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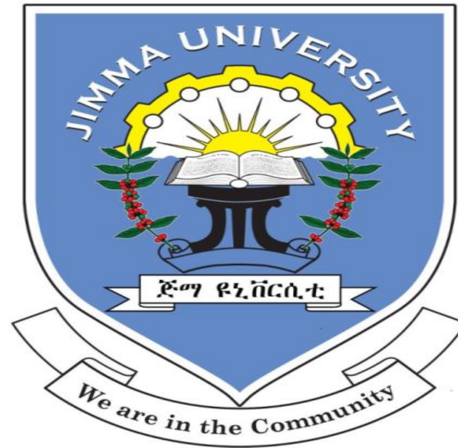

APPLICATION OF BANKRUPTCY PROCEEDINGS TO FINANCIAL LEASES UNDER THE ETHIOPIAN LAWS: ANALYSING THE CHALLENGES AND PROSPECTS

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DECLARATION

I hereby declare that the Dissertation entitled "***Application of Bankruptcy Proceedings to Financial Lease under the Ethiopian Laws: Analysing the Challenges and Prospects***" has been submitted for the degree of Masters in Commercial and Investment Law at Jimma University School of Law and Governance. The Study is entirely my original work and has not been presented to any University or Institution for the award of a degree or otherwise and all resources used in the study are duly acknowledged. Any errors in thinking and omissions are entirely my responsibility.

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This is to certify that a thesis prepared by Tamiru Degefa entitled "***Application of Bankruptcy Proceedings to Financial Lease under the Ethiopian Laws: Analysing the Challenges and Prospects***" was submitted in fulfillment of the requirement for the degree of Master in Commercial and Investment Law. The thesis complies with the regulations of the University and meets the accepted Standard concerning Originality and quality.

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CERTIFICATE:

This is to certify that the dissertation entitled "***Application of Bankruptcy Proceedings to Financial Lease under the Ethiopian Laws: Analysing the Challenges and Prospects***" has been submitted to the Jimma University, College of Law and Governance, Department of Commercial and Investments Law for the award of a degree of the Masters of Law (LL.M) in Commercial and Investment Law. It is a record of genuine research work done by Mr. Tamiru Degefa under our guidance and supervision that complies with the regulation of the University and meets the accepted standards concerning originality and quality. Therefore, we hereby declared that no part of this thesis was submitted to any other university or institution for the award of any degree or diploma.

ABSTRACT:

The New Commercial Code (hereinafter NCC) of Ethiopia draws the objectives of bankruptcy proceedings to arrange liquidation of the debtor's business that maximizes the values of the assets available for the creditors. NCC has established the trustee and incorporated the enabling bankruptcy provisions to achieve these objectives. Once a bankruptcy case is filed, bankruptcy provisions deprive the debtor of pursuing any business activity. It automatically creates an estate with a legal personality different from the debtor. An automatic stay ends all transactions undertaken before filing a bankruptcy case. An ipso facto clause that accelerates, terminates or withholds the performance is revoked. The legal and judicial responsibility of the debtor is delegated to the trustee. Consistent with the NCC's bankruptcy provisions, a trustee is empowered to terminate ongoing financial leases. Despite these objectives and the bankruptcy provisions, the Capital Goods Lease Business (hereinafter CGLB) requires the "full payout, non-cancelability and forces the trustee to remain performing financial leases. This indicated that the bankruptcy provisions of the NCC are inconsistent with the functional nature and bankruptcy provisions of the CGLB. Thus, this thesis analyzed the challenges and prospects of applying bankruptcy proceedings of the NCC to financial leases. Qualitative research methods and data collection tools were used to understand the practical aspects. The finding of this research has revealed that functionally the bankruptcy provisions of NCC are incompatible with the full payout, non-cancelable, and responsibility of the trustee to continue performing the financial leases of the CGLB. The practitioners' inconsistency and awareness constraints rendered the application of bankruptcy proceedings of the NCC to financial leases business insufficient. Owing to these, the thesis recommended the inconsistency of the bankruptcy provisions in the NCC and the CGLB proclamation for amendments.

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LISTS OF ACRONOMY:

- *Art.- Article*
- *CGLB _Capital Goods Leasing Business*
- *CGLB_ Capital Goods Leasing Business Proclamation*
- *DIP _Debtors In Possession*
- *FDRE _Federal Democratic Republic of Ethiopia*
- HPR_ House of Peoples' Representatives
- *Ibid _ is short for ibidem which, in Latin, means in the same place*
- *IMF _International Monetary Fund*
- *LN _League of Nations*
- *MPSRP_ Movable Property Security Rights Proclamation*
- *NBE _National Bank of Ethiopia*
- *NCC _New Commercial Code*
- *OCGFBSC_ Oromia Capital Goods Financial Business Share Company*
- *P _Page*
- *PP. _pages*
- *PRP _Preventive Restructuring Proceeding*
- *RP _Reorganization Proceeding*
- *BP _Bankruptcy Proceeding*
- *UCC _Uniform Commercial Code*
- *UCC _Uniform Commercial Code*
- *UN _United Nations*
- *UNCITRAL _United Nations Commission on International Trade Law*
- *UNIDROIT _International Institute for the Unification of Private Law*
- *US _United States of America*
- *Vol. _Volume*
- *WB _ World Bank*

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Tokkicha Morkataa hinqabne!

Kan tolchiif hingorfamne!

Kan balleesseef hinwaqqafamne!

Uumaa waan hundaa!

ATI GALATOOM!

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CHAPTER ONE: INTRODUCTION:

1.1. Backgrounds:

The historical development of bankruptcy law was traced back to the Hindu, Hammurabi, and Roman laws.[1] At those times the creditors could seize the debtor and compel him into labour, cruelty to kill.[2] Enforcement of the creditor's claim against the debtors was focused on the personal harassment of the debtor rather than on the property. However, in the Egyptian from 772-729 BC; the creditor's claim against the debtor's property was recognized.[3] It had adopted the superiority of the debtor's personality over the creditor's claim. Inspired by these experiences, Athenians put an end to the practice of enslaving the debtor.[4]

The progress of bankruptcy law was accelerated by the growth of international trade and commerce in the 16th century for better debt recovery.[5] In the middle of the 17th century, taxes were inadequate to cover the public expenditures that had initiated credit as a vital source for the public and private economy.[6] The early bankruptcy law approach was shifted from the harsh consequences to a more liberalized approach. The approaches became grounds for the introduction of discharging the debtors. The England and USA introduced their first official bankruptcy law in 1542 and 1800 respectively.[7] From 1825 to 1883 the existing bankruptcy law had made substantive reforms to include voluntary bankruptcy, Bankruptcy Court, and bankruptcy officers.[8] Then later, the bankruptcy laws of the 20th century were born with further regulative innovating reforms.

Historically, the practice of Ethiopian bankruptcy law was elder than the Ethiopian Bankruptcy Law of 1933.[9] In ancient Ethiopian societies, the way the creditors were claiming credit from the debtors was similar to the ancient Roman practices. Punishing the defaulting debtors into

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[1] Louis E. Levinthal, "Early History of Bankruptcy Law," University of Pennsylvania Law Review and American Law Register Vol. 66, No. 5 (1918), pp. 223-250
[2] ibid,
[3] Supra Note 1, p.231
[4] Ibid,
[5] Edelman J., Meehant H. and Cheung G., "The evolution of bankruptcy and Insolvency Laws and The Case of the Deed of Company Arrangement," LLOYD's Maritime and Commercial law Inquiry, (2019) pp.570-602
[6] Ibid,
[7] Alemnew Gebeyehu, "the Historical Development of Bankruptcy Law both in the World in General and Ethiopia in Particular: In Comparison and Contrast," Social Sciences, Vol. 4, No. 4, (2015), pp.106-109
[8] Supra Note 5, p.575
[9] Taddese Lencho. "Ethiopian Bankruptcy Law: A Commentary Part I." Journal of Ethiopian Law Vol. 22 No. 2 (2008), p. 60

imprisonment and enslavement was the common practice. However, those practices were abolished by the introduction of the 1933 bankruptcy law. During the era of the codification of Ethiopian Laws, Bankruptcy law became part of the Ethiopian Commercial Code (CC) and was amended in the 1960s. In 2021, the 1960s Commercial Code was replaced by the New Commercial Code (NCC) i.e.; proclamation No 1243/2021. Despite its long time endurance in the Ethiopian legal system; bankruptcy law has been criticized for remaining idle from the judicial practice.

The New Commercial Code proclamation No 1243/2021 was amended with objectives to protect and maximize the values of the assets available to creditors.[10] Bankruptcy proceedings are intended to maximize overall efficiency by eliminating functionally inefficient firms so competent and feasible business firms take over the market. It gives the debtors an escape from their financial burdens and allows them to build a new life. To achieve this objective, the NCC included the safeguard provisions of the automatic stay, bans to ipso facto clause, bankruptcy estate and organized the bankruptcy organ**.**

To sum up, before discussing how the Ethiopian bankruptcy regimes of the NCC treat the financial leases, observing the historical overviews of the financial leases may be important. In various parts of the world, as a means of acquiring capital-intensive goods; leasing was a long-existing phenomenon.[11] Ancient Babylonian, Egyptians, Greek, and Romans were known to have engaged in the lease of personal property.[12] In those countries, leases were widely accepted as a form of credit that allows a lessee acquires the equipment necessary for the trade activities without demanding funds to purchase. The modern leasing industry was launched first in the US, and then by the 1960s expanded to the UK.[13] The explicit statutory financial lease was publicized in the US with Art 2A of the Uniform Commercial Code (UCC) in 1987 with the 1990s

[10] Commercial Code Proclamation, Proc. No. 1243 (2021), Fed. Neg. Gaz. Extra Ordinary Issue, Art 588 (3)
[11] Liu, Guojin. Finance Leasing in International Trade (2010 the University of Birmingham For the Degree of Doctor of Philosophy (LLD). the University of Birmingham), p. 12
[12] Jeffrey Taylor, "The History of Leasing" as cited in Liu Guojin, p. 13
[13] Ibid, p. 15

amendments.[14] Then after, the leasing transaction became an attractive alternative to outright purchase.

Having been encouraged by its higher interest charges, capital formation, job creation and economic growth, the finance industry adopted financial lease transactions as an alternative to purchasing and facilitated sales of goods worldwide.[15] Because of its advantages, the Bretton Woods Institutions (i.e. the WB and IMF), League of Nations and UN have played a great role to expand.[16] By taking the US's practice as a model, they have contributed to expanding the capital goods leasing practices from developed nations to developing countries. The financial lease practice attracted the attention of the League of Nations and the UN to set common rules of laws around the world. The UNIDROIT[17] Convention on International Financial Leasing that ultimately born the Model Law of 2008 was among their works.

In Ethiopia, the historical practice of financial leases was connected to the adoption of the 1960's Civil Code. It introduced a modern legal platform for equipment financing with a different mode of contracts. Sale with ownership reserved, sale with right of redemption, hiring sale /hire purchase/ and letting and hiring are among the types of contracts.[18] A sale with ownership reserved contract operates where the possession of the good is transferred to the buyer with ownership reserved to the seller until the price is fully paid. Whereas, the sale with the right of redemption is an arrangement of financing in which the seller reserves the right to redeem the goods sold.[19] On the other hand, the hire-purchase is more of an installment sale. Letting and hiring refers to the similar definitions of the modern operating leases defined in the CGLB.[20] To promote the financial lease business in Ethiopia, CGLB Proc No 103/1998 and its amendment of

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[14] Heermann W. Peter, the Structure of lessees and lessors' Remedies Regarding the Finance Lease of Equipment and Personal property Under the United States and German laws, Loyola of Los Angeles International and Comparative Law Review, Vol. 15 No. 2 (1993), p.311

[15] Supra Note 11, p.14

[16] World Bank Groups and International Monetary Fund were created by the Bretton woods treaty and negotiation they are called Bretton Woods institutions.

[17] Three organizations have been involved in the creation of model laws worldwide: the International Institute for the Unification of Private Law (UNIDROIT i.e. which is founded in 1926 by the League of Nations (LN), the United Nations Commission on International Trade Law (UNCITRAL), and the Organization of American States

[18] Commercial Code of the Empire of Ethiopia Proc No 166, (1960), Neg. Gaze. Extra Ordinary, *Vol. 17952* No. 207152-500), sale with ownership reserved (Art 2387-2393), sale with right of redemption (Art 2390-2393), hiring sale/purchase/ (Art 2412-2415), and letting and hiring (Art 2727-2738)

[19] Ibid,

[20] Capital Goods Leasing Business Proclamation, Proc. No.103 (1998), Fed. Neg. Gaz. Year 4 No 27 Art 2 (5) defines an operating lease as a ' type of leasing for a period not exceeding two years, by which a lessor provides a lessee against payment of mutual: agreed rent with the use of specified capital goods that the lessor has at hand;

proc No 807/2013 were introduced with several regulations of CGLB issued by the NBE at different times.

The CGLB proc came with the definition of the financial lease as it is a type of leasing by which a lessor provides a lessee against payment of mutually agreed installment over a specified period with the use of specified capital goods which are:[21] *"(a) either already acquired by the lessor; or (b) purchased by the lessor from the third party, known as the supplier, chosen and specified by the lessee, and under which the lessor shall retain full ownership right on the capital goods during the period of the lease agreement, and subject to agreement between the two parties, the lessee may have the option to purchase the capital goods outright after the termination of the lease period at an agreed price".*

From this definition, financial leases operate among the three parties the lessee, lessor and supplier interlinked with the contracts of bailment and supply. During the lease periods, the lessee shall hold the capital goods as a mere bailee of the lessor and shall not have an ownership right. In such setups, the relationship between the lessor and lessee seems to be governed by the contract of bailment. When the financial lease transaction is viewed from the optional rights of the lessee to purchase the leased goods at the end of the lease periods, it looks to be governed by the contract of hire-purchase. On other hand, when the arrangement is viewed from the rights of the lessee to choose and specify the goods and supplier, and the obligation of the lessor to finance the goods by retaining the ownership title of the leased goods has the nature of secured finance. From these approaches, the financial lease business operates from a mixture of the contracts of bailments, hire-purchase and secured finance, to create alternative sources of finance for the lessee. Thus, financial lease is an operation in which substantially all the risks and rewards of an asset, except the mere ownership title of the goods are transferred from the lessor to lessee. Lessee owns the economic benefits of the goods, while the Lessor owns the title of the goods, the full payout and irrevocability of the financial as a guarantee of the periodical payments. Hence, the lessor serves merely as the vehicle to facilitate the transaction between the lessee and the supplier.

[21] Ibid, Art 2/3

Regardless of the objectives and functional nature of bankruptcy provisions of the NCC, the CGLB proclamation enacts the obligation of the financial lease is 'full payout, non-cancelable and the obligations of bankruptcy officers to remain to perform the obligations of the financial leases. This indicates that nevertheless the lessee is judicially declared bankruptcy; the nature of financial leases incorporated under the CGLB proclamation prevents justifying suspension of the periodical payments to the lessor. The practice of bankruptcy provisions in the NCC and CGLB laws are appeared paradoxically to stand side by side in the Ethiopian legal system, which is an interesting issue that has attracted the researcher to conduct this study. Thus, this thesis is envisioned to investigate the application of bankruptcy proceedings to the financial leases under the Ethiopian bankruptcy law of NCC and the CGLB Proc No 103/1998 with its amendment proc No 807/2013.

1.2. Statement of the Problem:

Bankruptcy proceedings, on one hand, are aimed at protecting and maximizing the claims of the creditors, and on other hand, it tries to protect the interest of the debtors and other stakeholders.[22] To achieve these objectives, the NCC bankrupt provision deprived the debtor of involvement in business transactions and also suspends transactions made before a bankruptcy case. It automatically creates an estate with a legal personality different from the debtor. As a result of filing a bankruptcy case, a contractual clause that accelerates terminates, or withholds the performance is annulled. All the legal and judicial responsibility of the debtor party is delegated to the trustee. Consistent with the NCC bankruptcy provisions, officers are allowed to terminate the obligation of ongoing financial leases. The lessor's claim of getting the periodical payments against the debtor lessee may be suspended by the automatic stay, of the bankruptcy provisions.

Despite the objectives and bankruptcy provisions of the NCC, the CGLB proclamation enacts the obligation of the financial lease is 'full payout, non-cancelable and trustee are duty bound to remain to perform the financial leases before the expiration period.[23] This indicates that anyhow the lessee is judicially declared bankruptcy; it cannot justify termination or suspension of the periodical payments to the lessor.

[22] Charles Gulaine. OTC Derivative Contracts in Bankruptcy: The Lehman Experience ." New York Business Law Journal Vol. 13. No. 1 (2009).
[23] Supra Note 20, Art. 2/3

Thus, the operations of these two laws are appeared paradoxically to stand side by side in the Ethiopian legal system. Alongside these inconsistencies, this study examined how the bankruptcy proceedings of NCC treat the obligation of the financial lease under the Ethiopian laws with the challenges and prospects.

1.3. Research Objectives:

Based on the background and a statement of the problems discussed here above, the paper has two types of objectives: general and specific objectives.

1.3.1. General Objective:

The paper has the general objective to analyze the challenges and prospects of applying bankruptcy proceedings to financial leases under Ethiopian laws. It will do so, by investigating the texts of the NCC part of the bankruptcy law and the CGLB Proclamation No 103/1998 with its amendment proclamation No 807/2013.

1.3.2. Specific Objectives:

Under the specific objectives:

- To examine how the NCC bankruptcy provisions of automatic satay, bans to ipso facto clause and the power granted to bankruptcy officer operate with CGLB provisions of the 'full payout, non-cancelable and obligations of the trustee to continue performing the financial leases.
- Analyzing how the bankruptcy proceeding of the NCC treats the contractual hybrid nature of CGLB financial leases.

1.4. Research Questions:

Based on the above background, statement of problems, and research objectives, the study seeks to answer the following questions and understand the challenges and prospects of applying bankruptcy proceedings to financial leases. In doing so, it looked at the texts and contexts of the Ethiopian bankruptcy provisions in the NCC and the CGLB Proclamation No 103/1998 with its amendment proclamation No 807/2013 as primary judicial sources. Other relevant legal, and policy documents and foreign experiences that Ethiopia can draw a lesson from are being taken into account. The questions are as follows:

- ❖ How do the NCC bankruptcy provisions of automatic satay, ban to ipso facto clause and powers granted to the bankruptcy officer treats the ‘full payout, non-cancelable and obligations of the trustee to remain to perform the CGLB financial leases?
- ❖ How do the bankruptcy proceedings of the NCC apply to the contractual hybrid nature of the CGLB financial leases?

1.5. Significance of the Study:

Despite the practical challenges of enforcing the bankruptcy proceedings to the financial lease in Ethiopia, very limited studies are available. Therefore, the primary contribution of this study is to add insight to a scantly existing body of scholarship and indicate further areas of research on this topic i.e. on the reconciliation of the inconsistent objectives of bankruptcy provisions in the NCC and CGLB proclamations.

1.6. Scope of the Study:

The scope of the study is limited to the application of bankruptcy proceedings to financial lease under the Ethiopian bankruptcy laws and CGLB Proclamation No 103/1998 with its amendment proclamation No 807/2013. The application of the bankruptcy (liquidation) proceedings of the NCC on the full payout, non-cancelability and obligation of the trustee who subrogated the debtor lessor to remain performing the financial lease is the specific domain of this study.

1.7. Organization of the Study:

The entire content of the study is organized into five chapters. The first chapter presented the backgrounds, statements of the problems, methodology and organization of the study. Chapter two covers the reviews of the literature, theoretical and conceptual framework of bankruptcy proceedings and financial leases. Bankruptcy proceedings treatment to an executory contract and the bankruptcy laws of some selected countries were discussed in chapter three. Chapter four discussed the practical challenges and prospects of applying bankruptcy proceedings to financial leases under Ethiopian laws. Lastly, chapter five presented the conclusions and recommendations part of the study.

1.8. Limitations of the Study

This research work met with limitations that have impacted the outcome of the study. These limitations are: there was no domestic research and written materials on the implementation of

the bankruptcy proceedings to financial lease. In the business community and judicial experience, bankruptcy proceedings were rarely practiced. The lawyers' lack of awareness of the subject matter is also among the limitations confronted by this study. Although the modern law of the CGLB has been available since 1998 in Ethiopia, in judicial practice it is not such a practically tested area of the law. As the issue is new to lawyers, the researcher has come across a shortage of relevant reference material and pre-informed interviews. Predicting the happening of these limitations, the writer has made the most efforts to minimize their impacts on the findings of the study. Having contacted the diversified sources of the data, accessible kinds of literature and the experiences of selected countries were used to acquire a comprehensive thoughtful.

1.9. Research Methodology:

The study is a non-doctrinal (empirical) method of research which focused on the application of bankruptcy proceedings to financial leases under Ethiopian laws. Particularly, the bankruptcy law of the NCC and the CGLB proclamation with other relevant legal and policy documents are the legal documents under analysis. Subsequently, the qualitative legal discussion was substantiated with empirical evidence that was gathered through interviews and document analysis.

1.9.1. Research Design:

As stated earlier, the general objective of this study is to analyze the challenges and prospects of applying the bankruptcy proceedings of NCC to financial leases under the Ethiopian laws. To achieve this objective, literature analysis and qualitative data were utilized. Thus, the study used a qualitative research design.

1.9.2. The Research Setting:

The research was conducted both at the Federal Democratic Republic of Ethiopia and Oromia National Regional State. The power to legislate bankruptcy and financial lease laws are under the jurisdiction of the Federal government. Art 5 (1) (d) and 11 (2) (A) of the Federal Courts proclamation[24] and 600 (1) of the NCC puts the bankruptcy proceedings under the jurisdiction of the Federal High Court. According to Art 80 (2) of the FDRE Constitution, the Oromia Supreme

[24] Federal Courts Pro. No.1234, (2021). Fed. Neg. Gaz. Year 27 No. 26

Court also has the delegation jurisdiction of the Federal High Court to adjudicate bankruptcy and financial lease cases. Conducting the study in Finfinne City and Surrounding Finfinne is believed to enable the researcher to discover the challenges and prospects of applying bankruptcy proceedings to financial leases. Therefore, Finfinne is the site for both the Federal and Oromia National Regional State Courts, and the City was selected as the research setting. Among institutions of the Federal and Oromia Regions that reside in Finfinne, the study was conducted on the Federal High Court, Oromia Supreme Court, Federal and Regional Advocate and the lessor company of the OCGFBSC. The diversified persons in these institutions were selected believing that adequate and appropriate data to address the objective of the study could be acquired.

1.9.3. The Participants of the Study:

To collect necessary data for this study, among the total three judges of the Federal High Court Lideta Bankruptcy Divisions Bench two judges, among five judges of the Oromia Supreme Court who have been presiding over the Civil Division Bench for the past three years three judges, among three advocates licensed at both Federal and Oromia Courts who were identified handling commercial and bankruptcy cases for the past three years one advocate, and the only lawyer of the lessor company OCGFBSC were selected. Thus, seven participants were selected for interviews as the main participants of the study. In Ethiopia, as these institutions and organs are the main implementors to execute bankruptcy proceedings to financial leases; the researcher purposively selected. In this type of sampling, the substances of the sample were selected purposively by the researcher.[25] The purposive sampling technique was employed to select the sample of the study.

Furthermore, the Ethiopian legal framework available for the bankruptcy proceedings treatment to financial lease was evaluated in light of well-developed and practically tested foreign jurisdictions. Since the bankruptcy and financial lease laws were mostly practiced and developed, the US, France, Spain, and German experiences were analyzed with Ethiopian laws. Particularly, the US bankruptcy system treatment to financial leases was selected as the standard of applying bankruptcy proceedings to the financial leases.

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[25] Kothari, Research Methodology Methods and techniques, (2nd ed. 2004), New Deli, New age international (p) limited, p.59

1.9.4. Method of Data Collection

Data required for this study were collected through interviews and document analysis.

1.9.4.1. Interviews:

Interviews were belied to gather data important to address the challenges and prospects of applying bankruptcy proceedings of NCC to the financial Leases. From Bankruptcy related trial Benches both at Federal High Court Lideta Civil Bench and Oromia Supreme Courts, the presiding judges and other team leaders' judges were selected for interviews. Advocates licensed at both the Federal and Oromia Region Court and the legal practitioner of the OCGFBSC lessor company were selected. The judges, advocate and Lessor company lawyers who have been handling the bankruptcy and commercial-related cases for the past three years were selected. The advocate lawyer licensed both at Federal and Oromia Regional Court was also selected because of their exposure and handling the bankruptcy-related cases. These judges, lawyers and legal practitioners were believed to provide the important data for the study. Based on their responsibilities to implement the bankruptcy proceedings to financial leases, the researcher believed they have the richest possible information. Among the total three judges of the Federal High Court Lideta Civil Divisions Bankruptcy Bench two judges, among 5 judges of the Oromia Supreme Court currently presiding the Civil Division Bench three judges who have been consecutively presiding the trials for the past three years, among three advocates licensed and handling bankruptcy cases identified from the bankruptcy cases of the Federal and Oromia Courts one advocate and the only lawyer of the OCGFBSC lessor company were selected.

Thus, five judges, one licensed advocate lawyer and one legal practitioner of the OCGFBSC lessor and a total of seven participants were selected and interviewed. To extract important data from these participants the researcher believed having face-to-face interviews is more tenable to address the objectives of the study. The interview was conducted on data that helped to address the objectives of this study. It was conducted based on the guide that was prepared before the interviews. To collect adequate information, how the judges and advocate lawyers who have exposure of handling bankruptcy cases and commercial-related cases were believed to provide the necessary information. They were selected as the key informants who were identified to provide appropriate and relevant data for the study. The data collected through such methods

revealed the challenges and prospectus of executing the bankruptcy proceedings for the financial lease. The interviews were done based on semi-structured interview guides.

Hence, seven participants in this study were securitized for interviews. As an explanation of the background and technical issues of bankruptcy proceedings and financial leases is needed, the interview conducted with judges, team leaders' judges, advocate lawyer and Lessors company legal practitioner was conducted semi-structured. By providing the nature and meanings of bankruptcy proceedings and financial leases, the interview was conducted by guides to provoke the concerned interviewees to narrate what they experienced due to their works.

1.9.4.2. Review of Literature, Laws, and Other Publications:

The extensive literature on bankruptcy and financial lease laws, and comparative bankruptcy in the US, France, Germany, and Spanish were also assessed. To trace the existing knowledge the materials available in hard copy and online domestic and foreign sources were utilized. The bankruptcy law of the NCC Proclamation No 1243/2021, the CGLB Proclamation No 103/1998 with its amendments proclamation No 807/2013 and other relevant documents were considered.

1.9.5. Method of Data Analysis:

The collected data was analyzed with the help of qualitative data analysis; i.e.; the collected data were identified, categorized, and described based on their qualities and how it relates to the statement of the problems. Then, the critical analysis of data was conducted in a way it answers the research questions with analytical arguments ranging from the theoretical framework up to its practical challenges under the Ethiopian bankruptcy and financial lease legal systems.

CHAPTER TWO:

2. REVIEW OF RELATED LITRATURE AND THE CONCEPTUAL AND THEORTICAL FRAMEWORKS OF APPLYING THE BANKRUPTCY PROCEEDINGS TO THE FINANCIAL LEASES:

2.1. Introduction:

This section discusses the reviews of relevant domestic and foreign literature relating to the application of bankruptcy proceedings to financial leases. The definitions, characteristics, objectives and theories underlying the application of bankruptcy proceedings to financial leases will be analyzed as well. This chapter is further extended to discuss the conceptual frameworks of bankruptcy provisions treatment to ongoing (executory) contracts, the policy rationale, and the financial lease.

2.2. Review of Literature:

One of the domestic-related literatures is the work of Mr. Tafese Takele titled "*Treatment of Secured Creditors under the Ethiopian Bankruptcy Regime"*[26] *that* dealt with bankruptcy proceedings and the treatment of the secured creditors. The work evaluates the legal framework regarding the effect of bankruptcy proceedings on encumbered assets. It investigated whether the provisional safeguard of the bankruptcy provisions of automatic stay suspends the suit of secured creditors. His work was limited to analyzing the bankruptcy proceedings treatment to the secured creditors, but; it did not cover issues of applying the bankruptcy proceedings to financial lease.

The second domestic literature related to this title is the article written by Getahun Walalegn.[27] Getahun indicated the importance of introducing the consumer bankruptcy law into the Ethiopia bankruptcy legal regime. Having reviewed the experiences of the foreign jurisdictions, Getahun noticed the importance of adopting the consumer bankruptcy law of the German Model. But, his study did not touch the bankruptcy proceedings treatment to financial leases. Likewise, Fekadu

[26] Tefese Takele, "Treatment of Secured Creditors under Ethiopian Bankruptcy Regime," International European Extended Enablement in Science, Engineering & Managemen (IEEE-SEM), Vol. 8 No. 5 (2020), pp.144-173

[27] Getahun Wallalign, "Consumer Bankruptcy Law For Ethiopia: Lessons From the United States And Germany," Haramaya Law Review, *Vol. 3* No.1 (2017)

Petros[28] has analyzed the challenges created by the regulation regime issued by the National Bank of Ethiopia (NBE) and specified to launch of an appropriate and enabling regulation regime for the financial leases. His, work also did not trace the issues of bankruptcy treatments to financial lease.

Mesfin Taddese is another scholar who has tried to provide the skeleton of the financial lease which was introduced in CGLB proclamation No 103/1998 with its amendment proclamation No 807/2013.[29] Mesfin described the regulations enacted by the NBE and its untouched areas to flourish the financial lease business. In his book on the Ethiopian Law of Security Rights in Movable Property Mr. Asress Adimi[30] also noticed the Ethiopian financial lease transaction resemblances to a sale contract. According to Mr. Asress the financial lease transaction should have been covered under the movable property security rights proclamation (MPSRP).

Likewise, there is significant foreign literature on the application of bankruptcy proceedings to financial leases. The work written by the Robert Tissot[31] on the title *"the Effect of Reorganization of a bankruptcy proceeding on the executory contract in the comparative study of the United States, France, Germany, and Switzerland Legal Systems"* analyzed the issues of enforcing bankruptcy proceedings to executory contracts. Among the types of bankruptcy proceedings, it has specified the reorganization proceedings treatments to executory contracts. It did not touch the specific areas of my work that covered both the reorganization and bankruptcy /liquidation/ proceedings treatment to the financial leases.

Another foreign literature was written by Daniel Hamel[32] that examined the bankruptcy proceedings treatment to the lessors is more favorable to secured lenders. The study was comparing whether bankruptcy law arrangements are granting more favorable treatments to lessors or to secured lenders. In scope, it was limited examining the bankruptcy proceedings

28 Fekadu Petros, "Sense and Nonsense in the Regulation of Equipment Financing Business in Ethiopia," Mizan Law Review, *Vol. 13, No.1, (2019), PP.*30-63

[29] Mesfin Taddese, "Rights of Secured Creditors of a Bankrupt Trader in the Commercial Code of the Emperor of Ethiopia of 1960," (Addis Ababa University, Unpublished)

[30] Asress Adimi Gikay. Ethiopian Law of Security Rights In Movable Property, (2021) Research Gate, pp. 140-148

[31] Fabrice Robert-Tissot and Lévy Kaufmann-Kohle "The Effects of a Reorganization on (Executory) Contracts: A Comparative Law and Policy Study [United States, France, Germany, and Switzerland]." (2011). International Insolvency Institute. International Insolvency Institute. As accessed on August 03, 2022, available at <https://www.iiiglobal.org>, p.2

[32] Hemel Daniel, "The Economic Logic of the Lease/Loan Distinction in Bankruptcy," The Yale Law Journal, Vol. 120 (2011), pp.1492-1530

treatment of the lessor and secured creditors. It also did not touch the specific areas of the bankruptcy proceedings treatments to financial leases. There was also another foreign literature written by Shu-Yi Oei[33] who evaluated the consequences of recharacterizing the lease transaction to a true lease or finance lease. This work ha relation with my research in which the bankruptcy proceedings treat the financial leases may be recharacterized. As financial leases have unique natures, the bankruptcy courts in the US recharacterize whether the lease is a true lease or other transaction disguised to finance lease.

Therefore, to sum up, there is no significant literature at domestic and foreign levels on the title that the researcher has selected. All of this literature has raised the application of bankruptcy proceedings to the specific issues of secured creditors or general executory contracts. All of them did not touch the detailed and specific issues of the bankruptcy proceedings treatment to the financial leases. Hence, to the best knowledge of the researcher, there is no domestic literature available on bankruptcy proceedings that exactly address the financial lease arrangements under Ethiopian laws.

2.3. The Meaning and Characters of Bankruptcy Proceedings:

2.3.1. Defining the Concepts of Bankruptcy Proceedings:

The nature of bankruptcy law is more procedural than creating substantive rights. As a consequence, it is not easy to find the historical and legal definition of bankruptcy. Historically, the term "*bankruptcy*" is traced back to the Latin words '*bankus and ruptus'* which stands for table and broken respectively.[34] The term bankruptcy is also believed to have roots in the Italian medieval words "*banco and rotto"* which was roughly translated to 'broken bank'.[35] The word bankruptcy was also alleged to derive from the French and Italian words with its meaning of the 'broken the table or bank of the debtor.[36] That means the debtor who was unable to satisfy his debt was exposed to the acts of "breaking the bench" used in the marketplace. From this view,

[33] Shu-Yi Oei, "The Recharacterization of Leases In Bankruptcy and Tax Law." American Bankruptcy Law Journal Vol. 82 No. 635 (2008), pp.101-164.
[34] Adegbemi Babatunde & Ayooluwa Eunice, "Bankruptcy and Insolvency: An Exploration of Relevant Theories," International Journal of Economics and Financial Issues*, Vol. 7 No* 3 (2017), p.706.
[35] Ibid,
[36] Garner Bryan A, A Dictionary of Modern Legal usage. Oxford: Oxford University Press (OUP), 1987. - Available at: https://library.au.int/dictionary-modern-legal-usage-4, see also Taddese, Supra Note 9, p. 57

the study perceived that bankruptcy law is more procedural in which creditors file claims to get their debts or the debtor files for relief from financial difficulties to start a fresh business.

On the other hand, the Black's law dictionary defines the word bankruptcy as the *"statutory procedure by which a debtor obtains financial relief and undergoes a judicially supervised reorganization or liquidation of the debtor's assets for the benefits of the creditors*".[37] The concept of this definition is vast and complex. The elements of this definition are: bankruptcy is a '*statutory procedure'*. That means bankruptcy is a procedure that is sided to provide the way the debtors take financial relief under judicial supervision.

In the procedural approach, bankruptcy law prefers the scheme of arrangement (reorganization) process rather than liquidating the debtor's assets.[38] Once a business enterprise is financially distressed, the consequence is more superfluous for the enterprise's environment (workers, creditors, consumers, suppliers, and the owner). That means: the workers will remain jobless, the consumers will be exposed to scarcity of food products, and the creditors (lenders of money and government who collect tax) may face problems to cover their debt by collecting taxes from enterprises and failing to generate revenue. The suppliers who supply raw materials for the enterprise may lose a market, and then, in the end, the owners (shareholders) of the enterprises will fail into poverty.

To avoid these interrelated problems; some countries have adopted the redistributive justice model of bankruptcy that prefers more reorganization process rather than liquidating the asset of the bankrupted debtors. This procedure (reorganization) is a pro-debtor since it provides a period of breakthrough for the debtor as it revives from financial distress. The US Bankruptcy Code chapter 11[39] is a typical example of a redistributive justice model of bankruptcy proceedings that chooses to restructure the enterprises in financial distress to restore their financial well-being and viability.

Another element that is incorporated in the black's law dictionary definition is the phrase "*.....a liquidation of the debtor's assets for the benefits of creditors".* The last resort in bankruptcy

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[37] Garner, B. A. "Black's Law Dictionary" (7th ed. (1999). (B. A. Garner, Ed.) St. Paul Minn: West Group.
[38] Supra Note 18 prefers a scheme of arrangement while the New Commercial Code Proclamation, Supra Note 10 prefers the reorganization process.
[39] The US bankruptcy law chapter 11 deals with reorganization proceeding

proceedings is liquidating the assets of the debtors to distribute among the creditors. When the debtor is failed to take breakthrough from its financial distress under the reorganization process, the voluntarily or involuntarily petition may be submitted to the bankruptcy court. After the petition is submitted, the court appoints the trustee (liquidator or trustee) who take the case of the administration of the estate and oversee the process. Such organs are responsible for the administration of the estate identifying the creditors' claims and assets of the debtors and reporting to the bankruptcy court for the division among the creditors.

Some country directly prefers the procedure of allotting the estate of the debtor rather than endeavors to rehabilitate the debtor. The repealed Commercial Code of Ethiopia more or less followed this approach, whereas the procedure of liquidation is backed by the economic efficiency theory. Under the liquidation procedures, the economic efficiency theory deals with the merchants who must efficiently and effectively do their business unless otherwise, the bankrupted debtor may be kicked out of the market and no one protects him. The drawback of this model is, unlike the redistributive justice theory, it does not give a breakthrough for the debtor to reorganize its financial status for well-being and viability.

The other document which contains the definition of bankruptcy is the UNCITRAL Legislative Guide of the model law. It indirectly defines bankruptcy proceedings by taking into account the term reorganization and liquidation. Under this document, the term liquidation is defined as *"the process of assembling and selling a debtor's assets in an orderly and expeditiously technique so that dissolve the enterprises and distribute the proceeds to the creditors according to the established laws*".[40] The same document defined reorganization as "*the process of restructuring enterprises' financial relationship to restore its financial well-being and viability"*. From this definition, we may sort out that liquidation is a process of assembling the property of the debtors to secure the creditor's claim. A bankruptcy officer /trustees/ who is assigned to identify the property of the debtor must satisfy the claim of the creditors and submit the reports to the bankruptcy court. Then, the bankruptcy court may decide to sell the property of the debtor, and distribute the proceeds among the creditors. Though the liquidation proceeding is not designed to protect the interest of the debtor, it is more inclined to protect the interest of the creditors.

[40] World Bank principle and Guideline for Effective Insolvency and Creditors Right System and United Nation Commission on International Trade Law (UNICITRAL) Legislative Guideline as cited in Meaza Ayalke. (2011), p.8

Coming to the Ethiopian bankruptcy legal regime, both the repealed and the new commercial codes fail to provide outlined the definitions of bankruptcy. But, its nature can be inferred from the whole provisions of book V and Book III of the Repealed and the NCC respectively.

Likewise, the phrase "*bankruptcy proceeding*," is defined as "*a process of filing a petition by the debtors or creditors to the Bankruptcy Court to request for the reorganization or liquidation process".*[41] Once a petition for the bankruptcy proceedings is filed to the Bankruptcy Court for reorganization or liquidation; the process of adjudicating or hearing by the court is the process of bankruptcy proceedings.[42] Thus, the concept of bankruptcy proceedings may be understood as the judicial or procedural action of adjudicating /hearing/ the bankruptcy-related cases. The Ethiopian NCC introduced three types of proceedings. These are the preventive restructuring proceedings (PRP),[43] the Reorganization proceedings (RP),[44] and the liquidation (bankruptcy) proceedings (BP)[45]. In the 1960s, the Ethiopian Commercial Code introduced only two types of bankruptcy proceedings which are: scheme of arrangement[46] and liquidation process.[47]

From both the repealed and the NCC of Ethiopia, there are no hints on how the bankruptcy proceedings are applied to financial leases. Thus, the thesis strives to analyze how the bankruptcy proceedings treat the financial lease under the Ethiopian legal systems, while both the bankruptcy and financial lease concepts paradoxically stand side by side. To progress with the detailed discussions of applying the bankruptcy provisions to financial lease, the next sub-section deals with the provisional safeguard characteristics of bankruptcy proceedings.

2.3.2. The Provisional Safeguard of Bankruptcy Proceedings:

2.3.2.1. The Automatic Stay:

In bankruptcy proceedings, the rule of the automatic stay is one of the most notable provisional safeguards of bankruptcy proceedings. The moment of opening bankruptcy proceedings affords several immediate benefits. It stays the commencement or continuation of judicial action, non-judicial claims, and other obligations of the debtor. It prohibits the creditors from undertaking

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[41] Supra Note 18, Art 989
[42] Supra Note 40, P. 8
[43] Supra Note 10, Art 588(2)
[44] Ibid, Art. 588(3)
[45] Ibid, Art. 588(4)
[46] Ibid, Art. 1119
[47] Ibid, Art. 974

any act to collect, assess, or recover a claim against the estate. This protection tool granted to the bankrupt estate is collectively known as the automatic stay. The stay is 'automatic' because it operates without requiring judicial interventions. Without requiring authorization or requests of the court, it is triggered upon filing bankruptcy cases.[48] By precluding the continuation or commencements of any claims, the automatic stay protects the bankrupt estate against the scattered /piecemeal/ claims of several creditors.

2.3.2.2. The Bankruptcy Estate:

The bankruptcy estate refers to all the assets of the debtor that are controlled by the trustee and subject to the proceedings. The bankrupt estate is only created under the operation of liquidation /bankruptcy/ proceeding. The opening of the bankruptcy proceedings to the court creates a bankruptcy 'estate' that comprises the entire property of the debtor. The bankruptcy estate comprises all the assets, rights, claims, and interests in the property that may be tangible or intangible.[49] The rights and interests of the debtor embodied in the encumbered assets owned by a third party are also a parcel of the estate. According to the contents of the estate, the lessee's possession rights combined with the leased capital goods may establish the debtor lessee's estate. Similarly, the ownership titles of the debtor lessor owned in the leased capital goods may also establish the debtor lessor's estate.

2.3.2.3. The Ban of Ipso Facto Clause:

The '*ipso facto clause'* is defined as a contract clause that specifies if one contracting party is subjected to bankruptcy; the other party is no longer owed to perform.[50] In the ordinary contract, it is the freedom of a contracting party to include such clause into their contracts to terminate the obligation that one party breached as a consequence of the bankruptcy. Under normal course, parties are free to include a contractual clause in their agreements to terminate their obligation on the occurrences of specific events (bankruptcy case).

However, bankruptcy proceedings overruled the freedom of the contracting party to terminate the obligation in occurrences of bankruptcy by the non-debtor party.[51] The restriction on the

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[48] Lewis, Kevien. M. *Bankruptcy Basics: A Primer.* Congressional Research Service, (2018), p.5
[49] Supra Note 10,, Art 729 (1 (a-b))
[50] Ibid,
[51] Andrea Coles-Bjerre, Ipso Facto: The Pattern of Assumable Contracts in Bankruptcy. *New Mexico Law Review, Vol. 40 No.*1 (2010), p.78

contract clause has precluded the operation of the 'ipso facto clause' that permits the non-debtor party to exit out of the obligations costlessely. At the opening of the bankruptcy case, unilaterally terminating and abandoning the contract is only vested in the trustee of the debtor party. Bankruptcy law has empowered the debtor party to unilaterally terminate and walk away from the obligation but prohibits the non-debtor party. Notwithstanding that the parties have mutually agreed to enforce in the occurrences of bankruptcy, bankruptcy law has crushed the enforcement of such an agreement.[52] At the cost of the non-debtor party, the bankruptcy officer is empowered to make a strategic decision either to assume or reject the contract for the interest of the debtor or estate. If the contract is likely to be burdensome, the bankruptcy officer in the proceeding may reject it. On the other hand, if the contract creates more gains for the debtor /estate, without considering its unprofitability to the non-debtor party, the bankruptcy officer may assume.

From the side of the debtor party, because of opening the bankruptcy case, the inability to perform the obligation does not put in default. For the reasons attributed to the bankruptcy case, the debtor's inability to honor the contractual obligation does not enable the counterparty to terminate. Thus, restricting the enforcement of the ipso facto clause is justified to enhance the bankrupt estate and help the debtor's business rehabilitation.[53]

2.3.2.4. The Responsibility and Power of the Trustee:

The trustee is empowered to maintain the objectives of the bankruptcy law to maximize the bankrupt estate.[54] The bankruptcy statute has the objective to allow the debtor party runs away from ongoing contracts that are unfair to his estate, and retain the favorable ongoing contracts that assist to maximize the estate. In upholding this objective, the trustee may reject the ongoing contact that is burdensome and accepts the obligation that is more beneficial.

The historical meaning and the provisional safeguard characteristics of the bankruptcy proceedings are what we have discussed so far. In the next section will present the meaning and characteristics of the financial lease contracts.

[52] Ibid, p.82
[53] Che, Yeon-Koo., "Mandatory bankruptcy Rules and Inefficient Continuance,". Journal of Law, Economics, and Organization, *Vol.15 No.*2 (1999), p.442
[54] Ibid,

2.4. Defining the Concepts and Natures of Financial Leases:

2.4.1. Defining the Concepts of Financial Leases:

A financial lease sets the right and obligations of the parties (lessor, lessee, and supplier) in the financial lease and it has a more substantive nature than procedural. It creates a triangular relationship between the lessee, lessor, and supplier. It links two separate agreements through interrelated arrangements. Leasing contracts are formed between the lessor and the lessee, while supply contracts are created between the supplier and the lessor.[55]

The modern historical development of the financial lease was connected to the International Institute for the Unification of Private Law (UNIDROIT)[56] and the Uniform Commercial Code (UCC)[57] of the US in the international and domestic model law respectively. Accordingly, the UNIDROIT model law defines a financial lease with or without an option to purchase all or part of the goods subject to lease contracts with its three operational characteristics. These are: *"(a) the lessee specifies the asset and selects the supplier; (b) the lessor acquires the assets in connection with the lease agreement and the supplier has knowledge of that fact, and (c) the rental payable under the lease agreement takes into accounts or does not take into accounts the depreciation of the goods of the lessor".*[58] In the interconnection of the lease agreement, the supply agreement, and the active involvement of the lessee in selecting the supplier by specifying the goods subject to the lease.

Likewise, the US Uniform Commercial Code (UCC) characterizes the nature of financial leases among true leases under UCC Section 2A-103(1) (g) and the transaction that create a security interest in the UCC Section 2A 103 (j).[59] Before Art 2A was added to UCC in 1987, the financial lease was regarded as a secured loan transaction under Art 9. So, the term "financial lease" is defined under UCC Section 2A (103) (g) as consisting of an overall three-party transaction in

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[55] David A. Levy, Financial Leasing under the UNIDROIT Convention and The Uniform Commercial Code: A Comparative Analysis, Indiana International and Comparative Law Review Vol. 5 No. 2 (1992), p.272.

[56] The International Institute for the Unification of Private Law (UNIDROIT) is which is founded in 1926 by the League of Nations (LN), the United Nations Commission on International Trade Law (UNCITRAL Legislative Guide on the Insolvency Law, New York, United Nations, (2005)), and the Organization of American States (OAS)

[57] The uniform Commercial Code is a comprehensive set of laws governing all commercial transactions in the United States. Except for Louisiana of the US, all states accepted this commercial and the code set a minimum threshold on the commercial issue in the US.

[58] Ibid

[59] Supra Note 14, p.315

which (1) the lessor does not select, manufacture, or supplier, (2) the lessor did not own the goods before the lease was arranged, and (3) the lessee either approves the purchase contract or receives specified warranty and the supplier gets information before signing the lease agreement.[60] From this definition, the lessee's active involvement in the selection of the supplier and specification of the leased capital goods is considered a key element of a financial lease. Due to the limited role that the lessor plays in the financial lease, Art 2A of the US UCC offers special statutory protection to the lessors. Based on the satisfied factors specified under section 1-203 (b) for the definition, the financial lease may be characterized as a secured sale or finance. Hence, to divide the line between the secured sale and a lease, consideration is given to whether the lessor retains a meaningful economic interest in the residual value of the equipment.[61]

When come to the case of Ethiopia, the legal document that defines the financial lease is the CGLB proclamation No 103/1998. Under this proclamation, it is defined as a type of leasing by which a lessor provides a lessee against payment of mutually agreed installments over a specified period with the use of specified capital goods which are: (a) either already acquired by the lessor; or (b) purchased by the lessor from the third party, known as the supplier, (c) chosen and specified by the lessee, and (d) under which the lessor shall retain full ownership right on the capital goods during the period of the lease agreement, and (e) subject to agreement between the two parties, the lessee may have the option to purchase the capital goods outright after the termination of the lease period at an agreed price.[62]

Based on these reviews, we can arrive at the definition of financial lease as an operation in which substantially all the risks and rewards of an asset, except the ownership titles are transferred from the lessor to the lessee. It is a financing technique in which the lessor puts the capital goods directly at the disposal of the lessee in place of finance. Similarly, the definition stated under the Ethiopian CGLB proclamation takes financial lease as a "*type of leasing by which a lessor*

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[60] Ken Weinberg, the 'The In's Outs' of the UCC Finance lease & Co-Lease Issues, January 15, 2020 p.1 accessed on September 1, 2022. See also Gordon W. Brown and Paul A. Sukys, Art. 2A-103 (g), p.798

[61] RM Contino, Complete Equipment Leasing Handbook: as cited in Liu Guojin Finance Leasing in International Trade (2010), p.30

[62] Supra Note 20, Art. 2/3

provides a lessee against payment of mutually agreed installments over a specified period with the use of specified capital goods".[63]

2.4.2. The Unique Nature of Financial Leases:

2.4.2.1. The Triangular Nature of the Financial Leases:

Diverse to other types of contracts, financial lease transaction operates among three parties and two contracts. Namely, the supplier, lessor, and lessee are three parties involved in the financial lease arrangements with the contract of supply and financial lease. A financial lease is a lease contract between the lessor and the lessee, while a supplier contract is between the lessor and the supplier. Thus, a financial lease contract has unique nature that involves three contracting parties and two types of contacts in one transaction. Thus, financial lease arrangements operate when the three parties i.e. the lessee, lessor, and suppliers are interlinked by the contract of financial leases.

2.4.2.2. The Contractual Hybrid Nature of the Financial Lease

Compared with other types of contracts, the financial lease has a hybrid nature. During the entire lease period, the lessee holds the goods as a mere bailee of the lessor and does not have ownership rights. In such setups, the relationship between the lessor and lessee seems to be governed by the contract of bailment. Likewise, when the transaction is viewed from the optional rights of the lessee to purchase the capital good at the end of the lease periods, it seems to be governed by the hire-purchase contract. Similarly, if we view from the exclusive rights of the lessee to choose the goods and the supplier, and the obligation of the lessor to finance the goods by retaining the ownership title, it has the nature of secured finance. In such a situation, by providing the finance the lessor functions merely as the vehicle to facilitate the transaction between the lessee and the supplier. Thus, a financial lease contract is established from a mixture of the contracts of bailments, hire-purchase and secured finance.

2.4.2.3. The Full Payout and Non-Cancelability Nature of Financial Lease:

According to art 5 (1) (b) of the CGLB proclamation, the financial lease agreement between the lessor and lessee is a full payout and non-cancelable contract. Here, the phrase 'full payout' indicates the periodical payments that the lessee undertook to pay are calculated based on the

[63] Ibid, Art 2 (2)

economic life of the capital goods. On other hand, the 'non-cancelability' nature of the financial lease is defined in Art 2 (11) of the CGLB proclamation. It indicates a lease agreement that is cancelable only by the operation of the law or by mutual agreement. Hence, until the period agreed in the lease is expired or the lessor and lessee are mutually agreed, the obligation of the financial lease that binds the lessee and lessor is non-cancelable.

2.4.2.4. The Recharacterization of the Financial Lease:

Financial lease duration is equal to the useful economic life of the goods, and the lessor does not normally return the goods. At the end of the lease periods, based on the lessee's optional rights to purchase, in various countries it is subjected to characterization by looking at the totality of the circumstances.[64] If the lessee must purchase the capital goods at the end of the lease periods, the Canadian and US Courts characterize it as secured finance. Where the lessor enters into a contract with the supplier and the supply contract is grouped around the lease, the France law considers such agreement at the end of the lease term an obligation to unilaterally sell the goods to the lessee is incumbent on the lessor.[65]

Since the aggregate values of the rental paid during the lease time include more than the rights to use the goods, which includes the amortization price and the lessor's profit margin, French law and other civil law legal systems recognize the essential function of the financial lease is the financing transaction rather than a mere grant of the possession and use rights.[66] Thus, when a financial lease is subjected to recharacterization, the US and France bankruptcy law treated as a secured finance.

Thus, evaluating how the safeguarding provision of the Ethiopian bankruptcy law treat financial lease with such unique natures is the main objective of this study. These discussions are all about the historical meanings and the unique nature of the bankruptcy proceedings and financial lease, whereas the next section presents the main objectives of the bankruptcy and financial lease.

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[64] Herbert Kronke. "Financial Leasing and Its Unification by UNIDROIT: The General Report". Uniform Law Review, *Vol. 16 No.*1-2 (2011), P.27
[65] Ibid, p.28
[66] Ibid,

2.5. The objective of the Bankruptcy Proceedings and Financial Leases:

2.5.1. The Objectives of Bankruptcy Proceedings:

Traditionally, as discussed in Chapter One the bankruptcy proceeding was mainly formulated to protect the interest of the creditors. It was initiated to organize the collective actions of the creditors against the debtor so that they would receive the maximum share out of the debtor's assets in the bankruptcy process.[67] However, modern bankruptcy law goes far beyond protecting the interest of the creditors and extends to serve the broader objectives of social and economic matters.

From an economic point of view, bankruptcy proceedings have the objective to maximize the overall efficiency of eliminating functionally inefficient firms so competent and feasible business firms take over the market.[68] From the side of estate maximization and efficiency objectives, bankruptcy law tried to decide whether the debtor's business in reorganization, sale as a going concern, or liquidation would bear the greatest value.

On the other hand, Gordon W. Brown and Paul A. Sukys pointed out the most important objectives of bankruptcy law.[69] Protecting the interest of the creditors who have lent money or extended credit to the debtor by making certain that the debtor's money is divided fairly to creditors is the primary objective. The bankruptcy process also gives the debtors an escape devise from their financial burdens and allows them to build new lives as the second objective.

2.5.2. The Objective of the Financial Lease:

Under section 2.3 of this chapter, we argued that the "*Financial Lease*" is an operation in which substantially all the risks and rewards of an asset, except the bare ownership title are transferred from the lessor to the lessee. From this definition, we can sort out that the objective of the financial lease is to create reliable sources of finance for the lessor. That means, the lessee periodically pays rent for the lessor who provides the goods, and such transaction generates periodical revenue for the lessor.

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[67] Meaza Ayalke, The Ethiopian Law of Bankruptcy: Its Short Comings In Comparison to Modern Law of Bankruptcy and Areas of Concern for Its Revision. (2011 unpublished School of Law Addis Ababa University), p.13
[68] Ibid
[69] Gordon W. Brown and Paul A. Sukys, 'Business Law With Uniform Commercial Code Application, Instructor's and Noted Edition, pp.514-515

On the other hand, it puts the economic benefits of the capital goods under the usage of the lessee. This means financial lease transaction puts available capital-intensive goods at the usage of the lessee. It creates an alternative source of finance available for the lessee. It allows the lessee to obtain the capital-intensive goods utilize in the production so that able generate continuous cash flows. Unlike other lending and borrowing institutions, without requiring feasible credit history, down payments, and collateral security, a financial lease arrangement enables the lessee to acquire 100% fully financed purchased capital goods. It provides the financial service accessible to the lessee as an alternative to another mode of financing.

The financial transactions enable the supplier to make a sale contract with a more solvent and reliable lessor. In its tax treatment advantage, the financial lease arrangement encourages the transaction over other means of acquiring equipment.[70] It helps the lessor to get the accelerated depreciation and the lessee's deduction of rental payments. Thus, the financial lease arrangement helps the lessor and lessee with an opportunity to obtain tax benefits from owning or possessing the leased capital goods.[71]

2.6. Theories Underlying the Application of Bankruptcy Proceedings to Financial Leases:

Under section 2.8 of this study, we will see as the financial leases are types of executory contracts. By its nature, the presence of an executory contract includes the obligation or rights of the past and future expectations.[72] In such arrangements, when one of the contracting parties encounters financial distress, the obligation or rights of an executory contract represents an expected loss or gain to the bankrupt debtor.[73] In bankruptcy proceedings, rejection or assumption of such contract may enhance or impair the estate.[74] Since the main objective of the bankruptcy proceedings is to maximize the estate value; it includes the mechanisms to ease the power of the bankruptcy officer to terminate the obligations of executory contracts.[75] The system

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[70] Supra Note 14, p.309
[71] Ibid,
[72] David Hahn "The Internal Logic of Assumption of Executory Contracts: Bar-Ilan Univesity Public Law and Legal Theory Working Paper No.13-10, Social Science Research Network Electronic Paper Collection. (2010) available at https://deliverypdf.ssrn.com.
[73] Ibid,
[74] Ibid,
[75] Davalos Susana "The Rejection of Executory Contracts: A Comparative Economic Analysis," Mexican Law Review Vol. 10 No.1 (2017), p.69.

is normally designed to enable the officer to pursue the performance of the profitable and avoids unprofitable executory contracts. However, avoiding the burdensome and reducing the cost of rejection of executory contact allows the officer to externalize the cost of the ongoing obligation to the non-debtor party.[76] Thus, to ensure the objective of protecting the interest of the estate, rejecting the performance of the executory contract may affect the interests of the non-debtor party as well.

From efficiency perspective, if the contracts have been performed would have increased the total value; the views of the executory contract should not have been terminated because bankruptcy objectives were maintained.[77] Then, from the efficiency perspective, Jesse Fried proposed that "*the bankruptcy rules for termination of the executory contract should be aligned with the social goals of maximization of the total value"* that have influenced the dimension of the benefits.[78] Hence, in the course of deciding to reject the executory contracts, only considering the burdensome caused to the debtor's business or estate is inadmissible. However, unquestionably; the social goals to maximize the total values of the executory arrangement while rejecting the executory contract must be considered.

Thus, from these perspectives in the application of the bankruptcy proceedings to the executory contracts, there are two modalities creditor-friendly and debtor-friendly. The next sub-section presents these two approaches briefly.

2.6.1. The Creditor-Friendly Approaches:

The creditor-friendly approach of the bankruptcy regime supports the creditor's interest against the debtor. It is known by the measures of replacing the manager /debtor/ with administrators who represent the interests of the creditors in the management of the estate. In the NCC of Ethiopia, for instance, administrators who take responsibility for the bankruptcy proceedings are known as the trustees'. It requires the managers or the debtor to lose control of the business to the bankruptcy officer (trustee).

Another justification that shows the approach is pro-creditor is the principle of equity or *pro-rata* share to the creditors, rather than striving to rescue the business of the debtor. In other words,

[76] Ibid p.70
[77] Jesse Fried (1996) as cited in ibid, p.71
[78] Ibid,

although the creditor-friendly system helps to avoid ineffective reorganization, its permission for the larger risks of premature liquidations is the drawback.[79] Although the creditor-friendly system favors ineffective reorganizations, its counter effect causes to accelerate the liquidation of the debtor's business. Such types of bankruptcy regimes are characterized by their incentives for healthy and good corporate governance, and also accelerate the deterioration of the assets of an unhealthy company.[80] The system does not tolerate helping the rehabilitation of the debtor in financial difficulties. Thus, the pure creditor-friendly bankruptcy legal systems are characterized by giving priority to secured creditors and replacing the managers with the bankruptcy officer which may accelerate the liquidation of the debtor's business rather than reorganization.[81]

2.6.2. The Debtor-Friendly Approaches:

The debtor-friendly approach favors the interest of the debtors over the creditors. It seeks to keep the debtor or the managers in place to facilitate the reorganization plan and makes the automatic stays functioning that suspends or terminates any claims from running.[82] It pursues to minimize the social costs of financial distress and avoids incidents of systematic risks.[83] To commence new financial activities and get rid of the financial distress, enables the bankruptcy courts to change the priority and the security contracts issued to the secured creditors.[84] The debtor-friendly system empowers the bankruptcy court to change the credit contracts concluded between the creditor and debtor in favor of the debtors.[85] To help the survival and rehabilitation of the debtor's business, it prohibits the set-off rights of the creditors.[86] The pure debtor-friendly approach is known by keeping the manager/debtors/ in position and terminating or suspending the creditor's claims to ensure the reorganization plan.

2.7. The Application of Bankruptcy Proceedings to Contracts:

Regarding the application of bankruptcy law to contracts, the UNCITRAL Insolvency guide law has established two difficulties to develop legal policies.[87] The first difficulty is, unlike all assets

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[79] Philippe Froute "Theoretical Foundation for a Debtor Friendly Bankruptcy Law in Favour of Creditors." European Journal of Law and Economics (2007), p.203
[80] Ibid p.204
[81] Ibid p.205
[82] Supra Note 67, p.25
[83] Supra Note 75, p.204
[84] Ibid,
[85] Ibid,
[86] Supra Note 67, p.25
[87] Supra Note 79, p.119

of the bankruptcy estate, the contract may be tied with liabilities or rights. When the contract entails valuable interests, to enjoy such potential rights, the trustee need to assume and perform for the benefit of the estate or debtor's business. However, if it entails burdensome to the debtor's assets or estate, the officer may decide to reject the contract. To produce the maximum values, but; deciding how to treat a contract entails rights or liabilities is the most challenging.

The other difficulty lies in the complex nature and types of contracts in which the bankrupt debtor is involved. The debtor may have engaged in the contracts as a buyer, a seller, a lessor, a lessee, a licensor, a licensee, an assignor, an assignee, a receiver, or a supplier. Having considered the objectives of bankruptcy law to maximize the value of the estate, promote equality and enhance the reorganization, deciding how to treat the obligation /rights/ in such types of contract requires taking advantage.[88] To take advantage of the contracts, the officer is required to decide to reject burdensome contracts; and assume contracts that contribute value to the estate. However, from the side of non-debtor counterparties, such treatment may hold to honor the contracts that did not ensure their advantage. Therefore, the bankruptcy officer is charged with the obligation to evaluate how to treat the obligation or rights in the contracts.

In filing the bankruptcy case, the contract may be a contract under which contracting parties have continued obligations to perform or the contracts under which both parties have already performed. Based on the continued obligation to perform, Art 592 (1&2) of the NCC categorizes claims under pre-insolvency and post-insolvency. Claims that arose before the filing of the bankruptcy case are treated under 'pre-insolvency claims', while claims that arise from the continued performance of the contracts after the opening of the bankruptcy case are treated as 'post-insolvency'.[89] The bankruptcy proceedings' treatment of the obligation of the contracts that have already been performed (pre-insolvency claims) is not an issue. The contractual obligation that has already been performed or terminated before the opening of the bankruptcy case cannot pass to the bankruptcy officer for rejection or assumption. As the officer cannot assume a contract that was validly terminated before the opening of the bankruptcy case, it is outside the objectives of this study. As classes of the contracts, the bankruptcy process treatment to the executory contract in general and the continued financial lease under the domain of this thesis.

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[88] Ibid, p.120
[89] Supra Note 10, Art 592 (1 and 2)

The next sub-section, therefore, discusses the application of bankruptcy proceedings to executory contracts.

2.8. The Application of Bankruptcy Proceedings to Executory Contracts:

The experiences of several jurisdictions designated contracts with continued performance under different terms. In the repealed Commercial Code of Ethiopia, the concept of executory is addressed in the 'continuation of lease'[90] and in the NCC it is regulated as the 'treatments of ongoing contracts.[91] The US Bankruptcy Code[92] used the phrase 'executory contract and unexpired lease', while the French Commercial Code[93], the German Insolvency Code[94] and the Spanish Insolvency Act[95] used words equivalent to the 'executory contract'. Permissible to show the treatments of bankruptcy proceedings to the continued performance the author favors to use of the term 'executory contract' in this paper as used by the US Bankruptcy Code.

For the operational meaning of the 'executory contracts, the US bankruptcy systems and the judicial experience observed the existence of unperformed obligation of both the bankrupt debtor and the other party to the contract in which the failure of either party to complete performance would constitute a material breach to excuse the performance of the other.[96] Section 103 and 279 of the German Insolvency Code adduces the existence of an executory contract when both contracting parties have not yet performed the contract at the time of filing the insolvency case. Moreover, in French case law and legal doctrine, an executory contract is a contract whose '*principal obligations are not performed* at the time of filing the bankruptcy case.[97] At the moment of opening the bankruptcy case, if the two contracting parties have material remaining obligations to be performed, the NCC of Ethiopia classifies in the 'treatments of the ongoing contract'.[98]

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[90] Supra Note 18, Art. 1040
[91] Supra Note 10, Art 793
[92] United States Code (U.S.C.) (1994), Title 7, Section 365
[93] Code De Commerce [C. Com.] [Commercial Code], arts. L. 631-1 - L 632-4.
[94] The German Insolvency Code (1994), the Rejection of Executory Contracts: A Comparative Economic Analysis. Mexican law Review, *10*(1), 69-101.pp. 80
[95] Insolvency Act (Ley Concursal), (B.O.E., 2003, 22) (Spain)
[96] Supra Note 30, p.26
[97] Ibid
[98] Supra Note 10, Art 593

Due to its economic importance and operational complexity, the application of bankruptcy proceedings over executory contract requires attention. Filing the petition of the bankruptcy case normally neither automatically terminates nor enforces the executory contract against the debtor /estate/. However, it operates only when the trustee decided to reject or assume. Thus, the effect of bankruptcy proceedings against an executory contract is under the responsibility and the power of the officers to decide on the assumption or rejection. Having satisfied with the specified standards of the bankruptcy law the bankruptcy officer may assume or reject the executory contracts. As a consequence, the next discussion contemplates the power granted to the bankruptcy officer (supervisor in reorganization or trustee in bankruptcy) to reject or assume obligations of an executory contract.

2.9. The Power to Reject or Assume the Obligation of Executory Contracts:

Rejection is the choice of the bankrupt estate or debtor in possession not to become a party to a pre-insolvency executory contract of the debtor, which in effect results in the termination of the prospective obligation.[99] On the other hand, the assumption of the executory contract indicates that the bankrupt estate accepts and is subjected to the pre-petition obligation of the debtor's contract.[100] In several bankruptcy jurisdictions, the bankruptcy officer (trustee or supervisor) is empowered either to assume or reject the obligation of the executory contract. However, considering what standards are recognized by the bankruptcy regimes to allow the supervisor in reorganizations or the trustee in the bankruptcy to decide rejection or assumption is an important point. Thus, the next section outlines the standards used to justify the rejection or the assumption of an executory contract.

2.10. The Standards of Rejection or Assumption of Executory Contracts:

There are bankruptcy laws in countries that offer the standards upon which the bankruptcy officer must decide to accept or reject an executory contract. Among those, Section 365 (a) of the US Bankruptcy Code grants to the trustee, based on the court's approval and limitations set in Section 365,[101] of the power to assume or reject an executory contract or unexpired lease. Away

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[99] Udofia, Kubianga M. The Impact of Insolvency on Corporate Contract: A Comparative Study of the UK and US Insolvency Law Regimes (2014 the University of Nottingham for the Degree of Doctor of Philosophy), pp.220-221

[100] Ibid,

[101] Section 365 (a) of the US Bankruptcy Reform Act of 1978 states that Sections 765 and 766 of the Bankruptcy Code limit the trustee's power to reject or assume the executory contract of nontransferable and default obligations before the commencements

from the court's approval, the power of the bankruptcy officer to reject or assume an executory contract is free from any limitation.[102] In the reorganization proceedings, the French Bankruptcy Code limited the power to reject an executory contract under two specified conditions. It justifies the rejection of an executory contract when; "(i) must be necessary for the reorganization of the debtor; and (ii) it must not adversely impact the interest of the counterparty".[103] Likewise, in determining whether to approve the rejection of executory contracts, the Bankruptcy Court in the US and the UK have developed two broad standards i.e. the burdensome test and the business judgment test.[104] In the next subsections, we will discuss these standards.

2.10.1. The Standards of Burdensome Test:

Under the burdensome test, the bankruptcy officer rejects the executory contract if the assumption and performance of the contract will give rise to the loss.[105] In rejecting the executory contract, the trustee must be able to prove that the income generated from the performance will not cover the operating expenses incurred in the performance. Hence, the rejection of the executory contract is only justifiable upon proof of the net loss incurred to the bankruptcy estate.[106] Unless otherwise, an assumption of an executory contract is burdensome to the bankruptcy estate, the trustee could not justify the rejection.

2.10.2. The Business Judgement Test:

The business judgment test emphasizes the potential profits that could be added to the bankruptcy estate if an executory contract is assumed or rejected.[107] If a greater profit is accrued to the unsecured creditors by rejecting the executory contract, the officer is entitled to decide rejection.

[102] Supra Note 99, p.236
[103]Emilie Ghio (2019) *Executory contracts in insolvency law: The National Report For France.* Retrieved August 09, 2022, from Academia.edu: https://www.academia.edu, p.233, the France Commercial Code, Art L 622–13 IV
[104]Supra Note 99, p.236
[105] Ibid, p, 235
[106] Ibid,
[107] Ibid, P.239

2.11. The Policy Rationale to Reject and Assume the Executory Contracts:

2.11.1. The Asset Preservation /Maximization/ Policy:

The policy objective behind the rejection or assumption provisions of bankruptcy law is quoted in Kubianga Michael provided that: [108] "*… the purpose for allowing the trustee or debtor-in-possession to assume or reject an executory contract is to enable them to take advantage of a contract that will benefit the estate by assuming it or to relieve the estate of a burdensome contract by rejecting it. Rejection of an executory contract ... relieves the debtor of burdensome future obligations while he is trying to recover financially".*

This quoted sentence shows that the cardinal objective of bankruptcy law is to maximize and preserve the assets available for the benefit of the creditors. The rejection or assumption provision of the bankruptcy law is to ensure the mechanisms through which the bankruptcy estate maximization objectives can be upheld.[109] The power to reject an executory contract given to the bankruptcy officer assists in bringing back any unbeneficial pre-petition executory contract to the debtor's account.[110] It distinguishes the burdensome executory contract from the estate. Rejection helps the officer to avoid the executory contract that wastes the limited estate of the debtor in performance.[111] Hence, the rejection power enables the debtor-in-possession or the bankrupt estate to have a clean break from the pre-petition executory contractual liabilities.[112] Particularly, it relieves the debtor in possession of burdensome contractual obligations while the debtor is trying to recover from financial difficulties.

Likewise, the powers granted to the bankruptcy officer to assume an executory contract is intended to accrue the benefits available in the executory contracts for the estate.[113] Hence, the power to assume an executory contract granted to the officer allows for preserving a pre-insolvency executory contract that is beneficial to the creditors. It ensures that valuable executory contracts and assets should not be lost as a result of the bankruptcy proceedings, rather than channeling the assets available towards the creditors.[114] The power to assume an executory

[108] Ibid, P.217
[109] Ibid, p.215
[110] Ibid,
[111] Ibid,
[112] Ibid,
[113]Ibid, p.216
[114] Ibid, p.217

contract relies on the heart of maximizing the bankruptcy estate available for the creditors. Thus, the rejection or assumption of power of the bankruptcy officer is devised to serve the bankruptcy objectives to avoid burdensome obligations and maximize the values of the estate available to creditors.

2.11.2. The Equality Treatment Policy:

There is an important assumption that the rejection of the executory contract gives the trustee or debtor-in-possession to breach the contract so as similarly situated creditors could be treated equally.[115] The creditors' compensatory action for the breach of executory contract against the debtor or bankruptcy estate grants equal treatment to creditors and get a pro-rata share at the end of the proceedings. Hence, it is a suggestion that the rejections of the executory contract could result in the equal treatment of the creditors that allocates them a pro-rata share of the estate.

However, in practice, the role of the rejection to ensure equal treatment among creditors is very limited. In rejecting an executory contract, the primary objective of the trustee or debtor-in-possession is to relieve the debtor or estate from being chained to unbeneficial contracts, rather than ensuring equal treatment among creditors.[116] The aim is to avoid the asset depletion likely to occur through the performance and acceptance of an executory contract. During the decision to assume or reject the executory contract**,** habitually**,** the impacts of such a decision on the individual creditors are not the primary concern. The effect of such a transaction on the debtor's net assets is the center of the consideration.[117]

For instance, whenever the debtor is subjected to multiple executory contracts, the logical action is to assume one or two of the contracts and rejects the rest. In doing so, the bankruptcy officer relies on the demand of the debtor or the bankruptcy estate, to avoid wasting resources on performing unprofitable contracts.[118] Thus, the practical objectives of rejecting the executory contracts are not to ensure equal treatment among creditors, but rather than enhancing the interest of the debtor's business or bankruptcy estate.

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[115] Ibid,
[116] Ibid, pp.217-18
[117] Ibid,
[118] Ibid, p.219

2.12. The Time for Rejection or Assumption of Executory Contracts:

The executory contract normally remains effective pending the assumption or rejection by the bankruptcy officer. To reject or accept an executory contract, the debtor in possession needs adequate time to arrive at a valuable decision. Hence, from the side of the bankruptcy estate and the creditors, usually there are rival interests. The debtor-in-possession needs to have substantial time, to be able to deliver a profitable decision in favor of the creditor. However, the non-debtor party favors having an early decision rather than a delay.[119] The non-debtor party may hesitate to disburse the resources towards the contract which may later be rejected or performed. The lack of prompt decision to reject or assume an executory contract prevents the non-debtor party from making a reliable future business plan.

2.12.1. The Effects of Assumption or Rejection of Executory Contracts:

The effects of the assumption or rejection of an executory contract determine the status of the creditor's claim. It ascertains whether the claims are the pre-petition obligation of the debtor or the post-petition obligation of the debtors. Thus, the next subsection presents the effects of rejection and assumption.

2.12.1.1. Effects of Assumption and Performance:

The assumption of an executory contract constitutes the acceptance of both the prospective rights and the liabilities in the contracts.[120] As a result of assuming an executory contract, the obligation related to performance joins the ranks of post-insolvency claims. Since the commencement of a bankruptcy case invalidates the termination clause (ipso facto clause) of the contracts, the non-debtor party cannot refuse to perform an executory contract. The assumption of an executory contract binds both the bankruptcy estate and non-debtor party in its original terms. However, for the benefit of the non-debtor party who is forced to continue with the executory contract, the bankruptcy law placed some preconditions for the assumption. The preconditions aimed at protecting the contractual interests of the affected non-debtor parties as the result of assumption.[121] Thus, before assuming executory contracts, the bankruptcy law of some countries provided some preconditions.

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[119] Ibid, P.225
[120] Ibid, p.242
[121] Ibid, p.243

Accordingly, to assume executory contracts the bankruptcy law of the US requires justifying with: *"(a) the bankruptcy estate must cure all defaults, (b) compensate the non-debtor party for all pecuniary losses arising from such defaults, and (c) provide adequate assurances for future performance."*[122] This precondition reflects the intention of the bankruptcy policy to protect the legitimate interest of the non-debtor party whose contract is being assumed. However, contrary to the positions of the US systems, the German Insolvency Code did not find it necessary to cure the pre-petition defaults to assume an executory contract.[123] Pre-petition default of the debtor remained the debtor's responsibility, and the assumption should not change the pre-petitions default into post-insolvency claims. The German bankruptcy system justifies such treatment to ensure equal treatment for the creditors similarly situated.

When come to Spanish Bankruptcy law, the commencement of the bankruptcy case does not suspend the performance of the executory contract. Both the bankruptcy estate and non-debtor parties are obliged to perform an executory contract. Without any preconditions, the Spanish bankruptcy law treats the obligation of executory contracts to become the party of the post-insolvency claims that enjoy priority.

2.12.1.2. Effects of Rejection:

Under the bankruptcy laws of most countries, the commencements of a bankruptcy case create the district estate entity which is different from the debtor. As a consequence, the bankruptcy estate should not be subjected to pre-petition contracts, unless otherwise assumed. Hence, rejection is deemed as a breach of an executory contract that in effect brings back to the date before the opening of the bankruptcy case. The no-debtor party whose executory contract is rejected is treated as an unsecured creditor. Under US bankruptcy law, the effect of rejection of an executory contract is to make the remaining unforced. Rejection by the bankruptcy officer on the behalf of the bankruptcy estate or debtor is the decision to refuse to take the obligation of the pre-petition contract. Hence, where an executory contract is rejected, the non-debtor party cannot continue to perform its obligation as there will be no party to the contracts.

[122] Section 365(b)(1) (A), (B), and (C) of the US Bankruptcy Code states the preconditions required to achieve to justify the assumption of the executory contract, as cited in Supra Note 99, p.244
[123] German Insolvency Code Section 105

CHAPTER THREE

3. THE APPLICATION OF BANKRUPTCY PROCEEDINGS TO FINANCIAL LEASES: EXPERIENCES OF THE SELECTED COUNTRIES:

3.1. Introduction:

The Commercial Code of the Ethiopian is organized from the institutional practice of the continental legal systems of Latin, Germany, and France. The existence of common-law legal practices in the US has also contributed to the legislation of Ethiopian bankruptcy law. Hence, the sources and developments of Ethiopian bankruptcy and financial lease laws have a similar history with many other countries and cannot be traced to a single country as a source of limited legal family. Therefore, regarding the application of bankruptcy proceedings to the financial lease, this chapter presents the experience of the selected countries believed to have relations with historical developments and influences on the Ethiopian bankruptcy systems. Accordingly, from the families of the legal system, the French, Spain, and German bankruptcy laws are selected from civil law legal systems, whereas the US bankruptcy system is selected from the common-law legal systems. Moreover, the US and French bankruptcy systems are selected from the representative of the debtor-friendly approaches, while the German and Spain bankruptcy systems are selected from the representative creditor-friendly approaches. [124]

To draw appropriate lessons for the Ethiopian Bankruptcy regime treatment to financial leases, the bankruptcy systems of these jurisdictions are deliberately selected from both the civil law and common law legal systems, as well as from the creditor and debtor friendly approaches.

3.2. The US Bankruptcy Systems:

The US Bankruptcy Code Section 365 is the main law that enacts the treatment of executory contracts and unexpired leases. It does not automatically make executory contract and unexpired lease part of the bankruptcy estate. But empowers the bankruptcy officer (trustee in bankruptcy or the debtor in reorganization) to assume or reject the obligation of executory contract upon

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[124] Supra Note 67, p.25

authorized by the Court.[125] Hence, assumption has the effect of making all the obligations that arise from the executory contract or unexpired lease to be treated as administrative expenses. Where a contract is breached after assumed by the trustee, the damages resulting from such breach are also considered as the administrative expense.[126] However, where the executor contract or unexpired lease is rejected, it will be considered as the pre-petition that has been already breached by the debtor.[127] The damage claims that could arise from such rejection enjoy the effects of unsecured claims with the bottom priority rank.[128]

The rationale behind treating damage claims that arise from the rejection of executory contract as the unsecured claim is to ensure that the US bankruptcy policy provides equal treatment to creditors and maximizes the bankruptcy estate.[129] As a result, the US bankruptcy system is characterized on the basis that, the debtor's business is more valuable as an ongoing concern than sold in pieces. The US bankruptcy system tends to favor the debtor over the creditors.[130] It is viewed from the objectives to maximize the debtor's assets and protect the debtor from being dissolved by creditors, which made the US bankruptcy system under the debtor-friendly model.

When come to the specific concern of the financial lease treatment, the US bankruptcy court and UCC has developed different standards. Based on the unique nature of the financial lease, the US Court characterizes whether the lease is a true lease or a lease disguised as 'secured finance'.[131] Characterizing the financial lease under the 'true lease or secured finance' by the bankruptcy system gives completely different outcomes. True lease is the arrangement in which the risk and rewards of the ownership of the assets are retained by the lessor, and only the use and possession rights are left for the lessee.[132] If the obligation is characterized to true lease, as presented in chapter two, the trustee are empowered to exercise their powers of assumption or rejection.

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[125] Ibid p.75
[126] Ibid p.76
[127] Prof. John D. Aye, M. L. "Bankruptcy Issues For Land Lord and Tenancy," American Bankruptcy Institute Journal, *Vol. 23 No 8 (2004),*
[128] Upra Note 75,, p.76
[129] Ibid p.77
[130] Thomas H. Jackson & Robert E. Scott. "On the Nature of Bankruptcy, An Essay on Bankruptcy Sharing and the Creditors' Bargain". *75 (Va. L. Rev. 155, 159) (1989), 78*(155) p.74
[131] Chapman and Cutler LLP '*Selected Bankruptcy Issues for Equipment Lessors.* (2015) Retrieved August 02, 2022, from CHAPMAN, Focused on Finance: https://www.chapman.com, p.22
[132] Ibid,

However, if the financial lease is characterized to the secured finance, it gives different outcomes. In such cases, the bankruptcy court is not bounded to treat the lease, because the agreement says. Since the lease period is expected to run throughout the life span of the capital goods, and the lessee will amortize the total values of the good over the lease term by paying the rent, the court characterizes the financial lease to confirm its operational nature. Similarly, during the lease periods, the lessee bears the risks and enjoys the rewards associated with ownership. Furthermore, at the time of entering into the lease agreements, there is a reasonable expectation by the lessee and lessor that the leased capital good may not return to the lessor.[133]

As a consequence, the Bankruptcy Court opted to characterize whether the transaction is secured finance or true leases.[134] In characterizing whether the finance lease transaction masked to lease is secured finance, the court and the UCC have developed the following standards.[135]

1. *The transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee and*
2. *The original term of the lease is equal to or greater than the remaining economic life of the goods;*
3. *The lessee is bound to renew the lease agreement for the remaining economic life of the goods or bound to become the owner of the assets with no additional consideration or nominal consideration*

Based on these conditions, the US court characterizes the lease transactions under secured finance. Section, 1-203 (b) of the UCC also enacts where the lessee does not have the power to terminate the lease, and one of the above-mentioned factors is met, it characterized as secured finance.[136] Since it suggests a situation in which a debtor is bound to the pre-agreed repayments, inability of the lessee to terminate the lease transaction indicates the existence of the secured finance.[137] Other cumulative factors listed as the standards indicate the lessor's rights to retain the 'residual value' of the leased goods. Hence, the lessor's right to retain the residual values in the leased capital good is to compel the purchase option.

[133] ibid
[134] Ibid,
[135] Supra Note 30, p.129
[136] UCC § 1-203(b) cited in ibid p.130
[137] Supra Note 30, p.130

When the lease arrangement is subject to recharacterization has fulfilled the standards, the bankruptcy court treats the financial lease as the sale contract or '*secured finance'*.[138] In secured finance, the capital goods subjected to finance are considered the property of the debtor lessee used to secure the finance of the lessor. In a financial lease that is characterized as secured finance, the lessor could not have other than the role of the lender. In such case, if a bankruptcy case is commenced against the business of the lessee, the lessor's right to the leased good is not more than a claim for the value of the secured debt.[139] This recharacterization evidences that the application of the bankruptcy process to the financial lease changed the nature of the financial lease transaction into sale contracts or secured finance. In such characterization, if the nature of the financial lease is changed to secured finance, the automatic stay of bankruptcy proceedings operates against the full payout or non-cancelability of the financial lease. It overrules the non-cancelability and full payout nature of the financial lease.

In such ways, if the debtor lessee is judicially declared bankrupt, the lessor's rights to repossess the leased goods may be challenged. For example, in the judicial practice of England case "*on Demand Information Plc. vs. Michael Gerson (finance) PLC*", instead of the lessor's right to repossess the leased capital good, the bankruptcy court settled by granting equitable relief to the lessor.[140] Since the interest of the lessor in the leased capital good is characterized to the payments of the rents rather than returning the goods. In the experience of England's court; there was also a case in which equitable relief was sought instead of the repossession of the leased capital goods.[141]

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[138] Ibid,

[139] Supra Note 14, p.164

[140] The court settlement on the case between "*On Demand Information Plc. vs. Michael Gerson (finance) Plc." (2010)* cited in Udofia, Kubianga Michael (2014) p.116 … evidences the bankruptcy courts are recharacterizing the financial lease into secured finance.

[141] In the case, '*Celestial Aviation Trading 71 Ltd Vs. Paramount Airways Pte Ltd' (2010)* cited in Udofia Kubianga Michael (2014) p.116 in the case filed to request equitable relief in the place of the repossession of the leased capital goods, the court suggested it has no jurisdiction to grant equitable relief against forfeiture in operative lease. In this case, equitable relief was sought against the forfeiture of three aircraft (with an economic life of at least 20 years each) in eight years of specific operating lease agreements.

3.3. The German Bankruptcy System:

The German bankruptcy law that governs the treatment of executory contracts is organized under Chapter II Part III of the 1994 Insolvency Code.[142] It gives power to the trustee in liquidation or debtor in the reorganization plan[143] to assume or reject the executory contract without requiring the court approval.[144] Here, the law assumed the rationality that the bankruptcy trustee knows how to accomplish the objective of the bankruptcy law of maximizing the bankruptcy estate. However, the power of the trustee to assume the executory contract is subjected to some restrictions from the non-debtor party.[145] Against the decision of the trustee to assume the executory contract, the non-debtor party may restrict such decision and in place may choose termination. The power granted to non-debtor party to restrict the assumption power of the bankruptcy officer suggests that the German bankruptcy system is the procedural device that assists the enforcement of the creditor's right against the debtor.[146] Thus, the German bankruptcy system is from the '*creditor friendly'* approach. However, the power granted to the non-debtor party to interfere in the trustee's authority to assume the executory contract does not extend towards the rejection. The non-debtor party was not empowered to intervene in the power of the bankruptcy officer to reject. Whether the debtor's business is subjected the reorganization or liquidation process; the German bankruptcy system is devised to maximize the share of the creditor's portion rather than the viability or rehabilitation of the debtor's business.

However, until the bankruptcy officer expressly rejects, the executory contract continues to bind both the debtor and non-debtor party. Nevertheless, the bankruptcy estate is created as a result of opening the bankruptcy case; the executory contract binds both parties. At the stage of filing the bankruptcy petition, the bankruptcy estate is not an entity that is completely different from the debtor. The bankruptcy estate includes the entire property of the debtor. The debtor's property will be charged for the benefit of the creditors. Executory contracts are also part of the bankruptcy estate. At the moment the bankruptcy case is opened, the executory contract is valid

[142] The German Insolvency Code of 5 October 1994 (Federal Law Gazette I, p. 2866), was enacted in 1994 but come into effect in 1999 as cited in Supra Note 98, p.80

[143]Under the German Insolvency Code, the "bankruptcy trustee" is known as the "insolvency administrator" (*Insolvenzverwalter),* who is the individual that administers the bankruptcy estate.

[144] Supra Note 75, p.80

[145] Ibid p.81

[146] Ibid

and binds the bankruptcy estate, but its effect is "suspended" until the trustee decides on rejection or assumption.[147]

If the bankruptcy officer rejected the executory contract, the non-debtor party is entitled to compensation for the rejection. The damage that arose from rejection of the executory contract is classified under an unsecured claim.[148] The effect of treating damages that arises from rejection under an unsecured claim is to serve the bankruptcy policy to maximize the bankruptcy estate and afford equal treatment to the creditors.[149]

On another hand, the effect of assuming an executory contract or breaching post-assumption is administrative costs that enjoy priority in repayments. When the executory contract is assumed it becomes binding to the bankruptcy estate and non-debtor party in its original terms. Unlike the US bankruptcy system, assuming an executory contract does not require to cure the prepetition defaults. Notwithstanding that the executory contract is assumed, the prepetition default remains the liabilities of the debtor; which is treated under the unsecured claims. The German bankruptcy law refrained from curing the prepetition defaults to uphold the objectives of the bankruptcy law that offers equal treatment for the creditors.[150]

When come to the bankruptcy system treatments to the financial lease, the German Insolvency Code has explicitly provided cases where the power of the trustee to reject the executor contract is restricted.[151] Different from the exclusive powers of the bankruptcy officer to decide rejection, the application of bankruptcy law to some executory contracts is restricted. It puts special types of executory contracts in which the bankruptcy officer is prohibited from deciding rejection. The contracts in which the property rights have already been transferred to the non-debtor party by the virtue of the contract is among the restriction.[152] It prohibited the rejection of executory contracts where the non-debtor party has already acquired a property right by the virtue of the contract. Particularly, the law empowers the rejection or assumption where the debtor is the lessee or buyer but prohibits the rejection where the debtor is the lessor or seller.[153] This implies

[147] Ibid, p.82
[148] Ibid
[149] Ibid, p.84
[150] Ibid
[151] Ibid p.82
[152] Ibid,
[153] The German Insolvency Code Section 104, 107, 115-117 cited in ibid p.86

that where the debtor is the lessor the termination power of the bankruptcy officer is limited by the law, but; the assumption power was not restricted where the lessee is a debtor. Even though the financial lease was not included, it seems suitable with the provision of the CGLB proclamation Art 8 (1) of Ethiopia that obliges the bankruptcy officer of the debtor lessor to assume a financial lease.

3.4. The French Bankruptcy System:

The French legal system that recognizes the financial lease treatments in bankruptcy proceedings is enacted under Art L622-13 and Art L641-11-1 of the Commercial Code, in which the former applies to reorganization and the latter to the liquidation.[154] In the French Commercial Code, filing a bankruptcy case (reorganization or liquidation) does not cause the automatic termination of the debtor's executory contract.[155] The law requires the counterparty to perform its obligation irrespective of the debtor's failure to perform.[156] Hence, in the liquidation proceedings, the obligation of the executory contract remains binding to both parties pending the decision to assume or reject. The French bankruptcy law granted the power to assume or reject the executory contract to the bankruptcy officer (administrator).

Since reorganization is based on the debtor’s financial sufficiency to perform the executory contract, the officer can request the counterparty to perform its executory obligation. Then, the counterparty has the right to require the bankruptcy officer to give his opinion on the continuation of an executory contract, and if left unanswered for longer than one month it is assumed automatically terminated.[157] However, where the asset of the debtor is proved insufficient to repay the next terms of the executory contract, the officer must apply to the court for termination.[158] Since early termination of the executory contract causes significant damages to the non-debtor party, the law requires the officer to present his decision to the court for approval. Where the non-debtor party did not agree with the assumption of the executory contract may terminate automatically. The law obliges the decision to terminate an executory contract upon the application of the officer is approved by the Bankruptcy Court (*jugecommissionnaire*). Upon approval, the power to reject the executory contract is limited

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[154] Supra Note 99, p.230
[155] The France Commercial Code, art L622–13 I., cited in ibid, p.232
[156] Ibid, p.232
[157] Ibid
[158] Ibid p.233

under two conditions: (i) must be necessary for the reorganization of the debtor; and (ii) it must not adversely impact the interest of the counterparty.[159] However, in the case of liquidation, French bankruptcy law does not require the decision of the trustee to terminate an executory contract to be approved by the Court. The decision of the trustee to terminate the executory contract automatically activates without requiring court approval.

With regards to the application of bankruptcy law to financial leases (*contrat de bail)*, the French Commercial Code categorized certain types of executory contracts that hold special treatment.[160] The financial lease contract is among the executory contracts that the French bankruptcy law conferred special treatment. As a consequence of opening bankruptcy proceedings, terminating the obligation of the financial lease requires the satisfaction of special rules. The special rule is offered to the termination of a financial lease on the leased capital goods or the goods used by the debtor in the course of business. It allows termination of the financial lease on satisfying either: [161]

1. *On the date when the lessor is informed by the insolvency officer of his decision not to assume the lease contract, or*
2. *When the lessor requests the termination of the contract based on a default payment after the opening of the insolvency proceedings*
3. *The absence of the activity during the observation period in the rented property does not lead to the automatic termination of the lease, notwithstanding the clause to the contrary*

The listed conditions show that the opening of the bankruptcy process does not automatically lead to the termination of the financial lease. Even during the observation period, the absence of activities with the leased capital goods does not lead to the termination of the financial lease.

However, the obligation of the financial lease contract may be terminated, where the bankruptcy officer of the debtor lessee has informed the lessor of his decision not to assume. In French bankruptcy proceedings, the power to terminate the financial lease is not only endorsed to the bankruptcy officer. After the opening of the bankruptcy case, relay on the default, the financial lease contract may be terminated upon request by the non-debtor lessor. The defaults of the

[159] France Commercial Code, Art L 622–13 IV, cited in Supra Note 99, p.233
[160]Supra Note 99, p.234
[161] French Commercial Code, Art L622–13 II, L622-14, and L622-14-2

payments that occurred as a result of the bankruptcy case empower the non-debtor lessor to request termination of the financial lease. As a consequence of a bankruptcy case, if the lessee is in default, against the application of automatic stay, the lessor is empowered to request the termination of the financial lease. Thus, the French Bankruptcy law allows the termination of the financial lease by the decision of the bankruptcy officer not to assume, or as a result of default by the lessor.

3.5. The Spanish Bankruptcy System:

The bankruptcy proceedings treatment to executory contract is ruled by the Spanish Insolvency Act (Ley Concursal (hereafter LC)) of Chapter III and Title III.[162] The Spanish Insolvency Act has the objective to reorganize the debtor's business as a means to maximize the value of the assets available to the creditors.[163] In Spain's bankruptcy system, the bankruptcy case commences at the time when the Bankruptcy Court orders bankruptcy relief rather than at the time when the bankruptcy petition is filed.[164] The periods that exist after the petition is filed and before the court orders relief, are called the first stage of the proceedings.[165] During this stage, unless the bankruptcy court orders prejudgment measures, the debtor continues in operation and no automatic stay is imposed on the creditors to collect their payments. All the contracts continue to bind the debtor and the non-debtor party to continue performing their obligations.[166] Thus, in the Spanish insolvency system; the issues of executory contract arise after the Court ordered the bankruptcy relief rather than upon filing.

Unlike the bankruptcy systems of the US, German and France discussed in this chapter above, filing a bankruptcy case does not create an entity with its legal personality.[167] It creates a pool of assets that have been seized from the debtor for the benefit of the creditors.[168] Bankruptcy estate includes the entire debtor's property, in which the debtor does not lose the ownership rights, in

[162] Insolvency Act (Ley Concursal), (B.O.E., 2003, 22) (Spain)
[163] Supra Note 75, p.86
[164] L.C. Article 21
[165]L.C Article 17
[166] Supra Note 75, p.87
[167] Ibid,
[168]L.C. Article 76, as cited in Davalos, S. (2017). The Rejection of Executory Contracts: A Comparative Economic Analysis. *Mexican law Review, 10*(1), p.87

its place; the bankruptcy officer (administradoreconcursales)[169] is appointed to administer the estate.

Since filing the bankruptcy case does not create an entity different from the debtor, the Spanish bankruptcy law considers the executory contract as part of the bankruptcy estate that is valid and binds both the estate and the non-debtors party.[170] Hence, unlike the German and French systems, the Spanish bankruptcy law automatically assumes all the obligations of the executory contracts. The main consequence of automatic assumption is that all the obligations related to the performance of a contract are treated as administrative expenses with a priority over unsecured creditors. Since all the obligations of the executory contracts are assumed and become the debts of the estate; in the Spanish bankruptcy, the system setting the periods within which the bankruptcy officer rejects the executory contract is not important.

However, with the executory contract that is considered burdensome to the bankrupt estate, the bankruptcy officer is empowered to reject it with the approval of the court. Hence, rejection has the effect of breaching the executory contracts that enable the non-debtor party to claim damages for breaches which are treated as an administrative expense.[171] Categorizing the damages of rejection under administrative expenses ensures that the non-debtor party is compensated in full for the loss of the expected gain from the performance of the contract.[172] This rule forces the bankruptcy estate to pay the full damages for the breach of the contract. In compensating for the full damage the law has the intention to prevent value-wasting through rejection. Similarly, the trustee chooses rejection of the executory contract when the costs of performance of the bankruptcy estates are greater than the benefits of performance to the no debtor party. Economically, such a mechanism of the bankruptcy process treats executory contracts are considered to encourage efficiency. By providing the automatic assumption of all executory contracts, the Spanish system ensured the bankruptcy principles of equal treatment among the creditors. It makes the non-debtor party to the contract not a creditor of the debtor party, but also a creditor of the bankruptcy estate as well.

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[169] Under the Spanish bankruptcy law, the bankruptcy trustee is a collegiate body, known as the bankruptcy administration (administradores concursales), which charged with the administration of the bankruptcy estate
[170] LC Article 61
[171] LC Arts 61 and 62
[172] Supra Note 75, p.89

Regarding the application of bankruptcy proceedings to the financial lease, in Art 21 the Spanish Insolvency Act specified in the definition of an executory contract as types those contracts in which both the debtor and non-debtor party owe performance of their obligations at the time of the opening of the bankruptcy case. It does not exclude the financial lease contracts from the definition of the executory contract. The Spanish Insolvency Act offers the treatments accorded to other executory contracts to the financial lease. It assumes all the obligations of the financial lease unless considered burdensome to the estate or to the interest of the non-debtor party in which termination is allowed upon approval of the court.

CHAPTER FOUR:

4. THE CHALLENGES AND PROSPECTS OF APPLYING BANKRUPTCY PROCEEDINGS TO FINANCIAL LEASES UNDER THE ETHIOPIAN LAWS:

4.1. Introduction:

In the preceding chapters, on the application of bankruptcy proceedings to the financial lease, we have drawn the general concepts and experiences of the selected jurisdictions. However, this chapter directly examines the challenges and prospects of implementing bankruptcy proceedings for financial leases under Ethiopian laws. Based on the objective of this study, this chapter analyzes and discusses the challenges and prospects of applying the bankruptcy proceedings of NCC to financial leases.

To address the objective of the research the data collected were analyzed by the qualitative method. Hence, based on the specific objectives, this chapter is organized into five main sections with other subsections. These five sections analyze the challenges and prospects of applying the NCC bankruptcy proceedings to financial leases.

However, before beginning with the discussion of the challenges and prospects of applying the bankruptcy proceedings to financial leases, the writer observed conferring how the NCC bankruptcy law treats the executory (ongoing) contracts is important. Alongside classifying the financial leases under ongoing contract, examining the ways bankruptcy provisions of the NCC treats ongoing contract is noteworthy. One thing that makes the application of bankruptcy proceedings to ongoing contracts interesting is that opening a bankruptcy case encompasses both past and future claims. Such claims may endow either with the expected gain or loss to the debtor. The fate in which the bankruptcy proceedings applied to the past and future claims could suggest the effects on the financial leases. Since accepting and performing an ongoing contract may enhance or impair the debtor's business value, it would have the same influence on the financial lease that comprises the debtor lessee or lessor.

Thus, concerning the obligation or rights classified under ongoing contracts, Art 593 (4) of the NCC allowed the bankruptcy officer to assume or terminate. Accordingly, the next section

presents the responsibility granted to the trustee to assume, terminate or assume and perform the obligation of ongoing contracts.

4.2. The Responsibilities of the Trustee to Terminate, Assume or Assign Ongoing Contracts:

If the lessee or the lessor is filed for bankruptcy, most bankruptcy laws equip the bankruptcy officer with three basic options. Termination, assumption, or assignment of the ongoing contract for a third party is the three optional routes available. The next sub-sections present the power and responsibility of the bankruptcy officer to govern the ongoing contracts.

4.2.1. The Termination:

Consistent with the conditions listed under Art 593 (4) (a, b, and c), the NCC of Ethiopian allows the bankruptcy officer to terminate the ongoing contracts. These conditions are:

1) *where the debtor in reorganization or the estate of the insolvent debtor does not have sufficient finance to continue the performance of the ongoing contract, or*
2) *the continuation of the ongoing contract is not in the interest of the debtor or the estate, or*
3) *Such early termination does not unfairly prejudice the interest of the creditors.*

The first two conditions allow termination of the ongoing contracts for the inadequacy of the debtor's estate, debtor's business or where termination protects the interests of the estate /debtor/. In other words, the legislation empowered the bankruptcy officer to terminate ongoing contracts as a result of a financial deficiency or where it prejudices the interest of the estate/debtor. Independent of the first two conditions, the 3rd factor allows termination when continuance is likely unfairly to prejudice the interest of the creditor. It allows the termination of ongoing contracts to protect the interest of the non-debtor party.

Comparing the standards of termination recognized in the NCC of Ethiopia, the US and Spain bankruptcy systems exclusively granted the powers to the trustee. Except for the approval of the court, the Spain and USA systems exclusively granted the power to assume or reject ongoing

contracts to the trustee.[173] Rejection or assumption is under the exclusive responsibility of the trustee. Though in most cases the decision of the bankruptcy officer to reject or assume an ongoing contract is approved, during evaluation the US and UK Bankruptcy Courts have developed the *'burdensome test and equality test'* standards.[174] The court rejects the assumption of an ongoing contract that violates the equality of the creditors or that is burdensome to the estate. However, the German bankruptcy system granted the assumption or rejection power exclusively to the trustee without requiring court approval. On other hand, only in the reorganization proceedings, the France bankruptcy system offered the satisfaction of the specified conditions to reject ongoing contracts. It allows termination only where*: "(i) it must be necessary for the reorganization of the debtor; and (ii) it must not adversely impact the interest of the counterparty"*.[175]

From these bankruptcy systems, we can observe that the Spanish bankruptcy requires an active and free bankruptcy officer, while the UK and the USA favored fairly putting under judicial control. However, the approaches adopted both by the Ethiopian and France bankruptcy systems similarly have provided the conditions upon which termination can be justified. To justify terminations, trustee are required to satisfy the specified conditions. The difference only lies in the types of proceedings that require the satisfaction of the conditions. The France bankruptcy system requires reorganization proceedings, while the Ethiopian system requires both reorganization and bankruptcy proceedings. The approaches adopted in France and Ethiopian bankruptcy systems are likely to control the power granted to the bankruptcy officer by providing conditions required to satisfy.

4.2.2. The Assumption:

The NCC bankruptcy provisions list only grounds upon which trustee terminate ongoing contracts. It does not specify the conditions upon which ongoing contracts may be assumed. Apart from the conditions listed for termination, the bankruptcy officer is appeared empowered to assume. The decision to assume ongoing contracts may be justified for the achievement of the bankruptcy objectives. Since estate maximization or rehabilitation of the debtor is the objective

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[173] Section 365 (a) of the US Bankruptcy Reform Act of 1978 states that Sections 765 and 766 of the Bankruptcy Code limit the trustee's power to reject or assume the executory contract of nontransferable and default obligations before the commencements

[174] Supra Note 99, p.236

[175] France Commercial Code, Art L 622–13 IV, cited in Supra Note 99, p.233

of the bankruptcy proceedings, activities that ensure these objectives can be the justification for the assumption. Accordingly, when the assumption of the ongoing contract is believed to maximize the estate or enhance the rehabilitation of the debtor's business, the bankruptcy officer is entitled to assume. Based lessons can be drawn from the experiences of the countries discussed in chapter three; empowering the bankruptcy officer to assume the ongoing contract that ensures the bankruptcy objectives may be useful.

4.2.3. The Assignment:

In the bankruptcy process, assignment is the final activity available to the trustee. In most legal systems, despite the ipso facto clause that provides anti-assignment, the bankrupt officer is allowed to assign the obligation of ongoing contracts.[176] The NCC Art 595 (3) puts the assignment of leased immovable business by the debtor lessee. Irrespective of the contractual provisions of anti-assignment, it allows the bankruptcy officer to assign the lease agreements for the remaining lease periods. Unless otherwise authorized by the supervisory judges, by limiting to the purposes for which the business premises have been utilized, the law empowered the bankruptcy officer to assign. Thus, against the contractual clause prohibiting sub-lease, the bankruptcy law of Ethiopia has allowed the assignment of the leases. As long as the assignments help uphold the objectives of the bankruptcy proceedings, by changing the purposes of utilization upon authorization by the supervisory judge the bankruptcy officer is entitled to assign.

4.2.4. The Observation Period for Termination or Assumption:

At the moment of commencing a bankruptcy case, Art 651 (1) of the NCC enacts the opening of the observation periods. In reorganization proceedings Art 651 (a-c) of the NCC lists the purpose of granting 'observation periods'. It granted an observation period to help the debtor in possession or the supervisor to get adequate time to prepare the reorganization plan. It gives time for the supervisor so the creditors contribute an opinion to the reorganization plan or develop an alternative reorganization plan. It gives the sufficient time that assists the trustee to conduct a market study to sell the business as a going concern. The observation period gives a reasonable time in which the officer or the debtor-in-possession could decide on the assumption or termination of the ongoing contracts.

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[176] Supra Note 99

Where there is a delay to assume or reject the obligation of an ongoing contract, the non-debtor party cannot compel to assume or unilaterally terminate the obligations. Because the automatic stay of bankruptcy provision prevents the non-debtor party from *ex-part* termination or compelling the debtor party to accept. As a result, the bankruptcy law ensured the non-debtor party knows within a limited time in which the bankruptcy officer can decide for assumption or rejection.

Thus, the initial duration of the observation period is provided in Art 651 (2, 3, and 4) of the NCC. The reasonable time for supervisory in the reorganization is limited to the maximum period of four months and with the extension and renewal of additional six months. Similarly, Art 744 (2) of the same law provided the observation periods of six months and an extension of another six months that enables the trustees in bankruptcy. Here, the extension and renewal observation periods are not automatic but must be obtained from the bankruptcy court upon request. Thus, the rights of the creditor party requesting for assumption or termination are only applicable after the expiration of these reasonable periods.

Likewise, the US bankruptcy law gives 60 days for the liquidation and 120 days for the reorganization to decide on the assumption or rejection of the executory contract. Besides, it is deemed rejected if not assumed within such periods.[177] However, the bankruptcy laws of German, England, and the French did not provide the periods within which the assumption or rejection could be decided. The German bankruptcy law empowers the non-debtor party directly to request the trustee or debtor-in-possession should accelerate its decision to assume or reject. Similarly, the French bankruptcy law enabled the non-debtor party to request the debtor in possession to decide promptly. Based on such requests, under both the French and German bankruptcy laws, if the trustee or debtor-in-possession failed to take action within one month or reasonable time respectively, the law considers the bankruptcy officer has decided rejection.

In comparison, the Spanish and German bankruptcy laws have left the discretionary power to determine the observation periods within which the bankruptcy officer can accomplish its tasks. However, the US and Ethiopian bankruptcy laws provided the time limits within which assumption or rejection should be decided.

[177] Section 365(d)(2) the liquidation and 1121(b) of reorganization US Insolvency Code

By providing the time limits, the US and the Ethiopian bankruptcy systems are similar. The differences are only the duration of the observation periods provided. The duration of the time limits provided in Ethiopia is larger than the periods provided in the US. Within maximum observation periods, if the trustee did not decide on the assumption, Art 593 (5) of NCC enables the creditor to request the assumption. After the request is done, the officers are obliged to decide to assume or reject it within 15 consecutive days and notify the non-debtor party. However, failing to decide and notify the non-debtor in such periods amounts to the termination of the ongoing contract by the law.

4.2.5. The Power of the Bankruptcy Court:

The concept of bankruptcy proceedings can be understood from the judicial or procedural action of adjudicating /hearing/bankruptcy-related cases. As a consequence, in most cases, the power of the debtor-in-possession or the trustee to assume or reject the obligation of the ongoing contract is supervised by the Bankruptcy Court. In the Ethiopian bankruptcy system, the decision of trustee to assume or terminate an ongoing contract does not require court approval. The Court hears only appeal lies from the supervisor judge's decision on the application opposing the decision of the bankruptcy officer to terminate or assume ongoing contracts.[178] However, when the conditions listed in Art 652 (1-4)[179] of the NCC are satisfied, the Bankruptcy Courts are empowered to terminate the observation periods and convert the reorganization proceedings into bankruptcy (liquidation).

The US bankruptcy law requires the decision of the trustee or debtor-in-possession to assume or reject an executory contract to be presented to the Bankruptcy Court for approval.[180] The Spanish Insolvency Act precisely puts the decision of rejection under the approval of the Bankruptcy Court.[181] In Spain, the decision of the trustee to reject is not enough to breach the executory contract unless the Court approves. However, the Germany Bankruptcy system grants exclusive power to the debtor-in-possession or trustee to decide the assumption or rejection of executory

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[178] Supra Note 10, Art 594 (3)

[179] Ibid, Art 652 (1-4), … where (1) it becomes apparent that the proportion of creditors which could prevent the adoption of the reorganization plan does not warrant the continuation of the negotiations; or (2) it becomes apparent that the supervisor in reorganization is unable to find any investor for the sale of the business as a going-concern; or (3) the request is made by the debtor, the supervisor in reorganization or the controller; or (4) the debtor is not able to meet its payment obligations concerning claims that arise after the opening of reorganization proceedings

[180] ***See*** 11 U.S.C. 365 (a)

[181] The Spanish Insolvency Act L.C. Art 61, 62 and 192

contracts without demanding the court's approval.[182] It offers the court intervention only when conflict raise among parties affected by the proceedings.[183]

The Ethiopian and German Bankruptcy systems offered little judicial intervention to the powers of the bankruptcy officer to reject or assume the obligation of ongoing contracts. The Ethiopian system empowers the court intervention only appeals from the decision of the supervisory judge, while the German system offered whenever a conflict occurs on the power of the officers to reject or assume. Thus, the approach followed by the Ethiopian and German bankruptcy systems is encouraging the bankruptcy officer to carry out their respective duties independently.

4.3. Challenges of Applying the NCC Bankruptcy Proceedings to Financial Leases:

4.3.1. The Practical Inadequacy of Applying NCC to Financial Leases:

The data collected through interviews have indicated that there are bankruptcy cases application to executory /ongoing/ contracts as enacted in Art 593 (4 (a, b, c) of the NCC. In the application of the bankruptcy process to ongoing contracts, trustee is empowered to terminate or assume ongoing contracts. The case of Ms. Yenenesh Tsegae disposed of in Oromia Supreme Court evidences the practical application of bankruptcy proceedings to the obligation of ongoing contracts.[184] Officers assigned to take care of the estate have decided on the termination of the unexpired contracts of rental.

However, concerning the application of the bankruptcy proceedings to unexpired financial leases, the data collected did not reveal practical experiences. Concerning the NCC bankruptcy provisions treatment to financial leases, the data have indicated that the commercial communities, lawyers, and judges in Ethiopia were not experienced. The data collected have designated the lack of awareness that exists among the commercial communities, lawyers, and judges. Judges, lawyers, and advocates who have participated in this study have provided that they are not familiar with the practice of implementing bankruptcy proceedings to financial

[182] The German Insolvency Code Section 270
[183] Ibid, Section 56
[184] The bankruptcy case filed by Ms. Yenenesh Tsegae, Oromia Supreme Court File No. 410706, unpublished

leases.[185] Particularly, with the functional concepts of financial leases, the advocate and judges have suggested that the concepts of applying bankruptcy provisions to financial leases are new concepts to them. Even among the participants, it was only the lawyer from the financial lease company who did not request the author on the concepts of financial leases.[186]

By observing the provisions of NCC and CGLB laws, the participants have indicated that the NCC bankruptcy provisions are ambiguous to cover the concepts of financial leases. But, they have indicated that the bankruptcy provisions of ongoing contracts must be interpreted to embrace the issues of the financial lease as well.[187] For them, the definition of ongoing contracts stipulated in Art 593 (3) of the NCC as… at the moments of opening the bankruptcy process at least one party still has to perform an obligation is adequate to comprise the concepts of financial lease business. The bankruptcy issues stated under the CGLB proclamation should have been covered under the bankruptcy provisions of the NCC. Attempts to address the same matter under different legal systems have contributed to operations contradicting applying the bankruptcy proceedings to financial leases.

Concerning the questions of applying the unique nature of the bankruptcy provisions of NCC to financial leases, the collected data have disclosed that both laws are not designed to operate together. Particularly, the safeguard bankruptcy provisions of automatic stay and restriction to ipso facto clause in the NCC are opposing the full payout and non-cancelability nature of financial leases. Functionally, the safeguard bankruptcy provisions of the NCC and the specific nature of the financial lease are contradictory. To reconcile these operational antagonistic provisions of these laws, most of the participants appealed to adopt the rules of interpretation.[188] Since the bankruptcy law of NCC is the latest and the special law that governs the bankruptcy proceedings, judges at Federal High and Oromia Supreme Court have proposed the adoption of the rules of interpretation that resorted to the latter and special law prevails over the general and

[185] Interviews conducted with judges of Oromia Supreme Courts, Federal High Court Lideta Civil Bench of the Bankruptcy Division, Advocate at Law and Lawyers of the Oromia Capital Goods Financial Business Share Company (OCGFBSHC

[186] Interviews with the lawyers of the Oromia Capital Goods Financial Business Share Company (OCGFBSHC)

[187] Interviews conducted with Federal High Court Lideta Civil Bench Presiding judge, the Oromia Supreme Court Civil Bench team leader judge, the lawyers of the Oromia Capital Goods Financial Business Share Company (OCGFBSHC)

[188] Ibid,

previous laws.[189] Accordingly, as the bankruptcy law of the NCC is the latter and special law to govern the matters of bankruptcy proceedings, they have favored applying the bankruptcy provisions in the NCC over bankruptcy provisions in the CGLB proclamation.[190]

The data collected on the automatic stay and restriction of the ipso facto clause enshrined under the NCC bankruptcy proceedings is incompatible with the full payout and non-cancelability nature of the financial lease. For the participants, the restriction provided to the ipso facto clause by Art 593 (3) of the NCC also works for the statutory ipso facto. Per the suggestion of these participants, the law that prohibited the contractual provisions terminates, accelerates, or modifies the obligation of ongoing contracts for the reason attributable to bankruptcy overrules the statutory provisions that enact the continuance of the ongoing contract.[191] Relied on these grounds, the bankruptcy provisions in the CGBL proclamation that stipulate the continuation of financial leases are overruled by Art 593 (3) of NCC. Concerning the question of how the trustee would continue with the non-debtor lessee to comply with the obligation and rights in the financial lease has been suggested in reversing.

Deficiencies related to the lawyers' and commercial communities' awareness of the bankruptcy provisions treatment to financial leases were pointed as the basic challenges. The participants of this study have commented on the importance of revisiting the provisions of the laws and the importance to provide extensive training for practitioner lawyers and commercial communities. The legislators and policymakers were also advised to revisit the bankruptcy provisions in the NCC to reconcile with the bankruptcy provisions of the CGLB proclamation. Therefore, the practical inadequacy of bankruptcy proceedings of NCC to treat financial lease was considered as the challenges hindered the developments of the subject matter

4.3.2. Lack of the Definition of Ongoing Contracts to Embrace Financial Leases:

As we have presented in chapter three, most countries have addressed the application of bankruptcy proceedings to the executory contracts and financial leases through their legislation or judicial experiences. Consistent with the experience of those countries, the bankruptcy

[189] Interviews conducted with Federal High Court Bankruptcy Bench Presiding judge, Oromia Supreme Court Civil Bench Division team Leader judge
[190] Ibid,
[191] Interviews conducted with the senior judges at Federal High Court Lideta Civil Division Bankruptcy Bench presiding judge and the Oromia Supreme Court Judge

treatments to the executory contract have got recognition in Art 1140 of the repealed and Art 593 of the NCC. The Book III Chapter III of the NCC enacts the bankruptcy proceedings treatment to ongoing contracts. Art 593 (2) of the NCC defines ongoing contracts as "*types of contracts that include, but not limited to, essential service contracts and immovable business lease... under which at the moments of the judgment opening proceedings, at least one party still have to perform an obligation that is specific to the contract*".

The sentence ... *at the opening of the bankruptcy proceedings at least the presence of obligation between the debtor and creditor that at least one party still must perform"*[192] is comprised of the definition that recognizes the application of bankruptcy proceedings to ongoing (executory) contracts. However, to substantiate the existence of an 'executory contract', the judicial experience in the US requires the existence of an unperformed obligation of both the debtor and non-debtor party to the contract in which the failure of either party to complete performance would *'constitute a material breach*.[193] Similarly, the French bankruptcy systems and its legal doctrine require the presence of a contract whose '*principal obligations are not yet performed* at the time of filing a bankruptcy case.[194] The German bankruptcy system, but requires the existence of an executory contract only when both contracting parties have not yet performed the contracts at the time of filing the insolvency cases.

From these stipulations, the definition of executory contracts provided in the US and France similarly requires establishing the unperformed obligations needs to the 'principal that constitutes material breach if one party terminates as a consequence of bankruptcy. But, German bankruptcy law requires only the existence of contracts that both contracting parties have not yet performed at the time of filing a bankruptcy case. Here, the definition specified to 'ongoing contracts' by the NCC is similar to that of the definition provided to 'executory contracts by the German Insolvency Law. The definition designated to 'ongoing contracts' and the data collected have pointed out that the NCC has recognized the application of bankruptcy proceedings to executory

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[192] Supra Note 10,, Art 593 (2)
[193] Supra Note 30, P.26
[194] Ibid,

contracts. The data collected through interviews also suggested for the position of the NCC provision to treat ongoing contracts.[195]

When come to other types of contracts identified in the definition, the NCC has specifically picked out the '*essential service contract and the immovable business lease*' cumulatively under the ambit of ongoing contracts.[196] The 'essential service and immovable business lease' arrangements are specifically identified in the definition of ongoing contracts. However, the legislators who have specified the essential service and immovable business leases under the realm of ongoing contracts have kept salient to financial leases. Associated with the experiences of other jurisdictions and the special characteristics required in the financial leases, the Ethiopian bankruptcy law is ambiguous to administer financial leases under ongoing contract. The experiences of the countries discussed in chapter three have specifically comprised the financial lease business under the domain of executory contracts. In the title *'the executory contract and unexpired lease,'* Section 365 of the US Bankruptcy Code expressly specified lease transactions under the executory contracts. Similarly, France, German, and Spain's experiences also either in their judicial practice or their legislations have explicitly included the financial lease business under the scope of the executory contract and unexpired lease.

Under the Ethiopian bankruptcy systems, issues governed under and transactions excluded from the applications of bankruptcy proceedings are listed in Art 596 (1-4) of the NCC. It lists the contracts of employment, banking and insurance, administrative contract, financial markets, and stock exchange outside the realm of bankruptcy laws. In the arrangements listed outside the scope of the NCC bankruptcy law, the financial lease transaction was not stated. In an illustrative mode of drafting legislation, failure to point out the financial lease amounted to the inclusion into the NCC bankruptcy code.

Moreover, from the word '*but not limited to...*' introduced in the definition of the ongoing contract, we may expand the definition goes beyond the specified transaction to comprise the 'financial leases' arrangements. To substantiate this expansive mode of interpretation, the researcher did not get the judicial disposed cases. However, the data collected and comparative

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[195] Interview with the Federal High Court Ledeta Civil Bench Division of the Bankruptcy Bench presiding judges
[196] Supra Note 10, Art 593 (2)

experiences included in this thesis support this approach.[197] Hence, it is more persuasive to conclude that the bankruptcy provisions of the NCC are not well drafted to comprise the financial lease transaction. This deficiency can be considered as the challenge of applying the bankruptcy proceeding of NCC to a financial lease.

4.3.3. The Ambiguity of the NCC Bankruptcy Provisions to Treat the Financial Lease:

The application of bankruptcy proceedings to financial lease is not precisely addressed both in the repealed and NCC of Ethiopia. As a consequence, before providing the application of the NCC bankruptcy provisions to a financial lease, noticing the concepts and the nature of the financial lease under Ethiopian laws is indispensable. Active Ethiopian statutes that address the concepts and natures of the financial lease are the CGLB Proc No103/1998 with its amendment Proc No 807/2013. The first proclamation defined a financial lease as a *"lease arrangement in which the lessor puts the goods already acquired or based on the choice and specification of the lessee the lessor buys from 3rd party supplier, and during the lease periods, the lessor retains the full ownership rights on the leased goods and transfers the possession and use rights of the leased goods to the lessee by lease agreement in which the lessee pays periodical payments and may have the option to purchase at the ends of the lease by agreed price*".[198]

From this definition capital goods subject to the lease are goods that the lessor already acquired or based on the choice and specification of the lessee may purchase from the 3rd party suppliers. This expression displays that the lessee is actively involved in the selection and specification of the supplier and the leased goods. The lessee has a closer involvement with the leased goods and supplier, whiles the lessors underscore the financial aspects. During the lease periods, the lessor retains the full ownership rights over the goods as a security of the funds financed to purchase the goods. The lessor leases the goods to the lessee and the lessee pays periodical rents and would have an option to purchase the goods at the end of the lease terms. Therefore, the CGLB proclamation defined financial lease as a type of lease by which a lessor provides funds to a lessee against payment of mutually agreed installments over a specified period with the use of the capital goods, based on the mutual agreements in which at the end of the lease terms the lessee would have an option to purchase.

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[197] Interviews conducted with the team leader judges of the Oromia Supreme Courts Civil Bench Division and Federal High Court Lideta Civil Bench Division team leader judge

[198] Supra Note 20, Art. 2/3

In conjunction with this definition, the proclamation also provides the operational features of the financial lease agreements. With the obligation of the lessee to pay periodical rents and nature of the financial lease, CBLB provides specific features. During the lease periods, the lessee holds the leased goods as a mere bailee of the lessor and shall not have any ownership rights. It also granted the right to enjoy quite a possession and use of the leased goods to the lessee during the entire period of the lease. At the end of the lease periods, based on the mutual agreements the lessee may have the option to purchase the leased goods. A financial lease arrangement is the 'full payout and non-cancelable agreement.[199] After entering into financial lease agreements and accepting the leased capital goods, the lessee must pay the rents and no excuse will be available to relieve. The rent payments are full payout and the lease agreement is irrevocable. Thus, a financial lease transaction operates in which the lessor puts the capital goods for the benefit of the lessee. The leases arrangement puts the ownership rights, the full payout of the rent, and the irrevocability of the lease agreements for the lessor. At the end of the lease periods, it saved the optional rights of the lessee to purchase the goods. Therefore, where a financial lease transaction with such character and nature is subjected to bankruptcy proceedings, how the NCC Ethiopian bankruptcy law treats is the main objective that motivated the researcher to conduct this study.

The application of bankruptcy proceedings to the 'continuation of lease' was enacted in Art 1140 of the Repealed Commercial Code (hereinafter RCC) and the bankruptcy treatments to 'ongoing contract' is covered in Art 593 of the NCC. The general word of the 'continuation of lease' built-in in the RCC is likely to comprise the treatment of the bankruptcy proceedings to all types of leases that could include a financial lease. However, its operational contents are limited to the lease of 'immovable property used for the business or industrial operation of the debtor' which may not embrace the financial leases. Correspondingly, as we have discussed in Section 4.3.1 above; the NCC opted for the application of bankruptcy proceedings to 'ongoing contrasts' and also lacks clarity to comprise the financial lease specified with the above nature. The concept of the lease in Art 595 of the NCC points out the bankruptcy treatment to the lease of immovable business property, which is uncertain to comprise the financial lease. These indications and data collected suggested that neither the bankruptcy provisions of the RCC nor the NCC has carefully addressed the bankruptcy treatment of financial leases. The data collected through interviews and

[199] Ibid, Art 5 (1) (b)

documents assessed did not indicate how the bankruptcy provisions of NCC could treat the financial lease. The lawyers and judges who have participated in the study have provided that they did not familiar with the practice of applying bankruptcy provisions of NCC to the financial lease.[200] The challenges are not limited to the practical inadequacy of the bankruptcy proceedings to financial leases, but also the discrepancy of applying the bankruptcy provisions of the NCC to CGLB laws. The next section presented the discrepancy of bankruptcy safeguard provisions to the bankruptcy and operational features of the financial leases.

4.3.4. The Inconsistency of Applying Automatic Stay of NCC to Non-Cancelability and Full Payout Nature of CGLB Financial lease:

The rule of the automatic stay is incorporated in three types of bankruptcy proceedings, namely: preventive restructuring, reorganization, and bankruptcy proceedings.[201] To assist the negotiation of the preventive restructuring plan, Art 625 of the NCC empowers the debtor in-possession to apply for a 'single stay' of action that suspends the enforcement of any type of claim. Similarly, at the moment of filing reorganization and bankruptcy proceedings, during the observation periods of Art 54 and 761 of the NCC respectively calls for the automatic stay of enforcing all individual claims. The enforcement of all claims secured *in REM* by a pledge, mortgage, and creditors benefiting from a sale contract with ownership reserved are stayed by mere facts of filing a bankruptcy case. Without further steps, filing a bankruptcy petition is enough as a matter of law to suspend any type of claim from enforcement.

Despite the automatic stay of the bankruptcy provisions, the CGLB proclamation calls for the *"full payout and non-cancelable"* of financial leases. Before the end of the lease periods, the CGLB law prohibited the lessee and the lessor from terminating the obligation of the financial lease. Irrespective of starting a bankruptcy case, Art 8 (1) of the CGLB proclamation requires the continuation of the financial lease with the organs subrogated by the debtor lessor. Regardless of whether the lessor's bankruptcy may be benefited from the automatic stay of safeguard provision, it calls for the continuity of performing the financial leases. Thus, how the automatic stay of the bankruptcy process that suspends any type of claim could operate with the non-cancelability and full payout nature of the finance leases is the question. The practical operation of automatic stay;

[200] Interviews conducted with the team leader of the Federal High Court Lideta Civil Bench Division and Oromia Supreme Court Civil Bench Division team leader judges
[201] Supra Note 10, Art *593 (3) (b),625, and 654*

and the non-cancelability and full payout nature of the financial lease are incompatible. How the bankruptcy official who is empowered to administer the viability of the debtor, or maximize the creditors' share in the liquidation process is forced to comply with the bankruptcy provisions of the financial lease is controversial.

On this question, the data collected have established that it is still unsettled. To pave the way outs, some data have pointed out the implementation of the bankruptcy provisions in the NCC by disregarding the bankruptcy provision of the CGLB proclamations.[202] Other lawyers have preferred to implement the bankruptcy provisions in the CGLB proclamations rather than the bankruptcy provision in the NCC.[203] In substantiating their arguments, both sides have appealed to the rule of interpretation. The supporters of the former approach have contended that the bankruptcy provisions in the NCC are the latter and special laws to govern bankruptcy related matters. Whereas, the supporters of the latter views also have preferred that the bankruptcy provisions in the CGBL proclamation are the special laws to govern the bankruptcy issues of financial leases rather than the NCC. The arguments and reasons that arose from both sides are not easy. With this particular point, the researcher did not get a practical case disposed of in the bankruptcy court to substantiate the opinion of either side.

Whether the power granted to the supervising judge to exclude some claims from the scope of the automatic stay of the individual action in Art 654 (4) of the NCC works for financial lease is also controversial. If this provision is construed to embrace the financial lease, under what circumstance the exclusion applies to the financial lease transaction could work for bankruptcy officer is still absurd. The data collected through interviews and the documents analyzed also did not specify such an application. Thus, it may be examined and developed practically where the commercial community and lawyers have brought this issue to the court rooms.

4.3.5. The Interest of the Lessee Invested in the Leased Goods Vs. Repossession Rights of the Lessor:

When the lessee is judicially declared bankrupt, Art 8 (2) of the CGLB proclamation establishes that the lessor shall not lose its ownership rights over the leased goods. If the financial lease is

[202] Interviews conducted with the Federal High Court Lideta Civil Division Team leader judge, the bankruptcy Division Bench presiding judges and advocate lawyers

[203] Interview conducted with the Oromia Capital Goods Financial Business Share Company (OCGFBSHC) advocate lawyer

terminated as a result of the bankruptcy of the lessee, the lessor shall not lose its ownership rights over the goods. The lessor can repossess the leased capital goods from the organ subrogated by the debtor lessee. However, during the opening of the bankruptcy process, the fate of a defaulted rent payment did not get an answer in the CGLB proclamation. If we apply the bankruptcy provisions in the NCC, the full payout rights of the lessor will be restricted to the pre-insolvency claim which may be ranked under unsecured claims. When the financial lease is treated in such ways, it loses the very purposes of the financial lease transaction to be treated under ordinary claims.

Lessee has been paying the periodical rents that consider the economic useful life of the goods into account. As a result of the lessee's bankruptcy, where the lessor resorts to repossessing the leased goods, is there a condition to consider the interests of the lessee invested through periodical payments in the goods is the question. This displays another conflicting concept of the provisions that increase the complexity of applying the bankruptcy provisions in the CGLB proclamation to financial leases.

This question cannot get answered unless the bankruptcy process treatments to financial leases experienced by the US courts to characterize financial leases with their operational nature are transplanted in Ethiopian Bankruptcy Court. With this particular question, some data extracted from practitioner lawyers have provided the opinions to treat the financial leases as secured finance.[204] For them, unless the bankruptcy proceedings treat the financial lease business like secured finance, the very purposes of the financial lease are going to be suppressed. The writer also found this approach is persuasive opinion that may serve the objectives of both the financial lease and bankruptcy systems.

4.3.6. The Insolvent Estate and the Interest of the Lessee or Lessor in the Leased Goods:

The bankruptcy estate comprises all assets of the debtor, including rights, claims, and interest in the goods that may be tangible or intangible.[205] The NCC Art 729 (1) (a, b) illustrates the estate as (a) all assets and rights, including usufruct, owned by the debtor and (b) civil liability claims against third parties. The claims against *de facto* and *de jure* managers were also recognized as

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[204] Interviews conducted with the Federal High Court Lideta Civil Bench Division team leader and the Bankruptcy presiding judge

[205] Supra Note 10, Art 729 (1 (a-b))

the debtor’s estate. According to these provisions, the rights and interests of the debtor embodied in the encumbered assets owned by a third party are also part of the estate. The goods in the debtor's estate are generally used to meet the claims of the creditors and the costs of the proceedings.

According to the definition of estate, where the lessee who enjoys the possession and uses rights of the leased capital goods is declared bankrupt, the possession and use rights of the debtor lessee in the leased goods can be considered as bankruptcy estate. However, certain types of property, rights, assets, or interests are exempt to be part of the estate and can be detached from satisfying the claims of the creditors. Consistently, Arts 751 and 752 of the NCC provide the conditions and types of property rights recoverable from the estate. The property, interest, or rights belonging to a third party in the possession of the insolvent debtor could not constitute part of the estate. It is types of the rights recoverable from the estate of the insolvent debtor.[206] According to this legislation, the owner of the tangible or intangible goods and property rights, under the possession of the debtor lessee can be recovered. At the moment of opening a bankruptcy case, notwithstanding that the tangible or intangible goods and assets are under the possession of the debtor lessee, the lessor who owned the good can repossess from the debtor lessee’s estate. Article 752 (2 (a-d)) of the NCC lists, “*negotiable instruments; goods in deposit or handed over for sale; goods delivered under the ownership reserved clause; and goods in transit delivered to the debtor's warehouse”* are considered as the rights, goods, and assets can be recovered from the estate.

Exceptionally, by the recoverable rights and goods, the use and possession rights acquired through a financial lease were not included in the law. Where the lessor is judicially declared bankrupt, consistent with Art 8 (1) of the CGLB proclamation; how the leased capital goods belonging to the lessor would escape from being the portion of the debtor lessor estate is the question. Without categorizing the leased capital goods outside the domain of the estate, how the bankruptcy officer of the debtor lessor would continue with the non-debtor lessee to perform the financial lease is still a controversy. The law does not comprise the mechanism through which the no-debtor lessee could separately continue to possess the leased goods from the bankrupt lessor’s estate. As bankruptcy proceedings are the leased practically examined part of the

[206] Supra Note 10, Art 751 (1)

Ethiopian law and bankruptcy treatment to the financial lease are hardly experienced, the interviews and documents assessed on this question did not indicate the ways out. The data collected revealed that the ways of repossessing or excluding the leased capital goods from the lessor's estate were not practically examined in the courtrooms.

4.3.7. Ban to Enforce Ipso Facto Clause of NCC and Non-Cancelability and Full Payout of CGLB:

The ipso facto clause is normally a contract clause specifying that if one party to the contract defaults as the result of bankruptcy, the rights of the other party to reject the performance. [207] However, contrary to the application of this normal contract, the bankruptcy provision restricts the freedom of contracting parties to agree and comply in such a manner. Article 593 (3) of the NCC restricts the freedom of creditor contracting parties to withhold, modify, accelerate, or terminate the obligation of the ongoing contracts in determinant to the debtor for a reason attributable to bankruptcy. The bankruptcy provision vitiated the contract clause that may make the creditor party modify, accelerate, terminate or withhold the performance of the contract as a consequence of bankruptcy.[208] The bankruptcy provision eliminated the contractual clause that empowers the creditor or non-creditor party to make any changes to the obligation of the unexpired ongoing contracts because of bankruptcy.

However, as the special features of the lease transaction, Art 5 (1) (b) of the CGLB proclamation provides the non-cancelability and full payout of the lease agreements. This provision may be understood as the guiding principle that indicates the conditions to be included in the contractual agreement containing the specific nature of non-cancelable and full payout of the financial lease even in case of bankruptcy. If the contractual clause of the financial lease includes the non-cancelability and full payout, how it could operate with the restriction of the ipso facto clause of the bankruptcy provision is the question. The non-cancelability and full payout obligation embodied in the CGLB proclamation is the statutory ipso facto clause. It displays that the conditions are the statutory clause of the CGLB proclamation that contravene with the bankruptcy provisions. In other words, the contractual clause embraced in the CGLB proclamation provided the nature of the financial lease is opposing the bankruptcy provisions

[207] Supra Note 51,

[208] Supra Note 10, Art 593 (3) (a, b)

that prohibit agreeing on the fate of the contracts in case of bankruptcy. This understanding may raise the question of whether the bankruptcy provisions that have restricted the application of the 'contractual ipso facto clause' work for the 'statutory ipso facto clause'.

From the justification of prohibiting the creditor lessor to burdensome the debtor lessee; the provision of the CGLB proclamation sanctioned to continue performing the obligations and conditions placed in the financial lease agreements may be rational. The provision of the CGLB proclamation that obliges the lessor creditor to honor the obligation matches the mandatory provision of the bankruptcy law that binds the creditor to comply with the conditions and obligations in the ongoing contracts.

4.4. The NCC Bankruptcy Provisions Treatment to Financial Lease and Lessons Can is acquired from the Foreign Experience:

Among the experiences of the countries discussed in chapter three, the US and France's bankruptcy systems treatment to financial leases are the most practically examined systems. Thus, comparing the Ethiopian bankruptcy system with the experiences of the French, the US, Germany, and Spain may help to draw the best experiences. From the perspectives of common law and civil law legal systems, considering the experiences of the US and French may be significant. Thus, the next sub-section analyzed the Ethiopian bankruptcy process treatments to the financial leases in line with the experiences of these countries.

4.4.1. The NCC Bankruptcy Provisions Treatment to Financial Lease and the Recharacterization Experiences of US Bankruptcy Court:

Concerning the application of bankruptcy proceedings to financial leases, the US Bankruptcy Courts have developed a standard. In dealing with the lease arrangements, the US Bankruptcy Court characterizes whether the transaction named to lease is a "true" lease or a secured transaction masked as a 'lease'.[209] Under bankruptcy proceedings, the division between the true lease and secured finance offers a different result. The lease arrangements in which the risk and rewards of the ownership of the leased good are retained by the lessor, and only the use and possession rights are transferred to the lessee, the Court treats as a "true lease".[210] When the Court characterizes the financial lease transaction as a 'true lease', the application of bankruptcy

[209] Supra Note 131, p.22
[210]Ibid,

process follows the ordinary procedure of Section 365 of the bankruptcy treatments to executory contract. The trustee may reject, assume, or assign the obligation of the lease. Application of the bankruptcy process to a true lease adheres to the normal procedure of applying bankruptcy proceedings to executory contracts.

However, where the Bankruptcy Court characterizes the financial lease as secured finance, it yields different results. Based on the functional nature of the financial lease, the US Court characterizes the financial lease transaction as secured finance if it meets the following criteria:[211]

1. That the original term of the lease equals or exceeds the remaining economic life of the asset.
2. That the lessee is bound to renew for the remaining economic life or to become the owner of the asset.
3. That the lessee may renew for the remaining economic life for no or nominal additional payment
4. That the lessee may become the owner at the end of the lease term for no or nominal additional payment.

Even if none of the above criteria is met, the US courts have held the transaction to be characterized as secured finance. In arrangements where the lessor has no reasonable expectation of meaningful residual values in the goods, the court considers secured finance more than other transactions.[212] If the lessor knows that at the end of the lease period the goods have no use or the lessee is paying rent for the ownership of the goods and the lessor retained the title only to secure the periodical rents. The essence of the criteria employed to characterize the arrangements is to identify the intention of the parties to the agreements. Where the intention of the transaction leaves the lessor with no value in the good at the end of the lease term, the court considers such the transaction as securing the loan than becoming the real owner of the goods.[213]

The ways the US Court characterizes financial lease arrangement is similar to the operational definition of the finance lease indicated in the CGLB proclamation. The full payout and non-cancelability of the lease agreements, as well as the optional rights of the lessee to purchase the

[211] Supra Note 30, p.142
[212] Ibid,
[213] Ibid,

leased goods at the end of the lease term, are important elements identified in both legal systems. The nature and the operational character of the financial lease identified in the Ethiopian CGLB are similar to the standards of applying bankruptcy proceedings to financial leases developed by the US Courts.

In his book on the Ethiopian Law of Security Rights in Movable Property Asress Adimi has pointed out that the Ethiopian financial lease transaction with the above character resembles a sale contract that is likely to be treated as security finance rather than other forms.[214] According to Asress, the transaction is subjected to security finance which should have been covered under the movable property security rights proclamation (MPSRP). He criticized that the financial lease with the functional approach that embraces the transaction of secures payments and performance of an obligation, putting outside the realm of the MPSRP potentially defeats the purpose of modernizing the Ethiopian secured transaction law.[215] In financial leasing where the lessee pays installments for prolonged periods that are equivalent to the remaining economic life of the good, the title retained by the lessor has no purpose than securing the performance of the lease obligation. Thus, Asress noted the reason why the financial lease transaction is placed outside the realm of the moveable property security rights proclamation is unsatisfactory. He commented on the nature of the financial lease acknowledged in the Ethiopian CGBL proclamation to adhere to the characterization models adopted in the US courts. The data collected also indicated that to offer certain priority rights, certain collateral rights should be granted to the lessor.[216] At the time the lessee is declared bankrupt; to the extent of the rights in the leased capital goods, the lessor should be given certain priority rights.

Accordingly, if the application of Ethiopian bankruptcy law to financial leases adhered to the characterizations of the US court, the scenario may be changed to the bankruptcy law treatment to secured finance. It may be shifted to the application of bankruptcy proceedings to secure finance. In which the bankruptcy treatment of the 'secured finance' is completely different from the nature of financial lease transactions enacted in the CGBL proclamation. The debtor lessee retains the possession rights of the leased goods during the bankruptcy process without making the post-petition rent payments. There is no deadline for the debtor lessee to assume or reject the

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[214] Ibid, p.144
[215] Ibid, p.144
[216] Interviews conducted with the Federal High Court Lideta Civil Bench Division Bankruptcy presiding judge

secured finance, no need to cure the perpetual defaults, and no need to provide adequate assurance of the future performance of the leases. If the extent of the secured finance is greater than the value of the collateral, the debtor party may use a bifurcate (division) of the finance into the secured and unsecured claims.[217] In such a division, the secured claim is only limited to the extent of the value of the underlying collateral and an unsecured claim is for the balance owed. The functional method of the Ethiopian financial lease is similar to the US's approach and differing from the bankruptcy treatments to the financial lease is unsound. Thus, the US approach to determine whether the financial lease is secured finance or another mode of transaction is considered more tenable and comprehensive.

4.4.2. The CGLBP Bankruptcy Provision and the French Bankruptcy Systems:

This section presented the application of the bankruptcy proceedings to financial leases in the CGLB proclamation and the France experiences. As we have presented above, the NCC bankruptcy provision treatments to finance lease is ambiguous. However, alongside the NCC provision, the CGLB proclamation contains some bankruptcy provisions that treat financial lease arrangements. These provisions are indorsed in Art 8 (1 and 2) of the CGLB proclamation that reads as follows:

1. *The obligation and condition of the lease agreements shall continue with an organ legally subrogated to the judicial bankruptcy lessor as long as the lessee performs his obligation following the terms of the lease agreement.*
2. *The Lessor shall not lose his right to the capital goods leased even though the lessee is judicially declared bankrupt.*

Art 8 (1) of the CGLB proclamation enacts the irrevocability of the lease agreements as a consequence of the lessor's bankruptcy. It forces the organ subrogated the bankrupt lessor to honor the continuation of the lease agreements with the lessee. The organs subrogated by the debtor lessor (i.e. supervisor or trustee) are precluded from exercising the power of termination granted to them by the NCC Art 593 (4). As the result of the lessors' bankruptcy, the bankruptcy provision of the CGLB protects the possession and use rights of the lessee from termination. It guaranteed the use and possession rights of the lessee.

[217] US Insolvency Code Section 502

From the ownership rights, Art 8 (2) of the CGLB enacted the exclusive rights of the lessor. Nevertheless, the lessee is judicially declared bankrupt; it assured the continuity of ownership rights of the lessor. Without considering the prolonged periodical payments the lessee has paid, it safeguarded the exclusive ownership rights of the lessor. From the rights entitled to the lessor and lessee, the law assures the continuance of the possession and use rights of the lessee, as well as the ownership rights of the lessor against the bankruptcy of either party. Divergent to the bankruptcy provisions of the NCC that terminate every kind of claim; the bankruptcy provision in the CGLB proclamation assures the continuance of the economic rights of the lessee and the ownership rights of the lessor. Thus, if the lessor or the lessee judicially declared bankrupt, whether the bankruptcy provision of NCC or the CGLB proclamation applies is challenging. Data collected also showed that the bankruptcy provisions in the CGLB proclamation and the bankruptcy provision in the NCC are contradicting.[218]

The provisions of Art 8 (1&2) are enacted to have application in all types of capital goods leasing businesses like; hire-purchase, operating lease, and finance lease. However, the purpose and functional structure of the finance lease is different from the operating lease and hire purchase. In either of the contracting party is declared bankrupt, the financial lease agreement prohibits the termination of the lease agreement between the lessor and lessee. The non-cancelability and full payout, the optional rights of the lessee to purchase the leased capital goods outright, and the active involvement of the lessee to choose and specify the suppliers are conditions that make the financial lease different from the hire-purchase and operating lease. In financial lease agreements, the lessee is considered the economic owner of the capital good that enjoys all the risks and rights that arise from the possession of the goods. But, in the operating lease, the lessee is not endowed with the economic ownership and risks of the capital goods. Though the case of operating lease and hire-purchase is not the objective of this research, why the organs subrogating the bankrupt lessor (trustee or supervisor) are obliged to honor the leasing agreements in operating lease and hire-purchase is not clear. How the trustee exercise the termination powers endowed to them under Art 593 (4 (a, b, and c)) of the NCC is illogical.

[218] Interview conducted with the OCGFBShC, advocate lawyer and Federal High Court Lideta Civil Bench Division of Bankruptcy presiding judges and advocate lawyers

According to the bankruptcy provision of the CGLB proclamation, if the organ who subrogated the debtor lessor is forced to continue performing the obligation of the financial lease, how the safeguard provision of the bankruptcy proceeding operates with such continuation is the question. However, before proceeding to this issue; we will see the bankruptcy approaches in the CGLB proclamation with the experiences of a foreign jurisdiction. The French bankruptcy law categorizes the financial lease transaction under executory contracts that enjoy special treatments. As a result of bankruptcy to terminate the financial lease, the French Commercial Code requires the satisfaction of special rules. It allows termination of the financial lease agreement where the next elements are fulfilled.[219]

a) *on the date the lessor is informed by the insolvency officer of his decision not to assume the lease contract, or*
b) *when the lessor requests the termination of the contract based on a default payment after the opening of the insolvency proceedings or*
c) *the absence of the activity during the observation period in the rented property does not lead to the automatic termination of the lease, notwithstanding the clause to the contrary*

From these provisions as a principle, opening a bankruptcy case cannot become grounds to terminate or suspend the obligations or rights of the financial lease. Though the lessee is judicially declared bankrupt, it does not automatically terminate the financial leases. However, the financial lease may terminate either by the decision of the bankruptcy officer of the debtor lessee not to assume, or by the requests of the lessor as the result of the lessee defaults to pay the rent. The obligations of the financial lease may be terminated by the decision of the bankruptcy officer of the debtor lessee. Likewise, as a result of filing a bankruptcy case where the lessee is in default, the financial lease may be terminated at the time the lessor requests. It allows the termination of the financial lease when the organ that subrogated the debtor lessee decides not to assume, or as a consequence of the lessee's defaults, and where the non-debtor lessor requested the termination. Where the debtor lessee is bankrupted, this evidences that the France bankruptcy system recognized the ordinary procedure that empowers the trustee to decide the rejection or assumption.

[219] French Commercial Code, Art L622–13 II, L622-14, and L622-14-2

Opposed to the bankruptcy provision of the automatic stay, the lessor is empowered to terminate the financial lease as a result of defaults of the lessee to pay the rent. Hence, nevertheless, the lessee is in default to pay rent as a case of bankruptcy, the lessor is empowered to terminate. In the contractual clause, the lessor and lessee can agree to terminate the financial lease in the absence of the activity with leased capital goods during the observation periods. The France bankruptcy law allows the contracting parties to agree and terminate the financial lease during the observation periods in the absence of the activities with the rented goods. This statutory clause indicated that against the limitations of the ipso facto clause, the France bankruptcy systems law allowed the lessor and lessee to contract for the grounds of termination.

If we compare the CGLB bankruptcy provision that prohibits the termination of the financial lease and the exclusive ownership rights of the lessor against the bankruptcy of either party, it is different from the experiences of the USA and France. The US Bankruptcy Court characterizes a financial lease as secured finance (collateral loan) in which the lessor or lessee could be considered a lender or borrower. The France bankruptcy law allows the termination of the financial lease upon request by the lessor as the result of defaults of the lessee after filing the bankruptcy process. When the lessor is informed by the bankruptcy officer of his decision not to assume the lease, the obligation of the financial lease terminates. Thus, the CGLB bankruptcy process approach to treating the financial lease is different from the France and US experiences.

Data collected disclosed that the questions of how the obligation of the trustee to remain to perform the obligation of the financial lease could settle with the NCC bankruptcy provisions allow the trustee to terminate. The data exposed that the bankruptcy provision in the CGLB proclamation is antagonistic to the bankruptcy provisions of the NCC.[220] As a result, to apply the NCC bankruptcy proceedings to financial leases, the data have suggested adopting the rules of interpretation.

Although the data have indicated that there was no practical case of bankruptcy process treatments to financial leases, it established the two laws are contradicting. Thus, regarding bankruptcy-related issues; as the bankruptcy provisions of the NCC are the special and the latest

[220] Interview conducted with the lawyer of the (OCGFBSHC) advocate lawyer, Federal High Court Lideta Civil Division Team leader judge, the Bankruptcy presiding senior judges, and Oromia Supreme Court Civil Division Bench team leader

law, in the application the bankruptcy provision of the NCC should prevail over the bankruptcy provisions of the CGLB proclamation.[221] In the next section, how the automatic stay, restriction to ipso facto clause, the scopes of the bankruptcy estate, and power granted the bankruptcy officer to terminate run with the full payout, non-cancelability, the officers' responsibility to honor continuance, the possession and use (economic ownership) rights of the financial lease contracts.

[221] Ibid,

CHAPTER FIVE:

5. CONCLUSIONS AND RECOMMENDATIONS:

After offering this much time discussing the challenges and prospects of applying the bankruptcy proceedings of NCC to financial leases, now it is the time to sum up, the points that arose in the previous chapters and locate areas that need to amend in the future. Based on the analysis and findings of the study, this chapter presented the conclusions and recommendations part of the study.

5.1. Conclusions:

The Ethiopian bankruptcy provisions convey the objectives of bankruptcy proceedings to enhance the rehabilitation of a viable debtor and organize the liquidation of the estate that maximizes the values of the assets available for the creditors.[222] Bankruptcy law employed safeguarding provisions and established trustees to realize these objectives. Opening a bankruptcy case deprives the debtor of undertaking any business activities. Transactions performed before filing a bankruptcy case may be terminated by the 'automatic stay' of the bankruptcy provisions. Filing a bankruptcy case creates an 'estate' with a legal personality different from the bankrupt debtor. The Bankruptcy Court appoints a trustee who takes care of the estate and proceedings. The trustee takes all the legal and judicial responsibilities of the estate and bankrupt debtor. It is duty-bound to ensure the main objectives of the bankruptcy proceedings to organize and liquidate the debtor's business among the creditors. Regarding the bankruptcy proceedings application to ongoing contracts, when the debtor or estate does not have enough finance to continue the performance or where continuing performance is not in the interest of the estate or the debtor, or where it does not unfairly prejudice the interests of the creditors, the trustee is authorized to terminate.[223]

On the other hand, financial leases operate in which the lessor purchases the capital goods from 3rd party supplier selected by the lessee, and puts the purchased goods in the possession and disposal of the lessee in which the latter pays periodical rents.[224] The lessor purchases the capital goods in connection with the lease agreement, while the lessee possesses and uses the goods in

[222] Supra Note 10, Art 588
[223] Supra Note 10, Art 593 (4 (a, b, and c)
[224] Supra Note 20, Art 2

his business operation subjected to periodical payments. Hence, financial leases transfer all the risks and rewards of the leased capital goods from the lessor to the lessee. As a result, the lessee is considered an economic owner of the leased goods; while the lessor holds the ownership title of the goods as the assurance of the periodical payments. Thus, a financial lease is a financing technique in which the lessor puts capital-intensive goods directly at the disposal of the lessee in place of finance. The lessee acquires the goods instead of the finance that enables him to purchase the capital goods. In such a way, a financial lease serves the objective of creating alternative sources of finance, in which the lessee could have access to capital-intensive goods instead of finance. To assure the periodical payments for the lessor, the CGLB proclamation enacted the "full payout and non-cancelability" of the financial leases.[225] Unless the period agreed is expired or the lessor and lessee mutually agreed to terminate, obligations of the financial leases are non-cancelable. It requires the continuance of the financial lease agreements and the periodical payments. Irrespective of the bankruptcy of the lessor, it specifies the continuation of financial lease agreements with the trustee (organ) subrogated by the debtor lessor.

Consistent with the nature and objectives of the bankruptcy proceedings and financial leases, the finding of this study designated that the main objectives of the bankruptcy proceedings in the NCC and the CGLB proclamation are incompatible. Hence, to maximize the value of the assets available to creditors, the automatic stay of the NCC bankruptcy provision suspends the continuation of any judicial or legal claims. Contrary to this, the bankruptcy provision in the CGLB proclamation endorses the "full payout, non-cancelability and persistence of the financial leases with the organ substituted the debtor lessor.[226] Notwithstanding that the lessor is judicially declared bankrupt; the CGLB proclamation advises the obligation of the trustee subrogated the debtor lessor to continue performing the financial leases. This revealed that, despite the bankruptcy provisions of the automatic stay and bans to the ipso facto clause, CGLBP order the full payout, non-cancelability, and continuance of the financial leases.

The bankruptcy provision in the NCC that defines the bankruptcy treatment to the ongoing contract was not well drafted to comprise the financial lease arrangements. The deficiencies

[225] Supra Note 20, Art 5 (1)
[226] Supra Note 20, Art 5 (1) and 8 (1)

manifested to define ongoing contracts in the NCC can be observed as the challenges of applying bankruptcy proceedings of NCC to financial lease business. The transactions included in the bankruptcy process treatment to an ongoing contract are limited to the lease of an immovable business that is not necessarily excluding the financial lease business. Thus, the definition provided by the NCC for ongoing contracts is poorly drafted to broadly comprise the transaction of financial lease business.

In cases where the lessor is judicially declared bankrupt; how the leased capital goods belonging to the lessor could escape from the estates of the bankrupt lessor is another challenge. Without labelling the leased capital goods outside the domain of the bankruptcy estate, how the trustee who is subrogated the debtor lessor could continue with the non-debtor lessee to comply with the financial lease is a controversy. The law does not comprise the mechanism through which the non-debtor lessee could continue to possess and use the leased capital goods excluding from the bankruptcy estate of the debtor lessor.

The NCC banned the enforcement of the ipso facto clause that makes the non-defaulting party modify, accelerate, terminate or withhold the performance of the contract as a result of a bankruptcy case.[227] It abolished the contractual clause that empowers the creditor or non-debtor party to make any changes to the obligation of ongoing contracts as a result of a bankruptcy case. However, this enactment appears to oppose the CGLB proclamation that demands the continuation of the financial leases with the organ legally subrogated to the bankrupt lessor.[228] Thus, this study has identified the operational paradox of banning the enforcement of the ipso facto clause and continuance of the financial lease with the trustee of the debtor lessor.

There is also an unsettled question of whether the bankruptcy provision that banned the enforcement of the 'contractual ipso facto clause' in the NCC works for the 'statutory ipso facto clauses. It is challenging whether the bankruptcy provision of NCC that has expressly restricted the enforcement of the ipso facto clause could apply to the statutory ipso facto clauses.

Lessons could be drawn from the experiences of the foreign jurisdictions; the ways the US Bankruptcy Court characterizes financial leases are similar to the definition and operational

[227] Supra Note 10, Art 593 (3) (a, b)
[228] Supra Note 20, Art 8 (1)

structures of the finance lease adopted in the CGLB proclamation. The full payout and non-cancelability of the financial leases, as well as the optional rights of the lessee to purchase the leased goods at the end of the lease periods, are some features that make both regimes resemble. However, the application of bankruptcy proceedings to financial leases employed in the CGLB proclamation is neither resembles nor similar to the regimes. Thus, such nonconformity may also be identified as the challenges of the Ethiopian bankruptcy system to govern the financial lease business.

The application of the NCC bankruptcy provision to the financial lease in the CGLBP was not yet practically tested. The judges on the commercial and bankruptcy-related bench of the Federal High Court, Oromia Supreme Court, senior lawyers of the OCGFBSHC, and licensed lawyers interviewed replied to their unfamiliarity. All the volumes of the cassation decision of the Federal Supreme Court were reviewed, but no case is available yet. Furthermore, as observed from the interviews, the practitioners were not aware of the application of bankruptcy proceedings to financial leases. The lack of awareness of the judges, advocates, commercial communities and lawyers of the OCGFBSC also identified as the challenges of applying the bankruptcy provisions of the NCC to the financial lease.

5.2. Recommendations:

For the above-mentioned findings, the following recommendations are forwarded:

I. Consistent with the contractual hybrid nature and objectives of financial leases to create alternative sources of finance, the HPR should amend the full payout, non-cancelability and continuance of the financial leases with a trustee of the debtor lessor of the CGLB proclamation to reconcile with the automatic stay and bans to the ipso facto clause of the NCC. Specifically, the amendments should include:
    - As the NCC is a general law that governs bankruptcy-related cases, it must be amended to put the effects of applying the bankruptcy proceedings to financial leases of the CGLB.
    - The CGLB proclamation provision that obliges the trustee to remain to perform the obligation of a financial lease with a non-debtor lessee must conform to the powers of the bankruptcy officers to terminate the obligations of ongoing contracts under the NCC provisions.

- The scopes of the NCC provisions that ban the enforcement of contractual clauses to modify, accelerate, terminate or withhold the performance of the contract as a result of filing a bankruptcy case should compatible with the statutory clause of CGLB that require the continuation of the financial leases with the trustee who subrogated the debtor lessor.

II. Until the NCC and CGLB laws are amended to reconcile; in applying bankruptcy proceedings to financial leases, the Bankruptcy court should take into account the optional rights of the lessee to purchase the leased capital goods at the end of the lease periods that has the operational characteristics of security finance rather than other forms of transactions. Thus, in applying the bankruptcy proceedings of NCC to financial lease business, by adopting US Bankruptcy Court experiences that characterize the contractual hybrid nature of financial lease to secured finance, the writer recommends recharacterizing the financial lease business as secured finance.

III. With regards to capacity building and awareness creation, the Commercial Community, the Courts and the Lessor Company should work with the concerned organ to get access to training for their professions, practitioners and experts in bankruptcy and financial leases.

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Interview with Mr. Oluma Yigazu, the Oromia Supreme Court Civil Division Bench Senior Judge, made on November 03 /2022

Interview with Mr. Diriba Fayera the Oromia Supreme Court Civil Bench Division Judge, made on November 03 /2022

Interview with Mr. Mulsa Dhaba Legal Director of the Oromia Capital Goods Financial Business Share Company made on November 04/2022

Interview with Mr. Tuli Bayisa, the Senior Licensed Advocate both at Federal and Oromia Courts, made on November 04/2022

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7. ANNEX

7.1. Interview Guide:

Introduction:

My name is Tamiru Degefa: I am working on my LL.M study at the Jimma University School of Law and Governance, Department of Commerce and Investment Law, on the topic *"**Application of the Bankruptcy Proceedings to Finance Lease Under the Ethiopian Laws: Analysing the Challenges and prospects".*** The researcher strongly believes that your genuine responses to the interview guide are very helpful to reach the correct findings. Therefore, I kindly request you to give a genuine answer to the following interviews. Furthermore, the researcher wants to ensure you that the information gathered will be used purely for academic purposes. The name and other personal information can be anonymously reported by the researcher in case you need it. Owing to this, the researcher is grateful for your time, concern, and cooperation in advance.

Backgrounds of the Interviewees:

Name: ___________________________________Post _________________________________

Year/s of experience: ____

Note:

- Bankruptcy proceedings for this study indicate the legal process conducted under the supervisor role of the judiciary to reorganize or sell out the business of the debtor and distribute it to the creditors.
- A financial lease indicates a type of leasing by which a lessor provides a lessee against payments of the mutually agreed installments over a specified period with the use and economic ownership of the capital goods that the lessor purchase from the 3rd party supplier based on the choice and specification of the lessee, and during the lease time the lessor retains the full ownership rights and at the end of the lease periods the lessee may have the option to purchase.

The main Questions:

1. Have you ever come across any case of the application of bankruptcy proceedings to ongoing contracts in general and the financial lease in particular?

2. Did the NCC bankruptcy provision is comprehensively addressed the treatment of the financial lease?
3. What are the basic challenges and prospects of applying the bankruptcy proceedings to a financial lease?
4. In your view, is the unique nature of the bankruptcy provisions and financial lease laws are designed to consistently function together?
5. Were the law practitioners, judges, lawyers, and corporate lessors are familiar with the application of bankruptcy proceedings to financial lease?
6. How does the automatic stay and restriction of the contractual clause of the NCC operate with the full payout and non-cancelability nature of the financial lease?
7. In your view, what are the challenge and prospects of statutory inadequacy and the lawyers' awareness to apply the bankruptcy process to financial leases?
8. What are the criticisms, comments, and recommendations you have for the subject matters?

Once again, I am grateful for your cooperation!