ADDIS ABABA UNIVERSITY

COLLEGE OF LAW AND GOVERNANCE STUDIES

SCHOOL OF LAW

Priority Right between Creditors over Collateralized Properties in Ethiopia with Special Emphasis on Properties Given as Collaterals to Secure Bank Loans.

By

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A Thesis Submitted to the College of Law and Governance Studies of Addis Ababa University in Partial Fulfillment of the Requirements of the Degree of Masters in Business Law (LL.M)

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June, 2025

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Declaration

I, Hawi Feyisa, hereby declare that this thesis is my original work, and has not been presented for a degree in any other institution, and to the best of my knowledge and belief all sources of materials used for the thesis have been fully acknowledged and cited.

Hawi Feyisa Aredo

Signature:

Date: 12/5/2025

Acknowledgment

First of all, I would like to thank the Almighty God, for giving me the courage and strength to accomplish this thesis.

I want to express my heartfelt gratitude to my advisor, Prof. Zekarias Keneaa, for his invaluable guidance and unwavering support throughout this academic journey. His professional advice, critical comments, and insightful recommendations have significantly shaped this work.

My special thanks go to all my coworkers at Hibret Bank S.C who collectively made this thesis possible. I am deeply grateful for their generous contributions of ideas, insights, and practical knowledge related to priority rights and secured transactions. Their willingness to share the workload during this period provided me with the time needed to focus on researching and writing this thesis. Their support and understanding have been instrumental to the completion of this work.

Last but not least, I would like to thank my family, friends, all interviewees, written interview respondents who participated in this study and everyone who contributed to the successful completion of this thesis.

Acronyms

CBE- Commercial Bank of Ethiopia

Civil Code- Civil Code of the Empire of Ethiopia Proclamation No. 165 of 1960

ERCA- Ethiopian Revenues and Customs Authority

FDRE- Federal Democratic Republic of Ethiopia

FSC- Federal Supreme Court

HMRC- Her Majesty's Revenue and Customs

IMF- International Monetary Fund

IP- Intellectual Property

IRS- Internal Revenue Service

NBE- National Bank of Ethiopia

NPL- Non-performing loan

PBGC- Pension Benefit Guaranty Corporation

PLC- Private Limited Company

PMPBP- Property Mortgaged or Pledged with Banks Proclamation

S.C- Share Company

TAP- Tax Administration Proclamation

UCC- Uniform Commercial Code

VAT- Value Added Tax

ERISA- Employee Retirement Income Security Act

Abstract

*This research investigates the legal framework governing priority rights between creditors over collateralized properties in Ethiopia, with emphasis on properties securing bank loans. The study is motivated by the existing uncertainty in Ethiopia's secured lending system, where various types of creditors, both secured and unsecured, assert competing claims against a single property, leading to disputes whenever debts mature and payment is sought. Through a combined doctrinal and non-doctrinal approach, analyzing legal provisions, examining court cases, and conducting face to face and written interviews with bank officials, the research identifies significant gaps and inconsistencies in Ethiopia's fragmented legal framework. The findings reveal that while the Civil Code establishes that secured creditors should have priority rights, subsequent laws have eroded this principle, granting preferential status to certain non-consensual creditors without appropriate limitations. The study argues that Ethiopia's current approach undermines the effectiveness of secured transactions as a mechanism for facilitating access to credit, with negative implications for financial inclusion and ec*onomic development.

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Chapter 1
Introduction

1.1 Background of the study

Collateralizing property to secure loans is crucial for the nation's economic development and this practice is common worldwide. In Ethiopia, the Civil Code of 1960 allows both legal entities and natural persons to use movable and immovable properties as collateral. This legal framework ensures that if a debtor defaults, creditors can recover their dues including principal, interest, costs and any penalties by selling the collateralized property.

One notable feature of Ethiopian law is the ability for multiple creditors to collateralize a single property. As stated in Article 3081 of the Civil Code, "Where several creditors have a registered claim on the same immovable, they shall rank according to the date on which they have registered their claim." This provision illustrates that several lenders can secure their loans against a single mortgage, facilitating a more dynamic and efficient marketplace.

The implications of allowing multiple loans secured by single collateral are significant for both mortgagors and mortgagees. For mortgagors, it provides greater access to credit, enabling them to utilize their assets to obtain necessary financing for business ventures or personal needs. On the other hand, mortgagees benefit from increased security in their lending practices, as they can diversify their risk across multiple loans secured by the same asset, potentially leading to higher overall lending volumes and economic activity.

However, complications arise when multiple creditors seek to exercise their right to foreclose on single collateral. The Civil Code under article 3076 states that the mortgage shall secure the payment to the mortgagee, in priority to other creditors, of the registered amount of the claim. This means that in the event of liquidation or default, the creditor with the earliest registered claim will have priority over others, creating a competitive environment among creditors.

Adding to this complexity, there are specific laws that grant priority rights to certain creditors. For instance, Article 12(15) of Proclamation No. 1268/2022 (Private Organization Employees' Pension Proclamation) stipulates that pension contributions, as a social security payment for employees, shall take precedence over other debts. This provision underscores the importance of protecting employee entitlements, ensuring that their pension contributions are prioritized in the event of a debtor's default.

Similarly, Proclamation No. 1156/2019 (labor proclamation), in Article 168, asserts that any claims arising from employment relationships shall have priority over other payments or debts. This legal framework reflects a commitment to safeguarding workers' rights, emphasizing the significance of timely payment for wages and benefits.

The Federal Tax Administration Proclamation No. 983/2016 outlines the rights of the tax authority regarding claims on a taxpayer's assets, particularly concerning unpaid taxes. According to Article 39(1), once a taxpayer's tax becomes due and payable, the tax authority is granted a preferential claim on the taxpayer's assets, meaning it can recover unpaid taxes before other claims are settled, provided there are no prior registered secured claims. Article 39(2) further clarifies the hierarchy of claims, stating that while the tax authority has this preferential status, the rights of secured creditors, like banks, and employee claims related to salaries and wages must also be respected. However, secured creditors must ensure that the tax clearance certificate is held by taxpayer before extending loans, as indicated in sub-article (7). Importantly, the priority rights of banks do not apply to specific taxes outlined in Article 33(1) (a), such as withholding tax, value-added tax (VAT), turnover tax, and excise tax. This means that in cases of default on these particular tax obligations, banks cannot claim priority over the tax authority's interests in the taxpayer's assets. Overall, this legal framework creates a complex interplay between the rights of the tax authority and those of secured creditors, underscoring the importance of tax compliance and the need for clarity in the hierarchy of creditor claims to facilitate smoother transactions and mitigate potential conflicts among stakeholders.

Given the multiplicity of laws granting different priority rights, it becomes evident that there is no clearly defined hierarchy among these right holders. This lack of clarity can lead to disputes among creditors and complicate the enforcement of claims, ultimately undermining the effectiveness of secured lending practices in Ethiopia.

This study aims to explore these complexities, providing a comprehensive analysis of the priority rights among creditors over collateralized properties, and advocating for a clearer legal framework to enhance the predictability and fairness of debt recovery processes.

1.2 Statement of the problem

In Ethiopia, banks require collateral to provide loan in most cases, though not necessarily in every situation.[1] This practice of collateralizing property to secure loans is vital for economic growth, yet it is filled with complexities that hinder effective lending practices. The Civil Code of 1960 allows multiple creditors to register claims against a single property, fostering access to credit for mortgagors and enabling mortgagees to diversify their lending risks. However, this system creates significant challenges when multiple creditors attempt to exercise their foreclosure rights on the same collateral. The existing legal provisions, particularly Article 3076 of the Civil Code, prioritize the creditor with the earliest registered claim, generating a competitive environment that can lead to disputes and inefficiencies in debt recovery. Regulation No. 163/2016, under Article 24 (5), states that if there is a prior registration of collateral securing a loan, the registration of any subsequent collateral must only occur with the written agreement of the first creditor. This creates a contradiction, as it restricts a creditor's ability to directly register their rights which is stated under the civil code. Furthermore, this approach does not address the challenges faced by unsecured creditors, leaving them vulnerable and without recourse, thereby failing to provide a solution to the issues within the lending framework.

Moreover, various laws grant specific priority rights to certain creditors, complicating the hierarchy of claims further. For instance, the Private Organization Employees' Pension Proclamation and the Labor Proclamation prioritize employee claims for pension contributions and wages, respectively, while the Federal Tax Administration Proclamation grants the tax authority a preferential claim over unpaid taxes. This overlapping framework creates uncertainty for creditors, as the rights of banks and other secured creditors are circumscribed by these specific provisions, particularly concerning taxes such as VAT withholding and excise tax.

The lack of a clearly defined hierarchy among these competing rights holders undermines the predictability of secured lending processes and can lead to protracted legal disputes. As a result, creditors may be hesitant to extend loans, fearing the complexities and potential losses associated with the current legal framework. This study seeks to address these critical issues by analyzing the existing legal landscape, identifying the challenges posed by the multiplicity of priority

[1] Deresse Marsha and Zerihun Ayenew, Financing Practices of Middle and Small Enterprises in West Oromia Region, Ethiopia, 2 (10) Journal Of Management Research, 2018, P. 10-11

rights, and advocating for a more coherent legal framework that enhances the fairness and efficiency of debt recovery practices in Ethiopia.

1.3 Literature review

To the knowledge of the researcher, there is no domestically written literature specifically addressing priority rights between creditors over collateralized properties in Ethiopia. However, there are various domestically written articles and research papers that examine different aspects of creditor rights and related issues within the Ethiopian legal framework.

Hagos Bereket[2] examines the scope of banks' powers under Ethiopian law, emphasizing the significance of the Civil Code and the Property Mortgaged or Pledged with Banks Proclamation (PMPBP). The Civil Code lays the groundwork for security interests, while the PMPBP enhances banks' enforcement capabilities, granting them superior priority rights over collateralized properties. The thesis addresses the scope of banks' power in the enforcement of security interests under Ethiopian law. This is exemplified in the case of *Wegagen Bank v Ethiopian Revenues and Customs Authority*, where the court ruled in favor of the bank's security interest, affirming its precedence over subsequent government claims related to criminal proceedings. Such legal precedence underscores the preferential treatment banks receive in the Ethiopian legal system. However the paper is limited to enforcement of security interests by bank creditors only.

Gemmeda Amelo Gurero[3], on his journal, has examined the scope of rights of creditor banks over mortgaged property within Ethiopia's legal framework, analyze validity requirements for mortgages, bank rights when multiple properties are mortgaged, priority rights among creditors, and scenarios involving third-party transferees or mortgagors. However, the journal fails to address issues such as the absence of a comprehensive law regarding priority rights and the impact of various laws that potentially erode secured bank creditor protections. While the article

[2] Hagos Bereket, The scope of banks' power in the enforcement of security interests under Ethiopian law: lessons from the US and the OHADA laws, Central European University, 2018

[3] Gemmeda Amelo Gurero, Scope of Rights of Creditor Banks over Mortgaged Property in Ethiopia, Hawassa University Journal of Law, volume 8, July, 2024

mentions priority rights under Article 3081 of the Civil Code and discusses certain exceptions (such as tax authority claims under Federal Tax Administration Proclamation No. 983/2016), it doesn't examine the fragmented nature of priority rules scattered across different laws or analyze how recent legislative developments might be undermining secured creditor protections. Additionally, there is insufficient clarity in the procedural mechanisms for coordinating between multiple creditors during foreclosure processes, leading to potential inefficiencies and disputes.

Adamu Shiferaw's[4], in his LLM thesis, has written on the law and practice of power of sale foreclosure in Ethiopia analyzes and identify the legal and practical challenges in case of sale foreclosure in Ethiopia. The journal concluded that, the recently enacted law of power of sale foreclosure neither enabled banks to collect their loan nor encourage good business culture. Even if the thesis shows the gaps in relation to foreclosure law, it does not delve into the competing priority rights between different creditors, such as bank, pension organizations or employee salary claims, leaving a gap in understanding how these relationships interact.

Alefe Beza[5] on his literature examines the rights and obligations of mortgagees and pledgees under Ethiopian law, identifying disconnects between legal provisions and court practices. The author's primary contribution lies in exposing how Ethiopian courts systematically ignore judicial mortgage (Article 3044 of the Civil Code) in favor of attachment procedures, unnecessarily restricting mortgagors' ownership rights, particularly their ability to transfer property. When a mortgaged property is sold, the mortgagee has the right to receive payment first, positioning them ahead of unsecured creditor. Unsecured creditors can only claim payment after all secured creditors have been satisfied, and only if there is surplus money left from the sale of the property. The literature failed to discuss the controversy between laws related to priority rights between different types of creditors, specifically regarding the relationship between banks and other creditors, such as employees and tax authorities.

[4] Adamu Shiferaw Zeleke, The Law and Practice of Power of Sale Foreclosure in Ethiopia, 2005

[5] Alefe Beza, The Right and Obligation of Mortgagee and Pledgee under Ethiopian Law, The Law and The Practice, 2009

Given these identified gaps, it is crucial to undertake further research on the priority rights between creditors over collateralized properties in Ethiopia, particularly focusing on properties given as collateral to secure bank loans. This research aims to clarify the interactions between existing legal frameworks and propose necessary reforms to create a more efficient system for managing priority rights in Ethiopia's evolving financial landscape.

1.4 Research objective

1.4.1 General objective

The main objective of this thesis is to analyze the complexities of priority right among creditors over collateralized properties in general and Banks in particular in Ethiopia, with the aim of providing a comprehensive understanding of the legal framework in this regard and its implications for secured banks' lending practices.

1.4.2 Specific objectives

1. To identify and analyze the legal definition of "creditors" under Ethiopian law.
2. To examine the treatment of priority rights under Ethiopian law.
3. To evaluate the extent to which secured creditors are genuinely protected and prioritized over other creditors in Ethiopia.
4. To investigate how Ethiopian law regulates the rights of bank creditors in relation to properties pledged as collateral for bank loans.

1.5 The research questions

1. Who does the law treat as "creditors" in Ethiopia?
2. How do laws in Ethiopia treat priority rights?
3. Are secured creditors truly secured and are they given priority over all other creditors in Ethiopia?
4. How does the law treat bank creditors concerning properties given as collaterals to secure bank loans?

1.6 Methodology

This research has combined both doctrinal and non-doctrinal methodologies to explore the priority rights between creditors over collateralized properties in Ethiopia, particularly focusing on properties used as collateral to secure bank loans. The doctrinal component began with a literature review aimed at establishing a foundational understanding of the legal framework governing priority right between different creditors over a property given as collateral to secure bank loan. This review also included an analysis of academic articles, journals, legal textbooks, reports and relevant commentaries. To further enrich this aspect of the study, relevant legal cases have been examined to understand how Ethiopian courts interpret and apply laws regarding priority rights and secured transactions. This examination helped identify the status of secured creditors relative to that of unsecured creditors in Ethiopia.

On the non-doctrinal side, an empirical investigation assessed the practical implications of the legal framework on the priority rights of creditor banks. This involved gathering data through face to face interviews with legal department directors and written interview with persons with relevant experience in the field from seven (7) selected commercial banks. I chose a stratified purposive sampling method based on the National Bank of Ethiopia's classification of banks into large, medium, and small categories. This approach allowed me to select representative banks from each category that had relevant experience with collateralized loans and priority rights issues, giving me a balanced perspective across Ethiopia's diverse banking landscape while keeping my research manageable.

The research employed comparative analysis examining the priority rights protection of four jurisdictions: Kenya, United States, China and the United Kingdom. These jurisdictions were selected based on legal system diversity and varying economic development levels.

1.7 Scope of the study

This study focuses on the legal framework governing priority rights among creditors over collateralized properties in Ethiopia. The scope encompasses an analysis of relevant laws, including the Civil Code of 1960, the Private Organization Employees' Pension Proclamation, the Labor Proclamation, Federal Tax Administration Proclamation and other related laws. The research specifically examined how these laws define and regulate the rights of various creditor groups, including secured creditors, unsecured creditors, tax authorities, and employees.

The study also investigated the implications of allowing multiple creditors to secure loans against a single collateralized property. It addressed the hierarchical structure of claims, particularly in the context of mortgage/pledge contracts, and explore the practical challenges that arise when multiple creditors seek to exercise their foreclosure rights. Furthermore, the research included qualitative insights gathered from legal practitioners to provide a real-world perspective on the complexities of enforcing priority rights.

While the primary focus was on Ethiopian law, the study incorporated comparative insights from other jurisdictions to identify best practices and potential reforms that could enhance the existing legal framework. Ultimately, this study aims to contribute to a clearer understanding of the legal landscape surrounding priority rights and to propose actionable recommendations for improvement.

1.8 Limitation of the study

Limited attention has been given to this issue by lawyers and researchers, resulting in lack of sufficient publications on the subject in Ethiopia. In addition to this, conducting this research alongside my regular job has presented time constraints that may have impacted the depth of the study. Furthermore, the unwillingness of legal practitioners and lawyers of different banks to share documents, information and even to complete the written interview become challenges to obtaining comprehensive data for the research.

1.9 The preferred referencing and citation style

The preferred referencing and citation style for my doctrinal research is the Oxford University Standard for Citation of Legal Authorities (OSCOLA)**.** This style utilizes a footnote or endnote approach, allowing for detailed citations without interrupting the main text. Additionally, a bibliography will be included at the end of the document, listing all sources cited throughout the work and organized alphabetically by the author's surname. This combination ensures clarity and facilitates easy access to the referenced materials, enhancing the credibility of the research.

Chapter 2
General Overview of Securities and Creditors

2.1 The concept of security

The word security has various meaning depending on the field of study it is utilized. In the context of law, the term security is commonly used to express a mechanism of providing the holder with assurance that the principal and interest on an underlying debt will be paid (or that some performance of obligation will be met). Accordingly, security refers to "Collateral given or pledged to guarantee the fulfillment of an obligation; esp. the assurance that a creditor will be repaid (usu. with interest) any money or credit extended to a debtor."[6] Hence, security is a commitment that provides assurance to a creditor that their debt will be repaid or obligations met satisfactorily. It offers creditors an alternative recourse if the debtor fails to fulfill their financial obligations or other commitments.

The word collateral is defined as a "Property that is pledged as security against a debt; the property subject to a security interest or agricultural lien."[7] This shows that even if the definition of security is broad in concept and collateral seems narrow, their definition seems the same. That is why both words are commonly used interchangeably. This approach of using the words interchangeably will be applied in this thesis.

When we see definition of security under Ethiopian civil code, even if it is not clearly defined under the code, we can extract the definitions from other related provisions as well as commentary written by Planiol on the basis of French Code[8]. Art. 2825 of our civil code states that "A contract of pledge is a contract whereby a debtor undertakes to deliver a thing, called the pledge, to his creditor as security for the performance of an obligation." Based on this provision, security can be understood as a protective arrangement where someone who owes money (the debtor) offers something valuable (pledge) they own to the person they owe (the creditor). This

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[6] Black's law dictionary 9th edition, page 1475-1476

[7] Ibid, page 297

[8] Marcel Planiol's, Elementary Treatise on Civil Law, It is a commentary written on French civil code which served as a principal material source for Ethiopian Civil Code

valuable item serves as a promise or guarantee that the debtor will pay back what they owe or fulfill their obligations. In addition, Marcel. Planiol define security contracts as those designed to protect creditors from their borrower's default or insolvency. Insolvency is the state when liability of debtor exceeds his asset.[9] This shows that the creditors want a guarantee in case the debtors are unable to pay their debts when due.

2.1.1 Purposes of security

Use of security has many justifications. Here, only the major purposes will be discussed. From the definitions given above it can be said that the main purpose of the security is to secure/ ensure the creditor that the debt will be paid. Security used as an instrument protecting creditors from the risk of losing the money they have lent for the debtor. In the event of a borrower's default, it will be achieved by a creditor directly taking the guarantee/property secured the loan or selling it to third party and satisfying its claims against the borrower from the payment.[10] Securities are like safety nets in the financial world. It "operates as broad insurance against uninsurable risk or intentional default lending to nonpayment of the loan".[11]

In addition, securities enable creditors to take a risk and provide finance. It makes the creditors confident on lending money. This will result in availability of more finance in the business. The availability of finance in an economy serves as a crucial catalyst for growth and development a country. By facilitating capital formation, it enables businesses to expand operations, invest in development, and adopt modern technologies that enhance productivity. When creditors lend money, they are taking a risk. Securities help reduce this risk by giving lenders something to fall back on if the borrower can't pay. This makes lenders more willing to lend money and creates trust between borrowers and lenders as lenders have a backup plan if things go wrong. This trust will allow borrowers to use their property as a security to get loan and do more with what they own. Therefore, there has to be clear law secure the security right of those creditors. Having such

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[9] Gadissa Tesfaye and Mebratom Fetehawi, Law of Sales and Security Devices, Prepared under the Sponsorship of the Justice and Legal System Research Institute, 2009, P. 116

[10] Bereket Alemayehu Hagos, The scope of banks' power in the enforcement of security interests under Ethiopian law: lessons from the US and the OHADA LAWS, central European University, 2018, P. 7-8

[11] Heywood Fleising et al., Reforming Collateral Laws to Expand Access to Finance, The world bank, 2006, P. 3

law will make lending safer and more predictable, keep money flowing through the economy and supporting growth and stability.

2.1.2 Types of security

There are different mechanisms of classifying securities. The most common classifications are based on the nature and types of the securities. Based on nature of the thing or object securities can be classified as corporeal and incorporeal things. Corporeal things are things that have physical existence that can be seen and touched whereas incorporeal things are things that don't have physical existence like Intellectual properties. Ethiopian legal framework has recognized the utilization of both properties as collateral.

In practice, Ethiopian financial institutions extend loans only to applicants with tangible collateral assets. Despite IP being legally recognized and protected under Ethiopian law, banks have not yet incorporated these intangible assets into their collateral acceptance practice.[12] The reason for not using intellectual properties as loan collateral is not merely from lack of awareness about its benefits, but also from different challenges including legal uncertainties, policy gaps, institutional challenges and various practical obstacles that need to be addressed.[13]

The second classification if based on physical mobility or immobility and value attached to properties. Based on these securities can be classified as movable and immovable things. Under Ethiopian law both types of securities are recognized, when immovable properties are used as security then the word Mortgage is used, while movable securities are used it is called as pledge. Ethiopian civil code recognizes both mortgage and pledge.[14] The 1960 Civil Code lacks an explicit definition mortgage. Definition of the term mortgage differs contextually. For the porpose of this paper we shall define it as a security right established on immovable property (or certain special movables) that serve as a guarantee for performance of the agreed obligation. Pledge is defined in the code as a security device where the debtor or a third party guarantor

[12] Fasika Dereje Gemechu, Collateralization of Intellectual Property Rights in Ethiopia: An Examination of Legal, Policy and Institutional Frameworks, Haramaya Law Review 9 (2020), P. 71

[13] Ibid., P. 90

[14] Civil code, chapter 4 of title XVIII of book V for mortgages and Chapter 6 of title XVII of book V for pledge

transfers possession of movable collateral to the creditor to secure the performance of an obligation.[15]

Movable Property Security Right Proclamation No. 1147/2019, states that movable property security right is created through a written security agreement that must contain signatures from both the grantor (which can be either the borrower himself or other third part guarantor) and secured creditor. This agreement needs to clearly identify the obligation being secured and reasonably describe the collateral involved. In order to establish third party enforceability of a security right, a secured creditor must employ one of three methods. These are: first registering a formal notice with the collateral registry, second taking physical possession of the corporeal asset, such as money, negotiable instruments, negotiable documents and certified securities; or third, establishing control over payment rights of funds held in deposit accounts or electronic securities.[16] These three mechanisms provide different mechanisms to establish third-party effectiveness of the security interest in movable property.

The proclamation presents a good development as it allows secured creditors to register a valid security right over movable asset. This applies to all forms of rights related to tangible or intangible movable assets that currently exist or may arise in the future. However, it does not cover immovable property (such as land, buildings, and fixed assets), ships, aircraft, or publicly traded securities, as there are existing laws that mandate their registration or special registers already in place for these assets.

Registration of immovable properties (such as land and buildings) as collateral follows specific legal procedure. The primary legal frameworks governing this process include the Civil Code of Ethiopia, various proclamations on land administration, and banking regulations. The registration process typically involves, first to have proper documentation of ownership. Since land in Ethiopia is owned by the state and the people, what is typically pledged as collateral is the “use right” or “leasehold right” to the land and any buildings or improvements on it.

[15] Ibid. Art. 2825

[16] Movable Property Security Right Proclamation No. 1147/2019, Art 13

Banks and financial institutions require a formal written mortgage contract that clearly identifies the property, the loan amount, repayment terms, and consequences of default. This agreement must be signed by all relevant parties. The mortgage must be registered with the appropriate land administration office in the jurisdiction where the property is located. Different regions may have slightly different administrative procedures, but registration generally involves: verification of ownership documents, property valuation, and payment of registration fees and issuance of a mortgage certificate. Once registered, up to 10 years,[17] the mortgage creates a legal encumbrance on the property that prevents the owner from selling or transferring it without the lender's consent until the loan is fully repaid.

2.2 Definition of creditors

As discussed above the main purpose of security is to secure the creditor against loss in case of loan. Collateral can reduce the risk of default leading to nonpayment of the loan, as the property used to secure the loan can provide fund for the lender by sell. From this we can understand that creditors are those who have claim right over the debtor.

The legal dictionary Black Law defines creditor as "One to whom a debt is owed; one who gives credit for money or goods. A person with a definite claim rights against another especially a claim that is capable of adjustment and liquidation."[18]

Under Ethiopian law, creditors are natural or juridical person that have a legal right to claim performance of certain activity such as payment from another party, known as the debtor. Even though the Civil Code does not provide a single definition for the word creditor, it is addressed throughout various provisions as persons to whom an obligation is owed. Book IV of the civil code govern the relationship between creditor and debtor. According to Article 1890 of the Civil Code, a creditor is a person who is entitled to demand performance of an obligation from another person. According to this article a creditor definition encompasses a significantly broader scope than merely those who lend money. This right to demand performance might arise from a law or negotiated contract between creditor and debtor or creditor and other third-party guarantor. This

[17] Civil Code, Article 3038 states that the registration of a mortgage shall be effective for ten years from the day when the entry was made. Therefore, after this period, the creditor needs to renew the registration to maintain their preferential claim right.

[18] Black's law dictionary 9th edition, page 424

expansive definition recognizes that tax authorities possess legitimate claims to unpaid taxes, employees hold valid rights to demand unpaid wages and salaries, and pension organizations maintain lawful entitlements to contributions deducted but not remitted from employees' earnings. These entities all qualify as creditors not because they advanced funds expecting repayment, but because they have acquired the legitimate right to demand performance of an obligation from another party.

2.3 Types of creditors

The 1960 civil code, proclamation number Proclamation No. 1243/2021 and bankruptcy law of the state establishes two kinds of creditors: unsecured creditors, who share proportionally in the debtor's assets regardless of when their claims originated and secured creditors, who enjoy priority over unsecured creditors with respect to specific collateralized assets and get preferential right among themselves according to several racing rules (first in time is first in right as stated under article 3059(1) and article 45 of Movable Property Security Rights Proclamation number 1147/2019). Here both types of creditors will be discussed exhaustively.

2.3.1 Secured creditors

First let's discuss properties used as collateral to secure creditors. Historically, developed economies maintained a clear dichotomy in secured transactions: real estate served as collateral in non-possessory arrangements, while personal property primarily functioned within possessory security frameworks.[19] As the economy evolved, and the demand for credit increased, the absence of robust legal mechanisms for non-possessory security interests in personal property created significant constraints for business borrowers who needed to retain possession and operational use of their collateralized assets. The subsequent development of sophisticated legal frameworks governing personal property security interests ultimately reduced borrowing costs substantially, thereby facilitating broader credit accessibility throughout these economies.[20]

The Roman law recognized both possessory and non-possessory secured rights. In most cases, the former was used for security of personal property, and the latter for real estate. It seems that

[19] Roger J. Goebel, 'Reconstructing the Roman Law of Real Security' Tulane Law Review, Vol. XXXVI, P. 29

[20] Alan Schwartz, 'Security Interest and Bankruptcy Priorities "A Review of Current Theories" Journal of Legal Studies, P. 4

their law did not prohibit from using non-possessory secured transaction of personal property, but we do not have evidence that it was widely used.[21] The clear classification of possessory secured rights in personal property, and non-possessory rights in real property, survived in Civil Law systems for many years. In general, Civil Law jurisdictions have been reluctant to introduce legal non-possessory secured interests in personal property. Nevertheless, several developed European countries invented different specific types of non-possessory secured rights. The French and the German legal systems addressed this problem in two different ways: The former provided for a limited non-possessory lien on equipment. The latter provided a fiduciary transfer of title, which permitted the debtor to retain possession on the collateral.[22]

Both Civil Law and Common law legal systems have been classifying between non-possessory and possessory types of secured arrangements. Until the 19th century, real estate was primarily used for the latter type of transactions, and personal property for the former. However, the development of a non-possessory secured arrangement in personal property was significantly different among different legal systems. While in the US, advanced chattel mortgage devices exist for almost two centuries; many developed countries are still struggling today to establish reliable real estate mortgage rules.[23] In Common Law developed countries; the chattel mortgage was introduced in the early 19th century (beginning in the US in 1820, and then England, Australia, and Canada). Nevertheless, in Civil Law-less developed countries, legislation of non-possessory secured rights in personal property was introduced only recently. There are still many developed countries in which, such legislation does not exist as of today. In developing countries such as Ghana, the non-possessory secured interest is recognized only for real estate, and was introduced only recently (1979). It is not surprising that is such legal systems, creditors are not willing to lend with a non-possessory personal property security. The same thing happened in Asia; in most countries, non-possessory rights over personal property are difficult, or impossible, especially in Asian countries with Civil Law background.[24]

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[21] Ibid

[22] Yoram Keinan, The Evolution of Secured Transactions, University of Michigan law school, 2000

[23] Ibid 14

[24] ibid

From a substantial perspective, real property and personal property secured transactions are substantially similar. Nevertheless, there are several differences in the ways each type of property is used as collateral. Generally, real property is used primarily in non-possessory secured transactions (except from certain developing countries, such as some countries in Africa). Personal property can be used either for possessory secured transactions, or for non-possessory ones. Nevertheless, in most developing countries, as well as transitional economies, the mechanism of a non-possessory personal property secured transactions is not significant yet. Thus, in light of the non-possessory nature of real estate secured transactions (which is similar in both, civil law and common law systems), legal rules governing such transactions are necessary, especially with respect to registration and priority rules.[25]

Based on the preceding discussion, secured creditors are lenders or creditors who have been granted a legal security interest in specific assets of a debtor as collateral to guarantee repayment of a loan or other financial obligation. This security interest creates a legal right that allows them to claim specific property if the debtor fails to meet payment obligations. This arrangement reduces the lender's risk exposure. In Ethiopia, security interests are properly documented through formal contract and is often registered with appropriate government authorities (either at national bank or other office where the property is previously registered) to establish priority against other potential claimants.

2.3.2 Unsecured creditors

Unsecured creditors are any individuals or entities who have a legal right to claim payment from a debtor, whether that right comes from a contract or is established by law. This includes lenders without collateral, but also extends to employees claiming unpaid wages from employers, pension organization, tax authority and anyone else with a valid claim not backed by specific assets. These creditors rely solely on the debtor’s promise to repay and have no preferential claim to specific property if the debtor defaults or becomes insolvent.[26] Common examples include trade suppliers who sell goods on credit, service providers, employees owed unpaid

[25] Ibid,

[26] Dr. Dossy Iskandar Prasetyo and Zakiyah Nur Zuroidah, Legal Framework and Creditor Rights in Bankruptcy: Analyzing Property Collateral Protection, Journal of Multidisciplinary Research Vol. 3, 2024, P. 74

wages (though labor laws may grant them some priority), and general lenders without secured agreements. In cases of bankruptcy or liquidation, unsecured creditors rank lower in priority compared to secured creditors[27] (who hold mortgages or liens) and certain preferential creditors, such as tax authorities or employees claiming back wages. Under Ethiopian law, the repayment hierarchy is governed by various laws such as the commercial code, Federal Tax Administration Proclamation No. 983/2016, Private Organization Employees' Pension Proclamation No. 1268/2022 and labor proclamation No. 1156/2019.

In the event of default or bankruptcy, unsecured creditors stand behind secured creditors in the priority of payment and may recover only a fraction of what they are owed, or potentially nothing at all, depending on the remaining assets after secured claims are satisfied. However there are complicated/ unclear exceptions to this principle which will be discussed in the next two chapters.

2.4 Rights and obligations of creditors

2.4.1. Rights and obligations of secured creditors

Ethiopian law gives secured creditors specific rights and responsibilities, mainly found in the proclamation No. 1147/2019 and the Civil Code. These lenders can claim rights over property whether it's something you can move like equipment or something fixed like land by getting everything in writing and signed properly. When borrowers can't pay, these lenders get paid before anyone without collateral, with earlier registrations getting first stand on payment.

If a borrower defaults, lenders can take the collateral, sell it reasonably, or go to court to enforce their rights. They can even follow and claim proceeds if the original collateral was sold or transformed. Lenders can also transfer their rights to someone else if needed.

But these rights come with responsibilities. Lenders must register their claims properly. If they're holding someone's property, they need to take good care of it. Before taking action against a defaulting borrower, they must notify everyone involved. If they sell collateral and make more than what was owed, they have to return the extra money. Throughout everything, they must act

[27] Ibid, P.73

fairly and follow both the agreement and the law. When the debt is finally paid off, lenders must officially end the registration and release their claim on the property. The balance between creditor rights and debtor protections ensures a fair but efficient security enforcement system within Ethiopia's legal framework.

Within Ethiopia's secured transactions framework, secured creditors maintain categorical priority over unsecured creditors. When multiple security interests created by the same grantor encumber identical collateral, priority rank is determined strictly according to the chronological order of registration, irrespective of when each security right was created. Similarly, when a single property has been mortgaged to multiple creditors, the determination of relative priorities follows the established 'first-in-time' doctrine, whereby earlier perfected interests generally maintain precedence over subsequently established claims.[28] Hence, when multiple creditors secure their loan against the same property, who gets paid first is determined by when they officially registered their mortgage it's basically first-come, first-served at the registry office. It doesn't matter when the loan became valid or when payment was due those dates aren't considered in deciding who stands where in the payment line.[29] The only date that counts is when each lender formally recorded their claim in the official registry.

In case of movable properties the preferential treatment of secured creditors is outlined in articles 45-46 of Proclamation No. 1147/2019 and Article 2860 of the Civil Code. Under these provisions, creditors with security interests take precedence over those without security. When the same debtor grants multiple security interests in the same movable collateral, the ranking of these competing claims is determined using the same principles applied to real property, as explained earlier.[30]

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[28] Habtamu Bishaw, Mortgage Valuation in Ethiopia: The case of Commercial Banks (PhD Dissertation, 2021) p.15

[29] Civil Code, Art. 3081

[30] Muluken Seid hassen, Brief summary major reforms introduced by Movable Property Security Rights Proclamation, No.1147/2019, <Brief summary major reforms introduced by Movable Property Security Rights Proclamation, No.1147/2019 - Blog> accessed March, 2025

2.4.2 Rights and obligations of unsecured creditors

Ethiopian law gives unsecured creditors certain rights and responsibilities, mostly found in Ethiopia's Civil Code and Commercial Code. These lenders can demand payment when it's due and can take borrowers to court if they don't pay up. If a borrower goes bankrupt, these lenders get to participate in the proceedings, though they'll have to wait in line behind lenders who secured collateral.

The law also gives these unsecured lenders some rights. They can challenge any transfers made by borrowers trying to hide assets or favor certain creditors. They have also the right is to pursue debt repayment through civil action in courts, where they may obtain a judgment against the debtor.

But with these rights come responsibilities. However, in insolvency proceedings governed by the Commercial Code, unsecured creditors rank lower in priority, being paid only after secured creditors, administrative expenses of the bankruptcy, and certain preferential claims such as employee wages and tax obligations. When taking someone to court, they need to prove their claim exists and how much they're owed. When using their special rights to challenge suspicious transfers, they must prove actual fraud occurred and show how it hurt their interests. And when there are multiple unsecured lenders and not enough money to go around, they generally have to accept getting paid proportionally unless specific legal preferences apply.

While Ethiopian laws[31] provides mechanisms for unsecured creditors to pursue their claims, the practical reality often results in partial or no recovery, especially in cases where the debtor's assets are insufficient to satisfy all obligations. This inherent risk underscores the importance of thorough credit risk assessment and contractual safeguards when extending unsecured credit in Ethiopia's commercial environment.

[31] Civil Code, Articles 1945-1951, Labor Proclamation No. 1156/2019, Commercial Code, Article 1028 and Private Organization Employees' Pension Proclamation No. 1268/2022

2.5 Justification for protection of secured creditors

In a market economy, a business frequently require funding to increase their manufacturing capacity, innovate new offerings, deliver demanded services, and fulfill the requirements and aspirations of their clients and stakeholders.[32] The effectiveness of legal structures governing secured lending plays a vital role in enhancing the financial systems.[33] During financial industry crises, a well-functioning legal system for secured transactions allows banks and lending institutions to minimize the decline in value of their loans while also enabling business reorganization through mechanisms that facilitate temporary funding arrangements. In the long run an effective framework for security interests fosters economic development as it allows access to funds. Additionally it makes it easier for business to get the loans they need to expand their business. Furthermore, when there's a solid system for handling secured loans, it helps create a stronger banking sector and better financial markets. This works because credit flows to where it's needed most, and lenders have clear, reliable ways to recover their money when borrowers can't pay back their loans.[34]

Many economists think that economies grow best when lenders have strong legal protections in place.[35] Such protection enhances the willingness to lend and hence leads to development. But there are various kinds of creditors whose interests can potentially conflict. These are: lenders, guarantor, unsecured creditors (including regular creditors without collateral such as suppliers who let businesses pay later), employees and governments that are owed taxes.

A World Bank study discovered a relation between country per capita income levels and kinds of claims that have priority "Lower-income countries are less likely to give priority to secured lenders" and are more likely to give priority either to claims of labor or to government claims.[36] The law in many countries, and not just developing countries, makes tax claims of governments and certain rights of workers, normally the right to unpaid wages, senior even to secured

[32] Elizabeth warren, 'Bankruptcy policy making in an imperfect world' 92 Michigan law review 336

[33]Thomas Laryea, Counsel, development of standards for security interest IMF Legal Department (2009) 1

[34] ibid

[35]Kenneth W. Dam, Credit Markets; Creditors' Rights and Economic Development the law school university of Chicago February 2006

[36] World bank report, Doing Business, 2020

creditors.[37] According to a World Bank survey, labor claims have top priority in France and in many French legal origin countries as well as in India (a common law country), while taxes have top priority in a number of countries of French, German, and common law legal origin.[38] When bankruptcy and creditor protection laws are well-crafted, they make it easier for businesses to get loans and help the private sector development.[39]

2.6 Protection of the rights of creditors in bankruptcy cases

The term "bankruptcy" comes from the Old Italian word "bancarotta," which literally meant "broken bench." Back in medieval times, when a merchant ran off with money or goods that belonged to their creditors, angry crowds would smash the trader's market stall or counting table as a public sign of their dishonesty. It was basically the medieval version of putting someone out of business for good.[40] Bankruptcy literature exhibits a lack of clarity and uniformity when it comes to using the term "bankruptcy" and related terminology such as insolvency and reorganization.[41] The confusion partially arises from the fact that "bankruptcy" and "insolvency" are sometimes treated as synonymous terms, while at other times they are given distinct technical meanings. Certain sources define insolvency as the actual state of being unable to meet debt obligations, reserving the term bankruptcy specifically for the formal legal proceedings that are initiated once someone becomes unable to pay their debts. Black's law dictionary defines insolvency as the condition of being unable to pay debts as they fall due or in the usual course of business and limits bankruptcy to the statutory procedure.

A fundamental principle in bankruptcy law establishes that creditors must compete for their share of the proceeds generated from selling the debtor's assets. It is an underlying principle that the unsecured creditors treated on an equal footing *(*pari pasu), which entitles those creditors to

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[37] Kenneth W. Dam, (n 35)

[38] ibid

[39] The world bank, principles for effective insolvency and creditor/debtor regime the world bank group, (The world bank group, revised 2015), P. 5

[40] Taddese Lencho, 'Ethiopian Bankruptcy Law: A Commentary (Part I)' 2008 Journal of Ethiopian Law 65-66

[41]Tafesse Tekle ,Treatment of secured creditor under Ethiopian bankruptcy regime,vol.8,issue 5,may 2020 july

receive dividends in proportion to the size of their claim. Pari pasu distribution means proportionate distribution.[42]

2.7 Legal protections provided for secured creditors during bankruptcy

There are different approaches in different legal system regarding the treatment of secured creditors during bankruptcy proceeding.[43] A few countries allow secured creditors in general to enforce their security interests, untroubled by the commencement of bankruptcy. Those systems they discharge secure secured creditors from application of suspension of suits. On contrary to this, laws which include encumbered assets in the bankrupt estate, to be controlled by trustees, subject to some conditions. The third approach is that in some laws, the power of trustee in connection to encumbered assets is dependent upon the nature of the proceeding reorganization or liquidation.

Under Ethiopian commercial code the status of secured creditors seems confusing. Because article 785 of the new commercial code clearly states that "creditors secured by right *in rem* over specified assets, including by pledge and mortgages, shall have an exclusive right on the realization value of the encumbered assets, after deduction of costs and expenses for the realization of such encumbered assets." from this article it is possible to conclude that secured creditors have special treatment and priority right over property they use as a collateral to secure their debt.

But when we came to article 781,782 and 783 of new commercial code it may come up with another conclusion. For instance article 781 of the code states that "where the trustee in bankruptcy realizes encumbered assets of the estate the proceeds secured creditors shall be paid and shall be treated as unsecured creditors for the residual amount still remaining due". By reading Article 781(1) and (2) of the new commercial code it can be concluded as when a trustee realizes encumbered assets whether immovable or movable, tangible or intangible secured creditors are prioritized for payment from the proceeds of these assets after deducting the costs and expenses associated with the realization of these encumbered assets. However, any secured creditors who

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[42] Abyssinia law, Principles of Bankruptcy, <https://www.abyssinialaw.com/study-on-line/bankruptcy-law> accessed March, 2025.

[43] Taddese Lencho, Ethiopian Bankruptcy Law: A Commentary on Promoting Rehabilitation and Restructuring (part 2) P. 44

have been compensated from these proceeds are treated as unsecured for remaining amounts.
This shows that while secured creditors have priority in recovering debts from realized assets, they will be treated as unsecured for any outstanding balances. Similarly, article 782 of the code states that where the trustee decides to sell and distribute unencumbered assets before the sale of encumbered assets of the estate, secured creditor may participate along with unsecured creditors in proportion to the whole of their pre insolvency claims. So, these shows that when a trustee in bankruptcy chooses to realize unencumbered assets before selling encumbered ones, both secured and preferred creditors, who have verified and admitted claims, and unsecured creditors will be treated equally and the distribution will be proportional to the total amount of their pre-insolvency claims. This means that all creditors, regardless of their secured status, will have equal status on unencumbered assets. This indicates that the commercial code provides no special treatment for secured creditors in bankruptcy proceedings, making their priority rights dependent on the trustee's discretionary decisions.

There is a case that the Cassation Division of the Supreme Court decides that secured creditors are not outside of the bankruptcy proceeding.[44] The case involved Holland Car PLC (the applicant) and Zemen Bank Share Company (respondent). The bank had lent money to the PLC, which subsequently became bankrupt. The court issued an injunction preventing the PLC from transferring property to third parties. Zemen Bank brought the case to the Federal First Instance Court seeking to exempt its collateral (manufacturing building and machinery) from the injunction so it could recover its loan. The First Instance Court rejected this request, finding no legal grounds to do so. The bank appealed to the Federal High Court, which ruled in its favor, stating that the injunction should be lifted specifically for the properties used as collateral based on Proclamations No. 97/1990 and 216/1992.

Holland Car PLC then appealed to the Federal Supreme Court, arguing that neither proclamation addressed bankruptcy issues and that the 1960 Commercial Code Book five should apply instead. The Supreme Court rejected this appeal. Then the PLC appealed to the Federal Cassation Bench, the bench concluded that allowing the bank to sell collaterals used to secure the loan through a separate auction would not ensure that: employee claims would be verified and paid according to

[44] Zemen Bank Share Company v Holland Car Pvt. Ltd. Co. (2015 E.C), Cassation Division of the Federal Supreme Court, Vol.17, File No. 102061

their legal priority rights under Article 167 of Decree No. 377/96 and the government would receive proper tax payments from the bankrupt company

Additionally, permitting the bank to sell the collateral while unassembled cars remained would be impractical, considering the additional costs of transporting and storing assets. The court established a priority order for claims: first employees of the PLC, then government taxes, and finally the bank's claims ahead of other claimants. The court ruled that Proclamation 97/1990 was not applicable in this case.

The case reveals a fundamental disconnect between secured transactions law (Proclamations 97/1990 and 216/1992) and bankruptcy law (Commercial Code Book 5). This creates uncertainty about which legal regime should prevail when a borrower becomes bankrupt, leaving secured creditors' rights vulnerable. As the efficiency of the legal frame work for secured credit is a critical factor in the strengthening of financial systems,[45] the protection given for secured creditors under our legal system is confusingly structured and needs to be improved to develop potential recommendations and solutions.

[45] Thomas Laryea, Counsel, development of standards for security interest IMF Legal Department (2009)

Chapter 3

Priority Rights of Secured Creditors on Collateralized Properties

3.1 Definition of priority rights

Ethiopian civil code allows property re-collateralization by multiple creditors. Article 3084[46] of the civil code preserves the debtor's right who collateralize his property for loan to sell the property. The provision protects property owner's autonomy to utilize their property even if it is collateralized. In addition, article 3088[47] of the civil code and Article 46 of proclamation 1147/2019 allows multiple mortgages and plegges on the same property. This shows that the law recognizes the right of property owners to retain substantial rights over their assets. By explicitly allowing both the sale of mortgaged property (Article 3084) and the creation of additional mortgages on already encumbered property (Article 3088), the law ensures debtors can use their property to its fullest economic potential across multiple financial relationships. This will create competition among creditors with interests in the same property.

Priority rights establish the hierarchy among competing creditors (whether secured or unsecured) when multiple parties have claims against the same collateralized property. This right determines who stands at the front of the line when it comes time to recover from limited assets, making it the backbone of creditor protection and lending confidence across global markets. The internationally recognized principle governing priority follows "first in time, first in right". It is a fundamental principle that rewards diligence and timely registration of security interests.

Ethiopia's approach to priority rights reflects both this universal principle and its own unique economic priorities. The Ethiopian Civil Code establishes the foundation through Articles 3041-3060, mapping out the complex terrain of creditor rankings. However, the Property Mortgaged or Pledged with Banks Proclamation No. 97/1998 introduces a significant clarification in Article 3.

[46] Civil Code, under article 3084 (1) states that "He whose immovable is mortgaged shall retain the right to transfer the ownership thereof."

[47] Ibid, Art. 3088 (1) states that "He whose immovable is mortgaged shall retain the right to charge it with a usufruct, servitudes, mortgages or other rights in rem."

When examining priority rights through the lens of Ethiopian banking practice, we see how these legal frameworks translate into real-world consequences. For businesses seeking multiple rounds of financing using the same assets as collateral, the registration date becomes the decisive factor in determining which lender stands first in line.[48] The system incentivizes registration by rewarding diligence with priority status.

3.2 Right of creditors over collaterals used to secure bank loans

As it is defined under chapter 2, collateral is an asset pledged by borrowers to secure loans from financial institutions. Common types of collateral generally include real property (land and buildings), personal property (vehicles, equipment, and inventory), financial assets (cash deposits, stocks and bonds), accounts receivable, and sometimes intangible assets like intellectual property rights.

Under Ethiopian law, mortgages, pledges, business mortgage and financial collaterals including bank deposits and securities are used as collateral to secure loan. The law provides judicial foreclosure procedures through courts, contractual foreclosure clauses that sometimes allow direct seizure and specific auction procedures mechanisms for enforcement of their right.

3.2.1 The rights of creditors in case of cross collateralization

Cross-collateralization occurs when a borrower uses multiple properties as collateral to secure a single loan or several loans. In this arrangement, the lender has the right to seize more than one property if the borrower defaults on the loan.[49] Cross-collateralization commonly emerges in two situations. The first one is in case a borrower who already has an existing mortgage might seek additional financing for a separate property, prompting the lender to implement cross-collateralization as a security measure. This arrangement effectively places both properties as collateral for all outstanding loans, significantly enhancing the lender's protection against default. The second common application occurs during debt consolidation efforts, where a borrower with multiple outstanding obligations opts to merge them into a single, comprehensive loan. This

[48] Ibid, Art. 3076

[49] Mark Maldonado, Understanding Cross-Collateralization in Mortgage Lending, Understanding Cross-Collateralization in Mortgage Lending | Mark Maldonado Mortgages, Sep 13, 2024

consolidation strategy simplifies the borrower's financial management by replacing several separate mortgages with one unified debt instrument that is secured against multiple properties, streamlining payments while providing the lender with expanded collateral coverage.[50]

In Ethiopia, the legal framework permits creditors to secure a single loan with multiple properties. This practice raises questions regarding the creditor's rights when exercising its security interest. The Ethiopian legal system has addressed some of these questions through legislative provisions and judicial decisions, while leaving other aspects to be determined by banking practice.

When a creditor bank secures a single loan with multiple properties, Ethiopian law grants discretion to the creditor regarding the order and manner of exercising its rights against those properties. The Federal Supreme Court Cassation Bench has provided clarification on this matter through binding decisions.[51] The court has ruled that where two or more properties are mortgaged for the same loan, the determination of which property should be sold first lies with the creditor bank, not with the court or the debtor. This ruling prevents debtors from bringing applications to dictate the order of sale and prohibits courts from intervening to decide such matters. This discretionary power granted to creditor banks aligns with the framework of foreclosure laws in Ethiopia, particularly Proclamation No. 97/98, which favors creditor banks by granting them easy enforcement mechanisms.

Despite this broad discretion, creditor banks must still adhere to procedural requirements when enforcing their rights against multiple properties.[52] The Federal Supreme Court Cassation Bench has clarified that banks must follow the procedures outlined in Articles 394-449 of the Civil Procedure Code during the foreclosure process. Failure to follow these procedures may result in liability for the bank if the debtor sustains damage due to such irregularities. In conclusion,

[50] Ibid

[51] Wegagen Bank v. Biruk Cheka et al, (2004 E.C), Federal supreme court cassation decision Vol.13, File No. 70824.

[52] Gemmeda Amelo Gurero (n 3) P. 171 - 172

Ethiopian law gives creditor banks discretion when multiple properties are collateralized for a single loan, particularly regarding the order of sale and the valuation of properties.

3.2.2 The rights of creditors when several creditors have claim right on single property given as collaterals to secure bank loans

Under Jackson and Kronman's article[53], as per Article 9 of the Uniform commercial code, the fundamental principle under which creditors get priority rights is "first-in-time, first-in-right," codified in UCC section 9-312(5)(a), which ranks competing security interests according to priority in time of filing or perfection. Under this system, there is no restriction on collateralizing a single property for multiple creditors rather their priority right will be governed by creating a temporal ordering of creditor's right registration. The authors identify exceptions to this general rule, which is the purchase money security interest (PMSI). A creditor who finances the debtor's acquisition of specific new assets can obtain priority over earlier creditors with after-acquired property clauses if they meet certain procedural requirements. For inventory, this includes providing written notification to holders of conflicting security interests; for other collateral, the purchase money interest must be perfected when the debtor receives possession or within ten days thereafter. The purchase money priority is limited by the "tracing requirement," meaning the loan must be directly connected to the acquisition of identifiable, discrete assets.

The notice-filing system establishes another key condition for priority. Under this system, a creditor who files a financing statement obtains priority from the time of filing, even if the actual loan is made later. This means that a creditor who has filed first can make subsequent advances that will automatically receive priority over intervening creditors, regardless of when those advances are actually made. This creates a situation where prior creditors maintain a competitive advantage for future lending. The article also discusses the way through which creditors can modify these priority rules through contractual arrangements. Junior creditors can protect themselves by obtaining subordination agreements from senior creditors, and debtors could potentially contract around the notice-filing rule by expressly limiting the effectiveness of a particular filing on the financing statement.

[53] Jackson and Kronman's, Secured Financing and Priorities among Creditors, The Yale Law Journal, Vol. 88, No. 6 (1979), P. 1161-1162

As stated above, collateralizing a single property for various debts is allowed under Ethiopian law.[54] Furthermore, in a case between Development bank of Ethiopia and Commercial Bank of Ethiopia[55] the court decided that the same property can be mortgaged by several creditors and the priority among several creditors is made based on the date of registration of the mortgage. Such plurality of creditor can be created either from the first or it created through sale or contractual transfer of property to many people, each of creditors can demand the debtors to do full payment.[56]

However, there are various restrictions on such collateralization that can be classified as legal and practical challenges. Regarding the legal framework, the Addis Ababa City Administration Land Holding Administration Service Delivery Directive Number 12/2004 establishes procedural requirement. This directive specifically mandates creditors other than the first to obtain confirmation from preceding creditors before registering their rights.[57] Even though this requirement aims at protecting the interests of prior creditors, it significantly limits property owners' right to utilize their property to its maximum potential, particularly in cases where second creditors are willing to extend loans with full knowledge of existing prior encumbrances.[58] In practice, the collateral registry system fails to register subsequent creditors against the same property once an initial registration exists.[59] This administrative barrier

[54] Cumulative reading of article 3084 and 3088 of the civil code.

[55] Development bank of Ethiopia v Commercial Bank of Ethiopia (2000 E.C), FSC Cassation Decision Vol. 7, File No. 25863

[56] Dr. Seyyed Hossein Safaei and Aref Abdollahi, Position of Plurality of Creditors and Holders of Right in Law and Fiqh (Islamic Jurisprudence), The Turkish Online Journal of Design, Art and Communication, 2016, P. 741

[57] Addis Ababa city Administration Land Holding Administration Service Delivery Directive no.12/2004, Article 33(2) of the directive states that "When verifying that whether there is collateral registration by another creditor, if it is found that there is a previous collateral registration on the specified property, the body that imposed the restriction or registered the collateral should be informed promptly. However, if the entity that previously registered the collateral and the entity now requesting registration agree and notify their agreement in writing, the registration will proceed"

[58] Interview with Ato Gezu Ayele Mengistu, Legal Department Director, Addis International Bank S.C, (Addis Ababa, 16 April 2025)

[59] Ibid

prohibits multiple creditors from collateralizing a property to its maximum value capacity, resulting in a low incidence of multiple secured creditors over a single secured property.

The provision of directive number 12/2004 and refusal of registry offices to register without the prior creditor's consent creates an unnecessary impediment that restricts the democratic right of citizens to property ownership, which includes the right to use property in a manner compatible with the rights of other citizens. This practice appears to contradict both the legal allowance for multiple creditors established in the civil code[60] and the judicial precedent set by the Federal Supreme Court's cassation decision.[61]

In case of priority right of creditors, in principle secured creditors have the priority right on the collaterals used to secure the loan in priority to other creditors. The priority may be either in reference to unsecured creditors or secured creditors.[62] Creditors who are not secured have rights to be paid after all secured creditors, i.e., after all creditors having mortgage contracts with the mortgagor are paid, if, surplus money exists from the sale of the property.[63] It provides that secured creditors shall have an exclusive and absolute right over the encumbered assets, after deduction of costs and expenses for the realization of such encumbered assets under Ethiopian bankruptcy law.[64] The empirical data collected through written interview reveals that banks commonly encounter challenges from various competing priority claimants. These competing entities include tax authorities, employees with wage claims, customs offices, pension authorities, other financial institutions, and judgment creditor.

Based on the written interview responses from legal professionals at various Ethiopian banks challenges they frequently face is summarized in the following tables.

[60] Cumulative reading of Article 3084 and 3088 of the Civil Code

[61] Development bank of Ethiopia v Commercial Bank of Ethiopia (n 55)

[62] Alefe Beza (n 5) P. 28

[63] Ibid. P. 22

[64] Commercial Code, 2021, Article 785

Legal Framework Challenges

Challenge Category	Key Insights
Registration Requirement Interpretation	"There is a common misconception that the tax authority does not need to register its claim with the registering authority in order to establish security right over the assets of the taxpayer, which is contrary to the text of the law(read Article 39(3)(4) of the tax administration proclamation)."
Fragmentation of Legal Provisions	"The provisions that deal with priority rights are scattered in different proclamation. Issues related to priority rights are decided based on general principles and principles may not always come up with the same outcome."
Inconsistent Application of Laws	"Since there is no specified law so systematic ignorance exists."

Practical Enforcement Challenges

Challenge Category	Key Insights
Administrative/Registration Issues	"There is grave incompetence of the officers of the registering body. There are frequent misinterpretations of the law made by officers of the registering authoring with respect to the ranking of mortgage rights (priority) over a collateralized property."
Court Injunctions/Prolonged Litigation	"Improper intervention of court specially providing injunction order. Prolonged litigation."
Document Fraud/Verification Issues	"Due to fraudulent documentation presented by the borrowers, documents seemingly verified by the relevant government agency but later discovered to be forged, the bank unfortunately lost its priority right over the collateral."
Property Transfer Obstacles	"Most problems arise at the time of transfer of ownership of the property foreclosed."

Rights of secured creditors: Claim of multiple secured creditors on single collateral, balancing interest

Mortgagor has the right to establish multiple mortgages on the same immovable property, allowing several creditors to secure their loans against a single asset. This gives people more financial flexibility and options during tough times, rather than leaving them stuck with no way to access the value in their property. With current restrictions on registration procedures, the likelihood of conflicts arising between multiple secured creditors has decreased.[65] Even if this situation may reduce risk for first secure bank creditors, simultaneously making debtors' obligations more complex.

When multiple creditors hold mortgages on one property, the priority among these secured creditors is determined by the first-in-time principle.[66] This means that the ranking of creditors is based on the registration date of their mortgage contracts, without considering when their claims became certain or enforceable. The creditor whose mortgage is registered first will be paid first, followed by the next registered creditor, and so forth. However, when both a legal mortgage (created by operation of law) and a contractual mortgage (created by agreement between parties) exist on the same property, Ethiopian law gives priority to the legal mortgage regardless of the registration date.[67] Where creditors have their claims registered on the same date, such claims shall rank concurrently and be paid in proportion to the amount of each claim.[68]

The date when claims become due or enforceable is not considered in determining the priority among secured creditors. Therefore, the order of payment is determined only by the timing of registration irrespective of when those claims may have become eligible for enforcement. This approach can create insecurity and uncertainty for secured creditors. If a creditor registers their mortgage after another creditor, they may find their claims subordinate, even if their loan agreement was finalized first or their claims became enforceable earlier. This may discourage lenders from extending credit against the same collateral.

Even though the legal framework is silent on this scenario, in practice, when a second-registered creditor's loan becomes eligible for enforcement as a non-performing loan (NPL) while the first-registered creditor's loan remains performing and has not reached the foreclosure stage, the

[65] Interview with Ato Gezu Ayele Mengistu, (n 58)

[66] Cumulative reading of article 154(2) of the 2021 commercial code and Art. 3081of the Civil Code

[67] Commercial Code. Art. 154(3)

[68] Ibid. article 154 (2) and article 3081of the Civil Code

second creditor may exercise its enforcement rights only after satisfying the first creditor's claim.[69]

In case of bankruptcy the 2021 commercial code under its section three it clearly states the hierarchy of creditors even though there is some ambiguity. Under the law, creditor banks have priority over preferred creditors including the claims of employees and tax authorities on mortgaged property.[70] Article 786 of the 2021 commercial code outlines the ranking priorities for distributing the remaining proceeds from the realization of encumbered assets among preferred and unsecured creditors. First, costs and expenses of the proceedings are addressed. Next, new financing related to preventive restructuring takes priority, followed by new financing in the context of reorganization. New financing authorized during bankruptcy comes next, followed by post-bankruptcy creditors, which include those with new and ongoing contracts. Employee claims and claims from social security authorities are prioritized after that. Taxes and duties owed to federal, regional, and local government authorities follow, excluding those that can be claimed from the debtor holding taxes on behalf of the government (without interest and penalties). Here, the status of those holding taxes on behalf of government is unclear. The next priority is amounts ordered for the maintenance of the bankrupt debtor and their family, followed by other preferred creditors. Unsecured creditors are next in line, and finally, penalties and fines imposed upon the debtor are addressed.

In addition, the law fails to address issues relating to the status of creditors in case of subrogation. This legislative gap creates significant uncertainty regarding whether a subrogated creditor assumes the original creditor's priority position or receives a new priority based on the date of subrogation registration. Without clear legal provisions governing the transfer of security interests through subrogation, creditors face unpredictable outcomes when claims are paid by third parties who then step into the original creditor's position. However, the Federal Supreme

[69] Interview with Ato Beyene Ayenew, Legal Department Director, Nib Bank Share Company, (Addis Ababa, 09 April 2025)

[70] Commercial code of 2021, Art.786

Court has provided some clarity on this matter, ruling that the subrogating creditor will assume the original creditor's priority position.[71]

Bank and tax authority: Competing Claims on Collateral

Federal Tax Administration Proc.No.983/2016 art.39(2&7) provides that if the notice of security is registered over the property mortgaged by the banks, the priority of banks in relation to secured claims applies so long as the banks, confirm that the taxpayer has a tax clearance certificate from the Authority. However, the interpretation of Article 39(1 and 2) of Proc.No.983/2016 seems argumentative. On the one hand cumulative reading of article 33(1) and article 39 of the Federal Tax Administration Proclamation is being understood as tax authority has priority over creditor bank for claims of withholding tax, value added tax, turnover tax and excise tax. These priority tax claims represent claims for payment of taxes from a debtor who collected and has been holding the taxes in trust on behalf of the government and does not even form part of the debtor's estate. On the other hand, there is cassation decision that gives decision in favour of banks.[72] This legal misunderstanding will be discussed later in detail.

Ethiopia's legal landscape reveals a complex struggle between banking institutions and tax authorities over collateral claims. When we look at how courts have handled these competing interests, we find confusion that threatens both effective lending and tax collection. The heart of the problem lies in how judges, even at the Federal Supreme Court level, have blurred the lines

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[71] Hibret Bank S.C. v Abyssinia Bank S.C. (2001) Federal supreme court cassation decision Vol. 8 file No. 39778

[72] Federal Ministry of revenues and custom authority Vs Dashen Bank S.C, 2016, FSC Cassation decision file No. 235004 (Unpublished),). The bench states that Article 33(1) of Proclamation No. 983/2008 specifies that the tax authority has a preferential claim in cases of withholding tax, value-added tax, turnover tax, or excise tax. This does not explicitly prohibit the priority rights of creditor banks that use the debtor's property as security prior to tax debts. Additionally, Article 39(7) indicates that banks will have priority over collateral if the debtor provides a tax clearance certificate at the time of the loan. Furthermore, Article 39(2) asserts that, subject to sub-article (7), the priority for prior secured claims includes the priority of banks regarding secured claims and the priority of employees concerning salaries and wages. Therefore, there is no legal ground that limits the right of creditor bank.

between two completely different tax enforcement tools tax foreclosure and tax liens.[73] When a bank extends a loan and secures it with collateral, it needs certainty that its claim won't be unexpectedly pushed aside. Yet the misreading of tax laws creates this uncertainty.

In addition, tax authorities simply declare priority over assets without following proper notification and registration procedures even Federal Cassation Bench decide in favor of the authority in the case of ERCA v. Adale Seid[74] suggest otherwise. This undermines the fundamental "first come, first served" principle that gives our financial system stability.[75]

What makes this situation particularly troubling for banks is the unpredictability it creates. This doesn't just affect banks rather it affects the whole economy. When lenders can't trust the collateral system, they become more hesitant to extend credit, ultimately limiting access to financing for businesses and individuals.[76]

Mr. Kinfe Micheal[77] suggested that the solution isn't favoring either banks or tax authorities, but rather ensuring both systems work as designed. Tax authorities should absolutely receive their due, but through proper channels giving notice, registering their interest, and following judicial processes when acting as legal mortgagees. Courts need to recognize that tax collection and credit markets can coexist harmoniously when the rules are applied correctly. Only then can Ethiopia achieve both efficient tax collection and the stable, predictable lending environment needed for economic development.

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[73] Knife Michael**,** An Introduction to the Ethiopian Law of Tax Foreclosure: A Commentary, 2015, The commentary explains the difference between the two as A tax lien is a legal claim or encumbrance placed on a property by tax authorities due to unpaid taxes whereas Tax foreclosure is the actual enforcement process through which a tax authority seizes and sells a property to recover unpaid taxes.

[74] Ethiopian Revenues and Customs Authority (ERCA) Jimma Branch v. Adale Seid and Firomsis Plc, 2003, Federal Supreme Court Cassation Decision V. 11 File Number 57100

[75] Kinfe Micheal Yilma, Tax Foreclosure and Tax Liens: Where Lies the Line? A Case Comment, Bahir Dar University Journal of Law, Vol.2, 2012

[76] Interview with Ato Gezu Ayele Mengistu, (n 58)

[77] Kinfe Micheal Yilma (n 75)

Bank and employees: Prioritizing worker claims

The employees are entitled to priority right over any claim.[78] It means that if a company faces financial difficulties, any unpaid wages, benefits, or severance owed to employees will be settled before any other debts are addressed. This prioritization reflects a commitment to social protection. Workers rely on their earnings to support themselves and their families, so ensuring they receive their rightful compensation is crucial, especially during challenging times. By placing workers' claims at the forefront, the provision not only supports individuals facing economic uncertainty but also reinforces the idea that businesses have a responsibility to their employees.

In this relation there is a case that involved Holland Car PLC (the applicant) and Zemen Bank Share Company (respondent).[79] In this case Federal Cassation bench denied the bank to sell the property used to secure its loan by stating that allowing the bank to sell the mortgaged property through a separate auction would not ensure that employee claims would be verified and paid according to their legal priority rights under article 167 of Decree No. 377/96.

While protection for employees' claim has a legitimate social purpose, the unlimited nature of this protection could create unintended consequences. Such extensive protection might encourage employees to delay asserting their rights, knowing they can do so at any time without losing priority status. This delay could lead to larger accumulated claims that ultimately affect the interests of secured creditors who exercised in due diligence.

Bank and pension organizations: Navigating liabilities

Under Ethiopian law, the competition between bank creditors and pension organizations for priority claims presents a complex situation governed by different laws, mainly by civil code and Private Organization Employees' Pension Proclamation No. 1268/2022. This proclamation has

[78] FDRE labor proclamation number 1156/2011, Article 168

[79] Holland Car PLC (the applicant) V. Zemen Bank Share Company, FSC Cassation decision Vol. 17 File No.102061

established a priority position for pension claims that directly impacts the standing of those with secured interests.

Article 12(5) of Proclamation No. 1268/2022 provides the cornerstone of this new priority framework, stating: "Since pension contribution payment emanates from employment agreement and it is the social security payment for the employees, the payment of pension contributions shall have priority emanate from the law, agreement, or court decision or over any payment of debt." This provision establishes pension contributions as superior to all other claims, regardless of their legal basis or security status. The justification for this is the source of the money that is from employment agreement and it serve as social security payment for the employees. This characterization reflects a view that pension obligations are not merely financial claims but essential social protections that warrant special legal status.

For banks in Ethiopia, these provisions create subordination of most diligently documented and registered mortgage or pledge to pension claims. The legislation's language leaves no room for exceptions. This shows a policy chosen by the Ethiopian legislature is to prioritize social security over the commercial interests of lenders. This can lead secured creditors, banks, to follow more conservative lending approaches, additional due diligence on borrowers' pension compliance, and potentially higher costs of credit to compensate for the increased risk.

Bank and other unsecured creditors: Addressing priority disputes

A person (either legal or natural) holding secured debt possesses preferential standing or priority right, allowing it to receive payment from funds generated through the sale of property under mortgage before any other claimants can access these proceeds. Unsecured creditors are to be paid the amount of the value of sale of the mortgaged kept the surplus.[80] The practice shows that when these unsecured creditors demand the sale of the mortgaged immovable, courts prohibit such demand. But this bad practice is unlawful.[81] The only thing the law accepted is that

[80] Menbertsehay Tadesse, Mortgage Guaranteeless guarantee Law, 1998, P. 8

[81] Alefe Beza (n 5) P.22

unsecured creditors may demand the sale of the immovable mortgaged, but their debt is to be paid after the secured in the priority.[82]

Ethiopia's updated legislation has further defined the superior position of creditors holding security interests compared to those with preferred claims. This may not be the case in case of bankruptcy. The law establishes that creditors with secured interests maintain complete and exclusive rights to assets serving as collateral, with only the necessary expenses for liquidating such pledged property being deducted before payment, as stipulated under Ethiopia's insolvency regulations.[83]

3.2.3 Enforcement of security interest by creditor banks

Property mortgaged or pledged with banks proclamation number 97/1998 under its article 9 allow banks to agree with their borrower to sell the collateral by auction upon giving a prior default notice of minimum of 30 days to the debtor. As per the proclamation banks can bypass lengthy court proceedings through the Foreclosure Proclamation, by directly foreclosing the property after publishing notices in widely-circulated newspapers.[84]

Before publishing the notice, the bank will fix the value of the asset to be sold by auction. Both substantive and procedural laws of Ethiopia are silent about the procedures to be followed by banks in fixing the price of the property to be auctioned. Hence, Property valuation method practiced by most of Ethiopian banks are manuals which are to be up dated every year and some of the banks used nationally developed Ethiopian banker association Manual.[85] After property

[82] Ibid

[83] Cumulative reading of Art. 785 & 668 of the new Commercial Code.

[84] Bereket Alemayehu Hagos (n 10)

[85] Bekele Ejeta, Assessment of real property valuation methods in Ethiopian financial institutions (Banks): The Case of Jimma Zone, 2020. The study reveals significant challenges in relation to property valuation including data collection difficulties, inconsistent valuation practices between institutions, and outdated guidelines. Residential buildings are the most frequently valuated properties for collateral purposes, with valuation claims arising from standardization issues and outdated guidelines. The research recommends developing nationally standardized valuation guidelines for all financial institutions, establishing independent research centers to regularly update

valuation and publishing notice of the auction then the property will be sold. During the sale of property any surplus amount will be returned to the borrower as compensation has to be equal with the damage. Then transfer of ownership of the property to the buyer will be made. However, if no bidder comes to the auction to buy the property, then the bank has the right to take over the mortgaged property at the initial price of 1st auction if there is no buyer at 1st and 2nd auction.

If banks fail to follow the procedures it has to follow, especially articles 394-449 of the Civil Procedure Code, and if the debtor sustains damage due to that irregularity, the bank is liable.[86] Under the case between Wegagen Bank S.C and Biruk Cheka et al it is stated that a debtor cannot file a claim to prohibit the foreclosure sale based on procedural irregularities; instead, it gives the debtor's the right to seek compensation after the foreclosure process has been fully completed.[87]

From the assessment conducted across seven banks in Ethiopia, several common challenges were identified that hinder banks' enforcement of their security interests. The challenges the respondents stated are: Tax authorities frequently assert absolute priority rights over collateralized properties, often supported by what respondents describe as court bias favoring these government entities taking possession of a collateralized property especially in relation to movable property, Incompetence within registry offices presents another significant obstacle, exemplified by a case where both Commercial Bank of Ethiopia and Development Bank[88] were erroneously registered as first-priority creditors for the same property. Banks also face court injunctions that impede their enforcement rights under Proclamation 97/90. Land administration offices frequently refuse to register property transfers to buyers of foreclosed properties, citing

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valuation manuals, providing continuous professional training for valuators, and implementing regulatory oversight by the National Bank of Ethiopia to ensure consistency and accuracy across the banking sector.

[86] Property Mortgaged or Pledged with Banks Proclamation No. 97/1998, cumulative reading of article 6 and 7

[87] FSC Cassation Decision Vol.13, File No. 70824 (The case of Wegagen Bank Vs Biruk Cheka et al).

[88] FSC Cassation Decision Vol.14, File No. 75743.

unpaid taxes by the original debtors and directives from tax authorities prohibiting such transfers. Additional challenges include legal illiteracy among administrative officials, instances of non-existent collateral or incorrectly valued assets, and provisions in newer laws that allow debtors to appeal foreclosure proceedings, thereby delaying the enforcement process that was designed to be speedy under the original foreclosure framework.

3.3 Protection of bank creditors' priority rights under Ethiopian law: Movable and Immovable collateral

Bank creditors' priority right is a critical aspect of Ethiopia's financial and legal framework. This right establishes the order in which creditors' claims are satisfied when a debtor's assets are insufficient to meet all obligations. In the banking context, priority rights are particularly important for ensuring financial stability and encouraging lending within the economy.

Proclamation No. 97/1998, the Banking Business Proclamation, and Proclamation No. 1147/2019, Movable Property Security Right Proclamation, do not primarily address priority rights for banks, but rather focus on enforcement mechanisms that allow banks to more efficiently realize their security interests. Proclamation No. 97/1998 was a legislation that allowed banks to bypass court proceedings when foreclosing on collateral. It gives the banks the right to directly sell mortgaged or pledged property through auction after providing a 30-day notice to the debtor. The preamble of Proclamation 97/1998 explicitly states its purpose is addressing the problem that "it takes rather too long a time to obtain judgment, from courts of law, for sale of property mortgaged or pledged with banks and to subsequently have it executed." This created a significant procedural advantage for banks but did not solve the priority ranking of creditors.

Proclamation No. 1147/2019 (Movable Property Security Right) protects a security interest in movable property. It established a modern secured transactions system, especially in relation to the registration system. While it contains provisions regarding priority among competing secured creditors,[89] these provisions largely codify general principles of priority rather than creating special priority status for banks.

Part Five of the proclamation establishes a detailed framework governing the determination of priority rights among competing security interests in movable property. Article 45 articulates the fundamental principle underpinning this framework, secured creditors enjoy priority status over unsecured creditors with respect to the collateralized property. This provision creates a clear hierarchical structure that privileges those who have obtained formal security interests through proper legal channels. Article 46 further refines this priority structure by instituting a "first-to-register" rule for competing security interests. This provision establishes temporal registration rather than the chronology of creation as the determinative factor in establishing priority among multiple security interests encumbering the same collateral granted by the same grantor. In addition, Articles 3041-3130 of the Civil Code establishes the general framework for privileges and priorities.

Analysis of written interview responses shows a consensus among banking legal professionals regarding the distinction between legal framework and practical application when comparing movable and immovable collateral. All respondents indicated no substantive legal difference in a bank's priority rights over movable versus immovable property. As one senior attorney from Zemen Bank stated, "There is no significant difference in the right of a bank in this regard. Similar requirements are stipulated in order for a bank to establish mortgagee/pledgee right over both moveable and immovable property." This view was consistently raised by professionals across different banks.

However, despite this legal equivalence, respondents highlighted substantial practical enforcement challenges specific to movable property. As articulated by Nib International Bank's attorney, "As per the legal protection it has no difference but execution of the right of the bank in movable collateral face problem like concealment, disassembly (part sale), change of address, depreciation..." Similarly, a Cooperative Bank attorney explained, "Exercising a bank's priority rights on immovable properties is relatively straightforward since the property is fixed and can

[89] Movable Property Security Rights Proclamation No. 1147/2019, Part Five

be easily claimed. However, when it comes to movable assets, there is always the risk of theft or concealment, making enforcement more complex." These findings demonstrate that while Ethiopian law establishes equivalent rights over both property types, the practical reality of enforcement creates significant operational differences.

In general, there is no difference in the prior rights of a bank based on the nature of the property. Claim rights relating to both movable and immovable property are legally required to be registered. Such registration gives the banks rights and advantage with regard to priority over mortgaged or pledged properties.

3.4 **International practice of priority right on a collateralized property.**

Under this section experience of different countries regarding hierarchy between secured and unsecured creditors will be discussed, along with their law regarding hierarchy and limitation of preferential claim rights. In order to do the analysis experience of 4 countries, Kenya, the United States, China, and the United Kingdom, will be discussed.

Kenya

Kenya's Property Security Rights Act of 2017 established a regulating system for secured transactions. Under this framework, Kenya generally follows "first to register" principle, where secured creditors who register their interests first enjoy priority over subsequent claimants. However, the law creates an exception to this principle. The Kenya Revenue Authority (also called non-consensual creditor) has priority rights under the Tax Procedures Act of 2015. When a tax claim is filed, it receives priority over many competing claims, though properly registered security interests created before the tax maintain their priority.[90] While tax authorities are subordinate to secured creditors, they can get priority by registering a notice before the security right is made effective against third parties.[91]

[90] TAX PROCEDURES ACT NO. 29 OF 2015, Art, 40 states that “Where a taxpayer, being the owner of land or a building in Kenya, fails to pay a tax by the due date, the Commissioner may direct the Land Registrar in writing that the land or building, to the extent of the taxpayer's interest in the land or building, be the subject of a security for the unpaid tax specified in the notification to the Land Registrar” this shows us that tax authority to get priority there need to register their claim thus there will be common Principe to govern the creditors.

[91] Movable Property Security Rights Act 2017, Cap 499A.

The Employment Act Cap. 226 under its Article 66 show a compassionate approach to protect workers when their employer goes bankrupt.[92] Rather than forcing employees to stand in line with other creditors the law creates a safe way that addresses the immediate financial needs of workers who suddenly lose their income. When a company fails, employees are particularly vulnerable. The second schedule of insolvency Act, 2015 provides for preferential treatment to employees claim and places those claims as the second priority next to expenses of bankruptcy.[93] But this protection is limited to Kenyan shilling 200,000 per employee.[94] Unlike banks who can spread their risk across many clients, workers typically depend on a single employer for their livelihood. This provision recognizes that reality by allowing the Cabinet Secretary to step in and make direct payments from the National Social Security Fund to employees who are owed wages or other employment debts.

Pension claims also receive preferential treatment under the Retirement Benefits Act, though they typically rank below employee wage claims in the priority hierarchy. The Kenyan Retirement Benefits Authority has emphasized the importance of this protection, noting that pension contributions represent deferred wages that must be safeguarded to ensure workers' financial security in retirement.[95]

United States

In the US legal system, creditors are categorized primarily based on whether they hold security interests in a debtor's property.[96] Under Article 9 of the Uniform Commercial Code (UCC), a law that governs secured transactions involving personal property, secured creditors generally have priority over unsecured creditors in claims against the collateral securing their debt. This fundamental principle establishes the baseline hierarchy among creditors. Secured creditors who

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[92] THE EMPLOYMENT ACT CAP. 226, Art 66 (a) states that “Where on an application made to him in writing by an employee or his representative the Cabinet Secretary is satisfied that the employer of an employee has become insolvent, the Cabinet Secretary shall, subject to section 69, pay the employee out of the National Social Security Fund, the amount to which, in the opinion of the Cabinet Secretary, the employee is entitled in respect of the debt.

[93] Calystus Juma Kisaka, Corporate Insolvency: Protection of Employee Rights in Kenya, 2022, P. 49

[94] Insolvency Act, 2015, Second Schedule paragraph 3(2).

[95] The Retirement Benefits Act Cap. 197, 1997

[96] Bereket Alemayehu Hagos, (n 10), P. 20

properly perfect their security interests (typically through filing financing statements) establish their priority position against other creditors. The priority among secured creditors themselves is generally determined by the "first to file or perfect" rule, meaning the creditor who first files a financing statement or otherwise perfects their security interest has priority over subsequently perfected interests in the same collateral.[97]

Bereket Alemayehu Hagos identified several exceptions to this general priority principle. For instance, tax liens held by government authorities, may take priority over earlier perfected security interests in some circumstances. In US the Internal Revenue Service relies on the federal tax lien to secure payment of unpaid tax liabilities.[98] However, the authority cannot exercise such right automatically over other claimants. As the federal law follows the “first in time first in right” principle, the state is deemed to be in existence for first in time when it has been perfected the property subject to the lien and amount of the lien are established.

Judgment lien creditors[99] have priority over the Internal Revenue Service, if the Internal Revenue Service files its federal tax lien after the judgment lien arises by getting state court judgment before the IRS files its federal tax lien notice, the judgment lien creditor is thought to be first and thus senior.[100] The decision shows that courts will examine several factors to determine priority between competing claims, these are: the time when the bank creditor perfected its security interest, the time when the tax authority filed its notice of tax lien, whether the security interest meets any statutory exceptions that would grant it priority regardless of timing, and whether proceedings have been initiated, potentially altering the priority scheme. When a bank properly perfects its security interest before a tax lien is filed then a federal tax lien is not valid against

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[97] Ibid

[98] William D. Elliott, Successfully obtaining a judgment against a delinquent taxpayer, 2012

[99] Judgment lien creditor, is a person who has obtained a valid judgment in a court of record and of competent jurisdiction for the recovery of a specifically designed property or for certain amount of money.

[100] United States v. McDermott, 507 U.S. 447 (1993)

such secured creditors.[101] If a bank has already recorded its mortgage or security interest before federal tax lien, the bank maintains priority for the value of the collateral up to that point.

Additionally, Purchase Money Security Interests (PMSIs)[102], security interests that secure loans used to acquire the collateral itself, receive special priority treatment under Article 9. In this scenario, secured creditors enjoy significant freedom in choosing enforcement methods. This flexible approach to priority and enforcement reflects the US legal system's works more toward facilitating credit markets by providing strong protections for secured lenders, while still maintaining certain safeguards for debtors and other creditors through specific statutory exceptions to the general priority rules..

In case of employees, their claims receive limited protection under American law.[103] The Bankruptcy Code grants priority to employee wage claims, but only up to specified money and day. Section 507 of the US Bankruptcy Code establishes a clear hierarchy for the payment of claims when a debtor's assets are liquidated. At the top of this hierarchy, there are administrative expenses and fees necessary for managing the bankruptcy process, followed by certain unsecured claims arising between involuntary filing and trustee appointment. The code then prioritizes protection for vulnerable parties, allocating the third priority to employee wage claims (up to $4,000 per person) earned shortly before bankruptcy, with employee benefit plan contributions taking fourth position. Agricultural producers and fishermen receive fifth priority protection (up to $4,000 each), while consumer deposits for undelivered goods or services are sixth (up to $1,800 per person). Domestic support obligations like alimony and child support take seventh position, while governmental tax claims occupy the eighth spot, covering income taxes from returns due within three years of filing, recently assessed taxes, and various other tax obligations. Commitments to federal banking regulators round out the list at ninth priority. This carefully

[101] Federal Tax Liens: A Guide to the Priority System of Section 6323 of the Internal Revenue Code Dean L Overman, Bon-0N College Industrial and Commercial Law Review

[102] Purchase money security interest is defined in Section 9-312 of the UCC as a legal claim that allows a lender to either repossess property financed with its loan or to demand repayment in cash if the borrower defaults. This gives the creditor priority right over claims made by other creditors.

[103] Ibid. 29

structured system balances the protection of vulnerable individuals, public interests, and the overall predictability needed for credit markets to function effectively. The code also includes additional provisions addressing secured creditors who receive inadequate protection, subrogation rights, and the treatment of erroneous tax refunds, ensuring comprehensive coverage of the complex relationships between debtors and their various creditors.

Pension claims in the United States receive protection through the Employee Retirement Income Security Act (ERISA), which establishes priority for certain pension contributions. However, these protections are narrower than in many other countries.[104] The Pension Benefit Guaranty Corporation (PBGC) obtains priority for certain claims when it takes over underfunded pension plans, but these priorities are subject to various limitations and exceptions.

The U.S. legal system set a balance between competing financial interests, acknowledging the fundamental tension that exists between secured and unsecured creditors. Rather than simply favoring one group over another, lawmakers have established a favorable framework that attempts to balance these competing claims through some limitations and protections.

China

China's approach to secured transactions and creditor hierarchy has evolved significantly with the implementation of the Property Rights Law of 2007 and Enterprise Bankruptcy Law of 2006, which form the backbone of China's priority framework.[105] These laws generally recognize the priority of properly registered security interests over unsecured claims, showing China's movement toward market principles while retaining distinctive Chinese characteristics. Under China's Property Law, Article 180 established a positive list of assets that can be used as security, with a general provision stating that any property not prohibited by laws or administrative regulations can serve as collateral.[106]

China lacks a centralized registry for movable collaterals, with registration affairs managed by several registries based on collateral type, making the process inefficient and costly.[107]

[104] James D. Hutchinsont and David M. Ifshintt, Federal Preemption of State Law Under the Employee Retirement Income Security Act of 1974, The University of Chicago Law Review, 1978

[105] JIN Man, Secured Transactions Under China and US Law, Canadian Social Science, Vol. 11, No. 3, 2015, P. 14

[106] Ibid, P. 14-15

[107] Ibid P. 16

China's priority system reflects a balancing act between developing a modern secured transactions system that attracts investment and credit, while maintaining strong protections for workers and state interests through preferential claims for employees, tax authorities, and social insurance contributions.[108]

Chinese tax authorities enjoy substantial priority rights. The Tax Collection and Administration Law grants tax claims priority over most other creditors, though properly registered security interests created before the tax claim arose typically maintain their priority. This approach reflects what Chinese legal scholar Wang Liming describes as "China's balancing of state revenue interests with the need to develop a modern secured transactions system. Employee claims receive robust protection under Chinese law, reflecting the country's socialist heritage and emphasis on worker rights. The Labor Contract Law and Enterprise Bankruptcy Law establish that claims for unpaid wages, medical expenses, and severance payments take priority over both unsecured creditors and many secured creditors. This creates what some foreign creditors view as an unusually strong preference for workers. Pension claims also receive strong protection in China. Under the Social Insurance Law, unpaid social insurance contributions (including pension contributions) constitute preferential claims that rank ahead of most secured creditors. As Chinese pension expert Professor Lin Cancan explains, "China's approach reflects a social policy decision that retirement security cannot be compromised even in the face of competing commercial interests."

United Kingdom

The UK generally adheres to the principle that properly registered security interests take priority according to the date of registration, providing predictability for secured lenders.[109]

However, British law establishes important exceptions to this general principle. Her Majesty's Revenue and Customs (HMRC) previously enjoyed a preferential claim for certain taxes, but these "Crown preferences" were largely abolished in 2003 to enhance the rescue culture for

[108] Ibid P. 17

[109] Slaughter and May, In brief: security interests and guarantees in United Kingdom, August 22 2019, <In brief: security interests and guarantees in United Kingdom - Lexology> accessed may 2025.

distressed businesses. In a significant policy reversal, Finance Act 2020 partially restored HMRC's preferential status for certain tax claims, reflecting what insolvency practitioner Peter Sargent describes as "an ongoing tension between revenue collection and business rescue objectives."

Employee claims receive meaningful protection under UK law. The Employment Rights Act 1996 establishes that certain employee claims constitute preferential debts in insolvency. These include unpaid wages (up to specified limits), holiday pay, and certain pension contributions. The Enterprise Act 2002 further enhanced this protection by creating a "prescribed part" of floating charge proceeds that must be set aside for unsecured creditors, including employees.

Pension claims have gained increasing protection in the UK following several high-profile pension scandals. The Pensions Act 2004 established the Pension Protection Fund and granted it significant priority for certain claims when it assumes responsibility for underfunded pension schemes. Recent court decisions, including the landmark Bloom v. Pensions Regulator case, have further strengthened pension priority in certain contexts.

The UK system distinguishes between different types of security interests, with fixed charges generally enjoying priority over floating charges regardless of registration timing. As Lord Hoffmann noted in the seminal case of Re Spectrum Plus Ltd, "The distinction between fixed and floating charges represents the British approach to balancing secured creditor rights with the interests of other stakeholders."

These four jurisdictions reveal both commonalities and significant divergences in priority frameworks. All recognize the fundamental importance of security interests and registration systems for establishing baseline priority, but they differ markedly in how they balance this commercial imperative against competing social and governmental interests. Tax authority priority varies substantially across jurisdictions. Kenya and China grant significant priority to tax claims, though generally preserving the priority of pre-existing security interests. The United States takes a similar approach through its federal tax lien system. The United Kingdom stands out for having significantly reduced tax authority priority in 2003, though partially reversing this position in 2020.

Employee claims receive protection across all jurisdictions, but with varying strength. China offers particularly robust protection, with employee claims frequently obtaining priority even over secured creditors. Kenya follows a similar approach, while the United States and United Kingdom offer more limited protection, typically subject to monetary caps and temporal limitations. Pension claims similarly receive protection in all jurisdictions, though with significant variation. China grants strong priority to pension claims, while Kenya offers moderate protection. The United States and United Kingdom provide more limited statutory protection, though the UK has strengthened pension priority through both legislation and case law in recent years. The overall balance struck between secured creditors and other stakeholders reflects each country's distinct legal traditions and policy priorities. The United States and United Kingdom, with their well-developed financial markets, tend to offer stronger protection for secured creditors while providing more limited carve-outs for other stakeholders. Kenya, and China, with their different developmental contexts and social priorities, generally provides more robust protection for employees and pension claimants, sometimes at the expense of secured creditors.

Chapter 4

Impact of Lack of Clear Hierarchy between Creditors

4.1 Challenges faced by creditor banks

Banks in Ethiopia face different challenges when attempting to exercise their priority rights over collateralized property. During the face to face interview conducted with the six banks, Nib International Bank S.C[110], Hibret Bank S.C[111], Zemen Bank S.C[112], Addis International bank S.C[113], Cooperative bank of Oromia[114] and Goh Betoch S.C[115] the researcher discovered that despite the legal protections afforded to secured creditors, in practice, banks face competition while trying to enforce their priority rights over collateralized property. The common challenges are interplay of different legal frameworks, timing of claim by those non-consensual creditors, lack of awareness regarding intention of the law, court injunction, lack of civilized registration system, lack of designated enforcement authority to ensure compliance with the rights granted to banks under Article 97/1998 and weak justice system. These all supersede banks' secured claims right, regardless of the legal framework designed to protect secured creditors.

In Ethiopia, secured transactions-related laws are scattered across different codes and statutes.[116] The 1960 Civil Code governs real estate mortgage, antichresis possessory pledge and the pledge of incorporeal assets.[117] The civil code under article 3076 establishes the secured creditor's priority right to receive payment from the mortgaged property, ensuring they can recover the

[110] Interview with Ato Beyene Ayenew, (n 69)

[111] Interview with Ato Solomon Belete, Legal department Director, Hibret Bank Share Company, (Addis Ababa, 29 April 2025) and Kebede Assefa, Advisory and legal Research division manager, Hibret Bank Share Company.

[112] Interview with Ato Birhanu Beyene Birhanu, Legal Director at Zemen Bank Share Company, (Addis Ababa, 10 April 2025),

[113] Interview with Ato Gezu Ayele, (n 58)

[114] Interview with Bikila Ababu, Legal Department Director, Cooperative Bank of Oromia (Addis Ababa, 16 April 2025)

[115] Interview with Getahu Tufa, Senior Attorney, Goh Betoch S.C (Addis Ababa, 16 April 2025)

[116] Asress Adimi Gikay, Rethinking Ethiopian Secured Transactions Law through Comparative Perspective: Lessons from the Uniform Commercial Code of the US, Mizan Law Review, Vol. 11, No.1, September 2017, P. 153

[117] Civil Code Article 2287(1), Title XVIII Chapter 4 Articles 3041 -3130 for Mortgages and Antichresis and Title XVII Articles 2825 – 2874 for pledges and Art. 1128 & 2829

registered claim amount before any other creditors can access these proceeds. However, currently this right given by the code for secured creditors is being eroded with other laws enacted after the code. As a result, the civil code collides with some laws and informal arrangements that are being practiced by various creditors. Practically when a debtor defaults and mortgagee try to exercise its right, they discover that the collateralized property they believed was securely pledged to them is subject to various competing claims from different claimants either secured or unsecured. Most common challenges that bank in Ethiopia face when trying to enforce their priority rights are discussed here in detail.

Preferential claim rights of certain entities such as employees, tax authorities and pension agency arise from the law. The law seems justifiable.[118] However, implementation of these priority rights is problematic. These preferred creditors enjoy unrestricted an unlimited power to pursue their claims whenever they choose, even when they have neglected to collect debts promptly. In a case between Nib Bank S.C and private pension agency, the agency pursues its claim after 2 years of the bank settle its debt by selling the property.[119] In the case the amount the pension agency claiming for was payment of 2 years of arrears. This shows that there is no reasonable limit on the amount and years of arrears they can demand. In addition, there is no limitation of period to exercise the priority right this result in legal uncertainty, extended liability, undermining the purpose of secured transaction and finally lack of interest to give credit. Hence, question of when do creditors who have preferential claim right will exercise their right have to be answered.

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[118] Interview with Ato Beyene Ayenew (n 69), He states that protecting the employees right in preference to other creditors is justifiable as it directly relate with social security.

[119] Nib bank S.C v. Private Organization Employees' Pension Agency (pending case) in the case the bank argues that they properly notified the agency to take its claim before the bank and the claimant failed to collect these funds promptly. As a result the bank settles its debtor's debt and pay the excess money for employees claiming instead. After almost 2 years this action takes place the pension agency acknowledges that employees received the money but contends that under the law, the bank never held priority rights over the agency in any circumstance. The pension agency insists the bank must pay them in any case. The Federal Supreme Court ruled in favor of the pension agency. Subsequently, the bank has filed an appeal to the Cassation Bench, seeking reversal of this decision.

There is legal clarity challenge on proclamation No. 97/1998. Scholars commented on legality of the proclamation in two sides. On the one side objective of the proclamation is to establish a system allowing banks to sell property on which they have established security rights without requiring court approval, and to use the proceeds from the sale to repay loans. Court interventions (for example: by ordering injunction on execution of banks foreclosure right) is unnecessary and contradict with objective of the proclamation. Therefore, court intervention to such right given by law has to be prohibited.[120] On the other hand, some argue that the proclamation conflicts with the constitution by denying right of access to justice stipulated in Article 37 of the FDRE Constitution and the right to property stipulated in Article 40.[121] This argument is criticized, first, for the proclamation clearly states that such enforcement applies only to borrowers who have explicitly agreed to out of court enforcement in their loan agreements.[122] Second the proclamation doesn't eliminate court access total, but channels it appropriately. Courts retain authority to intervene when prescribed procedures aren't followed, fraud or irregularities occur in the sale process and compensation claims arise from improper handling as per article 6 and 7 of proclamation no. 97/1998. There is US court decisions that support the principle that "mere postponement of judicial inquiry is not a denial of due process" when adequate ultimate judicial recourse exists.[123] In these regard banks assert that they are not objecting to court intervention in cases explicitly outlined in the proclamation. Rather, their concern is that issuing an injunction while executing the banks right as per the proclamation to give the rights to other entities beyond the scope of the proclamation is inappropriate. Such judicial expansion of rights undermines the protection established by the law.

It appears that non-consensual creditors are receiving preferential treatment, as they are able to assert their claims regardless of whether they have properly followed the established legal procedures.[124] Article 39(3) of tax admiration proclamation no. 983/2016 oblige tax authority to

[120] Interview with Ato Beyene Ayenew, (n 69)

[121] Birhanu Beyene Birhanu, The Constitutional Acceptability of Proclamation No. 97/90,2025 P. 3 (Translation from Amharic)

[122] Property Mortgaged or Pledged with Banks Proclamation no. 97/1998, Art. 3

[123] Birhanu beyene Birhanu P.7

[124] Interview with Ato Birhanu Beyene Birhanu, (n 92)

register its security interest in any asset owned by the taxpayer who failed to pay tax to cover the unpaid tax.[125] However in practice the authority exercise its right even if it failed to register its claim in competent registry office organized to register the specific property. In a case between Zemen Bank vs. Revenue Authority, even if the authority failed to register its claim in Movable Collateral Registry Office working under National Bank of Ethiopia as required by Article 55(1) of Proclamation 1147/2011, both federal high court and supreme court state “The bank's failure to register the movable property with the NBE registry couldn't suppress the tax authority's preferential claim rights under Article 33 of TAP” and ruled in favor of the authority. This shows that the authority is favored. This creates an imbalance in the system, while these creditors are successful without fulfilling the procedural requirements, banks and other secured creditors are expected to strictly adhere to all procedural safeguards outlined in the law to enforce their rights. Even they will be held liable for not following the procedural requirements.

Registration formalities and compliance with procedural requirements constitute another critical factor. The Ethiopian Civil Code establishes the fundamental legal framework for mortgages through Articles 3041-3130, with Article 3052 explicitly mandating that "No mortgage shall be valid unless registered in the registry of immovable property." This registration requirement is implemented through a geographically-determined system of registries across Ethiopia. Specifically, a mortgage must be registered in the land registry corresponding to the property's location: urban properties must be registered with the respective City or Municipal Land Administration offices; properties within Addis Ababa must be registered with the Addis Ababa City Administration Land Development and Management Bureau; and rural properties must be registered with the appropriate Woreda Land Administration offices. This registration process is not merely administrative but constitutes a substantive legal requirement, as failure to properly register with the correct authority renders the mortgage legally invalid and unenforceable against third parties, regardless of any contractual agreements between the mortgagor and mortgagee. In addition, failure of administrative organs to notify or disclose previously registered priority

[125] Tax Admiration Proclamation No. 983/2016, article 39(3) states “When a taxpayer is in default in paying tax, the Authority may, by notice in writing, inform the taxpayer of the Authority’s intention to apply to the Registering Authority to register a security interest in any asset owned by the taxpayer to cover the unpaid tax together with any costs incurred in recovery proceedings”

rights undermines the enforcement of secured bank claim.[126] As priority rights are mainly determined based on the order of date registration, but if administrative bodies fail to notify the prior records, then subsequent creditors may unknowingly register overlapping claims. This leads to disputes, increased risks for creditors, and a lack of confidence in the registration system. Ensuring accurate records, timely notifications, and efficient registry systems is crucial to safeguarding the priority rights of secured creditors, aware of their risk and maintaining trust in secured transactions.

Court decisions and judicial interpretations also have substantial influence on priority outcomes. The Federal Supreme Court Cassation Division has issued binding precedents. However, the existences of different contradicting decisions limit its applicability. Decision given on a case between Federal Ministry of revenues and custom authority and Dashen Bank Share Company can be good example. The case will be discussed under case study section.

In practice, factual circumstances surrounding the creation and enforcement of security interests often influence priority determinations. Issues such as notice to third parties, knowledge of existing encumbrances, fraud, or misrepresentation can affect the enforceability and priority of security interests. Therefore, the resolution of competing priority claims ultimately requires a comprehensive analysis of these interconnected factors.

To conclude, right given for secured creditors under the civil code is being eroded by subsequent laws. More concerning is that competing priority rights have been established without appropriate limitations on timing, amount, or procedural requirements, creating an unpredictable environment that reduces the secured transaction system's effectiveness.

4.2 Consequences of ambiguity in priority rights

4.2.1 Increased risk for secured creditors

As discussed above there is no single comprehensive law regarding hierarchy of creditor's priority right and also there are some unsecured creditors with absolute priority right. This could result in uncertainty for the secured transactions. This uncertainty will affect the banks' lending

[126] Interview with Ato Beyene Ayenew, (n 69)

procedures as it increases their risk. Here scenarios that contribute for the increment of risks of secured creditors will be discussed.

Legal uncertainty

Under Ethiopian legal system there is no comprehensive law that sets hierarchy between different creditors that have claim right on a single collateralized property. This gap creates repeated collision of right between competing creditors claiming against the collateralized property. Without clear statutory principles, courts and practitioners such as pension organization, tax authority and employees follow the general principle that is "the latest law prevails over the earlier". This approach will create a situation where a creditor who secures priority position today may be subordinate to other future claims because of laws that may be enacted in the future.

Such lack of comprehensive law is creating inconsistent application of priority rules among courts in Ethiopia. In a case between W/ro Zemzem Nuru and Development bank of Ethiopia[127], the bank objected the sale of property for Bahir Dar Special Zone Inland Revenue Office debt by stating its mortgage right over the property itself. The court rejected the objection, saying that the bank cannot reject sale of mortgaged property rather it has the right to claim payment in priority from the sale of the collateral. In this case federal cassation court explained the scope of the rights of a bank over mortgaged property stating that the bank shall have the right to preference over the mortgaged property.

Contrary to this there is a case between Zemen Bank vs. Revenue Authority (the case will be discussed in detail under case study section), in the case the court deny right of creditor bank and give priority for tax authority.

Furthermore, provisions introduce ambiguity. Specifically, Articles 33 and 39 of the Tax Administration Proclamation have caused uncertainty among various legal experts, impacting court rulings. In the case between Tax authority and Dashen Bank S.C[128], the judges stated that although 33(1) of the Tax Administration Proclamation grants the tax authority priority rights

[127] Ms. Zemzem Nuru v. Development bank of Ethiopia, Vol.9, File No. 36013

[128] Federal Ministry of revenues and custom authority v. Dashen Bank Share company, file No. 235004

over taxes such as withholding tax, value-added tax, turnover tax, or excise tax, this not imply the exclusion of secured creditors' priority rights if they register the security fulfilling the procedures expected. Therefore, when the bank obtains tax clearance from the authority accordance with Article 39(7) of Tax Administration Proclamation, it acquires priority rights. The authority may assert these rights if the creditor extended the debt without verifying whether the debtor had pre-existing tax obligations, solely by presenting clearance.

Article 39(3) of Tax Administration Proclamation obliges the tax authority to notify the taxpayer in writing of their intent to pursue the next step and then apply registering authority to register a security interest against assets owned by the taxpayer when the taxpayer fails to pay the required taxes. In this regard different lawyers interpret the issue in differently. Some understand it as tax authority must register their claim and they lose their right if they fail to do so.[129] On the other hand, there is others interpret the law as the law does not mandate registration unlike banks to claim priority right.[130] Despite this debate, in practice, the authority claims payment through a mere circular. Although the definition of circular is not provided under the Tax Administration Proclamation, it is understood as a letter circulated from the authority to others.[131] It remains unclear what law states in this regard, i.e., whether such registration of the authority's claim may affect its priority right or not.

The other confusion is article 39 (7) of tax administration proclamation.[132] The provision establishes a condition for banks to claim priority right over property collateralized. Banks only receive priority status in relation to secured claims if they verify that the borrower (taxpayer) possessed a valid tax clearance certificate issued by the Authority at the time of lending. However, the provision fails to specify whether the tax clearance requirement applies to the debtor (the person receiving the loan) or the mortgagor (the person pledging property as security)

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[129] Interview with Ato Birhanu Beyene Birhanu, (n 92)

[130] Interview with Gezu Ayele, (n 56)

[131] Interview held on Meri podcast with Dr. Tadesse Lenco (PhD) on February 26, 2025

[132] Tax administration proclamation Article 39 (7) states that "The priority of banks in relation to secured claims in accordance with sub-article (2) of this Article applies only where the banks, before lending any amount, confirm that the taxpayer has a tax clearance certificate from the Authority."

when these are different parties. This distinction becomes particularly problematic in cases where a third party provides collateral for someone else's loan. This lack of clarity could lead to inconsistent application by banks and potential disputes if a bank's priority claim is challenged.

Weak enforcement mechanisms

The ambiguity in hierarchy will limit the effective enforcement mechanisms for creditor banks. While the objective of enactment of Property Mortgaged or Pledged with Banks Proclamation no. 97/1998 to enable banks enforce their right promptly and to create a more suitable environment for economic development and enable banks to efficiently collect debts, current legal ambiguity is making banks to hesitate to initiate enforcement proceedings. Instead, they are adopting a wait and see approach.[133] That is waiting other creditors to undertake the burden and expense of enforcement procedures, then to subsequently assert their priority rights against the collateral. Regarding this there is a real case between tax authority and Addis international bank.[134] This delay may have many consequences such as increasing the debt of borrower, its asset value depreciation (this will reduce the probability of debtors to settle their debt) and increased the cost of credit.

This all result in making banks to maintain higher provisions against these loans, i.e., to safeguard potential losses, reduce their capital adequacy and provide limited credit access to productive sectors of the economy.

4.2.2 Effects on borrowers

The ambiguities in Ethiopia's priority rights legal framework also affect the borrowers across the economy. These effects create significant barriers to financial inclusion and economic development through several interrelated mechanisms.

[133] Interview with Ato Birhanu Beyene Birhanu, (n 92)

[134] The case involves a dispute between the revenue authority and Addis International Bank S.C. over a property owned by Green Land Tour Operator in Arbaminc. The bank holds a debt of approximately 100 million while the authority claims around 400 million. If the bank sells the property, the authority will assert priority rights to the proceeds and if the bank acquires the property after second auction if no buyer came, the authority will demand the outstanding amount directly from the bank, potentially adding penalties and interest.

Increased lending costs

When banks become uncertain regarding their ability to enforce their right over secured property, they will transfer the risk to borrowers through interest. While calculating loan price banks incorporate risk premiums as one component. The premium shows the probable delays in enforcement and uncertain recovery rates caused by different reasons. As a result, borrowers will face higher borrowing cost. In addition, banks demand collateral valuations below market rates to account for potential depreciation during extended enforcement periods.[135] This undervaluation forces borrowers to pledge significantly more assets than would otherwise be necessary in a system with clear priority rights and efficient enforcement mechanisms.

Reduced credit availability

The ambiguity can create a lending environment characterized by quantity restrictions on some sectors. Banks can limit exposure to sectors or borrower profiles perceived as having higher enforcement risks.[136] To lend or not to lend are the way a bank influences the economic development of its community.[137] As the lending process affects not only the banking activity but also the development process, risks should be avoided as much as possible.

4.2.3 Effects on economy of the country

Beyond just considering a bank's own profit margins, lending decisions fundamentally shape the economic path of communities.[138] While banks certainly need to manage risks effectively, their lending practices don't merely affect their balance sheets they directly influence local development patterns, business formation, and economic opportunity. This broader perspective recognizes that banking isn't just a financial service but a critical infrastructure that either enables or constrains community growth and prosperity.

[135] Habtamu Bishaw Asres, Understanding the Bases and Approaches of Mortgage Valuation in Ethiopia, Journal of African Real Estate Research, Volume 5, Issue 1, 2020, P. 67. The literature states that commercial banks in Ethiopia recognize the cost approach as the suitable mortgage valuation approach to the Ethiopian real estate market. And cost approach is involves estimating the cost to produce the improvements, subtracting depreciation, and finally adding the site value at its highest and best use.

[136] Tihitina Ayalew, Legal Problems in Realizing Non-Performing Loans of Banks in Ethiopia, 2009, P. 10

[137] Ibid,

[138] Ibid

The unlimited rights granted to unsecured creditors (tax authorities, pension agencies, and employees) promote negligence in their collection practices, as they postpone pursuing their claims promptly. When these entities eventually demand payment simultaneously, the accumulated debt can devastate the debtor who is unable to meet the financial obligations.[139]

Failure of debtor to secure affordable loans to expand their businesses, may affect lives of their families, employees and others who can get advantage or payment from the debtor. In addition, advanced machinery that would have been imported may not be imported because of financial limit and the increased tax revenue that would have funded new schools and healthcare centers will not be there. The government's development plan suffers as well. With limited tax revenue from a constrained private sector, infrastructure projects remain inactive.

Therefore, resolving priority right ambiguities would make capital accessible for individual borrowers and businesses activities in the country, which will result in expanded job opportunities, expanded the tax base and helping the country achieve its development vision.

4.3 Case studies

1. **Ms. Zemzem Nuru Vs Development Bank of Ethiopia, File number 36013**

Federal Supreme Court Cassation bench examined the rights of secured creditors in relation to mortgaged property. The bench established that while a bank holds preferential rights over mortgaged property, this preference is not absolute. The court determined that all creditors, regardless of secured status, may initiate enforcement proceedings against any debtor property, including mortgaged assets. When other creditors seek to attach and sell mortgaged property, the bank must affirmatively assert its priority status during the enforcement process. Significantly, the court ruled that if a bank fails to claim its priority rights before the property is sold at auction to satisfy another creditor's judgment, the bank loses its security interest and cannot pursue claims against the auction buyer.

Comment on the case:

[139] Interview with Gezu Ayele (n 58)

- The decision fails to establish a hierarchy among different classes of creditors. While the court acknowledges the banks preferential right over mortgaged property, it fails to articulate a framework that ranks different types of creditors.
- The court's determination that "any creditors (secured or unsecured) can claim for payment by attaching and selling any of the properties of the debtor including the mortgaged one" grants unsecured creditors potentially excessive rights. This creates a problematic legal condition where unsecured creditors may undermine the purpose of security interests by initiating enforcement proceedings against mortgaged assets.
- The decision places Inadequate Protection for Mortgage Lenders. By ruling that the bank loses its right to follow the property if it fails to claim priority during an auction, the court creates significant practical difficulties for mortgage lenders. The decision fails to establish reasonable notice requirements that would protect the bank's interests while allowing enforcement proceedings to proceed."

2. Federal Ministry of revenues and custom authority Vs. Dashen Bank Share company. File No. 235004 (decided on August 30, 2016) (unpublished)

Federal Supreme Court Cassation bench examined the competing priority claims between tax authorities and bank creditor. The court analyzed Proclamation No. 983/2008, particularly Articles 33(1) and 39, to determine the hierarchy of claims. The majority opinion established a conditional framework where tax authorities have preferential claims for specific taxes (withholding, VAT, turnover, and excise taxes), but with an important qualification: banks can maintain priority over secured collateral if they verify the debtor has obtained a tax clearance certificate before loan disbursement. The court concluded that tax authorities gain priority when banks fail to verify tax clearance status before lending, creating a procedural prerequisite for secured creditors to maintain their priority position. The decision was not unanimous, with one judge dissenting on the grounds that certain taxes (specifically VAT and withholding tax) grant unconditional preferential status to tax authorities under Articles 33(1)(a) and 39(2) of the Tax Administration Proclamation. This dissent highlighted the critical distinction between income taxes, where bank priority depends on tax clearance verification, and certain indirect taxes where the dissenting judge believed tax authorities maintain absolute priority regardless of procedural compliance.

Comment on the case:

1. The legal framework lacks clear temporal demarcation principles for competing claims. The decision fails to establish whether security interests should be ranked based on creation date or if certain tax claims inherently supersede prior security interests regardless of when they arise.
2. The split decision (4-1) with a dissenting opinion highlights the absence of statutory clarity. When judges interpreting the same provisions reach different conclusions about the conditionality of tax authorities' preferential status for different types of taxes, it shows a fundamental gap in the legislative framework itself.

3. Wegagen Bank S.C Vs. Ethiopian Customs Authority, Vol. 14 File No.81215

The legal dispute originated at the Mekelle City Court, involving the claimant, Wegagen Bank S.C., and the defendant, the Ethiopian Customs Authority. The case centered around a vehicle that Wegagen Bank had registered as collateral for a loan given for Ato Berihe Hagos. When Ato Berihe Hagos defaulted on the loan, Wegagen Bank sought to foreclose on the vehicle to recover its debt.

Before the bank could proceed with the foreclosure, the vehicle was seized by the Ethiopian Customs Authority due to its association with contraband activities. The Customs Authority argued that because the car was involved in illegal activities, it should be forfeited to the government, thereby prioritizing its claims over those of Wegagen Bank.

The Mekelle City Court ruled in favor of the Ethiopian Customs Authority, affirming their claim to the vehicle based on its illegal use. The Regional Supreme Court reviewed the case and upheld the lower court's decision, reinforcing the Customs Authority's position.

Displeased with the ruling, Wegagen Bank appealed to the Federal Cassation Bench. The court examined the legal implications of properties seized under criminal circumstances, specifically focusing on the status of collateral used to secure loans. The Federal Cassation Bench concluded that, despite the absence of explicit legal provisions addressing properties seized by the government in criminal cases, the bank's prior registration of the vehicle as collateral gave it a superior claim. The court reasoned that since Wegagen Bank had utilized the vehicle as security for the loan before the criminal act occurred, it should prevail over the Customs Authority's claims.

This case highlights significant principles regarding the prioritization of secured creditors' rights in the context of property seizures related to criminal activities. The Federal Cassation Bench's ruling emphasizes the importance of timing and the registration of collateral in determining the outcome of disputes between financial institutions and government authorities. Ultimately, it affirms the rights of creditors when they have established security interests prior to any illegal activities associated with the collateral.

Strengths of the Decision

The Bench recognized the priority of previously registered security interests over subsequent government claims. The court established an important precedent that reinforces the temporal priority principle in secured transactions. This decision enhances predictability in lending relationships and protects financial institutions that properly secure their interests.

Gaps Identified

1. The court itself acknowledged "the absence of explicit legal provisions addressing properties seized by the government in criminal cases." This statutory gap forces courts to create judicial solutions without clear legislative guidance, potentially leading to inconsistent rulings in similar cases.
2. The legal framework fails to clearly identify how criminal forfeitures interact with pre-existing security interests. This case required the Federal Cassation Bench to develop this interaction through judicial interpretation rather than applying established statutory principles.
3. The decision does not establish clear procedural mechanisms for financial institutions to protect their interests when collateral becomes subject to government seizure. Questions

remain about notice requirements and the timing for banks to assert their priority claims in such scenarios.

4. **Zemen Bank vs. Revenue Authority, File No. 250318 (September 12, 2016) (unpublished)**

In the case Zemen Bank S.C give a loan to Verde Beef Processing PLC, secured by a car with plate number 3-A02113 AA. When Verde Beef defaulted on the loan, the bank following the standard procedure stated on proclamation 97/98, sell the collateralized vehicle on 28/08/2013 to recover its losses.

The complications began when the bank attempted to transfer the vehicle's registration to its new owner. The Driver and Vehicle Licensing and Control Authority informed Zemen Bank that they couldn't process the ownership transfer due to an existing order from the Revenue Authority. This order initiated Zemen Bank to take legal action against the authority. In court, Zemen Bank presented three arguments: First, they cited Article 39(3) of Proclamation No. 983/2016, which only authorizes the Revenue Authority to register claims on a taxpayer's property for unpaid taxes before the transfer of ownership occurs. Second, they argued that since the Revenue Authority had failed to register their claim with the Movable Collateral Registry Office working under National Bank of Ethiopia as required by Article 55(1) of Proclamation 1147/2011, they couldn't assert priority rights. Third, bank foreclosure proceedings should be treated with the same legal weight as court-ordered executions, meaning that subsequent claims against the already-sold property should be invalid.

The Tax Administration countered with some points: first, They invoked Article 33(1) of the Tax Administration Proclamation, which establishes that turnover tax, pension contributions, income tax, interest, and fines are collected by the debtor in a trustee capacity. Consequently, these funds never truly belonged to the debtor. Furthermore, they maintained that a valid property sale requires not just transfer of possession but formal change of title. Since the vehicle's registration remained under the original owner's name, the bank couldn't legitimately claim the property had been sold.

The first instance court sided with Zemen Bank, declaring the Revenue Authority's block on the title transfer illegal and affirming the bank's priority rights. Then the authority appealed to FHC.

The High Court reversed the lower court's decision, reasoning that: The bank's failure to register the movable property with the NBE registry couldn't supersede the tax authority's preferential claim rights under Article 33 of TAP, Unpaid tax money couldn't be considered as the debtor's property and according to a previous Cassation decision (Volume 8, File No. 41544), transferring ownership of special movable property requires formal title change, not mere possession.

When Zemen Bank appealed to the Federal Supreme Court, the highest court upheld the Federal High Court's decision, citing Articles 33 and 39 of the Tax Administration Proclamation. Ultimately, the bank was compelled to pay the outstanding tax amount owed by Verde Beef Processing PLC, effectively settling the debt to the Revenue Authority.

Legal Gaps Identified

1. The case exposes a fundamental tension between banking proclamations (97/98) and tax administration laws. While banking laws establish a seemingly clear procedure for banks to recover loans through collateral, the Tax Administration Proclamation creates a competing priority system that effectively undermines secured lending.
2. Despite the establishment of a Movable Collateral Registry under the NBE, the court did not recognize its primacy in determining priority. This undermines the purpose of having a registry system and creates uncertainty about what steps secured creditors must take to protect their interests.
3. The court's acceptance of the argument that certain taxes are held in a "trustee capacity" creates an absolute priority for tax claims without clear statutory boundaries. This interpretation effectively creates a super-priority for tax authorities that cannot be defeated by prior registration or other security interests.
4. The decision allows tax authorities to assert claims after the foreclosure process has been completed but before administrative transfer is finalized. This creates unpredictable risks for both lenders and purchasers of foreclosed property.

5. Hibret Bank S.C. vs. Abyssinia Bank S.C. Vol. 8 File No. 39778

The case involves appellant Hibret Bank S.C. and defendant Abyssinia Bank. The dispute centers on Demise Investment PLC, which borrowed money by collateralizing a house and business mortgage, first from Commercial Bank of Ethiopia (CBE) as a first-degree creditor and then from Abyssinia Bank as a second-degree creditor. Hibret Bank subsequently made an agreement with CBE and Demise Investment PLC to close CBE's loan and assume the position of first-degree creditor, effectively substituting CBE. The registry administration replaced CBE with Hibret Bank in the records, noting that Hibret Bank had paid CBE's debt and received all title deeds from CBE.

The First Instance Court ruled in favor of Hibret Bank. However, when Abyssinia Bank appealed to the Federal High Court, that court ruled in Abyssinia's favor, stating that even though Hibret Bank had paid CBE's loan, Hibret Bank did not have a prior registered security right over the property. Hibret Bank then appealed to the Supreme Court, which affirmed the High Court's decision. The case subsequently reached the Cassation Bench.

The Cassation Bench elaborated on the meaning of subrogation and the rights it confers, consulting various legal literature and dictionaries. The bench concluded that the right of subrogation can derive from either the consent of the creditor or debtor, or from the law itself. In this case, since CBE gave its consent, subrogation was valid. The bench determined that Hibret Bank's payment of CBE's debt did not affect Abyssinia Bank's interests, and therefore Hibret Bank's ranking as first-degree creditor was correct.

The researcher’s observation is that although the Ethiopian Civil Code allows for subrogation under Article 3083(1), there is no comprehensive legal framework that addresses priority issues in cases of subrogation.

Legal Gaps Identified

1. While Article 3083(1) of the Ethiopian Civil Code acknowledges subrogation, the legal system lacks comprehensive provisions detailing how subrogation affects priority rights,

particularly in multi-creditor scenarios. This creates uncertainty for financial institutions when structuring refinancing arrangements.

2. The case reveals procedural confusion regarding how subrogation should be properly documented and registered. The lower courts' conflicting decisions demonstrate that registry administrators and judges lack clear guidance on handling subrogation cases.
3. The framework provides inadequate mechanisms for notifying and protecting junior creditors when subrogation occurs. While the Cassation Bench correctly noted that Hibret Bank's subrogation did not prejudice Abyssinia Bank's interests, this outcome resulted from judicial interpretation rather than explicit statutory protections.
4. The bench's need to refer various legal literature and dictionaries to elaborate on subrogation indicates a lack of established domestic jurisprudence on this important commercial concept, creating uncertainty for market participants.

Chapter 5
Findings, Conclusion and Recommendations

Findings

This section presents key findings derived from the comprehensive analysis of Ethiopia's legal framework governing priority rights between creditors, incorporating insights from doctrinal analysis of legal provisions, examination of court decisions, comparative analysis of international practices, and empirical data collected from banking legal professionals.

1. Ethiopian law adopts an expansive definition of creditors that encompasses a broad spectrum of entities with legitimate claims against debtors. Definition given under Article 1890 of the Civil Code establishes a framework that extends beyond traditional lending relationships. This definition includes both consensual creditors, such as banks and private lenders who voluntarily enter into contractual relationships with debtors, and non-consensual creditors, including tax authorities asserting revenue claims, employees demanding unpaid wages, and pension agencies pursuing contribution arrears. The research reveals that Ethiopian law creates these distinct creditor categories but fails to establish clear relationships between them, resulting in competing claims without adequate prioritization mechanisms. Furthermore, the legal framework lacks comprehensive provisions addressing how these different creditor types should interact when multiple claims exist against the same debtor property, creating uncertainty and potential conflicts in enforcement scenarios.
2. The treatment of priority rights under Ethiopian law is characterized by fragmentation and inconsistency across multiple legal instruments. Priority rights provisions are scattered throughout various codes and proclamations, including the Civil Code, Commercial Code, Tax Administration Proclamation, Labor Proclamation, Pension agency proclamation and sector-specific regulations, without adequate coordination between these instruments. The fundamental "first in time, first in right" principle, while recognized in the Civil Code for mortgage priorities and in proclamation number 1147/2019 for pledges, is inconsistently applied across different creditor types. Most significantly, subsequent laws enacted after the Civil Code have systematically eroded secured creditor priority without establishing clear limitations on competing claims. The research identify that laws such as the Tax Administration Proclamation, Labor Proclamation, and Private Organization Employees' Pension Proclamation create absolute

priority rights for certain creditors without any restrictions, effectively undermining the predictability and effectiveness of the secured transactions system.

Additionally, Addis Ababa City Administration Land Holding Administration Service Delivery Directive No. 12/2004 contradicts both the Civil Code and the FDRE Constitution by requiring prior creditor consent for subsequent registrations. This provision undermines the federal legal framework that explicitly permits multiple mortgages on the same property and violates constitutional property rights by requiring the prior creditor consent for the later creditor to collateralize the property in secondary status.

3. Secured creditors in Ethiopia do not enjoy consistent priority over all other creditors, despite legal provisions that protect their interests. The research demonstrates that secured creditors face substantial erosion of their priority status due to competing legislative frameworks that grant superior rights to various non-consensual creditors. Non-consensual creditors enjoy unlimited priority rights that supersede properly registered security interests, creating situations where secured creditors lose their expected priority despite compliance with all legal requirements for establishing and perfecting their security interests. Court decisions reveal inconsistent protection for secured creditors, with some cases affirming bank priority rights while others subordinate properly secured claims to competing interests. The unlimited nature of priority rights granted to certain creditors creates particular problems, as these entities can assert claims without time limitations, amount restrictions, or procedural requirements that apply to secured creditors such as bank.

4. Ethiopian law provides banks with significant procedural advantages for enforcing security interests but fails to adequately protect their substantive priority rights against competing claims. Proclamation 97/1998 grants banks streamlined foreclosure procedures that bypass lengthy court processes, allowing direct sale of collateralized property after proper notice to debtors. However, these procedural advantages do not resolve fundamental priority conflicts that arise when multiple creditors assert claims against the same collateral. Banks face practical enforcement challenges despite these legal protections, including court injunctions that prevent foreclosure, competing claims from tax authorities and other preferred creditors, and administrative obstacles in property transfer processes. Registration protects banks by establishing their security interests, but these advantages are undermined by competing priority

claims that can be asserted without similar registration requirement. The research reveals that banks commonly encounter situations where their properly registered and perfected security interests are subordinated to claims asserted by tax authorities, employees, or pension agencies, creating unpredictable outcomes that increase lending risks and costs.

The comparative analysis of Kenya, the United States, China and the United Kingdom reveals consistent foundational principles despite varied implementations. All jurisdictions recognize the fundamental priority of properly registered security interests and apply "first in time, first in right" as their baseline principle, while allowing limited exceptions for public policy priorities. Social protection approaches vary significantly across jurisdictions.

The analysis shows that no examined jurisdiction grants unlimited priority rights to any creditor class, all provide temporal, amount, or procedural limitations on preferential claims to balance commercial lending needs with social protection goals; and clear registration requirements apply to all creditors, including government entities.

Conclusion

Ethiopia's legal framework for defining and categorizing creditors suffers from fundamental structural deficiencies that create uncertainty and inefficiency in commercial transactions. The broad definition of creditors lacks the clarity necessary for a functional secured transactions system. The absence of clear prioritization mechanisms between consensual and non-consensual creditors creates an environment where legitimate security interests can be undermined by competing claims that lack equivalent procedural safeguards. This definitional ambiguity contributes to increased transaction costs, reduced lending efficiency, and potential conflicts that could be avoided through more precise legal categorization and priority determination mechanisms.

The scattering of priority provisions across multiple legal instruments resulted in inconsistent application of fundamental priority principles. This undermines the reliability of security interests as risk mitigation tools, while the systematic erosion of secured creditor priority through subsequent legislation has created an unstable legal environment that discourages commercial lending and investment.

The current legal framework grant of unlimited priority rights to certain creditor classes without appropriate limitations has created a system where properly perfected security interests cannot provide reliable protection for lenders. This erosion of secured creditor protection increases lending risks, raises borrowing costs, and reduces credit availability, ultimately harming the broader economy by constraining private sector development and investment.

The analysis reveals that certain non-consensual creditors, particularly tax authorities, pension agencies, and employees, have been granted preferential status without appropriate limitations. This creates an unpredictable legal environment that undermines the effectiveness of the secured transactions system.

In general, Ethiopia's current approach to priority rights between creditors over collateralized properties is undermining the effectiveness of secured transactions as a mechanism for facilitating access to credit. Without a clear and predictable framework for determining priority, the fundamental purpose of collateral security providing certainty of recovery is compromised, with negative implications for financial inclusion and economic development.

Recommendations

Based on the findings of this research, the following recommendations are proposed to address the identified gaps and enhance the effectiveness of Ethiopia's secured transactions framework:

1. Ethiopia should enact specialized legislation that brings together and aligns existing priority rights provisions across all relevant legal instruments. This legislation should establish clear definitional categories for different types of creditors and create an unambiguous hierarchy for priority determination. The framework should make "first in time, first in right" principle as the foundational rule while defining narrow, specific exceptions for legitimate public policy interests. Any preferential rights granted to non-consensual creditors should be subject to clearly defined period of limitation, amount, and procedural limitations that preserve system predictability while addressing legitimate social protection needs.

With regard to movable property, Proclamation No. 1147/2019 has to be amended to create an explicit priority framework stating that properly registered movable security interests in the NBE registry take absolute priority over subsequently arising claims with narrow exception for those non-consensual creditors.

2. The country should establish formal coordination mechanisms between relevant government agencies, including tax authorities, pension agencies, labor authorities, and financial regulators, to ensure consistent application of priority rights principles. This should include the creation of a centralized electronic registry system that covers all types of security interests and provides real-time information about competing claims. Inter-agency protocols should be developed to govern the assertion of preferential claims and ensure that all creditors, including government entities, comply with registration and notification requirements that provide transparency to other stakeholders.

To solve contradiction regarding Addis Ababa City Administration Land Holding Administration Service Delivery Directive No. 12/2004, the city administration should pursue one of two approaches. First, the directive could be amended to align with federal law by removing the prior creditor consent requirement and allowing multiple mortgages without such restrictions. The second is the administration could implement a notification system rather than a consent requirement.

3. Ethiopia should implement comprehensive procedural safeguards that protect the effectiveness of secured transactions while balancing competing interests. This includes establishing mandatory registration requirements for all creditors asserting priority claims, implementing time limitations for the assertion of preferential rights, and creating amount restrictions that prevent unlimited accumulation of priority claims. The framework should include enhanced notice requirements that ensure secured creditors are informed of competing claims and have opportunities to protect their interests through appropriate legal procedures.

To address the problem of non-uniform court interpretations in priority right cases, the country should establish specialized commercial courts staffed with judges specifically trained in secured transactions law, ensuring that complex creditor priority disputes are handled by experts who understand the nuances of commercial lending and security interests. Additionally, the justice system should implement mandatory judicial training programs on secured transactions that keep judges up to date with evolving legal frameworks and international best practices in creditor rights. The reform package should also include the development of standardized case management procedures for multi-creditor disputes that ensure consistent handling of complex cases involving multiple competing claims. Finally, Ethiopia should establish specialized appellate review mechanisms specifically for priority right cases, creating a clear pathway for resolving conflicting lower court decisions and ensuring the development of coherent jurisprudence in this critical area of commercial law.

4. Ethiopia should strengthen protections for banking sector creditors through both legislative and regulatory measures. This includes clarifying the relationship between banking proclamations and other priority rights legislation, establishing clear enforcement procedures that prevent arbitrary interference with legitimate foreclosure processes, and creating specialized dispute resolution mechanisms for multi-creditor conflicts. Regulatory authorities should develop enhanced supervision and risk management guidelines that help banks navigate the complexities of the current priority rights system while advocating for necessary legal reforms to restore predictability to secured lending practices.

Tax authorities should be required to provide comprehensive notification of all outstanding tax obligations, including both direct and indirect taxes. This expanded notification requirement is essential as the Zemen Bank case demonstrated how indirect taxes collected in a "trustee capacity" can create significant risks for secured creditors when these obligations are not properly disclosed prior to loan disbursement.

All creditors, including preferential creditors such as tax authorities, should be required to register their claims in the appropriate registry to maintain their priority status, enhancing transparency and predictability in the secured transactions system.

By implementing these recommendations, Ethiopia can develop a more predictable and efficient system for establishing priority rights between creditors over collateralized properties. This reformed system would enhance access to credit, reduce lending costs and contribute to sustainable economic development while still balancing the legitimate interests of various stakeholders in the credit ecosystem.

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- Ato Bikila Ababu, Legal Department Director, Cooperative Bank of Oromia, Addis Ababa, 16 April 2025
- Ato Getahu Tufa, Senior Attorney, Goh Betoch S.C, Addis Ababa, 16 April 2025.
- Ato Beyene Ayenew, Legal Department Director, Nib Bank Share Company, (Addis Ababa, 09 April 2025)

Face to face Interview Questions

1. In your experience, what are the most common challenges banks faces when trying to enforce their priority rights over collateralized properties in Ethiopia, particularly when multiple creditors have claims on the same property?
2. Could you describe specific cases you've encountered where the priority right of a bank over collateralized property was successfully challenged by another creditor, and what were the key deciding factors in those situations?
3. What practical measures do Ethiopian banks currently implement to ensure their priority rights over collateralized properties are properly established and protected throughout the loan period?
4. From your perspective, how effectively does Ethiopia's property registration system support the establishment and enforcement of priority rights for banks?
5. How does the current legal framework in Ethiopia address the determination of priority among different types of creditors (banks, private lenders, tax authorities, employees, Private Organization Employees Social Security Fund Administration) over the same collateralized property, and what improvements do you believe are necessary?
6. Do you believe Proclamation 97/90 (the Banking Business Proclamation) is adequate for protecting banks' priority rights enforcement over collateralized properties in today's economic environment, or has it become endangered by subsequent legislation or practical challenges? What specific aspects might need reform?

Written Interview Questions

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Purpose of the Research:

This written interview aims to gather information about the current practices, challenges, and future outlook regarding priority rights between creditors over collateralized properties in Ethiopia, with a particular focus on properties used to secure bank loans.

Confidentiality Statement:

All information provided will be kept confidential and used solely for research purposes. Your identity will not be disclosed without your consent.

Respondent Information:

Institution: ____________________________________

Position: _____________________________________

Years of Experience in the Field: ________________

Questions:

1. Have you ever dealt with a legal case where someone challenged the bank's right to claim a property that was used as collateral? ◻ Yes ◻ No If yes, please briefly describe your experience:

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2. What problems do you run into when trying to enforce your rights over properties that borrowers put up as collateral?

3. Has your bank ever been involved in a legal case where there was a dispute about who gets paid first when collateral securing a loan was involved? If yes, how did the courts handle the case, and what was your experience with the court's decision-making process?

4. Does it make a difference in your rights as a creditor whether the collateral is something that can be moved (like equipment) or can't be moved (like land or buildings)?

5. Do you think secured banks get enough legal protection for their rights over properties used as collateral? □ Yes □ No If yes, what's working well?

   If no, what changes would make things better?

6. Can you tell me about a time when your rights as a creditor were either protected or ignored, and how that affected your bank?

7. Do you think there has to be a law that protects secured creditors better than unsecured creditors? If yes, do you think there has to be exceptional?

8. Who or what most often competes with banks' rights to claim collateral first?

9. Do you think courts are ignoring banks' rights that are guaranteed under Proclamation 97/90? Why or why not?

Additional Comments:

If you have any other thoughts or experiences related to priority rights among creditors that weren't covered by the questions above, please share them here:

Thank You:

Thank you for taking the time to complete this written interview. Your insights are valuable for understanding the current status and challenges regarding priority rights over collateralized properties in Ethiopia.

Date Completed: ________________ Signature and name (Optional): _____________