The Enforcement of Commercial Contracts in Ethiopia

By

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ABSTRACT

The Commercial Contracts enforcement in the Ethiopian legal and judicial systems of framework comprises four major pillars of enforcement mechanisms. Namely, it embraces the formal judiciary system, the informal ADR mechanism, the private law regimes and international normative order.

The empirical findings testify that both court adjudication and ADR mechanisms in the Federal and Regional States to resolve commercial disputes are to be in the medium and very low range. Thus, the major problems facing traders with respect to commercial contracts enforcement, in order of significance could be encapsulated incorporating elements of: *slow settlement of cases*; *lack of skill and knowledge in law that govern commercial activities*; *red-tape in the judiciary and unethical exercise in the court system*. Besides, the other problems found in analyzing the quantitative study alluded to the *lack of competent lawyers* and *supporting institutions* for executing the court's order.

Moreover, the credit facilities currently allotted for MSMEs as well as big business undertakings are almost negligible and always subject to attachment of security devices/collaterals and suretyship/individual guarantee. Finally, by way of conclusion the paper under scores the pitfalls facing traders and the major commercial contract regimes currently, and suggests policy, legal and institutional recommendations to overcome these glaring hiatus.

1: Introduction

Commercial Contract Enforcement Mechanisms in Facilitating Business Transaction and Economic Development

a) General Background

The ability to make, honor, enforce contracts and resolve disputes effectively and efficiently when they arise, ensures predictability in commercial relationships and proper functioning of markets, thereby contributes to economic and industrial development. This calls for, among other things, the enactment of market friendly policies and laws, having competent and independent judiciary, establishing mechanisms through which both informal and formal enforcement mechanism operate in synergy and ensure the adaptability of the overall legal system to the global commercial transactions.

Commercial contracts have developed through tremendous past social experiences. As life necessitates interaction between human beings, concerns for regulating such multifaceted transactions and the creation of an enabling environment for them have emerged.[1] As the scope of transactions started crossing borders and widened their horizons, issues of ensuring compliance by the respective parties and enforcement mechanisms have become crucial. This is so because; there have been significant implications attached to it in every aspect of social, economic and legal spheres.

Thus, since early 1990s the business community in Ethiopia is caught up between the traditional and the modern route which demand formal competitive orders and trajectories of *laissez-faire* economy. And, what has been observed in Ethiopia is cash based economic and commercial activities as opposed to the most dynamic form of credit based and other

[1] A. James Barnes, J.D. *et al*: Law for Business, 7th ed, McGraw-Hill, 2000, p. 112.

technology oriented commercial transactions that have been dominant at the international arena.[2]

It is natural that the expansion of trade unquestionably invites the increments in the volume of commercial disputes. Such disputes need to be settled in a timely and effective manner in order to enhance the smooth business transaction. To this end, the establishment of an efficient and effective legal system for swift resolutions of commercial contracts is a pre-requisite for economic development, and contributes to a healthy commercial transactions by enabling the business community to safeguard their contractual rights and enhancing predictability through self-enforcement mechanism in curtailing confrontational attitudes and, in difficult circumstances, paving the way for third party interventions of dispute settlement mechanisms. This should also be made in tune with international best practices and rules governing the area.[3] Of course, setting up the mechanism of settlement for such disputes is no less essential as drafting and signing the contract covenant. Devoid of such mechanism, companies, trans-national corporations, MSMEs and especially women owned micro/small enterprises will greatly be affected.

However, in Ethiopia, despite the observed developments, no meaningful effort has yet been taken. It is neither fully equipped with the technologies, which current commercial trends demand, nor with the policies and laws that govern adequately its internal and external business developments.[4] Business trends are advancing rapidly whereas the commercial legal regimes, general contract laws and ADR rules are more or less tuned to the spirit of the 1960s and could not cope up with innovative legal ideas and are devoid of the contemporary ADR laws and procedures. In this light, the system is generally at a crossroads. The situation calls for an urgent remedy by way of enhancing contract enforcement mechanisms through capacity building and scaling-up expertise competency.

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[2] *See for instance*, Gardachew Worku: Electronic-Banking in Ethiopia- Practices, Opportunities and Challenges; Journal of Internet Banking and Commerce, Vol. 15, No. 2, 2010, pp. 1-8.

[3] See Julian D.M Lew, Loukas A. Mistelis and Stefan M. Kroll, *Comparative International Commercial Arbitration*, Kluwer Law International, The Hague, 2003, p. 52, concerning "UNICITRAL Model Law' definition of 'commercial'; regarding the New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (the New Convention), p. 687; as regards the Uniform Law on the International Sales of Goods (1964), p. 825 ; Washington Convention o the Settlement of Investment Disputes between States and Nationals of other States 1965, (ICSID), pp. 2-24; ICC International Court of Arbitration;' General', pp. 2-10; International Chamber of Commerce, pp. 1-37.

[4] Ibid.

It is high time to let the policies, laws and institutions keep abreast with the over all changing economic and social realities, international legal developments and practical necessities. Such efforts should be made on informed basis, and particularly, need to be backed by researches in the area. Accordingly, this paper is designed to probe the issues, policies, and problems of commercial contract enforcement in Ethiopia, and their significance in terms of contribution to the economic development, particularly in the fields of micro, small and medium enterprises.[5]

In due course, it evaluates the roles that the private sectors have been playing and should play, and the policy, legal and institutional (formal and informal) frameworks existing in this area. It will also examine pertinent international conventions directly or indirectly dealing with enforcement of commercial contracts. The paper lastly forwards conclusions and recommendations which would help in rectifying the observed loopholes and creation of an enabling environment for commercial contracts enforcement in Ethiopia.

b) Economic Significance of Commercial Contract Enforcement

In all commercial transactions, contracts have to be completed and enforced. Contractual performance involves ascertaining the efficient terms of the exchange. Enforcement means ensuring that these terms are complied with. Problems arise in contractual performance mostly because of lack of information, whilst the problem of enforcement is related to informational asymmetries between the partners, which make them prone to opportunistic behavior.[6]

[5] Micro Enterprises are those small business enterprises with a paid-up capital of not exceeding Birr 20,000.00 and excluding high technical consultancy firms and other high tech establishments. Small Enterprises are those business enterprises with a paid-up capital of above 20,000 and not exceeding Birr 500, 000 and excluding high technical consultancy firms and other high tech establishments. Medium/ Large Enterprises are those with more than Birr 500, 000 capital. Definition of MSE is taken from the Ethiopian Ministry of Trade and Industry and is used to categorize the sector for the purpose of a strategy. *See* Micro and Small Enterprises Development Strategy 1997. Inconsistency in the use of these definitions in different regions, and also, federal and regions, is observed.

[6] *See* Benito Deffains, The Role of Institution In The Contractual Process ", in "The Economics of Legal Relationships, Vol.6, Law and Economics in Civil Law Countries, Bruno Deffains and Thierry Kirat (eds.), 2001, pp. 149-150.

Information scarcity explains a variety of complex mechanisms used to perform a contract, i.e. to accurately define the terms and conditions of the exchange or the commitments between the parties. The definition can occur *ex ante* or *ex post*, i.e., before or after the parties become committed to each other. It may be carried out by the parties themselves and/or by various social institutions, in particular the judicial system, the involvement of which to a large extent reduce the scarcity of information problem.[7]

Thus, a sound judiciary is pivotal in enhancing contract enforcement. No doubt some technical laws can be enforced by administrative means, but a rule of law, in the primary economic sense of protecting property and enforcing contracts, require a judiciary to resolve dispute between private parties. The judiciary is a vital factor in the rule of law and more broadly in economic development.[8]

Moreover, the relative efficiency of different contractual enforcement mechanisms depends on the characteristics of the goods to be exchanged, the cost of and use of the mechanism and the predictability of the outcome. State legal institutions do, however, have an important role to play. They can facilitate exchange among anonymous individuals and firms and provide impartial and predictable enforcement of contracts. [9]

Low-cost and impartial contract enforcement procedures are commonly held to provide a critical incentive for the formation of complex commercial agreements and, thereby, facilitate trade and economic growth. These procedures enhance predictability in the system by restraining opportunism among contracting parties. This redaction in uncertainty decreases the cost of exchange and promotes transactions.

In general, information asymmetries, opportunism, and transaction costs limit the effectiveness of state institutions. Particularly in developing countries, state institutions share the overarching weaknesses of the public sector, and often do not provide for predictable contract

[7] Ibid.
[8] *See* Kenneth W.Dam, "The Judiciary and Economic Development", University of Chicago, John M.Olin Law and Economics Working Paper No. 287, (2nd Series) October 2006, p. 1.
[9]Satu Kahkonen and Patrick Meagher IRIS Center, University of Maryland, College Park, "Contract Enforcement and Economic Performance", May 1997, p. 1.

enforcement. In light of the new institutional economics, if state institutions are ineffective, non-state institutions that is, informal-institutions arise to govern the commercial exchange. Non-state institutions of contract include social norms, customary law, alternative dispute resolution forums, and *ad hoc* mechanisms of reciprocity and collective punishment.[10]

Sub-Saharan Africa is often perceived as a part of the world where business is hindered by the lack of contact discipline. Because of Africans' laid-back culture, the argument goes, supplies are delayed, and quality is unreliable, and payment comes late.[11]

The lack of respect for contractual obligations deters investment, particularly foreign firms which can find a more disciplined business environment elsewhere.[12] One can substantiate further this line of argument by the fact that this trend hurts Africa's capacity to export manufactured products to the West.[13]

Thus, reviewing the status of commercial contracts and its enforcement mechanisms in light of the Ethiopian legal regimes two crucial considerations are deemed to be taken into account:

1) Bringing enforcement to center stage offers the advantage of bridging law and economics;
2) This bridge helps couch policy recommendations that emerge from the economic analysis of institutions in terms of legal procedures.[14]

Contract law has many purposes but the central one is to support the multitude of agreements that collectively make up the market economy, and, hence, operates in the context of dispute resolution mechanism. Besides, it empowers the parties to make agreements that will be enforced in court of law or formal ADR forums. It also enables parties to the contract to make

[10] Ibid.
[11] *See* Marcel Fafchamps, "The Enforcement of Commercial Contracts in Ghana", Wold Development, Vol. 24, No. 3, 1996, p. 427.
[12] Ibid. Most of the time researchers allude East Asia, as a prospective investment opportunity.
[13] *See* Biggs, T. G. Moody, J. H. von Leeuwen, and E. D. White, "Africa Can Compete! Export Opportunities and Challenges in Garments and Home Products in the U.S, Market," RPED, Discussion Papers, Washington D.C., the World Bank, March 1994.
[14] *See supra note* 11, Marcel Fafchamps, p. 428. See also Word Bank, Doing Business 2009, 2010 and 2011, Wahington D. C., especially, the 'Enforcing Contracts' section.

exchanges that might otherwise carry a great risk whether of disruption by some contingencies or default by the other party. Accordingly, contract laws in this respect are the most important instruments which create smooth functioning of business transaction by creating certainty, predictability, and enforceability. It is clear that individuals should be free to pursue their own self-interest but they recognize that in some cases 'the market' may not operate efficiently. For example, in cases where there is some kind of monopoly or where one party does not fully understand the nature of a given contract, the law intervenes to serve the purpose of clarifying the obligations under a given circumstance.

The basic economic function of contract law is to provide sanction for non-performance; which, is in the absence of sanctions, sometimes tempting where the parties' performance is not simultaneous. At the heat of it lies the concept of an institution that deters the opportunistic breach of contract.[15] It also reduces the costs of the exchange process by supplying a standard set of risk allocation terms for use by contracting parties, and most rules are backed by economic justifications.

Hence, in the absence of efficient courts and other enforcement mechanisms, firms undertake fewer investment and business transactions, and they prefer to involve only a small group of people who know each other from previous dealings. If courts are not efficient, the overall economy, industrial peace, the interests of government and public will be endangered.[16] A number of studies suggest that the degree of judicial independence is correlated with economic growth and that better performing courts have been shown to lead to more developed credit markets, thus, contributing to rapid growth of small as well as larger firms in an economy.[17] Furthermore stable rules with consistent results are advisable in the promotion of economic development.[18]

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[15] *See supranote* 11, Marcel Fafchamps, p. 427.

[16] *See* Memberetsehai Tadesse,*The Features of Ethiopian Law and Justice (Amharic Version)*', Addis Ababa (2007) p.6. *See also* Memberetsehai Tadesse, 'Commercial Enforcement and Insolvency Systems' The World Bank, Global Judges Forum, Pepperdine University School of Law, Malibu, California, 2010, pp. 2-15.

[17] Kenneth W. Dam, 'The Judiciary and Economic Development', University of Chicago John M. Olin Law & Economics Working Paper No.287, (March 2006); available at: http://papers.ssrn.com/sol3/papers.cfm?abstract id=892030., visited on August 23, 2010.

[18] John W. Van Doren, 'Positivism and the Rule of Law, Formal Systems or Concealed Values: A Case Study of the Ethiopian Legal System', *Journal of Transnational Law & Policy*, Vol.3, No.1, (1994), p. 197.

Different studies examining the role of financial intermediaries in facilitating for economic growth, and how legal and accounting practices (including contract enforcement) affect financial development, provided that the degree to which financial intermediaries can acquire information about firms, conclude contracts, and have those contracts enforced will fundamentally influence the ability of those intermediaries to identify worthy firms, exert corporate control, manage risk, mobilize savings, and ease exchanges; and the legal and regulatory system will fundamentally influence the ability of the financial system to provide high-quality financial services.[19] The primary reason why financial markets are particularly dependent on law and institutions of contract enforcement is that financial contracts tend to be highly technical and complex and usually involve large amounts of financial assets. The broad 'law and finance' literature suggests, on the basis of extensive empirical testing, that a country's contract, company, bankruptcy and securities laws, combined with effective enforcement of these laws, fundamentally determine the rights of securities holders and the performance of financial systems.[20]

Nobel Laureate Douglass North was quoted as saying "the inability of societies to develop, effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World."[21] North contends that decisions made by individuals are contingent upon the information and institutions available to them and, hence, institutions are the rules of the game in a society.[22] Thus, these rules and norms governing economic interactions are the most significant drivers of the success or otherwise failure of an economy.[23] There are, however, skeptics, for instance, Avner Greif argues that, the legal system does not govern, directly or indirectly, many exchange relations in historical and contemporary market economies as well as in developing economies, and in fact in much of the world's economic development occurred absent of a legal system to govern

[19] Ross Levine, *et al.*, 'Financial Intermediation and Growth: Causality and Causes', *Journal of Monetary Economics*, Vol. 46 No. 1, (2000), p. 35.
[20] Thorsten Beck & Ross Levine, Legal Institutions and Financial Development', in Claude Ménard & Mary Shirley (eds.), Handbook of New Institutional Economics 251, (2005), p. 253.
[21] *See* Michael Trebilcock and Jing Leng, 'The Role of Formal Cotract Law and Enforcement in Economic Development'Vol. 92, No. 1, (2006), p.1520.
[22] *See* Amy Hilsman Kastely *et al:* Contracting Law, 3rd ed, Carolina Academic Press, 2005, pp. 20-29.
[23] Ibid.

private economic transactions.[24] Some writers reiterate that many economic activities that foster economic development do not need a means of formal third-party enforcement.[25] What is implicit in the latter's approach is that there is an obvious need for enforcement of contracts irrespective of the fact that they are pursued in a formal and institutionalized manner.

Following the institutional hypothesis, originated in the economic growth literature, institutional factors are incrementally considered as one of the fundamental causes of economic growth, whereas countries with low quality institutions are mostly characterized by lower investments and lower economic growth.[26] To this end, the World Bank has conducted an extensive study for a couple of years through its working team exclusively on 'enforcement of contracts' coordinates and verifies the responses through multiple interactions with the respondents in different countries, and the outcome indicated that time and cost of enforcing contracts are both significantly lower in high-income countries compared to low-income countries which provide empirical evidence on the relationship between countries' average income per capita and their efficiency in contract enforcement regulations.[27]

When procedures for enforcing commercial transactions are bureaucratic and cumbersome or, not swift and cost-effective, economies rely on less efficient commercial practices. Traders depend more heavily on personal and family contacts; banks reduce the amount of lending because they cannot be assured of the ability to collect on debts or obtain control of property pledged as collateral to secure loans; and transactions tend to only be conducted on cash basis.

Inefficient courts impose big costs, and a recent study conducted in Eastern Europe shows that in countries with slower courts, firms on average have less bank financing for new investment. Reforms in other areas, such as creditor's rights, help increase bank lending only if contracts

[24] *See* Avner Grief, Contracting, Enforcement, and Efficiency: Economics beyond the Law, in Michael Bruno and Boris Pleskovic (eds), Annual World Bank Conference on Development Economics 1996-1997, p.241.
[25] Lisa Bernstein, 'Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry', *J. Legal Study* Vol. 21, (1992), p.115.
[26] Knack, S. and P. Keefer, Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures, Economic and Politics 7, (1995), pp. 207-77.
[27] *See* Contract Enforcement–The World Bank's doing Business Project, p. 74, CES ifo DICE Report 1/2010, also available at:(http://www.doingbusiness.org/documents/fullreport/2010/DB10-full-report.pdf), accessed on 12 February 2011.

can be enforced before the courts.[28] Generally, the ability to enforce contracts and resolve disputes is fundamental if markets are to function properly. Good enforcement procedures enhance predictability in commercial relationships and reduce uncertainty by assuring the business community and investors that their contractual rights will be protected promptly.

C: Commercial Contract Enforcement Framework in Ethiopia:

[28] *See* Safavian and Sharma (2007), as cited in World Bank Doing Business Report 2009, p. 49.

The chart focuses on the Ethiopian Commercial Contract Enforcement Legal Framework and attempts to encapsulate four concentric circles- (a) International/Regional Trade Regimes and ADR Mechanisms, (b) National Courts and ADR Mechanisms, (c) Policy Framework/Regulation MoT & NBE, mandated to regulate and enforce the national and institutional aspects of trading activities, banking, insurance and undertaking consumer protection concerns, by being overarched and embraced by the Ethiopia's Private Law Regime, namely, Civil, Commercial, Maritime and Civil Procedure Codes. (d) National Legal Framework, incorporates, contract law: sales & construction; commercial law: banking and insurance The Maritime Code is incorporated in this chart merely to allude the actual present day domain of the private law.

D) Contract Enforcement and the Private Sector Development

Problems associated with the enforcement of written contracts usually began at the stage of drafting the terms of contracts. The terms, conditions and the scope and extent of obligations might not be clearly set and pose difficulties on effecting ones performance. For contracts, concluded orally there might arise a misunderstanding on the exchange of words and even it would be very difficult to prove what terms were employed in the contract.

Nevertheless, what makes contracts unique from other sorts of dealings is their enforceability, provided that the legal requirements are met. Of course, theoretical foundations of development rest upon the notion that individual acts as a rational economic agent. In other words, individuals need assurances that contractual promises will not be arbitrarily breached and that there will be recourse to hold the non-performing party liable.[29] In our day-to-day life, it is a well known fact that individuals require incentive to act.[30]

The state system of contract enforcement also needs to be reliable, legitimate and widely known. This presupposes that relevant legal provisions are widely known to the business community. The inaccessibility of laws and the perception that they are not legitimate militates against contract enforcement. In addition, laws should not be open ended and out dated. If laws

[29] Michael Trebilcock and Jing Leng, *supra note* 21, p. 1524.
[30] Ibid.

allow wider discretion to judges to revise, annul and amend laws, contract enforcement through the judiciary becomes less reliable. If the laws are out-dated, parties to the contract tend to avoid the judiciary for the enforcement of their contracts. Hence, they must be updated and must be reconsidered in light of current business patterns and practices. Laws related to adjudication, alternative dispute resolution mechanisms, civil procedure and other related aspects must be designed to reduce costs of enforcement. As it can be observed from the practices of other countries, particularly with regard to issues of commerce, it has become useful to establish commercial courts or divisions specialized in disposing disputes involving commercial contracts. For instance, the introduction of specialized commercial court in Guinea-Bissau along with trained judges and other support personnel helped it to enhance its commercial contract enforcement capacity.[31]

Non-state mechanisms comprises of the self-enforcement mechanisms which includes posting bonds and ending or risking a commercial relationship, prejudicing reputation, etc.[32] Such mechanisms are believed to block the other alternatives such as opportunism of parties to the contract, thereby, prompting them to perform their obligations duly. Mostly, as litigation is deemed to exceed the costs of its benefits, parties use 'non-legal sanctions'[33] rather than insisting on legally-enforceable rights and pursue through legal means.[34] In addition, studies have revealed that private parties largely transact without much attention to written laws or detailed contractual provisions, without which the parties are quite capable of conducting the majority of their business transactions outside the court system.[35]

There are also other non-state mechanisms usually referred to as the ADR means (both formal and informal or traditional mechanisms), a generic term used to describe a range of mechanisms designed to provide ways to resolving disputes, alternatively to court

[31] *See* World Bank, Doing Business 2011, p. 71.
[32] *See generally*, James Andreoni, Trust, Reciprocity, and Contract Enforcement: Experiments on Satisfaction Guaranteed, University of Wisconsin, (2005); and Satu Kähkönen and Patrick Meagher: Contract Enforcement and Economic Performance, (1997) available at http://pdf.usaid.gov/pdf_docs/_PNACE021.pdf accessed on September 27, 2010.
[33] David Charny, 'Non-Legal Sanctions in Commercial Relationships', p. 373. He defines Non-Legal Sanctions as 'commitments that are not legally enforceable as formal contracts.'
[34] *See also*, Marc Galanter and Joel Rogers, A Transformation of American Business Disputing? Some Preliminary Observations; Working Paper Dispute Processing Research Program (DPRP) No.10-3 University of Wisconsin, 1990.
[35] Stewart Mac Aulay, 'Non-Contractual Relations in Business', 28 *American Sociological Review*, (1963), p. 55.

procedures.[36] The resolution of disputes through ADR is primarily initiated by the good will and consent of the parties to the dispute although sometimes, courts or other quasi-judicial or even executive bodies could play a role in referring the settlement of disputes through ADR. They play crucial roles in enforcement of contractual claims. These mechanisms have been described as useful for the reason that they help parties to control their cases and keep their reputation. The use of formal international ADR forums has been introduced to deal with the potential enforcement issues including the recognition and execution of foreign decisions. This has been the best solution available to deal with disagreements on contracts involving foreign elements.[37]

The fact that enforcements of contracts have far reaching implications especially in economic terms has been a well established one. Recent research shows that a country's ability to enforce contract is important determinant of its comparative advantage in the global economy among comparable economies those with good contract enforcement tend to produce and export more customized products than those with poor contract enforcement.[38] This is so because, having a swift, predictable, low-cost and impartial mechanism for the enforcement of contracts helps to attract investors, ensure enhanced transactions and trade, saves the time and money of those involved in the process, etc. Economic development also influences the enforcement of contracts. For instance, such a process can take, on average, less than a year in Norway or South Korea, both among top ten on the case of enforcing contracts, while it requires more than four years in Bangladesh or Angola.[39] However, the Report on the Implementation of Federal Courts for 1997-2001 E.C., and plan for 2003-2007 E.C., Supreme Court, have indicated that the duration taken to dispose a particular case in the Federal Courts has been reduced. The this end, the data provides that the Federal First Instance Court takes 1.76 year;

[36] Alternative Dispute Resolution (ADR) was introduced in the 1980s for the resolution of commercial disputes. *See* www.venables.co.uk/adr accessed on 16 July, 2010.

[37] See *supra note* 3, Julian Lew and *et al*, here, reference is made to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Award, p. 697ff.

[38] *See* World Bank, Doing Business 2010, Co-publication of Pagrave Macmillan, IFC and the World Bank, 2009, p. 55.

[39] Ibid.

the Federal High Court takes 3.03 years; and the Federal Supreme Courts takes 1.5 year[40]. In addition, delay in the justice system has been described as a basic problem of the judiciary.

Today, ensuring effective enforcement of commercial contracts has been considered as a pivotal tool to attain the required level of economic development and this should be met with enabling contract laws and policies, and institutions. Otherwise, both local and international commercial endeavors would bring about little developmental outcomes. Accordingly, the business community and actors of a country should be given clear policy and legal framework that would help them conduct their transitions effectively, and also make sure that the system stride into the internationally recognized standards of enforcement mechanisms.

2: The Major Contractual Transactions in Ethiopia

2.1 Sales Contracts

It is a common knowledge that sales contracts form the basis of the commercial transactions in most parts of the world. In a simple commercial sense, sales can be described as exchange of things for money. The sales contract primarily involves a buyer and a seller, both at a domestic and international forum. In this transaction, the title over goods/commodities is expected to pass to the new master upon delivery and the seller obtains money in the form of consideration. Such contracts are very common in import-export scheme which play a pivotal role in accruing a foreign exchange reserve for countries. Ethiopia cannot be an exception to this reality and, it has now devised strategies towards revamping its economy with emphasis on export to amass an immense income from international trade. The subject matter of the sales transaction could be a movable or an immovable property.

Micro and Small Enterprises are currently flourishing in Ethiopia. MSMEs become active in the commercial sphere and significantly are involved in the sales of goods and services. They have been complaining that there are inadequate markets available for their products despite the fact that there have been considerable supports given to them from government and NGOs

[40] See the Federal Supreme Court Report and Memberetsehai Tadesse, *The Feature of Ethiopian Law and Justice* (Amharic Version), Addis Ababa, 2007. The study at hand, regarding commercial contract cases disposition time frame, 52.4% of the respondents preferred by suggesting a maximum of 30 days be allotted for settling commercial disputes.

alike and laws are enacted in lieu of their favor.[41] Besides, when they conclude contracts, they simply give due consideration for the amount of money involved and the potential profit they can make rather than taking consideration of the legal consequences of their acts. And, at times, they face enforcement problems due to various reasons.

In the Ethiopian context, regarding contract of sales, distinct from physical marketing costs, are costs related to conducting or coordinating market, transaction between actors, such as the costs of searching/screening of a trading partner, the cost of obtaining information on prices, qualities and quantities of goods, the cost of negotiating contract, the cost of monitoring contract performance and the costs of enforcing contracts.[42]

2.2Banking

Banks are business organizations that are involved in providing different financial facilities such as credit facilities and deposit/saving activities. In Ethiopia, this business can be conducted either under the government ownership or can be privately owned by Ethiopians.[43] The regulatory organ of the banking sector in Ethiopia is the National Bank of Ethiopia, which undertakes the regulatory service through the licensing and operational oversight on the banking activities with the objective of maintaining banking security and the management of the monetary system.[44]

The banking services in Ethiopia are considered still low by international and regional comparisons.[45] The services rendered by the banks are focusing on short-term loans. A major

[41] *See for instance*, Regulation No. 8/ 2009, A Regulation to Provide for Market Opportunity Promotion of Micro and Small Enterprise of Addis Ababa City Government. *See also* Negarit Gazeta Proclamation No. 626.2009, Micro Finance Business Proclamation, Art. 16

[42] See Elleni Z. Gebre-Medhen and *et al*., "Does Ethiopia Need a Commodity Exchange?: An Integrated Approach to Market Development", November 2005, p. 3.

[43] *See* Banking Business Proclamation No. 591 & 592/2008, which requires that only Ethiopian nationals can invest in banks in Ethiopia. *See also*, Art. 513 of the Commercial Code under which private limited companies are clearly excluded from conducting such business.

[44] *See* the Licensing and Supervision of Insurance Business Proclamation No 86/1994. In an interview with Ato. Solomon Desta , NBE Banking Supervision Directorate Director, and W/ro Kibre Moges, NBE Legal Division Directorate Director, it has been revealed that the NBE has been conducting a prudential supervision and compliance mechanisms by issuing number of directives.

[45] Ministry of Trade and Industry, 'The Impact of WTO Accession on the Financial Services Sector of Ethiopia', Final Report, Addis Ababa, (30 April 2007), p. XII. (Here in after, MoTI-2007); *see also*, Gebrehiwot Ageba and Derk Bienen, 'Ethiopia's Accession to the WTO and the Financial Service Sector', Ethiopian Business Low Series, Faculty of Law, Vol. 2, 2008, p. 10.

feature of the Ethiopian banking sector is accumulation of large excess liquidity among banks.[46] From the credit policy of the banks, it is noted that a loan can only be granted subject to adequate collaterals. Also, they mainly concentrate on helping big business by granting only a limited sum. This prevailing situation is likely to impede the development of the upcoming micro, small and medium sized organizations. The creation of an enabling environment for Ethiopian firms to borrow capital represents a critical step in raising the status of the private sector particularly micro, small and medium enterprises to ensure their transformation from a small, static player to a large and more dynamic competitor. This has also been recommended by a previous study which aims to bring a concrete substantive structure to a long-term agenda for legal, institutional and trade related reforms that set a welcoming stage for entrepreneurship, investment, trade and development in Ethiopia.[47]

Moreover, the Banking gives recognitions in particular to the following negotiable instruments: Bill of Exchanges, Promissory Notes, Cheques, Traveler Cheques, Warehouse Goods Deposit Certificates, Shares, Treasury Bills, Government Bonds and other transferable securities.

The legal framework governing banking sector and transaction has been under immense pressure due to the increased international interactions with foreign financial institutions and the tendency of adopting foreign banking practices. Internet banking, automatic telling machines, telebanking, etc. are such instances. Moreover, to deal with such challenges and observed perplexities, it is imperative to introduce appropriate legal frameworks that are capable of protecting the interest of those involved so that banks have to stand abreast with the latest technological development and business exigencies at both local and international levels.

2.3 Insurance

The insurance sector is another important factor in the financial industry besides the banking and microfinance institutions. Insurance in the realm of commercial contract plays a very important role in terms of supporting economic development. Given its dual role as an infrastructural and commercial service, the sector directly or indirectly affects activities of

[46] Ibid.
[47] See Booz Allen Hamilton, Ethiopia: Commercial Law & Institutional Reform and Trade Diagnostic, USAID, January 2007, p. 41-46

individual entrepreneurs and businesses entities. A well-functioning insurance sector enables efficient allocation of a country's capital and channels national resources to investments.

Insurance arrangements serve the purpose of risk distribution and professional risk management. Once a business person has bought an insurance coverage, it is possible for him/her to undertake business activities with confidence irrespective of the fact that various risks might occur in due course. On the other hand, insurance companies can be used as a vehicle for investment. Thus, from domestic and international contributions of insurance, it can be noted that insurance promotes financial stability, supports trade, commerce and entrepreneurial activities and improves individuals' quality of life and increase social stability.[48] An effective domestic regulatory framework tailored to national policy objectives can contribute to realizing development gains.[49]

In terms of the significance of insurance to the economic development, various studies indicate the existence of a strong correlation between the development of financial intermediaries and economic growth. The first relationship is that the financial sector has a supply-leading relationship with growth and the second is a demand-following relationship where the demand for financial services can induce growth of financial institutions and their assets.[50]

Concerning the insurance policy, whether the currently employed system has legal validity as 'a contract' and the fact that the policy is prepared in the English language which might not be understandable by the parties also caused some problems even from the very beginning of the formation of insurance contract. To cap it all, the contract of insurance should be separated from the formalities stipulated in the Civil Code Art. 1725(b). The Commercial Code should be designed to accommodate the dynamic mature of insurance contract.

[48] UNCTAD, "Trade and Development Aspects of Insurance Services and Regulatory Framework", note by the UNCTAD Secretary, UNCTAD/DITC/TNCD/2005/, United Nations, N.Y. and Geneva, 2005, p. 3.
[49] Ibid, p.1.
[50] Patrick, "Financial Development and Economic Growth in Underdeveloped Countries", Economic Development and Cultural Change, Vol.14, No.2. 1966, pp. 174-189.

2.4 Construction Contracts

The construction industry has important contributions to the Ethiopian economy, as demonstrated by its share in the GDP. For instance, the share of the sector in the total GDP averaged at about 6.2% in the period 2002/03-2006/07. Empirical researches support the strong linkages between the construction industry and other economic sectors. Scholars, who have made an in-depth research on the construction industry, have confirmed that the construction industry generates one of the highest multiplier effects through its extensive backward and forward linkages with other sectors of the economy.[51]

Currently, it is noted that the government has taken certain measures which encourage local contractors in adjusting the requirements, particularly in road construction. The effort has helped increase the number of contractors in the road construction sector. Hence, they now cover 50% of that task. The plan for the coming 5 years hints that it would cover 70% of the work. Besides, it is estimated that there are about 100 first grade level contractors on road construction out of which only 20 construction firms are presently working on different projects. The government endeavors to draw more of them by allocating further budget for road and building constructions, inevitably motivates entrepreneurs in the area and crates work opportunity at Federal and Regional States levels.

A variety of factors make a construction contract different from most other types of contracts. These include the length of the project, its complexity, its size and the fact that the price agreed may change as it proceeds.[52] Moreover, construction of a building is a complex enterprise that requires the coordinated effort of a temporarily assembled multiple-member organization of many discrete groups. Thus, each enterprise is deemed of having different goals and needs, each expecting to maximize its own benefits. As a result, disputes in the construction contract are common as in other business sectors.[53] They arise from the interpretation or application of ambiguous rules, unplanned and conflicting building or engineering contract documents at any

[51] See Ethiopian Economic Association, Report on the Ethiopian Economy, Vol VI, 2006/07, Addis Ababa, 2008, pp. 237-238.
[52] John Adriaanse, *Construction Contract Law: The Essentials*, Palgrave, Macmillan, Norfolk, (2005), p. 1.
[53] Zewdu Shiferaw *et al*., 'Amicable and Judgmental/ADR/ Methods in Public Building Construction Projects', *Ethiopian Association of Civil Engineers Bulletin* Vol. 7, No. 4, 2008, pp. 13-14.

time during the execution of the contract.[54] Nevertheless, it is not unusual to have disputes of different nature during and after the *performance* of the contract in which the contractor and the employer disagree on many contractual issues.[55]

2.5. International Aspect

In our contemporary world, among the laws that govern International Dispute Resolution, the one that holds the primary position is the "New York Convention", set up by the UN in 1958 (G.C.) and authorized as the "Convention on the Recognition and Enforcement of Foreign Arbitral Awards". The main objective of the convention is to enable the enforcement of a verdict given by a state to be implemented in any other member state in as much as it is enforceable in all places within the state.[56] Many intellectuals agree that resolutions reached by International Dispute Resolution forums are currently more readily acceptable in member states than judgments handed down by regular courts.[57] More than 142 countries are signatories to the convention and, among them; we find those who play the leading role in global business.[58]

Upon realizing the warm acceptance of the Convention, The UN has promulgated two laws consecutively which the signatories duly recognize and enforce. *UNCITRAL* has developed two legal regimes regarding dispute resolutions. These are the 1976 (G.C) *UNCITRAL* Rules of Arbitration and the 1985 *UNCITRAL* Model Law on International Commerce Arbitration. As one may understand from the wording, the latter rule is not directly instrumental but envisaged to be the framework which each member country ought to adopt when promulgating or improving its laws. It is based upon a world-wide study which looked into the ADR

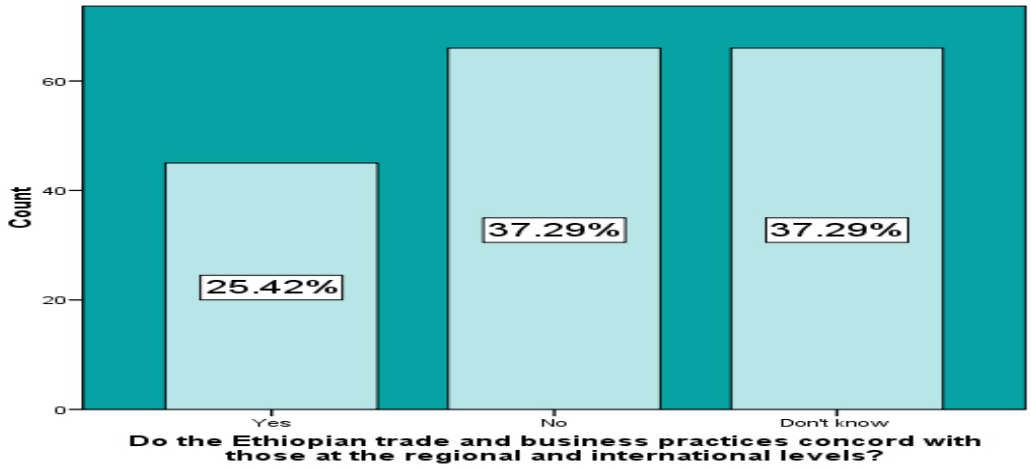
[54] Ibid.
[55] Tadesse Yemane, 'Claims and Settlement of Disputes: A Comparison between FIDIC and the Ethiopian Standard Conditions of Contract', *Ethiopian Association of Civil Engineers Bulletin* Vol. 6, No. 2, (2005), p. 18.
[56] *See* Art.I & III of the New York Convention of 1958.
[57] It should be born in mind, the New York Convention has ushered in a global enforcement and "arbitral awards are relatively easy to enforce-much easier world-wide than judgments of national courts." *See* Andreas F. Lowefieed, *A Premier on International Arbitration*, p.2, As extracted from the EACC's Report of Arbitral Awards, Vol. 2, pp. X-XI. See also EACC's Collection: 'The ADR Process: Selected Materials.' as cited in the EACC-2010 collection. *See further,* Stephan J. Wore, Alternative Dispute Resolution, West Group, St.Pawl, Ninn, (2001), p.100.
[58] *See* list and copy of the Convention, Balak Barin, Carswell's Handbook of International Dispute Resolution Rules. Thomson Canda Lizuated (1999) pp.611-618.

mechanisms of various countries so as to give it uniformity.[59] This has a particular benefit for developing countries. First, it enhances confidence of the business community in any member country. Secondly, in earlier days, contracts that Western commercial institution made with their compatriots in developing countries used to look up to places like London, Paris, New York and Switzerland for settlements upon breaches of contract for the reason that underdeveloped or developing countries lacked effective laws.[60] Recognition of this rule not only avoids that notion but also enables developing countries to take up cases in their own states.[61]

The development challenges of LDCs are enormous: while the multilateral trading system provides flexibilities, identifying such trade activates and making use of them for developmental objectives is a challenge for countries like Ethiopia.[62]

Regarding the status of Ethiopian business practice, in light of regional and international levels, 25.42% seems to agree that it is consistent, 37.29% consider it inconsistent while the remaining 37.29% are not certain to take a stand. (See Figure 1)

Figure 1



[59] *See supra note* 3, for further elaboration on the UNCITRAL Secretariat on the Model Law. *See also*, Karl-Heinz Bockstaigel's *Introduction to the Model Law* in Balak Barin, *ibid*, pp.512-514.

[60] *See*, Micheal Kerr, *International Commercial Arbitration World-Wide: Arbitration in Africa*, Engene Cortan and Austin Amussah, eds, (2006) p.18.

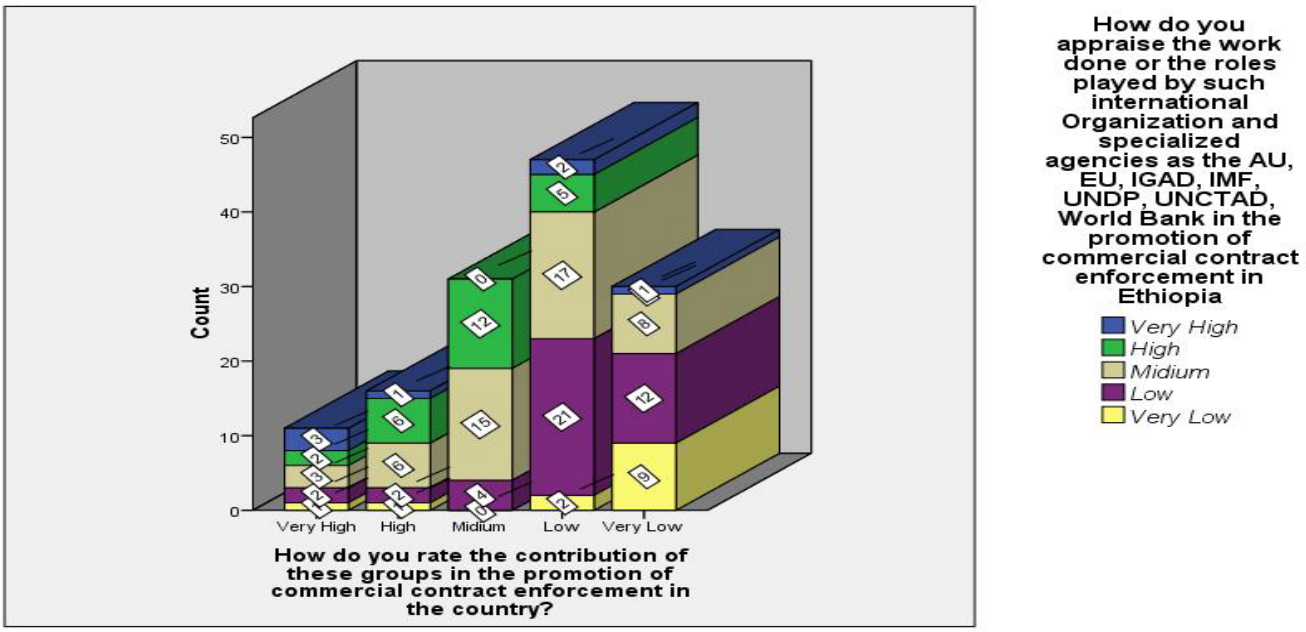
[61] Ibid.

[62] Fikremarkos Merso, Accession of Ethiopia to the WTO: Mapping out Possible Challenges; A Presentation at the Conference on Law and Economic Development in Ethiopia, Sheraton Addis, 13 November 2008, p.3.

On the importance of Ethiopia's accession to WTO, the great majority agree that such a move could help for efficient disposal of commercial disputes and to facilitate for the flow of foreign direct investment to Ethiopia.

The significance of international regional organizations such as UNCTAD, USAID, and WB in terms of promoting commercial contracts enforcement in Ethiopia is rated by 5.2% of the respondents very high, 18.5% as high, 36.3% as medium, 30.4% low, and 9.6% as low.(See Figure 2)

Figure 2

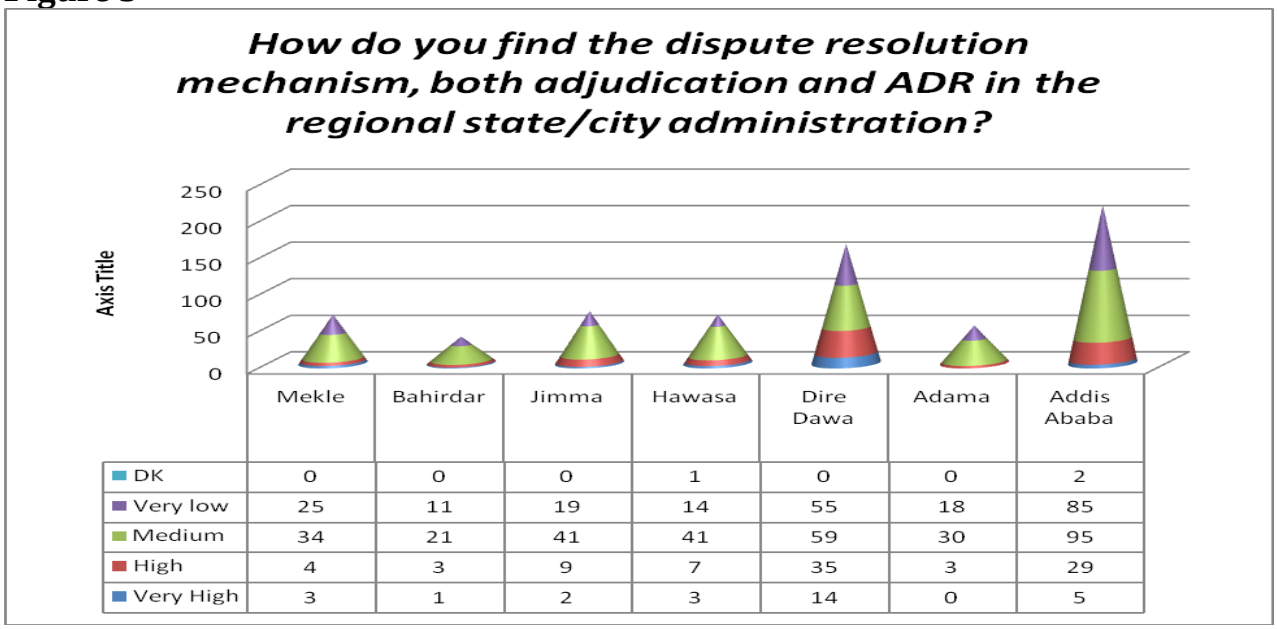


3: Findings of the Empirical Study

3.1 Court System and Legal Framework

In this Study, both adjudication and ADR in the Regional State/City Administration to resolve dispute are found to be in the medium and very low range (See Figure 3 with tabular representation)**.**

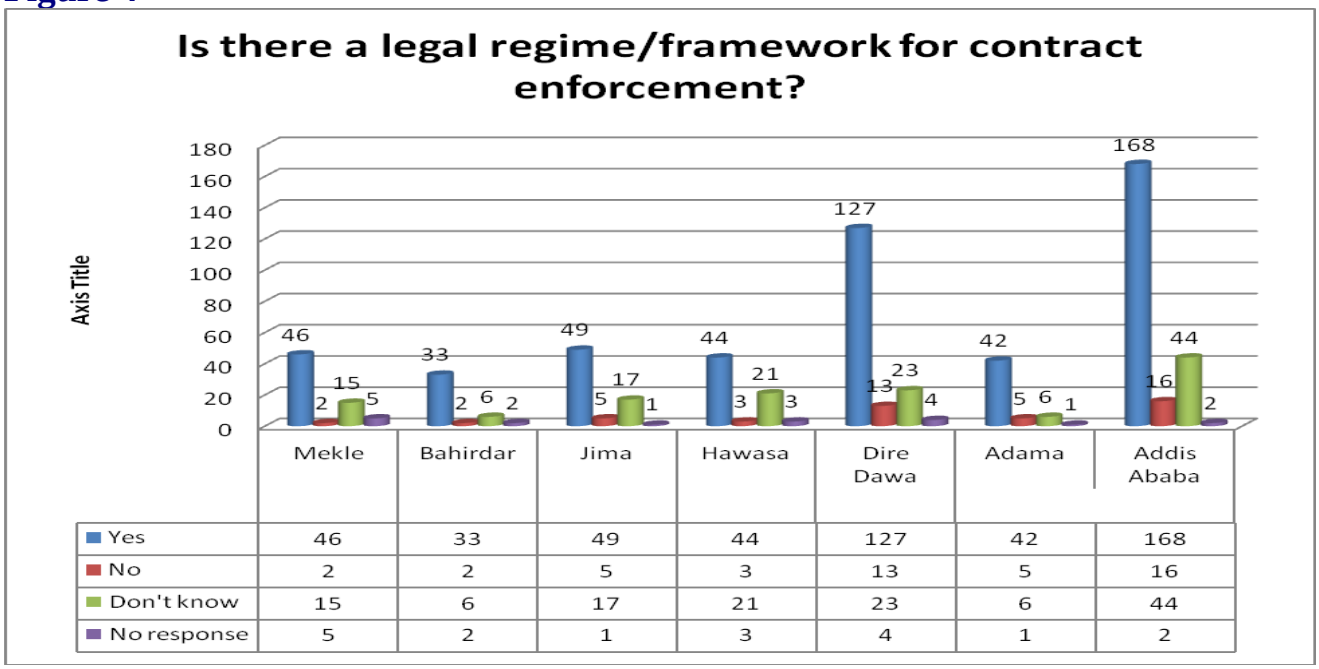
Figure 3



The responses indicate the various costs incurred to get the enforcement of commercial contracts through the judicial process.

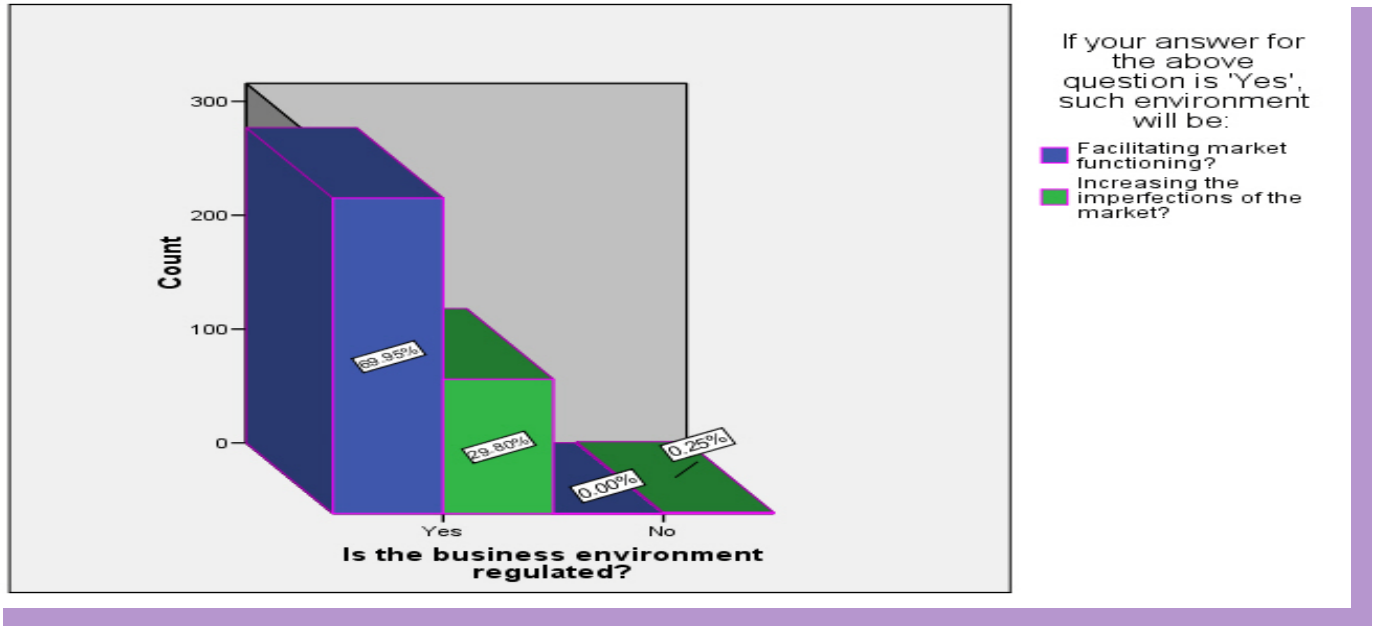
Based on our Study, awareness of ADR forums among the population is a requirement for successful working of contract enforcement. Most of the respondents i.e., 72% know the existence of legal framework in the area they reside. However, the degree of awareness is variable from place to place (Figure 4 with the help of tabular representation). For example, people in the major cities like that of Addis Ababa and Dire Dawa seem to have a better degree of awareness of the availability of the legal regime for contract enforcement than business people in other places. Respondents in Adama and Bair Dar come next to Dire Dawa and Addis Ababa in that order. According to the survey, Mekele and Jimma are towns where there is the least awareness, i.e., the percentage falls below the overall average of 72%.

Figure 4



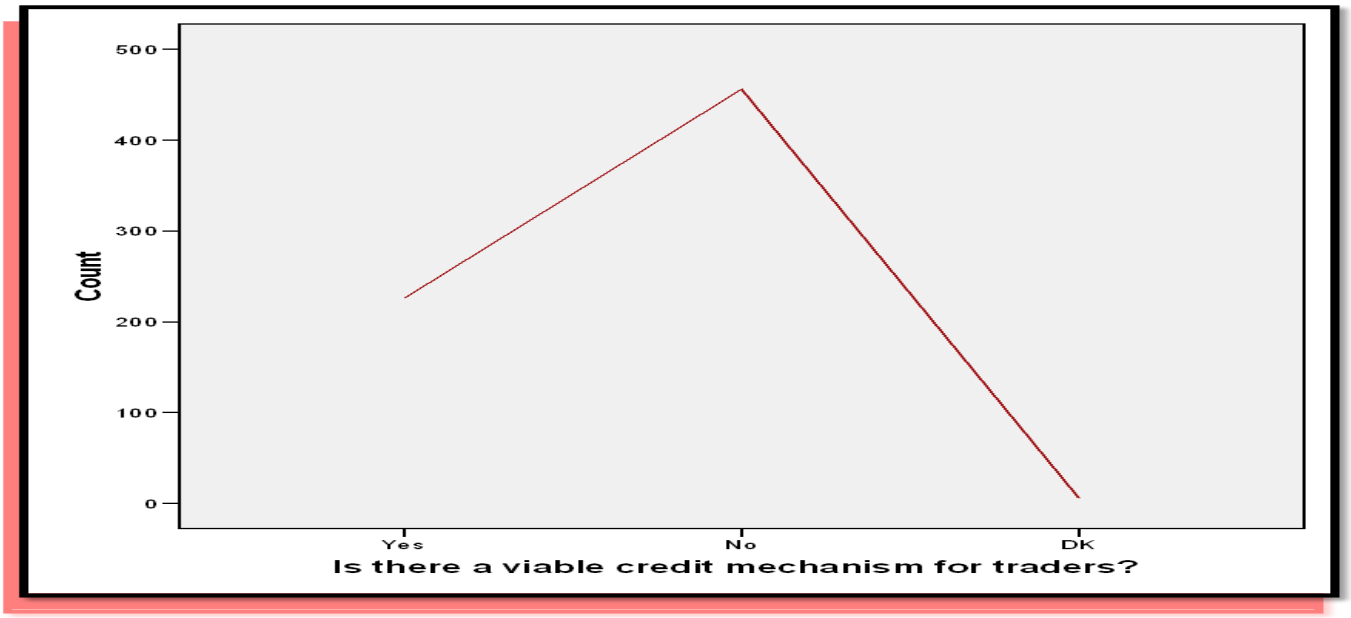
Most of the respondent believed that the business environment is regulated. From these respondents 69.95% of them stated that the regulation is facilitating market functioning. However, the remaining 30.05% of the respondent replied that it exacerbate the imperfection of the market. *(See Figures 5*)

Figure 5



Concerning the availability of a viable credit mechanism for traders most of the respondent answered that there is no as such a credit facility for traders from banking and micro-finance institutions. (*See Figure 6*)

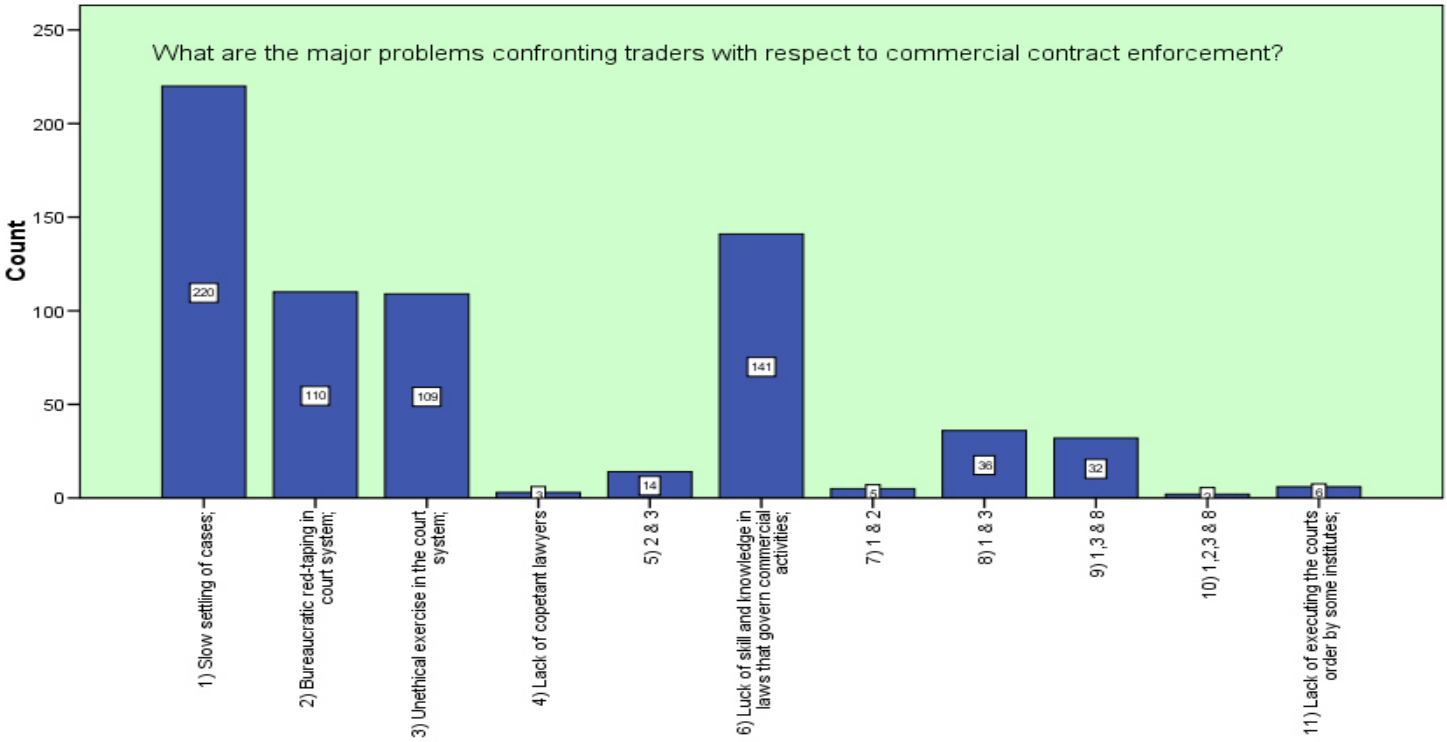
Figure 6



3.2 Enforcement of Commercial Laws

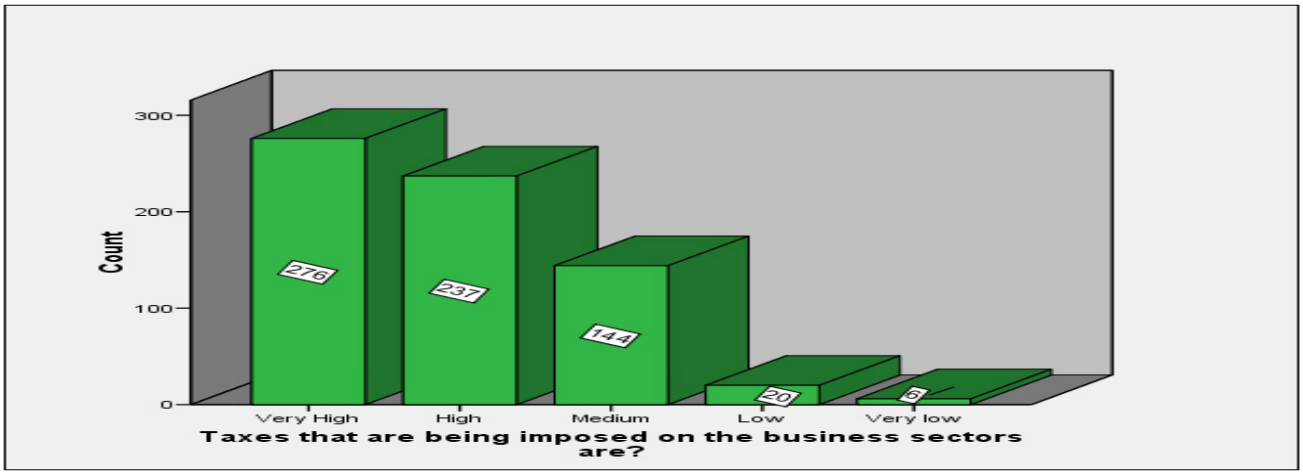
The four major problems confronting traders with respect to commercial contract enforcement, in the order of their significance are listed as follows: slow settlement of cases; lack of skill and knowledge in laws that govern commercial activities; red-tape in the court system; and unethical exercises in the court system. Other problems include: lack of competent lawyers and lack of pertinent institutes for executing the court's order. *(See Figure 7)*

Figure 7



This is one of the sources of inefficiency in market trends. For example, taxes that are imposed on the business sector are generally felt to be on the high and very high side. *(Figure 8)*

Figure 8



Part Four: Conclusion and Recommendation

4.1Conclusion

It is clear that commercial contracts made between parties have to be honored and enforced in timely, effective and efficient manner, to ensure predictability in commercial relationship and proper functioning of market-oriented economy.

Thus, a sound judiciary system is very essential to enforce commercial contracts for the attainment of economic development and protection of private properties. Moreover, sales, banking, insurance and construction sectors contractual transactions in our contemporary world play a vital role in the development of the national economy.

The empirical findings have disclosed that court system and dispute resolution mechanisms, in enforcing commercial contracts in Ethiopia, are time consuming, costly and lack skilled manpower. There are numerous factors which have resulted in this low achievement and they are attributed to policy related problems, defects in the existing legal rules, the capacity of the enforcing institutions and the business communities' behavior and lack of legal knowledge.

4.2. Recommendation

As a result, by way of soliciting remedy for this complex problem, the following recommendations are forwarded:

- Establishing specialized commercial courts for expeditiously rendering decisions on intricate and complex commercial disputes is of paramount importance;
- Small claims court should be introduced by law and strengthened so that they share the burden of regular courts;
- Court-annexed ADR forums, such as multi-door courts houses and full-fledged ADR tribunals should be established in significant numbers both at Federal and Regional State levels;
- Electronic-litigation system and legal frameworks should be enacted and encouraged since this mechanism would enable the business community to run businesses without interruption;

• Regarding contract of sale, effort should be made in designing a sample contract forms for movable and immovable properties;

• MSMEs lack a suitable workplace for trading or services, therefore, special care and preferential treatment should be given to them to secure such places;

• MSMEs by far are devoid of access to credit facilities, as result, access to finance for micro, small and medium enterprises must be encouraged without any collateral or suretyship, as a motivating force for their livelihood and national economic development strategy at a grassroots levels;

• MSM enterprises tax exemption has to be introduced by law, until their development is assured;

• MSMEs have to be motivated to get machineries on lease, raw materials and various in puts on credit for the smooth operation of their trade and services;

• MSMEs periodically have to be trained and educated to manage their finances, accounts, by way of enhancing their marketing, purchasing and technology know-how skills;

• In insurance contract, the practice and its theoretical foundation are different and contradictory. The insurance contract should stand on its on feet and should be separated from the Civil Code, i.e., Art. 1725(b). This will enable the (Draft) Commercial Code to be enacted autonomously. Besides, for prospective insurance holders an Amharic version of insurance contract should be forwarded along side the English version;

• In contractual relation of insurance there must be good will as a core factor of business understanding. The existing interpretation of insurance leaves a gap in law that has to be linked for uniform application of the commercial contract enforcement;

• Set-up a system-wide body which directs and regulates the construction industry as a whole;

• Amend existing laws or introduce new organs that regulate the sector on periodic basis;

• Set-up desirable ADR mechanisms to settle disputes that arise between parties in the construction sector in a timely manner.

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