual pursue their self-interest rationally subject to constraints and that the government should design institutional structures at the macro level to define the opportunity sets, facilitate the political and economic exchange that maximizes gain and wealth, set the form of economic organization and improve the society's wealth-producing capacity.²⁵ This theory also supports those regulatory measures including bailout that are taken by governments following the financial and economic crises of 2008. According to the author, most of the modern theories recognize governmental and non-governmental regulations of business and Ethiopia should raise the capacity and interest to effectively intervene and regulate the business.²⁶ From this perspective, to effectively respond to the problem faced by businesses that existed in Ethiopia, assessing regulatory frame work of bailout of business is essential and evaluating the laws to make them suitable to for current condition of the country is crucial. All in all, this thesis tries to make general observation on the legal framework of bailout regulation in Ethiopia.

Hussein Ahmed Tura, on his article "Ethiopian Merger Regulation", discusses Ethiopia's competition and consumer protection laws, and focuses on merger regulation. It examines the merger laws of the United States of America, European Union, United Kingdom and South Africa, and draws lessons for Ethiopia from the comparison. In order to assess the threshold limits, pre-merger notification, and substantive merger assessment of the Ethiopian competition law the researcher uses FDRE Trade Practice and Consumer Protection Proclamation No 685/2010. By comparing Ethiopian law with international best practices he reached the conclusion that Ethiopia authorities do not employ threshold restrictions to determine whether they have jurisdiction to review a merger.²⁷ Instead, Ethiopia's Authority can block a merger if it causes or is likely to cause a severe restriction of competition, or eliminates competition.²⁸ Regarding Pre-merger notification he stated that, Ethiopian competition legislation requires all mergers to be reported to the Ethiopian authorities, who must then approve the merger before it is implemented.²⁹ Mandatory pre-merger notification

²⁵ See Id., p 81 & 82

²⁶ See Id., p 129 & 131

²⁷ Hussein Ahmed Tura, "Ethiopian Merger Regulation", The University of Oxford centre for competition law and policy working paper CCLP (L) 36, Research gate, SSRN Electronic Journal, (2017), p.16

²⁸ See Ibid

²⁹ See Id., p 17

is beneficial to prevent potentially damaging mergers from taking place.³⁰ It is more beneficial to prevent harmful mergers rather than to authorize and control their anticompetitive impact through unilateral conduct laws that prevent the abuse of dominance.³¹ It can also reduce delays caused by having to publicize the merger and wait for objections, which can be time consuming in government bureaucracies.³² Nonetheless, it is unfortunate that Ethiopian merger law does not provide for minimum threshold limits for merger notification.³³ Concerning substantive assessment of mergers the author asserts that FDRE proclamation No 685/2010 prohibits any merger that restricts or eliminates competition.³⁴ The Proclamation also empowers the Authority to approve a merger on a case by case basis if its efficiencies outweigh its anticompetitive impact.³⁵ This enables the Authority to balance the costs and benefits of merger and to maintain healthy competition.³⁶ The researcher also suggest that Like in other countries, merger regulation in Ethiopia should evaluate the public interest, and take account of domestic and international market competition, efficiency and consumer protection.³⁷ The Proclamation authorizes Council of Ministers to exempt all mergers in a particular industry from review, if that industry is deemed critical for facilitating Ethiopian economic development.³⁸ This provides the Council a lot of discretionary power, which could undermine very purpose of the Proclamation itself. So in order to rectify this, the government should issue guidelines that assist the Council of Ministers in exercising its broad discretion.³⁹ As I mentioned above this study was conducted in the context of FDRE proclamation No. 685/2010 and this proclamation allows anti-competitive merger if its precompetitive gain outweigh anticompetitive impact so the author did not give too much emphasis on failing firm defense as an exception for the debarment of anticompetitive merger.

1.9 Organization of the Study

The thesis is organized as follows. Chapter two discuss the concept of bailout in general and it overviews the bailout law of advanced countries and the guiding principles employed by

³⁰ See Ibid

³¹ See Ibid

³² See Ibid

³³ See Ibid

³⁴ See Id., p 19

³⁵ See Ibid

³⁶ See Ibid

³⁷ See Ibid

³⁸ See Ibid

³⁹ See Ibid

those nation for forming of bailout law. The third chapter critically analyses legal framework on bailout of business in Ethiopia. This Chapter discuss the preconditions and principles overlooked by bailout law in Ethiopia. Finally conclusion and recommendations on the findings are provided under the last part of the paper.

Chapter two

2. GENERAL OVERVIEW OF BAILOUT

2.1 The concept and nature of bailout

Defining the term bailout is not an easy task. This is partially due to the fact that the term bailout is a recent concept. Since the term bailout is reasonably a new term, there is no well-developed literature on the area. There had been scant literature on bailout until the world experience the great financial crises in 2008. However, this does not mean that the bailout phenomenon is a recent scenario. Instead, myriad of historical scenarios evincing several governmental interventions, which is qualified as what is currently known as bailout, since the first half of the 20th C. In USA, for instance, series of legislations were enacted to authorize governmental intervention to support big business enterprises in the time of economic distress.⁴⁰

In addition to lack of well-developed literatures on the area of bailout, there are also disparities among states on the definition and type of bailout. All countries in the world are not put on equal economic and political position. The world is made up on both developing and developed nations with different and sometimes irreconcilable economic policies and ideologies. Thus, states follow different approaches; some of them follow broader approach while others adopt the narrow approach, during crafting their bailout policy having regard to

⁴⁰ The Chrysler Corporation Loan Guarantee Act of 1979 which was enacted to authorize the Chrysler Corporation Loan Guarantee Board (which composed of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System and the Chairman of the Securities and Exchange Commission) to guarantee lenders against the loss of the principal and interest of loan made to the Chrysler Corporation, which was found under a serious financial distress, subject to such conditions as set out under the Act: the New York City Loan Guarantee Act of 1978 and Seasonal Financing Act of 1975: the Emergency Loan Guarantee Act of the 1971 was enacted to authorize the Emergency Loan Guarantee Board (which composed of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System and the Chairman of the Securities and Exchange Commission) to guarantee or make a commitments to guarantee lender major business enterprises against loss of principal or interest on loans that meet the requirements provided under the Act and so forth are some of the prominent instances of bailout **phenomenon** in 20th C which ignite governmental intervention under the veneer of extending assistance to industry, private firm during the time of financial misery.

their economic policy and economical capacity on one hand and, the nature, depth of and risks posed by the phenomenon which necessitate an action for bailout on the other hand.

What makes this problem overwhelming is that, there is no consensus among bailout scholars on the definition of bailout. Instead, many describe the concept of bailout from their own perspectives focusing on evaluating a specific type of bailouts instead of developing general principles which can be serving as bedrock for bailout legislation.⁴¹ All the above problems coupled with the availability of tremendous schemes of government intervention and subsidy provided to the public institution and business enterprises took the effort of finding a comprehensive but precise definition of bailout, which embracing all distinct features of bailout phenomenon, from the mud to the mud.⁴² Nonetheless, for the concern of this paper, Cheryl D proposed definition of “bailout” is used. Cheryl D. defined bailout as: a special form of governmental interventions or arrangements designed with the intention to provide backing to business enterprises facing financial crises or liquidity constraint which the later cannot claim as of right instead stemming out of the free will of the former with the aim of rescuing the later from inevitable failure with an adverse social and economic effect.⁴³

The above definition of bailout contained unique features of bailout and critical benchmarks which can be used to distinguish bailout from subsidies and other wider range of governmental support which worth further discussion under the following sub-topics.

I. Bailout as a form of government intervention

Countless number of assistance may be provided by individual or other private entities to an enterprise with liquidity constraint. However, for a given assistance to be labeled as bailout, such intervention must be made by the government.

II. The requirement of Facing Financial Distress or Business Failure

Wide range of governmental intervention such as provision of incentives, subsidy and so forth can be made to private enterprises through different assistance schemes. However, for

⁴¹ Eric Posner & Anthony Casey, "A Framework for Bailout Regulation," *Notre Dame Law Review* 479 (2015), Vol. 91, p. 484.

⁴² Schillig, M. (2020). The (Il-)legitimacy of the EU Post-Crisis Bailout System. *American Bankruptcy Institute Law Review*, 28, 135-203. <https://www.abi.org/member-resources/law-review/the-il-legitimacy-of-the-eu-post-crisis-bailout-system>.

⁴³ Cheryl D. Block (1992), *supra* note 2 , P. 960.

such intervention to be branded as bailout, the bailout recipient must be at the brink of business failure or facing business failure.

The requirement of ‘facing financial distress’ in the definition of bailout is practically challenging as it is difficult to determine when does an enterprise is facing financial distress or in what situation that the enterprise should have to be found so that regarded as facing financial crises or business failure.

2.2 The short and long term socio-economic benefits of bailout

Aftermath of the Global Financial Crisis witness in 20th C, bailout was considered as unnecessary expense to the taxpayer and thereby become subjected to extreme politician and public critics. Consequently, different measurements were taken by different stakeholders to avoid or at least to reduce the possibility of future bailout. At the international level, for instance, the G20 and the Financial Stability Board (FSB) were taken the responsibility to coordinate efforts against bailout. Similar efforts against bailout were also evincing at national level. In USA, for instance, the philosophical anti-bailout foundation was embedded within the Dodd-Frank Act which was enacted to protect American taxpayer by culminating bailouts.⁴⁴ Despite of all these anti-bailout efforts, currently, the inevitable nature and the socio-economic benefit of bailout become crystal-clear. Consequently, countless number of politicians and commentators culminating their ant-bailout political rhetorical and argued for the development of structured bailout framework up on which the legitimacy of bailout underpinned, ensure the efficiency of bailout and avoid its unnecessary social, economic and political impact.⁴⁵

The significant socio-economic benefits associated with bailout forced politicians and bailout scholar to change their position and advocate for crafting bailout framework. The bailout can be construed as an act of embedding long-term socio-economic advantages through short

⁴⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Publ. L. No. 111-203, 124 Stat. 1376 (2010), Preamble.

⁴⁵ Adam J. Levitin, In Defense of Bailouts, 99 GEO. L.J. 435 (2011); Jeffrey Manns, Building Better Bailouts: The Case for a Long-Term Investment Approach, 63 FLA. L. REV. 1349 (2011); Eric A. Posner & Anthony Casey, A Framework for Bailout Regulation, 91 NOTRE DAME L. REV. 479 (2015); Robert K. Rasmussen & David A. Skeel, Governmental Intervention in an Economic Crisis, 19 U. PA. J. BUS. L. 7 (2016). For an early systematic analysis of bailouts see Cheryl D. Block, Overt and Covert Bailouts: Developing a Public Bailout Policy, 67 IND. L.J. 951 (1992); and later Cheryl D. Block, Measuring the True Cost of Government Bailout, 88 WASH. U. L. REV. 149 (2010).

term measures. Bailout measures do not have permanent nature, instead, it is a short term assistance being provided today to encourage more responsible business practices, save jobs, and address inequality and climate change, and build long-term resilience against future shocks. This is the case when too big to fail companies or corporates which are systematically important and have a central position within the domestic economic place at the brink of collapse. In this case the failure of such type of corporates would have a devastating socio-economic consequence. Economically, since they are large and deeply ingrained within the economy and have influential market share, their failure may result for the failure of other similar corporates and thereby would be disastrous to the economic system as a whole. Socially, since they have hired large number of worker, their failure inevitably make tremendous number of individual jobless. In this case, the failure of such kind of corporate will have significant macro-economic consequences such as loss of huge amount of tax revenues and drain government revenue and thereby challenged to cover other mandatory expenses, increasing unemployment and the cost for welfare programs, reduction of economic output and productivity, and a possible explosion of government debt. In poor countries, like Ethiopia, which have no economical capacity to cover the cost of welfare programs, such kind of situations might have devastating human right impacts.⁴⁶ In this case, government intervention through bailout this kind of corporates will enable to avoid all the above consequence and allow reaping the associated socio-economic benefits.

2.3 Misconceptions associated with the cost of bailout

Most of the time politicians and scholars of different disciplines criticized bailout arrangements for its associated economic cost and questioned the feasibility of bailout in developing countries as they are considered as economically weak, so that cannot afford its economic cost. This question is partially stemming from the misconception which perceiving bailout exclusively in relation to government injecting of huge amount of money, which is considered as unnecessary expenditure of taxpayers' money, into failing institutions and

⁴⁶ Block (1992), *supra* note 2, at 1013; Levitin, *Ibid*, at 451; Posner & Casey, *supra* note 41, at 522; Carmen M. Reinhart & Kenneth S. Rogoff, *this time is different: eight centuries of financial folly*, 164 (2009), at 163; Tobias Tröger, *Too Complex to Work: A Critical Assessment of the Bail-in Tool under the European Bank Recovery and Resolution Regime*, safe working paper No. 179, 12 (Jan. 2017); https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3023184, at 5; Giovanni Dell'Ariccia, Maria Soledad Martinez Peria, Deniz Igan, Elsie Addo Awadzi, Marc Dobler, and Damiano Sandri, *Trade-offs in Bank Resolution*, IMF staff discussion note (SDN/18/02, February 2018) 6, at 9.

markets, and thereby impose pointless burden on the taxpayers. However, this critics not only ignoring the associated socio-economic problems steaming from the failure of the concerned enterprise otherwise saved by bailout, but also fall to comprehend other bailout arrangements which are not necessary involve expenditure of public revenue.

From the perspective of their cost, bailout programs can be dissected into different categories.⁴⁷ Thus, under the following sub-topic different categories of bailout will be expounded in detail.

Profitable bailouts are the first bailout category in which no government funds may ultimately be expended. In other words, before the government bailout, it makes a due analysis to make sure the solvency of the concerned firm. The corporate also required repaying the loans in full and fee which contain costs associated with the administration of the program. Furthermore, the government also takes warrants from the firm which secures the risk of default.⁴⁸ In this case, the government does not loss a fraction of cents instead it may generate profit from the sale of warrants.⁴⁹

No or low-cost bailout is the second bailout category which embrace those bailout programs which neither profitable nor involve significant amount of public revenue.⁵⁰ Loan guarantee programs, in which the government acting as a guarantee for the loan the concerned firm received from private lenders, deregulation arrangements and so forth, fail under this category.⁵¹

Third party funding bailout arrangement is the third category which contains those bailout programs which involve substantial amount of funding from the source other than public

⁴⁷ Cheryl D. Block(1992), supra note 2 , p. 963

⁴⁸ Ibid

⁴⁹ In the Chrysler Corporation bailout case, for instance, the corporation was able to gain sufficient amount of loan cash under bailout arrangement from the US Treasury Department which in turn require the corporate to sale stock to it as a warrant to secure the loan. The corporation repaid the government loan and the fee which covered the administration of cost of the loan program. Furthermore, when the Chrysler Corporate financially recovered the value of its stocks rocketing to the sky and enables the government to generate millions dollar as profit from the sale of warrants. See R. REICH & J. DONAHUE, NEW DEALS: THE CHRYSLER REVIVAL AND THE AMERICAN SYSTEM 254-57(1985).

⁵⁰ Cheryl D. Block(1992), supra note 2 , p. 963

⁵¹ Ibid

budget.⁵² In this case the funding might generate from local sources such as bank regulatory authority and/or foreign sources like donation provided by international and regional organizations to stimulate national economy or for funding bailout programs.⁵³

Public revenue bailout programs, which also called general revenue bailout, are the forth type of bailout which funding from or involving the expenditures of public revenue.⁵⁴ In this case the taxpayers are the bear of economic cost of such bailout program.

The fifth bailout category contains those bailout programs which funded from a combination sources including public revenue. That is why this bailout category also referred as combination bailouts.⁵⁵

2.4 Classification of different types of bailouts

2.4.1 Overt versus Convert bailouts

As it can be understood from the name itself, overt bailout refers to those bailouts which are easily identified because they are extend by the government expressly in accordance with previously designed bailout policies aimed to prevent identified enterprises from failure. These types of bailouts most of the time take the form of direct assistance, loans or loan guarantees extended by the government directly to the financially distressed enterprise at stake.⁵⁶ Covert bailouts, which are also called hidden or disguised bailout, are those bailouts which are not easily to identify as they are not made expressly. These bailouts contain different bailout arrangements short of an explicit transfer of consideration to the concerned firm. Most of the time convert bailout can be provided to the troubled enterprise in the form of special tax breaks, providing a cooling period which exempting or exonerating the troubled enterprise from burdensome regulations, provision of incentives by the government aimed to encourage solvent firms to buy or merge with the insolvent firm, or laying down trade barrier, such as imposition of high traffics, quotas or total banning, on those goods imported from abroad, but similar or substituted with those products produced by the domestic enterprise which is the subject of the bailout arrangement, and thereby reduced market completion, increase market share of the troubled enterprise.⁵⁷

⁵² Ibid

⁵³ Ibid

⁵⁴ See Id., p 964

⁵⁵ See Id., p 965

⁵⁶ See Id., p. 968

⁵⁷ Ibid

From covert or indirect form of bailout the Failing Firm Defence to compliance with the antitrust laws is the major one. This defence is long-established, but ambiguous, doctrine under which an anticompetitive merger may be allowed because one of the firms is failing.⁵⁸ The ambiguity referred to reflects the two rationales offered for the failing firm defence. The competitive rationale suggests that the merger of a failing firm does not raise significant competitive concerns in any event.⁵⁹ The majority of commentators reject this justification, arguing that the merger of failing firms might well have anticompetitive effects.⁶⁰ Under the hardship rationale, mergers of failing firms are permitted in order to ease the suffering of employees, shareholders, and others who would be affected by a firm's collapse.⁶¹ Various nations accept this hardship justification and concedes in their Merger Guidelines that the failing firm defense may immunize significantly anticompetitive mergers. To start with US failing firm defense first appeared in American case law in 1930, with the case Federal Trade Commission VS. International Shoe Co. by which, the Supreme Court allowed the merger of two shoe companies.⁶² The Court decided that the acquisition of one corporation with depleted resources and remote prospects of rehabilitation, which would result in "loss to its stockholders and injury to the communities where its plants operated"⁶³, by another competing corporation, did not violate Section 7 of the Clayton Act⁶⁴, because the transaction did not substantially lessen competition.⁶⁵

To identify the defense's proper domain the Department of Justice and the Federal Trade Commission of US prepare the US Horizontal Merger Guidelines in 1992 which spell out the requirements for such a defense to be accepted as follows:⁶⁶

1. *"The allegedly failing firm would be unable to meet its financial obligations in the near future;*

⁵⁸ Cheryl D. Block(1992), supra note 2 , p. 970

⁵⁹ Ibid

⁶⁰ See Id., p. 971

⁶¹ Ibid

⁶² Library of Congress, U.S. Reports: Internat. Shoe Co. v. Comm'n, 280 U.S. 291 [Supreme Court of the United States, Sutherland, George](#) (1930)

⁶³ Ibid

⁶⁴ Section 7 of the United States Clayton Antitrust Act of 1914, forbids one corporation to acquire stock of another corporation (both being engaged in interstate commerce), where the effect of such acquisition may be to substantially lessen competition between them or to restrain such commerce in any section or community, and declares that it shall not apply to corporations purchasing such stock solely for investment and not using the same to bring about the substantial lessening of competition.

⁶⁵ See Supreme court of the United States, supra note 62 at paras 302-303

⁶⁶ Louise Caffrey, [The Failing Firm Defense in Times of Crisis: Past, Present, Future?](https://www.revuedesjuristesdesciencespo.com/index.php/2021/05/30/the-failing-firm-defence-in-times-of-crisis-past-present-future/), (<https://www.revuedesjuristesdesciencespo.com/index.php/2021/05/30/the-failing-firm-defence-in-times-of-crisis-past-present-future/>) last visted on April 13,2022

2. *it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and*
3. *Absent the acquisition, the assets of the failing firm would exit the relevant market;*
4. *It would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act.”*⁶⁷

Notwithstanding its origins in US case law, the failing firm defense also developed in European Union case law.⁶⁸ The first successful use of the failing firm defense in European Union case law appeared in 1994, in the Kali and Salz/MDK/Treuhand case.⁶⁹ Given that the acquired company is on the edge of bankruptcy, the failing firm defense was raised in part because the merger avoided a large loss of jobs.⁷⁰ The European commission then outlined the following three criteria to be especially relevant for the application of a failing firm defense.

1. *“the allegedly failing firm would, in the near future, be forced out of the market because of financial difficulties if not taken over by another undertaking;*
2. *there is no less anti-competitive alternative purchase than the notified merger; and*
3. *In the absence of a merger, the assets of the failing firm would inevitably exit the market.”*⁷¹

In 2002 the commission departed from the second criterion to broadened the scope of its application of the defense by stating that it would rather assess whether "the failing company's assets would certainly exit the market" unless they were not taken over by another.⁷² Following that, in 2004, the Commission's Horizontal Merger Guidelines acclaim these evolving circumstances for the application of the defense.⁷³

⁶⁷ U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, Issued: April 2, 1992 Revised: April 8, 1997 (<https://www.justice.gov/atr/horizontal-merger-guidelines-0>) , last visited on April 15, 2022

⁶⁸ See Louise Caffrey, *supra* note 66

⁶⁹ Case IV/M.308 *Kali and Salz/MdK/Treuhand* (1994)

⁷⁰ Kriska-Leila Goolabjith and Romeo Kariga, “Fading Firms and the evolution of the Failing Firm Doctrine in South Africa Competition Law”, paper presented at the 14th annual competition law, economics and policy conference, 3-4 November 2020, p.7

⁷¹ EU Horizontal Merger Guidelines, OJ 2004 C31/5, VIII , Para.90 available at (<https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A52004XC0205%2802%29>)

⁷² See Louise Caffrey, *supra* note 66

⁷³ *Ibid*

Authorities in the United Kingdom, like in those in the United States and the European Union, will approve an otherwise anticompetitive merger if the merging parties reap the benefits from the failing firm defense. This defense requires that: 1) the firm would depart the market unless the merger did not occur; 2) the company cannot rescue itself; and 3) there is no other option that would cause less harm to competition⁷⁴

Other jurisdiction like South Africa, the failing firm doctrine is impacted by experiences of other countries. However, it takes into account the distinctive peculiarities of the legislative framework in the Competition Act, No. 89 of 1998 (as amended) for its incorporation and application.⁷⁵

The failing firm doctrine is set forth in section 12A (2)(g) of the Competition Act where it is listed as one of the aspects to be considered when assessing whether or not a merger will likely result in the substantial lessening of competition.⁷⁶

When determining a substantial lessening of competition (“SLC”), section 12A (2) (g) requires competition authorities to examine “*whether the business or part of the business of a party to the merger or proposed merger has failed or is likely to fail.*”⁷⁷ As previously indicated, the failing firm defense is not a stand-alone defense as it is other in jurisdictions like the United States, but rather one of the criteria to consider when assessing if there is an SLC.⁷⁸

In order to apply the failing firm doctrine in a specific merger case, certain conditions that have been articulated through case law have to be met. The tests which will be used to evaluate the existence of the failing firm doctrine in South Africa are:

“(i) *The firm is likely to fail or has failed;*

(ii) *Other alternatives to save the firm were properly exploited before the merger was concluded;*

(iii) *There was no alternative purchaser that would result in a less anti-competitive outcome;*
and

(iv) *The assets of the failing firm would exit the relevant market absent the merger.*”⁷⁹

⁷⁴ Husen Tura, “Ethiopian Merger Regulation” *SSRN Electronic Journal*. April 2014 supra note 27, p.18

⁷⁵ Kriska-Leila Goolabjith and Romeo Kariga, supra note 70, p 9-10

⁷⁶ Republic of South Africa Competition Act, No. 89 of 1998 (as amended) section 12 A (2)(g)

⁷⁷ Ibid

⁷⁸ Kriska-Leila Goolabjith and Romeo Kariga, supra note 70, p.10

⁷⁹ See Id. , p.26

2.4.2 Prospective v. Retrospective Bailouts

Retrospective bailout is the most common type of bailout arrangement which imply the ex-post facto crafting and implementation of the bailout arrangement. In other words, the concept of bailout come in to picture or the government provides money and/or resources, which is also known as capital injection, or implement different forms of bailout arrangement after the concerned company, that is the subjected of the bailout arrangement, is situated in financial distress. Prospective bailouts, on the other hand, imply the ex-ante facto designing of the bailout arrangements for future financial crisis. The Federal Insurance Programs and the Federal Crop Insurance program, in USA, are the prominent example which falls within in the prospective bailout category.⁸⁰ The Federal Insurance Programs were designed, in advance with reserve capital, to provide assistance to some enterprises in case of future financial distress.⁸¹ Similarly, The Federal Crop Insurance Program, which is established by the Agricultural Adjustment Act of 1938, was crafted with the aim to alleviating the economic crisis caused by scarcity of wheat-crop due to drought and other cause.⁸² Farming enterprises are, thus, the primary beneficiary of the program.

2.4.3 Generic v. Specific Bailouts

Again bailout can be categorized as firm-specific bailout, industry-wide bailout and generic bailout. A bailout can be considered as firm-specific bailout when it is designed to provide assistance to specifically identified firm, whereas industry-wide bailouts are bailout arrangements which are designed to provide assistances to a given industry sector.⁸³ Thus, those enterprises or firms which belong to the industry sector identified by the bailout arrangement will be eligible to bailout. Generic bailout, on the other hand, is uncommon and rarely implemented bailout type in which the bailout arrangement provides some prerequisites or eligibility criteria, without identifying bailout beneficiary firms, and any enterprise, which fulfill the eligibility requirements entitled to bailout.⁸⁴ The Chrysler rescue bailout, Saving and Loan Industry rescue, and the Emergency Loan Guarantee Act, which authorizing federal loan guarantees to all enterprise which full fill the eligibility requirements

⁸⁰ Cheryl D. Block(1992), supra note 2., p 973

⁸¹ Ibid

⁸² Ibid

⁸³ See Id., p 976

⁸⁴ See Id., p 977

provided by the bill,⁸⁵ are some of bailout arrangements implemented in USA which are humdrum examples of firm-specific, industry-wide and generic bailout respectively.⁸⁶

2.5 Regulatory Bailouts

The organ empowered to provide bailout arrangements can vary from country to country. Nevertheless, most commonly bailouts arrangements may be made by the act of the parliament and/or by the decision of the executive branch of the government. In many countries the parliament has an inherent power to provide bailout arrangement through legislative actions, whereas the executive branch of the government's power to bailout steaming from a particular statute enacted by the parliament. In other words, a particular statute may vest sufficient discretionary power to the regulatory authority to provide bailout decisions concerning to firms subjected to its authority. Even in this case, the regulatory authority exercises such power up on the fulfillment of certain preconditions and subject to the proper scrutiny of the parliament.⁸⁷ Most of the time, Modern bank regulations, for instance, provide sufficient discretionary power to the regulatory authority to design bailout arrangements to banks subject to the conditions provided in the statute. Such bailouts arranged by the regulatory authority can be overt and/or covert in their form.

2.6 Subsidies

Bailouts and general government subsidies belong to the same conceptual family and share some characteristics; however they differ substantially as a matter of degree. Bailouts may have fewer beneficiaries than do general government subsidies.⁸⁸ Unlike general subsidies

⁸⁵ Emergency Loan Guarantee Act, Pub. L. No. 92-70, Stat. 178 (1971), established and authorized an "Emergency Loan Guarantee Board" to guarantee loans provided to any enterprise if:

(1) The Board believes that:

(A) the loan is needed to enable the borrower to continue to furnish goods or services and failure to meet this need would adversely and seriously affect the economy of or employment in the Nation or any region thereof,

(B) Credit is not otherwise available to the borrower under reasonable terms or conditions, and

(C) the prospective earning power of the borrower, together with the character and value of the security pledged, furnish reasonable assurance that it will be able to repay the loan within the time fixed, and afford reasonable protection to the United States; and

(2) The lender certifies that it would not make the loan without such guarantee.

⁸⁶ Ibid

⁸⁷ Cheryl D. Block(1992), supra note 2, p.977 & 978

⁸⁸ See Id., p. 956 & 957

which are intended to stimulate a particular desired or preferred activity, bailouts are intended to save a business or industry from collapse.⁸⁹ Individuals and businesses who incur significant losses as a result of natural disasters such as hurricanes, tornadoes, and floods may be eligible for subsidies.⁹⁰ This subsidy, like bailouts, may prevent financial collapse of a business that has sustained losses as a result of a natural disaster.⁹¹ However, assistance is not limited to those who would face bankruptcy without federal intervention. Rather, the subsidy acknowledges that natural disasters strike at random, imposing costs on the victims that the rest of us have avoided.⁹² When some private market players incur extraordinary expenses owing to circumstances beyond their control and the private insurance market is unable to cover the loss, communitarian arguments require that some kind of government assistance should be provided.⁹³

2.7 Theories of bailout

A The Public Interest Approach

A collection of shared beliefs or interests among citizens is known as the public interest.⁹⁴ This notion recognizes that there will be situation in which bailout will serve the public interest.⁹⁵ The challenge is to identify those special situations where public interest will be served. So some substantive and procedural standards will be necessary to determine the public interest to be served by any bailout.⁹⁶

b. The Pluralist Approach

The idea of a broad public interest is rejected by Pluralist or public choice theory, which holds that the market and the government are similar devices through which individuals cooperate in order to further their own interests.⁹⁷ Just as self-serving economic players enter into agreements in the economic arena; political actors enter into comparable agreements and compromises in the political marketplace.⁹⁸ Public choice theorists would argue that the real explanation for bailout legislation lies in the economic bargain reached by the relevant

⁸⁹ Ibid

⁹⁰ Ibid

⁹¹ Ibid

⁹² Ibid

⁹³ Ibid

⁹⁴ J. RoUssEAu, BOOK II in THE SOCIAL CONTRACT p.23.

⁹⁵ Cheryl D. Block(1992), supra note 2, p.996

⁹⁶ Ibid

⁹⁷ See Id., p. 997

⁹⁸ Ibid

players. In the case of a bailout by the efforts of powerful lobbyists, the individual firm or industry and its customers, creditors, and employees usually benefit.⁹⁹

C The Distributive Justice Approach

Allocative v. Redistributive Choices

Another relevant theoretical way to analyze bailout policies is Distributive justice analysis. According to this theory Legislation, particularly economic legislation such as a bailout, allocates or redistributes wealth.¹⁰⁰ However, the two concepts are distinguishable from one another. Redistribution presupposes a wealth transfer from some group members to others, Allocation, on the other hand, assumes *new* wealth that is to be allocated (as opposed to redistribute) to members of the group.¹⁰¹ Distributions of wealth undoubtedly occur during Bailouts. For example one may argue that deposit insurance redistributes wealth among participating financial institutions. Banks with greater risk investments profit at the expense of those with lesser risk investments due to the present flat-rate premiums imposed upon depository institution.¹⁰² Additionally, the rescue effort may have positive externalities or spillover economic benefits for the community.¹⁰³ The bailout is an allocative distribution if the community benefits to the point where everyone either benefits or remains neutral. A general revenue bailout is more likely correspond to redistribution of income from the general tax-paying public to the direct beneficiaries of the legislation, without any increase in net welfare.¹⁰⁴

2.8 Principles which should be incorporated within the framework designed to regulate bailouts

Bailouts can only be successful if the failing entity returns to a viable business model and profitability and, then, the state can recover the bailout funds from the profits.¹⁰⁵ Based on the known cases in U.S. such as Chrysler, which is one of big three automobile manufacturers, lost over a billion dollars in 1979.¹⁰⁶ The US government respond for this financial distress

⁹⁹ Ibid

¹⁰⁰ See Id., p. 999

¹⁰¹ Ibid

¹⁰² See Id., p. 1001

¹⁰³ Ibid

¹⁰⁴ Ibid

¹⁰⁵ See Virág Blazsek (2021), supra note 5

¹⁰⁶ Eric Posner & Anthony Casey, (2015) supra note 36, p 499

by injecting 1.2 Billion to the company.¹⁰⁷ The bailout took the form of a loan guarantee approved by the Chrysler Corporation Loan Guarantee Act.¹⁰⁸ During the process Chrysler tries to establish that the threatened collapse is due to outside factor. It claimed that a substantial portion of its financial trouble might be linked to the vehicle manufacturing industry's compliance with onerous environmental and safety regulations. In the end, Chrysler received no special relief.¹⁰⁹

In another instance, following the September 11, 2001 terrorist attacks, the US law makers authorized approximately \$15 billion in emergency government funding for airlines.¹¹⁰ Airlines received a direct payment of \$5 billion under the Air Transportation Safety and System Stabilization Act (ATSSSA).¹¹¹ This was characterized as compensation for the reduction in air travel caused by the grounding of flights following the attacks and the resulting decrease in air traffic. America West, American Trans Air, Aloha Airlines, Evergreen International Airlines, Frontier Airlines, US Airways, and World Airways all received guarantees.¹¹²

Even though bailouts procure myriad of benefits, this does not mean that bailout is short of any flaws: instead, significant number of bailout scholars, researches on the concerned area and empirical evidences demonstrate the socio-economic costs or problems inextricably intertwined with bailout.¹¹³ Most of these problems are not inherent to bailout system; rather partially they are the result of the lack of accountability and transparency of the bailout designing and implementation process.¹¹⁴ Yet, the ex post facto nature of bailout arrangement also exacerbates the problem.¹¹⁵

Thus, developing a framework which contains rules embedded on the following substantive and procedural principles is a cornerstone at least to reduce, if not possible to avoid, those

¹⁰⁷ See id., p. 495

¹⁰⁸ Eric Posner & Anthony Casey, (2015) supra note 41, p 499

¹⁰⁹ Cheryl D. Block(1992), supra note 2 p 970

¹¹⁰ Eric Posner & Anthony Casey, (2015) supra note 41, p. 504

¹¹¹ ibid

¹¹² ibid

¹¹³ Adam J. Levitin, supra note 45: Jeffrey Manns, Building Better Bailouts, supra note 45: Eric A. Posner & Anthony Casey, A Framework for Bailout Regulation, supra note 41: Robert K. Rasmussen & David A. Skeel, Governmental Intervention in an Economic Crisis, supra note 45: Cheryl D. Block, Overt and Covert Bailouts, supra note 2: Cheryl D. Block, Measuring the True Cost of Government Bailout, supra note 45.

¹¹⁴ Eric Posner & Anthony Casey, (2015) supra note 41.

¹¹⁵ Ibid

problems associated with bailout programs.¹¹⁶ Accordingly, the following sub-topics dedicated to expound those substantive and procedural principles which have been developed by scholars based on the U.S. bailout cases, i.e the advanced and where most bailouts were successful.

2.8.1 Substantive principles

2.8.1.1 Ex Post Efficiency

One of the driving forces behind making bailout is to rescue an illiquid firm which otherwise failed and thereby cause comprehensive socio-economic and political consequences. Thus, the government's respond to calling for help would be futile and the public resource spend for the implementation of the bailout arrangement would be lost if the enterprise so bailout cannot be saved from failing.¹¹⁷ Therefore, bailout, especially financial bailouts, should not be made to a firm unless it's ex post efficiency is certain.¹¹⁸ In other words, bailouts must be made to illiquid but solvent firm. This is because, the objective behind the bailout can be achieved and the associated externalities would be minimized if and only if the bailout is made to illiquid but solvent firms which are certain to be ex post efficient. If firms or enterprises so bailout would be ex post efficient, the objective behind bailout will be achieved, the cost associated with the bailout arrangement will be repaid and thereby the bailout may be profitable or at least has zero cost the public.¹¹⁹

2.8.1.2 The principle of Fairness

One of the major problems intrinsic to bailout is the issue of fairness- meaning most of the time bailouts are arranged to benefit some people while not to other or some group of individuals benefited more than some other groups.¹²⁰ Choosing limited number of firms from among similar or identical enterprises may be mandatory if there is resource limitation or if it could be possible to achieve the goal behind bailout by bailing out limited number of enterprises. Furthermore, most of the time, the decision making process and enterprise

¹¹⁶ Ibid

¹¹⁷ Cheryl D. Block (1992), *supra* note 2 , p. 956-58.

¹¹⁸ Ibid

¹¹⁹ Ibid

¹²⁰ Iman Anabtawi & Steven L. Schwarcz, *Regulating Ex Post: How Law Can Address the Inevitability of Financial Failure*, 92 TEX. L. REV. 75 (2013)

selection procedure for bailout is exposed to and criticized for political biasedness.¹²¹ The other sensitive issue which can be raised in relation to bailout is the fate of foreign enterprises.¹²² Favoring domestic institution than foreign firms also problem of fairness associated with bailout. The problem of unfairness witness during bailout not only impaired the individual interest of a given firm or class of firms, but it also defeated the national interest which aimed to advance by the bailout scheme and exacerbate other problems associated with bailout. Even though all the above issues are unavoidable and inextricably intertwine with and indispensable features of bailout, strong measurements, using broad-based programs or designing general eligible standards with uniform eligibility requirements or underpinning the bailout arrangement on broad-based eligibility requirements open for classes of firms and bailing outs only those that satisfy the eligibility criteria,¹²³ exploring ex-ante and ex-post efficiency, improving transparency and accountability and so forth should have to be taken to ensure the neutrality of the bailout schemes, limit favoritism towards individual firms, and to answer the issue of unfairness raised in relation to bailout arrangements.¹²⁴

Some criticized Broad-based bailout requirements principle as it might not be effective, because the government can designed the requirements in such a way that favor certain predetermine individual or politically connected firms. Furthermore, sometimes the government's decision to rescue individual firms through bailout arrangement might be

¹²¹ Timothy Geithner, the New York Federal Reserve Bank president and then Treasury Secretary, admitted in his memoirs that he underestimated Citigroup's problems because his mentor, Robert Rubin, sat on its board. See TIMOTHY F. GEITHNER, *STRESS TEST* 135 (2014). Similarly, in case of Goldman Sachs and Citigroup case, the government was accused for favoring politically connected banks (i.e. Goldman Sachs). Henry Paulson, the Treasury Secretary during the Bush administration, was a former Goldman CEO and hired numerous Goldman executives to work in Treasury

¹²² See, e.g., NEIL IRWIN, *THE ALCHEMISTS: THREE CENTRAL BANKERS AND A WORLD ON FIRE* 151–55 (2013); Neil Irwin, *How Ben Bernanke Saved Europe's Banks*, *GLOBALIST* (May 12, 2013), <http://www.theglobalist.com/how-ben-bernanke-saved-europes-banks/>; Jia Lynn Yang et al., *Fed Aid in Financial Crisis Went Beyond U.S. Banks to Industry, Foreign Firms*, *WASH.POST* (Dec. 2, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/12/01/AR2010120106870.html>.

¹²³ Dodd-Frank, for instance, permits only bailouts of groups of firms that satisfy broad-based eligibility requirements. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, Section 1101, 124 Stat. 1376, 2113 (codified at 12 U.S.C. Section 343 (2012)).

¹²⁴ . See Julie Creswell & Ben White, *The Guys from 'Government Sachs'*, *N.Y. TIMES* (Oct. 19, 2008), <http://www.nytimes.com/2008/10/19/business/19gold.html?pagewanted=all>.

justified. However, using Broad-based requirements put favoritism towards individual-firms more difficult than it might not otherwise be. Furthermore, if it is absolutely necessary and justified to rescue individual firms from public interest perspective, the decision of the government to that effect might not be subject to critics for discrimination.

2.8.1.3 Moral Hazard Principle

Serving as an incentive for the proliferation of different types of bad behavior is also the other cardinal problem of bailout. Bailout may make other firms to perceive that they will receive bailouts if they find themselves in similar situation with those firms so bailout. This is especially true when bailouts occur on regular basis.¹²⁵ The expectation for prospect bailouts encourages private agents towards socially undesirable behavior and bad market conduct. Thus, bailout packages should be structured so as to void the moral hazard externalities. To this end myriad of factors should have to be taken into consideration. First, bailout should only be made when the firms get into financial trouble due to reasons other than their own fault especially as a result of systemic collapse in the credit market. Bailouts provided during systematic financial crisis less likely to serve as an incentive. Second, bailouts should be accompanied by haircuts, high interest rates, and other penalties or payments which are sufficient enough to inflict some economic losses on creditors, owners and other stakeholders. This arrangement causes creditors, owners and other stakeholders not to profit from bailout. Third, the government should have shoulder the burden of proving that the bailout arrangement is absolutely necessary to halt an incipient crisis and achieve other public interest.¹²⁶

2.8.1.4 Administrative Costs

The other consideration during passing decisions concerning bailout arrangement is that, it is inevitable to have crowd of application for the bailout program if the bailout program is open to classes of firms or if the government offers bailouts too freely.¹²⁷ This is especially true in case capital injection and loan form of bailout.¹²⁸ Consequently, setting high administrative

¹²⁵ Eric Posner & Anthony Casey, (2015), Supra note 41. See also Adam J. Levitin, (2011) supra note 45; Jeffrey Manns, (2011) supra note 45

¹²⁶ Ibid

¹²⁷ Eric Posner & Anthony Casey, (2015), Supra note 41.

¹²⁸ Ibid

cost play a vital role to deter unnecessary applications and thereby avoid many firms from the realm of the bailout program.¹²⁹

2.8.1.5 Bailout should be used as a last resort

In the United States, any company requesting bailout assistance should be required to undertake an informal workout or a Chapter 11 reorganization in bankruptcy or to demonstrate that such an effort would not be impractical.¹³⁰ The enterprise also should demonstrate that private insurance was unavailable in order to disperse expenses among individuals in the sector.¹³¹ Although others in the same industry are not as closely associated with the enterprise as parties to a chapter 11 bankruptcy proceeding, they have a strong interest in the industry's survival. Before allocating bailout costs to the public, efforts should be made to allocate costs on a more appropriate group of beneficiaries.¹³²

2.8.2 Procedural Principles

2.8.2.1 The Principle of Transparency

As intimated earlier, bailouts can be made by the parliament and/or regulatory agencies.¹³³ Scholars of many disciplines propound for the authorization of regulatory agencies is justified for the reason that regulatory agencies can pronounce decisions of bailout more quickly and flexibly than the parliament and less likely to be influenced by irrelevant political factors. Furthermore, regulatory agencies are filled with professionals who enable the regulatory agencies to provide a valid decision concerning bailouts that advance public interest and their mission.¹³⁴ Yet, the parliament involvement is also very important for political legitimacy. However, to reduce problems associated with bailouts, achieve the reason behind them and save public resource, regulators should have to exercise their power transparently. The principle of transparency required them, among others, to hold public hearings before the approval of proposed bailouts. They have to hold public hearing in which they must inform the public, set a time frame work and invite any interested body to present pro or against arguments and adduce their evidence concerning the proposed bailout program. The

¹²⁹ Iman Anabtawi & Steven L. Schwarcz, (2013), *supra* note 120, p 124.

¹³⁰ Cheryl D. Block (1992), *supra* note 2, P. 1010

¹³¹ *Ibid*

¹³² See *id.*, P. 1011

¹³³ Eric Posner & Anthony Casey, (2015), *Supra* note 41.

¹³⁴ *Ibid*

recipients of potential bailouts should also be given an opportunity to propose terms, as should affected parties (such as creditors of the recipient), of the bailout program.¹³⁵

2.8.2.2 Allowing the Judiciary's Involvement

Bailout packages are designed to serve socio-economic interest. Yet, the decision and process of bailout packages as well as the content of bailout programs itself should have to be adherent with constitutional norms, democratic values and principles, and other relevant legal provisions enacted by the parliament. Even though the intensity of the judicial involvement is a matter of policy prefers, the judiciary must empower to receive and adjudicated cases related to bailout programs.¹³⁶ The court must have the power to check whether the bailout program is congruent with content of constitutional provisions, previously enacted frameworks for bailout regulation and other relevant legislations, the legitimacy of the agency to provide the concerned bailout package decision, the legitimacy and the justifiability of inclusion and exclusion criteria set for the bailout program and so forth.¹³⁷ Any parties affected by the bailout arrangement should also have the opportunity to present his/her grievance to the court and gain justice concerning to a given bailout program. If the term of the bailout imposed inappropriate burdensome and unfair obligations on a party, or if a person is improperly excluded from the realm of the bailout arrangement, the affected parties should have to entitle to judicial remedy. Thus, the role of the judiciary in evaluating the legitimacy of bailout programs and the decision making process is very important to reduce very complicated problems stemming from bailout programs and create an enabling environment to limit the power of regulatory agencies, save public resource, protect individual rights and public interest and achieve the motive behind the bailout programs.¹³⁸

¹³⁵ Ibid

¹³⁶ Eric A. Posner & Adrian Vermeule, *the executive unbound* 52–54 (2010).

¹³⁷ Ibid

¹³⁸ Eric Posner & Anthony Casey, (2015), *Supra* note 41

Chapter Three

3. The legal framework for business bailout in case of Economic Distress in Ethiopia

3.1 Introductory Remark

In spite of Ethiopia's weak economy, the current government uses some methods to assist businesses that are in distress. Among government assistance tools, subsidy and bailout can be mentioned as major one. To start with subsidy, **1**, To mitigate the impact of COVID-19 on service, manufacturing, export, finance and construction sector, ministry of finance of Ethiopia passed directive No. 64/2020 which relief the tax payer from the tax liability.¹³⁹ The tax amnesty applies for those who have been in dispute with the tax authority over unpaid taxes owing by a taxpayer until 2014/15 tax year.¹⁴⁰ According to the directive, these taxes would have to be paid in accordance with the provisions of the income tax proclamation, the mining income tax proclamation, the value added tax proclamation, the turnover tax proclamation, the excise tax proclamation and the tax administration proclamation.¹⁴¹ **2**, the ministry of finance has issued directive No 253/2013 which is applicable from September 2015, to support investors whose property has been destroyed due to natural and man-made disasters.¹⁴² This directive limited the beneficiaries to those businesses who have suffered 25% or more damage to their property as result of instability in the country or catastrophic floods.¹⁴³

When it comes to bailout; As a matter of policy Government of Ethiopia has followed a highly interventionist approach, it has been involved in almost every sector of economic activity and when this businesses faces distress it uses mostly public money to bail them out.

To prevent default or to restore SOEs already in default, the government establishes LAMAC under regulation No. 18/1997. This enables bailout decisions to be subject to the law. But the legislation does not address principles and criteria to be met for well-considered and successful bailing out. This undoubtedly opens the door for discretionary and arbitrary selections of business that might fail or require assistance. Lack of adequate regulation will also led to various irregularities: violation of already existing laws, use of taxpayers' money

¹³⁹ Tax relief directive No. 64/2020

¹⁴⁰ See Id., article 4(2)

¹⁴¹ See Ibid

¹⁴² Directive to support investors whose property has been destroyed due to natural and man-made disasters directive No 253/2013

¹⁴³ See Id., article 4

and state funds without prior legal authorization, lack of transparency and distortion of competition and overreliance on bailout funds and reckless risk-taking on the part of the public enterprise.

Another bailout program available to eligible merger applicants would be failing firm doctrine. Given the unprecedented economic devastation brought about by the lack of foreign currency and AGOA sanction, the failing firm doctrine may be raised more often by merging parties in the near future. So to prevent economic hardship from threatening the firms or industries viability there should be proper legal framework that gives effect to this special relief from regulatory requirements.

The establishment of the Ethiopian Deposit Insurance Fund through legislative action of council of minister is a proof for the existence of another bailout assistance arrangement in Ethiopia

In general this thesis interprets current bailout regime of Ethiopia as positive legal-regulatory development on the area, but it lacked certain conditions and fundamental principles that the legislator should have considered when designing bailout law. This thesis devoted on an analysis of principle and preconditions of bailout applied by other jurisdiction but are overlooked by bailout out laws in Ethiopia.

3.2 Failing firm doctrine in Ethiopia

The termination from AGOA beneficiary status and shortage of foreign currency are likely to result in a large number of businesses facing financial distress in Ethiopia. This will likely lead to increase merger notifications based on the failing firm doctrine (FFD).

This defence is long-established, but ambiguous, doctrine under which an anticompetitive merger may be allowed because one of the firms is failing.¹⁴⁴ To the extent that the failing firm defence does significantly immunize anticompetitive mergers that would otherwise be challenged by the competition authority, the defence can be regarded as a bailout

The Ethiopian Trade Practice and Consumer Protection Proclamation prohibit any merger which causes or is likely to cause a significant adverse effect on trade competition.¹⁴⁵ However the Proclamation allows the Authority to exceptionally approve a merger if

¹⁴⁴ Cheryl D. Block(1992), supra note 2 , p. 970

¹⁴⁵ Trade Competition and Consumer Protection Proclamation No 813/2013, Art. 9(1), Neg.Gaz. year 20th No 28

technological efficiency or other pro-competitive gain outweighs its anticompetitive effects and so long as such gain can be achieved without restraining competition.¹⁴⁶ This allows the competition Authority to balance the merger's costs and benefits, and is necessary to promote healthy competition.

To maintain the proclamation's purpose and to fill gaps in implementing the proclamation FDRE ministry of trade issued Directive No 1/2016. This directive incorporates concepts such as classification of mergers, factors which shall be taken into consideration during assessment of a merger, procedural requirements of merger notification, time frame for decision on notified merger, appeal, post-merger follow-up and penalties.

In Ethiopia the failing firm doctrine is enshrined in article 20.3B(1) of merger directive number 1/2016,¹⁴⁷ where it is listed as one of the factors to be considered when determining whether or not a merger will likely have adverse effect on the public interest and the public interest is viewed from general perspectives such as acceleration of economic development, promoting the transfer of technical knowledge or improving the production and distribution of trading goods or provision of service delivery.¹⁴⁸

Though Ethiopian merger directive treats saving failing business from the perspective of public interest, it doesn't provide further conditions to be met for assessing failing firm doctrine. This will likely create a difficulty for the competition authority to identify circumstances to be weighed in approving a merger based on FFD. Absence of tests for categorization of the failing firm also would open the gates to abuse in evaluating the merits of the failing firm merger filing.

The public interest considerations are neither sufficient basis for applying the doctrine in all cases; nor do they point to any clear way of identifying the doctrine's proper domain also difficult for merging parties to raise and satisfy the requisite evidentiary burden on the basis of these criteria.

According to article 20.3B (1) of merger directive, in dealing with merger the authority may consider the contribution of approved merger for salvaging a failing business but this does not determine how the doctrine of the failing firm should be applied or what test should be applied to establish that the business is a failing business.

¹⁴⁶ Id., Art. 11(2)

¹⁴⁷ FDRE Trade Competition and Consumers Protection Authority Merger Directive Number 1/2016

¹⁴⁸ Id. Art. 20.3(B)

The leading merger case, which captures public attention after the coming into force of a proclamation on trade competition and consumers' protection¹⁴⁹ is the approval of merger request between Meta Abo Brewery and BGI Ethiopia. Following the merger, Meta Abo joins BGI's other five breweries i.e., St. George Brewery, Kombolcha Brewery, Hawassa Brewery, Zebidar Brewery and Maychew Northern Brewery.¹⁵⁰ As the number of beer manufacturer's drops down to six this merger raises concerns of an oligopoly market structure in the brewery and distillery industry.¹⁵¹ Nonetheless the Ministry of Trade and Regional Integration approved this merger on January 1, 2024 under certain conditions.¹⁵² The ministry ordered BGI to avoid trade practices that affect product distribution route, not to enter into an agreement with other organizations that produce and distribute similar products that harm the commercial competition, to distribute the product by making sure that the consumer gets enough supply and quality product, not to abuse high market share caused by merger agreement, not to impose unfair selling price or unfair purchase on goods, services or commodities.¹⁵³ BGI Ethiopia is also obliged to maintain Meta Abo's workforce and employee benefits in compliance with agreed terms or obligations, to preserve the META brand and trade mark, to abide by contract made between Meta Beer Co., Ltd. and Meta Abo Beer Distributors and to continue to take social responsibility (for the benefit of the local community) that has previously been taken by Meta Beer Co., Ltd.¹⁵⁴ Some of this set of preconditions specified by the ministry are a mere reproduction of the proclamation on trade competition and consumers' protection while the rest are unfeasible for the ministry to routinely inspect whether BGI Ethiopia is adhering to the terms of the agreement. According to Senior merger and acquisition analyst who are close to the issue Meta Abo Brewery was in serious financial crises including 3.7 billion birr unpaid government tax debt starting from 2017 So the merger request is approved by considering the effect of the seizure of the factory by the government.¹⁵⁵ This also evidence that the ministry acknowledged Meta Abo Brewery as failing firm but it doesn't elaborate further in its decision on which test was applied to establish that the target was a failing firm.

¹⁴⁹ See Trade Competition and Consumer Protection Proclamation No 813/2013

¹⁵⁰ Meta Abo sells its share at measly 6% par value, Capital Newspaper, Jan.2,2024, (<https://www.capitalethiopia.com/2022/04/25/meta-abo-sells-its-share-at-measly-6-par-value/>) last visited on Sep 2,2024

¹⁵¹ Ashenafi Endale, Ministry approves Meta-BGI acquisition amidst monopoly concerns, The Reporter, Jan.2,2024, (<https://www.thereporterethiopia.com/38120/>) last visited on Sep 2,2024

¹⁵² Interview with Dagimawi Tsegaye and Dejene Legesse, Senior merger and acquisition analyst at Ministry of Trade and Regional Integration , 14 August, 2024

¹⁵³ Ibid

¹⁵⁴ Ibid

¹⁵⁵ Ibid

As it is mentioned above, this merger case raises serious competition concerns and lack of certain criteria to be applicable while considering failing firm doctrine exacerbates the situation.

In applying Merger Regulation including FFD the law doesn't make any difference between the public and private sectors. The only business activities exempted from merger regulation is those trade activities which are specified by council of ministers that deems vital in facilitating economic development.¹⁵⁶

In order to balance public interest considerations against the long-term competition effects of mergers, there are some factors, which are developed by other nation, that are material to the elements of the failing firm but are not included in the legislative frameworks of Ethiopia.

3.2.1 Whether the distressed company is likely to fail or has failed;

The 'failing firm' scenario is considered where one of the businesses claims to be in financial trouble and would have exited the market without the merger because of financial failure. Basically failing firm doctrine necessitate to show that a firm has failed or likely to fail.

In assessing these elements, other jurisdiction gives a relevant consideration to the business ability to survive under business rescue.¹⁵⁷ If business rescue has not been initiated, other similar factors will be considered to determine the likelihood of exit. In particular, this includes assessing whether (a) the company has a fundamentally sound business; (b) whether the financial distress is expected to be short-term rather than long-term; and (c) what alternatives have been explored to address the firm's liquidity problems including reorganize in bankruptcy.¹⁵⁸

In this regard, for approval of merger, the Ethiopian merger directive insists the competition authority to consider the salvageability of the failing business by significant contribution of the merger.¹⁵⁹ Despite the fact that this authorizes the competition authority to evaluate the claim of the businesses which may not be viable in the near future, it overlooked the businesses that have already failed

¹⁵⁶ See Trade Competition and Consumer Protection Proclamation No 813/2013, Art. 4(2)

¹⁵⁷ Raksha Darji, Rahma Leuner & Tamara Paremoer, "The Failing Firm Doctrine During COVID-19: A Perspective from South Africa", Competition Policy International, Antitrust Chronicle, September · Summer 2020, Volume 3(1) at page 5

¹⁵⁸ See Ibid

¹⁵⁹ See FDRE Merger Directive Number 1/2016, article 20.3B (1)

3.2.2 Whether there is a less anti-competitive credible offer from alternative purchaser?

This is second leg of inquiry that demands the merging parties to verify their good faith efforts into finding reasonable alternatives buyer whose purchase of the failing business would raise less competition concerns than the transaction under evaluation. If the failing business doesn't go through the process of finding alternatives to an anti-competitive merger, it won't be able to confirm that no such alternatives exist.¹⁶⁰ As is ordinarily the case, it is essential to consider all potential buyers who offered a price at or above the liquidation value rather than focusing solely on whose offer was the more lucrative, as that is likely to be the one with the largest anti-competitive effects.¹⁶¹ The FDRE merger directive doesn't incorporate the requirements to proof whether reasonable efforts have been made by failing business to find an alternative buyer which poses less anticompetitive risk.

3.2.3 Whether the assets of the failing company exit the market

The other notion that is overlooked by the FDRE merger directive in assessing the mergers under the FFD is the requirement from merging parties to show that if the business were to fail, its assets would exit the market rather than being acquired and put to productive use by other businesses.¹⁶² A merger is unlikely to increase market dominance, if one of the merging business impending failures would cause the assets of that business to exit the relevant market. In this instance, the exiting business's estimated market share and its significance are indeed zero. Customers are not worse off after the merger than they would have been had the merger been enjoined if the relevant assets would otherwise depart the market.¹⁶³

3.3 Debt servicing as bailout in Ethiopia

In Ethiopia a great deal of financial, commercial, agricultural or industrial enterprises are established under the ownership of the state or public authorities.¹⁶⁴ The country's economic policy can be raised as one of the major reasons which justify the establishment of public

¹⁶⁰ Raksha Darji, Rahma Leuner & Tamara Paremoer (2020), supra note 157 p. 6

¹⁶¹ See Ibid

¹⁶² See Ibid

¹⁶³ See U.S, Horizontal Merger Guidelines(1992), supra note 67

¹⁶⁴ Currently the government controls a significant number of business sectors, including airline, a commercial bank, an insurance company, a shipping company, a telecom company, chemical industries, mining factories, cement factories, metal works factories, pharmaceutical factories, coffee plantations, wineries, flour factories, shoe factories, hotels, and until recently even s beer factories and a spa. Based on 2009/10 data, access capital, Ethiopia: Macroeconomic Handbook 2011/2012, Access Capital, 2011 p. 64.

enterprises that engages in commercial activities. The second reason can be the need to address market failure such as insufficient private supply of goods and services and improving competition.¹⁶⁵ The third reason is to address capital shortages and market deficits, encourage economic growth, to increase employment opportunities, to develop capital intensive sector, and/or ensure national control over the economy's general course.¹⁶⁶ Because of their size and capacity these enterprises play huge role in the economy of the country.

For the start-up of megaprojects that were anticipated to enhance the manufacturing sector and exports, and for their expansion, State-Owned Enterprises (SOEs) borrowed heavily from domestic and foreign lenders and these businesses occasionally struggled to pay their debt obligations due to poor management, ineffective investments, and corruption.¹⁶⁷

To address the debt owed by SOE meaningfully, the Council of Ministers enacted a regulation for the establishment of the Liability and Asset Management Corporation (LAMC).¹⁶⁸ The LAMC was created mainly to overtake and service residual loans piled up by state-owned companies (SOEs) as well as loans that the SOEs failed to honor.¹⁶⁹

Of the 36 SOEs, LAMC has taken on 398 billion birr in debt from highly indebted public enterprises primarily from the Chemical Industry Corporation, Ethiopian Electric power, Ethio-Engineering group, and Ethiopian Sugar Corporation (ESC).¹⁷⁰

With regard to its asset, LAMC has four sources of funding to pay for the central government-guaranteed loans of SOEs. First is its own founding capital. LAMC was founded with 570 billion Birr of authorized capital of which 142 billion Birr is paid-up in cash and in kind.¹⁷¹ This is the country's biggest establishment capital followed by the Ethiopian investment holding which has a capital of 100 billion birr.¹⁷² The second source of finance comes from the proceeds of SOE privatizations and liberalizations and revenue generating

¹⁶⁵ Tewodros Meheret, "the concept and characteristics of public enterprises in Ethiopia: an overview", *Mizan law rev.*, Vol.8 No.2, December 2014, p. 356

¹⁶⁶ See Ibid

¹⁶⁷ Leul Estifanos, Ethiopia seeks to speed up reforms via new debt vehicle, Ethiopia Insight, 8 January, 2022, (<https://www.ethiopia-insight.com/2022/01/08/ethiopia-seeks-to-speed-up-reforms-via-new-debt-vehicle/>) last visited on March 19,2023

¹⁶⁸ Council of ministers regulations to provide for the establishment of Liability and Asset Management Corporation, 2021, Regulation No .483, Neg. Gaz. Year 27, no.13

¹⁶⁹ Ashenafi Endale, LAMC earmarks 176.3 billion birr for debt payment, The Reporter, Sep.3,2022, (<https://www.thereporterethiopia.com/26135/>) last visited on March 19,2023

¹⁷⁰ See Ibid

¹⁷¹ Liability and Asset Management corporation Establishment council of ministers Regulations No. 483/2021, Art. 6

¹⁷² See The Reporter, Sep.3,2022, supra note 169

activities.¹⁷³ The last source of funding that enables the government to earn returns on its bailout indirectly or that contributes greatly for the rescues to be ex post efficient is annual dividends paid by SOEs.¹⁷⁴

The previous few decades of international experience substantially supports the notion that bailouts of strategically significant businesses are inevitable but this does not signify that all bailout efforts were successful. Even after a rescue attempt, the business may fail, resulting in loss to government, employees, creditors, and others. One means of avoiding this loss is by having well-articulated legal regulation that prevent bailouts from following discretionary and arbitrary selections of business that might fail or require assistance. Lack of adequate regulation will led to various irregularities: violation of already existing laws, use of taxpayers' money without prior legal authorization, lack of transparency and distortion of competition.¹⁷⁵

Based on the available academic articles and known bailout cases it can be concluded that the US bailout selection technique was more effective than other countries' bailout methods.¹⁷⁶

Due to the existence of properly designed legal rules or principles at hand for bailouts that are specifically tailored for crisis situations, the US authorities have recovered every penny of the money spent on bank bailout with interest.¹⁷⁷ The failing businesses which undergone through bailout also exhibits relatively rapid economic recovery.¹⁷⁸

The establishment of LAMC through legislative action of council of minister is a proof for the existence of another bailout assistance arrangement in Ethiopia. But this legislation doesn't address the determinant factors or precondition under which bailout is appropriate. This gap in the law would cause the government bailout activity to be inefficient.

To prevent misallocation of public money or taxpayer money, the US framework for bailout and bailout cases embodies three basic factors and principles that determine when to rescue a firm or industry in financial distress.

¹⁷³ See Ibid.

¹⁷⁴ See Ibid.

¹⁷⁵ See Virág Blazsek (2021), supra note 5 p.2

¹⁷⁶ See See Id., p. 1

¹⁷⁷ See Ibid

¹⁷⁸ See Ibid

3.3.1 Reorganization bankruptcy

Any company seeking bailout assistance should be obliged to try an informal workout or chapter 11 reorganization in bankruptcy or at least demonstrate that such an effort would not be practical.¹⁷⁹ A case filed under chapter 11 of the United States bankruptcy code is often referred to as a “reorganization bankruptcy.”¹⁸⁰ The debtor usually remains “in possession”, has fiduciary powers and duties, is allowed to transact business and borrow new money with court approval.¹⁸¹ A plan of reorganization has been proposed, affected creditors can vote on the plan, and the plan can be approved by the court if it receives the necessary votes and meets certain legal requirements.¹⁸² From a standpoint of public policy, one advantage of the reorganization in bankruptcy is that the bailout costs are spread among those most closely associated with the company and those who benefit most from the company’s success.¹⁸³ The parties most interested in the operation will privately negotiate a solution in their own economic interest.¹⁸⁴

With regard to LAMC the regulation does not put forward the requirement of an attempt to reorganization or scale down to a smaller, more efficient enterprise. Resorting to bailout relief without realizing this step will compel the taxpayers to do what the banks would not do.

3.3.2 Deterring moral hazard

In US moral hazard concerns are the key to designing bailout rules. Except under extraordinary cases, an enterprise requesting bailout support should be required to demonstrate that the threat of failure is result of factors beyond its control.¹⁸⁵ Economic or other extreme conditions beyond the control of the enterprise requesting assistance may sometimes be the cause of failure. In other cases, however, threatened failure may be the result of fraud, mismanagement, or other internal factors.¹⁸⁶ In the latter case, providing bailout may exacerbate the moral hazard problem.¹⁸⁷ Allowing companies responsible for their own collapse to receive bailout assistance just as easily as those whose failure was

¹⁷⁹ Cheryl D. Block(1992), *supra* note 2 p.1010

¹⁸⁰ United States Courts, Chapter 11- Bankruptcy Basics, accessed from (<https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>) last visited on April 13, 2023

¹⁸¹ See *Ibid*

¹⁸² See *Ibid*

¹⁸³ Cheryl D. Block(1992), *supra* note 2 p.1010

¹⁸⁴ See *Ibid*

¹⁸⁵ See *Ibid*

¹⁸⁶ See *Ibid*

¹⁸⁷ See *Ibid*

beyond their control may encourage businesses to engage in risky behavior or it may promote more irresponsible and dangerous behavior.¹⁸⁸ In terms of public policy it should be clear that, unless in extraordinary situations, i.e. the public interest is so high that a bailout is required, bailout assistance requests will be considered only from those whose threatened failure is due to circumstances beyond their control. This second prerequisite is known as the "no-fault" precondition.¹⁸⁹

LAMC regulation does not specifically address or show any recognition of no fault precondition. It also does not lay down circumstances under which this criterion may be eased. According to the regulation LAMC will take over the liabilities of public enterprises as per the list it receives from the ministry of finance and service such debt with capital to be allocated from state funds and other resources that may become available to it.¹⁹⁰ Ministry of finance will provide the list of SOEs to LAMC that are identified as under a high risk of debt distress.¹⁹¹ So far the Ministry of finance does not have any well-articulated legislation or guidelines for selecting or designating failing eligible SOEs for bailout.¹⁹² As it is stated LAMC regulation does not require the government of Ethiopia to undertake any assessment on the root causes for the high debt distress of the SOEs, in consequence of this LAMC would settle debt of the SOEs even if a major portion of their failure could be attributed to the enterprises' own fault.

3.3.3 The likelihood of failure of Bailout recipient

As a third precondition, before considering bailout assistance, it should be reasonably clear that the business would fail without support.¹⁹³ As a practical matter, requiring the anticipated collapse to be clear and imminent has beneficial effect of avoiding unnecessary expenditure of government resource.¹⁹⁴ Furthermore, it is required by the operating definition of bailout itself that bailout is a type of government support or intervention meant to prevent enterprises failure.¹⁹⁵ Government assistance in the absence of adequate evidence that the company will

¹⁸⁸ See Ibid

¹⁸⁹ See Ibid

¹⁹⁰ Liability and Asset Management corporation Establishment council of ministers Regulations No.483/202 Art. 5(1)

¹⁹¹ Ministry of Finance Ethiopia, Overview of Liability Asset Management Corporation (LAMC),26 March, 2021, (<https://www.mofed.gov.et/blog/overview-liability-asset-management-corporation-lamc/>) last visited on April 14,2023

¹⁹² Interview with Tewedaj Mehammed, Senior legal officer at Ministry of finance, 10 July, 2023

¹⁹³ Cheryl D. Block(1992), *supra* note 2 p.1012

¹⁹⁴ See Ibid

¹⁹⁵ See Ibid

fail without support are not a bailout but another form of government subsidy.¹⁹⁶ Although the government of Ethiopia recognizes the debt servicing of SOEs as bailout¹⁹⁷, the law does not clearly specify at what stage of failure of the enterprises that bailout intervention would be made.

3.4 Deposit insurance as bailout in Ethiopia

In addition to FFD and debt servicing, another mode of government assistance which may also identify as bailout is deposit insurance. Deposit Insurance is a system established to prevent default of the banking system and protect depositors from losing their insured deposits in the event that a depository institution collapses.¹⁹⁸ This kind of protection strengthens public confidence in the banking system and prevents deposit runs.¹⁹⁹

Some have argued that the deposit insurance bailout is mislabeled because the funds aren't being used to bail out anyone; rather, they are being used to satisfy the government's insurance obligations to depositors.²⁰⁰ Under the proposed bailout definition, this argument initially has some validity, but upon closer examination a bailout surely can be found in the deposit insurance. Customers or depositors may be protected by a deposit insurance program, but when the program covers a liability to a customer or depositor for which the business enterprise would otherwise be liable, the payment does provide assistance to the enterprise.²⁰¹

In majority of the nations, explicit deposit insurance has been established after they have encountered a banking crisis.²⁰² Unlike these states, Ethiopia has not yet encountered any occurrences of bank failure.²⁰³ However, the Ethiopian Deposit Insurance Fund (here after shall be referred to as "the Fund") providing insurance for depositors in commercial banks was established by Regulation No. 482/2021.²⁰⁴

¹⁹⁶ See *Ibid*

¹⁹⁷ See Ministry of Finance Ethiopia, 26 March, 2021, *supra* note 191

¹⁹⁸ Senbeta, T. B. (2023). Regulatory Regime Governing Deposit Insurance under the Ethiopian Law: A Comparative Review in Light of International Core Principles' Perspectives. *Beijing Law Review*, 14, 253-274. p 253

¹⁹⁹ See *id.*, P. 256

²⁰⁰ Cheryl D. Block (1992), *supra* note 2, p. 960.

²⁰¹ *Ibid*

²⁰² Senbeta, T. B. (2023). *supra* note 198 P. 253

²⁰³ *Ibid*

²⁰⁴ Establishment and Operation of Ethiopia Deposit Insurance Fund council of ministers Regulations No. 482/2021

The fund is an independent organization authorized to manage and administer and effect payment of deposit insurance of all financial institutions in the event of bank failure.²⁰⁵ It was came into being as a single fund institution with the authority to serve all financial institutions including government banks and private ones under one umbrella.²⁰⁶

The Ethiopian deposit insurance fund regulation is composed of six parts and included 43 provisions.²⁰⁷ Under part one, definitions of term used and scope of application are included. It is applicable to all financial institutions licensed by the national bank of Ethiopia.²⁰⁸ Part two incorporates concepts such as power and functions of the Fund, organization of the Fund, meeting and benefits of board members, appointment, power and functions of the chief executive officer of the fund.²⁰⁹ payments made by a member financial institution to the Fund, incomes of the fund and the methods of financing the Fund when there is shortfall of Resources are captioned as financial provisions under part three.²¹⁰ Part 4 basically contains factors which shall be taken into consideration during Insurance Event, amounts of insurable deposits and coverage limits.²¹¹ Membership of the Fund, cessation of Membership and its effect are governed under part five.²¹² The final part consists of miscellaneous provisions including Grievance hearing and penalties.²¹³

3.4.1 Financing the Fund when there is Shortfall of Resources

Deposit insurance schemes can be established by contributing funds for the startup or without funding. In funded systems the members are required to contribute on a regular basis (ex-ante) to the fund which that will be used to reimburse depositor in the event of insurance incident.²¹⁴ In unfunded systems members are required to make contributions to the fund after the failure (ex-post).²¹⁵ There are certain scenarios that show The Ethiopian Deposit insurance regulation has followed the ex-ante funding system. The regulation requires deposit

²⁰⁵ Id. Art. 4(1)

²⁰⁶ Id. Art. 3 and 16

²⁰⁷ Regulations No. 482/2021, supra note 204

²⁰⁸ Id. Art. 1-3

²⁰⁹ Id. Art. 4-15

²¹⁰ Id. Art. 16-18

²¹¹ Id. Art. 21 and et. seq.

²¹² Id. Art. 24-28

²¹³ Id. Art. 29-43

²¹⁴ Senbeta, T. B. (2023). supra note 198 P. 265

²¹⁵ Ibid

insurers to pay yearly contribution and the initial premiums.²¹⁶ Furthermore, it also states that the government shall make contributions of 2 million birr to the fund.²¹⁷

Apart from the above, if at any time, resources of the Fund fall short of its liabilities, such shortfall will be covered by bailout funding by government when the shortfall induces systemic crisis in the financial system.²¹⁸ Such action restore consumer confidence, prevent bank runs, allows the bank to continue essential services or lessen risks posed to the Fund from severe financial conditions that might threaten the stability of a significant number of insured banks.²¹⁹ However contrary to this the regulation stipulates that the Fund undertakes to pay the insured deposits money only on the date when the National Bank announces the revocation of a business license of the failed financial institutions.²²⁰ In this case one might argue that banks are not bailed out as a result of The Fund payments to depositors. As is well known bailout is designed to prevent enterprise failure or keep troubled firms in business, the requirement of liquidation or closing of an insured bank to pay insured depositors contradict with the very essence of bailout. So it is essential to revisit this loophole in the legislation and make the payment available for the insured depositors before the financial institution withdraw from the market.

²¹⁶ Regulations No. 482/2021, supra note 204 Art 16(1)

²¹⁷ Id. Art. 16(4)

²¹⁸ Id. Art. 18(1)(a)

²¹⁹ Cheryl D. Block (1992), supra note 2 , p. 978

²²⁰ Regulations No. 482/2021, supra note 204 Art 21

Conclusion

This thesis has attempted to give an overview of bailout as well as outline the benefits of using bailout as a mechanism of rescuing failing businesses. It has analyzed the law of bailout in Ethiopia. In so doing, it highlighted some legal issues that have not been addressed by the Liability and Asset Management corporation Establishment council of ministers Regulations No. 483/2021, FDRE Merger Directive Number 1/2016 and Establishment and Operation of Ethiopia Deposit Insurance Fund council of ministers Regulations No. 482/2021. Bailout cases which involve finance are carried fully by government only to settle country's state owned enterprises' (SOE) debt. Apparently bailouts can only be successful if the failing entity returns to a viable business model and profitability and, then, the state can recover the bailout funds from the profits. Due to the existence of properly designed conditions or principles at hand for bailouts that are specifically tailored for crisis situations, the US authorities have recovered every penny of the money spent on bank bailout with interest. The failing businesses which undergone through bailout also exhibits relatively rapid economic recovery. So the thesis suggests that there is need for the LAMC regulation to conform to the US framework for bailout and bailout scenarios. With regard to the category of bailouts that exempt from the need to comply with burdensome regulation, the available bailout scheme to eligible merger applicants under Ethiopian context would be failing firm doctrine. The failing firm doctrine is enshrined on article 20.3B (1) of merger directive number 1/2016. However under the directive the concept of failing firm doctrine is not defined and further requirements that helps to identify this form of bailout is not provided. Therefore, this thesis proposes for the merger directive to be match up to other countries failing firm doctrine. In addition to FFD and debt servicing, another mode of government assistance which may also identifies as bailout in Ethiopia is deposit insurance. This program covers a liability to a customer or depositor for which the business enterprise would otherwise be liable. Nevertheless Regulations No. 482/2021 requirement of liquidation or closings of an insured bank to pay insured depositors contradict with the very essence of bailout.

Recommendations

- ❖ In order to clarify the idea of failing firm doctrine and to lay out test to be met under failing firm doctrine the current merger directive of Ethiopia need to be amended. This would entail the consideration of already well-established tests in the South Africa, US and EU as well as other jurisdictions to determine what would best suit the Ethiopian situation.
- ❖ F.D.R.E Ministry of Trade and Regional Integration Authorities also need to consider to issue a set of guidelines on what evidence should be submitted and how a merger predicated on the failing firm doctrine will likely be assessed. This would provide the merging parties some assurance on the type of evidence they should present to support of their reliance on the failing firm doctrine. In other word the competition authority should develop the list of standard to be satisfies by the merging firms in order to invoke the doctrine of the failing firm
- ❖ Given the urgency of the financial difficulties and eventual bankruptcy of the business, the directive need also specify a reasonable time in which the target firm should approach potential buyers.
- ❖ Regarding debt servicing, the major problem about this bailouts is that, it may generate socially undesirable incentives, so to minimize this effect, legal reform should be necessary to make moral hazard effect limited. The law is expected to be designed in a way to deter the enterprise from taking on excessive risk. accordingly, I suggest that bailout assistance (through lending or investing) requests will be considered only from those whose threatened failure is due to circumstances beyond their control
- ❖ The law should state preconditions and principles that cut down the LAMCs' bailout program to those SOEs that the anticipated collapse is clear and imminent.
- ❖ For the realization of the main purpose of business bailout council of minister should revisit and amend provision which contradict to the very essence of bailout and should make the payment available for the insured depositors before the financial institution withdraw from the market.

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