

Treatment of Secured Creditors under Ethiopian Bankruptcy Regime

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Abstract

This is research work on the treatment of secured creditors under Ethiopian bankruptcy regime with an objective of knowing how the secured creditors are treated under Ethiopian bankruptcy law during bankruptcy proceedings. Under this work, currently existing literature regarding the subject matter and the well-established jurisprudence with UNCITRAL insolvency mode law were reviewed. The main aim of bankruptcy system of many countries today is balancing different competing interests during bankruptcy proceedings as a result, this thesis tries to explain the treatment of secured creditors under Ethiopian bankruptcy regime; exploring the legal framework regarding the effect of judgment in bankruptcy on encumbered asset, whether the suspension of suit applies to secured creditors, investigating the source of post commencement finance and how it affects encumbered asset. Additionally, some practical cases entertained by the court were discussed. To achieve these objectives the researcher used qualitative research methodology and doctrinal legal research approach

Bankruptcy regime of Ethiopia encompasses the 1960 commercial code of empire of Ethiopia and banking business proclamation No 592/2008. The former is general law which applies to all bankruptcy issues and the latter is special law that applies to banking business only. All in all, this work highlights the concept of secured creditors in general; the experience of well-established jurisprudence of US and the UNCITRAL model law, and analysis of substantive provisions of Ethiopian bankruptcy regime and court cases on secured creditors.

Key Words: Bankruptcy, secured creditors, reorganization, liquidation, suspension of suit, encumbered asset, scheme of arrangement, Ethiopian bankruptcy Regime.

1. Introduction

The bankruptcy regime of a legal system usually affects unsecured creditors while those creditors who managed to secure their claims with some kind of guarantee over the property of the debtor are not affected. It is a rare creditor who makes a loan or sale of property expecting the debtor to go bankrupt. But it is a fact of life that some businesses are not healthy, and either expire or convalesce under the watchful eye of the bankruptcy law. To protect against such contingencies, a creditor often seeks to have the debtor's obligations secured by an interest in the debtor's property. The creditor assumes that if the debtor fails to honor the obligations, the security will always guarantee satisfaction of the debt.¹ Different legal systems follow different approaches regarding the treatment of secured creditors during bankruptcy proceeding.² Some countries allow secured creditors in general to enforce their security interests, untroubled by the commencement of bankruptcy. This approach is common in those systems which exempt secured creditors from the application of stay (suspension of suits). There are also, on the other hand, laws which include encumbered assets in the bankrupt estate, to be controlled by trustees, subject to some conditions. French law may be cited as an instance in this regard. The third approach is that in some laws, the power of trustee over encumbered assets is dependent upon the nature of the proceeding: liquidation or reorganization. A trustee has an unlimited power to sell encumbered assets when the proceeding involved is a reorganization while trustee's power to do so is limited by a period of time in a liquidation proceeding.³

A less than satisfactory solution is provided for the treatment of encumbered properties held by mortgages and creditors secured by immovable or mortgages on the business under Ethiopian bankruptcy law. In some provisions, it gives the impression that secured creditors are unaffected by the commencement of bankruptcy proceedings. Article 1026 of the Code, for example, suspends all individual suits of creditors included in the universality "except creditors whose claim is secured by "a special privilege, pledge or mortgage". Article 1026 (together with Article 1025) gives the impression that secured creditors are not affected by bankruptcy proceedings. Carried to its logical conclusion, this may mean, for example, that the secured (encumbered) property held by these creditors is not part of the bankrupt estate and hence outside the

¹ Larry peitzman and Margaret S.Smith, 'The Secured Creditors Complaint: Relief from the Automatic Stays in Bankruptcy Proceedings' 65 California law review (1977) 1216

²TadesseLencho, *Ethiopian Bankruptcy Law: A Commentary* (part 2) 44

³ Ibid.

jurisdiction of the trustee. We are compelled (at least partially and half-heartedly) to withdraw this conclusion or at least question our initial hunches when we come to Articles 1065-1072 of the Code. These provisions are couched in an unfortunate language of the order of sale of encumbered property vis-a-vis the ‘unencumbered’ bankrupt estate instead of stating the power of the trustee over encumbered assets (or even better stating whether encumbered assets are part of the bankrupt property).⁴ Thus, this researcher interested on this topic due to the above mentioned facts.

2. Statement problem

Even if the bankruptcy proceeding focuses on the protection of the interests of creditors, these interests may be competing. To avoid competition among creditors, the law impedes individual action and the judgment in bankruptcy heralds the beginning of a collective execution. One of the principles of a bankruptcy proceeding is to treat similarly situated creditors equally. The creditors who will be affected by the judicial process will be determined based on the policy stance taken by a legal system.⁵ Article 1026 of the commercial code of Ethiopia suspends all individual suits of creditors included in the universality “except creditors whose claim is secured by “a special privilege, pledge or mortgage”. Article 1026 (together with Article 1025) gives the impression that secured creditors are not affected by bankruptcy proceedings. Carried to its logical conclusion, this may mean, for example, that the secured (encumbered) property held by these creditors is not part of the bankrupt estate and hence outside the jurisdiction of the trustee.

The silence of the Commercial Code on the power of the trustee over encumbered assets is a potential source of distraction as trustees should move to assert the interests of unsecured creditors against secured creditors who refuse to have collaterals sold in bankruptcy. Even when courts decide in favor of trustees, the very fact that trustees might be dragged to courts over this matter is a cause of concern.⁶

one may conclude generally from the joint reading of Article 1026 with Articles 1068-1072 that encumbered asset are largely unaffected by bankruptcy. The provisions as they now stand may be read as denying the trustees access to encumbered property with an unpleasant result that the

⁴ Tadesse (n 2) 46

⁵ Tewodrosmeheret, ‘ An Appraisal of Ethiopian Bankruptcy Regime’ (2017) de jure 141

⁶ ibid

mortgagees might be able to call the shots over their collaterals and still be able to participate in the distributions from the bankrupt estate. Mortgagees can pursue their rights over their collaterals untroubled by bankruptcy proceedings. And their right to participate in the distributions from the bankrupt estate depends to a large extent upon the order of distributions from encumbered or unencumbered assets. As pointed out before, the ambiguity of Ethiopian bankruptcy law on this matter can lead to frequent disputes between trustees and secured creditors over collaterals and may result in substantial loss of time as trustees seek to yank encumbered property from the control of secured creditors for the benefit of unsecured creditors (universality of creditors). Moreover, the conclusion that Ethiopian law excludes secured creditors from the purview of the bankruptcy regime is now impugned. Recently, the Cassation Division of the Supreme Court ruled that secured creditors are not outside of the bankruptcy proceeding. In this case, the bank pleaded to the court to lift the injunction order it gave over a mortgage, so that it could foreclose it. The court of first instance rejected the application, while the appellate court reversed this ruling. Finally, it was settled by the Cassation Division of the Federal Supreme court, casting doubt whether secured creditors are not affected by a bankruptcy proceeding.⁷ This is a binding decision, leading to confusion as to whether the law, or this decision, should be used to come to this conclusion. As we have seen above, the law seems clear in this regard: secured creditors are outside of the purview of a bankruptcy proceeding. On the other hand, a binding decision establishes that they cannot foreclose or realize a collateral, and what they can benefit from is priority from the proceeds, making the exercise of the right contingent upon the insolvency proceeding.

All in all, the Ethiopian bankruptcy regime is not clear enough whether encumbered asset is part of bankruptcy estate, regarding the power of trustee to use encumbered asset for post commencement finance, and the protection of encumbered asset by the rule of suspension of suit. Based on these two elements, the place of secured creditors under bankruptcy proceedings is not clear. The literature which is available in this area, does not suggested the possible solution other than mentioning the existing discrepancies and the potential problem that might happen as a result of this difference. Therefore, this unclarity of Ethiopian legal system regarding the

⁷Holland Car Pvt. Ltd. Co. vs.Zemen Bank S.Co., Cassation Division of the Federal Supreme Court, File No. 102061 decided on 13/02/2015.

treatment of secured creditors needs investigation to come up with potential recommendation and solution.

3. Secured creditors under Ethiopian bankruptcy regime

a. Protection and preservation of the insolvency estate

Essential objectives of an effective insolvency law are protecting the value of the insolvency estate against diminution by the actions of the various parties to insolvency proceedings and facilitating administration of those proceedings in a fair and orderly manner. The parties from whom the estate needs the greatest protection are the debtor and its creditors. With regard to creditors, one of the fundamental principles of insolvency law is that insolvency proceedings are collective proceedings, which require the interests of all creditors to be protected against individual action by one of them. Many insolvency laws include a mechanism to protect the value of the insolvency estate that not only prevents creditors from commencing actions to enforce their rights through legal remedies during some or all of the period of the liquidation or reorganization proceedings, but also suspends actions already under way against the debtor. Such a mechanism is variously termed a “moratorium”, “suspension” or “stay”, depending on the effect of the mechanism.⁸ The Ethiopian commercial code uses the phrase ‘suspension of suit’ to refer to both suspension of existing actions and a commencement of new one.⁹ Suspension of suit is one of the fundamental effects of judgment of bankruptcy on the rights of creditors under Ethiopian commercial code.¹⁰ The controversy arises that effect of suspension of suit will include the secured creditors or not, which is not clearly provided under the code. Book five of commercial code of Ethiopia includes bankruptcy and scheme of arrangement. These two concepts follow different proceedings with their own respective goals. Under the code, the concept of bankruptcy includes liquidation and composition while the scheme of arrangement has the purpose of rehabilitating the dying business is separately provided. Under these two scenarios, the time and the way proceedings took place are different. When we closely read the provisions of these proceedings, the role of suspension of suit in protecting estate depends on the purpose that the proceeding is designed for. Article 972 of the commercial code stipulates that

⁸UNCITRAL *Legislative Guide on Insolvency Law* (new York, 2005)83

⁹Commercial Code of Ethiopia Proclamation No 166 of 1960, Negarit Gazeta, Gazette Extraordinary, 19th Year, No 3, Addis Ababa, 5 May 1960 (hereafter the Code, Commercial Code) article 1025

¹⁰ Article 1026 of commercial code

any trader who suspends payment of his commercial debts shall within fifteen days file a notice to this effect with the registrar of the court having jurisdiction with a view to the institution of bankruptcy proceedings or the approval of scheme of arrangement. Let me discuss the effect of suspension of suit under each of them.

i. Effect of Suspension of suit under liquidation

The imposition of a stay can ensure a fair and orderly administration of the liquidation proceedings, providing the insolvency representative with adequate time to avoid making forced sales that fail to maximize the value of the assets being liquidated and also an opportunity to see if the business can be sold as a going concern, where the collective value of assets may be greater than if the assets were to be sold piecemeal. A stay also allows the insolvency representative to take stock of the debtor's situation, including actions already pending, and provides time for all actions to be fully considered, increasing the possibility of achieving a result that is not prejudicial to the interests of the debtor and creditors. The balance that is difficult to achieve in liquidation proceedings is between the competing interests of secured creditors, who will often hold a security interest in some of the most important assets of the business and wish to enforce that security interest, and unsecured creditors, who may benefit from retention of that asset to facilitate sale of the business as a going concern. Under Ethiopian commercial code, after receiving the notice as per article 975, the court having jurisdiction shall make a preliminary investigation.¹¹ In doing so, it appoints a judge for the purpose of investigation into the affairs and activity of the debtor. The appointed judge will report the collected information to the court. After receiving the report, a court shall fix a date of suspension of payment and subject to the scheme of arrangement, it declares the debtor bankrupt.¹² This judgment follows the appointment of a commissioner in bankruptcy and one or more trustee in bankruptcy.¹³

After the adjudication of bankrupt, all the legal proceedings shall be instituted and all applications for execution be made by or against the trustee.¹⁴ That is why bankruptcy is defined as both a collective and universal mode of execution. Collective in the sense that it puts secured

¹¹ Article 976 of commercial code

¹² Article 977(1(b)) of commercial code

¹³ Article 981 of commercial code

¹⁴ Article 1024 of commercial code

and unsecured creditors more or less on an equal footing, universal in the sense that it applies to the total estate of the bankrupt person.¹⁵ Under commercial code of Ethiopia, as from the date of judgment in bankruptcy, all creditors whose claims are not secured by a special privilege, a pledge or mortgage shall bring their claims together in the universality of creditors in bankruptcy.¹⁶ This reflects the equality of creditors, not all, but non-secured one. With connection to this, the other effect of judgment in bankruptcy is suspension of individual suit. The judgment in bankruptcy shall prevent any creditor whose claim is included in the universality from bringing an individual suit except those creditors whose claim is secured by special privilege.¹⁷ On this point, by a contrario reading, the law seems clear that it excludes the secured creditors from the most important effect of judgment of bankruptcy which is suspension of suit. The phrase which says “special privilege” under article 1025 seems ambiguous, but for the purpose of this paper I shall interpret it as similar with mortgage and pledge. As it is discussed above, one of the fundamental purposes of bankruptcy is maximization of value of bankrupt estate for the benefit of creditors. During liquidation, one possible way of accomplishing this purpose is selling business as a going concern. To sell the business as a going concern, the suspension of suit should applied to the whole estate of the debtor, Here, the question raised is whether the selling of property as going concern includes encumbered asset or not under Ethiopian bankruptcy regime. To answer this question, one have to read book five of the commercial code entirely and understand it holistically other than concluding what is provided under article 1025 and 1026 of commercial code as Tadesse Lencho and Tewdros Mehret did by reading a contrario. In addition referring the practical cases entertained by the Ethiopian courts based on relevance is advantageous.

Types of action and act that may be stayed could include the commencement or continuation of actions or proceedings against the debtor or in relation to its assets; the commencement or continuation of enforcement proceedings in relation to assets of the debtor, including the execution of a judgment and actions to make security interests effective against third parties or to enforce a security interest; recovery by any owner of property that is used or occupied by, or is in the possession of, the debtor; payment or provision of a security interest in respect of a debt

¹⁵Win ship, *Background Documents of the Ethiopian Commercial Code of Ethiopia 1960* (1974) 105

¹⁶ Article 1025 of commercial code

¹⁷ Article 1026 of commercial code

incurred by the debtor prior to the commencement date; the transfer, encumbrance or other disposal of any assets by the debtor.¹⁸

To ensure transparency and predictability, it is highly desirable that an insolvency law clearly identify the actions that are to be included within and specifically excepted from the scope of the stay, irrespective of who may commence those actions, whether unsecured creditors (including priority creditors such as employees, legislative lien holders or Governments), third parties (such as a lessor or owner of property in the possession or use of the debtor or occupied by the debtor), secured creditors or others. Actions to protect public policy interests, such as to restrain environmental damage or activities detrimental to public health and safety; actions to prevent abuse, such as the use of insolvency proceedings as a shield for illegal activities; actions commenced in order to preserve a claim against the debtor; and actions against the debtor for personal injury or family law claims should be included as an exception. There is little debate regarding the need for the stay to apply to suspend or prevent the commencement of actions by unsecured creditors against the debtor or its assets. The application of the stay to actions by secured creditors, however, is potentially more difficult and requires a number of competing interests to be balanced. Ethiopian bankruptcy law seems it lacks clarity in this regard.¹⁹

The commercial code of Ethiopia talks about secured creditors under preceding and following sections than chapter four of the code. More interestingly, article 1028 of the code stipulates that interest on debt arising from debts guaranteed by security in rem shall run against the bankruptcy estate as from the day the judgment in bankruptcy rendered.²⁰ From this, we can say that, by extending the interest, the law is providing adequate protection to secured creditor by immovable. Extension of interest is not necessary if the law excludes the encumbered asset from suspension of suit; hence the holder is free to foreclosure it at any time as per the terms of prior existing contract.

The other point that makes encumbered asset subject to suspension of suit is continuation of operation of business. For the interest of public or creditors, the court may authorize the trustee

¹⁸UNCITRAL *Legislative Guide on Insolvency Law* (new York, 2005)84

¹⁹ *ibid*

²⁰ Article 1028 of commercial code

to continue operating the business²¹ after the judgment of bankruptcy which is similar to the concept of going concern in other jurisdiction. In order to operate business, the mortgage on business, which is encumbered, must be subject to suspension of suit. If encumbered asset that is vital for the continuation of business is allowed to be sold by the secured creditor, the concept of continuation of business will be impugned, which will affect the purpose of continuation, obviously maximization of value of asset that ultimately benefit public and creditors.²² Thus, the action of secured creditors be stopped and the suit needs to be suspended.

The other scenario is regarding secured creditors whose claim is secured by pledge. The law provides that creditors whose claim is secured by pledge entered into inventory for purpose of information only under article 1058 of commercial code. Again, the law provides with the authorization of commissioner, the trustee may at any time pay for and redeem the property pledged for the benefit of the estate. Here, the law provides no time framework for redeeming, but says at any time with prior authorization of the commissioner. Again, this raises the question of how can a trustee redeem an encumbered asset without making it subject to the suspension of suit. Redemption needs prior authorization from a commissioner who takes this responsibility for the benefit of the estate. For commissioner to decide whether the pledged asset benefits an estate or not, it needs consideration. The law does not provide clear criteria for authorization. This needs time. In addition, the security may be contested by the commissioner. The decision that the commissioner made depends on the information. The problem arises here is what shall the commissioner decides after receiving the information that he receives from inventory. As it is stated above he may decide to redeem or not based on the equity property encumbered had for the benefit of the estate. If the pledgee is allowed to exercise the right of selling an asset, there will be no room for commissioner to think and decide to authorize the trustee to redeem. Thus, it needs injunction by making the pledged property subject to suspension of suit.

The other point here I want to raise is one provided under article 1051 of the commercial code. Under this provision, the creditor whose security is contested may join in proceedings as a secured creditor. Contestation began after the production of proof of debt by creditors. In order to contest or object the security of creditors, the proceeding needs to include the encumbered

²¹ Article 1039(1) of commercial code

²² *ibid*

asset through the mechanism of suspension of suit. If the law allows the secured creditor to exercise its right freely according to the terms of contract creating security, the person who is in charge of undertaking the bankruptcy proceeding may not get a chance to contest. Related to this concept, the law requires the secured creditors to prove their security that it obliges all creditors who appear under balance sheet to prove their debts.²³ The production of proof of debt commences after adjudication of bankruptcy of debtor by the court. Production of evidence and admission of debt is one of the fundamental tasks during bankruptcy proceeding. If we conclude that the bankruptcy proceeding is excluding secured creditors as per article 1025 of the code, the task of admitting genuine debts and rejecting false claims will be impugned. To clear this stage of proceeding, the ongoing suit as well as selling of encumbered asset must be suspended.

Where the claims of a creditor are secured by movable properties, the trustees can at any time pay and redeem the property. Otherwise, the creditor can sell the property. Where the claim of the creditor is secured by an immovable, it would not be similar to that of the case of security by movables.²⁴ In the case of mortgage, as we know, the mortgagor is not under obligation to transfer possession of the immovable mortgaged. As opposed to the case of pledge, the right of possession over the immovable remains with the mortgagor. It is only the document of title of the immovable that could be handed over to the mortgagee. As a result, there will be no instance of redeeming since the immovable is under possession and ownership of the mortgagor. It is also not possible for the mortgagee to sell the immovable since the ownership and possession of the immovable remains with the mortgagor. As the immovable remains in the hands of the mortgagor, in case where the mortgagor is a person who is declared bankrupt, the immovable forms part of the bankrupt estate to be administered by the trustees. In case where the creditor, whose claim is secured by immovable, has not satisfied his claim from the proceeds of sale of immovable properties which is not the part of encumbered asset as per article 1065 of commercial code, can participate in the distribution of proceeds of sale of movable properties. The movable properties could be sold and the proceeds distributed either before the immovable properties or simultaneously. In other cases, both categories of properties may be sold one after the other. It is within the discretion of the commissioner as to which property should be sold

²³ Article 1042(1) of commercial code

²⁴ Mitiku Mada and Alemayehu Tilahun, *bankruptcy law teaching material*, justice and legal system research institute, (2009)152

when. Where the immovable properties are sold later than the movables, there is no way that the creditor whose claim is secured by immovable can participate in the distribution of the proceeds of such sale. Since it is not yet known that the creditor would satisfy his claims from the sale of immovable, he cannot participate in the distribution of proceeds of sale of movable properties. But where the sale of immovable properties takes place before the movable or simultaneously, there is a possibility to participate in the distribution of proceeds of sale of movable properties.²⁵ The commercial code of Ethiopia provides three times of distribution. Distribution from sale of immovable property not part of encumbered asset, none encumbered movable asset and the distribution of sale of encumbered asset itself as per article 1067. Under this article, the law clearly authorizes the trustee to sell the encumbered asset secured by immovable. But, the Ethiopian law provides adequate protection for secured creditors by immovable to satisfy their claims.

The law that applies to bank bankruptcy in Ethiopia has taken clear and different approach in this regard. It stipulates that in any liquidation of the assets of a bank, secured claims, if any, shall be paid in accordance with their terms.²⁶ Thus, the suspension of suit does not apply to them.

1. Practical case entertained related with secured creditors

It is no exaggeration to state that Ethiopian bankruptcy law (tucked away in the last book of the commercial code) is the least known and hence the least practiced in Ethiopia. Since the coming into force of commercial code in 1960, cases entertained related with bankruptcy have been few and far in between.²⁷ The notorious case related with secured creditors and suspension of suit is Holland car vs. Zemen Bank. The case was started at federal first instant court.²⁸ The zemen bank brought the claim asking for lifting injunction given by the court on the whole property of the bankrupt Holland car. But the court denied the request and confirms its prior decision. The zemen bank appealed this decision to federal high court where the decision of lower court reversed. Following, the Holland car appeal the order of high court to federal Supreme Court where the decision of high court was confirmed. Lastly, the Holland car brought the petition to the federal Supreme Court cassation bench, where this researcher based his argument. After

²⁵ Ibid 153

²⁶ Banking business proclamation No 592/2008, federal Negarit Gazeta 14th year No 57, 25 august 2008 article 45

²⁷ Tadesse Lencho, Ethiopian Bankruptcy Law: A Commentary(part1)2008 Journal of Ethiopian Law 57

²⁸ Holland Car Pvt. Ltd. Co. vs. Zemen Bank S.Co., Cassation Division of the Federal Supreme Court, File No. 102061 decided on 13/02/2015

calling for appearance, the cassation bench with power of rendering decisions of binding nature on the lower courts, unlike lower courts, entertained the case basing its argument more on public or policy issues in addition to law. This bench criticized the decision of lower courts that they based their reasoning on the mere principle of interpretation of law. They argued that the proclamation number 97/1990 was the latter law prevailing over commercial code which is the former. The Holland car claimed that the bank who is holding security should not exercise its power of foreclosure, because there are other debtors who have priority right over the bank. These are the employees and the government tax claim. In addition, the bankrupt company claimed that there is no provision which talks about bankruptcy under proclamation number 90/1990 and its amendment. On the other side, the zemen bank claimed that the proclamation gives a power to the holder of security to foreclosure the security it holds after the laps of period of 30 days. Again, it claimed that the proclamation is the latter law which prevails over the commercial code, which is the older one. But the cassation bench did not satisfied by the reasoning of the parties as well as the lower courts. It confirms the decision of federal first instance court by claiming the injunction given on the whole property of the bankrupt Holland car was right. To come up with this conclusion, the bench has widened its view to policy issues. The bank which is holding the security of machinery and building of the debtor is allowed to sell the asset encumbered separately; the rights of other preferred claimants will be jeopardized. The employees are entitled to priority right over any claim as per proclamation number 377/1996 article 167.²⁹ Again, the government does not enjoy its preferential right over tax claim if the bank sold the asset as per the proclamation. Moreover, the role encumbered asset which the bank has right to foreclosure as per the provisions of proclamation 90/1990 will plays in the fixation of the remaining unfinished cars will become zero. This will result in jeopardizing the rights of other unsecured ordinary creditors who are waiting to take their claim from the asset other than encumbered. Basing on its reasoning on the above points, the cassation bench reversed the decision of federal supreme and high court and confirmed the first instance court that the injunction given on the whole property of debtor including the encumbered was right. This means the cassation bench with the power of rendering binding decisions over lower courts and last bench of the Ethiopian court structure suspended suit on secured creditors. Here, let me raise the point brought by Ethiopian business community. They suggested that this provision needs

²⁹ FDRE labor proclamation number 377/1996 article 167

some reconsideration. There is a strong case to be made in favor of applying the rule to secured creditors as well. Many laws provide that encumbered assets are included in bankrupt estate, thus limiting the enforceability of security interests by application of stay. This has several advantages. This limitation is crucial particularly where the encumbered asset is essential to the business (for example, factory building). Of course, where encumbered assets are included, certain protections ought to be provided in the law, which will help maintain the value of the encumbered asset or the secured portion of the creditor's claim. An application of the stay against even secured creditors should not deprive them of their rights in encumbered assets.³⁰

Generally, Creditors seek a security interest for the purpose of protecting their interests in the event that the debtor fails to repay. If a security interest is to achieve that objective, it can be argued that, upon commencement of insolvency proceedings, the secured creditor should not be delayed or prevented from immediately enforcing its rights against the encumbered asset. The secured creditor has, after all, bargained for a security interest in exchange for value that reflects the reliance on the security interest. For that reason, the introduction of any measure that will diminish the certainty of the secured creditor's ability to recover debt or erode the value of security interests, such as applying the stay to postpone enforcement, may need to be carefully considered. Such a measure may ultimately undermine not only the autonomy of the parties in their commercial dealings and the importance of observing commercial bargains, but also the availability of affordable credit; as the protection provided by security interests declines, the price of credit may need to increase to offset the greater risk. Some of the insolvency laws that exempt actions by secured creditors from the stay focus, as an alternative to the stay, on encouraging pre-commencement negotiations between the debtor and creditors to achieve agreement on how to proceed.

ii. The treatment of secured creditors during composition

Composition is one way of the settlement of the proceeding of bankruptcy other than compulsory winding up. It takes place after a lodging of claims of all creditors who appear on the balance sheet or who has proved has the right following the announcement of notice in the official commercial gazette. A growing number of insolvency laws accept, however, that in many cases

³⁰Position of the Business Community on the Revision of the Commercial Code of Ethiopia, Private Sector Development Hub/Addis Ababa Chamber of Commerce and Sectorial Associations, (2009)96

permitting secured creditors to freely enforce their rights against the encumbered asset can frustrate the basic objectives of the insolvency proceedings, in particular in reorganization. For that reason, actions by secured creditors are increasingly included within the scope of the stay, subject to certain protections. The Ethiopian commercial code does not clearly provide how the secured creditors handled during composition. Article 1081(2) of the code provides that the proposed composition shall specify the percentage offered to unsecured creditors and period of time required for payment.³¹ The vote of the creditors is also needed to arrange the composition. On voting, creditors who have a secured claim shall not be counted in respect of their debts in the transaction related to the composition unless they forego their guarantees. The other provision that shows the treatment of secured creditor during composition is provided under article 1089 of the code. Under this provision, the law says that confirmation of composition shall be binding on all creditors other than those holding in rem³² which they have not relinquished. Again, sub article two of the above provision talks about confirmation shall not affect the creditor's mortgage on the debtor's immovable property registered in the name of estate under article 1006 and mortgage registered on the business in the name of the estate under article 1007. According to article 1006 of the code, the trustee shall cause the registration to be effected in the name of bankrupt estate on all immovable property in the possession of the debtor or which may at later date come in to his possession. As exception, the mortgage shall not registered on immovable property acquired by the debtor after the payment of the last dividend under a composition or where there is no composition, after a final closure of the winding up procedure. Regarding pledge or personal property, the law does not say anything whether the confirmation of composition affects it or not. Thus, we can conclude that the law is permissive in this regard, in the sense that it permits to include personal property security. But the rationality of permitting to include pledge and exclude mortgage is not clear in respect with the purpose of composition.

³¹ Article 1081 of commercial code

³² Article 1089 of commercial code

iii. Treatment of secured creditors during scheme of arrangement

The Ethiopian commercial code uses the phrase “scheme of arrangement” in place of reorganization in other jurisdictions. Besides difference in terminology, both are similar in effect. It may be desirable for the stay to apply to secured creditors for a sufficient period of time to ensure that the reorganization can be conducted in an orderly manner without the possibility of assets being separated before it can be determined how those assets should be treated in reorganization and an appropriate plan approved. To avoid application of the stay for an uncertain or unnecessarily lengthy period and encourage a speedy resolution of the proceedings, there may be advantage in limiting the application of the stay to the time it may reasonably take for a reorganization plan to become effective, provided that that does not take a significant period of time and the proceedings are not allowed to continue for years without a plan being proposed and approved. Such a limitation may also have the advantage of providing secured creditors with a degree of certainty and predictability as to the duration of the period of postponement of their rights and the treatment of those rights in the plan. Alternatively a fixed time period might be specified. The difficulty with that approach, however, is that the time period may not always be sufficiently long, depending on the size and complexity of the reorganization and the plan required, and may be difficult to enforce. Solutions may include establishing clear time limits, with the possibility of extension or providing for relief from the stay in certain circumstances. It is important that the overall design of the insolvency law encourage speedy and efficient progress of the proceedings, enabling the period for application of the suspension of suit to secured creditors, in particular in reorganization, to be minimized. Book five of Ethiopian commercial code contains bankruptcy and scheme of arrangement. Under the title of scheme of arrangement, any trader, who has or is about suspend payment and has not been declared bankrupt may apply to the court for the opening of a scheme of arrangement.³³ The debtor shall file the documents in article 973 together with report giving the reason for his suspension or impeding the suspension of payment, and the reasons for his proposing of scheme of arrangement.³⁴ The court who has received the application for scheme of arrangement from a debtor may call a public prosecutor to hear. After hearing a public prosecutor, they court may refuse the application where any of the conditions necessary for scheme is not present. But where

³³ Article 1119 of commercial code

³⁴ Article 873 of commercial code

the court considers that there are merits in the application, it shall order the scheme of arrangement to be opened. After the application has been made and until the confirmation of the scheme, no creditor holding a claim arising prior to judgment may distrain, acquire a preferred right over the debtor property or register a mortgage.³⁵ All prescriptions, preemptions and forfeitures shall be suspended. The code excludes the counting of interests of encumbered asset and amounts due in respect of taxes from the effect of application for the scheme of arrangement. There is controversy regarding the voting right and procedure of secured creditors for scheme of arrangement.³⁶ In order to approve the scheme of arrangement, it shall be approved by a majority of creditors representing not less than two thirds of all non-preferred or unsecured debts. Secured creditors may not vote unless they give up their security. Such surrender may be partial but shall not less than one-third of the full value of the debt. Where a secured creditor has voted without having made a partial surrender, he shall deemed to have a full surrender where he accepts the scheme. Again, the effect of judgment of scheme shall bind all creditors prior to the opening for the proceeding for scheme of arrangement.³⁷ All in all, it is possible to say that Ethiopian commercial code includes the secured creditors in the proceeding of scheme of arrangement, unless its purpose could not attain the very aim intended for.

Where actions by secured creditors are included within the scope of the stay in liquidation and reorganization proceedings, an insolvency law can adopt measures that will ensure that the interests of the secured creditor are not diminished by the stay. These measures may relate to the duration of the stay, protection of the value of the encumbered assets, payment of interest and provision of relief from the stay where the encumbered assets are not sufficiently protected or where they are not necessary to the sale of the entire business or a productive part of it.

b. Measures adopted to ensure the interest of secured creditors are not diminished by the stay

Where secured creditors are included in the scope of the suspension of suit; a bankruptcy law can adopt certain measures to protect their interests. In addition to limiting the duration of the stay, these measures may include allowing the stay to be lifted and adopting measures to ensure, where the value of the secured claim is more than or close to the value of the encumbered asset,

³⁵ Article 1131 (1) of commercial code

³⁶ Article 1140 (1) of commercial code

³⁷ Article 1150(1) of commercial code

that the value of the encumbered asset is protected against diminution as a result of the commencement of insolvency proceedings, either as a result of the use of the asset or because of the application of the stay. Since these measures are interrelated, it is desirable that an insolvency law adopt a coherent approach.³⁸ Where the length of the application of the stay is short, for example, there may be no need for the law to require protection of the value of encumbered assets. Where the stay applies for a long time, however, lifting of the stay may be a more cost effective remedy than providing protection for the value of the asset, provided the asset is not required for the proceedings. The interests of secured creditors can also be protected more generally, by consulting them on the use and sale of the encumbered assets; the payment of interest as far as the proceeds of the asset allow; and taking over the asset where the asset is worth less than the secured claim. These measures are discussed in the following sections. The desirability of approaches that provide protection for the value of the encumbered asset may need to be weighed against the potential cost and complexity of those measures, including valuation, and the need for the court to be able to make difficult commercial decisions on the question of protection.³⁹ Where protection is provided, it may be desirable for an insolvency law to provide guidance on when and how creditors holding some type of security interest over the debtor's assets would be entitled to the types of protection described below.

i. Relief from the stay

In liquidation and reorganization proceedings, circumstances may arise where it is appropriate to provide secured creditors with relief from the stay. For example, the secured creditor may be permitted to apply to the court for the stay to be lifted or the insolvency representative (without the approval of the court) may be permitted to release the asset. Relevant circumstances may include where the value of the secured creditor's claim exceeds the value of the encumbered asset; where the secured creditor is not receiving protection for the diminution in the value of the encumbered asset; where the provision of protection may not be feasible or would be overly burdensome to the estate; where the encumbered asset is not needed for the reorganization or sale of the business as a going concern in liquidation; where relief is required to protect or preserve the value of assets, such as perishable goods; or where, in reorganization, a plan is not approved within any applicable time limit.

³⁸ UNCITRAL model law on insolvency (new York, 2005) 94

³⁹ Ibid 95

Where relief from the stay is granted, the insolvency law may provide for the encumbered asset to be turned over to the secured creditor. The asset ceases to be part of the estate and the secured creditor will be free to enforce its rights. Under some insolvency laws the insolvency representative may be required to decide whether the asset should be turned over to the secured creditor or whether the asset can be relinquished, which the Ethiopian bankruptcy system is the best example, since the difference between these options may have cost implications for the estate. For example, where the asset is a large piece of equipment, turning it over to the creditor may require expenditure by the estate for transport, while relinquishment places the costs of removal on the creditor. In a case of redemption of pledge, the law authorizes the commissioner to order trustee to redeem for the benefit of the estate. Even if the Ethiopian law does not define the benefits are these points should be taken into consideration by the commissioner in order to give or not the authority to trustee to redeem the pledged asset. The commissioner authorizes trustee to redeem for the benefit of the estate. If the commissioner thinks the asset encumbered does not have equity, no need for redemption. If there is no redemption, no need to apply the suspension of suit on the asset. Hence, the holder of an encumbered asset can claim for relief by indicating that the asset has no equity for the estate of debtor.

ii. Protection of value

Some insolvency laws adopt provisions specifically designed to address the negative impact of the stay on secured creditors by maintaining the economic value of secured claims during the period of the stay (in some jurisdictions referred to as “adequate protection” which the USA is the best example). Where the estate is able to maintain the value of encumbered assets, it can be approached in several ways.

One approach is to protect the value of the encumbered asset itself on the understanding that, upon liquidation, the proceeds of sale of the asset will be distributed directly to the creditor to the extent of the secured portion of their claim. This approach may require a number of steps to be taken. During the period of the stay it is possible that the value of the encumbered asset will diminish. Since, at the time of eventual distribution, the extent to which the secured creditor will receive priority will be limited by the value of the encumbered asset, that depreciation can prejudice the secured creditor. Some insolvency laws provide that the insolvency representative should protect secured creditors against any diminution either by providing additional or

substitute assets or making periodic cash payments corresponding to the amount of the diminution in value.⁴⁰ This approach is only necessary where the value of the encumbered asset is less than the amount of the secured claim. If the value exceeds the claim, the secured creditor will not be harmed by the diminution of value until that value becomes insufficient to pay the secured claim. Some States that preserve the value of the encumbered asset as outlined also allow for payment of interest during the period of the stay to compensate for delay imposed by the proceedings. Payment of interest may be limited, however, to the extent that the value of the encumbered asset exceeds the value of the secured claim. Otherwise, compensation for delay may deplete the assets available to unsecured creditors. Such an approach may encourage lenders to seek a security interest that will adequately protect the value of their claims.⁴¹

The other approach provides different court based approaches. For example, rather than undertaking the valuation itself, the court may specify a mode of determining the value, which might be carried out by appropriate experts. This could be supported by stating clear principles in the insolvency law as a basis for the valuation. An alternative approach is for the court, possibly following an initial estimate or appraisal of value by the insolvency representative, to determine the value on the basis of evidence, which might include a consideration of markets, market conditions and expert testimony. Some laws require a market valuation of an asset through sale, whereby the highest price available in the market for the asset is obtained via tender or auction.⁴² This valuation technique is less applicable to protection of either the value of the encumbered asset or the secured claim than it is to disposal of assets of the estate by the insolvency representative. In some liquidation cases, the insolvency representative may find it necessary to use or sell encumbered assets in order to maximize the value of the estate. For example, to the extent that the insolvency representative is of the view that the value of the estate can be maximized if the business continues to operate for a temporary period in liquidation, it may wish to sell inventory that is partially encumbered. In reorganization proceedings also, it may be in the best interests of the estate to sell encumbered assets of a similar nature to provide needed working capital. Thus, in cases where secured creditors are protected by preserving the value of the encumbered asset, it may be desirable for an insolvency law to allow the insolvency

⁴⁰ UNCITRAL model law on insolvency (new York,2005)96

⁴¹ *ibid*

⁴² UNCITRAL insolvency model law (new York.2005)97

representative the choice of providing the creditor with substitute equivalent security interest, such as a replacement lien over another asset or the proceeds of the sale of the encumbered asset or paying out the full amount of the value of the assets that secure the secured claim either immediately or through an agreed payment plan. Under article 1065 & 1066, the Ethiopian commercial law gives priority for secured creditors to take the distribution of proceeds from the sold encumbered asset. Additionally, the commissioner may authorize the trustee to redeem the encumbered asset for the benefit of the estate.⁴³ In order to redeem, the trustee must pay the full debt that the debtor owed to the secured creditor in exchange of encumbered asset. Again, the Ethiopian bankruptcy system makes a trustee liable or responsible for his action, but the law is not clear how the valuation is made on encumbered asset.

c. Use or disposal of encumbered asset under Ethiopian law

The continued operation of the debtor's business after the commencement of insolvency proceedings is critical to reorganization and, to a lesser extent, liquidation where the business is to be sold as a going concern. To maintain its business activities, the debtor must have access to funds to enable it to continue to pay for crucial supplies of goods and services, including labor costs, insurance, and rent, maintenance of contracts and other operating expenses, as well as costs associated with maintaining the value of assets.

An insolvency law will need to address the question of use or disposal (including by further encumbrance) of encumbered assets and, in particular, whether the insolvency representative or the secured creditor will have the power to sell those assets. To a large extent, the approach adopted will depend upon whether the insolvency law includes encumbered assets in the insolvency estate; if not, the secured creditor will generally be free to enforce its security interest. Where encumbered assets are part of the estate, insolvency laws take different approaches to the issue. In some cases, the approach depends upon the application of other provisions of the insolvency law, such as application of the stay (while the stay applies only the insolvency representative can dispose of the assets), as well as law other than insolvency law, and whether encumbered assets can be sold free and clear of interests. It may also depend on the nature of the sale proposed, whether as an individual asset or as an integral part of a sale of the business as a going concern. Some insolvency laws, for example, provide that only the

⁴³ Article 1058 of commercial code

insolvency representative will be able to dispose of encumbered assets in both liquidation and reorganization. Other laws distinguish between liquidation and reorganization; the insolvency representative will be able to dispose of the assets during reorganization, but in liquidation this ability is time-limited. Once the insolvency representative's exclusive period has expired, the secured creditor may exercise its rights.⁴⁴ Whichever approach is adopted, an insolvency law should require secured creditors to be notified of any proposed disposal and have an opportunity to object. Where the secured claim exceeds the value of the asset or the asset is not required for the proceedings, the insolvency representative may be permitted to relinquish the encumbered asset to the secured creditor without notice.

Ethiopian law recognizes the continuity of operation of business for the benefit of public or creditors. For a public benefit in the sense the employment opportunity and the supply of important good or service. For creditors benefit in the sense the maximization of value of an asset. During liquidation, the court may authorize the trustee to continue the operation.⁴⁵ With the authorization of commissioner, later on, the trustee may appoint the receiver to carry on business. The law does not indicate source of the post commencement finance that needed for operation, but simply stipulates that the creditors whose claim has arisen out of such operation shall be creditors of the universality with priority right of refunding outside bankruptcy proceeding.⁴⁶ Here the question may be raised is can a trustee use and finance the encumbered asset? To answer this, as discussed above, it depends on whether the bankruptcy system includes the encumbered asset with in proceeding or not. When I was discussing the effect of suspension of suit, it is plausible to say that it extended to encumbered asset also. Moreover, the law authorizes the trustee to sell the encumbered asset with conditions. The conditions may be with the extension of interest⁴⁷ and in the form of redemption.⁴⁸ During scheme of arrangement, the one who is in a charge is the debtor. After the acceptance of application and proposal, the debtor continues the operation of business. For continuation, it needs fund. The effect of judgment confirming scheme of arrangement shall be binding on all creditors prior to opening of

⁴⁴ UNCITRAL insolvency model law (new York.2005)107

⁴⁵ Article 1039(1) of commercial code

⁴⁶ Article 1039(2) of the commercial code

⁴⁷ Article 1028 of commercial code

⁴⁸ Article 1039 of commercial code

proceeding for scheme.⁴⁹ The court laid down the procedures that could be done during scheme in judgment.⁵⁰

The application for scheme arrangement brought before bankruptcy or liquidation, the debtor may propose the conditions under application. It may indicate the source of finance. With the purpose of scheme of arrangement, it is possible to say the debtor can use and dispose for the funding of business. But the Ethiopian law silent in this regard. Under proposal of scheme, the debtor is obliged to give guarantee to perform according to proposed scheme. This may include the secured creditors with further encumbrance with another asset which may not be disposed as a result of scheme of arrangement. From the experience of other jurisdiction, the debtor is under duty to provide adequate protection for disposal of encumbered asset which is valuation of asset to avoid diminution and establishing priority with secured granted.

d. Is an encumbered asset part of bankruptcy proceeding under Ethiopian Law?

Pledges and mortgages are the most known type of securities utilized under Ethiopian law. Commercial Code devotes separate provisions to these categories of creditors; the rules relating to these creditors are virtually identical, justifying their treatment under the same heading. On the effect of bankruptcy upon pledge and mortgagees, there are different approaches. There are laws that allow secured creditors in general to enforce their security interests, untroubled by the commencement of bankruptcy. This approach is common in those systems which exempt secured creditors from the application of stay (suspension of suits). There are also, on the other hand, laws which include encumbered assets in the bankrupt estate, to be controlled by trustees, subject to some conditions. In some laws, the power of trustee over encumbered assets is dependent upon the nature of the proceeding: liquidation or reorganization.⁵¹ A trustee has an unlimited power to sell encumbered assets when the proceeding involved is a reorganization while trustee's power to do so is limited by a period of time in a liquidation proceeding. We start with Article 1026 - which exempts secured creditors in general from one of the effects of bankruptcy - suspension of individual suits. As already alluded to, what a suit means in particular cases is not clear from the language of Article 1026, but in one respect, what is included in the

⁴⁹ Article 1150 of commercial code

⁵⁰ Article 1151 of commercial code

⁵¹ Taddese lencho 'Ethiopian Bankruptcy Law: A Commentary (Part II)' *Journal of Ethiopian Law*(2008)45

suspension is beyond dispute - the suit includes an action for attachment of debtor's property. A **contrario** reading of Article 1026 will lead us to conclude that secured creditors can attach (and foreclose in some cases) the collateral which they hold as security.⁵²

The right of the pledgee to foreclose or effect sale is not unlimited. The trustee has the power to redeem the pledge by paying the debt in full to the pledgee.⁵³ A trustee, as a fiduciary representing the best interest of unsecured creditors, should seek to maximize the value of the bankrupt estate by exercising the right of redemption. A dispute may arise between a pledgee who wants to exercise his power of sale and a trustee who wants to exercise his power of redemption. Which of them takes precedence? As it is discussed on above section, the possible way is making the pledged asset subject to proceeding. This is inclusion approach.

Two sections of the bankruptcy law are devoted exclusively to the rights of mortgagees. These provisions contain some clues as to what bankruptcy may signify to mortgagees. One may conclude generally from the joint reading of Article 1026 with Articles 1068-1072 that mortgagees are largely unaffected by bankruptcy. The provisions as they now stand may be read as denying the trustees access to encumbered property with an unpleasant result that the mortgagees might be able to call the shots over their collaterals and still be able to participate in the distributions from the bankrupt estate. Mortgagees can pursue their rights over their collaterals untroubled by bankruptcy proceedings.⁵⁴ And their right to participate in the distributions from the bankrupt estate depends to a large extent upon the order of distributions from encumbered or unencumbered assets. As pointed out before, the ambiguity of Ethiopian bankruptcy law on this matter can lead to frequent disputes between trustees and secured creditors over collaterals and may result in substantial loss of time as trustees seek to yank encumbered property from the control of secured creditors for the benefit of unsecured creditors (universality of creditors).⁵⁵

⁵² *ibid*

⁵³ Article 1058 of commercial code

⁵⁴ n(184)46

⁵⁵ *ibid*

Regarding the rights of pledge and mortgage, the civil code⁵⁶ of Ethiopia and a proclamation to provide for property mortgaged or pledged with by banks⁵⁷ provide apparent clarity of the secured creditors to foreclosure has not prevented controversies from arising in practice as to the priority rights of secured creditors' vis- a-vis other creditors. Secured creditors frequently found themselves asserting their priority rights against tax authorities, employees and judgment creditors. **Inland Revenue Authority vs. Fissehaye W/Gebriel, Housing and Thrift Bank and Addis Ababa Abattoirs**, for example, involved a four-way dispute over priority of creditors.⁵⁸ Fissehaye took all the trouble of finding and attaching the property of a debtor (which was the house of the debtor), but when the property was up for sale, other creditors came into the scene and demanded payment from the proceeds of the sale. Fissehaye argued that he was entitled to priority because he took all the trouble and should be rewarded with priority as a result of his diligence as a judgment creditor. Housing and Thrift Bank claimed priority because it was a secured creditor (although in this case, its collateral was a garage not the house in question). Inland Revenue Authority (the Tax Authority) invoked a 1947 law which allegedly granted priority to government claims. Although this case involved the case of a secured creditor (the Bank) arguing priority over a property which was not its collateral, it is an illustration that the clear language of the Civil Code is no guarantee for the absolute priority rights of secured creditors, particularly when the competition comes to be against preferred creditors who are granted priority by other laws of Ethiopia.⁵⁹

From this all, I can say that secured creditors can't be outside the effect of bankruptcy proceeding in this modern era of commercial law.

4. CONCLUSION AND RECCOMENDATION

a. CONCLUSION

One of the main obstacles for rather traditional bankruptcy laws is that they commonly exclude secured creditors from the insolvency process, with the consequence, that they may enforce their

⁵⁶Civil Code of the Empire of Ethiopia Proclamation No 165 of 1960, Negarit Gazeta, Gazette Extraordinary, 19th Year, No 2, Addis Ababa, 5 May (1960) article 3076

⁵⁷ A proclamation to provide for property mortgaged or pledged with by banks No 97/1998negarit gazetta (1998) article 3

⁵⁸**Supreme Court, Civ/App. No. 13/1984, in Supreme Court Cases, Vol. 3, in Amharic, pp. 595598**

⁵⁹Taddese lencho 'Ethiopian Bankruptcy Law: A Commentary (Part II)' *Journal of Ethiopian Law*(2008)55

rights outside proceedings and thereby negatively affect the outcome of the reorganization and liquidation process. More modern insolvency codes usually include secured creditors in the process and make them thus subject to the general effects of insolvency. The treatment of secured creditors reflects the natural tension between the objective of maximization of asset value for the benefit of all creditors with along going enhancement of the chances of a successful reorganization and, on the other hand, the need to protect secured creditor and their interest in the collateral. Since any erosion of the value of security interests undermines the availability of affordable credit, balancing these two objectives requires careful consideration. Currently in the world, there are two approaches in which the secured creditors treated. The first one is Exclusion in which secured creditors may enforce their security rights outside insolvency proceedings. Basic argument in favor of this approach is that it creates strong incentives for a financially sound behavior of the debtor. The second one is Inclusion in which secured creditors become subject to general effects of proceedings in exchange for an adequate protection. The purpose intended to achieve during this approach is that the administrator seeks to sell the debtor enterprise as going concern in order to negotiate a reorganization plan or to sell assets piecemeal.

The American bankruptcy code follows the second approach. In order to protect the interest of secured creditors that may be infringed due to inclusion, the law provides adequate protection. This mechanism limits the power of administrator to dispose an encumbered asset as he wishes by making his decision to sell such property subject to court revision.

The other instrument that was discussed is UNCITRAL model law on insolvency. On the treatment of secured creditors, the UNCITRAL model law provides different approach based on the proceeding. During reorganization, the necessity of encumbered asset to a prospective reorganization or sale of the debtors business and the assurance of non-diminution of value of asset encumbered. During liquidation, if the inclusion is necessary to maximize the value of asset for the benefit of creditors and assurance of the protection against diminution of value of encumbered asset.

The approach an Ethiopian bankruptcy law follows is not clear. But it seems that it favors the first approach which is exclusion of secured creditors from proceeding. The new banking business proclamation also strengthens this approach. But, this conclusion itself is not free from

exception. The decision of cassation bench of federal Supreme Court which is binding on the remaining courts follows the second approach, which is inclusion.

B. Recommendation

The Ethiopian bankruptcy regime encompasses the 1960 commercial code and the banking business proclamation number 592/2008. Even if there is no basic difference between these two laws, commercial law book v is general law which applies to all bankruptcy cases and the banking business proclamation is special law that applies to banks only. Today, the US bankruptcy code and UNCITRAL model law on insolvency could be the best practiced and referenced laws. Ethiopian bankruptcy law encounters huge gap in comparison with both US bankruptcy code and UNCITRAL model law on insolvency. There are many lesson that could Ethiopia could learn from them.

Firstly, the Ethiopian commercial code book v is not clear enough whether the secured creditors are part of bankruptcy proceeding or not. The legislature should bring this clarity by revisiting the Ethiopian bankruptcy law with full intention that either the law is including or excluding the secured creditors from proceedings.

Secondly, the effect of suspension of suit, which is the heart of bankruptcy proceeding is not clear on secured creditors. The law did not put the pledge and mortgage on the effect of judgment in bankruptcy section. On this point, the code needs appraisal and must put clear effect on the secured creditors without ambiguity.

Thirdly, the duration of suspension of suit is not clearly provided under the code. The code must provide the time length how much the suspension stays in effect in order to control responsible persons during bankruptcy proceedings.

Fourthly, the law is unclear whether the trustee has power to use and dispose the encumbered asset during the continuation of business. This raises frequent dispute between secured creditor and trustee who wants to use an asset for post commencement finance. The law should provide clear provision by authorizing the trustee to raise additional finance to operate the business.

Fifth, the code is not clear whether to sell business as going concern is possible under Ethiopian law. To maximize the value of estate, selling of business as a going concern is best practice.

Selling business as going concern has a lot to do with encumbered asset and the Ethiopian law should have include the sell business as a going concern and its effect on the secured creditors clearly.

Sixth, the code does not define what are these public and creditors interests that the continuation of business operation needed for. This raises huge controversy to redeem or not the pledged property. Thus, the code should clearly indicate what these interests are in order to limit the discretion given for commissioner.

Seventh, the code does not provide the post commencement source of finance during scheme of arrangement. The code must oblige the debtor to indicate the source of finance during the application time for scheme of arrangement.

Eight, the Ethiopian bankruptcy law fails to include the mechanism of valuation of property. This raises huge controversy to determine the exact value of encumbered asset during judgment in bankruptcy. To grant security for disposal, it is difficult to evaluate the proportionality. Hence, the Ethiopian bankruptcy law should clearly provide the mechanism how to value the encumbered asset.

Ninth, no adequate protection provision is there under Ethiopian law except the continuation of counting interest. But the law should provide more than this by granting security and giving priority before any creditor on encumbered asset.

Lastly, by believing that the Ethiopian law includes secured creditor in proceedings (half-heartedly) it must provide the mechanisms how the secured creditors could get relief from application of suspension of suit.

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