



Reorganization under US and Ethiopian Bankruptcy Law.

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LLM Short Thesis

Comparative Bankruptcy Law

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Abstract.

The objective behind conducting this research is to assess the Ethiopian legal framework available for the reorganization of financially distressed businesses in light of the well developed and practically tested US bankruptcy law.

In this thesis it is claimed that, unlike the US bankruptcy law which encourage and provide sufficient legal framework for reorganization of a financially distressed business, the Ethiopian bankruptcy law lacks efficient and sufficient rules promoting reorganization. Such defects are reflected in the existing legal framework pertaining to the commencement of the proceeding, the filing and contents of the plan, the process of confirmation and its implementation.

It appears that absence of rules encouraging reorganization coupled with lack of other options, such as composition (as understood in US bankruptcy law) and workouts, force bankrupt persons to end up in liquidation.

Hence the existing legal frame work, available for the rehabilitation of distressed businesses, of Ethiopia, should be modified to provide an efficient legal framework with sufficient rules for the rehabilitation of a financially distressed business and the courts should consider reorganization as legal solution for bankruptcy cases.

KEY WORDS

Bankruptcy, Reorganization, scheme of arrangement, liquidation, composition

Acknowledgment

It is a pleasure to thank the people who supported me in writing this thesis.

It is difficult to overstate my gratitude to my supervisor professor Tibor Tajti, whose encouragement and support from the initial to the final level enabled me to develop an understanding of the subject. I am grateful for his support and encouragement in my academic career.

I am indebted to my friends Mr. Aytenew Debebe and Mr. Yodahe Tesfaye for their support, my sister Freweyni Beyene and my friend Bitanya Fikre, for being a big inspiration.

Lastly and most importantly I wish to thank my parents, Medhin Gebresilase and Beyene Gebremedhin. They bore me, supported me, taught me, and loved me.

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Index of Abbreviations

Art	article
Bankr.	Bankruptcy
ET AL	and others
Et seq.	and the following
Neg. Gaz.	Negrait Gazette (official gazette of laws of Ethiopia)
No	Number
p/pp	page/pages
Sec/secs.	Section/sections
Univ.	University
US/USA	United States/ United States of America
U.S.C	United States Code
Vol.	Volume.

INTRODUCTION

In the early days of the development of bankruptcy, the sole solution was liquidation where all the properties of the debtor was sold to the satisfaction of the claim of the creditors and the debtor could not be exempted until the claim of the creditors is fully satisfied.¹ The current version of bankruptcy law evolved through many developments and in today's society bankruptcy law contains concepts and solutions other than a mere liquidation.

One of the most developed and practically tested bankruptcy laws of the world is the US bankruptcy law. The US bankruptcy law is basically designed to serve three fundamental purposes.²

The first fundamental purpose was introduced to the American bankruptcy law at the beginning of the twentieth century, is called the idea of fresh start.³ The second purpose is providing rules which are equitable for the division of property of the debtor among the creditors.⁴ Such division will be made as per the equitable rules provided in the bankruptcy code and the specific features of the claim of the creditors. The third purpose is to provide a rehabilitation opportunity for the distressed business so that it can stay in the business and pay its debts to the creditors.⁵

Saving the detail discussion for the first chapter, in simple terms reorganization is all about the financial restructuring of the financially distressed business.⁶

¹ Kevin J. Delaney, **Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 To Their Advantage**, University Of California press 1998, p.12

² James J. White, **Bankruptcy and Creditors Right: Cases and Materials**, West Publishing 1995, p.29

³ ibid

⁴ ibid

⁵ ibid

⁶ Bryan A. Garner(ed)Black's Law Dictionary (9th ed. Thomson Reuters 2009)

This paper will basically focus on this third fundamental purpose, that is reorganization, but in addition I will also discuss concepts, like liquidation, composition, which are relevant for the main issue to be addressed in the thesis.

The Ethiopian bankruptcy law is attached to the 1960 commercial code. It is criticized for its distinct preference for liquidation than rehabilitation or reorganization of the financially distressed business. Such preference is evidenced by the arrangement of the code in a way that bankruptcy preceded the scheme of arrangement provisions and the devotion of large number of the provisions to liquidation of financially distressed business.⁷

One can infer such preference to liquidation by the bankruptcy law of Ethiopia by a simple scheming through the relevant provisions of the code.

In addition to the above criticism, it is also criticized for lack of practice. After the introduction of the commercial code, the provisions of the code governing bankruptcy remain to be dormant. As a result of which it is considered to be the most neglected part of the code both in terms of practical application by the courts and academic research to further develop this part of the law. Though scholars provide different justifications for such marginalization of this particular area of the law, all agree on the fact that the law in spirit and in practice gives priority to winding up of a financially distressed business.

As a result of which the legal framework of bankruptcy law in the country remains to be practically untested and unchallenged part of the code. But recent developments show the time for the practical application of this area of the law to face the challenge has come. The current trends are showing the fast growing of the corporate sector, particularly in the form of Share

⁷ Taddese Lencho, **Ethiopian Bankruptcy Law Commentary**. Journal of Ethiopian Law, Vol 22, No. 2, Dec 2008,p.63

Company. Such growth of the corporate sector is further intensified by the recently introduced growth and transformation plan of the government.

According to this plan of the government, the agricultural sector will play the dominant role in the economy of the country for the coming few years. But then the industrial sector will take the place to lead the economy of the country. Therefore the government has taken a big home work to make ready this sector to effectively take over the leading role in the economy.

To serve this purpose the government has deployed a number of different mechanisms. Following the initiation taken by the government and the various incentives deployed, a number of companies are being established by the private sector.

It is not difficult to infer, at least by taking into consideration the history of other countries, from such establishments that all will not be successful in the tough competition. I believe, in the near future we will have a number of these cases. The historical development of the idea of business reorganization in US is a good example for such assertion.

In US, railroad was the first instance for the emergence of the idea of business reorganization. Since the entire railroad could not be successful in the competition, the need to protect them with the idea of reorganization was justified by their critical role in the economy.⁸

The writer will make a comparative analysis of the Ethiopian and the US legal frameworks concerning reorganization and recommend some points on the areas that need reconsideration and the experiences that can be adapted to the Ethiopian bankruptcy law.

To serve its purpose, this paper is organized containing three chapters.

⁸ Supra note 5, p. 281.

In the first chapter the meaning of reorganization from the US perspective will be addressed. The Ethiopian law, though it contains conceptually similar arrangement with reorganization, it does not give any definition.

For the sake of proper understanding and appreciation of the concept of reorganization, it will also include a discussion about some related concepts of bankruptcy. The rationale behind reorganization of a financially distressed business and its comparative advantage over other bankruptcy related concepts which are available for the business will also be discussed in this chapter.

In chapter two, the legal framework available for reorganization of a financially distressed debtor in the two systems will be discussed.

Chapter 11 US bankruptcy law and the scheme of arrangement section of the Ethiopian commercial code are the legal frameworks that will be discussed in this chapter. From the big picture of the reorganization proceeding, the commencement of the proceeding, the reorganization plan, the confirmation process, the effect of confirmation of the plan and the role of the trustee in the process are the focuses of this chapter. These areas, I believe, are those which require reconsideration and transformation in the Ethiopian equivalent.

Chapter three is devoted to the conclusion of the comparative analysis and some recommendations. The paper finalizes that, the Ethiopian law favors liquidation of a business than reorganization. Such liquidation friendly approach is due to the fact that Ethiopian scheme of arrangement does not provide efficient and sufficient legal framework for the reorganization of distressed businesses. In the recommendation section of this last chapter, I will provide some

pointes that should be reformed in the Ethiopian commercial code to make it efficient and sufficient for the rehabilitation of financially distressed businesses.

Chapter one - reorganization: meaning, related concepts and rational: US perspective

This chapter begins with the meaning of reorganization. The related concepts, liquidation, composition and workout, to reorganization which are relevant for the proper understanding and appreciation of reorganization of a financially distressed business will also be discussed. The rational and the comparative advantage of reorganization over the other procedures in bankruptcy are also incorporated under sub sections of this chapter.

1.1 *Meaning*

The back's law dictionary defines the term reorganization as;

“A financial restructuring of a corporation, esp. in the repayments of debts, under a plan created by a trustee and approved by a court”⁹

Reorganization, unlike liquidation, basically focuses on the rehabilitation of the corporation. As one can see from the definition of liquidation and reorganization, the life of the corporation ends in case of liquidation.

One can properly understand the notion of reorganization by a close reading of the meaning of liquidation in bankruptcy. Black's law dictionary defines liquidation as;

“The process of collecting a debtor's none exempted property, converting that property to cash, and distributing the cash to the various creditors.”¹⁰

⁹ supra note 6

¹⁰ Ibid

In the case of liquidation the basic rational behind is converting the asset of the debtor in to cash for the satisfaction of the claim of the creditors.

In reorganization the corporation continues to function. By restructuring the finance of a business, the business can continue to function. As a result of which the business continues not only to pay its debts but also it will continue to provide its employees with jobs and also to provide a return to its stockholders.¹¹ Reorganization serves the interest of the creditors, the employee and the stockholders. The creditors want their money get paid back by the debtor, the employees want to have their jobs secured and the stockholders need some return from the investment that they have made.

As it is stated above, business reorganization accommodates and compromise interests together whenever a business is in trouble.

The theme of reorganization lays on the strong justification that it is better and important to use the assets of the business for the primary purpose for which the business is established to serve.¹²

In the case of liquidation the assets of the business are converted to cash, by legally provided mechanism, to make the payment to the creditors, which definitely is not the purpose for which the business is established. The business is indebted to the creditors only to raise finance to achieve the purpose for which its stockholders are looking for. Therefore, it is to the best interest of the business, the stockholders, the employees as well as the creditors to use the asset of the business for the primary purpose for which they are meant to serve.

¹¹ Charles J. Tabb & Ralph Brubaker, **Bankruptcy Law Principles, Policies and Practice**, Anderson Publishing co Ohio 2003, P. 595

¹² *ibid*

The above argument is further clarified and strengthened by Charles J. Tabb's work called future of chapter 11. He said: "A business is worth more alive than dead i.e. it is worth more as a going concern than in forced sale liquidation."¹³

Reorganization basically focuses on the future prospect of the business. The future prospect of the business matters because the debts are to be paid from the future income of the business. Such payment depends on how the business survives the crises to which it is facing.

The debtor's ability to come up with a positive net income in the future makes rehabilitation more viable. In such case it is appropriate to permit the business to keep its property and make the profit so that the claim of the creditors will be paid. To achieve this purpose, it is better to make the business active in the market than liquidating and forcing it out of the competition.

The above discussion is only to give the meaning and general overview of reorganization, thorough discussion of the reorganization process will be the main theme of chapter two.

I believe that for a proper appreciation of the features of reorganization, it is necessary to understand some relevant related concepts of bankruptcy. Taking in to account this purpose, the next sub topics of this chapter are devoted to it.

¹³ Charles Tabb, **the future of chapter 11**, as cited in Charles J. Tabb & Ralph Brubaker, **Bankruptcy Law Principles, Policies and practice**, Anderson Publishing co Ohio 2003, p.595

1.2. *Related concepts*

A. liquidation

Taking in to account the definition of liquidation reproduced at the beginning of this chapter, liquidation can be summarized as the sale of the assets of the debtor for the satisfaction of the legal claims of the creditors. Therefore in the liquidation process, the business will be dissolved and its assets will be sold and cash from the sale of the assets will be deployed to the satisfaction of the claim of the creditors of the debtor. In cases of liquidation, the financially distressed business comes to an end. The assets of the business will be deployed to the satisfaction of the claims of the creditors than serving the original purpose for which they were designed.

B. workout

Black's law dictionary define workout as

“A debtor's agreement, usu. negotiated with a creditor or creditors out of court, to reduce or discharge the debt.”¹⁴

From the above definition, in addition to their contractual nature, it is clear that workout can take either of the following two forms. First, it can be an agreement between the debtor and creditor/creditors to reduce the debt. It means, the debtor will not pay the full amount of the original debt. Second, the agreement between the debtor and the creditor/creditors can be for the extension of the time of payment.

In short, the first is the reduction of the debt and the second is extension of time of payment of the debt.

¹⁴ Supra note 6

C. composition

It is not the purpose of this sub topic to give the different concepts of composition in different Jurisdictions. Rather, it will limit itself only to the definition of composition.

The black's law dictionary defines composition as:

“An agreement between a debtor and two or more creditors for the adjustment or discharge of an obligation for some lesser amount; an agreement among the debtor and two or more creditors that the debtor will pay the creditors less than their full claims in full satisfaction of their claims.”¹⁵

Therefore composition is receiving partial payment instead of the full payment for the full satisfaction of the creditors claim and it depends on the agreement of the parties.¹⁶ Taking in to account the definition and explanation on workout, one can conclude that composition is workout which is out of court settlement mechanisms in US law.¹⁷

Of course in some other jurisdictions, including Ethiopia, it has a different meaning. In these jurisdictions unlike the US one, composition is not a pure private agreement and there is imposition on the dissenting creditors.¹⁸

In the Ethiopian commercial code the court is involved in the process of composition. The difference between composition and scheme of arrangement is not the involvement of the court. In both cases the law authorizes the involvement of the court. Rather, the difference is that composition is a procedure available after the declaration of bankruptcy by the court and on the other hand scheme of arrangement can only be applied before the declaration of bankruptcy.

¹⁵ ibid

¹⁶ Lawrence P. King & Micheal L. Cook, **Creditors' Right, Debtors Protection and Bankruptcy**, Mathew bender, NY, 3rd ed., 1997, P.610

¹⁷ Asres Gikay, **the role of work out under the US and the Ethiopian bankruptcy law: a comparative analysis**, LLM thesis at central European university. p. 10 (2011)

¹⁸ Ibid, p.11

1.2 Rational

In this section I will provide the different arguments justifying reorganization. There are different legal options for a financially distressed debtor. As discussed in the previous section, liquidation and composition can be mentioned as options available to the debtor. It is true that, all have their own advantage and disadvantage. But as far as this paper is concerned, the main focus is reorganization therefore the discussion hereunder is made accordingly.

What is the benefit in reorganization? Is a question worth asking at this juncture. Permitting rehabilitation of a financially distressed corporation is far beyond preserving the corporate as a legal entity, as it is stated by Douglas G. Baird; “. . . Corporation itself is merely a legal fiction. It is not a sentient being, and there is no virtue in preserving a corporation charter for its own sake.”¹⁹

Therefore reorganization is about compromising the different, most of the time conflicting, interests in case the corporation faced financial problem. Sometimes, the issues revolving around the survival or winding up of a single business is far beyond the business itself. There are many interests caught up in it and the existence of such business can have a direct or circuitous effect on the interests interwoven in it. The development of the concept of rehabilitating a distressed business also proves the same.

¹⁹ Douglas G. Baird, **Elements Of Bankruptcy**, Foundation Press New York 5th ed. 2010, p.59

In the US the concept of reorganization developed for the first time with respect to the railroad and such legal procedure becomes possible to the other sectors or businesses after the enactment of chapter X, XI and XII.²⁰

The railroad was critical to the functioning of the economy, though all were not fortunate in the competition, and their critical role in the economy of the country made the congress to enact law to enable the failing railroads to rehabilitate and continue their function.²¹

Douglas considering reorganization of the railroad as the progenitors of modern chapter 11, justifies the rehabilitation of the railroad taking in to account the values in the railroad like right of way over narrow trips of land, hundreds or thousands of miles of iron rails, millions of wooden ties and assorted bridges across the country and such values were better to be used for the purpose for which they are primarily designed for.²²

As it is provided at the beginning of this sub section on the statement of Douglas, reorganization is about restructuring the finance of the business for the benefit of the various stakeholders in the business, like the employees and the creditors.²³ All the stakeholders will derive some benefits due to the fact that the business is not liquidated or it is still running after the financial restructuring.

The book of Charles and Ralph states, as provided hereunder, the various stakeholders having interest in the business in one way or the other and who are beneficiaries due to the restructuring and rehabilitation of the distressed business. It says;

²⁰ See supra note 5, p.281.

²¹ *ibid*

²² supra note 19, p. 60

²³ supra note 11, p.594

“Reorganization, rather than liquidation, also may benefit other constituencies beyond the debtor and creditor. Employees of the company have an interest in keeping their job. Suppliers often benefit from keeping a good customer. Even the community in which the debtor operates may have an interest in keeping the company afloat.”²⁴

Therefore, the groups who can derive a benefit from the rehabilitation of the financially distressed business are the debtor, the creditors, employees, suppliers and the community.

It is clear that the debtor will get the immense benefit from the reorganization of its financially stressed business. Had it been for liquidation, its assets would have been converted to cash and payment would have been made to the creditor and the business’s life would have come to an end. Due to the rehabilitation chance, the assets of the debtor are saved from the sale and the business continues to operate. Also, due to the reorganization opportunity the business assets are serving the primary purpose for which they are organized.

Creditors will also get a benefit from the reorganization of the business. In cases of reorganization, as some studies indicate, the recovery rate of creditors is higher than liquidation.²⁵

It is true that reorganization of the business will benefit the employees of the business. Such benefit is bigger; I believe, especially in case of employees with firm specific skills. When the employee is a professional with specific skill which is peculiar to the activity of that specific business, liquidating and dissolving the business could mean more than changing or securing another job for such employee. It can also mean changing to and acquiring another new skill.

²⁴ Ibid, pp. 595 - 596

²⁵ Arturo Bris, Ivo Welch, and Ning Zhu, **the cost of bankruptcy: chapter 7 liquidation versus chapter 11 reorganization**, VOL. LXI, No. 3, journal of finance. 1253, 49 (2006)

The community at large will also get a benefit due to the fact that the business is rehabilitated than liquidated and continued to operate. Business entities, in most of the cases, are mobilizing huge amount of capital and labor force, both professional and unprofessional. The case is more sensitive in countries where there is limited amount of capital and skilled labor. The history of the railroad in the US is a typical example to such cases.

The community can also derive benefits from the rehabilitation of the distressed business because reorganization has the capacity to limit the externalization of the cost of business failure to the taxpaying public.²⁶ If the business is huge one; its failure will result in affecting, either directly or indirectly, many interests attached to it and the government will defiantly bailout the company. The money for the bailout is the tax payer's money. But if the company is given the chance to reorganize itself and come out of the financial crises without using the money of the tax payers, the tax payer's money can be used for the purpose for which it is primarily collected for.

The comparative advantage of business reorganization is better summarized by the legislative history of the bankruptcy code as reproduced in the book of Tabb and Brubaker. It says;

*"The purpose of business reorganization case, unlike a liquidation case, is to restructure a business finance so that it may continue to operate, provide its employees with jobs, pay its creditors and provide a return for its stock holders."*²⁷

Restructuring the debt of the debtor who is unable to make the due payment on the due date can be taken as a solution to save the business from liquidation rather than filing reorganization²⁸ and

²⁶ Elizabeth Warren, **bankruptcy policy making in imperfect world**, 92 Mich. L. Rev.1993-1994,p.368

²⁷ Supra note 24

²⁸ Lynn M. Lopucki & William C. Whitford, **Corporate Governance in Bankruptcy Reorganization of large, Publicly Held Companies**, 141 university of Pennsylvania law review. 1993, p.677

such restructuring can take the form of composition where the debtors debt is reduced and the creditor/s accept partial payment as a full satisfaction of their claim or extension where the time of payment will be extended so that the debtor will have some more time to make the payment.²⁹

But filing bankruptcy reorganization has advantage over settling the issue with out of court settlement mechanisms as described above, which can be either in the form reduction of the amount to be paid or extension of the date of payment. Therefore, what makes stakeholders to resort to filing bankruptcy reorganization than these mechanisms is a due question.

The first advantage is that the filing of reorganization can save the plan of reorganization from the dissenting minorities and makes them to be bound by the vote of the majority which is not the case in the other settlement mechanisms.³⁰ Unlike the case of reorganization, contractual out of court settlement mechanisms may not work to settle the conflict because in such mechanisms the creditors who do not want to submit to the restructuring either in the form of extension or composition cannot be forced to be bound by the agreement of the majority.³¹

The second advantage is that the benefit derived from the automatic stay protection which protects the debtor from the individual collection effort by the creditors.³² Automatic stay halts creditors having security or adverse interest from interfering the debtor or its property, from any action of collecting pre petition debts.³³ The detail discussion of automatic stay is saved for the next chapter.

²⁹ See the discussion on section 1.1

³⁰ *ibid*

³¹ *Supra* note 23, p. 596.

³² *Supra* note 30

³³ Dori Lombard, , **revisiting bankruptcy rules and reorganization plans**, money collage review of business winter, 2002, p. 21

The provisions of the bankruptcy law which authorizes the rejection of executory contracts and recovery of fraudulently transferred properties by the debtor are also typical advantages that one can get from the filing of bankruptcy reorganization³⁴ than settling the crises with out of court settlement mechanisms.

³⁴ Supra note, p. 28

Chapter two - Legal framework governing reorganization in US and Ethiopia.

In this chapter, I will discuss the legal frameworks available to reorganization of financially distressed debtors in the two systems. The bankruptcy code of US and the commercial code of Ethiopia are the relevant documents. The chapter contains two major parts. The first part is devoted to the general overview of the development of the concept and the legal documents. I believe this general overview will help the full appreciation of the concept in the two systems.

The second part is devoted to the reorganization proceeding. From the whole picture of the process, I will focus on the commencement of the proceeding, the reorganization plan, the process of confirmation, the effect of confirmation and the role of trustee in the process. Of course it is true that many more details deserve critical analysis. My focus on the above points is due to the position that these are the points which deserve much attention in the process of transforming the Ethiopian bankruptcy reorganization law. Within the above points, I will focus on specific concepts which I thought are lacking in the Ethiopian equivalent and need to be adopted.

2.1 General over view of reorganization under the bankruptcy code and the commercial code.

2.1.1 Reorganization under the US bankruptcy law.

As it is indicated in the previous chapter, the concept of reorganization came to picture as a result of the railroad.

After the railroad marked the birth of the concept of reorganization of a financially distressed debtor, it has gone through a lot of transformation and advancements in response to the economic need of different developments to acquire its contemporary version.

The 1930's great depression was historical event that leads to the codification of the various principles like, the going concern value maintenance, notice and disclosure requirement, absolute priority rules, fiduciary duty and obligations, automatic stay, cram down and others, which evolved and developed from the railroad equity receivership.³⁵

Since the 1898 Act did not contain provisions fit to alleviate the problem caused by the great depression which was the close down and liquidation of business, the congress addressed the problem with emergency legislation which were with a goal of preserving the various entities and latter followed by the comprehensive statute which takes in to account the experience from the railroad reorganization.³⁶

The statute, "*the chandlers act*", introduced several debtor relief chapters, of which chapter X was the most comprehensive, was added to the 1898 act.³⁷ Chapter x deals with the reorganization of large publicly owned companies and was available voluntarily or involuntarily. Chapter XI was designed to serve small privately owned enterprises and individuals on a voluntary base and did not provide authority to affect the right of secured creditors and Under chapter XI the debtor had an exclusive right to file a plan though there was no provision of cram down to impose it on the dissenting creditors.³⁸

Chapter XI cases increased, in addition to the merits attributable to this chapter in particular, some of the drawbacks of chapter X has contributed to the domination of chapter XI. This chapter i.e. chapter XI provided the debtor oriented, less expensive and expeditious process

³⁵ Harvey R. Miller and Shai Y. Waisman, **Does Chapter 11 Reorganization Remain a Viable Option For distressed Business For The Twenty – First Century?**, 78 *Am. Bankr. L.J.* 153, 2004, pp165 - 167

³⁶ Ibid, p.169

³⁷ Ibid, p. 168

³⁸ Ibid, p. 169

where as chapter X provides mandatory application of the fair and equitable rules, the displacement of managers by court appointed trustees and long duration process made it to be less polite to be followed for reorganization.³⁹

The increased number of cases, in terms of number and also in terms of amount of money, mandated for a comprehensive reorganization statute. It was as a result of this demand that the 1978 bankruptcy reform act was enacted which made a comprehensive change to the reorganization process.⁴⁰ It has codified chapter 11 of title 11 and the previous chapter X, chapter XI and chapter XII were incorporated to this act.⁴¹

2.1.2 Ethiopian commercial code.

The Ethiopian bankruptcy law is located in the last book (book V) of the commercial code of the 1960.⁴²

The French bankruptcy legislation of the 1955 and the 1942 Italian law were used as the sources for the bankruptcy law of Ethiopia by the drafter of the commercial code.⁴³ The French law is the primary source for book V and the Italian one is the primary source for title V of the same book which governs the scheme of arrangement regime.⁴⁴

³⁹ Ibid, p.172

⁴⁰ Ibid

⁴¹ Ibid

⁴² The title of book V is bankruptcy and scheme of arrangement. The word 'Bankruptcy' in the commercial code refers to liquidation or straight bankruptcy. Scheme of arrangement, which can be considered as conceptually similar with the US bankruptcy reorganization, is treated as an independent process from bankruptcy. This is a conclusion from the general reading of the title and the provisions of book V.

⁴³ Supra note 7, p. 62

⁴⁴ Ibid, p.63

The Ethiopian bankruptcy law, though it provides a means for the rehabilitation of a financially distressed business, both the practice and the law favors liquidation over rehabilitation of a financially distressed business.

As it is indicated on the 2007 diagnostic of USAID, it says; “The bankruptcy law provides for liquidation and reorganization, but in tone and practice clearly favors liquidation.”⁴⁵

The above quoted assertion clearly shows that, though the law provides a seemingly rehabilitation legal framework, the law as it is and the practice are in favor of liquidation. Saving the brief summary of the scheme of arrangement to a latter discussion, I will provide some arguments strengthening how the bankruptcy law favors liquidation.

There are some scholars arguing that the law’s choice of liquidation prior to and more than the rehabilitation of the business can be inferred from the arrangement of the provisions designed to address the two issues in the bankruptcy law.⁴⁶ If one looks at the arrangement of book V of the commercial code in addition to its title i.e. bankruptcy and scheme of arrangement, the liquidation provisions precede the scheme of arrangement and the pretty dominant number of the provisions are devoted to liquidation.

Also in practice, to the best of my knowledge, cases of bankruptcy in general and the cases of reorganization of distressed businesses are very few. I believe that the system’s favoring liquidation of the financially distressed businesses further intensified by the other laws, like the foreclosure law, of the country. The foreclosure law of the country authorizes, when the banks

⁴⁵ THE USAID, ETHIOPIAN COMMERCIAL LAW AND INSTITUTIONAL REFORM AND TRADE DIAGNOSTIC, Jan 2007, p. 53

⁴⁶ Supra note 44

are creditors, to sale the property of the debtors which they have received as security giving a 30 days' notice to the debtor,⁴⁷ and it is obvious that the major source of finance for businesses in the country is from the banks.

The study made by the Addis Ababa chamber of commerce and SIDA (Swedish Agency for International Development Cooperation) also supports that the attention given to the rehabilitation of financially distressed businesses is low and should be given more attention in the revision of the commercial code.⁴⁸

The system's favoring liquidation character can also be inferred from the provisions which are meant to rehabilitate the troubled business. These provisions indicate the low tolerance of the law within the petite room available for reorganization. Compared to the total number of provisions devoted to scheme of arrangement, those which authorize the court to convert the rehabilitation proceeding in to liquidation is not few. Simple illustration of such provisions, from the commercial code, is provided in the next few paragraphs herein under.

When the court rejects the application of the debtor due to the legally provided grounds or based on its own discretion, the same is under obligation to make an order for the adjudication of the bankruptcy (liquidation) of the debtor.⁴⁹

⁴⁷ The Federal Democratic Republic of Ethiopia, Federal Negarite Gazette, property mortgaged or pledged with banks Proclamation number 97/1998, art. 3

⁴⁸ Supra note 45, p. 125

⁴⁹ See Ethiopian Commercial Code, proclamation number 166, Neg. Gaz. 1960, art. 1123/3/

After the court accept to consider the application for its merit, the court gives a period not exceeding eight days to the debtor to submit the list of creditors and to make a deposit to the court registrar sufficient to cover its costs. If the debtor fails to do this in the given period, the court is under obligation to convert its application and order the adjudication of liquidation.⁵⁰

There are some prohibited acts provided in the law for the protection of the creditors. Like an act of gift and other gratuitous acts, loans, assignments not falling within the exercise of the business and mortgage during the proceeding or if the debtor committed such acts or try to conceal part of his assets or fraudulently omitted certain creditors or increase his liability or commits other fraudulent acts,⁵¹ the scheme of arrangement proceeding will be converted to bankruptcy (liquidation) proceeding.

At last, if the scheme of arrangement is not approved by the court, the court can adjudicate the debtor bankrupt.⁵²

Unlike the other sectors of the economy, the issue of reorganization is more or less well addressed in the banking business. The banking business proclamation,⁵³ in general and article 40/1/ in particular, indicates that rehabilitation of a financially distressed bank is the primary goal of the proclamation rather than directly going to liquidation of the bank.

⁵⁰ Ibid, art. 1125

⁵¹ Ibid, art.1134

⁵² Ibid, art.1142

⁵³ The Federal Democratic Republic of Ethiopia, Federal Negarite Gazette Banking and business proclamation number 592/2008.

In the next few pages, short and brief description about the scheme of arrangement in the commercial code is provided. And the discussion is limited to the most important features which I believe, reconsideration and major improvement is required.

2.2. Reorganization proceeding in the bankruptcy code and the commercial code.

2.2.1 Commencement and the reorganization plan

A) Commencement and reorganization plan in chapter 11

In chapter 11, a debtor who is unable to make the payment and worth of staying alive rather than going through the liquidation process files a bankruptcy reorganization under chapter 11 and in the mean time the debtor's business will continue to operate and do business with the rest of the of economy.⁵⁴ The first and one of the effects of filing for bankruptcy reorganization is automatic stay.⁵⁵ It is destined to prevent a race, by the creditors, to the assets of the debtor.⁵⁶

The automatic stay protects the estate by prohibiting the beginning or continuation of any act or proceedings against the debtor or to recover a claim, enforcement of judgment that arises before the commencement of the case, any act to get possession or create a lien against the property of the estate or setoff. The court can give relief to the creditors from such stay for lack adequate protection for parties holding an interest on property,⁵⁷ or if the property is not necessary to effective reorganization or it is a property on which the debtor does not have equity on.⁵⁸

Protecting the debtor from embarrassment arising from the individual debt collection effort by the creditors, letting the debtor to have a time to think about reorganization and preserving the

⁵⁴ Barry E. Adler, Douglas G. Baird & Thomas H. Jackson, **Bankruptcy: Cases and Materials**, 4th ed., Foundation Press New York 2007, p.678

⁵⁵ Sec. 362, 11 U.S.C

⁵⁶ Supra note 54, p. 103

⁵⁷ Sec. 362(d)(1), 11 U.S.C

⁵⁸ Sec. 362(d)(2), 11 U.S.C

estate of the bankruptcy proceeding,⁵⁹ are the main functions of the automatic stay; among others. It brings the claims and interests involved in the bankruptcy proceeding in to a single forum.⁶⁰ Preserving the assets of the debtor for the latter restructuring and rehabilitation, making the asset available for the benefit of the creditors community as a whole rather than individual secured creditor⁶¹ and thereby facilitates the rehabilitation process of the financially distressed business is the very purpose of automatic stay in reorganization cases. Automatic stay is a means to achieve the purpose for which a financially distressed debtor is filing for reorganization. This is because it has the capacity of preserving the estate from the individual collection of the creditors, and makes it available for the rehabilitation of the business.

As it is provided under sec.1121, the plan of reorganization can be proposed by the debtor and interested parties and in the plan the debtor is required to classify the claim and interests under different classes.⁶² Claims and interests which are substantially similar should be under the same class.⁶³ The plan must also provide the respective treatment for each class.⁶⁴ Creditors have claims and equity holders have interest.⁶⁵ Sec.101/5/ of chapter 1 of title 11 provides a wide definition of claim. I have reproduced the text of this section because I found it important for the subsequent discussions.

“(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

⁵⁹ James O. Johnston, JR. **the inequity machinations of section 362(a)(3): rethinking bankruptcy’s automatic stay over intangible property rights**, 66: 659 southern California law review, vol 66:659, (1992), pp. 662 – 665

⁶⁰ Raymond T. Nimmer, **secured creditors and the automatic stay: variable bargain models of fairness**, Minnesota law review, vol 68:1,1983, p.2

⁶¹ Ibid, pp 2-3

⁶² Sec. 1122(a)(1), 11 U.S.C

⁶³ Sec. 1122(a), 11 U.S.C

⁶⁴ Sec. 1123 (a)(2)(3), 11 U.S.C.

⁶⁵ Supra note 22, p.236

*(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.”*⁶⁶

Of course, the fact that there is claim does not mean it is due for collection, as it is stated “claim is necessary, but not sufficient, for collection from a debtor in bankruptcy.”⁶⁷ The quoted statement is referring to the exceptions provided under section 502. In principle, the plan must give similar treatment for claims and interests like other claims and interests in the class unless the holder of the claim or interest consented to less favorable treatment.⁶⁸

The debtor, to come up with a reorganization plan, has 120 days to do so. This is a period exclusively given,⁶⁹ to the debtor to come up with a plan. As indicated in the work of Yongqing Ren, Novica Petrovski considers this exclusivity period as the most important feature of the US bankruptcy reorganization compared to the reorganization laws of other countries.⁷⁰ Of course this period can be extended based on certain circumstances by the court.

The plan of reorganization can be imposed on the dissenting minority creditors through a procedure called cram down; but in order to impose the plan on the minority dissenters, the plan has to fulfill the requirements provided under sec.1129.

If the debtor fails to come up with a plan within the period provided by the law, the parties in interest have the right to come up with a plan.⁷¹

⁶⁶ Sec. 101/5/, 11 U.S.C

⁶⁷ Supra note 54, p. 141

⁶⁸ Sec.1123/a//4/, 11 U.S.C

⁶⁹ Sec. 1121/b/, 11 U.S.C.

⁷⁰ Yongqing Ren, **comparative study of the corporate bankruptcy reorganization law of the U.S. and China**, university of Groningen, p.46. Accessed at:<http://dissertations.ub.rug.nl/FILES/faculties/jur/2011/y.ren/thesis.pdf>.

⁷¹ Sec. 1121(d), 11 U.S.C

In general, in US the reorganization plan can be designed by the debtor or other parties designated by the law. The law provides a priority to the debtor to file the plan within a specified period. If the debtor fails to come up with a plan, then the designated parties can exercise their right.

If the debtor comes up with a plan as stated above, the next step is the debtor's effort to get the plan accepted. To get the plan accepted the debtor must submit a disclosure statement and persuade the court to accept the plan.⁷²

The rationale behind writing the disclosure statement is to provide adequate information to parties in interest to enable them to make educated judgment about the proposed reorganization plan and the adequacy of the information depends on the nature of the plan and the sophistication of the interested groups⁷³.

After the approval of the disclosure statement, the debtor moves to get the vote of the various classes in favor of the plan,⁷⁴ and Douglas provides two ways through which the debtor can get vote of the various classes.⁷⁵ The first is the vote of the creditors of a given class and their claim who voted in favor of the plan must have at least two third of the value of the claims of the total voting and second is the constructive approval from the unimpaired class.⁷⁶

⁷² Supra note 65

⁷³ Supra note 33, p. 22.

⁷⁴ Supra note 72

⁷⁵ Ibid, p. 232

⁷⁶ ibid

B) Commencement and reorganization plan in the commercial code

Under the commercial code of Ethiopia, the application of the scheme of arrangement is to be made to the court by the debtor who has or is about to suspend payment and has not been declared bankrupt.⁷⁷ Unlike the one in the US, in Ethiopia the law equips only the debtor with the right to apply for the scheme of arrangement.

The application has to be made in the form of declaration containing some documents, reason for suspension or impending suspension of payment and the reason for proposing the scheme of arrangement,⁷⁸ in addition the debtor should not have history of bankruptcy (liquidation) or scheme of arrangement within the past five years from the date of application.⁷⁹

The application of the debtor must contain the requirements specified by the law.⁸⁰ The debtor is required to incorporate in the proposal that he will pay not less than 50% of the capital value of unsecured debts within one year, or 75% within 18 months or 100% within three years and must provide to furnish material or personal guarantees to secure the payment proposal. He can also assign all assets held by him where it is sufficient to make payment as provided above.

2.2.2 Confirmation of the plan

A) Confirmation in chapter 11

After the plan has secured the approval as per the previous discussion, the next step is the confirmation of the plan by the court. Confirmation of the plan means official approval of the reorganization plan by the court.⁸¹ It is of two kinds “confirmation of consensual plan” and

⁷⁷ Supra note 52, art. 1119. A person to apply for scheme of arrangement he should be a trader. Trader is a person who conducts the activities listed under article 5 of the commercial code.

⁷⁸ Ibid, art. 1119.

⁷⁹ Ibid, art. 1120/3/c/

⁸⁰ Ibid, p. 1121

⁸¹ Supra note 73.

“confirmation of non consensual plan”.⁸² The first refers to the confirmation of a plan which is approved by the majority of a class, whereas the second refers to a procedure of confirmation of a plan which has not secured the vote of an impaired class.⁸³

While approving the plan, the court must make sure that the requirements provided by the bankruptcy code are satisfied in the plan.⁸⁴ In the process of approval the absolute priority rule of sec.1129 (b), the “best interest of creditor”⁸⁵ of sec.1129 (a) (7) and the “feasibility test”⁸⁶ of sec.1129 (a) (11) are very important.

Sec. 1129(a) (7) best interest protects impaired class of claims or interests which have accepted the plan. It makes sure that the holders of the above claims or interests receive or retain a value not less than they would have received if the debtor was liquidated.

In the best interest test, the value which each creditor would have received had they used their non bankruptcy remedies⁸⁷ can be used to assess the liquidation value which the creditor would receive in liquidation. For example using foreclosure, which is non bankruptcy collection mechanism available for creditors.

The feasibility test is all about making sure that the debtor will not again claim for other subsequent reorganization or the plan will not be followed by liquidation. The need for the subsequent reorganization can be claimed by the debtor himself or successor to the debtor according to the plan. But it will not affect the feasibility of the plan if the liquidation or subsequent reorganization is part of the plan itself.

⁸² Supra note 70, p.112

⁸³ <http://www.law.cornell.edu/uscode/text/11/1129> accessed: Friday march 09 2012 4:17:55 pm

⁸⁴ Sec. 1129, 11 U.S.C

⁸⁵ Supra note 65, p.235

⁸⁶ ibid

⁸⁷ Supra note 67, p. 732

As it is stated in sec. 1129(a) (9) (b), the court must make sure that the plan provides payment for specified pre bankruptcy claims as provided under sec. 507(a) (3)-(7).

Section 1129(b) provides that the plan can be accepted even without securing the acceptance of an impaired class. This alternative confirmation standard is called cramdown.⁸⁸ Paragraph 1 of the same section provides that, cramdown is to be applied on the request of the proponent of the plan. Again the same paragraph provides the requirements of unfair discrimination, fairness and equitability standards to be fulfilled by the plan with respect to each class of claims or interests, which are impaired and has not accepted the plan.

In short, the following quote better summarizes the purpose of the prohibition against unfair discrimination, faire and equitable test.

“The prohibition against unfair discrimination ensures that claims that enjoy the same priority outside of bankruptcy are treated comparably inside of bankruptcy as well and the faire and equitable test ensures that a claim that enjoys priority outside of chapter 11 enjoys priority inside of chapter 11 as well.”⁸⁹

From the above quoted statement, one can conclude that the prohibition against unfair discrimination is all about the protection of the treatment of a claim inside bankruptcy and outside of bankruptcy, whereas faire and equitable test is about the protection of the treatment for a claim inside and outside of chapter 11. Therefore, the difference between the two is their scope of protection otherwise, they both claim for comparably the same treatment for the claims inside and outside.

⁸⁸ <http://www.law.cornell.edu/uscode/text/11/1129> accessed: Friday march 09 2012 4:17:55 pm

⁸⁹ Supra note 87, p.707

What is fair and equitable with respect to each class, i.e. class of secured claims, class of unsecured claims and class of interest is exhaustively provided under paragraph 2 of section 1129(b).

B) Confirmation of the plan in the commercial code

The court is authorized to refuse the application on the strict legally provided grounds or using its discretion to the extent allowed by the law. It is up to the discretion of the court to refuse the application on the ground of non fulfillment of the formality requirement,⁹⁰ or when the court is in doubt that the debtor is not in a position to comply with the plan.⁹¹

On the other hand the court is legally required to refuse the plan when the debtor committed a fraudulent act; for example, when the debtor has absconded closing his place of business or misappropriated or reduced the value of the estate.⁹²

It is after the court's decision to accept the application that the creditors will be called and let to know about the plan.⁹³ If the court decides to consider the application because it has a merit, the court will appoint a delegate judge and a commissioner. The role of the delegate judge and the commissioner will be discussed under the last sub section.

During the court proceeding, since the debtor is not declared bankrupt yet, the debtor retains administration of the property under the guidance of the delegate judge and supervision of a commissioner.⁹⁴

⁹⁰ Supra note 80, art. 1122

⁹¹ Ibid, art. 1123/1/

⁹² Ibid, art. 1123/2/

⁹³ Ibid, art. 1125/2/b/

⁹⁴ Ibid, art. 1132

For the approval of the plan, the scheme of arrangement plan need the majority votes of two third of all none preferred or unsecured creditors and in principle the secured creditors are not allowed to participate in the voting unless they gave up their security fully or partially.⁹⁵

In the final approval, the plan goes through a second screening by the court. In addition, the law provides additional criteria for the second screening.⁹⁶

2.2.3 Effect of confirmation.

A) Effect of confirmation in chapter 11.

Sec. 1141 is devoted to address the issues surrounding the effect of the confirmation of the plan.

The first and obvious effect of confirmation of the plan by the court is that, the plan will be implemented thereof.

As it is provided under sec. 1141(a), the plan will be binding, and the property dealt with by the plan will be free from any claims (see sec. 1141(c)). It also discharges all the debts that arise before the date of such confirmation, of course subject to the exceptions provided under sec. 1141(d) or in the order confirming the plan.

B) Effect of confirmation in the commercial code.

In the commercial code, the provision designated to the effect of confirmation of the plan makes a distinction regarding the effect of the confirmation on the creditors based on the claim they own. The confirmation will be binding on the creditors pertaining to their claim towards the debtor, but the confirmation will not have any effect concerning their claim towards persons who are jointly and several liable with the debtor to the creditors.⁹⁷ The confirmed plan will be

⁹⁵ Ibid, art. 1140/2/

⁹⁶ Ibid, art. article 1144

⁹⁷ Ibid, art. 1150

performed under the supervision of the commissioner and the commissioner will conduct the supervision as per the procedure provided in the judgment of confirmation.⁹⁸

The rights of the debtor are also limited. Unless it is due to the nature of the business, the debtor cannot pledge, dispose of or set aside part of the property until he/she carry out his/her duty under the plan.⁹⁹

2.2.4 The role of the trustee in the process

A) The role of trustee in chapter 11

In addition to the principal duty of a trustee in reorganization proceeding, as provided in section 1106¹⁰⁰, the trustee has many other powers like leasing, selling or using the estates property¹⁰¹ avoiding executory contracts¹⁰² operate the debtor's estate.¹⁰³

Of all the powers of the trustee provided under the bankruptcy law, the short discussion of section 544 is provided hereunder. Though all the features of the power of a trustee deserve a deep comparative analysis, pertaining to its contribution for the efficiency of reorganization legal framework, I found it to be very important to discuss it in this sub section and I believe recent reforms in Ethiopia should consider such powers of trustee, as discussed hereunder.

Sec. 544(a) “strong arm clause”¹⁰⁴, makes the trustee “hypothetical lien creditor” or “hypothetical lien purchaser”¹⁰⁵ and sub section (b) gives the trustee a status of “actual creditor”¹⁰⁶

⁹⁸ Ibid, art. 1151.

⁹⁹ Ibid, art. 1146

¹⁰⁰ Clifford J. White III and Walter W. Tals Jr, **chapter 11 trustees and examiners after BAPACPA**, 80 Am. Bankr. L.J. 289, 2006 p.304

¹⁰¹ Sec. 363, 11 U.S.C

¹⁰² Sec. 365, 11 U.S.C

¹⁰³ Sec. 1108, 11 U.S.C

¹⁰⁴ www.law.cornell.edu/uscode/text/11/544 accessed march 10,2012 5:02 am

By virtue of section 544(a) (1) the trustee can avoid unperfected security interests at the time of commencement of the case. The trustee take the statues of a person who has extended credit to the debtor and get a judicial lien on all of the property of the debtor.

The trustee can use section 544/b/ to invoke state fraudulent conveyance law by applying section 548 which is the bankruptcy law version of fraudulent conveyance law.¹⁰⁷ Of course, the period the two i.e. the state fraudulent law and the bankruptcy version of it, which they could reach back is different. In the former case the period in which the fraudulent conveyance committed depends on the statute of limitation but in the latter case it is two years to be counted from the date of application.¹⁰⁸ Short of that the power given to the trustee is meant to protect the creditors from the acts of the debtor.

Sec. 548/a/empowers the trustee to avoid transfer made or obligation incurred with an “actual intent to hinder, delay or defraud”. Such transfer made or the obligations are incurred are made within two years from the date of filing.

The same section, allows the trustee to avoid transfers made or obligations incurred for less equivalent value while the debtor is insolvent or the debtor becomes insolvent due to such transfers or obligations, or the debtor received such less equivalent value in a transfer made with an intension or when it is obvious that the debtor will not be able to make payment on the due date of payment.

¹⁰⁵ Supra note 89, p. 275

¹⁰⁶ *ibid*

¹⁰⁷ Supra note 74, p. 139

¹⁰⁸ *ibid*

The power of the trustee is even extended to transfers made in partnerships.¹⁰⁹ The trustee can avoid any transfers made or an obligation incurred to the general partner within two years while the debtor is insolvent at the time of making the transfer or becomes insolvent as a result of such transfer.

The law also equips the trustee or debtor in possession with the power to avoid payments or transfers of an interest made by the debtor to a creditor within a legally determined period shortly before the filing.¹¹⁰ Any transfer made within 90 days from the date of filing or one year from the filing date, if the transfer is made to an insider, can be avoided. And the transfer enriches the creditor with an amount greater than what the creditor could get under bankruptcy.

B) Delegate judge and the commissioner in the commercial code.

The delegate judge and the commissioner in the commercial code are the equivalent of trustee under chapter 11. Both are appointed by the court after it decides to consider the application made by the debtor.

The delegate judge is a member of the court. It is the power of the delegate judge to authorize major decisions, for example granting mortgage, setting up pledge, contracting loan, assignment etc, concerning the estate of the debtor. The commissioner has a duty of supervising the activity of the debtor (see article 1135). Whenever there is fraudulent act, concealment or increase in liability by the debtor, recommends the delegate judge to move the court to declare the debtor bankrupt (see article 1134). Also supervise the implementation scheme of arrangement after confirmation using the procedure in the judgment as a guideline. There for the Ethiopian scheme of arrangement provides, unlike US, two layered supervisory bodies which basically perform the function of the trustee under chapter 11. The court, the delegate judge, the

¹⁰⁹ Sec. 548/b/, 11 U.S.C

¹¹⁰ Sec. 547, 11 U.S.C

commissioner, the creditors meeting and the creditors committee are involved in the scheme of arrangement process.

Chapter three - Conclusion and recommendations

3.1 Conclusion.

This thesis has identified the short comings of the legal framework available for the rehabilitation of a financially distressed business in Ethiopia and indicated the importance of having effective and efficient reorganization scheme.

At the end of this comparative analysis of the laws of the two countries concerning reorganization of a financially distressed business, I come to a conclusion that the legal framework available for the rehabilitation of a financially distressed business in Ethiopia is inefficient and insufficient. In addition to some other reasons, provided by some scholars, for the liquidation friendly nature of the Ethiopian bankruptcy law, this thesis shades light on the fact that the Ethiopian law lacks salient features of reorganization on the commencement and filing the plan, the confirmation of the plan, the effect of the confirmation and role of the trustee in the process. I believe that the absence of such important features is responsible for reorganization to be the last choice by stakeholders. Though it is apparent that a deep and meticulous study is imperative to reform the bankruptcy law of the country, the problems identified in this thesis are very important to be considered in recent modifications on the commercial code.

The fact that inadequate literature is referred to the present legal framework for the rehabilitation of financially distressed businesses and court cases in Ethiopia can be mentioned as a shortcoming of this paper. As indicated elsewhere in this paper, this limitation could be manly attributed to the fact this particular area of the law, for one or another reason, is neglected and empirically untested. Save this, I have a strong conviction that this thesis will have significant contribution in terms of showing the pertinent specific areas that are in need of consideration in

recent reforms and also, this research can be used as a roadmap for future full-fledged researches to be undertaken as part of the effort to renovate the country's bankruptcy law.

The fact that the plan can be filed by the debtor only, the absence of legally provided period within which the debtor is suppose to file the plan, the absence of a requirement for the classification of claims under different classes, lack of clear and precise definition of claim, lack of automatic stay and cramdown rules and the unnecessary role of the commissioner and the delegate judge are identified as the short comings of the scheme of arrangement of the Ethiopian commercial code.

3.2 recommendations

Taking in to account the shortcomings pinpointed in the foregoing section, I have made the following recommendations. Some justifications are also incorporated to supplement and render the recommendation persuasive.

- The trend in Ethiopia should be in favor of reorganization of business rather than liquidation. The law should be customized in a way that gives priority to reorganization. I believe the development of the concept in its early stage and its development can give an important lesson for countries with bankruptcy law favoring liquidation. The companies emerging in the country are mobilizing huge amount of labor and capital. The failure of these businesses is far beyond simple business failure and the consequence could be as grave as the event that led the Americans to develop the concept of reorganization. The government has two options to protect them: establishing an efficient and sufficient legal framework in which financially distressed businesses can rehabilitate and survive bad days; or extending financial support whenever they are in trouble. Having inadequate

legal framework, like the event in The Chrysler automotive case,¹¹¹ will force the government to take the second choice. Taking in to account the capacity of the government, the many other duties it has and the purpose behind the privatization policy of the country, I believe the second choice is not even an option that should be considered by the government. Therefore having efficient and sufficient legal framework presents itself as the only option. To realize this purpose, the current law should be modified in a way which accommodates contemporary developments in the area. Hereunder I have suggested some major modifications that should be considered by the legal renovation in Ethiopia.

- The plan should be permitted to be submitted by other parties like chapter 11. Of course the fact that the plan can be submitted by other parties may have some adverse effect on the interest of the debtor. But together with the introduction of filing the plan by other authorized parties, the law should also provide an exclusivity period. Allowing the filing of the plan by other parties without providing the exclusivity period could have the effect of discouraging the debtor from considering reorganization. The exclusivity period will provide the debtor a confidence on the process because only the debtor can file during that period and maintain control on the process, and it has the advantage of facilitating the reorganization proceeding by saving the time and energy of considering multiple plans at the same time.¹¹² In the writer's opinion, the two should be considered together with regard to the Ethiopian situation. Otherwise, introducing only one will make either the debtor or the creditor to avoid reorganization. If it is only the debtor that can file the plan, like the commercial code, the creditors may try to avoid its happening because it is

¹¹¹ Supra note 26, p. 366

¹¹² Supra note 82, p. 47

under the control of the debtor. And, on the other hand, if the other interested parties are allowed without giving an exclusivity period, the debtor may run away from the process because there is a possibility that the process could fall under the control of the other parties. As it is argued by some scholars, the exclusivity period has the effect of encouraging the debtor to file without delay after he faced the financial problem and making the reorganization process fast.¹¹³

- Designating the claims and interests under different classes and make similar claims and interests under the same class should also be considered to the Ethiopian case. Classifying claims and interests under different classes and making those which are similar under the same class makes treatment of the same claims and interests easy and acceptable by the holders of the same claims and interest. Such classification makes the holders of interest and claims to opt for reorganization proceeding at the beginning and make support in the process. But making the list of creditor as holders of claim for the reason that they appear in the balance sheet will have adverse effect on the holders submit ion to such process and make contribution even after it is launched. This is because there will be no fair and equal treatment for the same claims and interests or at least such treatment will be more difficult. This, in return, will make the parties holding interest and claims to opt for individual effort to get their money back than opt for collective actions under bankruptcy reorganization. As it is said, it has the effect of encouraging reorganization. It enhances bargaining power of the holders and reduces the cost of collection of claims and interest.¹¹⁴

¹¹³ *ibid*

¹¹⁴ *Ibid*, p. 105

- The Ethiopian commercial code should include a requirement that the plan should contain payment as a priority rule to designate types of payments. I believe, not making these designated payments has an adverse effect on the process of reorganization.
- The Ethiopian law should avoid the double layer administration of the process i.e. the delegate judge and the commissioner. Having both, to my opinion, will have two adverse effects on the process. The first is a needless lengthening of the process which could discourage the parties involved in the process, especially creditors with an alternative debt collection mechanism like the foreclosure law. The second is that it is causing more expenses on the process due to the payment for the services of both debtor and the delegate judge. Besides, the power given for both can efficiently be performed by one. Therefore, it is better to make one body with detailed and sufficient power responsible, like the US, for the process than having the delegate judge and commissioner.
- Having strong automatic stay, like the one in chapter 11, following the filing of bankruptcy proceeding will encourage the creditors to work together in the process of the reorganization and encourage participating in the reorganization process. this is because automatic stay stops any form collection by the claim and interest holders outside of bankruptcy proceeding or in short, out of bankruptcy proceedings are stopped which in return left the creditors with no choice than participate in the process. In short, automatic stay in the cases of reorganization has the function of preserving the assets or the estate for the rehabilitation and restructuring the business.¹¹⁵ Therefore, having a strong automatic stay will encourage and serve the purpose of reorganization. Therefore, the Ethiopian law should consider taking this experience or principle from chapter 11.

¹¹⁵ Supra note 59, see also the discussion in sec. 2.2.1/a/

- Finally, rather than making transfer from reorganization proceeding to liquidation proceeding due to the acts of the debtor, the Ethiopian law should provide legal ground to make the debtor lose his right and status of debtor in possession. Such measure will encourage rehabilitation of businesses than liquidation.

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