



**ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

**BUSINESS RESCUE PROCEEDING AND ETHIOPIAN
BANKRUPTCY LAW UPON BUSINESS DISTRESS**

BY

FITSUM ZELEKE TESFAYE

ID NO. SGS/0054/2006

**MAY, 2018
ADDIS ABABA, ETHIOPIA**

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**THESIS SUBMITTED TO ST. MARY UNIVERSITY, SCHOOL OF
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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Master of Business Administration. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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ENDORSEMENT

This thesis, titled “BUSINESS RESCUE PROCEEDING AND ETHIOPIAN BANKRUPTCY LAWUPON BUSINESS DISTRESS” has been submitted to St. Mary’s University, School of Graduate Studies for MBA program with my approval as a university advisor.

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May, 2018

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Abstract

This paper tries to research the benefits and advantages of rescuing businesses that are under financial distress by analyzing the practical and legal aspects of business environment. To achieve the objective of this study the researcher used data from both primary and secondary sources. Data from primary sources were collected using interviews with individuals within the Development Bank of Ethiopia (DBE) and the Federal First Instance Court. Data from secondary sources gathered from published and unpublished books, scholarly journals, DBE Rehabilitation data and articles. The data collected from DBE's rehabilitation department is categorized in table and analyzed using simple descriptive line graphs. DBE's data about the procedures they are implementing on Non-Performing Loans (NPL) and the two practical cases that are discussed would try to show the practical aspects rehabilitating or rescuing businesses that are under distress. DBE implements eight procedural steps that are necessary for the successful rehabilitation of business that are in NPL. These procedural steps help businesses that are under distress from moving towards foreclosure and give them different forms of help. Interview with Federal First Instance Court judge tried to show the practice of the Commercial Bench at the court and the attention given to the survival of a business is reflected. It is observed that most of our legal practitioners do not utilize or do not have the knowledge of the legal remedy put in place by the Ethiopian Commercial Law. The 1960 Commercial Code of Ethiopia's Book V regarding scheme of arrangement was also comparatively analyzed with the Republic of South African Company Act business rescue proceeding. Number of articles from the Commercial Code was discussed and recommendations were given for future amendment on the law. Four problems were identified in the Commercial Code that needs major changes: who to initiate business rescue, when to initiate business rescue, how long should the rescue take, and administration of the business. These problems were tackled from the experience of the Republic of South African Company Law. It is recommended any interested stakeholders should be able to initiate scheme of arrangement under the Ethiopian Law. The scheme of arrangement should be initiated at least six months prior to the business defaults on any payments. Businesses should not wait until the last possible moment to rescue the business. The rescue should be completed in the shortest possible time possibly not more than six months to protect the interest of creditors. The administration of the business should be given to business rescue practitioner not the trader to get the business out of financial distress. The business environment in Ethiopia as well as the legal practice needs to give due attention as businesses are one of the important pillars of the society and their existence benefits different stakeholders in the Country.

Key Words: Bankruptcy, Business Rescue Proceeding, Development Bank of Ethiopia, Ethiopia, Non-Performance Loans, Rehabilitation, Scheme of Arrangement

CHAPTER ONE

INTRODUCTION

This Chapter tries to show the background of the study, statement of the problem, the basic research questions about the study, objectives of the study, the significance of the study, the methodology used for the study, and the organization of the study is discussed comprehensively.

1.1 Background of the Study

Businesses in their daily transaction operate either on cash or credit basis. As a result of this transaction one party becomes the debtor and the other creditor. Because of different reasons the debtor may fail to pay its debts to the creditor. Especially, the debtor may be unable to fulfill its obligations because of not having enough liquid cash to cover all of the debts. When this happens, the debtor-creditor relationship has to be settled by a legal remedy called bankruptcy.

Bankruptcy can be defined as the fact of being financially unable (insolvent) to pursue one's business and meet one's engagements. It is the field of law dealing with those who are unable or unwilling to pay their debts. Different literatures provide various definitions for the term insolvency(Mada&Tilahun, 2007, p.5).Balance-sheet insolvency concerns businesses assets and liabilities, if the assets minus liability show deficit the business is insolvent. Commercial insolvency is concerned with liquidity or cash flow of the business. The business may have substantial assets and wealth that are tied up in property that is not readily realizable but the business is unable to pay its debts as they fall due. Ultimate insolvency is the final outcome of the events where the debtor's assets are to be sold for what they will fetch (Ibid, p.6).

The concept of bankruptcy under the Ethiopian Commercial Code can be found in Articles 969 and 970 of Book V, defines bankruptcy in two different ways. The first definitional provision indicates declaration of bankruptcy through judgment by competent court after investigation. To declare someone as bankrupt the main test is suspension of payments. This can be called judicial bankruptcy or legal bankruptcy. The second definition envisages the factual bankruptcy. In this case criminal court may pass sentence on the debtor even though suspension of payment is not

proved by court as alleged by interested party. The offence under which the debtor is sentenced shall be connected with bankruptcy or in respect of bankruptcy(Lencho, 2008, p.58).

Business rescue, under the South African Companies Act, defined as the temporary supervision of the company and of its management, a temporary moratorium on claims against the company, and the development, approval and implementation of a rescue plan to result in either the company's continued existence or, if that is not possible, in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company(Loubser, 2010, p.3).

The preconditions for commencement of business rescue proceedings are that the company is financially distressed and there is a reasonable prospect of rescuing it. A company is regarded as "financially distressed" if at any particular time it appears to be either reasonably unlikely that the company will be able to pay all of its debts as they become due within the immediately ensuing six months, or reasonably likely that the company will become insolvent within the next six months. In the case of an application to court the act also provides two alternatives for the requirement of financial distress shareholder (Cassim et al., 2012, p.862).

An application to court for an order commencing business rescue proceedings may be brought by any "affected person", defined as a shareholder or creditor of the company, any registered trade union representing employees of the company and any employee (or his representative) who is not represented by a registered trade union shareholder (Ibid, p.864).

The court may appoint an interim business rescue practitioner if the order is granted but this appointment is subject to ratification by the creditors at their first meeting. Any business rescue practitioner, whether appointed by the board of directors, the court or the creditors, must meet the requirements for appointment contained in section shareholder (Ibid, p.865).

The main duty of the practitioner is to develop a business rescue plan after consulting the creditors, other affected persons and the management of the company. The directors of the company are not automatically removed from office by the commencement of business rescue

proceedings but must continue to exercise their functions subject to the authority of the business rescue practitioner (Loubser Part 2, 2010, p689).

Business rescue proceedings are terminated by an order of court, the filing of a notice of termination by the business rescue practitioner or the rejection or substantial implementation of a business rescue plan. There is no provision for the automatic or compulsory termination of business rescue proceedings after a specified period, but if the proceedings have not ended within three months after commencement, or within a longer period allowed by the court on application by the practitioner, the practitioner must file a monthly report on the progress of the business rescue proceedings until their termination (Loubser, 2010, p.6).

The Ethiopian Bankruptcy law has a lot to learn from the concept of business rescue proceeding. There are number of bankruptcy cases in Ethiopian courts that would benefit from business rescue proceeding. Businesses that might have been rescued if they were given the chance and protection needed. Especially businesses that are taken to court because of commercial insolvency, where the liquidity or cash flow of the business is the only reason it is unable to pay its debts. If the business was to be given some time and protection from its creditors it would have paid its debts and keep its existence (Lencho, 2008, p.58).

1.2 Statement of the Problem

Business rescue proceeding is an opportunity for businesses that gives one more fighting chance before winding up the business. However, Ethiopian businesses that are unable to pay their debts are forwarded straight to bankruptcy. This is very harmful for creditors, shareholders, employees and the society in general. Businesses give various benefits for its stakeholders. Shareholders reap their investment, employees get their means of livelihood, creditors get their money, government get taxes, and the society gets different goods and services. This will all be lost when the business enters bankruptcy.

Ethiopian law needs to give more protection for businesses before they enter into bankruptcy. Businesses that fulfill the preconditions for commencement of business rescue proceedings need to be given a chance of being rescued. If the business is financially distressed and there is a reasonable prospect of rescuing it, business rescue proceeding should be available for Ethiopian

businesses. Under Ethiopian Law the rescue procedure called Scheme of Arrangement is available for any businesses that are under distress. However businesses do not use this procedure and there are some that do not even know the existence of this remedy. At the Federal First Instance Court Commercial Bench there was only one case brought to the bench for scheme of arrangement and the case is still on going.

In this study, the researcher argues the benefits of business rescue proceeding for Ethiopian businesses and how the Ethiopian Commercial Code can harmonize and entertain this concept with its Bankruptcy law.

1.3 Basic Research Questions

The research addresses the following questions:-

- A. How does Business Rescue Proceeding benefit Ethiopian businesses?
- B. How can other financial institutions in Ethiopia address their Non-Performing Loans before they are moved to foreclosure? What can they learn from Development Bank of Ethiopia?
- C. How can we can we rescue businesses that are under distress? What practical procedures can we implement?
- D. What changes can we make in the Ethiopian Law to make it suitable for businesses that are under distress?
- E. How can we adopt business rescue proceeding into the Ethiopian Law?

1.4 Objective of the Study

1.4.1 General Objective

This research shows the benefits of rescuing a business and what changes we need to make in the law to make it suitable for business that are under distress.

1.4.2 Specific Objective

This specific objective tries to:

- A. Identify how Business Rescue Proceeding benefits Ethiopian businesses
- B. Determines who directly and indirectly benefits from rescuing a business

C. Examine how we can make changes in Ethiopian Law on rehabilitation of businesses

1.5 Significance of the Study

Businesses who are financially distressed or who are unable to pay their debts, if their creditors take them to court they will find themselves in bankruptcy proceeding. Creditors have the only option of taking the business to court to recover their money. When the courts decide to rule in favor of the creditors, the business will be dismantled and its assets sold for what it will fetch to cover its debt. This will put all of the business's stakeholders; creditors, shareholders, employees, suppliers, customers and government; in great disadvantage.

First, creditors are not guaranteed they will recover all of their money if all the assets are sold. There is also a problem of preferred creditors. Ordinary creditors are paid after preferred creditors like banks get their money. Second, shareholders who are investors of the company who took the risk of investing with an expectation of return will be affected. When the company goes bankrupt they will lose their investment. After the assets are sold and all of the creditors are paid if there is any money left, shareholders will divide it among themselves. However this is very unlikely for bankrupt company to pay all of its creditors and still have money left for shareholders. Third, employees are the ones who get hurt the most from a business going bankrupt. Employees are individuals who base their living on the monthly income they get from the business. If the business exists no more they will lose their major if not only source of income and they will put their family in jeopardy.

Fourth, there are other businesses, like suppliers, that depend on the existence of this company. If this company is bankrupt and out of business, it will also affect the business of the suppliers. Fifth, customers would lose from the business being bankrupt, if the business was providing quality products and services and had a good value among trusted customers. Last, government benefits from collecting different taxes just because the company exists. The government would collect like income tax, value added tax, employment tax, customs duty, etc...

Bankruptcy is undesired and unwanted part of business cycle. That is why businesses try to avoid it at any expense. And that is why this research tries to give a way to avoid bankruptcy in general. This research would show how business rescue proceeding could be a way out for

businesses before going for bankruptcy. Business rescue proceeding would benefit all of the above stakeholders of a company by ensuring the business's existence.

1.6 Research Design and Methodology

This research will mostly be literature study of Ethiopian and South African literatures on bankruptcy. It will be supported by different data collection from Federal High Court and Development Bank of Ethiopia (DBE). The Federal First Instance Court is the court that has the mandate to see bankruptcy and scheme of arrangement cases. When businesses want to declare bankruptcy or enter into scheme of arrangement, the Federal First Instance Court has the power to entertain the cases. DBE is a government bank that is engaged on lending money for projects that have significant impact on the economy of the country. The procedures and experiences of DBE would help better show the business aspect of bankruptcy and rescuing a business.

1.7 Scope of the Study

The scope of this study is Ethiopian businesses that are bankrupt or about to be bankrupt. There is limitation finding readily available written research materials in Ethiopia on bankruptcy. The study will use the concept of business rescue majorly from the South African Company Law perspective because of the availability of different written resources to conduct the research.

1.8 Organization of the Research Report

This research has been divided in five different chapters. The first chapter is the introduction on the overall topic of the study. The second chapter is the literature review of different written sources about bankruptcy, scheme of arrangement and the experiences of South African law. The third chapter talks about the methodology and research design of the study. The fourth chapter shows the research result from the Lideta Federal First Instance Court and Development Bank of Ethiopia; and it discusses how the research findings would show the objectives of the research. The last and fifth chapter summarizes the previous chapters and, concludes and gives recommendation on the study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter tries to deal with different literatures on bankruptcy, scheme of arrangement and the South African law on business rescue proceeding. Different researcher's literature is reviewed to give better understanding on the topic of study.

2.2 Bankruptcy Overview

Persons could not be always financially self-sufficient. Sometimes it happens that persons enter into different transactions either on cash basis or on credit basis. It is common that persons enter into transactions as a result of which one becomes a creditor and the other a debtor. Where there is such a relationship, the relationship has to be settled by a legal device when one of them fails to discharge his/her obligation. Because of certain reasons, the debtor may refuse or fail to pay the debt he owes from the creditor. If the creditor were left without any remedy such as where the debtor defaults to pay the debt, it would have a repercussion on the relationship among the members of the society (Mada&Tilahun, 2007, p.1). One of the important mechanisms is the one that regulated the relationship by a legal device such as the law of bankruptcy. The law of bankruptcy is a legal mechanism to settle the relationship between the creditor and the debtor(Ibid, p.3).

Bankruptcy is defined as the fact of being financially unable to pursue one's business and meet one's engagements (Lencho, 2008, p.58). It is the status of business or person who has been made the subject of the application of bankruptcy law and who has been declared as bankrupt by a court of law. Bankruptcy is a situation whereby a person by his acts and conducts affords evidence of its inability to pay or its intention to avoid payment of its debts (Mada&Tilahun, 2007, p.5). The term bankruptcy is sometimes used interchangeably with the term insolvency. There are three instances where a company can become insolvent (Lencho, 2008, p.60). The first is balance sheet insolvency. This is in regard to the business's assets and liabilities, and examines whether there is an overall net surplus or deficit. Under balance sheet insolvency, if assets minus liability show a deficit, then that business is insolvent. Secondly, there is commercial insolvency, which is concerned with the liquidity of the business. Also referred to

as practical insolvency or insolvency on a cash-flow basis, here the business may have substantial assets, but is unable to pay its debts as they fall due. This would happen when the wealth is tied up in property that is not readily realizable or is over-spent in research and development for a new project. The last type, ultimate insolvency, is concerned with the final outcome of the events. The debtor's assets have been sold for a value that is found appropriate given the prevailing state of affairs. In other words, the assets are to be sold for what they will fetch. In a forced state, on a break-up basis the costs of realization and of administering the estate are taken into account (Mada&Tilahun, 2007, p.5).

Even though the term bankruptcy and insolvency are similar and used interchangeably, there are some distinctions between the two (Ibid, p.6). Insolvency presupposes bankruptcy or bankruptcy is an outcome of insolvency. Also, all insolvencies may not lead to bankruptcy and all bankruptcies are not an outcome of insolvency. However, if the business lacks liquidity then it is deemed to be in a state of bankruptcy. Liquidity is the status or condition of a person or a business in terms of his or its ability to convert assets into cash. As well as the degree to which, an asset can be acquired or disposed of without danger of incurring loss in nominal value (Beyene, 2012, p.9).

2.3 Bankruptcy under Ethiopian Law

It is no exaggeration to state that the Ethiopian Bankruptcy law is one of the least known and least practiced laws in Ethiopia (Lencho, 2008, p.57). Since the enforcement of the Commercial Code in 1960, cases having to do with bankruptcy have been few and far (Beyene, 2012, p.20). Bankruptcy is a natural law of business (Lencho, 2008, p.58). It is not that businesses in Ethiopia do not go bankrupt. It is that when they go bankrupt, the old law of the superior creditor seems to rule supreme in most cases. Banks, for example, have developed a practice of private receivership through private loan contracts. In this arrangement, the borrower-business agrees to submit their business to an employee or a consultant provided by the bank (Ibid). The employee or consultant of the creditor bank manages the financial operations of the debtor and attempts to restore the latter to solvency. This practice is seen by some as a snub to the formal bankruptcy proceeding. In referring to the Economist magazine Tadesse Lencho (2008) argues that imagining

capitalism (business enterprises) without bankruptcy is like imagining Christianity without hell and perhaps that is what happened in Ethiopia.

There have been different theories addressing the reason why the bankruptcy law is not being used as often as it should (Ibid). One theory puts the blame on the freezing of commerce in the aftermath of the 1974 Ethiopian Revolution, and ties the misfortunes of the bankruptcy provisions to the Commercial Code in general. This does not explain the situation at the end of the revolution, after 1991, when the economy of Ethiopia was more or less liberalized.

Another theory is lack of familiarity of the legal community with the provisions of bankruptcy in the Commercial Code (Ibid, p.59). Lawyers are a critical piece in the application of the law. If lawyers do not know or understand the law, it is unlikely that the law will ever come to the courts even if it is included in the Code.

The third theory points to the foreclosure laws and practices of Ethiopia as probable reasons for the eclipse of bankruptcy (Ibid). It is said that lenders are using foreclosure law and practice instead of bankruptcy. Secured lenders can institute accelerated proceedings to repossess and liquidate security and do not need to start bankruptcy action. Frequently, borrowers are captive to a single lender, with few other commercial obligations than their bank loan. In this case, the foreclosure effectively deals with most of the debtor's liabilities, although it does not permit rehabilitation or reorganization and often results in liquidation.

2.4 Background on Bankruptcy Law in Ethiopia

In the modern sense the history of bankruptcy law in Ethiopia, dates back to 1933. That was the year when Emperor Haile Selassie I passed a bankruptcy law containing 96 articles. The Bankruptcy Law of 1933 represents the Emperor's first attempt to modernize Ethiopian law relating to business. Article 1 of the 1933 Bankruptcy law states every person registered in the commercial register and who suspends payment may be declared bankrupt. Suspension of payment triggers the proceeding of bankruptcy only when the obligation of payment arises out of what the law calls an executor document. An executor document refers to three documents: a judgment against the debtor in a court of last appeal; a minute of conciliation proceeding in which the debt is recognized without reservation; and a commercial instrument signed or

accepted by the debtor accompanied by a protest for non-payment regularly drawn up (Lencho, 2008, p.61).

The 1933 Bankruptcy law allowed the initiation of bankruptcy only against debtors who suspended a payment, which in all respects is evident by a written document. However, it is not certain if the law has ever been applied in practice. All the reliable accounts of that period mention nothing about the law ever being put to use(Ibid).

Two features of the 1933 Bankruptcy law distinguish it from the Commercial Code of 1960. One is that the 1933 law did not have provisions for ‘Schemes of Arrangement’. The other is that the 1933 law contained penal provisions in Articles 85-93. The Commercial Code has no provisions regarding offences related to bankruptcy, leaving these matters to the 1957 Penal Code (Ibid, p.62).

2.5 The 1960 Ethiopian Bankruptcy Law

2.5.1InGeneral

Ethiopian bankruptcy law is addressed in Book V of the Commercial Code with provisions for bankruptcy and schemes of arrangement. It is odd to see distinct preference being given for bankruptcy and liquidation rather than rehabilitation of the debtor’s business (Ibid, p.63). This is inferred from the arrangement of the provisions rather than an explicit statement. The provisions regarding bankruptcy precede the provisions on schemes of arrangement. In addition, the largest numbers of provisions are devoted to liquidation of the business of the debtor. There are only few occasions where the law’s interest is in saving the business of the debtor. Ordinarily, a business that has financial difficulties goes through reorganization attempts first, and only when that fails will one proceed to liquidation (Ibid).

Book V of the Commercial Code is arranged into five titles. Title I refers to ‘General Provisions’. It lays down general rules for the whole Book V. It defines the scope of Book V and sets down the conditions for bankruptcy and schemes of arrangement. Title II is devoted to bankruptcy and composition. Title III deals with schemes of arrangement, in contradiction to Title II, the saving of the debtor’s business. Title IV addresses special rules of bankruptcy and

schemes of arrangement for business organizations. The last title, Title V, contains, simplified as well as accelerated bankruptcy proceedings.

2.5.2 Scope of Application

In earlier times bankruptcy was seen as a status that applied only to traders. Recently, many countries have now abandoned this restriction of bankruptcy to traders and extended it to all classes of persons; whether they are engaged in trade or not. However, Ethiopia is one of the countries, which still restrict bankruptcy only to traders (Ibid, p.69).

Ethiopian bankruptcy law applies to any trader, within the meaning of Article 5, and any commercial business organization within the meaning of Article 10, with the exception of joint venture. This is understood from the provisions of Article 968 of the Commercial Code, which reads as follows:

Art. 968- Scope of application

*(1) The provisions of this Book shall apply to **any trader** within the meaning of Art 5 of this Code and to **any commercial business organization** within the meaning of Art 10 of this Code with the exception of joint ventures.*

(2) Without prejudice to such provisions as are applicable to physical persons only or to the provisions of Title VI applicable to business organizations only, the provisions of Titles I, II, and V of this Book shall apply to traders and commercial business organizations.

Article 968(1) show that Book V of the Commercial Code is narrow in its scope of application. All traders who are defined by Article 5 of the Commercial Code are subject to the provisions of bankruptcy and therefore may be declared bankrupt. However, when it comes to business organizations there are limitations. Article 968 explicitly excludes ‘joint ventures’ from its application. In addition, it only allows ‘commercial business organizations’, which would imply that non- commercial business organizations are excluded.

Article 10 – Business Organizations

- (1) Business organizations shall be deemed to be of a commercial nature where their objects under the memorandum of association or in fact are to carry on any of the activities specified in Art 5 of this Code.*
- (2) Share companies and private limited companies shall always be deemed to be of a commercial nature whatever their objects.*

Businesses organized as private limited companies and shared companies, regardless of the objectives for which they are established, are always subject to bankruptcy. Even if their objectives do not fall under Article 5 listed activities. However, when we come to one of the three other forms of business organization, namely; ordinary partnership, general partnership and limited partnership, the question of whether the business organization in question is subject to Article 10(1). The business organization should either engage in activities listed under Article 5 of the Commercial Code or its memorandum should state it as the objective of the organization.

2.5.3 Commencement of Bankruptcy

The commencement standard for bankruptcy proceedings is central to the design of any bankruptcy law. It is what sets the process in motion and what maps the way forward for a business in financial difficulties. Commencement standards vary from country to country, although ultimately it should be crafted in consideration of the virtues of ‘accessibility’, ‘flexibility’ and the capacity to prevent ‘improper’ use of proceedings (Lencho, 2008, p.76).

Accessibility is measured by the ease with which all business stakeholders can apply for and set bankruptcy proceedings in motion. Flexibility is measured by the types of bankruptcy proceedings available, such as liquidation, composition, reorganization, and a combination of these. There should be a balance between the need to make the proceedings ‘accessible’ and the possibilities of abuse by those adamant on using the proceedings from ‘improper’ motives. Creditors wanting to disrupt the debtor’s business and gain a competitive advantage may use commencement standard. The standard therefore should be designed to prevent both debtors and creditors from using bankruptcy for motives other than collection of debts (Ibid, p.77).

The United Nations Commission on International Trade Law (UNCITRAL) guide recognizes two ways of establishing conditions for commencement of bankruptcy proceedings against debtors. They are the Liquidity, cash flow or cessation of payments test and the Balance sheet test (UNCITRAL, 2005).

2.5.4 Liquidity, Cash flow or Cessation of Payments Test

This commencement standard is the first and most extensively used standard. It allows applying for bankruptcy proceedings based on evidence of a debtor's inability to pay debts as they fall due. Bankruptcy proceedings could be set in motion when the debtor generally ceases making payments and will not have enough cash flow to cover existing obligations as they fall due(UNCITRAL, 2005).

This test has two principal advantages:

1. It puts the factors that trigger bankruptcy within the reach of creditors and the grounds for initiation of bankruptcy are fairly accessible and within the reach of creditors; and
2. It allows creditors to begin proceedings early to minimize the risk of debtor scattering assets so that the creditors won't be able to use them to recover their money.

This test has been appropriately called creditor-friendly test and some countries include it in their laws with the interest of creditors in mind. However, there are those who disapprove the test stating it might instigate bankruptcy proceedings against healthy businesses upon 'false signal' of mere suspension of payment. Critics point out the test allows initiation of bankruptcy proceedings solely on the grounds of 'temporary cash flow and liquidity problem'(Ibid).

2.5.5 Balance Sheet Test

This commencement standard test requires stricter regulations for the commencement of bankruptcy. The balance sheet test requires that in order for bankruptcy to commence, an excess of liabilities over assets must be shown. A mere suspension of payment by the debtor would not be enough under this test. The burden of proof rest upon the person applying for bankruptcy to show that the debtor has not only ceased payments but also the debtor's balance sheet sheets show an excess of liabilities over its assets. This test is regarded as debtor-friendly, because

bankruptcy proceedings are not initiated solely on the grounds of cessation of payments. This test can show an accurate reflection of the debtor's financial status and prevents commencement of bankruptcy proceedings upon false signals of temporary shortage of cash flows(UNCITRAL, 2005).

This test too has not escaped criticism for putting the commencement standards beyond the reach of most creditors. The balance sheet test mostly relies on information that is under the control of the debtor and it is difficult for creditors to determine the true state of the debtor's financial affairs. Establishing whether there is an excess of liabilities over debtor's assets takes time and creates delay for creditors. In addition, the balance sheet test can give a misleading indication of the debtor's financial situation. Different valuation methods may show different numbers depending on the accounting standards and valuation techniques that may produce results that do not reflect the fair market value of the debtor's assets (Ibid).

Tests employed to determine the commencement of bankruptcy have been criticized for one or more of their defects. It seems there can be no perfect fit to commence bankruptcy. Therefore, it is the duty of each country to adopt a test that best fits its business environment and would be applicable without trouble(Ibid).

2.5.6 The 1960 Commercial Law Commencement Standard

The Commercial Code sets two conditions for commencement of bankruptcy. Article 969 of the Code declares a trader bankrupt if the trader suspends payment and is declared bankrupt by a court of law. According to the Commercial Code, a mere suspension of payment does not make a trader bankrupt. Only a court with the jurisdiction to see the case has the authority to establish suspension of payment and declare the debtor bankrupt. This prevents labeling a debtor as bankrupt only on the grounds of suspension of payments (Lencho, 2008, p.79).

Article 970(1) of the Commercial Code stresses the declaration of bankruptcy by court: "*Where no judgment in bankruptcy is given, bankruptcy shall not result from mere suspension of payments*". The declaration of bankruptcy by a court of law guarantees the protection of the interests of debtors who have suspended payments. This would protect debtors from being labeled bankrupt solely on the grounds of temporary cash flow or liquidity problem. The court

that has jurisdiction to see bankruptcy cases would have the capacity to differentiate temporary cash flow problems from bankrupt businesses.

The court, before passing the judgment of bankruptcy, should establish that there is a suspension of payment by the debtor. Article 971 of the Code explains what suspension of payment entails. It states: *'Suspension of payments shall result from any fact, act or document showing that the debtor is no longer able to meet the commitments related to his commercial activities.'* This would allow creditors to apply for court based on facts, acts or documents that establish that the debtor is unable to carry out its financial obligations. The article seems to permit the commencement of bankruptcy when presenting to the court 'any facts, acts or documents' that could show the debtor is no longer able to meet the commitments related to his commercial activities. However, it is not clear from Article 971 what these 'facts, acts or documents' are that permit the commencement of bankruptcy (Lencho, 2008, p.80). It seems it could have a wider interpretation from all interested parties. From the reading of Article 971 one could argue that the Code wanted to give the bankruptcy courts wider room to interpret what suffices as suspension of payment that can commence a bankruptcy proceeding. There are different cases that come to bankruptcy courts that have different situations, which require the interpretation of the courts. This article does not limit the courts on their interpretation rather aims to give much needed room for their discretion (Ibid).

To help the courts determine the full situation of the business Article 976 authorizes the court to conduct 'preliminary investigation'.

Article 976: Preliminary Investigation

- (1) The court may, where it thinks fit, appoint a judge for the purpose of investigating into the affairs and activities of the debtor.*
- (2) Any judge so appointed may require the assistance of a trustee.*
- (3) All information collected shall be reported to the court.*

The court is given the discretion to appoint a judge to investigate into the affairs and activities of the debtor. The judge may require the assistance of a trustee to help him/her with the investigation. Article 976 is inserted so that the courts can be sure through their investigation

proves the existence of suspension of payment. Judges with the help of trustees can ascertain whether there really is suspension of payment and that the suspension is enough for the commencement of bankruptcy. The courts should carefully investigate the real situation the debtor faced and they should consider the implications and consequences of erroneous adjudication of a viable business. Courts using their authority under Article 976 would fulfill the duty laid upon them in all situations, except the obvious ones.

Article 972 of the Code lays the duty to give notice of suspension of payment on the debtor. It requires the debtor that suspends payment to file notice of suspension with in fifteen days with the registrar of the court that has jurisdiction. Along with the notice of suspension there are documents that need to be annexed by the debtor. Article 973 of the Code requires balance sheet of the firm's; profit and loss account and a list of commercial credits and debts with the names and addresses of the creditors and debtors. These documents would aid as additional commencement standards, besides the suspension of payment(Lencho, 2008, p.95).

From the above discussion on the Ethiopian Law on commencement standard, one could suggest the law combines the 'liquidity test' with 'the balance sheet test'. From the reading of Article 971 of the Code it seems the commencement standard falls upon the liquidity test. But a further reading on Article 973 and its requirements shows the additional requirement of 'the balance sheet test'. Therefore, it is possible to say Ethiopian law opts for an intermediate test rather than taking any side. This intermediate test is beneficial for both debtors and creditors in protecting their interests.

2.6 Scheme of Arrangement

2.6.1 In General

In normal a course of events, businesses are born, they grow, and after time they will die. The death of a business is what we call bankruptcy. Bankruptcy can be very harmful for creditors, shareholders, employees and the society in general. Businesses give various benefits for its stakeholders. For instance shareholders reap their investment, employees get their means of

livelihood, creditors get their money, government get taxes, and the society gets different goods and services. This is all lost when a business enters bankruptcy.

Businesses need further attention and protection before giving up and forwarding themselves into liquidation. Businesses that can be saved or that have a reasonable prospect of being saved should be given a chance. The Ethiopian law calls this chance ‘Schemes of Arrangement’. Under this arrangement, businesses that are under distress can apply to a court of law to enter this proceeding(Mada&Tilahun, 2007, p.231).

However the Ethiopian law has been criticized for preferring bankruptcy rather than scheme of arrangement. The Commercial Code seems to give preference for dismemberment of a business rather than saving the business from bankruptcy. This is not an explicit policy forwarded by the Code. Rather an inference more from the arrangement of the provision of the code. The Code does not encourage the use of Scheme of Arrangement for the protection of a business against liquidation. It should first give the option of saving the business before discussing the death of the business(Lencho, 2008, p.63).

2.6.2 Application to the Scheme of Arrangement

Scheme of arrangement is an alternative to bankruptcy proceedings, where the debtor can initiate when he/she thinks the bankruptcy proceedings have a more negative impact. The debtor starts the process of scheme of arrangement with an application to the court. Article 1119 states *“any trader who has or is about to suspend payments and has not been declared bankrupt may apply to the court for the opening of scheme of arrangement...”*

According to Article 1119 the only person that can apply to the court for scheme of arrangement is the trader who is about to suspend payments. Any interested party who will be affected by the suspension of payment is not authorized to apply for the trader to enter scheme of arrangement. It is not clear why the Commercial Code opted to let only debtors to apply for scheme of arrangement. There are other stakeholders who would benefit greatly from applying for scheme of arrangement rather than applying for bankruptcy. Creditors may not get their money back if the trader enters bankruptcy proceedings. The assets of the trader who is declared bankrupt after

getting sold may not cover all of the debts of the trader. When this happens, the creditors will be the ones who will get hurt. In this case, creditors might opt for the survival of the business rather than entering into bankruptcy proceedings. It is not clear why Article 1119 limited the application of scheme of arrangement only to the trader. Other interested parties who would benefit from the survival of the business should have been allowed to apply of the scheme of arrangement. This would protect both creditors and the debtor.

Trader who enters into scheme of arrangement gets protection from entering into bankruptcy proceedings. Once the scheme of arrangement is accepted and confirmed, creditors are not entitled to bankruptcy proceedings. For this reason, debtors who apply for scheme of arrangement are expected to make a declaration that he/she would comply with the proposed scheme of arrangement(Article 1120 (1)). Along with the declaration, the debtor is expected to file the documents set out under Art 973, such as the balance sheet of the firm, the profit and loss account, and a list showing the commercial credits and debts(Article 1120(2)). The debtor is also required to present the reasons for the suspension or impending suspension of payments and the reasons for his proposing a scheme of arrangement. The court requires this report mainly to know exactly whether the suspension of payments occurred due to the recklessness of the trader or due to reasons beyond his/her control. In addition, the debtor is required to justify the scheme of arrangement by giving specific reasons. The trader would have to convince the court that the circumstance scheme of arrangement is better a solution than bankruptcy for all interested parties (Mada&Tilahun, 2007, p.231).

Trader who is applying for scheme of arrangement should not be declared bankrupt. The right to apply for scheme of arrangement comes to an end when the trader is declared bankrupt. At all times scheme of arrangement comes before bankruptcy proceedings. Scheme of arrangement is an alternative to bankruptcy proceedings only where the debtor is not yet declared bankrupt. Moreover, the trader should show he/she has not entered scheme of arrangement previously in the past five years preceding the date of application(Ibid, p.232).

2.6.3 Contents of the Proposal

The contents of a proposal of the scheme of arrangement are set out under Article 1121 of the Code.

Article 1121: Proposal Contained in Application

(1) The application shall contain the following requirements:

(a) An undertaking to pay not less than 50% of the capital value of unsecured debts within one year from the date of confirmation the scheme, or 75% within a period of eighteen months or 100% within a period of three years;

(b) a promise to furnish material or personal guarantees to secure the undertakings made under paragraph (a) and giving details of the guarantees.

(2) The debtor may propose to assign to his creditors all assets held by him at the date of the application for a scheme of arrangement where the assets are sufficient to meet payments as provided in sub-art (1).

There are two important things under this article, which form parts of the content of the application. First, the trader is required to show its commitment with a guarantee. Due to numerous reasons the trader may either refuse or fail to comply with the commitment. To avoid such situations, the law requires the trader to include a promise to furnish a guarantee either material or personal so that it would be assured that the trader would comply with the undertaking. Second, the trader would undertake the payment of a certain percent of the claim of creditors. The trader is given three options to choose from to undertake the payment. The trader may propose to pay 50% of the claim of each creditor within one year period or to pay 75% of the claim of each creditor with in eighteen months period or to pay 100% of the claim within a period of three years.

Here it should be noted that the trader is not undertaking to pay the claim of all categories of creditors. The trader is expected to undertake the payment of claim of the unsecured creditors. Preferred and scored creditors have something to guarantee payment of the debt and the law does not bother much about such creditors. The trader has also another possibility of proposal. Instead of undertaking to pay certain percent of the claim, the trader can propose to assign all of the

assets held on the date of the application to the scheme. This does not include future or past assets only the existing assets on the date of application (Mada&Tilahun, 2007, p.237).

2.6.4 Consideration of Application

After hearing the public prosecutor, Article 1122 of the Code states the court may refuse the debtors application where any of the conditions laid down in Article 1120 is not present. It is enough for the court to refuse the application if even one of the conditions is not met. The public prosecutor may be of help to the debtor's conviction of offences related to bankruptcy and aid in investigating whether the debtor had formerly been declared bankrupt or entered a scheme of arrangement. After getting all the necessary information, the court will then determine whether all the conditions are met and continue with the scheme of arrangement or refuse to consider the application if any of the conditions is not fulfilled (Ibid, p.238).

In addition, Article 1123 states the court can refuse to consider the application even if the debtor submitted its application in proper form. This will take place if the court is of the opinion that the debtor is not in a position to comply with the undertaking required under Article 1121. Sub-article 2 of Article 1123 states the court shall refuse the debtors application, even if it is made in proper form, where he/she has absconded the closing place of business, or he/she is found misappropriating or fraudulently reducing the value of its assets.

The debtor who does not fulfill the requirements of admissibility in accordance with the law or who is not in a position to fulfill the requirements of its application for scheme of arrangement shall be refused by the court. The refusal of application by the court would have a significant implication on the debtor. The court shall order the declaration of bankruptcy of the debtor who has already suspended payments. Article 1123(3) authorizes the court to make an order of adjudication of bankruptcy on a debtor who has suspended payments or whose application is refused under Article 1122 or 1123(1)&(2)(Ibid, p.239).

2.6.5 Opening Scheme of Arrangement Proceeding

Where all the requirements of opening scheme of arrangement are met, the court can order the opening of the proceedings under Article 1125 of the Code. Once the court determines there is merit in the application and the scheme of arrangement is to be opened, no application to set aside such order could be admitted. Article 1125(2) of the Code gives list of matters to be contained in the judgment. The decision shall contain appointment of a delegate judge and commissioner. The delegate judge of scheme of arrangement will serve as the trustee if it was under bankruptcy proceedings. The delegate judge shall be selected from a list kept with the Ministry of Commerce and Industry who are Ethiopian citizens (Article 994).

Another factor that needs to be included in the decision is that creditors shall be called for a meeting within thirty days from the date of judgment (Art 1125 (2)(b)). Creditors have to meet and discuss over the matter so that they can decide whether to confirm the scheme or not. The decision also needs to contain the period within which the judgment shall be published and notified to the creditors. In addition, if the debtor previously has not submitted the list of creditors, the decision should contain a period, which may not exceed eight days, within which the trader submits the list of creditors. The debtor is also expected to deposit sufficient amount of money to cover the necessary costs to run the scheme of arrangement with the court registry. Such a period shall not exceed eight days. If the debtor is unable to submit the list of creditors or deposit the money to cover the expenses, he/she will be declared bankrupt (Mada&Tilahun, 2007, p.241).

The order of the court opening a scheme of arrangement is final. The judgment of the court has to be published by means of notices posted at the entrances of the court and published in a newspaper empowered to publish legal notices. The office of the registrar also needs to enter the judgment in a commercial register (Art 1128).

2.6.6 Effects of Admission Application

A. Effectson Debtor

Under scheme of arrangement the debtor retains the administration of the property and management of the business (Art.1132). As the properties remain under the debtor's custody, he/she can administer and deal with the properties and business. This right of debtor has

limitation to protect the rights of creditors. The debtor can exercise this right under the supervision of the commissioner and the guidance of the delegate judge. The debtor would not be as free as he has been before the scheme of arrangement. The delegate judge and the commissioner have the right to inspect the books and accounts of the debtor at any time(Mada&Tilahun, 2007, p.244).

Article 1133 of the Code limits the debtor not to enter into transactions that could affect the interests of creditors. Any gifts and other gratuitous acts during the proceeding of scheme of arrangement cannot be set up against the creditors. In order to contract loans, bill of exchange, assignments, mortgages or setting up of pledges, the debtor needs the written approval of the delegate judge. The execution of these rights would be implemented with the supervision of the commissioner. Under scheme of arrangement, in regard running of the business, major decisions are made by the delegate judge when the commissioner exercises the powers of supervision, while the execution is left to the debtor. Any interested party may apply to set aside the orders of a delegate judge within a ten days' notice of such order. If the debtor fails to comply with these requirements set out under Article 1132 and 1133 of the Commercial Code, the effect of failure would be a declaration of bankruptcy (Art 1134). The commissioner and delegate judge have the power to recommend to the court that the debtor be declared bankrupt if found breaching any of behavioral and procedural requirements (Ibid).

B. Effects on Creditors

Creditors holding claims against a debtor, before the opening of scheme of arrangement, cannot acquire a preferred right over the debtor's property or register a mortgage. In the time between application and confirmation of the scheme of arrangement, creditors cannot acquire preferred right over the properties of the debtor. In addition, no mortgage can be registered for the benefit of the creditor to make him/her mortgagee. The only option for the creditors is to look for a solution under scheme of arrangement as provided by the provisions of the law(Ibid, p.247).

The other effect of the application of scheme of arrangement is that preemptions and forfeitures shall suspend. If there are creditors holding a right that has no preference, as a consequence of the application made for scheme of arrangement, such debts shall be deemed to be due. The

creditors of such debts can claim it as of the time of application. But no interest shall run as of the time of application. Creditors can claim the interest due before the time of application but not for time between application and the final confirmation (Mada&Tilahun, 2007, p.248).

2.6.7 Approval and Confirmation of the Scheme of Arrangement

The court accepting the application and ordering scheme of arrangement to be opened would not be sufficient by itself. Creditors are supposed to have a say on the proposed scheme of arrangement. The delegate judge fixes the time and place for creditors meeting within the time fixed by the court. At the meeting the creditors will give their approval of the proposals put forward by the debtor. All unsecured creditors holding rights prior to the application for a scheme can take part. Creditors have to be present at the meeting in person or be represented by an attorney (Art 1136).

The creditor's meeting is presided by the delegate judge. The commissioner presents the report as regards to the behavior and actions of the debtor in relation to the proposed scheme of arrangement and the list of creditors. Following the report, the debtor is to submit his/her final proposals. If the creditors agree on the proposal, they can confirm and approve the proposed scheme based on the final proposal of the debtor (Article 1136).

Creditors who oppose the scheme or contest the debts of other creditors can intervene and explain their reasons. The creditor who opposes the scheme needs to explain why he/she is not willing to accept the scheme of arrangement and forward any justifiable reason that he/she has. If the reason is convincing the other creditors might change their position when it comes to voting. The main purpose of meeting of creditors is to vote on the proposed scheme of arrangement. For the scheme to pass, it should be accepted by a majority of creditors. It should be noted here that the majority is not a 'simple majority'. It is creditors representing at least two-thirds of the non-preferred or unsecured debts (Article 1140). As far as secured creditors concerned, they may not vote on the scheme for the reason that they have property of the debtor they hold as collateral. However secured creditors could participate in the voting if they give up the security they hold and be regarded as unsecured creditors(Ibid, p.249).

The effect of non-fulfillment of the majority of creditors representing at least two-thirds of the unsecured debts will be declaration of bankruptcy of the debtor (Article 1142). When the proposed scheme of arrangement fails due to vote of creditors, it is logical that the debtor be adjudged bankrupt as he/she has suspended payments. The court, based on the information received from the delegate judge, would declare the debtor bankrupt(Mada&Tilahun, 2007, p.251).

Where the required majorities have been fulfilled, the delegate judge makes an order for the parties to appear before the court within twenty days when the scheme is to be confirmed. Not less than three days before the confirmation hearing the commissioner needs to submit his/her reasoned order and the delegate judge submits a report of the hearing. At the hearing of the application for the confirmation of the scheme both creditors and debtor would be given the chance to raise any points which they think are important in relation to the proposed scheme of arrangement (Article 1143).

The mere fact that creditors approved the scheme of arrangement by majority vote would not be enough for the court to confirm the scheme. The court has to look into the proposed scheme carefully before it orders its enforcement, especially in relation to the protection of public interest and rendering of fair justice. The court also has to be satisfied that all procedures prescribed by law for the application, admission and approval have been fulfilled.

2.7 Business Rescue Proceeding under the SA Company Law

2.7.1 Brief Introduction

Since 1926 South African company law has provided for the rescue of financially distressed companies when the Companies Act 46 of 1926 was introduced. Unfortunately, for most of its existent judicial management under 1926 Companies Act has been severely criticized on many grounds. Then came the Companies Act 61 of 1973, replacing the Companies Act 46 of 1926, which did very little to improve the situation as the judicial management remained underutilized. As a result, the current Companies Act 71 of 2008 (the Act) introduces two newly-created corporate rescue procedures in the form of business rescue proceedings and a compromise with creditors(Loubser, 2010, p.3).

2.7.2 The Need for Business Rescue

A company or business is an integral part of the community in which it exists and does business, and it has direct impact on the economic and the social well-being of that community through its employees, suppliers and distributors (Loubser, 2010, p.1). Accordingly, the failure of a company affects far more people than merely its employees and creditors. In cases of a large company, for example mining companies, a whole community, or town could be ruined if that company collapses. Moreover, certain country's majority working population can be regarded as institutional investors because of trade unions, pension funds and other retirement funds, which invest their money in public companies (Ibid).

Business rescue seeks to take advantage of the reality that in many cases an enterprise not only has substantial value as a growing concern, but its growing concern value exceeds its liquidation value. (Loubser Part 1, 2010, p501) Three advantages of business rescue that can be stated are creditors get a better return on their claims than an immediate liquidation, business rescue saves jobs, and that business rescue does not carry the same stigma as straightforward liquidation. Business rescue is not only concerned with repaying creditors but also with protecting all affected parties by ensuring that various interests at stake are equitably balanced (Cassim, Cassim, Jooste, R., Shev, &Yeats, 2012, p.861).

One of the advantages of a successful corporate rescue is that it prevents or limits job losses. In a country like Ethiopia where unemployment rates are high, this is even more relevant. Having a successful and effective corporate rescue procedure has great importance to the economic growth and stability of the country. In addition, it is one of the factors that foreign investors take into account when deciding whether to invest in a country.

2.7.3 Overview of Business Rescue Proceedings under the Companies Act 71 of 2008

Companies Act 71 of 2008 provides for business rescue proceedings to give effect to one of the stipulated purposes of the act, which is to “provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders” (Section 7 & Section 128(1)(b) of the Act). This describes business rescue as a

temporary supervision of the company and of its management, a temporary moratorium on claims against the company, and the development, approval and implementation of a rescue plan. This would result in either the company's continued existence or, if that is not possible, in a better return for the company's creditors or shareholder than would result from the immediate liquidation of the company (Cassim et al., 2012, p.862).

The preconditions for commencement of business rescue proceedings are that the company is financially distressed and there is a reasonable prospect of rescuing it (Loubser Part 1, 2010, p502). A company is regarded as "financially distressed" if at any particular time it appears to be either reasonably unlikely that the company will be able to pay all of its debts as they become due within the immediately ensuing six months, or reasonably likely that the company will become insolvent within the next six months. The Companies Act gives two ways to initiate business rescue proceedings; the first is through the resolution of the board of the company and the second is through the application to the court (Section 129 and 131 of the Act).

As the management of the company would be the first to know about the impending financial problems, the board of a company may take a resolution to begin business rescue proceedings voluntarily with no involvement by the court (Loubser Part 1, 2010, p502). This would allow the board of directors to act immediately once they realize that the company is heading for insolvency and needs the protection and the breathing space that business rescue proceedings will provide. During this time a rescue of the company or its business can be attempted(Ibid).

An application to court for an order commencing business rescue proceeding may be brought by any "affected person". Any affected person is defined in the Act as a shareholder or creditor of the company, any registered trade union representing employees of the company and any employee who is not represented by a registered trade union (Section 131(1) of the Act).Neither the company nor the directors, in their capacity as such, are authorized to apply to court for commencement of business rescue proceedings. However, a director who is also a shareholder of the company may apply for court with his/her status as a shareholder (Cassim et al., 2012, p.865).

The inclusion of trade unions and individual employees in the list of persons who may apply for order commencing business rescue proceedings is part of the protection of the interests of workers. The right to apply for business rescue proceedings grants a very powerful right to a single employee which may be used as a bargaining tool by trade unions to protect their rights especially during wage negotiations (Loubser Part 1, 2010, p510).

If the order is granted, the court may appoint an interim business rescue practitioner but this appointment is subject to ratification by the creditors at their first meeting (Ibid, p506). The main duty of the practitioner is to develop a business rescue plan after consulting the creditors, other affected persons, and the management of the company (Section 150 of the Act).

Business rescue proceedings are terminated by an order of court, the filing of a notice of termination by the business rescue practitioner or the rejection or substantial implementation of a business rescue plan(Section 132(2) of the Act). There is no provision for the automatic or compulsory termination of business rescue proceedings after a specified period, but if the proceedings have not ended within three months after commencement, or within a longer period allowed by the court on the application by the practitioner. The practitioner must file a monthly report on the progress of the business rescue proceedings until its termination (Section 132(3) of the Act).

2.7.4 Board Resolution to Begin Business Rescue

A resolution by the board of directors of a company to voluntarily begin business rescue must be made by majority vote unless otherwise stated under Memorandum of Incorporation which requires the resolution to be unanimous (Section 73(5) of the Act). The business rescue resolution will come into force only when it is filed with the Companies and Intellectual Property Commission, and the rescue proceedings officially commence on the date of such filing. The company, within the next five business days after filing the resolution, must notify every affected person of the resolution. Also within the same five business days, must appoint a business rescue practitioner to oversee the company during its business rescue proceeding (Cassim et al., 2012, p.866).

If the board of the company does not adopt a resolution to commence business rescue proceedings although it has reasonable grounds to believe that the company is financially distressed, the board must deliver a written notice to each affected person (Section 129(7) of the Act). The notice should be explaining which of the stipulated grounds for financial distress apply to the company and why no business rescue resolution has been taken. The reason for this provision is clearly to prevent company boards from continuing to trade in spite of warning signs that the company is in serious financial trouble and to prevent them from leaving employees and creditors in the dark until the company is hopelessly insolvent. The aim is to give affected persons the information and also the proof of the company's financial distress to enable them to apply for business rescue proceedings themselves while the possibility of a successful rescue still exists (Loubser, 2010, p62).

The Act contains three measures that are intended as remedies against the very real potential for abuse of power by company boards who aim to start business rescue proceedings and appoint the business rescue practitioner of their choice (Ibid, p63). First, any affected person may apply to a court for setting aside the business rescue resolution if believed to be abused by company boards. Second, an affected person may also apply to a court for an order setting aside the appointment of business rescue practitioner and its replacement on the grounds that the practitioner is not independent of the company or its management (Section 130 (1) (b) of the Act). The third measure provides for an application to the court by an affected person for an order requiring the business rescue practitioner to provide security for an amount that the court considers necessary in order to secure the interests of the company and any affected person (Section 130 (1) (c) of the Act).

2.7.5 Court Order to Begin Business Rescue Proceeding

Any affected person may apply to court for an order to commence business rescue proceedings and place the company under supervision (Cassim et al., 2012, p.872). An application for business rescue may be made even after liquidation proceedings have been commenced by or against the company. This will have the effect of suspending the liquidation proceedings until the court has refused the application for business rescue or if the application is granted, until the business rescue proceedings have ended (Section 131(6) of the Act).

If the court is satisfied that the prescribed conditions and requirements have been met, it may make an order placing the company under supervision and appoint an interim business rescue practitioner nominated by the applicant. Alternatively, the court may dismiss the application and make any appropriate and necessary order, including liquidation of the company(Loubser, 2010, p77).

The moratorium that will protect the company against legal action by creditors comes into effect only once business rescue proceedings have commenced (Loubser Part 2, 2010, p689). In addition to the moratorium, the Companies Act of 2008 also protects the company against actions based on breach of any contracts to which the company was a part at the commencement of the rescue proceeding. The business rescue practitioner is given the right to suspend or cancel entirely, partially or conditionally any provision of such agreement other than an employment agreement (Section 136 (2) of the Act).

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

Proper and successful rescue of a business involves the business as well as the legal aspects of the business environment. To explain the business aspect the researcher has chosen the Development Bank of Ethiopia (DBE), as it is one of the oldest financial institutions in Ethiopia specializing in long term financing. The DBE is a bank established to promote the developmental agenda of the government. DBE's agenda is not focused on making fast money or engaging with businesses that only benefit a few individuals. The DBE is a bank that is focused on both the business and developmental aspect of loans, which makes it a perfect reference for the topic of this research.

To explain the legal aspects of rescuing a business, I have chosen the Lideta Federal First Instance Court, as it is the mandated court in Ethiopia that can examine bankruptcy and scheme of arrangement cases. When businesses want to declare bankruptcy or enter into scheme of arrangement, the Lideta Federal First Instance Court is the relevant institution to see and approve the cases. This means the court holds the power to declare the death of a business or to let the business survive. Therefore, a clear understanding of the legal aspects of bankruptcy and scheme of arrangement, especially from the courts perspective, would aid in the understanding of the benefits of scheme of arrangement (legal remedy of business rescue) and how to utilize it as a tool.

3.2 Research Approach

This study utilizes qualitative research approach in the data collection and reflective analysis for explaining the challenges and practices of business rescue proceedings in the Ethiopian Commercial Law. This research aims at discovering the underlying motives and desires, using the in-depth interviews and different literature materials for the purpose of explaining the topic. The qualitative research approach provides the opportunity to make deductive reasoning that is

clearly based on the facts produced during the research since it assists in the explanatory nature of this research. As a result, the conclusions and recommendations that emanate from this research are both grounded in the literature as well as in practice.

The research reviewed different literature to better explain the disadvantages of bankruptcy and the advantages of rescuing a business. The research explored various international perspectives that have illustrated the benefits of rescuing a business. This research reviewed the Republic of South Africa Company Law and how they handle businesses that are under distress and the procedures they employ to rescue them. This research gave a comparison between the South African Law and the Ethiopian Law, in regards rescuing a business, analyzing the differences while illustrating what the two separate laws can learn from one another.

For the purpose of this research, the researcher has interviewed Ato Sintayehu Zeleke, one of the senior judges in the Lideta Federal First Instance Court. Ato Sintayehu is a long serving judge on the Commercial Bench in Lideta, which gives him the mandate to examine bankruptcy and scheme of arrangement cases. He is well experienced in different commercial cases making him an adequate authority to interview for this research.

The researcher also interviewed the DBE's Project Rehabilitation and Recovery Department about the procedures they are implementing on Non-Performing Loans (NPL), investigating two practical cases from the DBE that applied NPL. This has assisted me in showing the theoretical and practical aspects of dealing with NPL and exemplify ways to help businesses survive rather than go through a foreclosure.

3.3 Data Collection

Data has been collected from both primary and secondary sources. Data from primary sources were collected using interviews with individuals within the Development Bank of Ethiopia and the Federal First Instance Court. The primary data collected is used to support the information obtained from the existing literature on business rescue and bankruptcy as well as to produce and support the conclusion and recommendations of this research project. Data from secondary sources arose from published and unpublished books, scholarly journals, and articles.

The Development Bank of Ethiopia's strategic plans and annual financial reports are also used as part of the secondary sources. The DBE, which is divided by five regions in Ethiopia, and its annual financial report on rehabilitated businesses, will be presented in the research. This data will support the assumptions made by the literature on the benefits of rescuing and rehabilitating distressed businesses.

3.4 Procedures of Data Collection

In order to collect primary data, all interviews were conducted in person by the researcher at the work place of each interviewee. The researcher, using the proper procedures of research at each institution where the data has been gathered, has collected practical case data. The interviews and data collected cover issues about business rescue and bankruptcy in the Ethiopian business environment.

3.5 Methods of Data Analysis

The researcher examined the interview results and data collected from primary and secondary sources. The data collected from DBE is categorized in table and analyzed using simple descriptive line graphs.

CHAPTER FOUR

RESEARCH RESULT AND DISCUSSION

A. RESEARCH RESULT

This research attempted to illustrate how the experiences of the Development Bank of Ethiopia and the Lideta Federal First Instance Court is able to explain the disadvantage of bankruptcy and why it is beneficial to give businesses a chance to be rescued before foreclosure. In this Section the researcher tries to show the Development Bank of Ethiopia's approach to businesses which are under distress or that have non-performing loans would be discussed.

4.1 Development Bank of Ethiopia

Development Bank of Ethiopia (DBE) is a one of the oldest specialized financial institutions in Ethiopia established to promote the governments' national development agenda through finance and close technical support to viable projects from the priority areas of the government by mobilizing fund from domestic and foreign sources while ensuring its sustainability. The DBE, being one of the state owned financial institutions, has a mission of accelerating the national economic development. In its many years of existence, the DBE has established recognition at the national and international levels. Nationally, it is the sole Bank with reputable experience in long term investment financing. Internationally, the DBE is recognized as an important leading channel for the development program financed by bilateral and/or multilateral sources. The DBE's distinguishing feature is its "project" based lending tradition. Projects financed by the DBE are carefully selected and prepared, thoroughly appraised, closely supervised, and systematically evaluated.

The DBE extends credit to credit worthy borrowers and projects that have received a thorough appraisal and are found to be financially and economically viable as well as socially desirable in relation to environment protection, employment generating capacity, and other social benefits that may be included in the framework of the development regulation act of the Government. The bank has a reputation of giving out loans on 70/30 basis. If the borrowers can come up with 30 percent of capital needed for the project, the bank will provide a loan for the remaining 70

percent of capital needed for the project. The credit process of the Bank is designed to serve customers within the shortest possible time, at minimum cost and with high quality of service. Through this process the bank attracts as well as persuades its customers to apply for manufacturing, agro-processing, and agriculture loans, which are the dominant priority areas for the government.

The credit policy of the DBE is designed to be helpful and accommodative to the borrowers in every situation they may encounter. As a bank involved in giving long-term loans, DBE is not always in a hurry to collect its money from borrowers by using any means necessary. The DBE is mainly concerned with the survival and continuation of the business for the reason that the large-scale projects that receive loans from the bank bring more benefit to the country if they can survive rather than foreclose. These borrowers conducting large-scale projects, create significant employment opportunities and a good flow of capital in the country.

4.1.1 Procedures Used by the DBE for Non-Performing Loans

After taking a loan from a bank if businesses are unable to pay back their loan in the time set for them it is called Non-Performing Loan (NPL). Non-performing loans are defined as either substandard, doubtful or loss loans. When borrowers start and continue to pay back their loans but it is below the expectation of the bank it is called Substandard. Doubtful loans are when it looks unlikely that the borrower would be able to pay back the loan. Lastly when it is known that the borrower is unable to pay back the bank the loan this is referred to as a loss loan.

The DBE has developed different procedures to help enable the borrowers to pay back the money they have borrowed. These procedures are advantageous in two ways; first these procedures enable the bank to get back the money loaned, and second, they help the borrowers pay back the money and avoid foreclosure or even a worst case scenario such as bankruptcy. Rather than foreclosing on non-performing loans, the DBE opts for rehabilitation of businesses.

DBE implements eight procedures that it believes would help rehabilitate non-performing loans. The following lists the procedures and provides a brief description of each.

1. **Follow Up-** The bank gives a close follow up to borrowers to enable them a smooth path to return the loan they have borrowed. The bank closely reviews the status of the borrowers

projects and what current as well as future plans they envision in order to be a successful and competitive business. When businesses are faced with different obstacles, the bank works closely with the borrowers on how to overcome these obstacles so that the business may continue.

2. **Rescheduling-** When businesses are unable to meet the designated time set for loan repayments, the bank will allow the borrower to reschedule the payment of their loan. This would give the business more time in order to pay back its loan.
3. **Additional Loan/Equity-** If the business is unable to pay its debt in time because of shortage of money; the bank would consider giving an additional loan to the business. At times businesses that are doing so well may be unable to pay their loan because of a shortage of money for the purchase of capital goods. When this occurs the bank may give an additional loan to the business in order to make it profitable, assuring the repayment the loan.
4. **Management Interference-** When businesses or projects are about to fail or stop repaying their loan because of a management problem, the bank may consider interfering in the management of the company. The borrower will have agreed, in the loan contract, that if the bank observes a management problem it reserves the right to interfere in the managerial affairs of the company. Decision making in the management of the company in might only consider the interests of the shareholders and hurt the overall existence of the company. In this case the bank may interfere in the management of the company to rectify the problem and ensure the existence of the company.
5. **Caretaker Administration-** If the management interference does not work the bank has the option of taking over the management of the company by putting in place a caretaker administration. With the caretaker administration the bank creates a board with group of people from inside the bank and if necessary with experts from outside the bank. The caretaker administration might continue managing the business until it repays the loan it took from the bank.
6. **Loan Restructuring-** After taking into account the credit history of the borrower, the bank could decide the borrower is worthy of loan restructuring. The bank can modify the terms of the loan to provide relief to the borrower who would otherwise have defaulted on payments. Under loan restructuring the bank would make the terms more favorable to the borrower.

7. **Partial or Full Cancellation-** The bank can cancel, within reason, part of the interest from the loan if it believes would help survival of the business and in the long run repay the initial loan granted. After implementing partial cancellation and/or any of the above procedures and still if the business is failing and it looks highly unlikely that the bank will get its money back, the bank can cancel or write off all of its debt.
8. **Foreclosure-** The last option the bank may resort to is a foreclosure on the business. Under the foreclosure, the bank would sell the properties of the business to get back the loan it provided. This method might not return the loan the bank initially granted in full. There are different factors that could make the bank lose its money from the sale of the property of a business, such as depreciation and inflation. For this reason the bank generally chooses this procedure as the last option from all the above stated procedures.

4.1.2 Model Cases

To illustrate the implementation of the above stated articles about the DBE, I have chosen two practical cases from the bank that I believe would best explain the benefits of rescuing a business. From the two practical cases, the first case concerns a business that was not given proper attention and in the end failed. The second case is a company that was rescued successfully and can be taken as an example for the bank's good deeds.

Case One:

Mersa Tannery

Ayew Degu Leather Factory also known as 'Mersa Tannery' was established in 2002 (G.C.) in Amhara Region, Wollo Zone, Mersa Town of Ethiopia. The business was set up as a Sole Proprietor with AtoAyew Degu being the sole owner of the business. Mersa Tannery had more than 120 permanent employees working at the time of its closure. The factory was producing different types of leather for local and international markets. One of the main reasons Mersa Tannery was established in this location is AtoAyew, the owner of the business, was originally from that area and wanted to benefit his birth place by opening this business.

From the beginning, Mersa Tannery was struggling to survive in the market due to different business reasons. One of the main reasons being the factory was set up far from a major market

like Addis Ababa and it had to incur unnecessary additional cost due to transportation. The second problem was the factory did not have a good management and leadership to bring it out of the difficult situations it faced. On top of that, there was a larger marketing problem at the time because of the decreasing demand for leather locally and internationally.

The Development Bank of Ethiopia (DBE) attempted to assist Mersa to help it get out of the financial trouble it faced. Over the years, the DBE loaned Mersa a total of Birr 220 Million (Two Hundred Twenty Million Birr). Understanding the importance of the survival of the business, the DBE tried different measures to rescue Mersa by rescheduling its loan in a total of nine times and by giving four more additional loans. However, the problem with Mersa was beyond pouring additional capital into the business. Due to the location of the factory set up and bad management, the business had no chance of survival. These two issues should have been addressed for the following reasons. First, changing the location of the factory so that the goods produced by Mersa could reach the market with no additional cost. This would give Mersa the same competitive advantage as the other factories set up in and around Addis Ababa. Second, the management of the business needed to change in order to move Mersa into the right direction. However, that did not happen because of the way the business was set up among other reasons. This as well as other factors expedited the failure of Mersa Tannery.

After repeated attempts by the DBE, Mersa Tannery could not show any signs of hope. Therefore, the DBE was forced to foreclose on Mersa Tannery (Ayenew Degu Leather Factory) in November of 2014. The DBE took over the factory from the owner but thinking it had done everything possible the bank was not willing to put in additional funds with the banks own management. The DBE had to do the inevitable, which was to close the factory and lay off all of the 120 employees.

Case Two:

Kabir Enterprise

Kabir Enterprise PLC is a garment and textile factory established in 2004 (G.C.) with a capital of One Million USD. The company has two shareholders, the major shareholder being Sheik

Mohammed Hussein Ali Al Ahmudi. Kabir has a capacity to spin 8.5 million tons of fabric per day and produce 16,500 garment pieces per day. The company also has a staff of more than 1,600 permanent employees.

The DBE had lent more than 380 million birr for purchase of equipment, raw materials, and working capital. In the beginning the company started really well producing different garments for international market. However after a while due to different problems in the international market the company could not continue its success. After some time, the price and demand for garments internationally fell unexpectedly creating a problem for most garment producing industries. Kabir was also affected by this international phenomenon making it difficult for them to stay in the market without additional outside help.

The DBE at the time had two options, to foreclose on Kabir stating the company's current situation or to help the company survive, in thinking that the problem Kabir faced was temporary and it would pass. The DBE chose the second option and decided to help Kabir survive and stay in the market. The DBE did not make this decision only because of the international market situation but also the fact that Kabir employs more than 1,600 employees and their fate would be on their hands. This decision did not emanate from the idea of only helping one business that was in trouble, the DBE's overall policy pushes the bank to see the overall impact foreclosing would have on the country. It is not only the two investors of the company that would be affected if the company closes. There are other indirect stakeholders of the company such as their 1,600 employees, the government that used to get taxes and foreign currency, the creditors, and the suppliers of raw materials, all would be affected.

The DBE gave Kabir a loan rescheduling that would enable them to stay in the market until the problems they faced had gone away. After some time the market stabilized and the garment market rose to normal conditions. As of today, Kabir is in a much better financial condition and has started repayment of their loan owed to the DBE. Due to the actions taken by the DBE all of the 1,600 jobs at Kabir were safe, the government is receiving its tax and foreign currency, and suppliers such as the cotton farmers still have a market with Kabir.

4.1.3 NPL Amount and Rehabilitated Projects

DBE, as a bank that focuses on long term project loans that are beneficial to the country, gives large amount of individual loans unlike many private banks. In addition the repayment period is usually longer than many private banks put in place. Because of the type of projects DBE gives loans to, the bank disperses billions of birr in a single year.

Below there is a data gathered by the researcher that tries to show the five years data of DBE's Central District in regards to non-performing loans, rehabilitated projects and foreclosure on businesses. The non-performing loans of each year and the number projects of that make up the NPL are shown side by side. The reason the researcher chose the Central District of DBE is this district is where significant amount of loans are entertained. The Central District gives loans which are above 25 million per project that big in terms of size and the impact they would bring on the market.

| Year | NPL Amount | Number of Projects | Rehabilitated Projects (in numbers) | Rehabilitated Project (Amount in Birr) | Foreclosure |
|---------|-------------------|--------------------|-------------------------------------|--|-------------------|
| 2016/17 | 5.17 Billion Birr | 30 | 3 | 64 Million Birr | 0 |
| 2015/16 | 3.9 Billion Birr | 26 | 3 | 278 Million Birr | 1 Project |
| | | | | | 17 Million Birr |
| 2014/15 | 1.6 Billion Birr | 22 | 2 | 56 Million Birr | 1 Project |
| | | | | | 22 Million Birr |
| 2013/14 | 850 Million Birr | 16 | 4 | 35.9 Million Birr | 1 Project |
| | | | | | 13 Million Birr |
| 2012/13 | 515 Million Birr | 20 | 4 | 60.6 Million Birr | 2 Projects |
| | | | | | 33.7 Million Birr |

Table 1: DBE Rehabilitation Data

Source: DBE Rehabilitation Division

The data collected tries to show DBE’s non-performing loan amount and projects from year 2012/13 – 2016/2017 and the number of rehabilitated projects with the amount of money saved because of the rehabilitation. Furthermore, the data also shows the number of foreclosed projects and the amount of the foreclosure. The data will show the efforts taken by DBE to rehabilitate NPL projects rather than choosing foreclosure.

Below in the table, the researcher tries to show the proportional relation of non-performing loans, rehabilitation and foreclosure. This proportional relation will be explained in the topics below.

| Year | NPL Amount (100,000) | Number of projects | Number of Rehabilitated Projects | Rehabilitated Amount in birr (million) | Number of Foreclosure | Foreclosed Amount in birr (million) | Proportion of projects rehabilitated | Proportion of projects foreclosed | Proportion NPL Rehabilitated | Proportion NPL foreclosed |
|---------|----------------------|--------------------|----------------------------------|--|-----------------------|-------------------------------------|--------------------------------------|-----------------------------------|------------------------------|---------------------------|
| 2012/13 | 515 | 20 | 4 | 60.6 | 2 | 33.7 | 15.38 | 7.69 | 9.9 | 5.5 |
| 2013/14 | 850 | 16 | 4 | 35.9 | 1 | 13 | 19.05 | 4.76 | 4.0 | 1.4 |
| 2014/15 | 1600 | 22 | 2 | 56 | 1 | 22 | 8.00 | 4.00 | 3.3 | 1.3 |
| 2015/16 | 3900 | 26 | 3 | 278 | 1 | 17 | 10.00 | 3.33 | 6.6 | 0.4 |
| 2016/17 | 5700 | 30 | 3 | 64 | 0 | 0 | 9.09 | 0.00 | 1.1 | 0.0 |

Table 2: Proportional Relation of Rehabilitation Data

A. NPL Amount

Non-Performing Loan is the term given to loans or projects that are in default of their repayments. DBE’s non-performing loans have seen significant increase the past five years. This can be attributed to; first, the significant increase in DBE’s loan disbursement and second, the priority sectors DBE give loans to, which are manufacturing and industry, face different challenges because they are relatively new for the market.

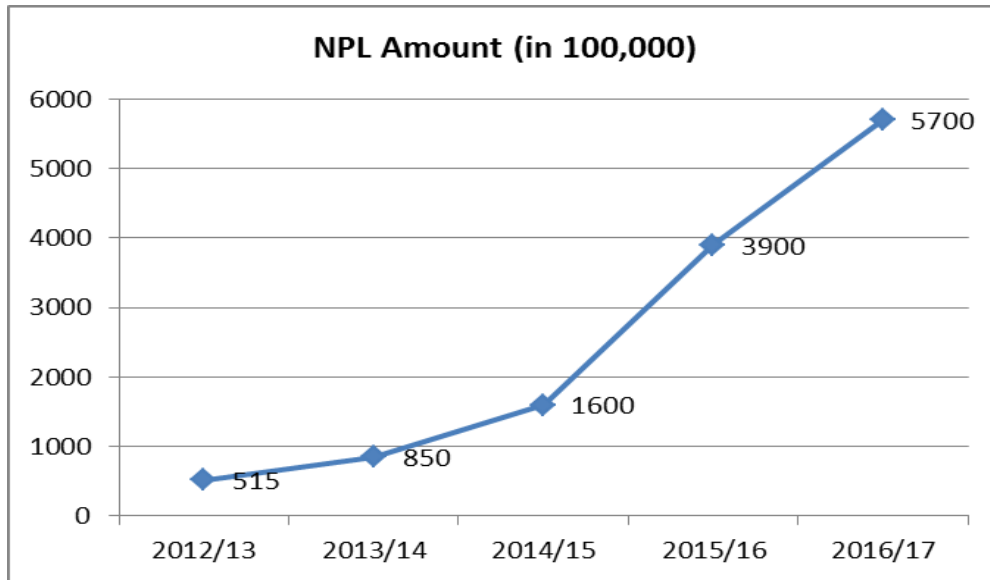


Figure 1: NPL Amount

Graphically, the above figures show the increase in NPL amount from year to year. The increase has seen significant rise from the year 2014/15. From this figure we can suggest DBE needs to limit the rise of NPL and control the increase through different banking mechanisms.

B. Proportion of NPL Rehabilitated

Because of DBE's rehabilitation procedures, the bank was able to save close to half billion birr worth of projects in the five year period. This number has significant impact on the market as well as on the bank itself. However, the proportion of NPL rehabilitated has seen significant decrease over the five years period.

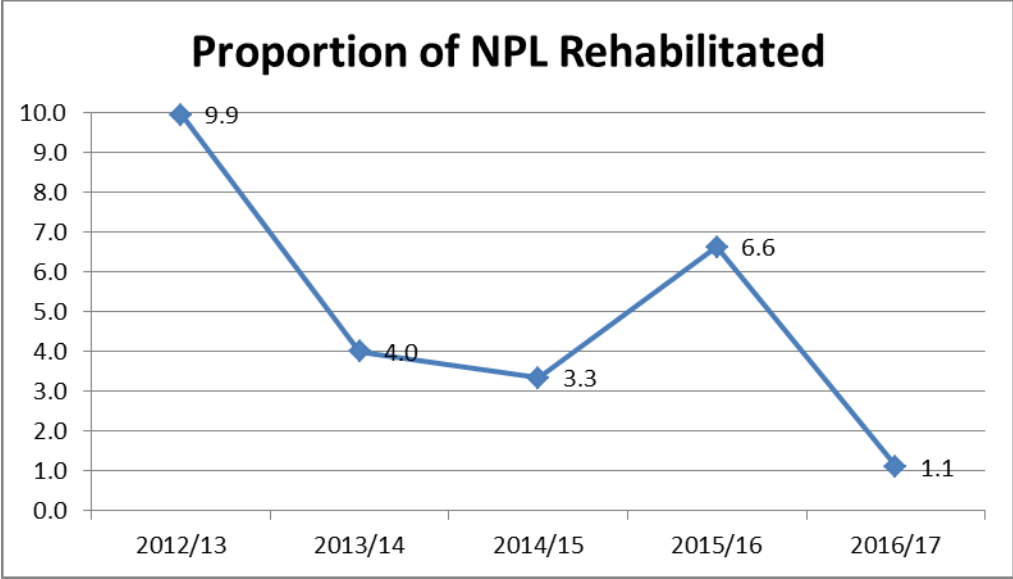


Figure 2: Proportion of NPL Rehabilitated

From the figure above we can understand the decreasing trend of the NPL rehabilitated over the five year period except in the year 2015/16. This can be attributed to the increasing number of loan disbursement and significant increase of NPL amount over the five years. The NPL amount that was a little more than half a billion birr in the year 2012/2013 have risen to 5.7 billion birr in the year 2016/2017. The rehabilitation department could not match this increase in NPL through rehabilitating more projects in a financial year period. Even though the amount that was rehabilitated in the year 2016/2017 is higher the year 2012/2013, the proportion of NPL rehabilitated has seen significant decrease from 2012/13 on wards except the year 2015/16.

C. Proportion of Projects Rehabilitated

It is not only enough to measure the work of DBE though the amount of money rehabilitated, but also with the number of individual projects that are saved. From the table above we can see the number of NPL projects have increased along with NPL amount. However the number of projects rehabilitated has not seen significant fluctuation over the five year period.

The figure below shows the proportion of projects rehabilitated over the five year period. Even though the number of projects rehabilitated has not seen significant fluctuation, because of the

increase in the number of NPL projects the proportion of projects rehabilitated has a decreasing trend.

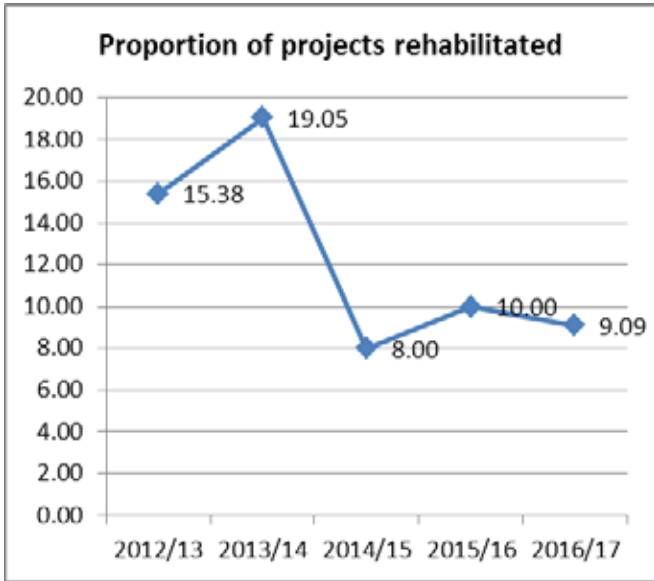


Figure 3: Proportion of Projects Rehabilitated

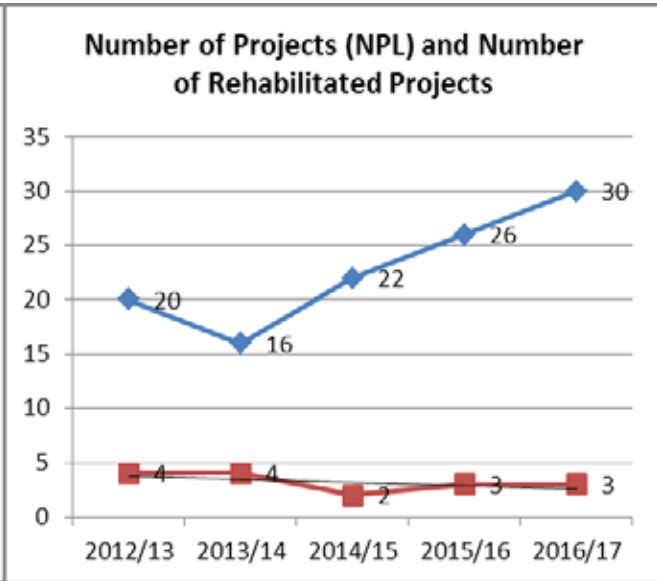


Figure 4: Number of Projects (NPL) and Number of Rehabilitated Projects

D. Proportion of NPL Foreclosed

DBE is not a bank that chooses foreclosure on projects over rehabilitation. However if the project is beyond saving the bank moves to foreclosure instead of losing money. Both the number of foreclosed projects and the proportion of NPL foreclosed are decreasing over the five years period. From the figure below we can see the proportion of NPL foreclosed has seen a decreasing trend.

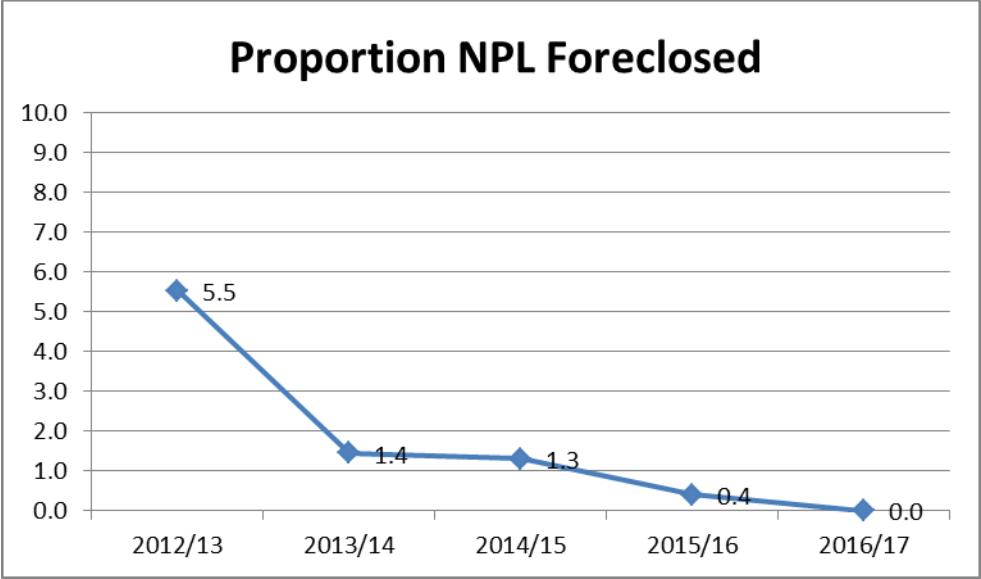


Figure 5: Proportion NPL Foreclosed

B. DISCUSSION

Commercial Code of Ethiopia is generally criticized for giving priority to bankruptcy rather than rescue businesses. This criticism first emanates from the placement order of these two concepts on the Book V of the commercial code. It is strange and odd to see distinct preference being given for bankruptcy and liquidation rather than rehabilitation of the debtor’s business. This is inferred from the arrangement of the provisions rather than an explicit statement. Different authors criticize the Commercial Code for preceding bankruptcy provisions rather than the scheme of arrangement. It is strange that the code would talk about liquidation and death of businesses first before addressing the rescue of distressed businesses. Bankruptcy should only follow if the rescue of distressed business is no longer possible. The Rescue of businesses should come first before giving the option of how to terminate the business.

Some might say the placement order of these two concepts should not warrant for criticism of the code. I believe also the criticism should go further than a mere placement order of bankruptcy and scheme of arrangement. Besides the above criticism the code has other short comings on the protection of businesses. The code lacks the proper attention for the rescue of distressed businesses and focuses more on bankruptcy. This might be because the code is giving priority to

the interests of creditors. The largest number of provisions is devoted to the liquidation of the business of the debtor. There are only few occasions where the law is interested in saving the business of the debtor. However, businesses should first get the chance to be saved before filing for bankruptcy.

This is not only seen in the written law of the country but also the legal practice has been warranted the same criticism. For this research purpose I have interviewed AtoSintayehuZelege, who is one of the longest serving judge at the Lideta Federal First Instance Court, has seen and passed decisions on a lot of bankruptcy cases in his time at the 5th Bench at Lideta Court, but never on scheme of arrangement cases. The first scheme of arrangement case was opened recently at the Lideta court and as far as his knowledge it is the first of its kind. This was all he could comment on as the case is currently still pending.

Businesses are important for any country they operate in as they are like a beacon for the society. No matter how big or small a business is, they all bring some type of benefit to the society. The growth of most countries depends on the opening of different private businesses that can bring different benefits to their country of origin. Businesses give various benefits for their stakeholders. Shareholders reap their investment, employees get their means of livelihood, creditors get their money, the government gets taxes, and the society gets different goods and services. Therefore, the existence of these businesses, in Ethiopia, that brings various benefits to the society and country at large need to be afforded better opportunities for protection from our commercial law. The collapse and existence of businesses will always have an impact on the society and country no matter how large or small the business may be.

AtoSintayehu thinks businesses hold an important part in the community in which they operate and they provide different benefits to the society. Besides the goods and services, they provide the community benefits through the employment opportunity created by the business. In addition, the government benefits through the foreign currency and different taxes the business generates if they make profit and export their products. Thus, when a certain business collapses the society and government are affected by the failure of the business.

Bankruptcy is a mere tool that creditors use to get their money back from debtors. The focus of bankruptcy is always dissolution of businesses which are under distress and have suspended

payments. Therefore this tool needs to be handled carefully as it determines the existence of businesses that provide different benefits to its various stakeholders. Creditors and our courts need to utilize it with utmost caution as it could bring greater damage than the benefits it was intended for. First, the option of rescuing the business that is under distress needs to be considered for the benefit of all. The scheme of arrangement provides this option to give one more chance to businesses. It is the last chance for survival of businesses that are under distress.

AtoSintayehu thinks bankruptcy always focuses on the dissolution of businesses which have suspended payment to its creditors. These businesses, if given the opportunity, could have the prospect of being saved. Because bankruptcy only focuses on dissolution, it deprives businesses that have the chance of being saved from getting that opportunity. Businesses that would be able to generate a different opportunity towards the society and government, they would be unnecessarily dissolved and cease to exist. The bankruptcy procedure does not at all guarantee creditors, who opted for bankruptcy, will receive their full repayment of a loan. The debtor is only obliged to pay up to what the sale of all of its assets can cover.

However, Scheme of Arrangement gives businesses one more chance for survival before using the option of bankruptcy. Scheme of arrangement sets the way businesses that are in distress could be saved. In AtoSintayehu's opinion, the survival of the business is often more beneficial than death of the business, as the death of the business cannot bring a desired benefit to all. The rescue of the business can benefit and accommodate all stakeholders of the business.

Businesses that are given the chance of being rescued and moved to scheme of arrangement would benefit all of its stakeholders. Under bankruptcy, creditors are not guaranteed the return of their money, however if the business is rescued, creditors would have a legitimate chance of getting all their money back. Employees would not lose their job, which in most cases can be their main source of survival, suppliers would not lose their source of income, and investors would not lose their investment.

Many of Ethiopian legal professionals do not know the scheme of arrangement specific area of the law and because of this; they do not advise their clients to use this scheme as a way to save their business. The lack of knowledge can be stated as the main reason why legal professionals do not use the scheme of arrangement. The public institutions that train and equip legal

professionals, which are our law schools, do not give much attention to scheme of arrangement. Our learning institutions need to start giving more attention to the subject in their curriculum if we want to make the changes we seek. Scheme of arrangement is an important part of our commercial code, which can determine the survival of businesses. Legal professionals especially lawyers have the responsibility to create awareness about the benefit of scheme of arrangement. Lawyers are always the ones who are close to both the law and the businesses they advise. They have the responsibility to their client's businesses to lead them away from bankruptcy and show them the option of rescuing their business. Besides lawyers, the private and government universities, Ministry of Trade, and different business associations such as the Chamber of Commerce have a responsibility to create awareness and show businesses they have the opportunity to save businesses that are in distress with the scheme of arrangement.

The benefits of survival can be clearly seen in the findings from the research on the Development Bank of Ethiopia (DBE). Like any banks, the DBE has non-performing loans that it has to deal with. The main difference from other banks is the procedures the DBE puts in place to help debtors to deal with their non-performing loans.

The two cases, Mersa Tannery and Kabir Enterprise, can exemplify the two extreme sides of bankruptcy and the rescue of business. Mersa Tannery even though the bank provided repeated assistance, because it was not the right assistance, the business went into an inevitable failure. Sometimes it is not only the help that counts it needs to be the right kind of help to get business out of difficult situations.

Kabir Enterprise can be taken as a good example of illustrating how giving a second chance for businesses that are under distress would result in their rescue. The work the DBE has done for Kabir and the other businesses that are stated above, is pioneering work and it will benefit not only the businesses that are involved with the bank but the country in general. This is a big lesson other banks and possibly even our courts should learn from the experience of the DBE. From the data above DBE's Central District because of their rehabilitation policy has saved close to half a billion birr worth of businesses from possible bankruptcy. This can be seen as a great achievement for giving businesses a chance through rehabilitation mechanism.

4.2 Comparative Analysis of Ethiopia and South African Law

Below I will attempt to show some points that the Ethiopian law lacks to address and how it can benefit from implementing a law that is similar to the South African law.

4.2.1 Who to Initiate Business Rescue

The Ethiopian law states the debtor starts the process of scheme of arrangement with an application to the court. Article 1119 states “*any trader who has or is about to suspend payments and has not been declared bankrupt may apply to the court for the opening of scheme of arrangement...*” It is not clear why the law only granted such a right only for debtors to utilize. Any interested party who will be affected by the suspension of payment is not authorized to apply for the court to enter scheme of arrangement. There are various stakeholders who would benefit greatly from applying for scheme of arrangement rather than applying for bankruptcy. Creditors may not get their money back if the trader entered bankruptcy proceeding. The assets of the trader who is declared bankrupt after getting sold may not cover all of the debts of the trader. When this happens creditors will be the ones who will be hurt financially. Employees would lose their main, if not the only, source of income if the business goes bankrupt. Employees will benefit a lot if they are allowed to apply for the scheme and the business will survive. These and other interested parties will benefit from the survival of the business if they are allowed to apply of the scheme of arrangement. Scheme of arrangement would protect creditors, the debtor, and all other stakeholders of the business. It is beneficial to all stakeholders of company and they all should have the right to apply to the court for the rescue of the business. In this regard, the law needs to be open for all stakeholders, who are interested in saving the business, to apply to the court.

Under the South African law, an application to court for an order commencing business rescue proceedings may be brought by any “affected person”. Any affected person is defined in the Act as a shareholder or creditor of the company, any registered trade union representing employees of the company and any employee who is not represented by a registered trade union. (Section 131(1) of the Act) Neither the company nor the directors, in their capacity as such, are

authorized to apply to court for commencement of business rescue proceedings. However, the director who is also a shareholder of the company may apply to the court with his/her status as a shareholder. The inclusion of trade unions and individual employees in the list of persons who may apply for order commencing business rescue proceedings is part of the protection of the interests of workers. The right to apply for business rescue proceedings grants a very powerful right to a single employee, which may be used as a bargaining tool by trade unions to protect their rights especially during wage negotiations.

4.2.2 When to Initiate Business Rescue

Under the Ethiopian law the period expected by the debtor set under Article 1119 of the Code to apply for the court is when the debtor has or is about to suspend payments. If the debtor waits too long before he/she suspends payment, it may be too late to avert the damage and get the company back into the profit path. Under normal circumstances, businesses should know their potential income and expenses as well as be able to predict their immediate future. In other words, businesses should be able to predict within a few weeks or months as to when they will suspend payments as the debts become due. Instead of waiting until the last minute to apply for the scheme, the law needs to require a longer period for businesses to apply to the court before they suspend payments. This will help to avert the situation quickly if the business enters the scheme before a lot of damage has been done.

The South African law states that a company is regarded as “financially distressed” if at any particular time it appears to be either reasonably unlikely that the company will be able to pay all of its debts as they become due within the immediately ensuing six months, or reasonably likely that the company will become insolvent within the next six months. The period given under the South African law seems reasonable to all parties involved and provides enough time to reverse the problem ahead. Businesses that have good record keeping has the capacity to know what will happen in the next six months whether they will be able to pay all of their debts or become insolvent.

4.2.3 How Long Should the Rescue Take

The Ethiopian law does not specifically state the time it should take to complete the scheme. However, under article 1121, as security for the scheme of arrangement the debtor would provide a certain percent of the payment claim of the creditors. The trader is given three options to choose from in order to undertake this payment. The trader may propose to pay 50% of the claims of each creditor within a one-year period, to pay 75% of the claims of each creditor within an eighteen months period or to pay 100% of the claim within a period of three years.

The period set out under Article 1121 seems too long for creditors to get their money back. This would discourage creditors from choosing the scheme of arrangement and move directly to bankruptcy. The law should consider a shorter period to make the scheme of arrangement more desirable. In consideration of all of interested parties the law should set out a reasonable period for the scheme to be completed. If the scheme of arrangement drags on for too long, the damage might be greater for all parties involved.

Under the South African law business rescue proceedings are terminated by an order of court, the filing of a notice of termination by the business rescue practitioner or the rejection or substantial implementation of a business rescue plan. (Section 132(2) of the Act) There is no provision for the automatic or compulsory termination of business rescue proceedings after a specified period, but if the proceedings have not ended within three months after commencement or within a longer period allowed by the court on application by the practitioner. The South African law gives a reasonably shorter period to make it desirable by creditors. This will allow them to get their money back in a few months' time. The period set out under the South African law would make business rescue proceedings desirable by all interested parties.

4.2.4 Administration of the Business

In the Ethiopian law under the scheme of arrangement the debtor retains the administration of the property and the management of the business. The properties remain under the debtor's custody allowing he/she to administer and deal with the properties and the business. Even though the debtor exercises this right under the supervision of the commissioner and the guidance of the

delegate judge, it is still open for mismanagement. It is under the debtor's management that has led to the company being in a distressful situation. The law should consider giving the management of the business to another manager or consultant until the scheme of arrangement is complete. The law should only consider retaining the debtor on the management position only as an exception. The debtor should be kept to administer the business after the court decides there is no fault or mismanagement on the debtor's side and that unforeseen circumstances got the business into distressful situation.

The Development Bank of Ethiopia has good experiences that can be used as an example to best describe this situation. From the different mechanisms the bank employs to help projects that are under distress two of them directly relate with the case at hand; they are management interference and care taker administration. Management interference is employed when the bank does not agree with certain decisions of the borrower and believes it would hurt the overall business or project that received the loan. The bank would then interfere in the management of the company. If the management interference does not work the bank would place the company under caretaker administration. The bank would create a board as the caretaker administration with people from inside the bank and external experts. The care taker administration might continue managing the company until it repays the loan it took from the bank. The Commercial Code can learn a lot from the experience of the Development Bank of Ethiopia regarding the administration of business. The court has different options which the can employ for the management of business, which has entered scheme of arrangement. The court need to closely consider its options before allowing the debtor to administer the business.

In the South African law when a business enters the rescue proceedings it removes the director of the business and places a business rescue practitioner to run the business until the proceeding is completed. This is to gain the creditors confidence for the proceedings. The knowledge that the person who is responsible for the down fall of the business is not still responsible for rescue of the business would create the confidence required. The South African law sets out the requirements to appoint the business rescue practitioner and if the creditors still are not confident with him/her, they have the right to ask for security from him/her. This intended to make the whole procedure and practitioner more transparent and accountable.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

Based on the findings of this, this chapter forwards the following summary, conclusion and recommendation concerning the rehabilitation of businesses.

5.1 Summary of Major Findings

The credit policy of the DBE is designed to be helpful and accommodative to the borrowers in every situation they may encounter. To this end, DBE has developed different procedures to help enable the borrowers to pay back the money they have borrowed.

DBE implements eight procedures that it believes would help rehabilitate non-performing loans. The procedures DBE implements to rehabilitate non-performing loans are follow-up, rescheduling, additional loan (equity), management interference, care taker administration, loan restructuring, partial or full cancellation, and foreclosure.

To show the practical implementation of the above stated procedures of DBE, two cases were selected to show the success and failure of rehabilitating business that are under distress. Moreover, five years data (2012/13-2016/17) of DBE Central District data were gathered to show the loan history and non-performing loans in relation with rehabilitated loans.

- The proportion of non-performing loans rehabilitated shows a decreasing trend except in the year 2015/16 because of the significant increase in non-performing loans over the five years period.
- In the average, three projects are rehabilitated by DBE's rehabilitation department every year over the five year period.
- DBE's non-performing loans foreclosure show decreasing trend over the five years getting it zero in the year 2016/17.
- Commercial Code of Ethiopia is generally criticized for giving priority to bankruptcy rather than rescue businesses.

- Lack of knowledge on the part of legal professionals and business owners can be considered as the main reason for the failure to use rescue of business (scheme of arrangement) in Ethiopia.
- In light of the comparative discussion and analysis on the Ethiopian and South African laws on rescue of a business, Ethiopian Commercial Code on the law of bankruptcy and scheme of arrangement has a lot to learn from the Company Law of Republic of South Africa.

5.2 Conclusions

Businesses are among the pillars of the society in which they operate. There are different stakeholders that depend on the existence of these businesses. Businesses generate different employment opportunities and provide goods and services to the society; they create different business opportunity for suppliers, wholesalers and retailers; and they generate different taxes for the government. The survival of businesses directly and indirectly affects different stakeholders in the society, therefore, due attention need to be given for the survival of businesses in Ethiopia that are in a state distress.

The main objective of this research is to show the benefits of rescuing a business and what changes we need to make in the law to make it suitable for business that are under distress. The study looked at the practical and legal aspects of business survival in the country. Development Bank of Ethiopia's business model which focuses on projects that are beneficial to the country in general and its rehabilitation procedure for businesses that are under distress makes it a good example for the topic.

Like other banks, the DBE has non-performing loans that it has to deal with. The main difference from other banks relate to the procedures the DBE puts in place to help debtors to deal with their non-performing loans. DBE has put in place eight rehabilitation procedures to help save non-performing loans that will benefit creditors. Other banks and financial institutions need to follow the example set by DBE to help their creditors and in directly help their stakeholders. Owing to DBE's prime target of development facilitation, the magnitude and duration in the pursuance of the rescue procedures may vary between DBE and other banks. Yet, other banks

should give due attention to rescue schemes commensurate with their functions because it ultimately enhances their customer base, customer loyalty and overall goodwill.

With regard to the legal aspects of dealing with businesses that are under distress, changes need to be made to make the law more accommodative for rehabilitation of businesses. It is to be noted that the Commercial Code does not give due attention to scheme of rescue and rehabilitation arrangements, which can be used by business undertakings that are under distress. Ethiopia's commercial law, including the Commercial Code opts for bankruptcy rather than scheme of arrangement.

The Commercial Code of 1960 can learn a lot from the Republic of South Africa Companies Act 71 of 2008. The Commercial Code on four specific points was comparatively analyzed with the South African company law. The Commercial Code is criticized on; *first*, who should initiate scheme of arrangement since it is not understandable why the law limits initiating the proceeding only to traders. *Second*, the timing of initiating scheme of arrangement appears to be too late for potentially saving businesses that are under distress. It is not clear why the law allows traders to wait until the last possible moment to apply for scheme of arrangement. *Third*, the period set out under the Commercial Code to complete scheme of arrangement appears to be too long. *Fourth*, the Commercial Code does not give the option of management interference in businesses that are under distress. It is not clear why this option is not available in the Commercial Code when DBE uses management interference in its procedure to rehabilitate non-performing loans.

It is not only seen in the written law of the country but also the legal practice has been warranted the same criticism. The scheme of arrangement part of the law is unused part of the Commercial Code. This can be attributed to the lack of knowledge with legal professional who are responsible to advise their clients to use this option. Besides lawyers, the private and government universities, Ministry of Trade, and different business associations such as the Chamber of Commerce are not adequately creating awareness and have failed to show businesses that the latter have the opportunity to save businesses that are in distress with the scheme of arrangement.

5.3 Recommendations

Based on the findings of this study, the following recommendations are forwarded to improve and/or change the rescue and rehabilitation of businesses that are under distress.

- a) Businesses, no matter how big or small they are, they all bring some type of benefit in the country they operate in. The lack of knowledge is the main reason why legal professionals do not use the scheme of arrangement. Public learning institutions that train and equip legal professionals need to start giving more attention to the subject in their curriculum and give more focus on scheme rather than bankruptcy. Lawyers, the private and government universities, Ministry of Trade, and different business associations such as the Chamber of Commerce have a responsibility to create awareness and show businesses they have the opportunity to save businesses that are in distress.
- b) DBE's procedures of rehabilitating non-performing loans need to be duplicated by other financial institutions. Other banks need to focus more on saving the business of their debtors rather than rushing for foreclosure.
- c) The Commercial Code states the debtor is the only one that starts the process of scheme of arrangement with an application to the court. It is not clear why the law only granted such a right only for debtors to utilize and allows stakeholders to apply for bankruptcy. Any stakeholder or affected party by the possible bankruptcy of the business should have the right to apply for scheme of arrangement. The Commercial Code of Ethiopia should allow the right to initiate scheme of arrangement to any affected stakeholders of the business.
- d) The Commercial Code sets the period to initiate scheme of arrangement to when the debtor is about to suspend payments. This could be too late to reverse the damage already done on the business. Under normal circumstance businesses would be able to predict when they would start suspending payments in the near future. Instead of waiting until the last minute to apply for the scheme, the Commercial Code needs to require a longer period for businesses to apply to the court before they suspend

payments. This will help to avert the situation quickly if the business enters the scheme before lot of damage is done.

- e) The Commercial Code does not specifically state the time it should take to complete the scheme once it is initiated. Furthermore it puts long period for debtors to provide a certain percent of the payment claim of the creditors. This would discourage creditors from choosing the scheme of arrangement and push them directly to bankruptcy. If the scheme of arrangement drags on for too long, the damage might be greater for all parties involved. The Commercial Code should consider a shorter period to make the scheme of arrangement more desirable.
- f) After the debtor initiates scheme of arrangement, the Commercial Code retains the debtor with administration of the property and the management of the business. When it is the debtor's management that has led to the company being in a distressful situation, it is not clear why the law would trust the debtor again when it is under scheme of arrangement. The Commercial Code should consider giving the management of the business to another manager or consultant until the scheme of arrangement is complete. The law should only consider retaining the debtor on the management position only as an exception. The Development Bank of Ethiopia has a good procedure that can be used as an example to best describe this situation called management interference.

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