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THE ETHIOPIAN LAW OF BANKRUPTCY: ITS SHORTCOMINGS IN COMPARISON TO MODERN LAWS OF BANKRUPTCY AND AREAS OF CONCERN FOR ITS REVISION

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(Submitted for partial fulfillment of Master's Degree in Business Law)

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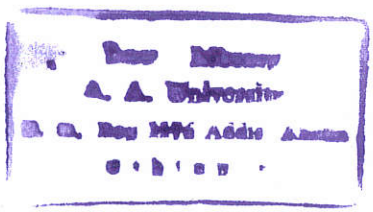

Declaration

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

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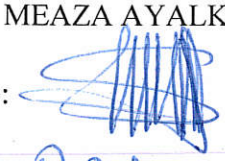
Signature: 

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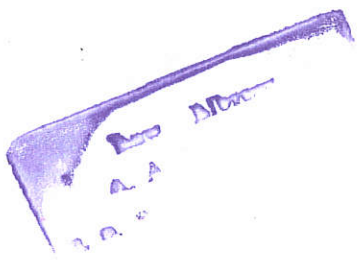

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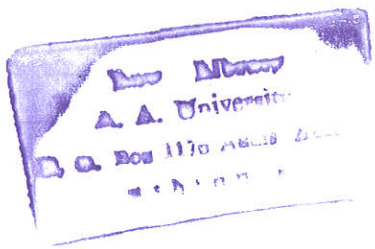

Dedication

I dedicate this thesis to my twin babies Yanet Misker and Yafet Misker whom I gave birth while working on this thesis.

Acknowledgement

I am indebted to a lot of people for all their support.

First of all, I would like to thank God with his mother for blessing me every day.

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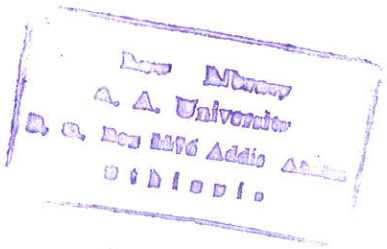
Abstract

The Ethiopian law of bankruptcy is said to be outdated and needs revision. This paper compares the Ethiopian bankruptcy law with modern laws of bankruptcy of four selected countries and international guidelines/principles for the same. The laws are the US and France bankruptcy laws from the debtor-friendly bankruptcy laws and the German and British bankruptcy laws from the creditor-friendly bankruptcy laws. The international guidelines are the World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems and the United Nations Commission on International Trade Law, Legislative Guide on Insolvency Law. The research reveals that some of the provisions of the Ethiopian law of bankruptcy are not compatible with the modern laws and principles while some are to some extent compatible. Although it is difficult to say that the Ethiopian bankruptcy law is totally backward, the law needs revision to be among the modern ones and current.



Introduction

In a preliminary report on the preparation of the Commercial Code of Ethiopia submitted to the Imperial Commission for the codification of Ethiopian law (January 18, 1954), Professor Escarra wrote:[1]

"... but a time will come when this method will no longer be adequate and entirely new institutions should be promulgated in a law supplementing the code. This is the reason for the many advantages of codification: with time codes are supplemented by so many laws that they break under the weight of legislative accretions."

I believe that time has already arrived. This is because the Commercial Code of Ethiopia is under revision (although the process has currently been halted) and it is the hope of the writer that this piece would be among the works that would assist the enactment of the new Code.

The paper is organized into five chapters; the first chapter contains the research proposal which provides the general background and organizational principles of the research. The second chapter discusses the historical and theoretical foundations of bankruptcy law. The third chapter is devoted to the discussion about the need for modernizing bankruptcy laws and the features of modern bankruptcy laws and principles that may be relevant for the revision of the Ethiopian Bankruptcy law. These are the principles from the World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems and the United Nations Commission on International Trade Law Legislative Guide on Insolvency Law. The modern Bankruptcy Laws are the US Bankruptcy Code, the French Commercial Code, the German Commercial Code and the UK Bankruptcy System. Chapter four, which is the main chapter of the paper, is about the shortcomings of the bankruptcy law of Ethiopia in comparison to modern laws of bankruptcy and areas of concern for its revision. The last chapter provides recommendations based on the findings in the preceding chapter.

The approach followed in the paper is mainly comparison of the Ethiopian bankruptcy law with bankruptcy laws of other countries and international principles/guidelines on the same. Both primary and secondary data are utilized.

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[1]Peter Winship (ed. And trans.), Background Documents of the Ethiopian Commercial Code of 1960, (H.S.I.U 1974), P.17.

CHAPTER ONE

RESEARCH PROPOSAL

1.1 Title

The title of this research is "The Ethiopian Law of Bankruptcy: Its Shortcomings In Comparison To Modern Laws of Bankruptcy and Areas of Concern for Its Revision".

1.2 Background of the Study

In Ethiopia, bankruptcy was governed by the 1933 Law of Bankruptcy enacted on the 12th of July 1933. Although my knowledge as to its practical application is limited, one can definitely say that Ethiopia had bankruptcy laws even before the enactment of the 1960 Commercial Code. Then, the Commercial Code of Ethiopia was promulgated on 5th of May 1960 and it repealed and replaced laws on areas that are dealt with in the Code.[1] Among the different books of the Code used to govern traders, Book V is devoted to bankruptcy and scheme of arrangements. Although five decades have passed since the promulgation of the Code, the Book on bankruptcy is the least applied and most unknown of all books of the Commercial Code, even by those in the legal profession.[2]

Bankruptcy is an inherent characteristic of businesses. That is why in governing businesses, bankruptcy should also be considered. As far as the writer is concerned, there is no evidence if the Book was in use during the reign of Emperor Haile Selassie I but the few bankruptcy proceedings filed during the Derg Regime were terminated due to nationalization of private firms by the government.[3]

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[1] See the Commercial Code of the Empire of Ethiopia, 1960, *Negarit Gazeta* - Extraordinary Issue No. 3 of 1960, Addis Ababa, preamble, where the Bankruptcy Law and the Company Law of 12th July, 1933 are repealed as from the 11th day of September, 1960.

[2] See Tilahun Teshome and Taddese Lencho(eds.) The Position of Business Community on the Revision of the Commercial Code of Ethiopia(Addis Ababa Chamber of Commerce and Sectoral Associations, *PSD Hub Publication No.8, July 2008*), P.115.

[3] See Tsegai Bekele ...[et al.](eds.), (2009), "Special Judgments (A case between Agricultural and Industry Development Bank (creditor/applicant) and Berta Construction Private Limited Company (debtor/respondent)", Case No. 1156/1974), 5th Half-Year, *Wonber Alemayehu Haile Memorial Foundation's Periodical*, P. 38.

Under the government of the Federal Democratic Republic of Ethiopia, the country's economic policy is one of free market allowing businesses to flourish and compete with others within the principle of free market economy. However, Book V of the Commercial Code still remains to be little applied in treating businesses in difficulty.

A recently conducted research on the commercial law and institutional reform and trade diagnostic reveals that no more than ten bankruptcy cases have been initiated since 1991 the reasons being attributable to lenders using foreclosure law and practice rather than bankruptcy.[4] That is, "secured lenders can institute accelerated proceedings to repossess and liquidate security" without the need to resort to bankruptcy.[5] In fact and often, foreclosure effectively deals with most of the debtor's liabilities as borrowers finance their business from a single lender, usually a bank.[6]

Although foreclosure law is not a substitute for bankruptcy, at least it served as a mechanism for settling debtor/creditor issues of a bank with its borrowers.

As Ethiopia is in the process of acceding to the World Trade Organization, it is obvious that the trade and investment relationship the state will have with other states will increase once the accession is completed. As one of the attracting mechanisms or as a safeguard for trade and investment activity, the investment laws of the country give various incentives and guarantees for investment especially for Foreign Direct Investment (FDI).[7] However, inefficient bankruptcy laws are strong deterrent to investment.[8] Therefore, the Ethiopian bankruptcy law should be as effective as the time dictates in order to boost the overall advancement of the state.

Although Book V of the Commercial Code is rarely practiced, the Ethiopian Commercial Code, in general, is on the process of reform and it is the belief of the researcher that there are different areas in the Ethiopian bankruptcy law that need revision so that it incorporates principles of modern laws of bankruptcy and give

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[4]United States Agency for International Development (USAID), Ethiopia: (2007) *Commercial Law and Institutional Reform and Trade Diagnostic*, Booz/ Allen/Hamilton, Addis Ababa.P.53.
[5] Ibid.
[6] Ibid.
[7] See Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia 8th Year No. 27, Investment Proclamation No. 280/2002, Addis Ababa, July 2002. Article 9.
[8] International Bank for Reconstruction and Development / The World Bank (2009) *Doing Business 2010 Ethiopia,* Washington. P.44. Available from World Wide Web: <http://www.doingbusiness.org/~/media/FPDKM/Doing%20Business/Documents/Profiles/Country/ETH.pdf> [Visited May 20, 2011].

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solutions for the practical situations of businesses in the country. Even if the process on the revision of the Commercial Code has been halted,[9] this piece is believed to have some contribution when the process proceeds.

1.3 Objective

1.3.1 General objective

The overall objective of the study is to make an analytical assessment on the legal problems in the regulation of bankruptcy in Ethiopia in comparison to modern laws of bankruptcy and thereby recommend sound remedial measures.

1.3.2 Specific objectives

- To show the existing law of bankruptcy in Ethiopia
- To show the shortcomings of Ethiopian law of bankruptcy
- To show areas of concern for its revision
- To compare the Ethiopian law of bankruptcy with modern laws\guidelines of bankruptcy
- To see what is useful or practical for our country.
- To recommend feasible solutions for the revision of the law.

1.4 Statement of the Problem

As has already been said in the background part, the Ethiopian law of bankruptcy is backward and may be one among the least implemented areas of the law when compared to other areas of laws of the country. Moreover, the provisions of the bankruptcy law under the Commercial Code are outdated. Specifically, the law does not exhibit the features of modern bankruptcy laws of other countries and international principles or guidelines on the same.

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[9] As to Ato Frew Mamo, Federal Democratic Republic of Ethiopia Ministry of Trade and Industry Legal Affairs Directorate Representative, the process is halted due to many reasons. Some of them are: one, the Committee on the revision of the Commercial Code have other duties and could not meet as regularly as possible to finish its revision. Two, there is difficulty on reaching agreement as to which provisions of the Code should be cancelled out and which should be kept as they are. Three, all stakeholders are not involved in its revision. For instance, the office of 'Documents Registration and Authentication' and the 'Ministry of Trade and Industry' have major interests as they are implementers of the Commercial Code. However, they were not involved in the process of its revision. Interview Conducted on 03, August, 2011. Unsuccessful efforts were made to talk to officials of the Ministry of Justice.

The provisions of the law need serious consideration and amendment if they are to be in conformity with the modern laws in the area and give practical solutions for the problems that businesses are facing.

The research, thus, assesses the overall provisions of the law in light of modern laws and principles of bankruptcy and shows the parts that have to be given due consideration for its revision.

1.5 Significance

There must be significance for a research endeavour. It is the belief of the researcher that the research will inform the revision process by providing a different perspective on how to see the problems in the existing law and give recommendation. In addition, the research would contribute towards the development of the would-be law of bankruptcy in the country.

1.6 Scope of the Study

This research paper will be looking at the Ethiopian law of bankruptcy. It will also see some selected modern laws and guidelines of bankruptcy. By doing so, it will explore the shortcomings of the Ethiopian bankruptcy law and identify specific areas of concern for its revision.

1.7 Methodology

In order to achieve the above stated overall and specific objectives, the following were employed as methodologies.

This research paper will mainly use literature review both local and foreign. Materials that are written on the law and practice of bankruptcy will be explored. In this regard, this research paper will use literatures that discuss the experience of other states so as to explore the possible areas and principles that may be tapped to overhaul the Bankruptcy law of Ethiopia.

Moreover, in order to reveal deficiencies of the existing bankruptcy law of Ethiopia in comparison to modern laws and guidelines of bankruptcy, analytical research method is employed in the study.

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Interview with concerned individuals like judges, lawyers, public prosecutors and other concerned government officials were conducted in order to find out problems found and related with the bankruptcy law of Ethiopia and its implementation.

1.8 Research Questions

The research is meant to compare the Ethiopian Bankruptcy law with international guidelines and other bankruptcy laws; discuss the shortcomings of the Ethiopian Bankruptcy law; and show areas of concern for the revision of the law. With this in mind, it is necessary to ask the following questions.

- What are the features of international guidelines/principles and modern laws of bankruptcy?
- What are the shortcomings of the Ethiopian Bankruptcy law compared to the guidelines/principles and modern laws on Bankruptcy?
- What are the main concerns for the revision of the Ethiopian Bankruptcy law?

1.9 Organization of the Study

To this end, the entire content of the study is organized into five chapters. The first chapter, which is this very chapter, covers background information and the main organizational principles of the study. The second chapter covers about the historical and theoretical foundations of bankruptcy law. Moreover, the objectives of the law of bankruptcy are also dealt with under this chapter.

Modernization of bankruptcy law and the features of modern bankruptcy laws are discussed under chapter three. The study under this chapter also discusses the relevant bankruptcy principles and guidelines. In addition, bankruptcy laws of some selected countries are also discussed.

Chapter four is devoted to the description and comparison of the Ethiopian law of bankruptcy with international principles and guidelines as well as laws of other countries. An attempt is made under this chapter to show the shortcomings of the law in comparison to other modern bankruptcy laws and areas of concern for the revision of the law. At last, a conclusion is forwarded.

Chapter five makes recommendations by underlining areas of concern for the revision of the Ethiopian law of bankruptcy.

CHAPTER TWO

HISTORICAL AND THEORETICAL FOUNDATIONS OF BANKRUPTCY LAW

2.1 Meaning and Nature of Bankruptcy

The term 'bankruptcy' found its origin in Italy during the medieval period.[10] Back then, every merchant had his bench (*banca*) in the place of exchange; and the normal practice at the time was to destroy his trading bench when he fails to pay his debts.[11] The multifaceted word "bankruptcy" is, therefore, believed to originate from the term "broken bench" or "*banca rotta*".[12]

There are, however, disparities among different literatures and jurisdictions with regard to the definition of bankruptcy. According to Eagles and Devos, the term "bankruptcy" refers to a "legal process in which a debtor who is insolvent is forced by law to expose his financial situation and authorities direct him to satisfy the claims of his creditors in a manner that is equitable."[13]This definition *inter alia* presupposes the knowledge of the term "insolvency". Insolvency is generally defined by Black's Law Dictionary as "the condition of being unable to pay debts as they fall due."[14]

Black's Law Dictionary, on the other hand, defines bankruptcy as a "statutory procedure by which a debtor obtains financial relief and undergoes a judicially supervised reorganization or liquidation of the debtor's assets for the benefit of creditors."[15] According to this definition, bankruptcy is considered as the procedure that is used to give relief to the debtor in a way that protects the interest of the creditors either through reorganization or liquidation. Thus, bankruptcy could refer to both reorganization and liquidation.

Generally, bankruptcy is different form insolvency on the basis of what is offered as definitions by Eagles, Devos and Black's Law Dictionary.

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[10]Sen, Anuradha. *The Bankruptcy Laws: Comparing Russia, USA, Canada, and UK*, 2006, P. 4. Available from World Wide Web: <http://ssrn.com/abstract=912931> [Visited February 23, 2011].
[11]Ibid.
[12]Ibid.
[13] Eagles, P. G. and Devos, P. A. A Guide to Bankruptcy Law, Proff. Books Limited, 1978, New York. P.2.
[14] Garner, Bryan A. (ed). Black's Law Dictionary, 8th edition, West Group, 2004, New York. P. 2331.
[15] Id, P. 442.

Though insolvency and bankruptcy are sometimes used interchangeably, they are distinctly different in their formal usage. As noted above, insolvency implies inability to pay debts as they mature and mainly signifies absence of liquidity. Though insolvency is often regarded as the immediate cause of bankruptcy, all bankruptcies are not the outcome of insolvency.[16] That is because, one may discharge his debts running his business on credit basis and at the same time a business may be unable to pay debts due to availability of more illiquid assets than liabilities.

Coming to the World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems (World Bank Principles) and the United Nations Commission on International Trade Law, Legislative Guide on Insolvency Law (UNCITRAL Legislative Guide), they do not define bankruptcy as such. In fact, the names of these instruments use the term 'insolvency' rather than 'bankruptcy'. However, they give definitions of the terms that are related to it, like Bankruptcy proceeding, insolvency, liquidation, reorganization and/or rehabilitation. For instance, the World Bank Principles recognize bankruptcy proceedings to include both rehabilitation and liquidation but emphasizes that ''[b]ankruptcy proceeding is often used to refer to a liquidation proceeding, whereas insolvency proceeding is more often used to refer to both liquidation and rehabilitation proceedings.''[17]

According to the UNCITRAL Legislative Guide, insolvency is said to exist ''when a debtor is generally unable to pay its debts as they mature or when its liabilities exceed the value of its assets.''[18] In addition, ''insolvency proceedings refer to collective proceedings, subject to court supervision, either for reorganization or liquidation.''[19]

Thus, there seems to be agreement between the two international instruments as to the definition of insolvency and bankruptcy.

The writer takes bankruptcy to include both reorganization/rehabilitation and liquidation instances. Thus, she explores the definitions of these terms. As to the World Bank Principles, liquidation is defined as ''[t]he process of assembling and

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[16] Altman, E. I. and Hotchkiss, E. (2006) Corporate Financial Distress and Bankruptcy: Predict and Avoid Bankruptcy, Analyze and Invest in Distressed Debt, 3rd Edition, John Wiley & Sons, Inc., New York. P. 5.

[17] World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems. World Bank .April 2001. P. 85. Available from World Wide Web: <http://www.worldbank.org/ifa/ipg_eng.pdf > [Visited February 23, 2011].

[18] United Nations Commission on International Trade Law (UNCITRAL), Legislative Guide on Insolvency Law, New York, 2005, P. Introduction(Para 12s). Available from World Wide Web: < http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf> [Visited February 23, 2011].

[19] Id, P. Introduction (Para 12u).

selling a debtor's assets in an orderly and expeditious fashion in order to dissolve the enterprise and distribute the proceeds to creditors according to established law. Liquidation can include a piecemeal sale of the debtor's assets or a sale of all or most of the debtor's assets in productive operating units or as a going concern.''[20] The UNCITRAL Legislative Guide provides the same definition although in a more summarized way.[21]

On the other hand, rehabilitation is defined as [t]he process of reorganizing (restructuring) an enterprises' financial relationships to restore its financial well-being and render it financially viable. This process may include organizational measures and the restructuring of business and market relationships through debt forgiveness, debt rescheduling, debt-equity conversions and other means. It can also involve selling the business as a going concern, in which case the procedure may be equivalent to similar sales under a liquidation proceeding.[22] Although the UNCITRAL Legislative Guide uses the word reorganization, the two are basically the same in the words they use and the examples they provide.[23] These definitions are adopted throughout this paper.

To find the definition of bankruptcy under the Ethiopian legal system, it is advisable to refer to the 1933 Law of Bankruptcy and the 1960 Commercial Code.

The 1933 Bankruptcy Law does not, in black and white, define what bankruptcy is but mentions what it means to be in a state of bankruptcy.[24] Accordingly, Article 1 of the 1933 Bankruptcy Law states that "[e]very person registered in the commercial register who suspends payment is in a state of bankruptcy." "Suspension of payments exists when the debtor does not pay an obligation which he has by virtue of an executor document (titre executoire)."[25] The Law, however, talks about declaration of bankruptcy under Article 4 and the following. Thus, being in the state of bankruptcy and being declared bankrupt were recognized as two different circumstances under the Law.

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[20] World Bank, Supra note 17, P. 84 and 85.
[21] UNCITRAL, Supra note 18, P. Introduction (Para 12w).
[22] World Bank, Supra note 17, P. 85.
[23] See UNCITRAL, Supra note 18, P. Introduction (Para 12kk).
[24] The 1933 Bankruptcy Law, Article 1.
[25] Id, Article 2 says that executor document is either of the three: a judgment against the debtor in a court of last appeal; a minute of a conciliation proceeding in which the debt is recognized without reservation; or a commercial instrument signed or accepted by the debtor accompanied by a protest for non-payment regularly drawn up.

The Commercial Code, on the other hand, provides that a trader is bankrupt when he has suspended payments and has been declared bankrupt.[26] Thus, for the purposes of the Commercial Code, the mere suspension of payments, being in the state of bankruptcy- in the words of the 1933 Law of Bankruptcy- does not amount to bankruptcy.[27]Thus, bankruptcy under the Commercial Code is suspension of payments plus declaration to that effect by a court of law.

Furthermore, countries have a considerably different experience with regard to the moment at which a debtor may be declared bankrupt. While some countries prefer to declare a debtor bankrupt from the moment he suspends payment of his debts as and when they fall due[28], countries like the UK and Australia prefer to wait until total liabilities outweigh the value of his assets.[29]But countries like Germany would commence the bankruptcy proceedings whenever the court is satisfied that the debtor will not pay the debts as they fall due or when the total liabilities are greater than the total assets.[30]

2.2 A Historical Overview of Bankruptcy Law

The historic legacy of bankruptcy in many countries meant that bankrupts have traditionally been treated with 'scorn'.[31] The basic aim has been to protect the interest of the creditor and the debtor was often considered as a criminal and his welfare was totally ignored.[32] In the middle ages in England, for example, punishments could be 'draconian and range from a spell in the debtor's prison to the death penalty'.[33] Whereas according to ancient Roman law, a creditor may have an option either to kill or sell the bankrupt in to slavery.[34]

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[26] See the Commercial Code, Supra note 1, Articles 969.
[27]Commercial Code, Supra note 1, Article 970 (1).
[28] This approach is known as the cash flow approach and is mainly concerned with liquidity rather than the evaluation of the assets and liabilities of the debtor, which is the main concern of the balance sheet approach. See Falke, Mike. (2003), *Insolvency Law Reform in Transition Economies*, Doctoral Thesis, Berlin.P.171-173.
[29] See Id, P. 172.
[30]*Basic Provisions of German Insolvency Law*. Available from World Wide Web: <http://www.abiworld.org/committees/newsletters/international/vol1num3/ReorgEuroUnion1.pdf> [Visited August 20, 2011].
[31] Sen, Supra note 10, P.4.
[32] Ibid.
[33] Ibid.
[34] *Fletcher* as cited in Burdette, David A. *A Framework for Corporate Insolvency Law Reform In South Africa*, University of Pretoria, Pretoria, 2002, P. 27.

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2.2.1 Roman Law

Under ancient Roman law, which was applied approximately around 451 BC, a creditor could enforce his judgment with a process known as *legis actio per manus iniectionem*(the action of the injection by the hands of the law).[35] A debtor, in this system, was given a period of grace of 30 days within which to comply with the judgment.[36] Failure to do so resulted in a debtor being brought before the praetor.[37] When the amount owed remained unpaid, the debtor was awarded to the creditor, whereby the latter held the former for 60 days as a private prisoner.[38] During this time it was possible for the debtor to enter in to an agreement with the creditor.[39] However, despite being under the custody of the creditor, the debtor remained a free man and owner of his property.[40]

The creditor had to bring the debtor before the praetor on three consecutive market days to announce in public the amount for which the debtor was liable.[41] Where the debtor was unable to reach an agreement with the creditor, and the amount owed still remained unpaid, the creditor could, on the third market day, either kill the debtor or sell him in to slavery.[42] Where there was more than one creditor, they were entitled to cut the debtor in to pieces, each creditor taking his rightful share.[43] This barbaric practice was repealed approximately around 326BC and replaced by a procedure whereby the debtor was held as a prisoner by the creditor in order to work off the debt owing to the creditor.[44]

The execution of the debt was, however, continued to be carried out on the person of the debtor himself. In this respect, an important innovation of the Roman law, at a latter period, was the introduction of a new method of execution against the property of the debtor in what was known as *missio in possessionem(mission in the possession*

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[35] *Viseer* as cited in Burdette, Supra note 34, P. 22.
[36] Id, P. 23.
[37] Ibid.
[38] Ibid.
[39] Ibid.
[40] Ibid.
[41] Ibid. Such practice had dual purpose; first, it was intended to persuade the debtor's friends to pay the debt in sympathy to the degradation that the debtor was suffering and second, to allow the debtor's other creditors to state their claims.
[42] *Viseer* as cited in Burdette, Supra note 34, P. 24.
[43] Ibid.
[44] Ibid.

of).[45] One or more of the creditors of the debtor could petition the praetor to grant them an order authorizing them to take possession of the debtor's property.[46] Once the prescribed period had lapsed all the creditors were summoned to a meeting by a praetorian order, so as to elect *magister bonorum(master of goods),* who would supervise the sale of the estate.[47] At the sale, the property of the debtor was sold in block to the person offering the highest price to the creditors.[48]

As has been said at the beginning of this section, all the procedures exercised during the early periods were primarily aimed at protecting the creditors, and no provision was made under the Roman law for the debtor to avoid the strict consequence of not being able to pay his debt.

This apparent shortcoming was addressed later and a debtor was allowed to renounce his rights to his property in favour of his creditors instead of incurring an execution against his person. This procedure was known as *cessio bonorum(concession of goods)* and enabled the debtor to make a voluntary *cession(the grant of)* of his goods to the creditors, who sold it and divided it in *pro rata* to satisfy their claims.[49]

2.2.2 Roman-Dutch Law

Personal execution against the debtor was the only means used to obtain payment of debts.[50] And it was towards the end of the 15th century that the Roman law concept of *cessio bonorum* was introduced in Holland.[51] However, unlike in the case of the Roman law, *cessio bonorum* was a privilege which was only granted by the courts after the debtor had given the full facts in respect of the position of his estate, and only after the debtor had informed all his creditors of the application.[52]

Once the *cessio bonorum* was granted by the court, the estate of the debtor was initially administered by commissioners under the supervision of local magistrates, but during the 18th century the so called *desolate boedelkamers* or "Holland

[45] *Viseer* as cited in Burdette, Supra note 34, P. 25.
[46] Ibid.
[47] Ibid.
[48] Ibid.
[49] Id, P. 26.
[50] Burdette, Supra note 34, P. 26.
[51] *Dalhuisen* as cited in Burdette, Supra note 34, P. 26.
[52] *De Groot* as cited in Burdette, Supra note 34, P. 26.

Chambers" were established, which were *inter alia* responsible for the administration of the insolvent estates.[53]

2.2.3 English Law

Like any other state in Europe, individual debt collection mechanisms preceded formal bankruptcy law in England.[54] The first Act that introduced attachment of the person and which had civil imprisonment as a result was the statute of Marlbridge of 1267.[55] This and other numerous statutes, which had been promulgated until 1869 allowed the creditor to imprison the debtor for nearly all cases of the non-payment of debt.[56] Such imprisonment, subject to certain exceptions, was abolished in 1869 when the Debtors Act was promulgated.[57]

Debtors, accordingly, designed all sorts of mechanisms to avoid civil imprisonment and in turn this led to the development of the English bankruptcy law to revolve around devising mechanisms to prevent debtors from avoiding civil imprisonment.[58] Towards this end, several bankruptcy Acts have been introduced, each having its own contribution towards the development of the English bankruptcy law. Of these Acts, the first Insolvency Act (the 1542 Act by Henry VIII) introduced the compulsory sequestration, designed to apply to a dishonest and absconding debtor.[59] This Act was repealed by the 1571 Act (this Act was amended twice before it was repealed by the 1732 Act) which limited the application of the bankruptcy procedures to traders;[60] introduced the concept of the equal distribution of a debtor's assets;[61] and introduced the appointment of commissioners by the Lord Chancellor who had the task of differentiating traders from non-traders.[62]

In the 19th century, England was flooded with a number of Bankruptcy Acts. The 1732 Act was repealed by the 1842 Act; the 1844 Act provided provisions for the voluntary surrender of the debtor's assets; and the Acts enacted in 1824/25 and 1844

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[53] *Mars* as cited in Burdette, Supra note 34, P. 27.
[54] *Dalhuisen* as cited in Burdette, Supra note 34, P. 27.
[55] *Boraine* as cited in Burdette, Supra note 34, P. 28.
[56] Ibid.
[57] Ibid.
[58] Ibid.
[59] *Dalhuisen* as cited in Burdette, Supra note 34, P. 28.
[60] *Rose* as cited in Burdette, Supra note 34, P. 28.
[61] *Dalhuisen* as cited in Burdette, Supra note 34, P. 28.
[62] Burdette, Supra note 34, P. 29.

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were consolidated into the 1849 Bankruptcy Law Consolidation Act.[63] The 1849 Bankruptcy Act introduced provisions for the debtors other than traders to enter in to a majority arrangement with their creditors.[64] In 1861, the Bankruptcy Act extended sequestration to persons other than traders.[65] There were also the Acts of the 1869 and the 1883.[66] But the basis for the modern English Bankruptcy law is the 1842 Act as it is this Act that introduced the office of the Official receiver, insolvency inquiries, and public interrogations.[67]

Generally, before the 18th century, bankruptcy law in England was a system that was mainly governed by creditors. Since the 19th century, this private sequestration developed into a system where it is mainly governed by the State.[68]

In the 20th century, the Bankruptcy Act of 1914, together with amendments made in 1926 and 1976, was an important new Act that applied until the 1986 Insolvency Act was enacted.[69]

2.3 Objectives of Bankruptcy Law

The historical overview of bankruptcy laws discussed in the preceding section revealed *inter alia* that traditionally bankruptcy procedures were mainly formulated with a view to safeguard the interest of the creditor. According to this traditional view, the basic objective of bankruptcy law was to organize a collective action in such a way that the value of the debtor's assets will be maximized so that the creditors receive a higher dividend out of the debtor's asset in bankruptcy.

Modern bankruptcy laws, however, go far beyond the protection of creditors' interest and crave to achieve much broader social and economic objectives. From a strict economic stand point, one of the primary aims of modern bankruptcy laws is to increase the overall efficiency by eliminating the functionally inefficient firms, whose assets can be used in a more productive way elsewhere.[70] They are expected to

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[63] *Dalhuisen* as cited in Burdette, Supra note 34, P. 29.
[64] Ibid.
[65] Ibid.
[66] Id, P. 30.
[67] *Fletcher* as cited in Burdette, Supra note 34, P. 30.
[68] Burdette, Supra note 34, P. 31.
[69] *Dalhuisen* as cited in Burdette, Supra note 34, P. 30.
[70] Sen, Supra note 10, P. 2.

promote the voluntary re-allocation of assets from inefficient and destructive to more efficient and productive firms with a positive result for the overall economy.

Bankruptcy laws and other procedures governing financial default are therefore perceived as the key elements in the functioning of market economies. However, although the issue of bankruptcy is common to all modern economies, the way the different economies react to it and the objectives they envisage to achieve with it, varies from country to country. Despite such differences some general objectives are still found to be common to most bankruptcy laws. The writer follows the method followed by Falk Mike as she found it to be convenient to elucidate the issue at hand.

2.3.1 Maximizing Asset Values

Asset maximization is one of the fundamental objectives of bankruptcy laws. Economical theories suggest that the technique that generates the greatest value should be used in deciding whether a firm should be reorganized, sold for cash as a going concern, or closed down and liquidated.[71] Such technical options are, however, unthinkable in the absence of bankruptcy law.

A typical firm, for example, may have claims outstanding to several creditors, each of whom may have their claim secured by specific collateral. In the absence of bankruptcy law, such a situation may lead to a creditors' "run" on a distressed firm to be the first to seize the available collateral.[72] One of the most important objectives of bankruptcy law is to prevent such runs, for example, by imposing an automatic stay on the firm's assets once it has entered bankruptcy.[73]

It is, however, acceptable that a liquidator with sufficient powers and the necessary skills in business management would maximize the value of the assets in bankruptcy, enable the temporary continuation of the enterprise and create the necessary condition for its rehabilitation.[74]

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[71] *WB-Economic Dimensions* as cited in Falke, Supra note 28, P.45.

[72] Smith, David and Stromberg, Per. *Maximizing the value of distressed assets: Bankruptcy law and the efficient reorganization of firms,* A Paper Prepared for the World Bank Project on Systematic Financial Distress, 2003, P.11.

[73] Ibid.

[74] Girma Dejene. The Need for Modernizing the Ethiopian Bankruptcy Law (A Critical Analysis), Addis Ababa University, Law Faculty, LLM Thesis Addis Ababa, 2005, P. 37.

2.3.2 Allocation of Risk among Participants

There is a principle that every market participant should bear the risk of transaction or relation according to his economical interest in it.[75] Accordingly, owners or shareholders should assume the greatest loss if a business fails as they are the ones who usually take the largest gains when it succeeds.[76] A creditor who extends credit to a debtor also bears some kind of risk but the risks should be balanced among different participants or creditors by taking into account different conditions.[77]In this respect, it is essential that bankruptcy laws recognize the differences among creditors both in terms of their abilities to assess the risk that a debtor will default and to allocate this risk and in their bargaining power to improve their repayment chances in the insolvency of their debtor.[78]

In explaining the implications of such differences Mike Falke argues that sophisticated creditors such as banks have a greater bargaining power to negotiate pre-insolvency entitlements which will give them preferential treatment in insolvency proceedings and thus, increases their chances of repayment.[79] Other creditors, like tort claimants or employees have no or only a limited prospect to assess the risk of a default of their debtors; and they have no chance or bargaining power to improve their repayment chances in the insolvency of their debtor by negotiating a respective security interest.[80] Such differences are inputs for bankruptcy laws that there exist several creditor types and risks should be allocated accordingly.[81]

2.3.3 Encouraging Investment Risk Taking

Another main objective of modern bankruptcy laws is encouraging investors to make more risky investment decisions. Businesses, especially start-ups, without existing credit standing are frequently in need of urgent funding; and creditors usually prefer to invest in businesses with a good credit standing since risk assessment and allocation is much easier.[82]

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[75] Falke, Supra note 28, P. 52.
[76] Ibid.
[77] Ibid.
[78] Id, P.53.
[79] Ibid.
[80] Falke, Supra note 28, P. 53.
[81] *Warren* as cited in Falke, Supra note 28, P. 53.
[82] Falke, Supra note 28, P. 53.

Investors may also finance businesses with a lower credit rating since the profits of such a transaction might turn out to be higher than investment in a business with an excellent credit rating.[83] However, predictable and easily enforceable rights in the case of insolvency of their debtors are their essential preconditions for their investments.[84]

In fact, certainty and predictability in commercial affairs is often considered as one of the single most important step a government can take to encourage investment and get the economy moving.[85] Whereas a lack of predictability does not only increase the costs of credit, it even jeopardizes the general availability of credit, which is one of the essential characteristics of a market economy.[86] An effective bankruptcy regime reduces risks by providing transparent and predictable provisions.

2.3.4 Supporting Wider Community Interests

Basically, bankruptcy laws are concerned with parties having formal legal entitlements. These laws organize and structure the conflict between the debtor and several types of creditors. However, the business failure of a debtor may also impact on parties who are not creditors and who have no formal legal rights to the assets of the debtor's business.[87] Therefore, bankruptcy laws must look beyond the final economical outcome for creditors and consider and rebalance the interest of parties who are indirectly affected by the business failure of a debtor. However, the protection a bankruptcy regime can give to parties without formal legal rights is usually secondary and indirectly considered through provisions that permit reorganization instead of liquidation of a business for the benefit of few 'anxious' creditors.[88]

Some try to achieve this objective by incorporating bankruptcy provisions which limit or extend rights and obligations of participants in insolvency when these are contrary or consistent with public interests or public policy. As in the case of Polish Bankruptcy Code, the court for example, may only confirm a reorganization plan

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[83] Falke, Supra note 28, P. 53.
[84] Ibid.
[85] Houerou, Philippe H. Le. *Studies of Economies in Transition: Investment Policy in Russia*, World Bank, 1995.
[86] Falke, Supra note 28, P. 53.
[87] Id, P. 57.
[88] *Warren*, as cited in Falke, Supra note 28, P.58.

when its outcome is in the interest of the public or in other words in the interest of the community.[89]

Others try to protect community interests by providing a general clause granting the court wide discretionary powers to consider such interests and to balance them with the interests of the debtors and creditors.[90] Moreover, the law could consider the varying interests in the bankruptcy process by granting the different interest groups participation rights, like employees and representatives of councils, which is the case in Hungary.[91]

Generally, bankruptcy laws usually endeavor to minimize losses to the general public when a business fails and try to compromise different interests.

2.3.5 Exit Mechanism

Bankruptcy laws should also facilitate the orderly market exit of enterprises that are inefficient. As Richard Posner has rightly noted:

The legal mechanism through which inefficient firms most often are eliminated is that of bankruptcy. It serves as a screening process designed to eliminate those firms, which economically are inefficient, and whose resources could be better used in some other activity.[92]

I agree that the insolvent debtor should be left with mechanisms to liquidate and distribute his estate when he is irretrievably insolvent or be provided with a way if it has effective existence.

2.3.6 Other Frequently Found Objectives

Besides the above mentioned ones bankruptcy laws have a number of other goals and functions.

Foreign direct investment(FDI) plays an immense role in the economic growth of developing and least developed countries through providing the much needed capital and technological knowhow.[93] However, foreign investors are cautious about their

[89] Polish Bankruptcy Code, Art.191 (3), as cited in Falke, Supra note 28, P.58.
[90] Falke, Supra note 28, P.59. The pitfall of such clauses is the fact that they may create non-uniformity and unpredictability among participants.
[91] The Hungarian Bankruptcy Code, Section 8 (1), as cited in Falke Supra note 28, P. 59.
[92] Posner, Richard. Corporate Bankruptcy: Economic and Legal Perspective, Cambridge University Press, 1996, Cambridge, P. 207. See also World Bank, Supra note 17, Principle 1(Para 20).
[93] Falke, Supra note 28, P.67.

rights and obligations in cases of insolvency and hence are reluctant to invest their money in unpredictable situations.[94] In this respect, the mere existence of an efficient bankruptcy law gives foreign investors more security and predictability.[95]

Bankruptcy procedures also enhance the overall economic efficiency of a country by forcing unprofitable and inefficient firms to exit, allowing re-allocation of their resources into more productive uses.

It also fosters competition by eliminating uncompetitive firms. From an economic point of view, competition is the market device that drives the market towards a state of long run equilibrium in which those firms remaining in existence produce at a minimum average costs.[96] This on the other hand benefits the economy in general and consumers in particular, as goods and services produced are sold at the lowest possible price.

Furthermore, bankruptcy law, and within its application especially reorganization provisions, can also be seen as creating economical safety net by protecting viable businesses, preserving jobs and protecting communities and giving debtors an opportunity to escape an economic downturn.[97]

The next chapter is devoted to the discussion on the need for modernizing bankruptcy laws and the different instruments and laws that will be used to show the shortcomings of the bankruptcy law of Ethiopia and areas of concern for its revision.

[94] Falke, Supra note 28, P.67.
[95] Ibid.
[96] Posner, Supra note 92.
[97] Falke, Supra note 28, P.67.

CHAPTER THREE

MODERNIZATION OF BANKRUPTCY LAWS AND THE FEATURES OF MODERN BANKRUPTCY LAWS

3.1 The Need for Modernizing Bankruptcy Laws

Over the past decade or so, there has been a magnificent effort to harmonize and modernize bankruptcy laws of many countries despite the fact that bankruptcy laws were areas of law that have received little attention for numerous decades.[98]

The need for renovating bankruptcy law basically arose from understanding the importance of having a sound and effective insolvency and creditors' rights regime for the attainment of a predictable and stable financial system and economic development.[99] In the aftermath of the financial crisis of the late 1990s, it was widely recognized that sound insolvency and creditors' rights systems constitute one of the twelve areas integral for sound financial systems and financial stability.[100] Accordingly, various efforts have been made both at the national and international level to devise mechanisms to improve the effectiveness of existing insolvency regimes and provide standards and guidelines to be used as benchmarks for reforming and enacting new and sound insolvency laws.[101] In this respect, the major efforts of reforming and modernizing insolvency laws came from South Asian Economies which were significantly affected by the financial crisis of the late 1990s.[102]

Whereas others maintained that the need for reforming insolvency and creditor/debtor regime arose in response to the accession of many countries to the World Trade Organization, growth of credit markets in many countries, the expansion of

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[98] Stiglitz, Joseph. Bankruptcy laws: Basic economic principles in Resolution of Financial Distress: An international perspective on the design of bankruptcy laws, *World Bank Development Studies*, The World Bank, Washington D.C, 2001, P.26.

[99] Ibid.

[100] Standard Forum: Financial Standards Foundation, Effective Insolvency and Creditor Rights Systems, Available from World Wide Web: <http://www.estandardsforum.org/about_standards/effective-insolvency-and-creditor-rights-systems> [Visited March 2, 2011].

[101] Ibid.

[102] Clift, Jenny. UNCITRAL Legislative Guide on Insolvency Law, *Forum on Asian Insolvency Reform*, 2006, Beijing, P. 1. Available from World Wide Web: <http://www.oecd.org/dataoecd/17/27/38166977.pdf >[Visited February 23, 2011].

entrepreneurship, establishment of securities exchanges, and globalization of business and financial transactions.[103] Moreover, the reforms were also taken as part of an effort to keep insolvency legislations current and reflective of the society.[104]

The need for the modernization of the Ethiopian Commercial Code, in general and the Bankruptcy law in particular, is triggered by the changes in the economic and social realities in the country and to ensure the compatibility of the law with relevant provisions of the Constitution of the country.[105] The need to modernize the Commercial Code in general and bankruptcy law in particular, also arose to entertain the 'interests and concerns' of the business community in the country.[106]

3.2 Characteristics of Modern Bankruptcy Laws

Cognizant of the fact that effective insolvency and creditor/debtor regimes are fundamental to the overall economic and financial advancement of countries, various efforts have been made at the international level, especially after the financial crisis of the late 1990s, to design model guidelines and fundamental principles in order to assist countries in their efforts to evaluate and improve their insolvency and creditor/debtor regimes.[107] In this respect, the UNCITRAL Legislative Guide on Insolvency Law and the World Bank Principles for Effective Insolvency and Creditor Rights Systems are complimentary documents that demonstrate the international consensus on best practices and set forth a unified standard for Insolvency and Creditors Right.[108] Thus, these two documents are mainly used in discussing the Ethiopian Bankruptcy Law with the view to identify areas of concern for its revision in the following chapters. In addition, four countries are selected for the sake of comparison (two countries that are debtor-friendly and the other two creditor-friendly).

The countries are selected because of the relevance of their laws either because they have advanced systems in the area of bankruptcy law or because they have comprehensive codified laws in this respect or because they are thought to be

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[103]Husseini, Hiba. Bankruptcy and Insolvency Law in the Arab World, *31 The Comparative Law Year Book of International Business*, United Kingdom (2009), P. 3
[104] Ibid.
[105] See Tilahun Teshome and Taddese Lencho(eds.), Supra note 2 , P.5.
[106] Id, P. 6.
[107]World Bank, Supra note 17, P. 2.
[108]Standard Forum, Supra note 100.

incompliance with the international standards in this regard. A brief discussion of these documents and laws follows.

3.2.1The UNCITRAL Legislative Guide on Insolvency Law

A. General

In 1992, the United Nations Commission on International Trade Law (UNCITRAL) held a congress to consider what had been accomplished in the harmonization of international trade law in the past twenty-five years and, more importantly, to identify what was needed for the next twenty-five years.[109] While the Commission had not undertaken any work in the area of insolvency law, it was proposed as an area of possible future work. The proposal was, however, opposed by some participants who argued that it was not practical to think of harmonizing the insolvency laws of different jurisdictions.[110] Despite such argument, the Commission adopted the UNCITRAL Model Law on Cross-Border Insolvency in 1997 due to an increasing caseload of insolvencies involving international aspects and absence of a formal framework within which issues of coordination and cooperation could be addressed.[111]

The financial crisis of the 1990s triggered the need for strengthening national insolvency and debtor-creditor laws both as a way of crisis prevention and crisis management. Consequently, upon the request of the government of Australia, the Commission had begun to work on harmonization of substantive insolvency law in 1999.[112]

The Commission, then, delegated Working Group V to prepare, inter alia, the following: a comprehensive statement of key objectives for a strong insolvency and debtor/creditor regime; and a legislative guide containing flexible approaches to the implementation of such objectives, including a discussion of the alternative approaches with their 'perceived benefits and detriments'.[113] The Working Group eventually came up with a draft "Legislative Guide on Insolvency Law"(the

[109] Clift , Supra note 102.
[110] Ibid.
[111] Ibid.
[112] Ibid. The UNICITRAL was designated to do this job mainly because of its successful conclusion of the UNCITRAL Model Law on Cross-border Insolvency and because of the opportunity for wide participation and discussion afforded by UNCITRAL working methods.
[113] UNCITRAL, Supra note 18, P. Preface iii.

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Legislative Guide) in July 2001 which was then adopted by consensus on 25 June 2004.[114]

B. Some Key Elements of the Legislative Guide

The Legislative Guide does not provide a single set of model solutions. It rather assists the reader to evaluate different approaches available and to choose the one that suits its situation.[115] "It is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations on bankruptcy."[116] It outlines the core issues that need to be addressed in any insolvency law and provides recommendations as to how certain provisions might be drafted.[117]

The Legislative Guide aims at achieving a balance between the interests of the debtor in financial difficulty and other interests be it creditors or to resolve the issue as quickly and efficiently as possible and the interests of others be it the creditors or public policy concerns.[118]

In this respect, part one of the Legislative Guide discusses designing the key objectives and structure of an effective and efficient insolvency law. Part two of the Guide, which deals with the core features of an effective and efficient insolvency law, comprises six chapters addressing eligibility and jurisdiction and commencement criteria (Chapter I); treatment of assets on commencement (insolvency estate, application of a stay, use and disposition of assets, post-commencement finance, treatment of contracts, avoidance proceedings, setoff or netting - Chapter II); participants (debtor, insolvency representative, creditors – Chapter III); reorganization, including "expedited" reorganization (Chapter IV); management of proceedings (claims; priorities and distribution, treatment of corporate groups – Chapter V); and conclusion of proceedings (discharge and closure of proceedings – Chapter VI).

Throughout the six chapters the legislative guide illustrates the importance of having an effective and efficient insolvency regime and provides the characteristics that an

[114] UNCITRAL, Supra note 18, P. Preface iii.
[115] Id, Introduction (Para 3).
[116] 2004 - Legislative Guide on Insolvency Law. Available from World Wide Web: <http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html> [Visited February 23, 2011].
[117] See UNCITRAL, Supra note 18, in general.
[118] 2004 - Legislative Guide, Supra note 116.

effective and efficient insolvency regime should encompass. As a discussion of the Legislative Guide in relation to the Ethiopian Law of Bankruptcy will be made in the chapter that follows, a detail resort to its provisions is not made now. But a general discussion moves to the World Bank Principles for Effective Insolvency and Creditor Rights Systems.

3.2.2 The World Bank Principles for Effective Insolvency and Creditor Rights Systems

The World Bank Principles for Effective Insolvency and Creditor Rights Systems (the principles) were developed in 2001 in response to the financial crisis of the late 1990s.[119] The principles contained fundamental elements of insolvency and creditor rights systems, including institutional and regulatory aspects of these regimes.[120] Together with the UNCITRAL Legislative Guide, the principles constituted internationally recognized benchmarks to evaluate the effectiveness of insolvency and creditor rights systems.[121]

The World Bank's initiative to develop principles that may serve as benchmarks or standards to evaluate the effectiveness of domestic creditor rights and insolvency system began in 1999 with the establishment of an 'ad hoc committee of partner organizations' and the assistance of international experts who partook in the 'World Bank's Task Force and Working Groups'.[122] Then, after a series of conferences and public discussions the principles were finally approved in 2001.[123]

Based on the experience gained from the use of the principles, and following extensive consultations, the principles have been thoroughly reviewed and updated accordingly.[124] The Principles were last updated in 2005.[125] As explicitly noted in the revised version, the principles have been designed as a 'broad-spectrum assessment tool' to help countries in evaluating and improving their commercial law systems that are essential to sound investment and economic growth.[126] They are also designed in

[119] World Bank, Principles for Effective Insolvency and Creditor Rights Systems (Revised) 2005, P. 1.
[120] World Bank, Supra note 17,P. 1.
[121] Ibid.
[122] Ibid.
[123] Ibid.
[124] Id, P.2.
[125] Ibid.
[126] Ibid.

such a way that they exist as a benchmark for different countries by encompassing several flexible and fundamental prepositions.[127]

"The Principles are a distillation of international best practices in the design of insolvency systems and creditor rights."[128] Accordingly, they recognize that market environments in which the systems operate should, first, be understood to adopt international best practices to the realities of countries.[129] This is especially true in developing countries, where difficulties like, 'weak financial institutions and capital markets'; 'ineffective and weak laws, institutions and regulation'; 'shortage of capacity and resources'; 'ineffective corporate governance and uncompetitive businesses'; and 'weak or unclear social protection mechanisms' are common.[130]

The principles recognize that an efficient, reliable, and transparent insolvency systems and creditor rights are of paramount importance for 'investor confidence', 'forward-looking corporate restructuring', the 'reallocation of productive resources in the corporate sector', and 'resolving matters of corporate financial distresses'.[131] Consequently, the principles recommend that it is of vital importance for any country, at all level of economic development, to have a sound and effective creditor rights and insolvency system.[132]

The 2001 World Bank Principles for Effective Insolvency and Creditor Rights Systems consists of 35 principles dealing with legal framework for creditor rights(Principles 1-5); legal framework for Insolvency(Principles 6-16); features pertaining to corporate rehabilitation(Principles 17-24); informal corporate workouts and restructuring(25-26); and implementation of the Insolvency System (institutional and regulatory frameworks)(Principles 27-35).

The 2005 Revised World Bank Principles for Effective Insolvency and Creditor Rights Systems is a 'distillation' of the previous principles and is composed of four parts. The first part discusses the legal framework for creditor rights; the second part is about risk management and corporate workout; the third part is on the legal

[127] World Bank, Supra note 17, P.2.
[128] Id, P. 3.
[129] Ibid.
[130] Ibid.
[131] Id, P. 2
[132] Ibid.

framework for Insolvency; and the last part is on the institutional and regulatory frameworks for implementation.[133]

Having forwarded general issues concerning the guidelines and principles on insolvency, brief discussion on the selected bankruptcy regimes will follow now.

3.3 Creditor Friendly and Debtor Friendly Bankruptcy Regimes

A conventional view of bankruptcy law is that it reflects a balance between creditor and debtor interests, and it is certainly possible to line up bankruptcy regimes on a "creditor friendly-debtor friendly" axis.[134] Generally speaking, a debtor-friendly bankruptcy law is concerned with the protection of the interests of the debtor while a creditor-friendly bankruptcy law is there to safeguard the interests of creditors. Although the development of bankruptcy laws shows that the move is from a completely creditor-friendly to a debtor-friendly bankruptcy regimes, nowadays, bankruptcy regimes exist somewhere on a conceptual scale between the two axes. Creditor friendly regimes employ measures such as; replacement of management through the appointment of an administrator, absence of automatic stays or asset freezes, and paying secured creditors first.[135] Debtor friendly regimes seek to keep the management in place and provide for automatic stays.[136]

There are also other indicators of assessing a law as being a debtor friendly or creditor friendly. For instance, a bankruptcy regime, favoring the principles of equity or pro rata sharing over a rescue policy and interference with several creditor rights is commonly seen as a creditor friendly.[137] On the other hand, regimes which prohibit or limit set-off rights of creditors in insolvency proceedings are generally regarded as debtor friendly.[138]

The respective indicators are, however, not always straightforward and often used in different ways.[139] As a result, the concept of debtor friendly and creditor friendly bankruptcy regimes is not always an accurate and complete yardstick to categorize

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[133] As is provided in the revised document, the draft principles have not yet been 'reviewed by the World Bank's Board and should not be relied upon as being the final statement of these principles.' Thus, much of the discussion in the chapters that follow is mainly on the 2001 principles. See World Bank, Principles for Effective Insolvency and Creditor Rights Systems (Revised) 2005, cover page.

[134] Falke, Supra note 28, P. 39.

[135] *WB-Economic Dimensions* as cited in Falke, Supra note 28, P. 39.

[136] Falke, Supra note 28, P. 39.

[137] Ibid.

[138] Ibid.

[139] Ibid.

bankruptcy regimes. Nevertheless, it might be beneficial to examine the characteristics of modern bankruptcy laws under the "debtor friendly-creditor friendly" perspective as it significantly eases the choice of sample jurisdictions.

Against this backdrop, the bankruptcy regime of four jurisdictions is discussed in the following sub sections. US Bankruptcy System and the French Bankruptcy System are generally taken as a representative of the debtor friendly bankruptcy regimes while the German Bankruptcy System and the English bankruptcy system are considered as creditor friendly bankruptcy regimes. [140]

3.3.1 The US Bankruptcy System

The United States bankruptcy laws have their conceptual origins in the English Bankruptcy laws.[141] The first bankruptcy law, passed in 1800, was virtually copied from the English law of that time.[142]

During the earlier times, the United States bankruptcy laws were strictly creditor friendly and a discharge for the debtor was not provided for.[143] Moreover, they were only applied to merchant debtors or traders.[144]

The Statute of Anne was passed in 1705 and among other things introduced a discharge of debts for co-operative debtors.[145] Although the Statute remained of a semi-criminal nature, it laid the foundation for a more humane approach to honest debtors who had suffered misfortune. However, the bankruptcy laws were still very much creditor oriented that discharge was introduced as a measure to assist creditors than defaulting debtors. For that matter, discharge was not an automatic entitlement and later creditor's consent became a prerequisite for the granting of a discharge.[146] However, despite the fact that bankruptcy laws remained creditor friendly all through the eighteenth and nineteenth centuries, a more liberal approach to bankruptcy had established itself by the middle of the eighteenth century, due to the changing

[140] Sen, Supra note 10, P. 4 and 6.
[141] Tabb, CJ. *The History of Bankruptcy Law in the United States*, 5 ABI Law Review, 1995, P.7.
[142] Ibid.
[143] Id, P. 8.
[144] Ibid.
[145] Id, P. 10.
[146] Id, P. 7.

attitudes towards credit and commerce that was brought about by the industrial revolution. [147]

Ever since the first permanent bankruptcy law was passed in 1800, a number of bankruptcy laws were enacted with varying but significant contribution to the development of bankruptcy regime. However, it is only the Bankruptcy Reform Act of 1978 that represented the first major overhaul of the federal bankruptcy laws for forty years, and repealed the law that had been in operation for eighty years.[148] Unlike previous bankruptcy legislations the Bankruptcy Reform Act was not preceded by any of the financial calamities that characterized previous legislations.[149]

The United States, currently, has one of the most effective and efficient bankruptcy regimes. Bankruptcy law is governed under the Bankruptcy Code, which provides a good-faith debtor with all available opportunities to restore its solvency and satisfy creditors' claims.[150] The Code gives the debtor relatively large influence and rights and provides four different kinds of bankruptcy proceedings, which are known as Chapter 7, Chapter 11, Chapter 12, and Chapter 13.

Chapter 7 deals with the common form of bankruptcy procedure. It provides a liquidation procedure whereby the debtor's assets, if any, are sold by a trustee appointed by the bankruptcy court and the proceeds distributed to the creditors according to the Absolute Priority Rule (APR).[151] The Chapter is available to individuals[152], married couples, corporations and partnerships.[153] Petition for liquidation may be initiated by the debtor (voluntary petition) or by the creditors (involuntary petition).[154] But in the latter case, it is incumbent on the creditor to prove the debtor's insolvency.[155] As long as insolvency is not proved, the debtor remains the owner of the assets.[156] The US Bankruptcy Code is unique among the bankruptcy

[147] Tabb, Supra note 141, P.32.
[148] Ibid.
[149] Ibid.
[150] Ibid.
[151] APR holds that prepetition contractual entitlements will be respected and the proceeds of liquidation are distributed in the following order; secured claims, administrative expenses, wage claims, tax claims and, finally, unsecured claims.
[152] Individual debtor gets a discharge within 4 – 6 months of filling the case.
[153] Tabb, Supra note 141, P.33.
[154] Ibid.
[155] Ibid.
[156] Ibid.

Code of major market economies in that it specifies no condition under which a debtor is obliged to file for liquidation.[157]

Chapter 11 is about a reorganization proceeding whereby corporations, partnerships and those individuals whose debt exceeds the limits of Chapter 13 may file and hence remain in possession of their assets and continue to operate their businesses, subject to the oversight of the court and the creditors' committee.[158] The procedure would enable debtors to continue in business ("debtor in possession") while enjoying the protection of automatic stay and exerting most of the powers of the trustee (such as "avoidance powers", which prevent the debtor's assets from being prematurely dismantled through transfers made at the expense of some categories of creditors).[159]

The debtor has one hundred twenty days[160] in order to prepare a reorganization plan, which, upon acceptance by a majority of the creditors, is confirmed by the court and binds both the debtor and the creditors to its terms of repayment.[161] Plans can call for repayment out of future profits, sales of some or all of the assets, or a merger or recapitalization.[162] To be valid, a plan must meet several requirements such as being feasible and satisfy the "best interest of creditor's condition", which provides creditors with a return greater or at least equal to that is obtainable under liquidation.[163]

Chapter 12 is a simplified reorganization for family farmers and fishermen whereby they retain their property and pay creditors over a period of time out of their future income.[164] Whereas Chapter 13 is about repayment plan for individuals with regular income and unsecured debt less than $290,525 and secured debt less than $871,550.[165] The debtor keeps his property and makes regular payments to the trustee out of future income to pay creditors over time (3-5 years).[166]

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[157] Tabb, Supra note 141, P.33.
[158] Ibid.
[159] Ibid.
[160] The number of the days can possibly be extended to 180 days.
[161] Tabb, Supra note 141, P.35.
[162] Sen, Supra note 10, P. 11.
[163] Ibid.
[164] Ibid.
[165] Id, P. 12.
[166] Ibid.

While Chapters 11, 12, and 13 involve the rehabilitation of the debtor to allow him to use future earnings to pay off creditors, Chapter 7 involves the winding up of the business and an automatic sale of the assets.[167] When a Chapter 11 bankruptcy petition is filed, the court does not usually appoint a trustee.[168] Instead, the petitioner is generally referred to as a "Debtor in Possession", which entitle him the rights and powers of a trustee and is expected to perform the same duties.[169]

Just like the development of bankruptcy in general, the US bankruptcy system began as a creditor friendly and eventually evolved into one of the most pro-debtor regimes or became source of relief for debtors from financial distress.[170]

3.3.2 The French Bankruptcy System

"French bankruptcy law can be traced back to the creation of the French Republic at the end of the 18th century and the emergence of the modern French legal system based on the Napoleonic Codes."[171] In fact, ancient bankruptcy laws were a direct replica of the Italian laws of that time.[172]

The 1807 *Code de Commerce* contained the first codification of legal provisions regarding merchants who were not capable of paying their debts.[173] The focus of these provisions was clearly to punish the debtor and included incarceration, the sealing and confiscation of the debtor's assets and various civil and professional sanctions.[174] The 1867 law introduced protection to creditors by assisting the company with its reorganization.[175] If the debtor company had the possibility of being reorganized, the courts would establish a payment plan and allow the company to continue its activities, the goal being to protect the creditors.[176] If the outlook for the debtor company was not positive, the court would order its liquidation.[177] According to this

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[167] Sen, Supra note 10, P. 12.
[168] Ibid.
[169] Ibid.
[170] Ibid.
[171] Legal Consequences of Bankruptcy: France. Available from World Wide Web: P. 1< http://ec.europa.eu/enterprise/policies/sme/files/sme2chance/doc/report_fra_en.pdf > [Visited February 28, 2011].
[172] Ibid.
[173] Hautcoeur, Pierre-Cyrille and Levratto, Nadine. Bankruptcy Law and Practice in the 19th Century France, Paris School of Economics, *Working Paper No.29*, 2007, P.3.
[174] Ibid.
[175] Ibid.
[176] Legal Consequences, Supra note 171.
[177] Ibid.

legislation, only debtors who were guilty of intentional, grossly negligent or negligent conduct were subject to civil and criminal sanctions.[178]

More recently, the tendency has been to use the bankruptcy procedures as a way to protect debtors from their creditors and assist them in reorganizing in order to return to financial health.[179] According to the law of 1984 the primary objectives of the French bankruptcy law was to assist companies in avoiding the necessity of seeking bankruptcy protection through alert procedures and facilitate the contacts between the debtor and its creditors to establish a reimbursement plan to avoid a bankruptcy procedure.[180] The law aims to save the company and therefore protect jobs and the activity of the company, which in turn ensures the reimbursement of the company's debts.[181]

The bankruptcy procedure is available to merchants, registered craftsmen, farmers and legal entities.[182] When the debtor is in default of payment the courts will decide whether to begin a liquidation or reorganization procedure.[183] The first stage of the procedure is the observation period which allows the court to determine the financial situation of the debtor.[184] At the end of the period, which may vary from 4 to 20 months depending on the size of the debt, the court makes its decision whether to liquidate the company or to adopt a reorganization plan which would consist either of the sale of the company as an ongoing concern or a continuation plan.[185] In case of a continuation plan, the management remains in control of the company while a court ordered sale of the company requires the transfer of all the company's assets to a third party.[186]

There was also the 1985 law whose purpose was to emphasize company reorganization over liquidation.[187] In addition, the 1988 law introduced collective

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[178] Legal Consequences, Supra note 171.
[179] Ibid.
[180] Under the French bankruptcy law, liquidation is ordered immediately only when the company ceases all activity or the reorganization and recovery of the company are clearly impossible.
[181] Legal Consequences, Supra note 171.
[182] Ibid.
[183] Ibid.
[184] Id, P. 2.
[185] Ibid.
[186] Ibid.
[187] Tetley, Andrew, Smith, Reed and Bayle, Marcel. *Insolvency Law in France*. P. 198. Available from World Wide Web: <http://www.reedsmith.com/_db/_documents/France_(as_published).pdf> [Visited May 10, 2011].

bankruptcy proceedings for individual farmers.[188] Then again, the 1994 law provided a clear distinction between reorganization and liquidation.[189] "In particular, the court was given the ability to order liquidation of a company immediately without necessarily having to go through the court supervised reorganization phase."[190] In 2000, the new commercial code was promulgated.[191]

The 2005 law provided a new approach by describing four types of proceedings.[192] These are; conciliation, safeguard, judicial reorganization, and liquidation proceedings.[193] There is also the law that came into force on February 15 2009. It amended many of the articles of the 2000 commercial code.[194]

Due to the sequence of laws enacted the system is now "complex…[and provides] increased choice of proceedings for businesses to react in the face of financial difficulties."[195]

3.3.3 The German Bankruptcy System

As was the case in most other jurisdictions, Germany had no bankruptcy law per se during its early history.[196] Until the late 15th century, creditors were able to take individual remedies only.[197] Although bankruptcy procedures were available in some cities since the 13th century, they only applied as regards dead or absconding debtors.[198] However, such procedures became more sophisticated during the later periods, largely due to the influence of Italian bankruptcy laws.[199] The *cessio bonorum*(concession of goods), for instance, was recognized by the laws of Bavaria and the laws of Wurttemberg of 1610 for the honest but unfortunate debtor in order to avoid going to prison.[200]

The first German Bankruptcy Code was passed, in 1877, during the period of escalating industrialization in Germany.[201] Accordingly, the Code contained classic

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[188] Tetley, Andrew, Smith, Reed and Bayle, Marcel, Supra note 187, P. 198.
[189] Id, P.199.
[190] Ibid.
[191] Ibid.
[192] Ibid.
[193] Ibid.
[194] Ibid.
[195] Ibid.
[196] Dalhuisen, JH. *Dalhuisen on International Insolvency and Bankruptcy*, 1, 1-10 (1986), P.98.
[197] Ibid.
[198] Ibid.
[199] Ibid.
[200] Ibid.
[201] Ibid.

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liberal theories.[202] However, the Code was criticized mainly for being tailored to meet the needs of big businesses and because it was based on the idea of debtor's fault.[203]

As a result, a bill to amend the Bankruptcy Code of 1877 was tabled in 1893, which eventually resulted in the Bankruptcy Code of 1898.[204] Besides the Bankruptcy Code, the Reorganization Code was introduced in 1935 to meet the need of providing relief to honest debtors without having to use the bankruptcy procedure.[205] Nevertheless, all these legislations were repealed and replaced by the *Insolvenzordnung* (Insolvency Code) of 5 October 1994, which came in to force on 1 January 1999.[206]

The new Code, *inter alia*, introduced a truly unified insolvency statute and the "single gateway" approach to insolvency, whereby all bankruptcies are filed through a well organized system of bankruptcy courts, which is exactly similar to the United States system of bankruptcy. However, unlike the bankruptcy law of the United States, the Bankruptcy Code of Germany provides more protection to creditors and can generally be regarded as a creditor-friendly regime.

Despite allowing the court to overhaul the conduct of creditors where it is required, the Bankruptcy Code provides a large degree of independence to creditors.[207] The Bankruptcy Code, for instance, grants more rights to creditors in regard to various administrative procedures such as the right to appoint their own administrator and the right to constitute a creditors' committee.[208]

Furthermore, the insolvency Code tries to keep consumer bankruptcy cases out of the courts and therefore out of the formal proceedings.[209] That is, it allows consumer debtors to enter an insolvency proceedings only if all other attempts at reaching an arrangement with the creditor have failed.[210]

3.3.4 The English Bankruptcy System

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[202] Dalhuisen, Supra note 196, P.98.
[203] Ibid.
[204] Ibid.
[205] Ibid.
[206] Ibid.
[207] Ibid.
[208] Ibid.
[209] Ibid.
[210] "Other attempts" refers to attempts such as extra-judicial agreements, debt adjustment plans and a release from remaining liabilities.

As has been discussed already, the early history of insolvency law in England dealt only with the insolvency of individuals. Statutes dealing with the insolvency of individuals were enacted at different times from the mid 16th century onwards. Although, reference had been made to an earlier statute, the founding statute appears to have been the statute of 1542, which dealt mainly with absconding debtors.[211] The Act contained vital bankruptcy principles such as the collective nature of bankruptcy proceedings and the *pari passu* principle of equal distribution among creditors.[212]

One of the main characteristics of English insolvency laws of earlier times was that they maintain a number of basic distinctions between the insolvency of traders and non-traders.[213] However, such distinction had a dire consequence for insolvent non-trader debtors prior to 1861, as they were subjected to the common law procedures for the enforcement of the payment of debts through the seizure and imprisonment of the debtor and the seizure and sale of his assets.[214]

A series of bankruptcy statutes enacted during the 19th century laid the foundation of modern English bankruptcy law. Currently, there are broadly five formal procedures which a debtor in financial difficulties may invoke.[215] These include; a voluntary arrangement, a scheme of arrangement, appointment of administrator, appointment of an administrative receiver or receiver and liquidation or winding up of the debtor's company.[216] While some of these procedures are designed to assist a company in getting back on its feet by restoring it to financial strength, others are procedures which apply when a company itself cannot be rescued and all that can be done is to sell the assets, if possible as an ongoing concern, and then dissolve the company.[217] Broadly speaking, voluntary arrangement and schemes of arrangement are procedures designed to assist a company to reach agreement by way of compromise with its creditors.[218] As such they may form part of a corporate reorganization or rescheduling of debts. Meanwhile, although the primary objective of the administrative procedure

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[211] *Fletcher* as cited in Burdette, supra note 34.
[212] Ibid.
[213] Ibid.
[214] The law was also very harsh at the time, not making any distinction between an honest and dishonest debtor.
[215] Slaughter and May, *An Introduction to English Insolvency Law*, 2009, P.1 Available from World Wide Web: < http://evanflaschen.net/UK%20Insolvency%20Summary.pdf > [Visited February 23, 2011].
[216] Ibid.
[217] Ibid.
[218] Ibid.

is intended to be the rescue of the company, it is generally a prelude to a break up and dissolution of a company.[219] As per the Enterprise Act 2002, the administrative procedure was streamlined to make the appointment of an administrator easier and to reduce the need to make application to the court for appointment.[220] The Act has also given power to certain secured creditors, the company or its directors to appoint an administrator out of court and to the administrator to make distributions to secured creditors and preferential creditors.[221]

Whereas receivership and liquidation are likely to signal an acknowledgement that the company itself has no future and all that can be sought is the maximization of the proceeds of the sale of its assets or business,[222] this may enable the purchaser to acquire, at least, part of the debtor's business as an ongoing concern, thereby preserving the underlying business and employment.

Laying the ground by a general discussion of the different guidelines/principles and laws that will be used in the comparison of the Ethiopian bankruptcy law and show areas of concern for its revision, it is high time that the discussion begins.

[219] Slaughter and May, Supra note 215. P. 1.
[220] Ibid.
[221] Ibid.
[222] Id, P. 2.

CHAPTER FOUR

THE ETHIOPIAN LAW OF BANKRUPTCY IN COMPARISON TO MODERN LAWS OF BANKRUPTCY AND AREAS OF CONCERN FOR ITS REVISION

4.1. General

Bankruptcy is not new to Ethiopia and laws are found to govern the "incidence" of bankruptcy long before the enactment of the modern codes of the country. Although my knowledge as to its test on the grounds is limited, there was the 1933 Law of Bankruptcy promulgated on 12, July 1933.[223] The law consists of 96 Articles arranged under 14 chapters.[224] The provisions range from general provisions and declaration of bankruptcy to the effect of bankruptcy, composition and discharge of the bankrupt.[225]

Then came the 1960 Commercial Code of Ethiopia (herein after the Commercial Code or the Code) with a Bankruptcy Book to govern "businesses in difficulty''.[226] The primary source used to draft Book V of the Commercial Code was the French legislation that was revised in 1955.[227]

The draft of the Commercial Code was prepared by two individuals, Professor Jean Escarra and Jauffret.[228] Incidentally, the drafting of the Code was left to professor Escarra but he died in 1954[229]which allowed Jauffret to take the task of completing the draft of the Code.[230] When Professor Jauffret took over, Books II, IV and V dealing with business organizations; negotiable instruments and banking transactions; and bankruptcy and schemes of arrangement, respectively, were already drafted by

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[223] Winship, Peter. (Ed. And Ttrans.). *Background Documents of the Ethiopian Commercial Code of 1960*, (H.S.I.U 1972), Appendix III, C.
[224] Ibid.
[225] Id, Pp. 209-220.
[226] See Commercial Code Supra note 1, Book V(in general).
[227] Winship Supra note 223, Pp. 114-115. By the time the Commercial Code was drafted, the French bankruptcy law was a creditor-friendly law. This is also evident from the provisions of the Ethiopian bankruptcy law (see for instance, Articles 1019, 1022 and1114 (2 and 3)). But the French bankruptcy law as it stands right now is a debtor-friendly law.
[228] Ibid.
[229] Tadesse Lencho, *Ethiopian Bankruptcy law: A commentary (part I)*, 22 Journal of Ethiopian Law 2, (2008), P.62.
[230] Winship, Supra note 223, P.35.

the deceased Professor. Books I (Traders) and III (Commercial Contracts)[231] were drafted by Jauffret.[232] Book V of the Commercial Code was satisfactorily drafted and Jauffret was required to make just revision and correction of what has already been drafted by Professor Escarra.[233]

The Commercial Code was promulgated on the 5th of May 1960; two years after Jauffret submitted the Code for approval on 1st of March 1958.[234] Book V is composed of five titles: General Provisions; Bankruptcy; Scheme of arrangement; Special provisions concerning bankruptcy and schemes of arrangement with respect to business organizations; and Summary procedures.

4.2 Purpose of Bankruptcy Law

As to the purpose of bankruptcy law, some say that it is "to allow debtors to be discharged of the financial obligations and debts they have accumulated".[235] However, protecting the interests of creditors and allowing debtors to rehabilitate and begin a fresh start could also be purposes of bankruptcy laws.
The UNCITRAL Legislative Guide provides for different purposes that must be achieved through the provisions of a bankruptcy law. These are briefly mentioned as follows.

The first purpose relates to the persons that are eligible under the law and the jurisdiction of the court that can entertain a bankruptcy case.[236] The second purpose that the bankruptcy law should achieve is setting transparent and certain commencement criteria.[237] The third one is related with the choice of law.[238] The fourth purpose that the law must achieve relates to the estate of the bankrupt debtor. That is, determining the estate of the bankrupt that will be subject to bankruptcy; its protection and preservation as such; and use and disposal of the estate.[239]

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[231] In the promulgated Commercial Code Book III is entitled Carriage and Insurance.
[232] Winship, Supra note 223, P.35.
[233] Id, P. 113.
[234] Tadesse Lencho, Supra note 229,P. 63.
[235] Bankruptcy Law Research Guide. P. 2. Available from World Wide Web: <http://www.law.syr.edu/Pdfs/1BankruptcyLaw.pdf >[Visited February 23, 2011].
[236] UNCITRAL Supra note 18, P. 43. Recommendations 8-13.
[237] Id, P. 64. Recommendations 14-29.
[238] Id, P. 72. Recommendations 30-34.
[239] Id, P. 82. Recommendations 35-38; P. 99. Recommendations 39-51; and P.111Recommendations 52-62.

The fifth purpose that the law must achieve relates to the post-commencement finance, treatment of contracts, and provisions on avoidance and set-off.[240] The sixth purpose relates to the rights and obligations of the debtor, qualifications of insolvency representatives, participation of creditors.[241] The seventh purpose relates to the provision of appellate mechanisms in the law to ensure that the interest of parties is protected.[242] The next purpose is related to the availability of alternative mechanisms like reorganization and voluntary restructuring negotiations.[243] The other purpose deals with the claims of creditors, priority and distribution.[244] The last purpose relates to the discharge and closure of the bankruptcy proceeding.[245]

Under the Ethiopian bankruptcy law, one can say that the protection of creditors is given much attention. However, the safeguard of the interests of the debtor is governed to some extent. In Germany also, the objective of insolvency proceedings is to safeguard the interests of creditors either by liquidation of the insolvent entity's assets or by reaching an arrangement by means of an insolvency plan that restructures the insolvent entity.[246]

In the coming sections, we will see to what extent the Ethiopian Bankruptcy law meets the purposes that the UNCITRAL Legislative Guide sets as a benchmark to be achieved by any bankruptcy law.

4.3 Scope of the Ethiopian Bankruptcy law

4.3.1 General

According to the World Bank Principles, the insolvency law should identify those persons that are subjects and left out of the ambit of the law.[247] This is because the "[persons] left outside the process will not be entitled to the benefits or exposed to the discipline of the system."[248]

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[240] See UNCITRAL, Supra note 18, P. 118. Recommendations 63-68; P. 132. Recommendations 69-86; P.152. Recommendations 87-99; P. 156.Recommendation 100; and P.158. Recommendations 101-107.
[241] Id, P. 171. Recommendations 108-114; P. 188. Recommendations 115-125;and P.202. Recommendations 126-136.
[242] Id, P. 206. Recommendations 137 and 138.
[243] Id, P. 233. Recommendations 139-159; and P. 244. Recommendations 160-168.
[244] Id, P. 263. Recommendations 169-184; and P. 275. Recommendations 185-193.
[245] Id, P. 284. Recommendations 194-196; and P. 286. Recommendations 197 and 198.
[246] Norton Rose Group - A quick overview on German Insolvency Law. P.1. Available from World Wide Web: < http://evanflaschen.net/German%20Insolvency%20Law.pdf > [Visited August 28, 2011].
[247] World Bank, Supra note 17, P. 28, Principle 9(Para 85).
[248] Ibid.

As per the UNCITRAL Legislative Guide, the law should apply to all debtors as long as they are engaged in economic activities and whether or not they are natural or legal persons, or whether or not these activities yield profit or not.[249] And when exclusions are made in the law as to the application of the law, it should be made in limited and clearly identified areas.[250] The Guide, however, recommends that special bankruptcy regimes could be applied to banks and insurance companies and that state owned enterprises could be excluded only if they are engaged in very sensitive areas of the economy.[251]

The same is true under the World Bank Principles which provide that all entities including state owned enterprises should be governed by the general rules of (bankruptcy) except financial institutions (banks) and insurance companies which should be governed by a special or separate bankruptcy laws.[252]

These two instruments give broader scope of application of the law of bankruptcy and we will try to see their application in the Ethiopian bankruptcy law in the following sub-sections. For the sake of convenience, the discussion is divided into three parts. The first part is about the general scope of application of the law; the second part is about those persons that need special bankruptcy regime. At last those that are excluded from the ambit of the bankruptcy law are discussed.

4.3.2 Traders/Commercial Business Organizations

The Ethiopian Commercial Code clearly limits the scope of the bankruptcy law to traders[253] or commercial business organizations.[254] The law provides general provisions that are applicable to all traders and special provisions that are applicable to business organizations. In

[249] See UNCITRAL, Supra note 18, P.44, Recommendations 8-13.
[250] Ibid.
[251] Ibid.
[252] World Bank, Supra note 17, Principle 9(Para 85).
[253] A trader could be not only a natural person but also a business organization but they are also subjects of the bankruptcy as far as they are commercial business organizations. According to Article 10(1) business organization, is a commercial one when its objects in fact or under the memorandum of association are to carry on any of the activities under Article 5. Share companies and private limited companies are however always taken to be commercial business organizations irrespective of their objects (See Article 10(2)). Banks and Insurance companies are Share Companies, which makes them subject to bankruptcy law under the Commercial Code.
[254] Commercial Code, Supra note 1, Article 968. Under Article 3 of the 1933 Bankruptcy Law, bankruptcy proceedings were limited to physical or legal persons registered in the commercial register or who, although not registered, are required to register by virtue of the law.

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Germany, as well, there is only one primary uniform insolvency procedure which applies to both individuals and companies.[255]

Now, the question is who are traders/ commercial business organization under the Ethiopian bankruptcy law? As per Article 5 of the Commercial Code, a trader is a person who professionally and for gain carries on any of the activities listed under the same.[256]

The Ethiopian Commercial Code also recognizes six forms of business organizations[257] of which only ordinary partnership is always a non-commercial (civil) business organization,[258]thus clearly excluded. Share companies and private limited companies are always commercial business organizations,[259]hence included. Joint Venture, General Partnership and Limited Partnership could either be civil or commercial business organization based on whether or not they are engaged in the activities listed under Article 5 of the Commercial Code.[260]

To talk, however, about the bankruptcy of Joint Ventures, it is important to consider their governance under other provisions of the Commercial Code. First, their formation is not made in writing; they are not legal persons and supposedly unknown to third parties.[261] Second, there is a possibility that joint ventures could be taken as partnerships where they are known to third parties.[262] Third, Article 968(1), however, excludes joint ventures from the domain of the law of bankruptcy without mentioning

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[255] *At a glance: Germany Insolvency law*. Available from World Wide Web: <http://www.mayerbrown.com/london/article.asp?id=2572&nid=369> [Visited August 28, 2011].

[256] These are: purchase of movables or immovables with a view to re-selling them either as they are or after alteration or adaptation; purchase of movables with a view to letting them for hire; warehousing activities as defined in Art. 2806 of the Civil Code; exploitation of mines, including prospecting for and working of mineral oils; exploitation of quarries not by handicraftsmen; exploitation of salt pans; conversion and adaptation of chattels, such as foodstuffs, raw materials or semi-finished products not by handicraftsmen; building, repairing, maintaining, cleaning, painting or dyeing movables not by handicraftsmen; embanking, leveling, trenching or draining carried out for a third party not by handicraftsmen; carriage of goods or persons not by handicraftsmen; printing and engraving and works connected with photography or cinematography not by handicraftsmen; capturing, distributing and. supplying water; producing, distributing and supplying electricity, gas, compressed air including heating and cooling; operating places of entertainment or radio or television stations; operating hotels, restaurants, bars, cafes, inns, hairdressing establishments not operated by handicraftsmen and public baths; publishing in whatever form, and in particular by means of printing, engraving, photography or recording; operating news and information services; operating travel and publicity agencies; operating business as an agent, broker, stock broker or commercial agent; operating a banking and money changing business; operating an insurance business. See also Commercial Registration and Business Licensing Proclamation No. 686/2010, Article 2(2).

[257] Article 212(1) lists ordinary partnership, joint venture, general partnership, limited partnership, share company and private limited company as the six forms of business organization.

[258] Commercial Code, Supra note 1, Article 213(1).

[259] Id, Article 10(2).

[260] Id, Articles 10(1), 213 and 280(2).

[261] Id, Articles 214, 210(2), 219(1).

[262] Id, Articles 272(4).

instances where they may be turned into actual partnerships. So, was Article 968(1) not cognizant of this situation?

4.3.3 Special Commercial Business Organizations

Bankruptcy is one of the main characteristics of businesses. But many[263] argue that some businesses (their discussion will soon follow) should be governed by special rules of bankruptcy instead of the general rules of bankruptcy that are applicable to any trader/business organization.

A. Banks and Insurance Companies

Like any other business, banks could be bankrupt. The reasons for the bankruptcy of banks could be attributable to keen competition that makes banks increase their market share and profits by imposing price policies, such as lowering loan rates, raising deposit rates, or even worse by loaning to those with high risks, which all could increase the probability of bankruptcy.[264] In addition, a research made on 36 Taiwanese banks shows that "capital adequacy and corporate governance play important roles in bank bankruptcy".[265]

That is why people strongly argue about the need for special regime of bankruptcy for banks. Some say that, it is the characteristic functions of banks that make them argue about the needs for special regimes for banks. [266] The characteristic functions being: one, banks provide long term loans and are liable for payment of deposits on demand, which creates a mismatch of maturity.[267] This mismatch of maturity may be a problem if something happens to disturb the confidence of the depositors of a bank.[268] That is, lack of confidence would make them withdraw their deposits creating liquidity problems and hence the insolvency of the bank.[269]

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[263] Hopkes, Eva. Insolvency - Why special regime for banks? 3 Forthcoming in Current Developments in Monetary and Financial Law, (2003), P. 3.

[264] Chiu, Yung-Ho , Chen, Yu-Chuan and Hung, Yu Han(2009) 'Basel II and bank bankruptcy analysis', Applied Economics Letters, 16: 18. P.1843. Available from World Wide Web: <http://dx.doi.org/10.1080/13504850701704241> [Visited August 28, 2011].

[265] Id, P. 1846.

[266] Hopkes, Supra note 263, P. 3. Other non-bank financial institutions could serve the same purpose but banks are special since they are vulnerable to the loss of public confidence.

[267] Ibid.

[268] Ibid.

[269] Ibid.

This will further threaten the solvency of other banks as banks are interconnected[270] and a failure of one bank means a default on its contracts with other banks hence creates instability on the entire financial system.[271]

Two, Banks are the hands of the government in the implementation of monetary policies.[272] Third, the financial services that banks carry out are fundamental to the functioning of the economy as they, for instance, extend credit, take deposits and process payments.[273]

Others, on the other hand, do not directly argue that there is no need for special rules of bankruptcy but say that the characteristics mentioned above are not of banks alone and that the special rules should also extend to other financial institutions like insurance companies.[274]

In countries like Italy and Norway banks are governed through bankruptcy rules that are supplementary/ exception to the general rule of bankruptcy while countries such as the US have completely moved banks from the general bankruptcy regime and provided special rules for them.[275]

Until recently, the bankruptcy of banks in Ethiopia was governed by the general rules found in the Commercial Code. The Banking Business Proclamation No. 592/2008(the relevant discussion on the provisions of the Proclamation will be made in the following sections), however, governs the bankruptcy of banks,[276] although the provisions of the Commercial Code are applicable in so far as they are in line with the rules set forth under the Banking Business Proclamation.[277]

As to the bankruptcy of Insurance Companies, special rules are needed as they play a vital role in the "distribution of risk, serving as a general guarantor of the credit system in the society at large".[278] The Licensing and Supervision of Insurance

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[270] See Tsegai Bekele, Supra note 3, P.38. On the case between Agricultural and Industry Development Bank(creditor/applicant) and Berta Construction Private Limited Company(debtor/respondent), Case No. 1156/1974, the claimant argued that the failure of the respondent to pay its debts would threaten the relation of the country with other international financial institutions.(translation mine)

[271] Hopkes, Supra note 263, Pp.24-25.

[272] Id, P.3.

[273] Ibid.

[274] Id, P.4 and 33.

[275] *Hopkes*, as cited in Tadesse Lencho, Supra note 229, P.71.

[276] Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia 14th year, No. 57, Banking Business Proclamation No. 592/2008, Addis Ababa, August 2008. Articles 32-48(Part Eight).

[277] Id, Article 48.

[278] Girma Dejene, Supra note 74, P.43.

Business Proclamation No. 86/1994 is the main governing law of insurance companies in the country. It, however, contains provisions that are, fair to say, not much special concerning the dissolution of these companies but our fear is minimized when we see the reference made under Article 44(a) of the Proclamation to the Licensing and Supervision of Banking Business Proclamation No. 84/1994 as much as it is applicable. Other laws, including the Commercial Code, are also applicable to insurers as long as they are consistent with Proclamation No. 86/1994.[279]
Since Proclamation No. 84/1994 has already been repealed and replaced by the Banking Business Proclamation No. 592/2008 and no reference is made by Banking Business Proclamation No. 592/2008 as to its applicability to insurance companies. Thus, one can conclude that in Ethiopia, there is special bankruptcy law applicable to banks but not to insurance companies.

B. State Owned Enterprises

According to the Public Enterprise Proclamation No. 25/1992, an enterprise is defined as "a wholly state owned public enterprise established pursuant to this proclamation to carry on for gain manufacturing, distribution, service rendering or other economic and related activities".[280] Although the definition is circular it is helpful in at least, setting the scope of application to those enterprises that are profit-oriented.

As to the bankruptcy of these enterprises, the Public Enterprise Proclamation No 25/1992 puts decision of a court declaring the enterprise bankrupt as one of the grounds for dissolution of an enterprise.[281] The Proclamation, however, did not try to govern bankruptcy of public enterprises anywhere especially under the chapter 'dissolution and winding up' since it limited the applicability of the articles under the chapter only to those dissolved as a result of grounds other than bankruptcy.[282]

On the other hand, Article 40(1) of the Public Enterprise Proclamation No 25/1992 provides that the provisions of Book V of the Commercial Code are, mutatis mutandis, applicable in cases of bankruptcy of an enterprise. The other guideline is provided by Article 40(2) of the Public Enterprise Proclamation No. 25/1992 which

[279] Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia, Licensing and Supervision of Insurance Business Proclamation No. 86/1994, Addis Ababa. Article 44(b).
[280] See the Public Enterprise Proclamation No. 25/1992, Article 2(1).
[281] Id, Article 39(6).
[282] See Id, Chapter Eight especially Article 41(1).

states that the court may order that bankruptcy proceedings of an enterprise be conducted by a summery procedure.

This clearly shows that Ethiopia is a country that subjects SOEs to the general provisions of the bankruptcy law, as the World Bank Principles and the UNCITRAL Legislative Guide recommend.

4.3.4. Excluded Persons

Traders and/or commercial business organizations are the ones in Ethiopia that bankruptcy law applies to, specifically. There are, on the other hand, persons whether business organizations or not that are altogether excluded from the ambit of the law of bankruptcy. Their discussion follows.

A. Consumers

A consumer is a "person who buys goods or services for personal, family, or household use, with no intention of resale; or a natural person who uses products for personal rather than business purposes".[283] Consumers being those that do not engage in business activities whether in the status of traders, commercial business organizations and so on, there is no consumer bankruptcy under the Ethiopian legal system.

In the US, special consideration is given for consumer's bankruptcy. Chapter 13 is a program under the US Bankruptcy Code available for "individuals (and their spouses) with regular income who have unsecured debts of less than $290,525 and secured debts of less than $ 871,550.[284] The plan under this chapter is to attempt to repay debts with in a period of five years.[285]

The benefits of this chapter, if the plan is successfully performed, are that the debtor would be able to retain non-exempt assets and will be discharged from many of his/her obligations.[286] The other benefit of filing a Chapter 13 bankruptcy is its potentially less onerous effect on the ability to obtain new credit.[287] The other -

[283] Garner, Supra note 14, P.591.
[284] Sen, Supra note 10, P.12.
[285] 11. U.S.C 1322(c) as cited in Id, P. 302.
[286] Buchbinder, David L. Basic Bankruptcy Law for Paralegals,Third Edition, A Division of Aspen Publishers,Inc.,1997, New York. P.302.
[287] Ibid.

remote reason is it has the effect of making the automatic stay applicable to a co-debtor who has not also filed a bankruptcy proceeding.[288]

Although the UNCITRAL Legislative Guide does not deal with the bankruptcy of consumers, it suggests that if a country recognizes the bankruptcies of both consumers and traders, similar rules should be adopted to govern such instances as it may be difficult to separate the debts into clear categories.[289] That would be something to keep in mind when Ethiopia subjects consumers to the law of bankruptcy as the country does not currently have a bankruptcy law for consumers.

B. Others

According to the Commercial Code, traders/business organizations other than the ones governed by the provisions of the Commercial Code are governed by the Civil Code[290] and this includes persons that carry on any of the activities mentioned under Article 5 of the Commercial Code unprofessionally and free of consideration.[291] Those that are engage in maritime trade are governed by the Maritime Code.[292]

The other ones are bodies corporate under public law that are excluded from the application of the bankruptcy law. These are for instance administrative or religious institutions that are not presumed to be traders even if they carry out activities under Article 5 of the Commercial Code.[293]

In addition, Agricultural or Forestry undertakings; Fishermen and persons breeding fish, shell-fish or shells; and Handicraftsmen are generally dealt under Articles 6 - 9 of the Commercial Code and are not considered as traders hence not governed by the bankruptcy law of the country.

Among these are cooperative societies that are governed by the Cooperative Societies Proclamation No. 14711998 and its amendment proclamation No. 402/2004. As per these proclamations, a cooperative society could be dissolved when the "auditing

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[288] 11 U.S.C 1301 as cited in Buchbinder, Supra note 286, P. 302.
[289] See UNCITRAL, Supra note 18, P. 284.
[290] Commercial Code, Supra note 1, Article 1. As per article 1676 of the Civil Code, the provisions with regard to contracts are applicable whatever their nature and whoever the parties maybe, unless such is governed by special provisions applicable to certain contracts as are laid down in Book V the Civil Code and in the Commercial Code.
[291] Id, an acontrario reading of Article 5 of the Commercial Code.
[292] Id, Article 2.
[293] Id, Article 4(1). The conditions and effect of trade carried on by bodies corporate is to be prescribed by law. See Article 27 of the commercial code.

reveals that it is bankrupt and when the appropriate authority ensures that causes the dissolution and the general assembly decides."[294] However, no reference is made to the Commercial Code as to the governance of the bankruptcy of the Society.[295]
The other ones are Charities and Societies that are governed by the Charities and Societies Proclamation No. 621/2009. As per article 93(1(c)) of the Charities and Societies Proclamation No. 621/2009, a charity or society maybe dissolved by the Charities and Societies Agency where it has become insolvent.[296]

The last ones that are not considered as traders are associations. They are prohibited from carrying on trade as per Article 25(1) of the Commercial Code.[297] In fact, carrying of trade by an association is a ground for its dissolution under Article 461 of the Civil Code. [298] In addition, Article 461(d) of the Civil Code provides that associations could be dissolved if they are 'insolvent'. Should Book V of the Commercial Code apply in this case? No reference as to the dissolution of an association is made to the Commercial Code.

To sum up, the above mentioned proclamations use the term bankruptcy/insolvency when they govern the dissolution of these excluded entities. However, there is no reference made to the Commercial Code in this case. Thus, the way the term bankruptcy/insolvency is used is different from the sense that is used in the Commercial Code.

In the US, bankruptcy is available to a range of persons. Chapter 7 bankruptcy is available to individuals, married couples, corporations, and partnership who petition

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[294] Cooperatives Societies Proclamation No. 147/1998. 5th Year No.27 A.A. 29th December 1998. Article 40 Cumulative with Cooperatives Societies(Amendment) Proclamation No. 402/2004. 10th Year No.43 Addis Ababa. 11th May 2004. Article 6(4). In addition, as per Article 2(7) of the Cooperatives Societies Proclamation, an 'Appropriate Authority' is "an organ established at federal level, or a bureau or an organ established for the same purpose at Regional or City Administration level, to organize and register cooperative societies and to give training, conduct research and provide other technical assistances to cooperative societies."

[295] As to Ato Frew Mamo, even if the Commercial Code says that the effect and condition of trade carried on by cooperatives is to be prescribed by law, they are currently carrying on trade without even registering as traders which makes their governance difficult. Interview with Ato Frew Mamo, Federal Democratic Republic of Ethiopia Ministry of Trade and Industry Legal Affairs Directorate Representative. Conducted on 3,August, 2011.

[296] Charities and Societies Proclamation No. 621/2009, 15th Year, No. 25, 13th February 2009. Article 93(2), the dissolution of Ethiopian charity and society is effected by the Federal High Court.

[297] As per Civil Code of the Empire of Ethiopia, 1960, *Negarit Gazeta* - Extraordinary Issue No. 2 of 1960, Addis Ababa, Article 404, an association is a grouping formed between two or more persons with a view to obtaining a result other than the securing or sharing of profits.

[298] Commercial Code, Supra note 1, Article 25(2).

for liquidation.[299] As has already been discussed above, Chapter 13 is a reorganization plan available for consumers. On the other hand, Chapter 11 is a reorganization proceeding available for corporations, partnerships and those individuals whose debt exceeds the limits of Chapter 13.[300] Chapter 12 is a simplified reorganization available for family farmers and fishermen.[301]

In France, the bankruptcy procedure is available to merchants, registered craftsmen, farmers and legal entities.[302] In Germany, although consumer bankruptcy is recognized, such cases are allowed to see formal bankruptcy proceedings only if all other attempts in reaching agreements with creditors have failed.[303]

The question still is should Ethiopia subject consumers to the provisions of bankruptcy law as in the case of the US and Germany and/or excluded persons as in the case of the above mentioned countries? This requires further investigation which the writer does not currently deal with.

4.4 Initiation, Effects and Settlement of bankruptcy proceedings

4.4.1 Who may apply for a Declaration of Bankruptcy?

Usually, it is the creditor(s) or the debtor himself that initiates the bankruptcy proceeding.[304] This is the case for instance in England and the United States. In Germany also, both the debtor and the creditors could file for the proceeding when the debtor encounters illiquidity or over-indebtedness (incapable to pay). However, it is only the debtor that can file for the proceeding in case of imminent illiquidity.[305]

Under the Ethiopian bankruptcy law, any of the following may initiate a bankruptcy proceeding by way of filing a petition.[306] The debtor, one or more creditors, the public prosecutor[307], or the court. Article 972 provides that a trader[308] must file a

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[299] Tabb, Supra note 141, P.33.
[300] Ibid.
[301] Sen, Supra note 10, P. 11.
[302] Legal Consequences, Supra note 171, P.1.
[303] Dalhuisen, Supra note 196, P.98.
[304] UNCITRAL, Supra note 18, P.6 and the US bankruptcy law, Article 2.
[305] Norton Rose Group - A quick overview on German Insolvency Law. P.2. Available from World Wide Web: < http://evanflaschen.net/German%20Insolvency%20Law.pdf >[visited on August 28, 2011].
[306] Commercial Code, Supra note 1, Article 975.
[307] Instances where the public prosecutor would participate in the bankruptcy proceedings are where a person is found guilty of a certain crime and that the sentence includes fine (the payment of some amount of money). These are for instance the crimes related with tax evasion and tax administration.

notice of suspension of payment of commercial debts within fifteen days[309] after the suspension with a view to the institution of bankruptcy proceedings or the approval of a scheme of arrangement.[310] This is, however, only for the debtor but when and how others should file petitions is unanswered under the law.

Ato Tadesse and Ato Israel argue that in order to avoid bad intentions of creditors phrases like "the debt must be based on court judgment" or "a significant portion of the debt be undisputed and free of set off "must be inserted on how the creditors should petition for bankruptcy of a failing debtor.[311]

In line with this, fifteen days is little time to establish the seriousness of the suspension of payments.[312] It may be beneficial to follow what has been adopted by the French bankruptcy code-forty five days after the cessation of payments.[313]

4.4.2 Institutions and Persons Involved in Bankruptcy Proceedings

It is usually the court, insolvency representatives, the creditors and the debtor[314] that participate in bankruptcy proceedings.[315]

A. The Court

The UNCITRAL Legislative Guide requires that the law should clearly specify the "court that has jurisdiction over the commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings."[316] In addition, it requires that sufficient connection to the State that subjects the debtor to

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For example, as per Article 98(1)(a)of the Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia 8th Year No. 34, Income Tax Proclamation No. 286/2002, Addis Ababa, July 2002, a person who obstructs or attempts to obstruct an officer of the Tax Authority in the performance of his duties commits an offence and may be fined with 10,000-100,000 Birr upon conviction.

[308] A firm's legal representative in case of a business Organization, or the liquidator in case of a business Organization in liquidation, or each partner in a general partnership and general partners in a limited partnership, must file a notice of suspension of payments. See Commercial Code, Supra note 1, Articles 1156 and 1158(1).

[309] The date is extended to twenty days for bankruptcies of general and limited partnership. See Commercial Code, Supra note 1, Article 1157(1).

[310] Commercial Code, Supra note 1, Article 972.

[311] See Tilahun Teshome and Taddese Lencho, Supra note 2, P.86.

[312] Id, P.85.

[313] Article L640-4 of the French Civil Code as cited in Id, P.85.

[314] World Bank, Supra note 17, Principle 27(Para 199); and UNCITRAL, Supra note 18, Pp.161,174 and 190.

[315] But, the role of the bankrupt/debtor, in Ethiopia for instance, is very much limited and everything is taken care of by the commissioner and /or trustee(s) unless it was found necessary for the debtor to participate. See Commercial Code, Supra note 1, Articles 1019ff.

[316] UNCITRAL, Supra note 18,P. 44. Recommendations 8-13, (Para. 19).

its insolvency law should be established.[317] This could be, inter alia, where 'the debtor has its centre of main interests or establishment in the State.[318]

As per Article 990 of the Commercial Code, the court that declared the debtor bankrupt has the jurisdiction to hear all claims arising in the bankruptcy except the ones that are reserved for a court due to claims in rem concerning immovable property. In addition, Articles 989 provides that the court supervises all bankruptcy proceedings and makes orders on matters that are outside of the commissioner and hears appeals made on orders of the commissioner. It also appoints and replaces the commissioner and trustee(s) in bankruptcy.[319]

These provisions provide that the court that declared the debtor bankrupt should supervise all bankruptcy proceedings; have jurisdiction to hear all claims arising in the bankruptcy; and shall appoint and dismiss representatives. However, the provisions do not mention whether this court is a Federal or a State one.

There are two layers of courts in Ethiopia, Federal and state courts. There is no mention of whose jurisdiction bankruptcy is under the bankruptcy law and Federal Courts Proclamation No. 25/1996 did not provide that bankruptcy is a federal matter. And as per the FDRE Constitution, a power that is not expressly given to the Federal Government alone, or concurrently to the Federal Government and the States is reserved to the States.[320] It may thus be argued that bankruptcy is a matter reserved to the states. However, trends in other countries show that bankruptcy is a Federal matter.[321] Even more, it is desirable if it is a matter reserved for Federal courts since "bankruptcy involves plurality of parties and suits and is essentially a collective mode of enforcement, which is better handled in Federal courts."[322]

Although neither the Commercial Code nor the Federal Courts Proclamation No. 25/1995 resolves the material jurisdiction of courts with regard to bankruptcy, the Code however provides provisions for the local jurisdiction of courts on bankruptcy. Accordingly, the court of the place where the business of a trader is situated is the

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[317] UNCITRAL, Supra note 18,P. 44. Recommendations 8-13, (Para. 10).
[318] Ibid.
[319] See Commercial Code, Supra note 1, Article 981 and 993.
[320] Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia 1st year No. 1, Proclamation of the Constitution of the Federal Democratic Republic of Ethiopia Proclamation No. 1/1995, Addis Ababa, August 1995,Article 52.
[321] In the US, for instance, bankruptcy is a matter reserved for Federal courts.
[322] Tilahun Teshome and Taddese Lencho, Supra note 2, P.115.

court that has Jurisdiction in bankruptcy proceedings in Ethiopia.[323]For business Organizations, it is the court where the head office is situated that has jurisdiction.[324] Where there are more than one businesses, the place where the principal business is situate is used to determine the court having jurisdiction in this case.[325] However, the fact that the principal place of business is abroad and a foreign court has exercised bankruptcy jurisdiction does not preclude Ethiopian courts from exercising jurisdiction, subject to international conventions.[326]

The following, however, are not addressed: whether or not bankruptcy of a branch business would affect other branches or the principal business; whether or not the bankruptcy of a holding company would affect a subsidiary company or vice versa; and which court would take jurisdiction where there are more than one branch offices in Ethiopia where a principal business is found abroad. As Ato Taddesse and Ato Israel argue, could that mean multiple bankruptcies are allowed?[327]

On whether Ethiopia needs specialized bankruptcy courts Ato Taddesse and Ato Israel argue that there is no need for specialized bankruptcy courts at the moment and that bankruptcy cases may be handled by commercial divisions of federal courts. I support their argument. I, however, believe that judges who handle such cases should be given special training so that they know how to go about them.[328]This could be a special training like the bankruptcy training given for (Federal) judges, a few years back.[329]

Once a petition is submitted to it for the declaration of bankruptcy, the court, after ascertaining that it has jurisdiction, may make preliminary investigation.[330] The preliminary investigation is to be conducted by a court-appointed judge who may be assisted by a trustee.[331] Ato Tadesse and Ato Israel say that the investigation should be performed by an 'appropriate expert' instead of a judge. I, however, think that the investigation should be performed by a judge but the judge should be assisted by an

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[323] Commercial Code, Supra note 1, Article 974(1).
[324] Id, Article 1157(1).
[325] Ibid.
[326] Id, Articles 974(2) and 1157(2).
[327] Tilahun Teshome and Taddese Lencho, Supra Note 2, P.89.
[328] It was not until recently that the Law of bankruptcy is being given as a course in the Ethiopian law schools. In fact, I myself did not take the course as an undergraduate student.
[329] Interview with Ato Mesfin, attorney at law and a former Federal judge, conducted on June 20, 2011.
[330] Commercial Code, Supra note 1, Article 976.
[331] Id, Article 976(1 and 2).

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'appropriate expert' instead of a trustee. This is because the trustee is yet to be appointed after the debtor is declared bankrupt as per article 981 of the Commercial Code. Besides, the purpose of the investigation is to check the veracity of the allegation that the debtor is bankrupt. And, this could be achieved by the judge using the appropriate expert.

Countries like Germany, France and England give the exclusive control of the proceeding to a preliminary administrator[332] who makes the initial decision whether the firm will be liquidated or remain in operation while a reorganization plan is formulated.[333] Others prefer to direct the manager with an impartial and independent administrator who assumes complete power if management proves incompetent or negligent or has engaged in fraud or misbehavior.[334] And countries like the U.S. give managers the right to choose between filing for bankruptcy liquidation or reorganization together with exclusive power to propose a reorganization plan.[335]

B. The Bankruptcy Administrators

Bankruptcy Administrators are given different names in different legal systems like, "trustees, liquidators, administrators, supervisors, receivers, curators, official or judicial managers, commissioners or promoters."[336] They could also be individuals, corporations or other separate legal entities.[337] The World Bank Principles require that administrators should act with independence, impartiality, and integrity and be competent to exercise the powers given to them.[338] "In many jurisdictions, it is the court that selects, appoints and supervises the representative."[339]

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[332] Basic Provisions of German Insolvency Law. Available from World Wide Web: <http://www.abiworld.org/committees/newsletters/international/vol1num3/ReorgEuroUnion1.pdf> [Visited August 20, 2011].

[333] Araujo, Aloisio and Funchal, Bruno. Past and Future of the Bankruptcy Law in Brazil and Latin America, *Ensaios Economicos* , 2005, P. 3.Available from World Wide Web: <http://bibliotecadigital.fgv.br/dspace/bitstream/handle/10438/656/1922.pdf?sequence=1 >[Visited February 23, 2011].

[334] Ibid.

[335] Ibid.

[336] World Bank, Supra note 17, P. 61. Principle 35.

[337] Ibid.

[338] Ibid.

[339] UNCITRAL, Supra note 18, P. 177(Para 45).

i. The Commissioner

In Ethiopia, the Commissioner is appointed by the court.[340]He or she is entrusted with the duty to supervise and deal with all matters concerning the bankrupt estate; take the necessary measures to preserve the assets of the bankrupt estate; call the creditors' committee and authorize the trustee to appoint assistant unless such is reserved to the trustee; and authorize the trustee to enter appearance in legal proceedings.[341]

As to the eligibility of a commissioner, Article 993 of the Commercial Code provides a clue. It reads: "[t]he court may at any time of its own motion replace a Commissioner by another of its members." This is an indication that a commissioner is appointed from among judges. In addition, the Amharic version of the Commercial Code literally translates the word Commissioner as an 'investigating judge'. Thus, Article 993 and the Amharic version of the Commercial Code show that a Commissioner is a judge.

As the commissioner is a judge under the Ethiopian legal system, the qualities of the commissioner is that of a judge. However, these are not the only qualities that a Commissioner should have and as the UNCITRAL Legislative Guide provides, the commissioner should have a range of qualities which include personal qualities and knowledge and experience in the field.[342] Thus, the qualities of the judge should be accompanied by special kind of training to know the technicalities of the duties of a commissioner.

ii. The Trustees

According to Article 994(1) of the Commercial Code, trustees are appointees of the court selected from a list of qualified persons of good repute residing in Ethiopia. They shall not exceed three in number although the commissioner shall move the court to replace the trustees when trustees are in contravention of their responsibilities under Book V of the Commercial Code.[343]

Even if they are of good conduct, the following are not to be appointed trustees:[344] persons who have been declared bankrupt; or persons who have been deprived of civil

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[340] See Commercial Code, Supra note 1, Article 981.
[341] See Id, Article 991.
[342] UNCITRAL, Supra note 18, P. 174-176(Paras. 36-43).
[343] See Commercial Code, Supra note 1, Article 994(2) and Article 999.
[344]Id, Articles 994(4).

rights;[345] or relatives by consanguinity or affinity of the debtor to the fourth degree inclusive: or creditors.

The Ministry of Commerce and Industry (currently, the Ministry of Trade and Industry) is authorized to prepare a list of potential trustees each year. However, such list has not yet been prepared by the Ministry.

Practice has, however, revealed that it is the parties that recommend the Commissioner and the court does not give a ruling unless the parties disagree on the issue.[346]

In the US, trustees are bankruptcy administrators and part of the US Department of Justice.[347] They ensure the integrity of the system playing an oversight role.[348] It is the belief of the writer that either the Ministry should prepare the list or Ethiopia should follow the US experience.

When it comes to functions of trustees, article 995(1) provides that they have the power to administer the bankrupt estate under the supervision of the commissioner and they represent the universality of creditors in relation to third parties. They shall be removed when they fail to deposit funds received by them as per Article 996(1) of the Code, fail to take the necessary care in the exercise of their duties, fail to keep register of their day to day activities, and take payment of or fail to refund money other than costs and fees, subject to civil sanctions or criminal penalties.[349]

Generally speaking, it seems, much attention is given under the Code to the institution of trustees than commissioners to the satisfaction of both the World Bank Principles and the UNCITRAL Legislative Guide.

C. The Creditors

Under the Ethiopian Bankruptcy law, creditors are represented by a committee. The creditors committee consists of three or five creditors chosen from among all the

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[345] Civil rights are those rights related with the right to life, movement, work, etc.

[346] Tsegai Bekele, Supra note 3, P. 40. And interview with Ato Adiam Seghed Atnafe, a Public Prosecutor at the Ministry of Justice, Conducted on June 26, 2011.

[347] Plumb, George T. and Irving, James R. Bankruptcy and Reorganization (Laws 713) Class Packet, Part I and Part II, P.3.

[348] Ibid.

[349] See Commercial Code, Supra note 1, Article 996(2),1000(1)-(2) and 1001(4).

creditors no later than ten days after the list of creditors is deposited with the registrar of the court.[350]

In addition to giving advice, the main function of Creditors' committee is to verify the accounts and statement of affairs prepared by the debtor and to supervise the acts of the trustees.[351]

They may also require information on the state of the bankruptcy proceedings and about receipts and payments.[352]

The chairman of the committee is appointed by the commissioner and he calls the committee whenever its advice is needed or he considers a meeting is required.[353] The decision of the committee is by a majority vote and members of the committee are liable if they were grossly negligent.[354] With regard to removal of the members of the committee, a relative by consanguinity or affinity of the debtor up to the fourth degree inclusive, is not allowed to be a member in the first place.[355] Although they are chosen by the commissioner, the members can only be removed by the court and the role of the commissioner is limited to proposing the same to the court.[356] They may however be replaced by the commissioner upon their own request.[357] The committee shall be consulted by the trustees in relation to all legal proceedings. Members are not entitled to remuneration except the reimbursement of expenses when approved in writing by the commissioner.[358]

It is the creditors whose interests are represented by the creditors' committee. However, reserving the right to choose the members of the committee to the commissioner is a wise choice since the commissioner is in a better position than the creditors to choose qualified members from among the creditors.

However, Creditors' Committee seems to lack real power as its role is limited to giving advice unlike the UNCITRAL Legislative Guide that requires creditors to play

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[350] See Commercial Code, Supra note 1, Article 1002 (1) and (3).
[351] See Id, Article 1003 (1) and (4).
[352] See Id, Article 1003 (5).
[353] Id, Article 1002(3) and1003(2).
[354] Id, Article 1003(3) and (6).
[355] Id, Article 1002(5).
[356] Id, Article 1002(1) and (4).
[357] Id, Article 1002(4).
[358] Id, Article 1003(5) and (7).

a role in 'recommending and selecting' bankruptcy representatives that meet the necessary qualifications and 'fixing or approving' the remunerations of the representatives.[359]

4.4.3. Effects of adjudication in bankruptcy

A. General

The adjudication of bankruptcy has effect on different individuals especially the debtor and his creditors. There are also parties that are affected remotely as will be discussed later in this section. The court, in the above mentioned case, emphasized that caution has to be taken in declaring a debtor bankrupt. To use the words of the judge:[360]

The effects of declaration of bankruptcy are far reaching. The properties of the debtor are taken away from his administration; the proceeds of the sale of the property are given for the creditors and the debtor is to take the leftovers, if any; and the business is liquidated and cancelled from the commercial register. That is why the court has to be very careful and certain in declaring a business bankrupt.

B. On the Debtor

The UNCITRAL Legislative Guide provides that there should be proper identification of the estate of the debtor that will be subjected to bankruptcy and some properties should be left out if the debtor is a natural person.[361] Under the Ethiopia Bankruptcy Law, the adjudication of bankruptcy has both positive and negative effects on the debtor. The negative effect is that: first, he is subject to such prohibitions or forfeitures as are provided by law in addition to the restriction of movement from his place of residence without the permission of the Commissioner.[362] Second, the debtor is allowed neither to administer nor dispose of his property once he is declared bankrupt until he is discharged.[363] The other bad news is all debts owing to the debtor become due although the interest stops running from this day on unless the debts are guaranteed by security in rem.[364]

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[359] UNCITRAL, Supra note 18, P. 177(Para 47) and P.182(Para 56).
[360] Tsegai Bekele, Supra note 3, P.59.
[361] UNCITRAL, Supra note 18, P. 82 Recommendations 35-38.
[362] Commercial Code, Supra note 1, Article 1019 and 1022.
[363] Id, Article 1023.
[364] Id, Article 1027(1) and 1028.

In the US, two principal grounds historically justified the exclusion of some of the property of the debtor from the reach of creditors.[365] First, ensuring that the debtor continues to live as a 'productive' member of the society, i.e., financial rehabilitation.[366] Therefore, "early exemption laws protected tools of the trade (those tools and implements necessary for carrying on a trade or business."[367] With the expansion of economies the goals of exemptions were broadened to include humanitarian and, in fact, economic aspects.[368] That is, protecting debtors and their dependents from destitution and shifting the burden/cost of assisting the debtor and his families from the state to creditors.[369]

Second, the debtor sits back from the administration of his business when he is declared bankrupt and in many instances his attendance is not required.[370] In addition, although some countries like Poland and Taiwan restrict the movement of a bankrupt debtor under their bankruptcy laws, such a restriction is not a feature of modern bankruptcy laws.[371]

As Ato Tadesse argues, I do not think that the debtor should always be restricted of his freedom of movement at all times, and this should be left to the discretion of the court to decide on a case by case basis. This is due to the fact that the debtor may be a "victim of unfortunate turn of events and finds himself in bankruptcy".[372]

The good news is, there is a chance that part of the bankrupt estate would be used to support the debtor and his family and the debtor could be employed although it is only for facilitating the winding up of the business. [373]

The other effect is that, the judgment in bankruptcy creates what is called the 'universality of creditors' which has the effect of preventing creditors from bringing an individual suit and/or attaching the debtor's property.[374] This is, however, with the

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[365] Bartell, Laura B. *The Peripatetic Debtor: Choice Of Law And Choice Of Exemptions*, 22 Emory Bankruptcy Developments Journal, (2006), P. 402.Available from World Wide Web: < http://www.law.emory.edu/fileadmin/journals/bdj/22/22.2/Bartell.pdf >[Visited February 23, 2011].
[366] Id, P. 403.
[367] Ibid.
[368] Ibid.
[369] Ibid.
[370] Ibid.
[371] Ibid and Id, foot note 99.
[372] Tadesse Lencho, *Ethiopian Bankruptcy law: A commentary (part II)*, 24 Journal of Ethiopian Law 2, (2010), P.22.
[373] Commercial Code, Supra note 1, Article 1020 and 1021.
[374] Id, Article 1025(1) and 1026.

exception of creditors whose claims are not secured by a special privilege, a pledge or a mortgage; as these creditors do not form part of the universality.[375]

Ethiopian law seems to include provisions to safeguard the interests of the debtor; however, the fact that the debtor is subjected to different 'prohibitions or forfeitures' in addition to the prohibition of movements would categorize the law as favoring creditors.

C. Effects as Regards Creditors

Not only the debtor but also the creditors are affected by the adjudication in bankruptcy. Although the bankruptcy of the debtor is not good news as such, the effect could be either bad or worse based on the pre relationship that a certain creditor has created with the bankrupt debtor. For instance, an unsecured creditor is in a worse situation than a secured creditor as the proceeds of the sale of the assets of the debtor are paid to a secured creditor before the unsecured creditor.

The effects of bankruptcy on the creditors are briefly discussed in the following sub-sections.

I. Avoidance of some acts of the debtor

The debtor may engage in some acts with some creditors that are detrimental to the interests of other creditors in whose interest the act is not performed. In other bankruptcy laws, like the US, these are termed as preferences, setoff, fraudulent transfers and post petition transfers.[376]

In this regard, Article 1029 of the Commercial Code provides that, creditors of the bankrupt are not to be affected if the debtor has carried out the following acts between fifteen days before the date of suspension of payments and the date of adjudication. These are gratuitous assignments; payments of debts not due, whatever the form may be; payments of debts due either by transfer to a bank or by negotiable instruments, but not in cash; and securities set up on the property of the debtor for debts contracted before the setting up of the security.[377] Invalidation of other acts requires knowledge

[375] Commercial Code, Supra note 1, Article 1025(1)
[376]. Blum, Brian A. Bankruptcy and Debtor/Creditor: Examples and Explanations, Third Edition, Aspen Publishers, 2004, New York. P.325.
[377] Commercial Code, Supra note 1, Article 1029.

as to suspension of payments on the part of the creditors who have dealt with the debtor or received payment for a due debt.[378]

The 'fifteen days before the date of suspension of payments' under Article 1029 is too general and too short. Too general in the sense that it does not discriminate among creditors and too short in the sense that a longer period of time should have been provided to differentiate the valid acts of the debtor from the rest. In the US, for instance, the date is 90 days before the date of petition[379] and it is one year before the date of petition for insiders.[380]

In addition, there is no mention of who shall apply for the invalidation of these acts under the Commercial Code. Are they automatically invalidated or an application for their invalidation must be presented to the court? As is evident from the words of Articles 1030 and 1073-1080, we may say that a request has to be submitted to the court and it is the trustee that shall apply for their invalidation. However, experiences of other countries show that creditors and even the debtor can initiate the invalidation.[381] This should be followed as it would be fair for all stakeholders to have their interests preserved.

It would be wise to have registered a right arising out of securities in rem when the act creating the security is contracted. This is in fear of invalidation if the registration is effected either after adjudication or after suspension of payments or within one month before suspension of payments in case of registration showing a gap of more than one month between the act creating the security and the date of registration.[382]

Invalidation of a security by a mortgage on an immovable or on the business is good news for the creditor who ranks next (the discussion shortly follows in the next sections), as he would substitute himself for such creditor in the distribution of the price of the immovable or of the business.[383] He would, of course, give back to the

[378] Commercial Code, Supra note 1, Article 1030.
[379] See the US Bankruptcy Code, Article 547.
[380] Id, Article 101.
[381] Plumb, George T. and Irving, James R., Supra note 347.
[382] Commercial Code, Supra note 1, Article1031.
[383] Id, Article1032.

bankrupt estate the difference between the sum distributed to him and the sum which he would have received, had the prior secured claim not been invalidated.[384]

As regards the invalidation of negotiable instruments, proceedings for reimbursement can be brought when the payment is effected between the date of suspension of payments and that of adjudication.[385] An action for the invalidation can, however, be brought against only the third party having first received (the first endorser in case of promissory note) the value of the instrument and the burden of proof as to knowledge of suspension of payments lies on the claimant.[386]

Two years is the period of limitation to bring proceeding for the invalidation of acts or payments under Articles 1029, 1030 and 1031 of the Commercial Code.[387] The starting date is the date of adjudication while the date of petition is taken into consideration in the US.[388]

In this regard, the law has dealt, in detail, with the acts of the debtor that might have negative consequences for some creditors in relation to the others. This is, however, without forgetting the shortcomings under the 'fifteen days' requirement and the persons authorized to apply for invalidation of the acts of the debtor.

II. Priority Rule as Regards Payment to Creditors

The interest of all creditors is to be the first to be paid and to get paid in full. However the bankrupt's estate may not be sufficient to satisfy the claims of everybody. Thus, the law prioritizes among creditors until the bankrupt estate is exhausted.

As to the UNCITRAL Legislative Guide, the law should require creditors to submit their claims using different means and specifying the 'basis and amount of the claim'.[389] In Ethiopia as well, before payment is effected to creditors of any class (as in secured or unsecured or preferred), they must show that they have a valid claim against the bankrupt estate. Failure to prove ones claim against the debtor or failure to appear within the prescribed period of time results in loss of the right at all or loss of

[384] Commercial Code, Supra note 1, Article 1032.
[385] Id, Article1033(1).
[386] Id, Article1033.
[387] Ibid.
[388] Plumb, George T. and Irving, James R., Supra note 347.
[389] UNCITRAL, Supra note 18, P. 263. Recommendations 169-184.

one's rank or loss of the right to receive from a distribution if creditors of such kind are found within the same class.[390]

Once the debts are admitted and registered even provisionally, it is then the duty of the administrators of the bankrupt estate to effect payment to creditors as per priority that the creditors receive either through the law or by way of contract.[391]

Article 1110 is the basis for establishing priority in paying creditors. Other clues as to priority are found in a section that is more of procedural than of substance (the chapter on proving of debts, Articles 1041-1080) and in other parts of the Book.[392] The Article says after the deduction of: (a) costs and expenses ; (b) sums applied, for the support of the debtor or his family; and (c)sums paid to preferred creditors; the rest is to be given to all the creditors in proportion to their proved and admitted debts subject to the provisions of Articles 1065, 1066 and 1068.

The questions that are not answered by Article 1110 are: one, do secured creditors rank before those in the list or after them? Two, who are preferred creditors? Three, do the ones mentioned from a-c rank equally or priority is based on alphabetical order? Questions as to the rank of employees of the business including the ones employed by the trustee (as they are necessary inputs if the continuation of the business is authorized), the trustees themselves, and taxes due to the government are not dealt with by the Code.

i. Secured Creditors

These are the class of creditors that fall outside of the universality of creditors and had their claims secured by a special privilege, pledge, or a mortgage. [393] Hence, they are to be paid out of the proceeds of the sale of the property that is encumbered and the automatic stay is not applicable against them but they have to prove their claims, of course.

In fact, these creditors having secured their claims by pledge or mortgage are entered in the inventory of creditors only for purposes of information and they have every right to claim the property encumbered unless the trustees paid the secured creditor in

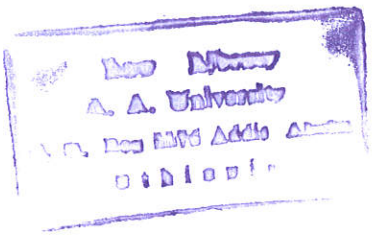
[390] See Commercial Code, Supra note 1, Articles 1041-1054 in general.
[391] Tadesse Lencho, Supra note 372, P. 60.
[392] See Commercial Code, Supra note 1, Article 1025(1).
[393] Ibid.

full and redeemed the property.[394] However, the secured creditor has the obligation to return the sum exceeding the amount of the debt and would be among the unsecured creditors where there is a negative difference between the price of the sale and that of the debt claimed.[395]

On the ranking of claims the UNCITRAL Legislative Guide recognizes the existence of countries that rank secured creditors in the first place.[396] There are also others that give the first priority to administrative costs and other claims,[397] such as "unpaid wage claims, tax claims, environmental claims and personal injury claims"[398] instead of the secured creditors.

Others, on the other hand, give the first priority to the secured creditors but limit the amount that can be recovered in priority to a certain percentage, leaving the rest of what is recovered to pay other creditors whatever their rank maybe.[399] An equitable share in the losses/costs of liquidation/reorganization among creditors is among the rationales for adopting such kind of rankings.[400]

However, such kind of exception to the rule of first priority of secured creditors creates uncertainty as to recovery of secured credit and discourages provisions of such kind of credit.[401]It would be better to make secured creditors contribute to cover the costs or expenses incurred if such are directly related to their interests.[402] That is, if a cost is incurred in maintaining the encumbered asset or if they have approved post-commencement finances.[403] I believe Ethiopia should follow suit as it seems reasonable to reward a creditor for going all the trouble of securing his/her claim without however leaving them unpunished if a cost is incurred for administering their securities.



[394] Commercial Code, Supra note 1, Article 1058, 1065, and 1069.
[395] Id, Article 1059,1067(2) and 1071(2).
[396]UNCITRAL, Supra note 18, P. 269(Para 62).
[397] Id, Para 63.
[398] Ibid.
[399] Ibid.
[400] Ibid.
[401] Ibid.
[402] Id, P. 270(Para 65).
[403] Ibid.

Under the Banking Business Proclamation No. 592/2008, priorities in payment of claims are dealt under Article 45. Accordingly, the first priority is given for secured creditors in accordance with their terms with the bank.[404]

ii. Costs and Expenses

The Commercial Code does not only generally say costs and expenses but also fails to mention what is included or excluded from the 'Costs and Expenses'. The UNCITRAL Legislative Guide could be of use in that it not only qualifies them as administrative costs and expenses but also defines them to include: "remuneration of the insolvency representatives and any professionals employed by them or even the debtor, costs arising from continuing contract obligations; costs of the proceeding; and under some insolvency laws, the remuneration of any professionals employed by a committee of creditors."[405] These are given priority next to the secured creditors under the Legislative Guide. The same is true under the Banking Business Proclamation No. 592/2008 where the remuneration of the receiver and necessary and reasonable expenses incurred by the receiver are paid after secured creditors.[406]

This being a satisfactory inclusion, I believe that employee salaries should be included in this class where the continuation of the business is authorized. This is because the employees may not be willing to work for a 'bankrupt' business unless there is some kind of incentive in the form of a priority next to secured creditors.

As the debtor and his families are given some part of the estate to support themselves, it would be unreasonable to put him/her at this part of the ladder whenever he/she is employed. Thus, what is to be left for supporting the debtor and his dependants should be given priority even before the secured creditors.

iii. Preferred Creditors

The Commercial Code uses words like 'preference'[407] or 'preferred' with regard to certain creditors. These creditors are given priority before unsecured creditors. Now the query remains as to what kind of creditors they are. We can take instances in the Code where such kinds of creditors are mentioned, to exemplify who the members of this class are.

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[404] See the Banking Business Proclamation, Supra note 276, Article 45(1).
[405] UNCITRAL ,Supra note 18, P. 270(Para. 66).
[406] See the Banking Business Proclamation, Supra note 276, Article 45(1)(a).
[407] Commercial Code, Supra note 1, Articles 1060, 1061 and 1063.

a. The Lessor

Articles 1060 and 1061 of the Commercial Code are relevant in this regard. The lessor could exercise preference in two conditions: first, where the lease is terminated, the lessor can exercise his preference for the two years of the lease prior to the adjudication of bankruptcy and for the current year but only as regards all claims arising out of the performance of the contract of lease and contingent damages.[408]The preference in this case extends to a period of extra one year after the end of the current year where movables furnishing the premises leased are sold and removed.[409]

However there should not be a preference for payments of any rent for the current period and for any rent to fall due, if the lease is not terminated and all rents due are paid in full, the guarantees given on the making of the contract are still in force or those given since the adjudication of bankruptcy are considered to be sufficient.[410]

The provisions of these articles show that the lessor may either be preferred or un-preferred based on the reasons mentioned in the provisions.

b. Creditors whose claims arose as a result of the continuation of the operation of the business

As per Article 1039(2), creditors whose claims arose as a result of the continuation of the operation of the business join the universality of creditors and shall be paid before others in this class. But do they stand equal to the lessor, when the lessor is not the only one who has claims as a result of the continuation of the operation of the business?[411] The Commercial Code does not clearly answer this question.

Under the Banking Business Proclamation No. 592/2008, creditors who extended new credit to the bank after the appointment of the receiver are placed before the claims of employees and taxes.[412]

As per the UNCITRAL Legislative Guide the priority or privileged claims are placed next to administrative costs and expenses and are often based on social and sometimes

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[408] Id, Article 1060(1).
[409] Id, Article 1061.
[410] Id, Article 1060(2).
[411] Commercial Code, Supra note 1, Article 1039(2).
[412] See the Banking Business Proclamation, Supra note 276, Article 45(1)(b).

political considerations and operate to the detriment of ordinary unsecured creditors as they reduce value of the assets available for their distribution.[413]

Unlike the Ethiopian bankruptcy law that puts the lessor and creditors whose claims arise as a result of the continuation of the business as creditors of this class, the Legislative Guide selects two categories that are particularly relevant,[414] although cognizant of the many different approaches taken to the types of claim that will be afforded priority.[415] These are: employee salaries and benefits; and tax claims, respectively.[416]

Thus, resort is made to the labor and tax laws so as to ascertain the status of these claims. As per Article 24(4) of the Labor proclamation, contract of employment could be terminated due to the bankruptcy of the employer and "any claim of payment of a worker arising from employment relationship shall have priority over other payments or debts."[417]

Does this mean employee salaries rank before or after secured creditors? Or even if they rank after secured creditors do they rank before all other creditors?

As to the priority of value added and income taxes, the relevant Proclamations provide that "from the date on which tax becomes due and payable under this proclamation, subject to the prior secured claims of creditors, the Authority has a preferential claim upon the assets of the person liable to pay the tax until the tax is paid."[418]

As to the rank of tax claims the law refers to those claims that have secured their claims by another and gives itself a second lien on the assets of the debtor if there are prior secured creditors. Thus, if the assets of the debtor are exhausted, then the claims of the tax Authority would be among the universality of creditors.

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[413] UNCITRAL ,Supra note 18, P.270(Para. 67).
[414] Id, Para. 71.
[415] Ibid.
[416] Ibid .
[417] Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia. 10th Year No. 12, Labour Proclamation No. 377/2003, Addis Ababa, February 2004. Article 167.
[418]Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia. 8th Year No. 33. Value Added Tax Proclamation No. 285/2002, Addis Ababa. July 2002. Article 32(1), and Income Tax Proclamation, Supra note 308. Article 80(1).

As to the priority of claim on tax withheld, Article 82(1)(c) of the Income Tax Proclamation No. 286/2002 provides that: " in the event of liquidation or bankruptcy of the withholding agent, does not form part of the estate in liquidation, assignment, or bankruptcy and the Tax Authority has a first claim before any distribution of property is made."

Some states put the status of employee claims at par with tax claims while others rank them equal with unsecured claims.[419] A number of reasons are put forward in support of priority for tax claims. First, it can protect public revenue[420], second, "it can be beneficial for reorganization because tax authorities will be encouraged to delay the collection of taxes from a troubled business on the basis that eventually they will be afforded a priority payment",[421] and because the government is a non commercial and unwilling creditor, it may be precluded from some commercial debt recovery options.[422]

As per the Banking Business Proclamation No. 592/2008, outstanding salaries and other benefits of non-managerial staff of the bank, for the three month period preceding the effective date of the receivership, are given priority next to employee salaries followed by deposits and taxes.[423]

These laws show that there is a discrepancy among them as to the priority in the payment of claims.

iv. Universality of Creditors

These are the creditors of the bankrupt estate that did not have their claims guaranteed by a security of some kind or another. In this class, the secured creditors are also included if their security was not enough to cover the whole of their claims. They are however considered as ordinary unsecured creditors.[424]

Although it does not say that they are ordinary, the Banking Business Proclamation No. 592/2008 provides that the group of creditors that rank next to the tax claim are,

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[419] UNCITRAL ,Supra note 18, P. 273(Para.73).
[420] Ibid.
[421] Ibid.
[422] Ibid. But provisions of priority for such claims is criticized among other things for compromising the uniform enforcement of tax laws.
[423] See the Banking Business Proclamation, Supra note 276, Article 45(1)(c)(d)and(e).
[424] Commercial Code, Supra note 1, Articles 1059,1068 and 1072.

other claims,[425] interest of claims,[426] claims that were not filed within the prescribed period of time,[427] and finally, claims of shareholders.[428]

Concerning the rank of unsecured creditors, the UNCITRAL Legislative Guide discuses about claims that are subordinated[429] to the ordinary unsecured claims.[430] These are owners and equity holders[431] preceded by related persons[432] and fines, penalties and post commencement interest.[433]

4.4.4 End of the Bankruptcy Proceeding

A. General

Under the Commercial Code, the bankruptcy proceeding could come to an end because of the following reasons. The first one is when the case is settled by a composition or compulsory winding up.[434] The other is when the bankruptcy proceeding is closed due to insufficiency of asset, or the final distribution of the product of the winding up, or absence of any claim against the estate.[435] The Code also provides for alternatives to liquidation under the provisions dealing with schemes of arrangement.[436] As will be seen shortly, composition suspends winding up and is

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[425] Commercial Code, Supra note 1, Article 45(1)(f). Maybe, salaries of managerial staff would fall within this group.
[426] Id, Article 45(1)(g)
[427] Id, Article 45(2)
[428] Id, Article 45(4)
[429] As per UNCITRAL, Supra note 18, P.268 (Para.56) subordination refers to a rearranging of the creditors' priorities and does not relate to the validity or legality of a claim. A subordinated claim maybe valid and enforceable, but, because of an agreement of a court decision, it will be paid latter in the distribution scheme than it would otherwise be paid.
[430] UNCITRAL, Supra note 18, P.277 (Para.75).
[431] It is acceptable under man insolvency laws that the owner and equity holders of the business are not entitled for payment up until other senior debts have been paid in full. See Id, P.273(Para. 76).
[432] When they are subordinated, they are paid once unsecured creditors are paid in full. They are treated differently under different countries. Some always, subordinate these claims while others subordinate them only where there is fraudulent quasi-fraudulent or inequitable conduct. While other connect them to issues like voting rights rather than ranking. See Id, P.274(Para. 77).
[433] Some states treat claims such as gratuities and fines and penalties (whether administrative, criminal or of some other type) as ordinary unsecured claims and subordinate them to other unsecured claims. In some insolvency laws these types of claim are treated as excluded claims. Different approaches are taken to the accrual and payment of interest on claim. Some insolvency laws provide that interest on claims ceases to accrue on all unsecured debts once liquidation proceedings have commenced, but that payment in reorganization will depend upon what is agreed in the plan. In other cases, where provision is made for interest to accrue after commencement of proceedings, payment may be subordinated and it will be paid only after all other unsecured claims have been paid.
[434] See Commercial Code, Supra note 1, Articles 1081-1112.
[435] Id, Article 1113.
[436] Id, Articles 1119-1153 and 1154.

similar to schemes of arrangement.[437]Hence, it would be better if the provisions on composition are incorporated into the provisions on schemes of arrangement.

B. Closure of Bankruptcy Proceedings

The bankruptcy proceeding could be closed for reasons of insufficiency of asset, or the final distribution of the product of the winding up, or absence of any claim against the estate.[438] The last two reasons have the effect of bringing the bankruptcy proceedings to an end and of restoring the debtor to his full rights.[439] On the other hand, the first means of closure results in the restoration of each creditor to the exercise of his personal rights but the debtor will not be restored back but remains dispossessed of his property and its administration. Furthermore, any new debts contracted by him may not be set up against the estate in which no further creditors may prove.[440]

The stand taken by the Code in restoring the creditors to their original position while leaving the debtor dispossessed of his/her properties is not only unfair to the debtor but also not cognizant of who should cover the costs of administration of the debtor's properties in such cases. Of course, the debtor or any other interested party may at any time apply for revocation of the closure order given by reason of insufficiency of assets by proving that there are sufficient funds or depositing sufficient funds to meet the costs.[441] But, I do not think that the court should allow such an application just because there are funds to meet the costs of the proceeding. There has to be an additional fund to the one that can be used to cover such costs.

For the debtor, "bankruptcy is an institutionalized form of forgiveness, providing borrowers with relief (whether in whole or in part) from their obligations if a business venture fails.[442] However, questions as to whether the closure of the bankruptcy would discharge the debtor for good or not is not covered under the Commercial Code. However, it should be a means for the discharge and a new start for the bankrupt debtor. Otherwise, it would be a disincentive for an honest debtor to file for bankruptcy.

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[437] Commercial Code, Supra note 1, Article 1081(3).
[438] Id, Article 1113.
[439] Id, Article 1117(2).
[440] Id, Article 1114(2)and(3).
[441] Id, Article 1115(1).
[442] Booz/ Allen/Hamilton, Supra note 4, P.52.

C. Alternatives to Liquidation

As alternatives to bankruptcy, the Commercial Code provides for composition and scheme of arrangement. A composition comes into picture when the debtor who has already been declared bankrupt makes a proposition to the Commissioner specifying the percentage offered to unsecured creditors and the period of time required for payment.[443] The proposition must also show the guarantees to cover the payment of debts, legal cost and the remuneration of the trustees.[444] The commissioner must in such cases seek the advice of the trustee and creditors' committee to be notified through a registered letter.[445] The letter must show a period not less than twenty days and not more than thirty days within which the dissenting creditors may file with the registry their refusal to accept the proposed composition.[446] The creditors would then take a vote and the proposal for a composition would be of no effect unless it is approved by two thirds of the creditors representing two-thirds of the debts.[447]

A scheme of arrangement comes into picture when a trader who has or is about to suspend payment and has not been declared bankrupt applies to a court of law for the opening of the same.[448] The application for a scheme of arrangement reorganization can only be accepted by the court if it includes the balance sheet of the firm, the profit and loss account, a list of commercial creditors and debts, with the names and addresses of the creditors and debtors.[449] The debtor must file these documents together with a report giving the reasons for his suspension or impending suspension of payments, and the reasons for his proposing a scheme of arrangement.[450] The debtor shall also show that: he has been registered in the commercial registry, he has been keeping proper accounts, he has not been declared bankrupt nor made scheme or reorganization, and he has not been convicted of offences under Articles 680-688 of the Penal Code (currently Articles 725-733 of the Criminal Code).[451]

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[443] Commercial Code, Supra note 1, Article 1081(1)(2).
[444] Id, Article 1081(2).
[445] Id, Article 1082(1)and(2).
[446] Id, Article 1082(5).
[447] Id, Article 1084(1).
[448] Id, Article 1119.
[449] Id, Article 1120(1).
[450] Id, Article1120(2).
[451] Id, Article 1120(3).

The parties involved in the process of scheme of arrangement are; the debtor, the delegate judge, the commissioner and the creditors.[452] The court is also involved in processing the application and in giving the final confirmation for the scheme of arrangement.[453]

The Commissioner supervises the whole process, particularly, he has the duty to prepare the inventory of the debtor's estate, check the list of debtors and creditors and prepare a detailed report on the affairs and conduct of debtor, on the proposed scheme and the guarantees offered to creditors.[454]

According to Article 1136(1), the creditors should consider the scheme in a meeting chaired by the delegate judge. The scheme of arrangement must be approved by a majority of creditors representing not less than two-thirds of all non-preferred or unsecured debts.[455]

As per Article 1132 of the Commercial Code, although under the supervision of the commissioner and the delegate judge, the debtor manages his business during the course of the proceedings of the scheme of arrangement.

Article 1131(1) provides that after the application has been made and until the final confirmation of the scheme, no creditors holding a claim arising prior to judgment may disdain, acquire a preferred right over the debtor's property or register a mortgage, although the creditors have the right to vote against the granting of the application of the debtor for a scheme of arrangement.[456] Prescriptions, peremptions, and forfeitures are also suspended.[457] On the other hand, gifts and other gratuitous acts or acts by way of guarantee done by the debtor during the proceedings shall not affect the creditors.[458]

Other countries also provide for even more alternatives than what is provided for under the Ethiopian Commercial Code. For instance, the English Bankruptcy System, generally, provides five procedures for a debtor in financial difficulty. These are; voluntary arrangement, scheme of arrangement, appointment of administrator,

[452] Commercial Code, Supra note 1, Article1125(2)(a)and (b).
[453] Id, Article 1119 and 1131.
[454] Id, Article 1135.
[455] Id, Article1140(1).
[456] Ibid.
[457] Id, Article 1131(2).
[458] Id, Article 1133.

appointment of an administrative receiver or receiver and liquidation or winding up of the debtor's company.[459] Generally, voluntary arrangement and schemes of arrangement are procedures designed to assist a debtor to reach agreement by way of compromise with its creditors.[460]On the other hand, administrative procedure is a procedure that is used to rescue the debtor.[461] Whereas receivership and liquidation are signals that the debtor has no future and all that can be sought is the maximization of the proceeds of the sale of its assets or business,[462]

In France, seven types of procedures are available, although some are more utilized than the others.[463] These are, from the most involved to the least invasive, liquidation proceedings, reorganization proceedings, safeguard proceedings, conciliation, compromise arrangement procedure specific to farming businesses, the ad hoc representative, and alert procedures.

From these procedures, the last five are the ones that catch one's eyes. "Conciliation" is a procedure that is requested only by the debtor whereby the debtor and creditors could reach to an agreement to defer the payments or reduce the amounts due to the creditors through the supervision of a court appointed conciliator.[464] "Compromise arrangement" is a kind of conciliation procedure applicable only to agricultural businesses.[465] The procedure has specific characteristics. For example, a creditor can request that the debtor submit to a compromise arrangement procedure.[466] "Ad hoc representative" is a procedure whereby a debtor who is not in a 'payment failure situation'[467] requests the court to appoint an ad hoc representative that would play the role of a conciliator but not bound by the procedural rules that attach to a conciliation procedure.[468]

"Safeguard proceedings" is a variation on the judicial reorganization and inspired by the US Chapter 11 proceedings.[469] This is invoked by a debtor who is not yet in a

[459] Slaughter and May, Supra note 215,P. 1.
[460] Ibid.
[461] Ibid.
[462] Ibid.
[463] Tetley, Andrew, Smith, Reed and Bayle, Marcel. Supra note 187, P. 200.
[464] Id, P. 196.
[465] Id, P.197.
[466] Ibid.
[467] 'Payment failure situation' is defined under Article L.631-1 of the French Commercial Code as the situation where a debtor company is unable to meet its current liabilities out of its disposable assets. See Tetley, Andrew, Smith, Reed and Bayle, Marcel, Supra note 187, P. 195.
[468] Id, P.196.
[469] Id, P.197.

payment failure situation but shows that he is encountering difficulties which he is not in a position to overcome.[470] The objective is for the debtor to obtain a moratorium on claims during the observation period.[471] On the other hand, "alert procedures" are rules that were incorporated in the 1984 law which first introduced the prevention of financial difficulties for companies.[472] The rules are designed to oblige managers of a company showing signs of weakness to explain themselves as to how they are going to resolve growing difficulties.[473]

When we see the different alternatives provided for under the Ethiopian, French and English systems, some are quite similar while others are different. This makes one wonder why more than one procedure is provided for essentially the same situations and how they are to be applied in practice.

Even if French and English systems are criticized for incorporating too many procedures, they have at least provided for the major procedures for both liquidation and reorganization of the bankrupt debtor. On the other hand, the Ethiopian bankruptcy law is criticized for its failure to incorporate strong reorganization provisions in the first place. To use the words of Ato Taddesse, [474]

...while simple adjustment schemes in bankruptcy qualify as 'alternatives' to straight liquidation schemes, it is not necessary to have two schemes for essentially the same end-adjustment of debts. What we need instead of two adjustment schemes is a genuine reorganization scheme, which contemplates the restructuring of the bankrupt business beyond revision of debt payment provisions.

4.5 Areas of concern for the revision of the Ethiopian law of Bankruptcy

4.5.1 General

This part is devoted to the discussion of the core areas that are worth noting in revising the Bankruptcy law of Ethiopia. These are issues related to the purpose of the law, commencement standards, and relation among the different laws.

[470] Tetley, Andrew, Smith, Reed and Bayle, Marcel, Supra note 187, P.197.
[471] Ibid.
[472] Id, P.198.
[473] Ibid.
[474] Tadesse Lencho, Supra note 372, P. 89.

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4.5.2 Purpose of the Bankruptcy law

As we have already seen, a bankruptcy law could achieve different sets of goals related with the commencement, parties involved in the proceeding, the administration of the proceeding, and the closure of the proceeding. But, the overall purpose of the law is either to provide for protection to creditors or the debtor or balance the interests of both. The Ethiopian law of Bankruptcy seems inclined towards the protection of the interests of creditors which is evident from the general organization and the words of the provisions. However, a law that is pro-debtor or pro-creditor is not fair to either of the parties and a balanced protection of the interests of both sides should be provided.

4.5.3 Scope of application

It is essential that the Ethiopian bankruptcy law clearly defines its subjects. This is because, the inclusion or exclusion has its own effects. First, those persons that are governed by the general rules of bankruptcy should be provided. Second, those persons that are subjected to special rules of bankruptcy should also be provided. In line with this, the law should clearly show when and how joint ventures are governed and whether insurance companies and state owned enterprises should be governed by special bankruptcy regimes. In addition, a clear list of excluded persons should be provided so that ease of application is attained.

4.5.4 Commencement standards

Under the Ethiopian Bankruptcy law, there is no clear guideline or criteria that a court may use in declaring a debtor bankrupt or a creditor may use in applying for the declaration of bankruptcy of the a failing debtor. In fact, the mere reading of the provisions of the Commercial Code shows that any fact could be used to prove that the debtor has suspended payment. This is however very broad and prone to abuse by parties with bad faith and gives the court too much power in this regard. Thus, a clear provision of the standards should be provided for by the law.

4.5.5 Jurisdiction

The jurisdiction of the court that entertains the bankruptcy case should clearly be provided for in the bankruptcy law. This is especially true in Ethiopia as there are two levels of courts. The Ethiopian Bankruptcy law does not tell whether bankruptcy is a Federal or State matter. This is, in practice, a matter reserved to Federal Courts and the Federal Courts proclamation should have provided provisions dealing with this matter. Any ways, the revision of the existing Ethiopian law on Bankruptcy should consider this shortcoming.

4.5.6 The issue of bankruptcy administrators

The concern here is about the Commissioner and Trustees. The Ethiopian Bankruptcy law does not clearly provide who the Commissioner is and it is through interpretation that one reaches to the conclusion that the Commissioner is a judge. In addition, the qualifications of a Commissioner and how he/she is appointed or removed/replaced is not clearly provided under the Commercial Code. Thus, the forthcoming law should clearly define who the Commissioner is, what his/her qualifications are and how he/she is appointed and removed/replaced. This would help in providing the right persons for the responsibility and better achieve the objectives of the bankruptcy law.

With regard to the Trustees, the Code provided for detail provisions than what is provided for the Commissioner. But the concern is that the Ministry of Trade and Industry has not yet prepared the list of potential trustees although it is authorized by the Commercial Code to prepare the list each year. This is something that the Ministry has to take into consideration as the enforcement of the Bankruptcy law highly requires the involvement of trustees.

4.5.7 Relation with other laws

Although the Commercial Code tries to limit the application of bankruptcy provisions to those persons that are said to be traders and commercial business organizations, the different laws dealing with 'non-traders' seem to use the word bankruptcy/insolvency. These are the laws on Cooperative Societies, Charities and Societies and associations.[475] Thus, there has to be a clear cut guideline on the application of the Commercial Code and those other laws. In addition, deeper research of existing laws and their implication should be made before a reference in new laws is made to

[475] See part 4.3.3. B of this Chapter.

Bankruptcy law in order to achieve consistency, ease of application and since being subjected to or excluded from the ambit of the law of bankruptcy has far reaching consequences.

Generally, whenever a reference is made from the Commercial Code to another code or whenever a reference is made from a certain proclamation to another or to the Commercial Code, caution should be taken to check the compatibility of one with the other.

4.5.8 Priority in paying creditors

This is the most controversial and still very important area of the Ethiopian Bankruptcy law that demands due consideration in revising the law. This is because as has already been said before, it is the interest of every creditor to be the first to be paid and to be paid in full and this is one of the areas that bankruptcy law governs. Thus, it is crucial that the priority in the payment of creditors be clearly provided for.

Usually, bankruptcy involves different parties governed by other non-bankruptcy laws. Thus, the priorities the parties have under other laws like the tax laws and the Labour law contradicts with the priority they are given under the bankruptcy law. The tax laws put the tax claims next to the secured claims[476] and sometimes even above the secured claims.[477] On the other hand, the Labour law provides that employee claims shall have priority over other claims.[478]

Thus it is mandatory that a revision of the law takes into consideration such contradictions and provides clear provisions as to the priority in the payment of claims.

4.5.9 Alternatives to Liquidation

Liquidation is not the only mechanism for solving the problems of businesses in difficulty. This is well recognized in the Commercial Code as well. However, the law provides for composition and schemes of arrangements as alternatives to 'direct liquidation'. This should, as Ato Taddese says, be replaced by strong reorganization laws instead of providing two similar procedures for the same end.

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[476] Value Added Tax Proclamation, Supra note 418, Article 32(1).
[477] See the Income Tax Proclamation, Supra note 308, Article 82(1)(c).
[478] Labour Proclamation. Supra note 417, Article 167.

This is because, if a balance has to be made between the interests of creditors, the debtor and other stakeholders, the inclusion of reorganization provisions is essential. In addition, the law should mention whether bankruptcy is a means for the starting of reorganization or liquidation.

Conclusion

The fear of failure does not always prevent one from engaging in a certain activity. This is especially true where one has the support it needs at hand before starting its journey. In our specific case, one would feel better if there are appropriate laws to govern his rights before one goes about starting a business or creating some kind of relationship with others.

Although, the Commercial Code of Ethiopia provides its supporting hand for businesses that are in difficulty, its support has rarely been sought. The reasons could be attributed to different factors, among which are the ignorance of Bankruptcy law even by those that are in the legal profession and resort to other mechanisms than the bankruptcy law.

In light of the 'support' that the Ethiopian bankruptcy law provides for bankrupt debtors and creditors of the bankrupt debtor, the paper has found out the following.

The Ethiopian bankruptcy law tries to achieve the purposes that are said to be met by any bankruptcy law as per the UNCITRAL Legislative Guide. However, not all the provisions of the law are detail enough or clear enough or comprehensive enough to say that the law has achieved the purposes.

The scope of application of the Ethiopian bankruptcy law is limited to traders/commercial business organizations and provides special bankruptcy law to certain business organizations which is acceptable under the international principles and guidelines. However, the experiences of countries like the US and France show that bankruptcy law is provided to govern non-traders as well. Besides, the Ethiopian bankruptcy law lacks clarity as to who are excluded from its scope of application.

With regard to the initiation of the bankruptcy proceeding, the Ethiopian law lacks clear commencement criteria. In addition, the law does not state whether bankruptcy is a Federal or State matter. This is unlike what is provided for in other countries like the US and what is required by the UNCITRAL Legislative Guide.

The World Bank Principles and the UNCITRAL Legislative Guide require that bankruptcy administrators should have appropriate qualities. Under the Ethiopian

bankruptcy law, the Commissioner is not governed in detail while relatively detail provisions are provided to govern trustees.

The debtor under the Ethiopian law is subjected to some restrictions. This is unlike the requirements of the international guidelines/ principles and not a feature of modern bankruptcy laws.

With regard to creditors, the UNCITRAL Legislative Guide requires that they should have a major role in the bankruptcy proceeding. Their role under the Ethiopian bankruptcy law is, however, limited. The priority in paying creditors is also relatively unclear. This is especially true since the provisions that are provided for by other laws provide different priority rules.

The bankruptcy law does not adequately provide for the discharge of the debtor. In addition, the alternatives to liquidation that are provided for by the law do not include strong reorganization provisions. These are unlike international instruments and modern laws of bankruptcy. This is a major area that should be considered in revising the law.

Having found out the above-mentioned facts about the Ethiopian bankruptcy law, although it is difficult and untrue to characterize the Ethiopian law as totally backward, it would equally be unfair to call it modern.

A lot has to be done to enhance the Ethiopian Bankruptcy law support system. This is from the perspective of the rights and restrictions on the bankrupt, the rights and privileges accorded to the creditors, the role of the administrators of the bankruptcy proceeding, the issue as to implementing and supporting institutions, in general.

Next, certain recommendations that are believed to contribute to the reform on bankruptcy law of Ethiopia have been forwarded by the writer. It is the hope of the writer that the future bankruptcy law of the country would be good enough in addressing the needs of the current and prospective business community.

CHAPTER FIVE

RECOMMENDATIONS

5.1 General Consideration

5.1.1 The challenges of bankruptcy reform

Reform, in general, is not an easy task and a lot of things have to be taken into consideration to bring about effective changes. On the difficulty of reforming/modernizing bankruptcy law Michele Vietti, a leader of the Commission for the Reform of the Bankruptcy Law in Italy, mentions many factors:[479]

> *[f]irst of all, attitudes ...toward bankruptcy make it a difficult subject to generate support for (its reform). Secondly, bankruptcy reforms are complex and lengthy. They require changes not only to the bankruptcy law but also to other important parts of the legal framework, such as the codes of civil procedures and... the penal code. Finally, they require support from those that must implement them...*

Against this backdrop, the following discussion is about a set of recommendations that need to be considered in revising the Bankruptcy law of Ethiopia.

5.1.2 Scope of reform

The trend in Ethiopia when a certain law is changed is either to completely repeal the existing law and enact a new one to govern areas that were previously governed by the repealed law,[480]or to amend the existing law.[481]

What should be the scope of reform on the Ethiopian bankruptcy law? On the approach that must be taken when reforming the Commercial Code, Prof. Escarra predicted:[482]

> *If, as appears desirable, the future commercial code of Ethiopia contains a reasonable number of institutions adapted to the present economic conditions of the country and capable of satisfying the needs of an expansion of the economy during the next few decades, one still must foresee that one day the code will perhaps*

[479] Vietti, M. Modernizing Italy's Bankruptcy Law: Smart Lessons in Advisory Services, International Finance Corporation. World Bank Group, December 2007.
[480]This could be by either including or excluding subjects of the law, or changes in the administration of the law or both.
[481] This is usually when the change that is needed to be made on the current law is not as such too much and it would be inefficient/uneconomical to try to change the whole body of the law.
[482] Winship, supra note 223, P. 17.

become obsolete and recognized as insufficient. Undoubtedly it will be possible to replace numerous provisions with other more refined and complex provisions which will find their place in the articles of the code, of which the number will not change. Perhaps one could just as easily add articles with sub-numbers or letters, which would permit the expansion of the code without upsetting the present numbering. For example, after Article 235, for example, there could be an Article 235.a or 235.1 an Article 235.6 and so on.

I do not think the approach preached by the Professor is the best one. This is because adding few more sub-articles doesn't seem to bring the desired modernization to the Bankruptcy law of the country. The approach should be more than amending the existing law and should be to overhaul the current law.

5.1.3 Benchmarking of International standards

When people think of investing in other states they take into consideration the laws of that country as one precondition for making their decision.[483] Other things kept constant, the closeness of a country's laws to internationally accepted standards is to make that state suitable for investment.[484] Bankruptcy laws are among the ones that are given much attention in investigating the feasibility of investing in another state.[485]

So, it is desirable, from an economic point of view that the bankruptcy law of Ethiopia is like modern laws or international standards on bankruptcy. These are, for instance, the UNCITRAL Legislative Guide on Insolvency Law and the World Bank Principles for Effective Insolvency and Creditor Rights Systems.

5.2 Specific Issues

5.2.1 The status of the bankrupt debtor

As much as a business may succeed and be profitable, there is also the unfortunate chance of failing. This is where bankruptcy law should take caution in helping an honest debtor to stand on his/her feet and a fraudulent one receives the appropriate punishment. Thus, the provisions have to be designed in such a way that honesty and bad faith are effectively addressed.

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[483] Doing business, Supra note 8, P. 44.
[484] Ibid.
[485] Ibid.

With regard to the discharge of the debtor, the law should discharge a debtor that is honest and paid most of its/his/her debts.

5.2.2 The priority in paying creditors

As to the rank of creditors in the payment of their claims, the first priority should be given to secured creditors. However, if a cost is incurred in maintaining their security, such shall be deducted before these creditors take what is due to them.

Next priority should be given to administrative costs and expenses. This should include: costs of the proceedings like court fees; remuneration of the insolvency representatives, such as commissioners and trustees and any professionals employed by them except the debtor; costs arising from continuing contract obligations.

The next set of creditors should be employees, followed by tax claims.

After these claims, the claims of unsecured creditors should be paid.

The last ones should be claims of owners, penalties and fines.

5.2.3 Institutional issues

A. General

Reform must be full-fledged or on all aspects of the law. That means, all stakeholders like the implementing institutions and officials must as well be in compatible with the rules that are found on papers. According to Dr. Menberetsehai Tadesse, former Vice President of the Federal Supreme Court, and current Director of the Justice and Legal System Research Institute of Ethiopia, the Ethiopian government is "now in the process of overhauling the justice system within a general package of a comprehensive justice reform program."

In addition, the other laws to which references are made or meant to govern the issues of bankruptcy must be made compatible or must likewise be reformed. Dr.Menberetsehai added that, the program includes "amongst many other things the revision of the basic laws which have been in force for about half a century now."[486]

In this regard, the forthcoming bankruptcy law should either establish or delegate the establishment of the following institutions. These are principally, the Commercial

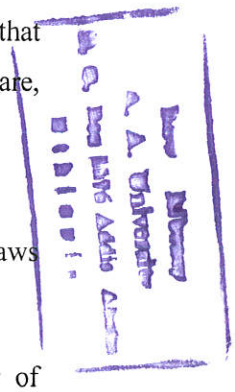
[486] The World Bank Global Judges Forum Commercial Enforcement and Insolvency Systems. P. 14.

Register, the Commissioner and the Trustee. Although the Ministry of Trade and Industry (and the Investment Agency by delegation) are authorized to make records of business related issues like business license, trade name, business address, names of managers etc., it does not make the registration of different acts that the Book on Bankruptcy authorizes the Commercial Resister to carry out.

It has been a while since the bankruptcy law has been thought of being reformed and there is the new Commercial Registration and Business Licensing Proclamation No. 686/2010. However nothing is mentioned as to the commercial registrar or no duty is given by the law for the body who is empowered to make registration and the registration of bankruptcy related things. The forthcoming bankruptcy law should either refer the duty to the Ministry of Trade and Industry or it should establish the office itself.

B. Implementing Institutions

The primary institution being the courts with judges, trustees, commissioners to implement the bankruptcy law, there are also supporting institutions that very much aid the bankruptcy process by providing expertise on certain fields of profession that may not be found from the normal individuals that the court may use. These are, among others, accounting and audit firms.



5.2.4 Debtor friendly or creditor friendly: a policy choice

Whether Ethiopia should have a debtor friendly or creditor friendly bankruptcy laws is a policy choice.

A presentation made at a workshop organized by the Addis Ababa Chamber of Commerce emphasized that the choice between privileging the recovery of the enterprise and the interest of the creditors requires the following preconditions.[487]

First, the existence of sufficient skilled personnel. This is due to the fact that "managing an enterprise in difficulty and auditing its possibility of recovery are much more difficult" than winding up a business. Second, the process requires knowledge, speed, and efficiency from the court and other administrators of the bankruptcy like the commissioner. Third, employees of the business need some kind of guarantees

[487] Ponsot, Dominique. Reform of Bankruptcy Proceedings, presentation of the modern tendencies and comparison with Ethiopian law, *Workshop on Business Management Organized by the Addis Ababa chamber of commerce*, June 1999, Addis Ababa.

that their salaries would be paid if they are to continue in the business in difficulty. Fourth, the balance between the creditors'' interest and the business should not be too unfavorable to the former. If so, creditors may be tempted to take actions that would make the evaluation of the solvency of a business difficult; like, call upon leasing etc. Lastly, the recovery would have high chances of success if the process starts immediately after the first difficulties occur.

Liquidation should be followed when other means have failed or most probably to fail unlike the Ethiopian case where such is considered as the first choice to be taken. This is true under the French Bankruptcy Code.

Liquidation may not be the best solution, inter alia, because "when a firm in financial distress needs to sell assets, its industry peers are likely to be experiencing problem themselves, leading the asset sales to prices below value in best use."[488] And reorganization is likely to maximize the insolvency return instead of liquidation.[489]

This does not however mean that reorganization is always the best solution. However, the thinking that liquidation is the only best solution should be reformed and strong rules on reorganization of firms should be enacted.

[488] Shleifer and Vishny as cited in Araujo, Aloisio and Funchal, Bruno, Supra note 333, P . 3.
[489] Araujo, Aloisio and Funchal, Bruno, Supra note 333, P . 3.

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