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Resurrecting the Tenets of Rule of Law in the Classical Gadaa Democracy in the Ethiopian Federation[#]

Solomon Emiru Gutema[*]

Abstract

The objective of this Article is to evaluate whether or not the tenets of rule law in classical Gadaa democracy can be utilized in the present Ethiopian multinational federation. Across the world, rule of law has been recognized as a symbol of good governance; and the antithesis of arbitrary rule in modern democracies. Many constitutions in the present world incorporate the elements of rule of law either directly or indirectly in their contents. The 1995 FDRE Constitution has recognized rule of law as a stepping-stone to building a political community to ensure lasting peace, guaranteeing a democratic order, and advancing economic and social development. Nevertheless, the elements of rule of law have transplanted from the western democracies in Ethiopia in particular and in Africa in general. But this Article has put its emphasis on exploring the compatibilities of the tenets of rule of law in the classical Gadaa democracy with the modern principles of rule of law and constitutionalism. Additionally, it has analyzed the extent to which the Gadaa brand of rule of law is consistent with the present multinational federal-based state structure in Ethiopia and beyond. The findings of this Article have pointed out that the principles of rule of law embedded in the classical Gadaa democracy are compatible with the modern principles of rule of law.

Keywords: Constitutionalism, Federalism, Gadaa, Rule of Law

[#] *A shorter version of this Paper entitled "Resurrecting the Tenets of Rule of Law in Classical Gadaa Democracy as a Remedy for the Fragile Ethiopian Multinational Federalism and Beyond" had been presented at the 35TH OSA MID-YEAR INTERNATIONAL RESEARCH CONFERENCE, ON ZOOM WEBINAR, August 7-8,2021 and has benefited from the colloquy thereof. I am grateful to those who, in the conference, commented on the earlier draft; and the current anonymous reviewers.*

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1. Introduction

> In Gadaa system, the law is more valuable than one's own child; accordingly, the Oromo people are committed enough to sacrifice their own children for the observance of rule of law.[1]

The term rule of law is a common legal and political value to give legitimation a certain government in the modern globalized world. Thus, the doctrine of rule of law is not defined within a single statement; since it contains both legal and political elements. For instance, the definition given for the rule of law may depend on political ideologies, legal and political customs, level of development; and geographical location/geopolitics. Hence, scholars may define the term rule of law based on various criteria like ideologies, capitalism versus socialism; the Western and Eastern World legal customs; North-South scenario categories; or the level of development; that means, developed and developing world. Therefore, every person who defines the term rule of law has defined it as per their partisan interest.

Nevertheless, a consensus is reached to comprehend the idea of rule of law in the contemporary world. Accordingly, rule of law is related to the notion of limited government; though, the nature of limitations on the government varies with the society, culture, political and economic arrangements; the need for limitations on the government shall never be obsolete, where and when rule of law is respected.[2]Additionally, rule of law is recognized worldwide as an essential component and precondition of good governance and sustainable development in modern jurisprudence.[3]

Thus, rule of law refers to a principle of governance in which 'all persons, institutions (both public and private) and the government itself are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards.[4]It requires measures that ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness, and procedural and legal transparency.[5]

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[1] Dirribi Demissie Bokku, Oromo Wisdom in Black Civilization, (Finfine Printing & Publishing S.C., April 2011, Ethiopia):278.

[2] Brian Z. Tamanaha, On the Rule of Law: History, Politics and Theory (Cambridge: Cambridge University Press, 2004): 101.

[3] Adriaan Bedner, An elementary Approach to the Rule of Law, Hague Journal on the Rule of Law, 2 (2010):48.

[4] Report of the Secretary-General on the rule of law and transitional justice in conflict and post-conflict societies (S/2004/616), para. 6.

[5] Ibid.

Tamaha puts it concisely that the notion of rule of law is just one aspect of a larger socio-political complex and what matter is not one piece on its own but how it all comes together.[6]Thus, the implications that can be derived from these values of rule of law include the notion of limited and constitutional government; the principle of legality; and the avoidance of arbitrary administration.[7] Generally, in the present civilized world, the notion of rule of law manifests itself in the perspectives of the legal context, democratic governance, and human rights. In a legal context, the doctrine of rule of law comprises various principles, like, the principle of equality before the law, avoidance of arbitrary laws, the generality of laws, predictability of laws, the non-retrospective effect of laws, rationality of law, and others. Rule of law may reveal itself in the principles of a democratic governance system in several manners. For instance, universal and periodic elections, limitations on political powers and the term of political office, and accountability and transparency of government officials. Furthermore, the principles of rule of law also manifest themselves in human rights perspectives. Accordingly, prohibitions against inhuman treatment, the right to life, the right to privacy, the right to liberty, the right of accused persons, and the like are related to the principles of rule of law.

However, the purpose of this Article is to assess the extent to which the Classical Gadaa Democracy is compatible with the modern principle of rule of law. It clarifies the modern principles of rule of law to compare them with the Gadaa-based principles of rule of law. Additionally, it has the objective to analyze the extent to which the Classical Gadaa brand of rule of law is consistent with the present multinational federal-oriented state structure in Ethiopia. Several research findings have pointed out that Gadaa governance accommodates the principles of modern democracy in its traditional platforms.[8] But, specifically, this Article puts its emphasis on the notion of rule of law in Gadaa governance system; the power of their leaders (Abbaa Gadaas)[9]; they had the culture of practicing accountability and transparency of the government

[6] Brian Z. Tamanaha, The History and Elements of The Rule of Law, Singapore Journal of Legal Studies [2012] 232–247:236.

[7] Ibid.

[8] See, Asmarom Legesse, Oromo Democracy: An Indigenous African Political System, (Trenton, NJ: Red Sea Press, paperback. ISBN 1-56902-139-2, 2006). Asafa Jalata (2012)**,** Gadaa (Oromo Democracy): An Example of Classical African Civilization **(***The Journal of Pan African Studies*, Vol.5, No.1, March 2012, **University** of Tennessee, Knoxville; From the Selected Works of Asafa Jalata). Dirribi Demissie Bokku, Oromo Wisdom in Black Civilization, Finfine Printing & Publishing S.C., April 2011, Ethiopia; and others.

[9] The single term office principle under the Gadaa leadership reveals an incredible value of democracy and rule of law; accordingly, the single term office in Gadaa Governance is eight years only; without the practice of re-election.

officials[10]; and they had the culture of legislating laws legitimately.[11] From various literature and research conducted on Gadaa system; well-known scholars like Asmerom Legese, Asafa Jalata, Mohammed Hassan, Diribi Demise, and others pointed out that Gadaa system consists of a well-crafted and nurtured traditional system of governance that protects human rights and ensures democratic governance in oral/unwritten forms.

Gadaa system had recognized the principles of human rights; far before the invention of all these concepts of human rights and democratic administrations and earlier than their incorporation in the famous International Human Rights Declarations and Covenants. For instance, in the 16th century, when human beings were hunted, made a slave, and sold like property, the Oromo people had been committed to the protection of human rights.[12]Gadaa laws protect females, children, and refugees, and ensure equal protection and equal subjection of laws, adoption, accountability, and transparency of the highest authorities.[13]Unfortunately, these golden principles of rule of law embedded in the classical Gadaa governance system were neither utilized as a source nor accommodated in the contents of both the regional and federal constitutions of present-day Ethiopia. For this reason, the critical problem we have had in Ethiopia is that the government fails to implement the transplanted elements of rule of law and other con-

[10] In Gadaa governace, the Oromo had the culture of "*Buqqisuu*" or literally uprooting, which means, impeachment in case the leaders/Abba Gadaas abusive their power during in their office term. Hence, there is both political and legal accountability in Gadaa Democracrcy. Under Gadaa system, the General Assembly serves this purpose (assessing the performance of leaders in the first-half of the term office); it may endorse the presidents' continuation or uproot a leader before completion of his term.

[11] In all types of Basic Law-Making Process, legislation will become a law only if it declared and accepted by people at large in Gadaa System. According to the Gadaa making of law procedures, anybody can oppose the draft law by saying "*damman qabe; kormaan qabe;fardaan qabe; tuni, tuni sirrii miti*"; which means, this law is not correct. In this opposing the declared law, no one would be silenced; but they are expected to talk based on the seniority of age.

[12]Makoo Bilii Laws of 1580, (Article 13, 41, 55) deemed enacted in 16th Century. In the history of the Oromo people; there were great law makers. Accordingly, it is said that the Gadaa Laws, of Boorana people were made by Gadaa under the leadership of *Gadawoo Galgalo*; the Gadaa Laws of Tuulama were made by the Gadaa under the leadership of *Cangaree koorbo*; and the Gadaa under the leadership of *Makoo Bilii* made the Gadaa laws of Maccaa. Hence, according to many scholars and Oromo oral traditions; *Makoo Bilii* was a traditional Great Law Maker in Macca Oromo. Some scholars also considered Makoo Bilii as Abba Gadaa, Abbaa Seeraa or Abba Duulaa. While others elders and scholars believed *Makoo Bilii* as a Great Prophet in Macca Oromo. Accordingly, Makko Bilii was declared oral laws which contains more than sixty-four (64) Law Articles; for instance, on the area of human rights, family protection, Relationship with other People living around the Oromo, the right to seek asylum, safety and health related laws, criminal punishment and others. Now days, the laws of Makoo Bilii are converted into written forms and available in various literatures and documents. For example, refer the following sources. See Dirribi Demissie Bokku, Oromo Wisdom in Black Civilization, (Finfine Printing & Publishing S.C., April 2011, Ethiopia)):278; Alessandro Triulzi, The Saga of Makkoo Bilii: a Theme in Mac'a Oromoo History, Paideuma: Mitteilungen zur Kulturkunde, Bd. 36, Afrika-Studien II (1990): 319-327; Published by: Frobenius Institute.

[13] Ibid.

stitutional principles continuously. Hence, Ethiopia has neither implemented the imported principles of rule of law nor utilized its traditions to nurture the principles of rule of law in the context of Ethiopian traditional governance systems, like the classical Gadaa democracy.

Therefore, this Article has examined the reasons why the drafters of Ethiopia's constitution had opted for transplanting the elements of rule of law, almost, all in all from the western democracies during the constitutional-making process. Moreover, it has evaluated why the already transplanted principles of rule of law have failed to ensure lasting peace and guarantee a democratic order in the present Ethiopian federation satisfactorily. Eventually, given, the value of laws and lawmakers in Gadaa system, this Article argues that resurrecting the tenets of rule of law in classical Gadaa governance can be utilized as a stepping stone to entrench the modern principles of rule of law in present federalist Ethiopia.

2. The Tenets of Rule of Law in Classical Gadaa Democracy: General Overview

Gadaa system is a very critical and complex system that shows the totality of the Oromo civilization since ancient times. Therefore, Gadaa system encompasses the overall cultural, historical, political, legal, philosophical, religious, linguistic, and geographical foundations of the Oromo society.[14] To this date, no one knows when and how Gadaa system emerged; but it has been proven through various studies that it existed as a full-fledged system at the beginning of the sixteen century.[15]During the beginning of the sixteen century, the Oromo were under a single Gadaa system/administration.[16]

Gadaa has three interconnected meanings: "it is the grade which a class of people assumes politico-ritual leadership, a period of eight years during which elected officials take power from the previous ones, and the institution of Oromo society.''[17]Using the philosophy of the classical Gadaa democracy; the Oromo prevented the power not to fall into the hands of war chiefs and despots and thereby ensures the prevalence of rule of law for centuries under the Gadaa-based governance system.[18]The Oromo achieve this goal by establishing a "system of checks and

[14] Asafa Jalata (2012)**,** Gadaa (Oromo Democracy): An Example of Classical African Civilization **(***The Journal of Pan African Studies*, Vol.5, No.1, March 2012, **University** of Tennessee, Knoxville; From the Selected Works of Asafa Jalata):130.

[15] Baissa, Lemmu, The Oromo *Gadaa* System of Government: An Indigenous African Democracy, edited by Asafa Jalata, *State Crises, Globalisation and National Movements in Northeast Africa*, (New York: Routledge, 2004), 101-121.

[16] Ibid.

[17] Legessee, Asmarom. 2006 [2000]. *Oromo Democracy: An Indigenous African Political System*, (Lawrenceville, NJ: The Red Sea Press):2

[18] Ibid.

balances that is at least as complex as the systems we find in Western democracies.''[19]Accordingly, the Gadaa system "organized the Oromo people in all-encompassing democratic republic even before the few European pilgrims arrived from England on the North American and only later built a democracy."[20]

Consequently, numerous tenets of rule of law are embedded in the classical Gadaa democracy in oral forms which we can mold to the present principles of rule of law in the Ethiopian legal system. In the Gadaa system, several social values strengthen the principles of rule of law. For example, values such as *Safuu* (morality/law), *sirna* (order*), Wal-dhageetti* (tolerance), *elaa fi elamee* (mutual understanding); *baallii dabarsuu* (transfer of power); *hangafa fi quxisuu* (seniority), *ulfina* (respect for one another) and other values which uphold the current principles of rule of law are recognized in the Gadaa system deeply. Moreover, the principles of checks and balances are recognized in classical Gadaa democracy in its traditional and oral forms. Hence, there is a periodic transfer of power within eight years; there is also a division of power, among the legislative, executive, and judicial branches of Gadaa administration; as well as, there is vertical sharing of power between the higher and lower Gadaa based administrative organs. Thus, these divisions and sharing of powers both in vertical and horizontal ways in Gadaa-based governance averts arbitrary administrations and has a great contribution to strengthening the prevalence of rule of law in practices.

Furthermore, Gadaa system has a great place for the protection and enforcement of human rights in its values, long ago, before the recognition of modern human rights documents. Gadaa recognizes the right of human beings, children, women, refugees, the natural environments like rivers, ponds, forests, and wild animals. For instance, the Oromo women respect their rights through the *Siiqqee* institution.[21] The *Siiqqee* represents motherhood and people respect and revere a woman because *Waaqa* (God) made her be respected and revered in the Gadaa values; hence, interference with a woman's rights is regarded as violating *seera Waaqa* and *safuu* (violating natural/human rights of a woman, as well as, the moral rules) as per the classical Gadaa democracy. The Gadaa respects the rights of the children, especially children from zero up to eight years (0-8 years children), and have great respect for the whole society not only their family in the Gadaa democracy. Their names are called *Dabballee* (children from age 0-8 years) and they have the right to get milk and food from any person/house; are free from any

[19] Holcomb, Bonnie K. "Akka Gadaatti: The Unfolding of Oromo Nationalism-Keynote Remarks," *Proceedings of the 1991 Conference on Oromia*, University of Toronto, Canada, 3-4 August, 1-10.
[20] Ibid, 4.
[21] Kumsa, Kuwee. The Siiqqee Institution of Oromo Women, *The Journal of Oromo Studies* 4 (1 & 2):127

physical punishments pursuant to the Gadaa rules. The Gadaa respects the rights of refugees and the right to seek asylum through a system of *Koluu Galuu* (seeking asylum).[22]Thus, all these principles assessed hereinabove point out that the classical Gadaa democracy has incorporated and recognized various principles which are related and consistent with the modern principles of rule of law.

3. The Statement of the Problem

Traditions, customary rules, and ritual practices have had great roles in molding present-day civilization in general and democracy in particular in this world.[23] Especially, Westerners have been developing their current concepts of democracy, constitutionalism, and rule of law from their traditions. For instance, England has derived its legal system from their traditions since ancient times. Japan, China, and India have now reached their current civilization by making the basic traditions and cultures they received from their forefathers (*Hindu, Shinto, and Mahiberata*) be kept, even at the time they were receiving Islam, Christianity, and other ideologies, especially, democracy and other free believes. They are not here through undermining the cultures and traditions of their forefathers.

However, Africa as a whole including Ethiopia has not been successful in utilizing its traditions and culture to mold its political, economic, legal, and religious system like the Westerners and the Easterners. Adding insult to injury, Africans as a continent, including Ethiopia, have been unable to rectify their past historical distorted history in all aspects even in the current civilized world. They remained followers in all aspects or they imitate either the Westerners or the Easterners. The problem is that Africans of which Ethiopia is a part had transplanted everything including their legal, political, economic, and religious ideologies from other places elsewhere outside Africa. For instance, the scenario of Capitalism versus Communism (Western and Eastern Ideology), Franco-phone versus Anglo-phone (Colonialism Case), Civil Law versus Common Law (Legal Tradition Model), Christianity and Islam (Christian and Islam World) had transplanted or imported from the Western or Eastern countries. The critical problems in these transplantations were that Africans had dropped out their own traditions, cultures, governance

[22] Makoo Bilii Laws of 1580, (Article 13, 41, 55).

[23] Since 15 June 1215; English Great Charter (Magna Carta); England has been evolving her customary or common laws at the level of the most legitimate Unwritten Constitution in the world in modern time. Therefore, it is her common or Unwritten Constitution and laws which made up the strength of England in history).

system, and religion totally. They had neither nurtured their own traditions nor utilized them with the imported system parallelly.

Similarly, many political scientists believe that the origin of rule of law in particular, and other related concepts like democracy, human rights, and constitutionalism was in Western countries. These concepts are considered as the western political culture; therefore, many pieces of literature and scholars believe that these concepts are totally un-African, as well as, un-Ethiopian. The assumption is that the source of democracy in general and the evolution of rule of law, in particular, is outside Africa. Africa has considered a continent where tribal, scattered, traditional, and undemocratic cultures of administrations were rampant; and everything they have been practicing in the modern world as rule of law has been transplanted from the Western democracies at different times entirely. Unfortunately, the prevailing practices also prove this position in many ways.

The 1995 FDRE Constitution aims to build a political community founded on the rule of law; and substantiate the enforcement of this notion with full respect for individual and people's fundamental freedoms and rights.[24] Nevertheless, the drafters of the 1995 Ethiopian Constitution haven't utilized the classical tenets of rule of law embedded in Classical Gadaa Democracy during the making process of this Constitution. The entire element of rule of law and other constitutional principles were fetched from outside; rather than searched from indigenous governance like Gadaa system. Hence, the reasons behind disregarding the classical tenets of rule of law in Gadaa governance irrespective of its compatibility with the modern principles of rule of law and democratic governance have remained an anomaly.

On the other hand, the already transplanted principles of rule of law from the Western Countries to build a political community; as well as, to ensure a lasting peace, guarantee a democratic order, and advance economic and social development has remained under question in Ethiopia till this date. Consequently, this Article argues that resurrecting the tenets of rule of law in Classical Gadaa Democracy will have paramount importance in entrenching the culture of rule of law in the present Ethiopian multinational federation.

4. The objective of the Study

The general objective of this paper is to evaluate the compatibility of the tenets of rule of law in Classical Gadaa Democracy with the modern principles of rule of law. Specifically, it has

[24] FDRE Constitution of the Federal Democratic Republic of Ethiopia, [Proclamation No. 1/1995. Federal Negarit Gazeta. 1st Year, No. 1., Addis Ababa, 1995]; Preamble Paragraph 1 and 2; Chapter Three of same Constitution.

the objective of excavating the tenets of rule of law in Classical Gadaa Democracy. It analyses the extent to which the Gadaa brand of rule of law is consistent with the present multinational federal-oriented state structure in Ethiopia. Additionally, it examines whether or not, the Gadaa-based rule of law has been accommodated in the contents of the Ethiopian constitution. Moreover, it assesses the extent to which the transplanted principles of rule of law are successful to ensure its laudable goals under the current Ethiopian Constitution. Eventually, it evaluates the extent to which resurrecting the classical principle of rule of law in Gadaa Democracy is possible to nurture the modern principles of rule of law from it in the current Ethiopian legal system.

5. Materials and Methods

This study has employed legal research methods to fulfill its objectives. Accordingly, it has utilized both '*black-letter methods'* and '*law in context methods.*' This *'black-letter method'*, focuses heavily, if not exclusively, upon the law itself; here, doctrinal legal research methods; which include a review of related literature, legal and document analyses, comparing principles, case analysis, and theories have been utilized. On the other hand, this study has utilized '*Law in context methods*'; here, the law itself becomes a problem or a cause of social problems; thus, this may be related to evaluating the non-law cases like culture, customs, history, politics, economy, social and others with laws.

Consequently, this study has employed mainly a library-based with documented facts on the Gadaa system, rule of law, and constitutionalism. Continuously, it has analyzed the principles of rule of law both in the modern governance system and in Classical Gadaa Democracy using the legal research methods mentioned hereinabove. Accordingly, in this study, various related literature is written or previously conducted studies on the Gadaa system, as well as, on the rule of law, constitutionalism, and democracy have critically analyzed. Moreover, the tenets of rule of law in Classical Gadaa Democracy have been excavated and compared with the modern principles of rule of law. In doing so, this study has pointed out the prevailing challenges and opportunities in resurrecting the classical tenets of rule of law to nurture it as a modern principle of rule of law in present federalist Ethiopia.

Hence, this study follows explorative research; observations, personal experiences (the researcher is experienced in conducting Gadaa-related research); and documentary methods. Thus, it has explored how one can utilize the principles of the Gadaa system as a modern con-

stitutional principle. It has evaluated the compatibility of traditional rule of law in Gadaa system with the modern notion of rule of law in Ethiopia. Additionally, it has strived a lot, to explore the place and the value of laws in Gadaa-oriented governance. To fulfill these objectives; it has reviewed various literature written on: Classical Gadaa Democracy, the principles of rule of law; the principle of constitutional governance; and the tenets of modern constitutionalism. For this reason, its method is a qualitative one.

6. Result and Discussion

As clarified hereinabove, the notion of rule of law can be better understood by assessing its core elements. Hereunder, the interwoven building blocks of rule of law in modern democracy have been analyzed and compared with the tenets of rule of law embedded in Classical Gadaa Democracy. The consistencies of the classical principles of rule of law in Gadaa-oriented governance have been discussed and aligned with the modern principles of rule of law. Accordingly, the essential yardsticks of rule of law; namely, the notion of limited government, the principles of legality, and the principles of rule of law, not a rule of man have been analyzed and compared. Additionally, the classical tenets of rule of law in Gadaa governance system have been evaluated and checked for reliabilities with the fundamental principles of modern human and democratic rights in the following manner.

6.1 The Principle of Limited Government

The broadest understanding of the rule of law is that the sovereign, the state, and its officials, are limited by the law.[25] In a nutshell, a limited government is a type of government in which all its governmental power is limited by law/constitution. This means the way in which a certain government is established (come into power), the manner in which it is exercising its governmental power, and finally, its duration in power is also limited by time. Accordingly, a limited government can attain governmental power only and only by the will of its citizen through a political process known as an election.[26] Hence, a fair and free election is the most important element of limited government. Additionally, after being elected and seizing political power a

[25] Brian Z. Tamanaha, The History and Elements of The Rule of Law, Cited at Note 6.
[26] See Article 8, 38 and 73 of the 1995 FDRE Constitution: cumulatively, these three constitutional provisions show that power of government shall be assumed through political election only.

certain government must be accountable and transparent in conducting its official duties.[27] Furthermore, the office duration of a certain government as an institution or as a leader must be restricted by specified time/years if it's a limited government.[28]Based on these concepts, the classical principles of limited government entrenched in Gadaa governance system has evaluated for compatibility in the following manner.

i) Holding Political Power in Gadaa Democracy

In the history of world politics, the source of political power varies depending on the time and political culture of a certain state. Thus, the system of holding political powers has been manifesting in numerous ways; such as a monarchical model of holding political power (hereditary politics); a military way of holding political power (military dictatorship); and holding political power through election (democratic government system). Generally, political power can be held either through democratic means or undemocratic means in modern global politics. Accordingly, the concept of limited government and the prevalence of rule of law can be guaranteed and practiced in a democratic government system only. Therefore, a democratic and legitimate way of holding political power in modern democratic republics is through an election that guarantees the free expression of the will of the people. Thus, to come into political power under the guise of rule of law, a certain group/political party shall prove that it is controlled the political power through a democratic and legitimate election only.

In Gadaa governance, political power is neither given from above (God) nor inherited from families/ancestors. The Oromo culture never knows political power as a hereditary lineage; as well as, it hasn't recognized holding political power through force or illegal means. Therefore, the only way of holding political power in Gadaa Democracy is through election as per the interest and consent of the people at large. Unlike Western democracy, which depends on election only for holding political powers; Gadaa system rather educates and trains the prospective leaders for forty years prior to allowing them to the election.[29] Even the concept of political election in its legitimate manner is a recent history in world politics; almost it appeared and

[27] Under the 1995 FDRE Constitution; the principle of accountability and transparency (both political and legal responsibility) as per Article 12; and the principles of '*Vote of No Confidence'* by the House of People's Representatives, under Article 55(17 &18) are clearly recognized.

[28] See Article 58 (3);70(4) & 72: Article 58(3): "The House of Peoples' Representatives shall be elected for a term of five years. Elections for a new House shall be concluded one month prior to the expire of the House's term. "Article 70 (4): "The term of office of the President shall be six years. No person shall be elected President for more than two terms." Article 72 – The Prime Minister shall be elected for five years; this Constitution hasn't limited for how many term offices can a certain Prime Minister shall be re-elected.

[29] To be elected as government official (Abba Gadaa), a certain Oromo shall attain the age of forty (40) years. To hold political power, a certain Oromo shall pass through in five Gadaa Grade, which are divided into eight years each. Accordingly, [0-8]-Daballee; [8-16 years]-Foollee; [16-24 years]-Qundaala; [24-32]-Kuusaa; [32-40years]-Raabaa Doorii.

was practiced in the post-Second World War. Nevertheless, the Oromo people had been practicing election since time immemorial. No one can precisely trace the time when the Oromo people started electing '*Abbaa Gadaas*' as their leaders; whereas, the modern form of the democratic and constitutional election was started in the post-1945 (in the post-Second World War).

ii) Conduct and Accountability of a Government

Electing a certain political party to hold political power is not an end by itself, it is a means to an end for a certain nation. For this reason, if the method of holding political power by a certain ruling government is legitimate pursuant to the spirit of rule of law (limited government); the next step is checking the manner of practicing its power with the same notion. The elected government shoulders multiple duties; commonly, the elected or appointed government officials shall be responsible for their actions, inactions and decisions both politically and legally.[30] Obviously, the accountability and transparency of government officials have remained theoretical in Africa. Similarly, making government officials responsible for their actions and inactions has remained a theoretical rhetoric in the Ethiopian political culture. Historically, the Ethiopian legal tradition and political history have not favored the culture of rule of law and accountabilities. The popular legal and political conception is that governments can and should do whatever they can to stay in power and benefit from their power.[31]The old Ethiopian adage "*semay ayitarus nigus ayikeses"* (roughly "you cannot plough the sky nor sue government"), and "*sishom yalbela sishar yikochewal"* (roughly "if you don't benefit (personally) when in power, you will regret it when out of power") capture popular conceptions of law and political power.[32]In short, historically in Ethiopia, the historical and social conception is that government officials are immune from accountabilities in all affairs.

Nevertheless, in Gadaa governance system, any authority that goes beyond his legitimate power shall be accused. For instance, when more than 5/9 of Gadaa leaders are incapable or weak the people do not have confidence in them or do not trust them; the *Gumii* (Gadaa Assembly) removes all Gadaa leaders from power.[33]This ceremony is called '*Buqqisuu*' (Removing from the Gadaa Position) and replaces them with collusion leaders formed from three parties/grades. That is three persons from *Raabaa grade*, three persons from *Yuuba second grade*,

[30] See the 1995 FDRE Constitution Article, 12 and 55 (17 &18) as an example.

[31]Abebe, Adem, 'Rule *by* law in Ethiopia: Rendering constitutional limits on government power nonsensical', *CGHR Working Paper 1*, Cambridge: University of Cambridge Centre of Governance and Human Rights, (April 2012):10.

[32] Ibid.

[33] Dirribi Demissie Bokku, Oromo Wisdom in Black Civilization,Cited at note 1:258.

and three persons from *Yuuba third grade*.[34] This collusion government is called '*Gadaa Kontomaa',* which means the last option.[35]

Hence, the backward tradition that says, "*Samay ayitaresim Nigus ayikasasim*" which means, "As it is impossible to plough the sky, the king cannot also be accused" has no place in Oromo Gadaa system. In Gadaa system, all are answerable to the laws for their actions, inactions, and decisions including the active '*Abbaa Gadaas'.*[36]Therefore, the Gadaa Democracy recognizes the principles of limited government and thereby practices the principles of rule of law genuinely.

iii) Limited Term of Political Office in Gadaa Democracy

The utmost democratic symbol in Gadaa system is that elections and changes of leaders shall be conducted every eight years. Thus, the term office of the Gadaa leaders shall be eight years. Any person shall be elected as leader/Abbaa Gadaa for a single terms office in Gadaa governance system. Unlike the presidents and premiers across sub-Saharan African countries, where they stay in power for an unlimited period of time, the single-term office principle under the Gadaa leadership reveals an incredible value of limited government and rule of law. Additionally, the Oromo has a genuine custom of transferring authority (*Baallii*) timely. In Oromo seizing power longer than the time it is expected to be transferred is abnormal (unconstitutional).[37] It is believed that if one doesn't transfer authority (*Baallii*), he may phase punishment from God, whilst the nearest monarchies and kings existing at that time claimed that they shall rule forever as the authority is given to them by God.

In short, the Classical Gadaa Democracy has recognized all the three elements of limited government by law genuinely; namely, the legitimate way of holding government power (through election); accountability of all government officials including *Abbaa Gaddas* for their actions, inactions, and decisions without any exceptions; as well as, the political term office of the elected government official is limited to a single office duration/term, that is, eight years. Consequently, the principle of limited government as one sect of rule of law is fully respected in Gadaa governance system.

6.2 The Principle of Formal Legality in Gadaa Democracy

[34] Ibid.
[35] Ibid.
[36] Ibid.
[37] Ibid, 278.

The second element of rule of law next to the principle of limited government is the principle of formal legality.[38]The principle of formal legality claims that laws must be set forth in advance, they must be general, they must be publicly stated, they must be applied to every one according to their terms, and they cannot demand the impossible.[39]In modern constitutional governance, a legal system that lacks these qualities cannot constitute a system of rules that bind officials and citizens. Above all else, formal legality provides predictability through law.[40]As Hayek put it succinctly, the rule of law makes 'it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances and plan one's individual affairs on the basis of this knowledge.'[41]Generally, formal legality enhances liberty of actions or individual autonomy, because people are advised of their permissible range of free action. It is attributed to the enhancement of predictability, certainty, and security.

Equally, the principle of formal legality is recognized in Gadaa governance system in a comprehensive manner. The term law is unique for the Oromo people in their Gadaa governance system. According to the Oromo, '*Law is more valuable than one's own child'*.[42]The Oromo people sacrifice their own children for the observance of rule of law.[43] As a result, 'law' is a vital instrument to ensure social justice; and where there is no rule of law, it is unlikely for citizens to exercise freedom, equally benefited from resources, and consequently maintain sustainable peace as per the Gadaa system.[44]

Therefore, the Oromo people are known for making laws by themselves and executing them in a very formal way. In Gadaa governance system, laws are made as per the pre-sated procedures, so it is impossible to enact laws arbitrarily. Laws are publicly stated, and in all types of making processes, legislation will become law only if it is declared and accepted by the people at large.[45]Even during the law-making process, anybody can oppose the draft law by saying "*dam-man qabe; kormaan qabe;fardaan qabe; tuni, tuni sirrii miti*"; which means, this law is not correct.[46]In opposing the proposed law, no one would be silenced; but they are expected to talk based on their seniority of age.[47]After it has been made in this democratic/legitimate way; the

[38] Brian Z. Tamanaha, The History and Elements of The Rule of Law, Cited at Note 6:240.
[39] Ibid.
[40] Ibid.
[41] Friedrich A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1994):80.

[42]Dirribi Demissie Bokku, Oromo Wisdom in Black Civilization, Cited at note 1.
[43]Ibid.
[44]Ibid.
[45] Ibid., 279
[46] Ibid.
[47] Ibid.

law of Gadaa of the Oromo cannot be broken or collapsed by any means; which means, "*Tumeen Seera! Hinjigu, hin dhangala'u; seera Gadaa Oromooti*."[48]In Gadaa system, the enacted laws must be applied to every one according to their terms, and they cannot demand the impossible.[49]At the frontispiece of the Oromo legislation, one can read these two fundamental adages, which must serve as a lighthouse for all the codes and as the guide for all legislators.[50] "1st Abban Hera Umaa Waaqa" i.e. "The Author of Laws of all Creatures that is God" "2nd Serri Waaqa Seera Biya Immoa i.e., the Commandment of God Rule over the National Legislation."[51] These two maxims precisely explained hereinabove by Martial De Selviac show the extraordinary wisdom of categorizing laws in the Oromo Gadaa system as Natural Laws which are immutable and not changeable and manmade laws or positive laws which can be changeable from time to time since the 16th century. This is exactly similar to the modern category of laws as natural laws like human rights which are emanating from the nature of mankind and Positive laws which are made by the parliament or given by the government, like democratic rights.

To sum up, the principle of formal legality has been accommodated in the Classical Gadaa Democracy. For instance, the law is enacted in a legitimate way (or not arbitrarily imposed by the government); the law is predictable, certain, general, and equally applicable to all persons in Gadaa governance. The Gadaa-oriented laws are rational, driven by the interest of the public, shall not command the impossible, amendable, and shall be declared publicly. Furthermore, the law protects the autonomy and liberty of an individual and a group of people in Gadaa governance system.

6.3 The Principle of Rule of Law; Not Rule of Man in Gadaa Democracy

The principle of rule of law, not a rule of man is commonly used by different names in modern legal literature; namely, 'the rule of law, not man'; 'a government of laws, not men'; 'law is a reason, man is passion'; 'law is objective, man is subjective.'[52]The inspiration underlying this idea is that to live under the rule of law is not to be subject to the unpredictable vagaries of other individuals; whether monarchs, judges, government officials, or fellow citizens.[53]It is to

[48] Ibid.
[49] Father Martial De Selviac, An Ancient People in the State of Menelil, The Oromo, Great African Nation, (Paris, 1901):229
[50] Ibid.
[51] Ibid.
[52] Brian Z. Tamanaha, The History and Elements of The Rule of Law, Cited at Note 6:243.
[53] Ibid.

be shielded from the familiar human weaknesses of bias, passion, prejudice, error, ignorance, or whim.[54] In modern constitutional republics, although, the rule of law not man's ideal applies to all government officials. But, as law interpreting organ of a government, judges have special preserve in enforcing the principle of rule of law, not the rule of man. It is believed that a judge must be unbiased, neutral between the parties, free of passion, prejudice, and arbitrariness, and loyal to the law alone to ensure the principle of rule of law, not the rule of man. To enforce the principle of rule of law, not the rule of man; there must be a well-developed legal tradition, well-educated and well-trained legal professionals, an independent judiciary, and public confidence in the justice machinery in a certain nation.

The principle of rule of law, not the rule of man has been recognized in Classical Gadaa Democracy nicely. The Gadaa system is an egalitarian democratic governance system that has been practiced among the Oromo people since the 16th century. In Gadaa Oromo, every being and everything have a rule; that is why the Borana states that there are laws for everything, even for the dog.[55]The Oromo culture has no place for arbitrariness, bias, prejudice, and ignorance in adjudicating and resolving all affairs of problems and disagreements both among the Oromo and the non-Oromo. The Oromo people upbringing their children by teaching and training them the fundamental principles that telling the truth, respecting nature, being trustworthy, standing for the right thing, respecting the laws/safuu, and protecting the environment.

Additionally, in Gadaa system, the Oromo had developed '*Safuu'* the principle of deep moral honor and accountability as one core of rule of law. '*Safuu*' Oromo, therefore, is an expectation that people must rise above self-interest and act in the public interest with wisdom and courage in the interest of rule of law not the rule of man. Therefore, the law should be interpreted and utilized in the interest of justice and truth; not be subjected to the unpredictable vagaries of other individuals during the interpretation and adjudication of cases.

6.4 The Place of Fundamental Human and Democratic Rights in Gadaa Democracy

In addition to the assessed elements of rule of law hereinabove; International Human and Democratic Rights Principles are also considered as one element of rule of law in the present constitutional governance system. The principles of human rights and principles of democratic

[54]Aristotle, *Politics*, ed. by Stephen Everson (1988), (Cambridge: Cambridge University Press, 1988) vol. 3:78.
[55]Asmarom Legesse (2006), The Oromo Democracy; An Indigenous African Political System", (Red Sea Press Inc., 2006):201.

governance as elements of rule of law in Classical Gadaa Democracy have been analyzed as follows:

i) The Concept of Human Rights in Gadaa Democracy

The Oromo people started to utilize Gadaa-oriented democratic governance during the 16th century when human beings were hunted and sold like animals throughout the land of Africa. In its contents, the Gadaa Basic Laws have recognized the concept of human rights, far before their inventions in the Western Democracies and earlier than their incorporations under the well-known International Human Rights Covenants and Declarations; like UDHR, ICCPR, ICESCR, CRC, CEDAW, and others.[56]Nevertheless, in the 16th century, when human beings were hunted, made a slave, and sold like property; the Oromo people had been committed to the protection of human rights.[57]

Gadaa Laws incorporate the basic principles of fundamental human rights which protect every aspect of living and non-living things. In its contents, it protects human beings, animals, wild-life, plants, rivers, ponds, hills, grasslands, and any aspects of nature. In Gadaa governance, the protection of human rights like the rights of children, women, refugees, war prisoners, and others is a culture for the Oromo; not only recognized and evolved after the Second World War like in the case of Western democracies. The Laws of Gadaa recognize that ‘‘an already born child is a human being’; all human beings have humanitarian dignity; a child of the nation is just like one’s own; the problem of the wife is the problem of the husband’’[58]The Oromo extends the notion of human rights to the non-humans (to both living things and non-living things). Consequently, in Gadaa laws/*Safuu,* the concept of human rights had been respected and aligned with the harmonious relationships among human beings, between human beings and animals, between human beings and the natural environment, and between God and human beings. Thus, the laws of Gadaa protect fundamental human rights in their classical form since time immemorial unconditionally.

ii)Democratic Principles as a foundation of the Rule of Law in the Classical Gadaa System

Of course, rule of law itself is one essential element of the democratic principle in the modern democratic governance system. But, in this paper, some basic democratic principles embedded

[56]These international Human Rights Declarations, Covenants and Treaties were enacted after the Second World War (in post 1945). They were developed as a response to the atrocities and sorrow those happened to the world people at the time.

[57] Makoo Bilii Laws of 1580, (Article 13, 41, 55) deemed enacted in 16th century. As it is commented before, it is very important to give more information about these laws and where they can be accessed. For example, where do you get them? Why didn’t you cite it properly?

[58] Jabessa Ejeta, Ye Oromo Biher Bahilna Acir Tarik, Finfinfine:69, [As cited in Dirribi Demissie Bokku, Oromo Wisdom in Black Civilization, Cited at note 1): 280]

in Classical Gadaa Democracy have been evaluated with its modern counterparts for checking consistencies. Accordingly, the pillars of modern democratic principles incorporated in the text of a certain legitimate Constitution have been analyzed in the following manner:

The sovereignty of the People

In its contents, the Gadaa laws incorporate and recognize the sovereignty of the people. In Gadaa Democracy, the sovereign power vests in the hands of the people not in the hands of leaders. For instance, Dirribi has briefly pointed out how the sovereignty of the people had accommodated in the Gadaa Democracy as follows:

> *In Oromo democratic culture, the supreme power is not in the hands of those well-respected individuals (elders) having the knowledge of law-making. It is also not in the hands of electoral committees, the 'Ayyaantuus', who get power through inheritance. The ultimate power holder is again not in the hand of 'Abba Duulaa' who gives military leadership for the armies; or those who are in the stage of kuusaa (qondaalaa) and gives military service in an organized way. All these have nothing to do with the ultimate power. The Abba Gada who are administering the country has no such authority. However, the supreme authority belongs to the people's Gumii (Assembly) the representatives of the people."*[59]

Consequently, the sovereign power vests in the hand of the people, and the people are also considered sovereign in the Gadaa system of the Oromo similar to the modern constitution.

Supremacy of the Constitution

Supremacy of the Constitution is the other core principle of democracy in the modern constitutional governance system. It is also considered an essential symbol for the prevalence of rule of law in a certain country. Similarly, the traditional Gadaa laws have incorporated the principles of supremacy of the Constitution in its classical platform. Concerning this principle, Asmerom has witnessed in the following manner:

> *"The Abba Gadaa himself is subjected to the same punishment as all other Borana if he violates laws, same laws, and same punishments. That is the evidence that shows us that law is above everybody including the Abba Gada."*[60]

Separation of Power

Unlike the division of powers between the federal and the states, or separation of powers among the three wings of government in modern jurisprudence; the Gadaa-based division of power

[59]Dirribi Demissie Bokku, Oromo Wisdom in Black Civilization, Cited at note 1.
[60]Asmerom Legesse, Oromo Democracy, cited at note 8.

follows generation and age-group-based power division. It is the type of division of power in which every citizen involves actively in the political and legal affairs of their country. The Gadaa is entitled to powers to govern the country and defend it from the enemy.[61]For instance, the Kuusaa (Qondaalaa) has the right and responsibility of attacking the enemy upon request.[62] The Gumii (Assembly) has the powers of changing laws, advising and guiding the Gadaa, or uprooting and make other elections.[63]The Ayyaantuus (Abba Mudaa) also have the power to decide Election Day and to bless the authorities like the ya'aas, jiila, Gumii, and Abba Gadas.[64]All groups work in cooperation and they do not have superiority and inferiority complexities.[65]Therefore, the principle of separation of power is also recognized under the Gadaa laws.

7. Conclusion and Recommendation

The Classical Gadaa Democracy of the Oromo people is a well-crafted and nurtured traditional system of governance. In Gadaa governance system, a government is limited by law. That means, the mechanism of holding political power; the manner of utilizing political power; as well as, the term of office of any appointed or elected officials are restricted under the basic laws. In Gadaa Democracy, a legitimate election remains the only source holding political power. The elected leaders (*Abbaa Gadaas)* shall lead their people as per the laws of Gadaa only for a single term office which is eight years. Acting beyond the power given or abusing the power or weakness in conducting the imposed duties under the Gadaa governance system shall lead to dismissal from the governmental power through a process of '*buqqisuu'* (uprooting or impeachment).

The culture of the law-making process is all-inclusive and participatory in Gadaa Democracy. In practice, the Oromo people are committed to enforcing, protecting, and fulfilling each and every principle of Gadaa laws after it has been enacted. Even, the Oromo are ready to sacrifice their own children rather than violating the Gadaa principles. The Gadaa laws are formal and rational; therefore, Gadaa laws are enacted in a general manner, declared publicly, set forth in advance, do not command the impossible, and are never imposed against the interest of the

[61]Dirribi Demissie Bokku, Oromo Wisdom in Black Civilization, cited at note 1.
[62]Ibid, 337.
[63] Ibid.
[64]Ibid.
[65]Ibid.

people at large. The Gadaa laws are applicable to all people equally; thus, there is no discrimination and arbitrariness in enforcing and interpreting these Gadaa laws. Gadaa laws protect the liberty and autonomy of individuals and groups.

Additionally, the fundamental principles of modern human rights and democratic rights are accommodated in the contents of basic Gadaa laws. The Gadaa brands of human rights protect both the rights of human beings and non-human beings. The traditional principles of human rights in Gadaa system have been implemented under the value of '*Safuu'.* Therefore, the *Safuu* of human rights *in* the Classical Gadaa System maintains; coexistence and harmony among all people; maintains a good relationship between humans and animals; maintains a good relationship between humans and the natural environment; and maintains a good relationship between God and man. Likewise, Gadaa laws recognize the basic principles of democratic governance, like the sovereignty of the people, the supremacy of the constitution, the separation of powers, and the participatory decision-making process.

In conclusion, the tenets of rule of law including the principles of limited government, formal legality of the law, and rule of law not the rule of men have high value in the Gadaa governance system. The fundamental principle of human rights and democratic rights are also recognized in the contents of Gadaa-based laws extensively.

To conclude, this Article recommends that resurrecting, collecting, and codifying the scattered tenets of classical rule of law in Gadaa system must be conducted by all concerned bodies; especially by the Oromo scholars, the regional government of Oromia, the federal government, and other concerned organs. Then, it recommends that the government shall utilize the Classical Gadaa brand of rule of law with the modern principle of rule of law parallelly. Eventually, this Article recommends potential scholars and researchers conduct further studies on the overall aspects of Gadaa governance system with the intention of upgrading it to the zeal of modern rule of law, constitutionalism, and democratic principles.

Position of Liquated Damages as a Remedy for Breach of Public Construction Contract in Ethiopia: The Law and Practice

Yenew B. Taddele*

Abstract

Contracting parties of a public construction contract can foresee how a type of uncertainty could be removed by agreeing on a specific consequence for a breach. They can address this by incorporating, inter alia a "Liquidated Damages Clause" to that outcome. Liquidated damage is a fixed sum agreed by the parties in their contract as a value of the damages that one party can claim against the other, without the need to prove that sustained damage when they enter into a contract. But, whether liquidated damage is a contractual or legal remedy; whether liquidated damage and penalty are similar and interchangeable or different in concept; can an employer seek liquidation damages together with other available general remedies after canceling such contract; and who, contracting parties or a government, in the agreement or by law, can figure out the amount of liquidated damages and its calculation mechanism are an unsolved conundrum in Ethiopian pertaining laws and its application in courts thereof. To write this article, a qualitative research design was preferred due to its suitability for addressing the research questions of this article and its high level of flexibility; relevant data has been collected under an "umbrella" of qualitative data collection techniques, mainly involving document reviewing and interviews. Both doctrinal and empirical approaches were simultaneously utilized. The finding indicates that liquidated damages are a contract-based remedy, not a legal remedy; penalty and liquidated damages are not similar concepts. Because the penalty is a payment of money stipulated as "in terrorem" of the offending party while liquidated damage is a pre-agreed sum payable as damages for a party's breach of such contract. However, The Federal Public Procurement Directive, 2010 and courts in Ethiopia have assimilated liquidated damages with penalty vaguely; in principle liquidated damages is an exhaustive remedy but parties, based on unique features of any single construction project, can agree otherwise.; and they are contracting parties through their contract, not a government by law who measures liquidated damages. Courts in Ethiopia are recommended to have common sympathetic about liquidated damages, and pertaining laws should be amended.

***Key Words*:** Exclusive Remedy, Liquidated damages, Remedy

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1. Introduction

Because of the need to carry out its functions, the government, via its undergrowth, will embark upon different activities which inevitably will invite the interplay of other undergrowths and private sectors. These branches otherwise known as administrative agencies assist a government in properly taking its tasks of service provision among other things.[1] It is, therefore, while these agencies carry out the functions that they use the law of administrative contracts to their ends. The ends are public services, the means of public contracts.

The construction industry plays a key role for which a government has intensively entered public contracts in building economic infrastructure like roads, railways in expanding social infrastructure like schools, and hospitals, and in expanding factories. As one side of improving people's lives is the building and renovation of premises, government-undertaken construction plays a great role in this regard as well.

Construction projects are inherently uncertain[2], based, as they are, on unique parameters for each project, be that design differences, construction method differences, differences in out-turn purpose, or just differences in the physical environment. Given a large amount of money spent on construction projects, and the impact on cost and value relatively small changes caused by these uncertainties can have, parties and their advisors have long looked for ways to eliminate these uncertainties or at least make them manageable. This can essentially be done in one of two ways; the uncertainty can be eliminated through investigation; or the risk of the uncertainty arising can be managed through ascribing that risk to one party or the other party.[3]

One part of the uncertainty in a public construction project that can make a significant difference to its commercial pricing is taking away the uncertainty of what happens if things don't go to plan. What if the project isn't finished on time, what if new work is instructed, what if the

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[1]Harold Ward, 'Delayed Performance in Construction Contract-Enforceability of Liquidated Damages Clauses', *Insurance Counsel Journal*, 1965, Vol.1, No' 1, PP. 250-258(Here in after, Harold Ward, Delayed Performance in Construction Contract-Enforceability of Liquidated Damages Clauses). It is also available at https://www.bing.com/ck/a?!&&p=c31a155828c8de4fJmltdHM9MTY2NDE1MDQwMCZpZ3VpZD0zZmI0Mjg5NC1jMjZlLTY5MmUtMDk2OC0zOTA2YzM2YzY4MDEmaW5zaWQ9NTMxOA&ptn=3&hsh=3&fclid=3fb42894-c26e-692e-0968-3906c36c6801&u=a1aHR0cDovL2VuLnVuaXYtc2V0aWYyLmR6L3BsdWdpbmZpbGUucGhwL, (accessed on October 13, 20022)

[2] Nael G. Bunni, *Risk and Insurance in Construction*, 2nd ed., Spon Press, London, and New York, 2003, P. 27 [herein after, Nael G. Bunni, *Risk and Insurance in Construction]*

[3] Ibid

desired output is not met, what if the quality is not right, what if key performance indicators are not achieved?

In the broad sense, the answer to all these questions is relatively straightforward, one would be entitled to damages to recompense for any loss caused by these breaches. However, if we try to go behind that and say, yes but what cash sum might that amount to, the answer generally will be that nobody knows until after it has happened.

Where the parties can foresee a type of problem, the uncertainty could be removed by agreeing to a specific consequence for a breach. Then, rather than being unknown, the loss or damage is then identified or liquidated. While this doesn't remove the uncertainty entirely as the event may still occur, it does at least add some predictability to the consequence of the event so that it determines any potential risk in their public construction contract.

The contract may provide for a contract period that is triggered by a notice to commence, or in some other way the construction contract will provide a means of fixing the date on which construction operations must be finished. It is established that an employer must give the contractor possession of the site on the due date and an employer who is in breach of that obligation is liable for damages. Provided that the contractor can enter upon the site on the date stipulated for possession and thus to commence construction work, he must finish by the completion date. If he fails to complete, the employer may recover such damages under the principles set out in the standard conditions of the construction contract annexed with the contract if can be proven a direct result of the breach.

In practice, it may be difficult to allocate damages, which damages directly and naturally flow from the breach and which damages do not so flow but depend upon special knowledge that the contractor had at the time the contract was made. The amount of damage is seldom easy to ascertain and prove.[4]

Regulating, in advance, the potential damage that either of the contracting party may suffer, as the consequence of the other party's failure to perform its contractual obligations is, however the order of the day in the construction industry.[5] The contracting parties address this by

[4]David Chappell, *Building Contract Claims*, 5th ed., A John Wiley &Sons Ltd Publication, The Atrium Southern Gate, UK, 2011, P.58[Here in after, David Chappell, Building Contract Claims]

[5] Nael G. Bunni, *The FIDIC Forms of Contract: The Fourth Edition of the Red Book*, 3rd ed., Blackwell Publishing Ltd, London, 2005, p. 100

incorporating a "Liquidated Damages Clause" to that effect. It is believed that the liquidated damages doctrine is used widely in common law countries. Nowadays, however, the doctrine has received a welcoming arm in administrative construction contracts including in civil law countries. In Ethiopia, for example, it is now fully being put into use in all administrative construction contracts. The doctrine might have made its entry into the Ethiopian construction laws via any general conditions like FIDIC General Condition Documents[6].

However, it does not mean that the civil law countries do not have a counterpart doctrine i.e., the "Penalty Clause", whereby the contracting parties to a contract regulate damages that will accrue to either of the parties should the other party fail to perform its contractual obligations. It is governed by the".

An essential characteristic of liquidated damages is really to introduce predictability and foresight to the consequence of a breach of contract. The aim in doing so is to remove some risk and thereby reduce the overall contract price. That way everyone wins; the contractor limits his liability and makes the outcome of the project more predictable, and the employer reduces the overall cost of the project by removing some risk but also achieves certainty of the consequences of a failure on the project.

The research design, to write this article, was a qualitative one. This design is preferred due to its suitability for addressing the research questions of the study and its high level of flexibility. Apart from its flexible nature, the best way to study the position of liquidated damages under pertaining laws of Ethiopia and its application there off depends on the subjective interpretation of such laws and judgments.

Both doctrinal and empirical approaches were simultaneously utilized. The study used a doctrinal approach because it involves a critical evaluation of legal documents and scrutiny of court judgments as primary sources, and journal articles and books as secondary sources to see

[6]International Federation of Consulting Engineers (commonly known as FIDIC, acronym for its French name Federation Internationale Des Ingenieurs-Conseils) is an international standards organization for consulting engineering and construction best known for FIDIC family of contract templates. The fact that FIDIC has a French title bears a testimony to its foundation in 1913 by three wholly or partly francophone countries, Belgium, France, and Switzerland. Today FIDIC has members in 104 countries. FIDIC, that is in Geneva, Switzerland, aims to represent globally Consulting Engineering by promoting interests of firms/Engineers supplying technology-based service for built and natural environment. Run mostly by volunteers, FIDIC is well known for work in defining conditions for contract for construction industry worldwide.

the experiences both at the state and global levels. The empirical research approach was also used in the study because the researcher was in need to explore problems in the area from a practical point of view by incorporating legal expert opinions and judgments of courts of law in Ethiopia. By using these mixed approaches, the researcher has filled the gap of the doctrinal research approach with help of the empirical research approach and vice versa is true.

Therefore, it is because the study is devoted to the reasons, justifications, and logical arguments on the existing legal document, and experiences dealing with the status of liquidated damages under pertaining laws of Ethiopia and its application there off, doctrinal and empirical approaches were preferred.

2. Meaning and Nature of Liquidated Damages

Liquidated damages[7] is a fixed and agreed sum as opposed to un-liquidated damages which is neither fixed nor agreed upon but must be proved in court, arbitration or adjudication. The addition of the words "and ascertained" to "liquidated damages" found in some contracts is not thought to be significant and the latest JCT[8] series of contracts has dispensed with the additional wording.

To recover damages in matters involving breaches of contract, it is necessary to prove that the defendant had a contractual obligation to the claimant, that there was a failure to full fill the obligation wholly or partly, and that the claimant suffered loss or damage thereby. Very often it is clear that there is damage, but it is difficult and expensive to prove it.[9] To avoid that situation, the parties may decide, when they enter a contract that in the event of a breach of a particular kind the party in default will pay a stipulated sum to the other.[10] This sum is termed "liquidated damages".

[7] The word "damages" here in this article is a singular verb and refer to a word "compensation"; it is not plural form of the word "damage"

[8] "JCT" stands for Joint Contracts Tribunal. JCT produces standard forms of control for construction, guidance notes and other standard documentation for use in the construction industry in the United Kingdom. From its establishment in 1931, JCT has expanded the number of contributing organizations.

[9] Ahmed Elsayed ABD EL Bakey, Termination of Construction Contracts and the Related Application of Liquidated Damages, MSc Thesis, The British University in Dubia, 2018, PP.36.41 [Unpublished, available at British University in Dubia] (Here in after, Ahmed Elsayed ABD EL Bakey, Termination of Construction Contracts and the Related Application of Liquidated Damages)

[10] Ibid

Even there is not a common designated name for "liquidated damages" so different scholars and documents have called it by different names; for instance, Belayneh Adimasu called "**የመዘግዬት ቅጣት**[11]-penalty for late performance"; Almaw Wolie "**የበሰለ የጉዳት ካሳ**[12]-pre-estimated compensation". Whereas FIDIC,1999, General Conditions for Constructions Contracts and Ministry of Work and Urban Development (MoWUD), 1994, Standards of Construction Contracts has named it "delay damages"[13] and "liquidated damages for delay" [14]respectively.

Liquidated damages, under a public construction contract, are a fixed sum agreed by the parties in their contract as a value of the damages that one party can claim against the other, without the need to prove that sustained damage.[15]

David Chappell has affirmed it has been the practice in the building industry to include a provision for liquidated damages in building contracts to avoid these difficulties.[16] The way the provision is generally expressed is that the contractor must pay a certain sum to the employer for every week, or every day as agreed by which the original completion date is delayed failed to perform, or performed in a defect. That sum must represent a genuine pre-estimate of the loss that the employer is likely to suffer.

The main purpose of the liquidated damages clause under public contract is, therefore, to promote the smooth flow of transactions, which means trade with the minimum occurrence of dispute. This purpose can be achieved by narrowing down the area of disputes during such transactions by establishing such clause to determine remedies in advance under such contract; includes not an only settlement but also the prevention of disputes, and the latter is of equal or indeed of greater importance than the former, as prevention is always better than cure.

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[11]በላይነህ አድማሱ፣ 'በግንባታ ዉል አፈፃፀምና አተረጓጉም ሂደት የሚያጋጥሙ ችግሮችን ለመፍታት አማራጭ የሙግት መፍቻ ዘዴዎች ያላቸዉ ሚና እና ተፈፃሚነት በአማራ ክልል'፣ *በአማራ ክልል የፍትህ ባለሙያዎች ማሰልጠኛና ህግ ምርምር ኢንስቲትዩት የህግ መፅሔት*፣2008, Vol.3, No' 1, PP.121-170, PP.143-144[Here in after, በላይነህ አድማሱ፣ 'በግንባታ ዉል አፈፃፀምና አተረጓጉም ሂደት የሚያጋጥሙ ችግሮችን ለመፍታት አማራጭ የሙግት መፍቻ ዘዴዎች ያላቸዉ ሚና እና ተፈፃሚነት በአማራ ክልል] [translated by the author]

[12]Almaw Wolie, የኢትዮጵያ የኮንስትራክሽ ህግና አፈፃፀሙ፣ training delivered to judges at ANRS Supreme Court, Bahir Dar, February 2010 E.C[Translated by the author] [Here in after, Almaw Wolie, የኢትዮጵያ የኮንስትራክሽ ህግና አፈፃፀሙ] [translated by the author]

[13]FIDIC, *General Conditions of Construction Contract*, 1st ed., 1999, [Here in after, FIDIC, 1999]

[14]MoWUD, *Standard Conditions of Contract for Construction of Civil Work Projects*, 1994, [Here in after, MoWUD, 1994]

[15]Ahmed Elsayed ABD EL Bakey, Termination of Construction Contracts and the Related Application of Liquidated Damages, supra-9

[16]David Chappell, Building Contract Claims, supra-4

In the construction industry in Ethiopia, the terms "liquidated damages" and "penalty" are commonly used as though they are interchangeable. In fact, they are totally different in concept. Whereas liquidated damages are compensatory in nature and should be a genuine attempt to predict the damages likely to flow because of a particular breach; a penalty is a sum that is not related to probable damages, but rather stipulated "*in terrorem*" as a threat or even, in some instances, intended as a punishment. The courts will enforce the former, but not the latter though the parties may be no less agreed upon in the matter in the first instance as in the second.[17] It is, therefore, of prime importance to establish into which category a particular sum will fall.[18]

3. Status of Liquidated Damages Under Public Construction Contract in Ethiopia

A question laden with jurisprudential tension, in judicial judgment and of legal, practical, and commercial significance for the construction industry involves is to what extent Ethiopian laws allow contracting parties to contract to specify their own remedies in damages in the event of a breach. And to what degree and status do courts in Ethiopia give attention when they have interpreted such laws to give judgments for disputes arising from such construction contract containing a liquidated damages clause.

Simply put, liquidated damages has been given a place in Ethiopian laws, for instance, Ministry of Finance and Economic Development Federal Public Procurement Directive, 1/2010.[19] And courts in Ethiopia have given judgments for cases about public construction contracts with liquidated damages clause. However, the doctrine and principle of liquidated damages of "rule against penalties" is not recognized in such courts but are considered similar concepts.[20]

The status of liquidated damages; whether contractual or legal remedy, whether it has a similar concept with a penalty, whether it is exclusive or apart from remedy, whether it is delayed performance remedy or quality related performance remedy, and who should determine its amount and calculation mechanism- the government by law or contracting parties through their contract is still an unsolved conundrum.

[17]David Chappell, Building Contract Claims, supra-4, P.57
[18]Ibid
[19]*Federal Public Procurement Directives*, Ministry of Finance and Economic Development, June 2010 [here in after, Federal Public Procurement Directive, 2010].
[20]Hamish Lal, 'Liquidated damages', *Construction Law Journal*, 2018, Vol.34, No'1, PP.3-18, PP.9-11[Here in after, Hamish Lal, Liquidated damages, Construction Journal]

3.1.1 Is Liquidated Damages Contractual or Legal Remedy?

A legal remedy is a monetary compensation to place the aggrieved party in the same position he would have been in if the contract had been performed, and permit recovery of any monetary loss suffered because of the breach though the contract has stated nothing. But the contractual remedy is monetary compensation to place the aggrieved party in the same position he would have been in if the contract had been performed and permit recoverable of any monetary loss suffered because of the breach only if the contract has stated to do so.

Damages for breach by either contracting party be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy for every construction project independently.[21] Thus, liquidated damages is typically paid as lump sum compensation for damage. And it is the sum agreed by the parties to the contract, authorizing the party suffering from the other party's default to receive a predetermined indemnity, following a particular breach.[22]

> If the contractor shall fail to achieve completion of the works within the time prescribed by the contract, then the contractor shall pay to the employer 1/1000 of the contract price per day as liquidated damages for such default and not as a penalty for every day or part of a day which shall elapse between the time prescribed by contract and the date of certified completion of the works. Depending on the nature of the works, liquidated damage higher than the minimum limit provided in MoWUD, 1994, Standard Conditions of Contract under Clause 47(4), may be fixed in the contract.[23]

MoWUD, 1994[24], Standard Conditions of Contract which many public authorities in Ethiopia have been annexing to their public construction contract as a general condition has incorporated clauses to draw a benchmark for how liquidated damages is calculated and what amount shall it be but give freedom to contracting parties to determine how should they calculate and the

[21]Lars A. Stole, The Economics of Liquidated Damages Clause in Contractual Environments with Private Information, MA Thesis, Harvard School of Law, 1998[Unpublished], P. 2[Here in after, Lars A. Stole, The Economics of Liquidated Damages Clause in Contractual Environments with Private Information]

[22]Lukas Klee, *International Construction Contract*, 2015, John Wiley and Sons, Ltd, Oxford United Kingdom, P. 28[Here in after, Lukas Klee, International Construction Contract]

[23]MoWUD,1994, supra-14, Clause 47(4)

[24]Ibid

maximum amount thereof to enable them to set up liquidated damages clause based on a unique feature of each construction projects.[25]

MOF has enacted a directive-the Federal Public Procurement Directive, 1/2010 that stipulates how liquidated damages is calculated and its maximum amount. Such Directive under clause 16.27.4 states the liability of the supplier for the delay in performing his obligation under the contract shall be

> (a) 0.1% or 1/1000 of the value of the contract price for each day of delay, (b) the cumulative penalty to be paid by the contractor shall not exceed 10% of the contract price and (c) If the delay in performing the contract affects its activities, the administrative authority may terminate the contract by giving advance notice to the supplier, without any obligation to wait until the penalty reaches 10% of the value of the contract.[26]

Courts in Ethiopia have not yet, as far as the possible extent the author looked at, interpreted liquidated damages similarly. For instance, Amhara National Regional State Supreme Court, in Amhara Towns Development and Construction Enterprise vs. Alamirew Mulate Building Contractor[27], has pronounced its judgment and rejected the plaintiff's claim in which the plaintiff argued that failing to include a liquidated damages clause in the contract can't relieve the defendant to pay liquidated damages since it is a legal remedy under Amhara Regional State Procurement Directive 1/2003, Article 14.21.[28] The court in its judgment stated that this Directive is a benchmark for contracting parties to add a liquidated damages clause when they enter into a contract but can't grant any one of the contracting parties to claim it as a legal remedy if the contracting parties failed to add a liquidated damages clause in their contract. However, Federal Supreme Court Cassation Division, in Ethiopian Road Authority vs Country Trading PLC[29] case, interpreted liquidated damages as it is a legal remedy.

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[25]Lars A. Stole, The Economics of Liquidated Damages Clause in Contractual Environments with Private Information, supra-21

[26]Federal Public Procurement Directives, 2010, supra-19, Although, this provision seems about contract of supply, the directive, under its scope of application, has stated as it is applicable to all federal public procurements so that it includes public construction contracts. See Art.3 of such directive.

[27]*Amhara Towns Development and Construction Enterprise vs. Alamirew Mulate Building Contractor*, Amhara Regional State Supreme Court, 2011 E.C, Civil Case No' 43935[Unpublished]

[28]Amhara Regional State Procurement Directive, Amhara Regional State Finance and Economic Cooperation Bureau, 1/2003, Article 14.21[Here in after, Amhara Regional State Procurement Directive, 2003]

[29]*Ethiopian Road Authority vs. Country Trading PLC*, Federal Supreme Court Cassation Division, 2003 E.C, in የፌዴራል ጠቅላይ ፍርድ ቤት ሰበር ሰሚ ችሎት ዉሳኔዎች፤ ቅፅ 12፤የኢፌዴሪ ፌዴራል ጠቅላይ ፍርድ ቤት፤ አዲስ አበባ፤ 2004 E.C፤ ገፅ 83-86

Alemu Tedebebe[30] has explained as liquidated damages is a contractual remedy but no legal remedy. To justify, he has forwarded two reasons; first, freedom of contract is prevalent phenomenon in this era so it is the parties who should measure such damages in their contract when either is in default; second each construction project may be constructed with a huge amount of money and has its own unique feature that makes very difficult and unattainable government's practice to enact laws to regulate liquidated damages for nonsimilar project sites.

Almaw Wolie also has supported this and described liquidated damages is a contractual remedy,

> It has been renowned that many employers allocate potential construction risks caused due delayed performance or below-standard agreed quality to a contractor in advance. The common mechanism to allocate such potential risks is including a liquidated damages clause in a construction contract. Then, liquidated damages is firmed in the construction contract that obliges the contractor to pay a pre-estimated certain amount of compensation to the employer for the reason the former is at default to perform on agreed time for each late performance or for the below agreed standard quality performance.[31]

In public construction contracts, in which huge financial, technical, and human resources are needed, it is vital to see several non-similarity ways of the construction process. To avoid non-conformities of laws to each unique public construction project, to increase the power bargain of parties, not to repeat the mistakes of others, and to allocate risks fairly between the contracting parties, a liquidated damages clause in a contract is a better "juridical act" than the enacted law which is primarily concerned with agreements in which one party, or each party, gives an undertaking or promise to the other.

It governs liquidated damages questions as to which agreements the law will enforce, what obligations are imposed by the agreement in question, and what remedies are available if the obligations are not performed. Thus, it is a contract in which contracting parties give their undertaking to perform public construction contract based on liability for breaches. Such undertakings should be emanated from a contract, not from the law due to the complex nature of construction transactions. Because the public construction process is governed by complicated contracts involving complex relationships in several tiers so that many risks are involved in such construction projects. These risks could be attributed to several reasons, which include the nature of the construction process, the complexity and time-consuming design and construction activities, and the involvement of a multitude of people from different organizations with

[30]Interview with Mr. Alemu Tedebebe, private Attorney, on *the status of liquidated damages in pertaining laws and its application in courts in Ethiopia, May 20, 2020*

[31]Almaw Wolie, **የኢትዮጵያ የኮንስትራክሽ ህግና አፈፃፀሙ**, supra-12

different skills and interests. Hence, a great deal of effort is required when entering public construction contract to co-ordinate to the wide range of activities including liquidated damages that are undertaken in such contract than leaving it to the laws which do have not enough space to act in response to address such complexities.

Measuring liquidated damages in a public construction contract is one and more decisive than enacting a comprehensive law to regulate it. Since the construction industry is the sum of all economic activities related to construction works, their conception, planning, execution, and maintenance, and a major influence on the economic growth of a country. Thus, in view of the fact, a public construction contract with liquidated damages is widely acknowledged as the most important single constituent in a developing country's investment program where contracting parties mostly take and annex general conditions of construction contract forms, for instance, The FIDIC General Conditions of Construction Contracts and the MoWUD, 1994, Standard Conditions of Construction Contracts to their specific contract that have liquidated damages clause.

Thus, enacting a law to regulate how liquidated damages is quantified and calculated can't be practicable. It is difficult to anticipate potential damages to allocate all construction project risks that have their own unique feature with a single law enactment. Because, each construction contracts have several documents that make up a construction contract such as special conditions, specifications, articles of agreement, and the lists are endless, the general conditions of a construction contract consist of or are based on a standard form of contract.[32] These conditions are those terms that are concerned with the primary rights and obligations of the parties and the administration of the contract so as to give effect to those rights and obligations including compensations measured in the liquidated damages clause.

In conclusion, where commercial parties have freely agreed, within a binding contract, to a regime for liquidated damages which is expressed in terms sufficiently certain to be enforced; the law should uphold its enforcement upon those terms. Such a notion serves a desirable commercial purpose in that it allows parties to anticipate with maximal certainty the remedial consequences where an administrative construction contract is breached. It is also consistent

[32]Julian Bailey, *Construction Law*, 1st ed., Routledge, Toylor Francis Group, London and New York, 2011, P.116 [Here in after, Julian Bailey, Construction Law].

with the underlying rationale for the enforcement of such contracts which seeks to ensure that obligations are undertaken freely and, once such voluntariness is established, allows for minimal interference by the courts.

3.1.2 Liquidated Damages vs. Penalty

A recognized threat to the continued life of the penalty rule is the principle of freedom of contract. The penalty rule is an intrusion on the freedom of contract which is an essential principle for certainty in contract law whereas the liquidated damages clause is recognized as part of the principle of freedom of contract.[33] Nevertheless, there remain certain considerations that support judicial interference with freedom of contract in limited circumstances. An arguably more genuine, but certainly less fashionable, approach to address the tension between the penalty rule and freedom of contract is to explicitly recognize that freedom of contract should only be observed to the extent that there is equality of bargaining power between the parties and in all other instances is nothing more than a legal fiction.[34]

Penalties could be interpreted as quantitatively excessive liquidated damages and are invalid under the common law.[35] While liquidated damages are pre-calculations of estimated loss under the contract, penalties go further and seek to punish a party in some way for a breach of contract above and beyond the loss suffered by one party as a result of the breach.[36] Many clauses which are found to be penalty clauses are expressed as liquidated damages clauses but are considered by courts as excessive, or punitive and so invalid. So, the distinction between liquidated damages and penalties does not rely on the name but on the legal characteristics and the intention of both parties at the time of contracting.[37]

However, when penal words are employed- the amount named is designated in the instrument by such terms as “forfeit”, “forfeiture”, “penalty”, “penal stun”, “fine”, “under a penalty”, or “under

[33]D. Geoffrey (et al), ‘Liquidated Damages: Canadian Adoption, Divergence and the Necessity for Restatement’, *Journal of the Canadian College of Construction Lawyers*, 2017, Vol. 1, No’ 1, PP.140-170, PP.148-150[Here in after, D. Geoffrey(et al), Liquidated Damages: Canadian Adoption, Divergence and the Necessity for Restatement]

[34]Ibid

[35]Hyuno Joo Kim, Study on Liquidated Damages in International Construction Contracts, at https://www.researchgate.net,> accessed on April 30, 2020 [Here in after, Hyuno Joo Kim, Study on Liquidated Damages in International Construction Contracts]

[36]Hyuno Joo Kim, Study on Liquidated Damages in International Construction Contracts, supra-35

[37]Ibid

a forfeiture", and the courts can see no other intention in the instrument they are inclined to regard such a sum as a penalty, whenever it can be properly done, in order that the question of compensation may be given to the justice may be done to the injured party.[38]

In most cases, there is no difference between a penalty and liquidated damages in Ethiopia. In Ethiopian laws, in every case, if a sum is named, in a public construction contract, as the amount to be paid in case of a breach, it is to be treated as a penalty. The rule of the recovery of liquidated damages in Ethiopia is somewhat different from the common law jurisdictions though the concepts and its trend originated from such jurisdictions through FIDIC General Conditions for Construction Contracts. Because of the strict interpretation of liquidated damages where it has been held that the party claiming liquidated damages needs to prove the clause in the construction contract was about liquidated damages, no penalty clause.

A Federal Public Procurement Directive, 1/2010, enacted by MoFEC under Article 16.27.4[39], has employed the word "penalty" though the very details of the provision are about pre-calculations of estimated loss under public construction contract than to go further and seek to punish a party in some way for breach of contract beyond the loss suffered by one party as a result of a breach.[40] Thus, this is a typical example of clauses that are found to be liquidated damages clauses named "penalty clauses" that can enable us to say the distinction between liquidated damages and penalties does not rely on the name but on the legal characteristics and the intention of both parties at a time of contracting.

The Federal Cassation Division has not established a common understanding of the status of liquidated damages. In cases, for instance, South Achefer Woreda Finance and Economy Development Office vs. Aderaw Mekonnen Contractor[41], and Dembia Woreda Health Office vs. Amsalu Gizie[42], has interpreted liquidated damages as penalty clause by stating Article 1889 of

[38]Edward C. Dowling, *Liquidated Damages*, Dissertation, Cornell University, School of Law, 1891, at <http://scholarship.law.cornell.edu/historical-these>, accessed on October 23,2019] [Here in after, Edward C. Dowling, Liquidated Damages]

[39]Federal Public Procurement Directive, 2010, supra-19

[40]Hyun-Joo Kim, Study on Liquidated Damages in International Construction Contracts, supra-35

[41]*South Achefer Woreda Finance and Economy Development Office vs. Aderaw Mekonnen Contractor*, Federal Supreme Court Cassation Division, 2011 E.C, Civil Case No' 1583509(Unpublished) [Here in after, Achefer Woreda Finance and Economy Development Office vs Aderaw Mekonnen Contractor case]

[42]*Dembia Woreda Health Office vs. Amsalu Gizie*, Federal Supreme Court Cassation Division, 2005 E.C, Civil Case No' 77185(Unpublished)

the Civil Code[43] irrespective of the Standard Condition of Contract, MoWUD, 1994, which states "liquidated damages"[44], that the contracting parties have annexed to their public construction contract. But, in other cases, for instance, Meseret Meseso and Water Drilling PLC vs. Africawit Construction PLC[45], it has been considered and interpreted as a type of remedy that contracting parties agreed on in advance-liquidated damages.

Lawyers who have participated in the interview, however, have a similar understanding; liquidated damages are different from penalty. For instance, Olanie Sorie[46] has explained as liquidated damages are different from penalty as follows.

> Even though countries from different legal traditions and jurisdictions have their own recognition and characterizing of relevant law is crucial to deal with liquidated damages; uncertainty to measure the actual damage of a construction project, being a pre-estimated amount in the construction contract, being a reasonable amount, and its status being and considered as compensation not as a penalty are common features of liquidated damages.[47]

Woubshet Shiferaw[48], however, has concluded that the status of liquidated damages and penalty are similar in Ethiopian laws, and their application in courts there off. Because he said, elements of the test i.e. "the amount fixed by the party in advance, there should be a failure to discharge an obligation on due time or fail to discharge the duty at all", that has been stated in the Civil Code, [49], of penalty are similar with elements test of liquidated damages i.e. pre-estimated amount, there should be a breach of the construction contract on the agreed time and quality. He added, both the penalty and liquidated damages "shall be due notwithstanding that no actual damages was caused to the employer."[50]

Unlike Woubshet's understanding, a practical problem faces the employer's position if liquidated damages is held to be a penalty. Is the employer restricted to the recovery of such amount as can be proved up to, but not greater than, the amount of the sum held to be penal? Some

[43]Civil Code of The Empire of Ethiopia, 1960, *Negarit* Gazzet, extraordinary issue, Proc. No. 165, 19th year, No'.2, Art.1889[Here in after, the Civil Code, 1960].
[44]MoMUD, 1994, supra-14, Clause 47(1)
[45]*Meseret Meseso and Water Drilling PLC vs. Africawit Construction PLC*, Federal Supreme Court Cassation Division, 2007 E.C, Civil Case No' 94825[Unpublished]
[46]Interview with Olani Sorie, an Attorney at Private institution, on *the status of liquidated damages in pertaining laws and its application in courts in Ethiopia, May 20, 2020*[Here in after, interview with Olani]
[47]Ibid
[48]Woubshet Shiferaw, *Construction Contract*, lecture delivered at, School of Law, Bahir dar University, June 03, 2019.
[49]Civil Code, 1960, supra-43
[50]Civil Code, 1960, supra-43, Art. 1892(1)

commentators have come to the conclusion that the amount stipulated as a penalty is not a ceiling on the amount of damages recoverable, while another thinks the question is still open, at least in so far as building contracts are concerned.[51] Stephen Furst traced the effect of courts of equity on sums stipulated as penalties and noted that if the actual damages could easily be estimated, the penalty would be cut down and the actual damage suffered would be assessed.[52] No qualification is placed upon the statement and, at face value; it could be taken as authority for the assessment of the damage of any amount, even greater than the penalty sum itself. It would probably be going too far to construe the remarks in that way, since removing a penalty in favor of actual damages is hardly likely to have been equitable if it resulted in the sum payable being thereby increased. Thus, unlike liquidated damages, penalty couldn't restrict an employer from claiming actual general damages as far as it can be proved.

The report of the Secretary-General of the United Nations Commission on International Trade Law has mentioned two common features in the regulation of liquidated damages and penalty clauses; an accessory nature of liquidated damages and penalty clauses, and special regulation to prevent abuse.[53]

First, in general, liquidated damages or penalties are only payable if there is a liability for non-performance of the principal obligation. Non-performance of the principal obligation may sometimes not entail liability e.g. because the principal obligation is void, or there is a sufficient defense for non-performance, such as force majeure or absence of fault, or a requisite "*mise en demeure*" or other notice has not been given. Since the purpose of liquidated damages or penalty clauses is to recover compensation or inflict punishment for breach of the principal obligation, no liquidated damages or penalties are payable when there is no breach.[54] However, the rules in some legal systems enable the parties by express agreement to make the penalty payable even when non-performance of the principal obligation does not entail liability.

Second, many legal systems contain special rules to prevent the use of liquidated damages or penalty clauses to oppress the weaker party in certain transactions, e.g. employment contracts, to

[51]Stephen Furst and Vivian Ramsey, *Keating on Construction Contracts*, 8th ed., Sweet & Maxwell, London United Kingdom, 2008, P. 319[Here in after, Stephen Furst and Vivian Ramsey, Keating on Construction Contracts]

[52]Stephen Furst and Vivian Ramsey, Keating on Construction Contracts, supra-51

[53]United Nations Commission on International Trade Law, 'Report of the Secretary-General: Liquidated Damages and Penalty Clauses', *Yearbook of the United Nations Commissions on International Trade Law*, 1979, Vol. X, PP.40-48, P. 41[Here in after, UNCITRAL, Report of the Secretary General]

[54]UNCITRAL, Report of the Secretary-General, supra-53, Id, P. 42

protect the employee; contracts of loan, to protect the debtor; and leases of lands and dwellings, to protect the tenant. No unification of these special rules is feasible, since they result from the special conditions and policies of each country, and accordingly these transactions must be excluded from the scope of any unified rules.[55]

The common law and equitable principles governing the enforceability of liquidated damages apply generally (though not necessarily uniformly) across commercial contracts including in the field of contracting for construction work; construction law texts along with many detailed papers and articles provide detailed commentary upon such damages almost invariably; and the standard forms of construction contract in widespread use for domestic or international construction works provide for the use of liquidated damages as a pre-estimated compensation not as a penalty against defaulting part. No exception couldn't be forwarded and justified concerning the status of liquidated damages in Ethiopia.

Taking one of the commentaries by Lord Dunedin is extremely important to distinguish liquidated damages from penalty. The rules for deciding whether a sum is to be considered liquidated damages or a penalty were formulated by Lord Dunedin in Dunlop Pneumatic Tyre Co Ltd vs New Garage & Motor Co Ltd[56] Case. These are set out below with a comment.

> Though the parties to a contract who use the words penalty or liquidated damages may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The court must find out whether the payment stipulated is in truth a penalty or liquidated damages.[57]

It is not particularly relevant that the parties have agreed on the sum as liquidated damages. Since the courts in common law jurisdiction have paid little attention to the terminology adopted by the parties, in that case, not only was the sum expressed by the parties as liquidated damages, but it was also clearly stated that it was "not a penalty or penal sum".

However, notwithstanding the clear words describing liquidated damages in public construction contract documents, courts in Ethiopia have had little hesitation in finding that the sum was a penalty, it has held that sums stated as penalties are in fact liquidated damages. So, Ethiopian laws and courts have deviated; the essence of a penalty is a payment of money stipulated as "*in*

[55]Ibid
[56]Dunlop Pneumatic Tyre Co Ltd vs New Garage & Motor Co Ltd, at <https://www.lawteacher.net,> accessed on April 10, 2020[Here in after, Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd]
[57]Ibid

terrorem" of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage.

In practice, it may be difficult to allocate damage that directly and naturally flows from the breach and which damage does not so flow but depend upon special knowledge that the contractor had at the time the contract was made. The amount of damage is seldom easy to ascertain and prove. But the question of whether a sum stipulated is a penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of making the contract, not as at the time of the breach.[58]

The court, in Dunlop Pneumatic Tyre Co Ltd vs. New Garage & Motor Co Ltd[59] Case, held its rule in two parts. The first part of the decision was whether a sum is liquidated damages or penalty will hinge not only on the terms of a particular contract but also on the inherent circumstances of that contract. The second part of the rule was that the terms and inherent circumstances to be considered are those existing at the time the contract was made, not when the term was breached. This is of importance when considering whether a sum is a genuine pre-estimate of loss, particularly when the likely damages were difficult or impossible to forecast at that time, but perfectly clear later.

In Dunlop, the court proceeded and set out four tests which could prove helpful or even conclusive to determine whether a provision in a contract is penalty or liquidated damages.

> (a) It will be held to be a penalty if the sum stipulated for is extravagant and "unconscionable" in amount in comparison with the greatest loss which could conceivably be proved to have followed from the breach; (b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid; (c) There is a presumption (but no more) that it is a penalty when a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damages and (d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties. Then, a pre-estimated compensation couldn't be a penalty.[60]

The effect of that appears to be that, where a sum is held to be a penalty, a party may act on the penalty and obtain a judgment, but the court will only allow execution of the judgment up to the

[58]Dunlop Pneumatic Tyre Co Ltd vs New Garage & Motor Co Ltd, supra-56
[59]Ibid
[60]Dunlop Pneumatic Tyre Co Ltd vs New Garage & Motor Co Ltd, supra-56

penal sum. However, the party may opt to disregard the penalty, in which case, s/he/it may sue for and recover the full amount of damages suffered even if they exceed the penalty figure. Because one definition of a penalty is that it is "extravagant and unconscionable in comparison with the greatest loss which could conceivably be proved to have followed from the breach", it will be rare that actual damages exceed the penalty figure.

In conclusion, liquidated damages are different from penalties; the former operates on the principle of "*restitutio in integrum*", while the latter is based on "*in terrorem*". The definitive ruling on the distinction between liquidated damages and penalties came from Dunlop Pneumatic Tyre Company vs. New Garage and Motor Company Ltd.[61] The case established that the core feature of liquidated damages is in being a genuine pre-estimate of loss. Although liquidated damages have been an integral part of Ethiopian pertaining laws and other supportive standard construction contract documents like MoWUD, 1994, document, it has been delighted as a penalty mistakenly in courts in Ethiopia.

Ethiopian courts in dealing with liquidated damages, in most cases, have not appreciated the difference between the liquidated damages and the penalty, where the liquidated damages are recoverable, and the penalty is not. Such courts are, even to be said "reluctant" to decide by considering a liquidated damages clause as a penalty and is mostly accepting the agreed term by the party that fixes the level of damages for breach.[62]

3.1.3 Liquidated Damages as an Exclusive Remedy

A question often arises whether a party to a contract containing a liquidated damages clause can sue for actual damages suffered or whether the party is restricted to the sum expressed as liquidated damages. In principle, where parties enter into a contract, it must be assumed that they know what they are doing and that the contract is an expression of their intentions.[63] It follows that if parties agree that in the event of a particular kind of breach, liquidated damages is payable by the party in breach, that agreement will be upheld by the courts and they will be allowed no other or alternative damages but the damages liquidated in the contract.

[61]Ibid
[62]Ahmed Elsayed ABD EL Bakey, Termination of Construction Contracts and the Related Application of Liquidated Damages, supra-9
[63]David Chappell, Building Contract Claims, supra-4

This principle should be distinguished from the situation where the defendant is in breach of two or more obligations, for one of which the stipulated remedy is liquidated damages, and for the other(s) the remedy is to sue for un-liquidated damages. A situation is where there is but one breach that gives rise to a loss which may be said to trigger a remedy in liquidated damages and a separate kind of loss for which other damages are appropriate.[64]

In the case of liquidated damages in general neither more nor less than the amount stipulated is recoverable, without proof of loss. To the extent that no more than the amount stipulated is recoverable, such a clause functions as a clause limiting liability.[65]

Where there is non-performance of an obligation by one party, the law permits the other party in certain cases to enforce performance. When enforced performance is available, the question arises as to the relationship between enforcing performance and the recovery of agreed liquidated damages. The solutions differ with the type of breach for which the agreed amount is payable[66]; cases where the agreed amount is payable on complete non-performance of an obligation, and cases where the agreed amount is payable for delay in performance.

Under the common law, the employer can obtain specific performance, or recover liquidated damages, but not both.[67] Similarly, in some civil law systems, the employer can enforce either performance or the penalty, but not both.[68] In other civil law systems including Ethiopia, however, while this is the rule in the absence of any agreement on the question, parties can agree that the employer can enforce both liquidated damages and performance.

Where the agreed amount is payable on defective performance, there is general agreement in civil law systems that in such cases the employer can enforce both liquidated damages and performance.[69] Similarly, under common law, the employer can obtain both specific performances of a delayed obligation and liquidated damages payable for the delay.[70]

[64]UNCITRAL, Report of the Secretary-General, supra-53
[65]Ibid
[66]UNCITRAL, Report of the Secretary-General, supra-53
[67] Ibid
[68]However, the 1960 Ethiopian Civil Code has stated that unless otherwise agreed, the employer may require the performance of a contract which includes a penalty, but enforcement of the contract and the penalty may not be required unless the penalty was provided in respect of delay or the non-performance of a collateral obligation. See Art. 1890 of the Civil Code, 1960.
[69] UNCITRAL, Report of the Secretary-General, supra-53
[70] Ibid

Since one of the objects of an agreed amount is to avoid the difficulties of an inquiry into damages, the common law and most civil law systems do not permit the employer, in cases where recoverable damages under the ordinary rules exceed the agreed amount, to waive the agreed amount and claim damages. Nor can the contractor, in cases where the amount recoverable as ordinary damages is less than the agreed amount, assert that should only be liable for ordinary damages.

There are, however, exceptions stated by the Report of the Secretary-General of UNCITRAL[71]; where the loss exceeds the agreed amount, the employer can recover damages for the excess if s/he/it can prove that the breach of contract resulted from negligence, or an intention to injure; if the parties have so agreed (but, some civil law systems provide that, where the loss exceeds the agreed amount, the employer can recover damages for the excess, unless the parties have agreed to the contrary); and the agreed amount is not due if the contractor establishes that the employer has not suffered any loss(unlike this report, under the common law traditions, the fact that no loss, or hardly any loss resulted from the breach of contract does not, in principle, prevent the employer from the recovery of the full amount agreed as liquidated damages. In practice, there is a tendency in such cases to decide that when the clause does not provide a genuine pre-estimate of loss, and therefore, is invalid.

Although a party cannot opt for un-liquidated damages since liquidated damages have been set out in the contract, it seems that a party may opt for an injunction instead.

In General Accident Assurance Corporation v Noel[72], a court in England held that where a party was in breach of a covenant in restraint of trade, the injured party could not have both an injunction to restrain further breaches and liquidated damages in respect of the breaches already committed. The rationale behind these precedents is that if the original obligation to perform the contract falls down after the termination, then all the related minor obligations, such as the liquidated damages clause will fall down accordingly.

The court concluded that the claimants had the option to elect between but could not have both remedies. It is suggested that this is the correct answer to the problem posed when a party commits this kind of breach. If it is assumed that the breach must cause the innocent party

[71]Id, P. 43

[72]General Accident Assurance Corporation vs Noel, at <https://www.law.justia.com,> accessed on April 10, 2020

undoubted but not readily quantifiable harm, liquidated damages appears ideally suited to the situation. But if the award of damages, as in this case, is expressed as a single sum, it may be argued that if the damages are paid, the party in effect has a license to carry on committing the breach, because the injured party can recover no more. The answer to that argument seems to be a party had the opportunity to make an appropriate bargain. An appropriate bargain, in this case, might well have been to have stipulated not a single sum as liquidated damages, but a sum for every week that the breach continued or, as in Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd[73] , for each separate breach.

Tilahun Teshome has agreed as liquidated damages are an exhaustive remedy by stating "being exhaustive/exclusive remedy is one of the basic features of liquidated damages that common legal traditions, like America and the United Kingdom, have accepted".[74]

Ethiopian courts have given their judgment to all sought claims including liquidated damages though the public construction contract that caused such litigation contains a "liquidated damages clause". There are precedents pronounced by the Federal Cassation Division that provides the applicability of the liquidated damages clause in different comportment after the termination of a public construction contract. Such Division sometimes has interpreted, for instance in Ale Nile Business Group PLC vs. Ethiopia Road Authority[75], liquidated damages as a non-exhaustive remedy and sometimes, for instance in South Achefer Woreda Finance and Economy Development Office vs. Aderaw Mekonnen Contractor[76], as exhaustive remedy so that it granted both liquidated damages and other actual general damages and rejected liquidated damages but granted other actual damages, respectively.

Although, almost all public construction contracts have annexed MoWUD, 1994, which lay downs, in principle, as liquidated damages is an exclusive remedy but gives freedom to the contracting parties to agree otherwise which "shall not relieve the contractor from any other of his obligations and liabilities under the contract".[77]

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[73]Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd, supra-56

[74]Tilahun Teshome(prof.), Liquidated *Damages as A remedy under International Construction Arbitration in Ethiopia*, lecture delivered at School of Law, Bahir Dar University, May 22, 2019.

[75]*Ale Nile Business Group PLC vs. Ethiopia Road Authority*, Federal Supreme Court Cassation Division, 2003 E.C, in የፌዴራል ጠቅላይ ፍርድ ቤት ሰበር ሰሚ ችሎት ችሎት ዉሳኔዎች፤ ቅፅ 12፤የኢፌዴሪ ፌዴራል ጠቅላይ ፍርድ ቤት፤ አዲስ አበባ፤ 2004 E.C፤ ገፅ 124-131[Here in after, Ale Nile Business Group PLC vs. Ethiopia Road Authority]

[76]South Achefer Woreda Finance and Economy Development Office vs. Aderaw Mekonnen Contractor, supra-41

[77]MoMUD, 1994, supra-14, Clause 47(1)

It is possibly suggested that where the parties simply omit to insert any rate, they have rendered the clause inoperative and that liquidated damages cannot apply. The employer is left to recover whatever un-liquidated damages can be proved. That may not necessarily be the case where the parties have crossed out the entry in the contract particulars, for instance, annexing any well-known general conditions of construction contracts. However, the sum expressed as liquidated damages has been held to be exhaustive of the remedies available to the employer for late completion or inferior quality performance where the amount of liquidated damages and its calculation rate has been stated well so that it has been held that once the parties had agreed that, in the event of late completion or failure to achieve the required quality, no damages should be applied except such liquidated one.

Some justifications could be stated for reasons why only liquidated damages should be claimed exclusively, one, once the contracting parties agreed as liquidated damages is an exhaustive remedy for any breach of any administrative construction contract, parties should keep their words that can greatly help transactions of the construction industry to be predictable, sustainable, and efficient, particularly in risk sharing mechanisms. Two, it is hardly possible to prove any damage sustained against the employer due to the complex nature of the construction industry which then creates an inconvenient environment for contractor and employer that make them busy for a long period of time to prove it in litigation before courts. Even after such a prolonged litigation period, the court may not consider that it couldn't be proved as to damages which should be or shouldn't be payable by the contractor in event of his failure to complete on time or below the agreed and standard quality. Third, allowing an employer to claim general damages while agreed and incorporating an exhaustive nature of liquidated damages may "terrorize" a contractor to assume and take risks to involve in the construction industry.

That, of course, does not preclude the employer from recovering as un-liquidated damages other losses not directly caused by the breach of an obligation to complete or inferior quality performance, but which may be connected to such breach. This happens in the situation where the defendant is in breach of more than one obligation, for one of which the stipulated remedy is liquidated damages, and for the other(s) the remedy is to sue for general damages. So, when there is one breach that gives rise to a loss that may be said to cause a remedy in liquidated damages and a separate kind of loss for which other damages are appropriate liquidated damages

may not be exhaustive. And again, the employer shall not be precluded from recovering un-liquidated damages when the parties have agreed and provided an exception to such exhaustive nature of liquidated damages or any other assertion that enables the employer to claim general damages apart from liquidated damages.

Another significant concern in relation to the exclusive nature of liquidated damages is when there is no harm at all or less damage sustained than stated in the construction contract. Two contradicting arguments have been reflected; the first argument is a mere default of a contractor gives a right to an employer to claim such liquidated damages irrespective of proving the existence of damage while the second argument is irrespective of the contractor's default, the employer shall not claim if the latter sustained no harm or the claimed amount shall be deducted equivalently to the actual harm if it is less than what stated in the contract.

As far as this researcher understands concerns the second argument is not logical and convincing. If we can agree that the employer couldn't claim any amount beyond the one stipulated in the construction contract under the liquidated damages clause when the contractor is in default. We shall not need to prove any damage sustained. Because the very purpose of the liquidated damages clause under a public construction contract is to avoid or at least minimize any potential conflicts and prolonged litigations in which a claiming party is duty-bound to prove the existence of actual harm. Thus, the employer is entitled to recover the amount specified as liquidated damages if the contract is in default irrespective of whether the damage suffered is less than the amount or nothing at all. Indeed, the employer can recover liquidated damages though it can be demonstrated that has gained from the breach.

To conclude, it appears that the liquidated damages clause is not an alternative or an additional remedy, however, exceptionally; it does not prevent recovering general damages at common law. And, in the situation liquidated damages clause is held to be ineffective, the relevant parties will be entitled to claim for general damages. Therefore, if an administrative construction contract provision provides an employer an option of receiving compensation as liquidated damages or suing for actual damages, it renders the liquidated damages provision unenforceable. The reason why the liquidated damages clause must fail, in this regard, is that the option granted to an employer either to choose liquidated damages or to sue for actual damages or to claim both indicate intent to penalize and terrorize the defaulting contractor. It also negates the intent to

liquidate damages in the event of a breach as far as the purpose of the liquidated damages provision within an agreement is to fix the employer's damages recovery at an agreed amount.

3.1.4 Calculation and Amount of Liquidated Damages

Pre-estimation of loss is seldom easy. The employer may have little idea how much loss may suffer if a construction project is not completed by the due date or completed with inferior quality. Although it has been held that liquidated damages are especially suited to situations where precise estimation is almost impossible, the employer should try to calculate as accurately figure as possible.[78] The employer should include every item of additional cost which can be predicted will flow directly from the contractor's failure to complete on the due date or to perform to the standard requiring quality; that is, the damages recoverable under the first limb of the principle of liquidated damages.[79] It also seems that the sum can be increased to include amounts that would normally only be recoverable under the second limb if the employer can show that special circumstances like gross negligence or intentional injury were involved.[80] It remains unclear whether, in the case of liquidated damages, the special circumstances must be known to the contractor when the contract is made. It also seems appropriate to reveal such circumstances at the tender stage although it could be argued that the higher figure for liquidated damages is itself a sufficient prior notification.

Courts from common law legal traditions have consistently held that liquidated damages provisions for 10% of the total price of the construction project are acceptable, with some contracts upholding percentages as high as 22% under appropriate facts.[81] Arthur J. has listed some court cases, from Florida Courts, that contain a different percentage of liquidated damages.

> Kirkland vs. Ocean Key Associates, Ltd 10% (held reasonable); Hot Developers, Inc. vs. Willow Lake Estates, Inc. 9.65% (upheld as liquidated damages and discussing ranges from 4.85% to 22% held to be reasonable); Bloom vs. Chandler (upholding a liquidated damages clause under which the employer retained a $49,500 deposit as liquidated damages on a contract for $225,000 or 22% of the contracting price); Hooper vs. Breneman (upholding a liquidated damages provision calling for forfeiture of 13.3% of the contracting price); Ivanov vs. Sobel (10% held not to be grossly disproportionate); and Johnson vs. Wortzel (18.2% was not sufficient enough to shock the conscience of the court).

[78]David Chappell, Building Contract Claims supra-4, P.78
[79]Ibid
[80]Ibid
[81]Arthur J. (et al), Liquidated Damages Project, February 2019, at <https://www.law.justia.com,> accessed on March 25, 2020

Pursuant to Sub-Clause 47.1, FIDIC, 1989, the contractor in delay should pay delay damages ("sum, stated in the particular conditions by an employer"), calculated for each day of default at the stipulated in the contract rate, however, the total amount of which should be limited to a stipulated maximum; these damages should be the exclusive remedy for this type of default and keep the contract and obligations intact.[82] According to the aforementioned statement, the minimum and the gadget how to be calculated the amount of liquidated damages claimed by an employer can be determined in the contract. And the maximum limit of the liquidated damage shall be 20% of the contract price.[83]

A Public Procurement Directive, 2010 under Article 16.27.4[84], has employed a provision on how liquidated damages are calculated i.e., 0.1% or 1/1000 of the contract price for each day of delay but limited to 10% of the contract price. The very details of this provision are about pre-calculations of estimated loss under a public construction contract which is difficult from the practical point of view due to the unique nature of each construction project.

Gadgets on how liquidated damages are calculated and the maximum amount thereof are, from all court cases the author reached, except one case of the Federal Cassation Division, 1/1000 or 0.1% of contract price per day and 10% of the contract price respectively. The Federal Cassation Division, at Ale Nile Business Group PLC vs. Ethiopia Road Authority[85], has given its judgment against the judgment debtor to pay 1% of the contract price per day still to reach 10% of the contract price.

"If one of the contracting parties breaches an administrative construction contract or fails to keep his/her/it promises stated in such contract", said Olani Sorie, "an amount of compensation to be paid to the non-default party and its calculation mechanism could be measured in the contract in advance".[86] To calculate liquidated damages, he has delignated two mechanisms; one, including a fixed amount in the contract in advance, for instance, a contracting party at default shall pay 1,000,000 ETB; two, a contracting party at default may pay a certain percentage per day or per

[82]FIDIC, *General Conditions for Construction Contracts*, 1989, Clause, 12(4) [Here in after, FIDIC, 1989]. See also FIDIC, 1999, supra-13
[83]Ibid
[84]Federal Public Procurement Directive, 2010, supra-19
[85]Ale Nile Business Group PLC vs. Ethiopia Road Authority, supra-75
[86]Interview with Olani Sorie, supra-46

week as agreed but limited to a certain percentage of the contract price, for instance, 0.1% of the contract price per day/per week until amounted 10% or 20% of the contract price.[87]

A specially drafted liquidated damages clause may be held to be entirely valid and enforceable despite the absence of any specified sum if it is expressed as two scenarios. The first scenario will be the interest calculated with reference to any trading banks of a country on daily balances of the total of items listed in the clause. Items may include payments made by the employer under any contract relating to the execution of the project and reasonable costs and expenses incurred by such employer in enforcing or attempting to enforce any contract relating to the execution of the construction project. The other items may be equally imprecise. The second scenario will be rates, statutory charges, and other reasonable outgoings.

Although referred to in the contract and by courts in common law jurisdictions as liquidated damages, it is difficult to see how such a clause can justify that description. An important aspect of liquidated damages is that it is a known amount at the time the parties enter into the contract. Although that does not preclude the damages being expressed as a method of calculation, such a method should be known to have a certain result in any given set of circumstances.

To end with, public bodies make use of a formula calculation that basically depends upon a percentage of the capital sum. Whether that would constitute liquidated damages will depend on the precise circumstances and particularly the difficulty with which a precise calculation could be made. The use of a formula is a perfectly sensible approach where it is obvious that substantial loss will be suffered in the event of delayed performance or inferior quality performance.

4. Conclusion

The process of claiming damages through courts is a lengthy and expensive process that requires the claimant to prove the breach and the loss suffered and the relation between the breach and the loss, and even if it is very often clear that there is damage; it is difficult always to prove the value of that damage. To avoid this, the contracting party may prefer to agree on the value of the damages in their contract that in the event of a particular breach the party in default will pay it to the other, and this is named the “Liquidated Damages”.

[87]Interview with Olani Sorie, supra-46

Liquidated damages are a contract-based remedy, not a legal remedy, for late completion of the contract project or inferior quality performance of such project. There is a clear contradiction between Federal Public Procurement Directive, 1/2010, Article 16.27.4, and the judgment rendered by Federal Supreme Court Cassation Division. Since both have a binding nature to lower courts in Ethiopia, courts may be challenged to interpret public construction contracts containing liquidated damages clause to consider as a contractual or legal remedy unless provisions of such directive are amended. The rules for deciding whether a sum is to be considered as liquidated damages or a penalty have been formulated differently whereas the Federal Public Procurement Directive, 2010, under Article 16.27.4 states it as penalty vaguely.

Penalty and liquidated damages are not similar concepts; the penalty is a payment of money stipulated as "*in terrorem*" of the offending party as a deterrent in punishment; extravagant and unconscionable sum; founded on equitable principles–designed to protect parties from contractual terms which are unconscionable; not a genuine pre-estimate of the loss out of all proportion amount; whereas liquidated damages is a pre-agreed sum payable as damages for a party's breach of such contract.

The liquidated damages Clause will be enforced where the court finds that the harm caused by the breach is difficult to estimate, but where the amount of liquidated damages is reasonable compensation and not disproportionate to the actual or anticipated damage. The intent of liquidated damages is simply to measure damages that are hard to prove once incurred. If the liquidated damages are disproportionate, they can, however, be declared a penalty. The clause is then void, and recovery will be limited to the actual damages that result from the breach. Thus, although, the parties to a contract who use the words penalty or liquidated damages may prima facie be supposed to mean what they say, yet the expression used is not conclusive.

In principle, liquidated damages is an exhaustive remedy so that an employer couldn't claim it together with other available general damages such as consequential loss, payment for bid difference, defective liability, and performance security unless contracting parties explicitly provide an exception for such principle and agreed otherwise.

ENFORCEABILITY OF RESTRAINT OF TRADE AGREEMENT UNDER NIGERIAN LABOR JURISPRUDENCE: *IROKOTV.COM LTD. V. UGWU* IN PERSPECTIVE

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Abstract

When an employment contract is created, a term can be inserted wherein the employee is restrained, during and after the cessation of the contract, from engaging in any business that is competitive to that of the employer for a specified period or within a geographic location. Such an agreement is known as a restraint of trade/employment. The questions are, what is the essence of such an agreement and when will it be enforceable under Nigerian law? What is the impact of such an agreement on capital and the mobility of labor on Nigeria's economy? What must employers who may be desirous of adopting the practice know? This article adopts the doctrinal methodology in appraising the validity and enforceability of restraint of trade agreement under Nigerian labor law by focusing on the decision of the NICN in IrokoTV.com Ltd. v. Ugwu. It analyses the validity of the practice under common law and pigeonholes when the same would be enforced by Nigerian courts. The paper highlights what employers who want to adopt restraint of trade clauses in employment contracts, must know and do. It discusses the defenses available to an employee who is unreasonably yoked by a restraint clause. It examines the impact of the judgment on the jurisprudence of restraint of trade in Nigeria; it argues that the judgment is a welcome development having balanced contending interests involved in the restraint of trade practice. It recommends that trade unions should sensitize their members on the position of law as laid down in the decision. Also, if the decision is appealed, the Court of Appeal (which is the final court on labor matters in Nigeria) should uphold the decision due to its rightness and plausibleness.

Keywords: Employment contract, National Industrial Court of Nigeria, Nigeria, Public policy, Restraint of trade

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1. INTRODUCTION

Parties who have the requisite contractual capacity, are legally permitted to enter into contract including a contract of employment.[1] Once such a contract is formed, the law will recognize it if the terms and conditions are not contrary to the express or implied stipulation of the law.[2] Generally, the law will neither recognize nor enforce any contract that is illegal or contravenes the law as this is contrary to public policy.[3] The fact that such a contract places an undue burden on either or both parties, will not qualify as a ground for its non-enforcement by the court.[4] Thus, Section 7 of the Labour Act[5] prescribes certain mandatory terms and conditions which must be contained in an employment contract (or written statement using the language of the Act), which an employer must give to the employee not later than three months after being employed.[6] Additional to these statutory terms, parties can add others so long as the added terms and conditions are not offensive to the law. One of such terms is the one requiring an employee, during the course of employment or so soon thereafter, within a specified time frame or/and geographic location, not to engage in a business that is the same or similar to that of the employer or accept employment from another employer who is a competitor.[7] This type of employment clause/agreement is what is referred to as a covenant in restraint of trade/employment.[8] Such covenants/agreements have become commonplace in Nigeria in light of the increasing competition in the market and the need to gain a competitive edge and stay afloat with business wise.[9] The employee, on the other hand, desires to exploit his/her skill, expertise, knowledge, and talent maximally for the benefit of society as a whole and the law must recognize this desire; create a balance and protect all these interests towards attaining harmonious employment relations.[10]

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[1] Itse E Sagay, *Nigerian Law of Contract,* 2nd ed. (Ibadan, Spectrum Books Ltd. 2000) 8.
[2] Barnabas C Okoro, *Law of Employment in Nigeria,* (Lagos, Concept Publications Limited 2011) 29.
[3] Olugbemi A Fatula, *Law of Contract* (Ile-Ife, Afribic Publications 2012) 89-90.
[4] *Olaniyan v Aroyechun* [1991] 5 NWLR (Pt. 194) 625; *Enigwe v Akaigwe* [1992] 2 NWLR (Pt. 225) 505.
[5] Labour Act Cap. L1 Laws of the Federation, 2004.
[6] Oladosun Ogunniyi, *Nigerian Labour and Employment Law in Perspective,* (2nd ed., Lagos, Folio Publishers Ltd., 2004) 9.
[7] Emeka Chinau, *Employment Law* (Akure, Bemicov Publishers (Nig.) Ltd. 2004) 1-20.
[8] *Andreas I Koumoulis v A. G. Leventis Motors Ltd.* [1973] 1 All NLR (Pt. 2) 144.
[9] Emmanuel J Uko "The Validity of the Doctrine of Restraint of Trade under Nigerian Labour Law" 4(2) *International Journal of Advance Legal Studies and Governance* (2013) 34-46.
[10] Abubakar Yekeni and Tanimola Anjorin, "Non-Compete Clauses in Contracts of Employment in Nigeria: A Critical Evaluation of the Decision in Afropim Engineering Ltd. v. Bigouret & Anor" (2016) 56 *Journal of Law, Policy and Globalisation* 101-108.

The existence of a restraint of trade/employment clause places various interests (i.e. the interest of the employer, the employee, and the society at large) at a variant that needs to be balanced for harmonious employment relations.[11] Several reasons, ranging from economic, social, and legal, account for employers resorting to such employment practices, and its effect on labor mobility and the economy at large cannot be overemphasized.[12] This is so, particularly in a country like Nigeria where it is generally acknowledged that there is an unprecedentedly high level of unemployment.[13]

The issues are: what is the essence of such an agreement and when will it be enforceable under Nigerian law? What is the impact of such an agreement on capital and the mobility of labor on Nigeria's economy? What do employers who may be desirous of adopting restraint of trade in employment contracts need to know? What interest does an employer need to have to warrant the court to inhibit the exploitation of an employee's or former employee's skill and talent; Does the practice of restraint of trade runs afoul of the demands of public policy and how can the various contending interests in a contract of employment with a restraint of trade clause/agreement be balanced? When will a restraint of trade/employment clause amount to an unfair labor practice under Nigerian labor law? This article proffer answers to these issues by reviewing the recent decision of the NICN in *IrokoTV.Com Ltd. v. Michael Ugwu*[14] where the Court had the opportunity to pronounce the validity and enforceability of restraint of trade agreement under Nigerian law. The paper, argues that the decision has deciphered the *raison d' etre* of restraint of trade agreement and what the employer needs to bear in mind in deploying the same in an employment contract. It proffers how a balance could be created between the three competing interests in implementing restraint of trade agreements and when the same would amount to an unfair labor practice under Nigerian labor law. The paper further highlights the impact of the judgment on the jurisprudence of restraint of trade in Nigeria and argues that the decision is a welcomed development and in the event that same is appealed, it should be affirmed by the Court of Appeal which is the apex court on labor matters in Nigeria.

[11] Oladosun Ogunniyi, (n 4) *Op. cit.* 257.
[12] Emmanuel J Uko (no 9) *Op. cit.* P. 39.
[13] David T Eyongndi, and Chi-Johnny Okongwu, "The Legal Framework for Combating Child Labour in Nigeria" (2018) 2(1) *UNIPORT Law Review* 221-234.
[14] Unreported Suit No. NICN/LA/169/2015 Judgement delivered on the 12th day of November, 2020 per Coram J.D. Peters J.

The paper is divided into six sections. Section one is the general introduction. Section two discusses the rationale and types of restraint of trade/employment agreements that parties could execute. Section three examines the validity and enforceability of restraint of trade/employment agreement at common law and how this has influenced decisions of Nigerian courts by virtue of Nigeria's common law heritage. Section four is a review of the NICN decision in *IrokoTV.Com Ltd. v Michael Ugwu*.[15] Section five highlights matters arising from the decision. Section six contains the conclusion and recommendations.

2. THE RATIONALE AND TYPES OF RESTRAINT OF TRADE AGREEMENTS

Before the rationale and types of restraint of trade/employment are examined, it is apposite to answer the question: what is restraint of trade/employment? According to Oji and Amucheazi[16] restraint of trade is a practice whereby an employer and his employee enter into a covenant for the purpose of restricting the right of the employee to engage in particular or specific types of business activities within a given area or locality and or within a stipulated period of time. Emiola[17] defines it as a practice whereby an employer and his employee enter into a covenant for the purpose of restricting the right of the employee to engage in particular or specific types of business activities within a given area or locality and/or within a stipulated period of time. From the foregoing, restraint of trade is a restrictive covenant that forbids an employee from engaging in the same or similar business activity as that of an employer within a specific geographical location or within a specified period of time. The restraint pertains to either locality or time.[18] It is worth noting that restraint of trade does not only operate between an employer and his employee but is a matter of contract thus: could be between two or more employers once executed *qua* parties. For instance, employers and A and B may agree that they shall not employ the former employees of either of each of them within a specific period of time upon cessation of their employment. This agreement, subject to certain conditions as would be discussed subsequently, is valid and therefore binding despite the fact that there is no employer-employee relationship between them. Restraint of trade is a precursor to modern competition law.

[15] *Ibid.*
[16] Elizabeth A Oji, and Offornze D Amucheazi, *Employment and Labour Law in Nigeria,* (Lagos, Mbeyi and Associates Nig. Ltd. 2015) 86.
[17] Akintunde Emiola, *Nigerian Labour Law* 4h ed. (Ogbomosho, Emiola Publishers Ltd., 2008) 61.
[18] Olumide Babalola, *Casebook on Labour and Employment Law* (Lagos, Noetico Repertum Inc., 2014) 314-315.

The main reason employers or business owners resort to restraint of trade/employment, is to protect their business interest from competitors.[19] No prudent employer or business owner would wish its venture to suffer a minor or major setback nor allow its trade secret to becoming public knowledge. The financial loss and even the possibility of folding up the business due to such an occurrence cannot be overemphasized. Restraint of trade, aside from primarily protecting the interest of the employer, in a long run, protects the economy in general as the effect of the negative consequences of leak or theft of an employer's business interest (trade secret) on the economy could be enormous.[20] An employer or anyone, even at common law, has a right to protect a legitimate interest. Where business concerns fold up due to sharp practices, it is capable of leading to loss of employment meaning decrees in taxes and an increase in crime rate as there would be several persons rendered unemployed wanting to make ends meet even through resorting to crime. It is therefore, in the overall interest of the economy, that reasonable and lawfully executed restraint of trade/employment agreements are honored or enforced.

As per the types of restraint of trade/employment agreements that can be executed, there are two. First, it could take the form of a restraint placed on the employee while in the employ of the employer. The second form it could take is for it to be placed and becomes operative after the departure of the employee from the employ of the employer post-employment. The first restraint, by its nature, is customarily justified as it seeks to protect the legitimate interest of the employer while in business and the law, would necessarily lend its aid.[21] It is worth noting that the validity of restraint during the currency of the employer-employee relationship, is not a matter of course, i.e. is not conclusively applicable just because it is made during th continuation or substance of the employment.[22] For it to be lawful and enforceable, it must, as a matter of compulsion, fulfill the basic elements of the general law of contract pertaining to the validity of a contract.[23] However, the second form, as a general rule, is *prima facie* illegal and therefore

[19] *Petrofina Great Britain v Martin* (1966) Ch. 146; *Tanksale v. Rubee Medical Centre Ltd.* [2013] 12 NWLR (Pt. 1369) 345.
[20] Andrew C Bells, *Employment Law* (London, Sweet and Maxwell, 2006) 175.
[21] *J. K. Randle & Anor. v. Nottidge* (1956) 1 F. N. C. 96; *Hivac Ltd. v Park Royal Scientific Instruments Ltd.* (1946) Ch. 169; *John Holt & Co. Ltd. v Chalmers* (1918) 3 N.L.R. 77.
[22] Akintunde Emiola, (n 17) *Op. cit.* 61-62.
[23] *Esso Petroleum Company v Harper's Garage (Stourport) Ltd.* (1967) 1 All E.R. 699; *Union Trading Company Ltd. v. Hauri* (1940) 6 WACA 148.

unenforceable. This is because, its justification that it purportedly seeks to protect the legitimate interest of the employer is prone to disputation as it can adversely affect the mobility of labor and the general interest of the public making it therefore, contrary to public policy.[24] For restraint after employment to be enforced, it has to be justified on reasonable grounds.[25] The onus to show that the restraint is reasonable and therefore valid and enforceable, rests squarely on the party (usually the employer) who is desirous of enforcing it and it will not shift to the employee.[26]

Also, the reasonableness of a restraint is determined based on the peculiarity of each case hence, what is reasonable in one case, may not be in another.[27] A post-employment restraint that ordinarily and merely seeks to protect an employer from competition from a former employee or from the employee's exercise of his/her skill simply because the same was acquired in the employ of the former employer is *ab initio* illegal, void and no effect whatsoever.[28] It is apposite to note that competition by an employee during the currency of an employment contract amounts to a breach of the implied term of fidelity and therefore amounts to a breach of contract.[29] It is therefore fair, just and reasonable for the law to protect the employer against an employee's breach of the hallowed obligation of fidelity which forms the substratum of the employment contract through restraint of trade/employment.

3. ENFORCEABILITY OF RESTRAINT OF TRADE CLAUSES AT COMMON LAW

Generally at common law, a restraint of trade/employment covenant is unenforceable since it is regarded as being contrary to the public policy of promoting trade and business and hence, void *ab initio.*[30] Where both parties to the covenant, abide by it and perform the covenant, that is the end of it but the Court will not assist either party to provide a platform for its enforcement. In *Mitchel v Reynolds*[31] Lord Smith L. C. stated that "it is the privilege of a trader in a free country, in all matters not contrary to law, to regulate his own mode of carrying it in according to his own discretion and choice. If the law has regulated or restrained his mode of doing this,

[24] Akintunde Emiola, (n 17) *Op. cit.* 62.
[25] *Union Trading Company Ltd. v Hauri* (1940) 6 WACA 148.
[26] Elizabeth A Oji, and Offornze D Amucheazi, (no 16) *Op. cit.* 87.
[27] Akintunde Emiola, (n 17) *Op. cit.* 63.
[28] *Ibid.*
[29] *Hivac Ltd. v Park Royal Scientific Instruments Ltd.* (1946) Ch. 169.
[30] *Nordenfeld v Maxim, Nordenfeld Guns and Ammunition Co.* (1894) A.C. 535.
[31] (1711) Ch. 125.

the law must be obeyed. But no power short of the general law ought to restrain his free discretion."[32]

In *Nordenfelt v Maxim, Nordenfelt Guns and Ammunition Co*[33]where a Swedish arm inventor promised on the sale of his business to an American gun maker that he "would not make guns or ammunition anywhere in the world, and would not compete with *Maxim* in any way." Lord Macnaughten in that case stated *inter alia* that such a restrain is justified only if it is reasonable; in the absence of special circumstances justifying them, they are void and unenforceable as they are contrary to public policy.[34]

The above common law position subsisted until in *Herbert Morris Ltd. Saxelby*[35] the Court came to a position that under certain circumstances, contracts in restraint of trade would be enforceable. Such circumstances include: where such contract is necessary to protect an employer's legitimate competitive interest; where the enforcement of the such contract is neither unreasonably burdensome to the employee nor harmful to the public interest; and where the time and geographical scope of the restriction is reasonable. In *John Holt & Co. Ltd. v Chalmers*[36] where a restrain covenant disallowed the employees after leaving the employ of the employer, not to conduct business or serve anyone in a similar business within a wide range without the prior consent of the former employer, the court held that the restraint was unnecessarily wide and unreasonable hence, void and unenforceable.[37] The court found that the restriction went beyond what was necessary to protect the legitimate interest of the covenantee.[38] In determining the reasonableness or otherwise of restraint, the status of the employee in relation to the employer's business is taken into consideration.[39] Where the employee holds an important post in the employer's employ whereby he/she is in possession of

[32] Norman Selwyn, *Law of Employment* (London, Butterworths, 2000) 408.
[33] (1894) A.C. 535.
[34] *Statoil Nigeria Ltd. v Inducon (Nig.) Ltd. & Anor.* (2012) LPELR-7955; *Okonkwo v Okagbue* [1994] 9 NWLR (Pt. 368) 301. In the latter case, the Court of Appeal defined public policy as "the ideals which for the time being prevail in any community as to the conditions necessary to ensure its welfare, so that anything is treated as against public policy of it is generally injurious to the public interest. Public policy holds that no subject can lawfully do that which has a tendency to be injurious to the public, or against public good, which may be term, as it sometimes has been, the policy of the law, or policy in relation to administration of the law."
[35] (1916) 1 A.C. 688.
[36] (1918) 3 N.L.R. 77.
[37] *Green v. Sketchley Ltd.* (1979)1 RLR 445.
[38] *Mason v Provident Clothing and Supply Co.* (1913) A.C. 724.
[39] Norman Selwyn (no 30) *Op. cit.* 413.

sensitive information like trade secrets, the court will be more willing to uphold a restraint agreement and *vice versa*. In *Plowman (G.W.) & Co. Ltd. v Ash*[40] the Court held that a restraint on a sales representative was valid on the ground that he was placed in a position to attract his employer's customers while in *M & S Drapers v Reynolds*[41] the Court held that the restraint imposed on a collector-salesman was unreasonable and therefore unenforceable.

Even in cases of restraint of trade, *pacta sun servanda* still prevails as a result, the court would be loath to strike out an agreement voluntarily entered into by the parties as it is a requirement of public policy that parties fulfill their agreements.[42] Where some of the provisions of a restraint clause are severable, the court will do all to severe and enforce that part under the doctrine of severance.[43] This doctrine requires that where a restraint clause contains two or more terms, the Court can discountenance the offensive term and enforce the other (s). Thus, where a restraint of trade agreement contains two or more terms with one not being unreasonable, the court will severe the unreasonable term and enforce the reasonable term (s).[44]

Nigeria, by her colonial history, adopted the common law position on restraint of trade/employment. Alexander J in *Leontaritis v Nigerian Textile Mills Ltd*[45] stated the law as follows:

> While it is true that a master is not entitled to protect himself at all from the mere competition of his servant, he is entitled to protect himself against the disclosure or use by the servant, especially when he is employed in a confidential position, of trade secrets, names of customers, and other information confidentially obtained… a reasonable restraint imposed for this purpose is valid, even if it has the effect of preventing to some extent the future competition of the servant.

[40] (1964) 2 All E.R. 10.
[41] (1956) 3 All E.R. 814.
[42] *Beresford v. Royal Insurance Co. Ltd.* (1938) A.C. 586 at 604.
[43] Abhishek Bansa, "Doctrine of Severability- How Operates?" <https://acumenjuris.com/article-single.php?id=34> accessed 20 November 2022; Dinesh Singh Chauhan, "Understanding the Blue-Pencil Rule of Severability under Contract Law" <https://www.legalserviceindia.com/legal/article-4214-understanding-the-blue-pencil-rule-of-severability-under-contract-law.html> accessed 20 November 2022**;** Minken Employment Lawyer, "Supreme Court of Canada Unwilling to Apply Doctrine of Severance to Restrictive Covenants"<https://www.minkenemploymentlawyers.com/blog/contracts/restrictive-covenants/supreme-court-of-canada-unwilling-to-apply-doctrine-of-severance-to-restrictive-covenants/> accessed 10 November 2022.
[44] *Scorer v Seymour-Johns* (1956) 3 All E.R. 814.
[45] (1967) NCLR 114 at 123.

The above view was adopted by the Supreme Court in *Andreas I. Koumoulis v A. G. Leventis Motors Ltd.*[46] where the court held that "generally, all covenant in restraint of trade are *prima facie* unenforceable in the common law. They are enforceable only if they are reasonable with reference to the interests of the parties concerned and of the public."[47] The above position had earlier been held in *Anglo-Africa Supply Co. Ltd. v John Benvie*[48] in this case, the Claimant employer executed a restraint agreement with the Defendant employee to the effect that six months after he ceases from its employ, it will not engage directly or indirectly in any business in competition with that of the former employer who was timber and general trading merchants. The employment was abruptly terminated and the Defendant started timer trade within the localities he had worked for the employer. The employer sought to enforce the agreement against him but the court held that it was unreasonably too wide as regards its geographical coverage and unreasonably comprehensive as regards the business from which the defendant was to be excluded from engaging.[49]

An important issue is, can a third party intervene in a covenant in restraint of trade? Generally, the principle of privity of contract states that only a party to a contract can derive benefit or incur liability therefrom[50] prevails to foreclose third parties from intervening in a contract. Based on the foregoing, it could be asked, if two employers have a trade-protection agreement that infringes on the right of an employee who is not a party to the agreement, can the employee intervene to set aside the agreement, or does he/she has no remedy? Certainly, the answer is negative as equity will not suffer a wrong-to-be without a remedy.[51] At least, two principles would come to the aid of such a third party. The first is that expounded by Lord Atkin in the famous case of *Donoghue v Stevenson*[52] i.e. "the neighborhood principle" which is to the effect that where a person is injured by a transaction arising from the contract of two persons, the third

[46] [1973] 1 All NLR (Pt. 2) 144.
[47] *C. F. O. A. v George Leuba* (1918) 3 N. L. R. 67.
[48] (1937) 13 N.L.R. 158.
[49] *Afropim Engineering Construction Nig. Ltd. v Jacques Bigouret* [2012] FWLR (Pt. 622) 170; *Hygeia HMO v Simbo Ukiri* Unreported Suit No. NICN/LA/454/2013; *The La Casera Co. Ltd. v Mr. Prahlad Kottappurath Gangadharan* Unreported Suit No. NICN/LA/533/2013 Judgment delivered on 17th March, 2016.
[50] *Ben Chukwuma v. SPDC* [1993] 3 NWLR (Pt. 289) 512.
[51] *Nasiru Bello v Attorney General of Oyo State &Anor.* [1986] 5 NWLR (Pt. 45) 828; David T Eyongndi, "The Supreme Court Decision in *Re Abdullahi* Re-Echoing *Ubi Jus Ibi Remedium* as a Shield and Sword" (2019) 4(1) *Miyetti Quarterly Law Review* 119-138.
[52] (1932) A.C. 562.

party is not necessarily precluded from bringing an action simply because he was not a party to the contract the performance or non-performance which has resulted in injury to him. The aforementioned principle was approved by the Supreme Court of Nigeria in *Patrick Abusomwan v Mercantile Bank of Nigeria Ltd.*[53] that the obligation of contracting parties extends to all persons who are likely to suffer injury from their action or omission and is not limited to the parties alone. The reason is such affected persons are neighbors whom the contracting parties ought to have in contemplation in all they do or forebear so that they are not exposed to in jury howsoever.

Aside from the neighborhood principle, a third party who is adversely affected by a restraint covenant will be allowed to intervene by the court based on public policy demand. On public policy consideration, where the restraint qualifies as an unjustified restraint on the mobility of labor, the same will be declared illegal hence, a third party can intervene to have the court declare it null and void. It is argued that if a restraint agreement would amount to an unjustified restraint on free competition (which is a necessary stimulus for economic growth), such restraint is equally illegal and should be voided. Monopoly is capable of negatively affecting the economy; where an employer is positioned to promote monopoly, it becomes imperative to protect the economy against such. The case of *Kores Manufacturing Co. Ltd. v Kolok Manufacturing Co. Ltd*[54] demonstrates the first arm of the public policy consideration (mobility of labor). The two companies covenanted not to employ the former employees of each other save after five years from the period of disengagement. The defendant company then employed the plaintiff's chief research chemist within five years of leaving the plaintiff's employ. The plaintiff sought to enforce the agreement between them. The court held that the agreement was not only too wide but constituted an unjustified restraint on the mobility of labor and therefore, not enforceable between the parties nor against their employees. In fact, an affected employee, where there is unjustified restraint of mobility of labor, can obtain an order of court setting aside the agreement. In *Eastham v Newcastle United Football Club Ltd.*[55] a footballer was granted a declaration that the system of "retain and transfer" operated by members of the English Football League was an undue restraint on the mobility of labor as it permitted the defendant to retain

[53] [1987] 3 NWLR (Pt. 60) 196.
[54] (1958) 1 All E. R. 65.
[55] (1963) 3 All E.R. 139.

him on from moving to other clubs where his talent and skills could be deployed despite the fact that constant playing was essential to his career growth and development.

In fact, the Court of Appeal in *Aprofim Engineering Construction Nig. Ltd. v Jacques Bigouret & Anor.*[56] where the Appellant had inserted a clause in the employment contract barring the respondent from engaging in a similar contract six months after leaving its employment. The Respondent, while in the employ of the Appellant, joined others to set up a parallel company and the Appellant commenced an action seeking injunctive reliefs. Both the trial court and the Court of Appeal held that the restraint was an affront to Section 17(3) (a) and (e) of the 1999 Constitution as it seeks to render the respondent unemployed for a period of six months making him useless to himself and his family after being sent out of job just to satisfy the mischievous, desires of a selfish, greedy, monopolist, who detests competition and loathes fairness.[57] The court commenting on the nature of the article on restraint of trade in the contract, described it as a" sentence of death, a wicked contrivance that completely negates employee's mobility of labor, and bars his right to work and earn a living."[58]

4. *IROKOTV.COM LTD V MICHAEL UGWU EXAMINED*

The brief facts of this case are that: by its General Form of and Statement of Facts filed on 8th of May, 2015, the Claimant sought the following reliefs against the defendant, a declaration that the act of the defendant in organizing the business known as Africagent ltd. and Freemedigital to conduct the business of digital music distribution and rendering other entertainment promotional services constitutes a breach of the non-compete and confidentiality obligations of the defendant as set out in the employee non-disclosure agreement dated 1st December, 2011; a declaration that the act of the defendant of openly soliciting the customers of the claimant constitutes a breach of their employee non-disclosure agreement; an order restraining the defendant directly or indirectly through its agent, privies or any other authorized persons from further breach of the employee non-disclosure agreement save after the lapse of two years from the date of termination. It also sought an order restraining the defendant from further contacting the clients of the claimant who he got to know while in its employ save after

[56][2012] FWLR (Pt. 622) 1740.
[57] *Aprofim Engineering Construction Nig. Ltd. v Jacques Bigouret & Anor.* [2012] FWLR (Pt. 622) 1740 per Mbaba JCA Pp. 1762-1764.
[58] *Ibid.*

the lapse of one year as contained in the employee non-disclosure agreement. It sought an order compelling the defendant to render an account for all profits made in breach of the agreement, damages for breach of contract, and cost of the action.

The claimant had employed the defendant from October 2011 to October 2013 as a Senior Manager of its business vide an employment contract dated 1st October 2011. On the 1st of December, 2011 after working two months under the said employment contract from the UK, and thereafter relocating to Nigeria, the Claimant caused the defendant to sign an Employee Non-Disclosure Agreement dated 1st December, 2011. One of the clauses provides that the employee shall not take up a job with any of the employer's clients, vendors, and partners without the written permission of the Management of the employer; in the event that the employee's employment is terminated for any reason, he shall for a period of one year, from the date of termination, have any business dealings whatsoever with the clients of the claimants directly or through any entities or associates with any customer or client of the claimant or its subsidiaries, or any firm or company which has contacted or been contacted by the claimant, a potential customer or client of the claimant and shall maintain the strictest confidentiality in all dealings with information and trade secrets while in the employ as pertaining to the employer's customers and businesses. The defendant, while in the employ of the claimant, breached the Employee Non-Disclosure Agreement by setting up parallel businesses to that of the claimant and soliciting the claimant's clients whom he got to know while working for the claimant. These actions of the defendant, infract the employment contract which is what regulates the parties judging by the decision in *Olaniyan v University of Lagos.*[59] It contended that parties are bound to perform their obligations to a contract they willingly entered.[60] As far as the Employee Non-Disclosure Agreement is concerned, the claimant furnished which is the period and continuous disclosure to the defendant of the claimant's trade secrets, knowledge, and confidential information which had come and which was to come to the knowledge of the defendant by virtue of his employment with the claimant placing reliance on *BFI Group Corporation v Bureau of Public Enterprises*[61] and that having failed to report to work in the month of October

[59] [1986] 3 NWLR (Pt. 9) 599.
[60] *Beresford v Royal Insurance Co. Ltd.* (1938) A.C. 586, 604.
[61] [2012] 18 NWLR (Pt. 1332) 209.

2013, the defendant did not earn the salary and was therefore not entitled to it placing reliance on *Adeko v Ijebu-Ode District Council*[62]

The claimant further contended that the termination of the defendant's employment was proper as his action amounted to gross misconduct warranting summary dismissal as was done it cited the case of *Union Bank Plc. Soares*.[63]

The defendant, in response to the claimant's claim, entered an appearance and filed a Statement of Defence and Counter-Claim. He contended that he was not in breach of the Employee Non-Disclosure Agreement between them and that, the said agreement is null and void and of no effect whatsoever having been signed under duress as he had resumed work with the claimant after signing the employment contract which its terms, he was agreeable to and relocated his family from the United Kingdom to Nigeria before he was subsequently presented the Non-Disclosure Agreement to sign two months later. Having altered his position to such an extent, the claimant had no choice but to sign the agreement. The defendant further contends that no consideration was furnished for the subsequent agreement and the consideration for the employment agreement, cannot avail the Non-Disclosure Agreement as same is regarded as past consideration making the whole contract, irregular and invalid in law since it lacks a major ingredient of a valid contract placing reliance on *Taura v Chukwu.*[64] The clauses of the Non-Disclosure Agreement which are covenants in restraint of trade are illegal, null, and void and therefore of no effect whatsoever as they are unreasonably unjustifiable based on the Supreme Court decision in *Andreas I. Koumoulis v A. G. Leventis Motors Ltd.*[65] the onus is on the claimant to prove that the restraint of trade is reasonable and therefore justified before the burden would shift to him. The way and manner in which the Employee Non-Disclosure Agreement was executed, constitutes an unfair labor practice that must be sanctioned by the Court. He, therefore, urged the Court to dismiss the claims of the claimant in its entirety as the same is frivolous. The defendant counter-claimed against the claimant for the sum of ₦ 628, 404 (Six Hundred and Twenty-Eight Thousand, Four Hundred and Forty Naira) only as his unpaid salary for the month of October 2013 which was outstanding. The sum ₦ 628, 404 (Six

[62] (1962) 1 SCNLR 349.
[63] [2012] 11 NWLR (Pt. 1312)550.
[64] (2018) LPELR-45990.
[65] [1973] 1 All NLR (Pt. 2) 144.

Hundred and Twenty-Eight Thousand, Four Hundred and Forty Naira) only as salary in lieu of notice of termination of his employment as contained in the contract of employment between the parties; interest on the sums at the rate of 21% per annum until the amount is totally liquidated; the sum of ₦ 5, 000, 000: 00 (Five Million Naira) only as damages for wrongful termination of employment; and the cost of the action.

After reviewing the case of both parties and the address of their counsel, the court formulated three issues for determination. They are, whether the Employee Non-Disclosure Agreement is valid and enforceable; whether the claimant has proved his/her case to be entitled to all the reliefs sought; and whether the defendant is entitled to any of his counter-claims. On issue one which is the plank upon which all other issues rest, the court held that at common law, restraint agreements, such as the one between the parties, are generally illegal therefore, null and void as was held in *Nordenfelt v Maxim, Nordenfelt Guns and Ammunition Co*[66] however, such agreement, would be enforced if and only if it is reasonable as was held in *BDO Seidman v Hirsh Berg.*[67] A restraint agreement is said to be reasonable and therefore enforceable if, it is not greater than is required for the protection of the legitimate interest of the employer; does not impose an undue hardship on the employee; and is not injurious to the public.[68] The court further noted that the above common law position is what is obtainable in Nigeria as decided in a plethora of cases by both the Court of Appeal and affirmed by the Supreme Court particularly cases such as *Andreas I. Koumoulis v A. G. Leventis Motors Ltd.*[69] *Afropim Engineering Construction Nig. Ltd. v Jacques Bigouret*[70] where the general rule and its exceptions were stated.[71]

The court came to the conclusion that it is settled law that even at common law, a party has the right to protect a legitimate interest. It then proceeds to pose the question "what then is the interest which the claimant seeks to protect"? It came to the conclusion that from the totality of the evidence adduced by the claimant, there was no evidence of any trade secrets to which the defendant has access that warrants protection hence, there was no legitimate interest worth

[66] (1894) A.C. 535.
[67] 690 N.Y. 2nd 854 (Ct. App. 1999).
[68] *Taprogge Gesellschaft MBH v IAEC India Ltd.* (1988) AIR Bomm.
[69] [1973] 1 All NLR (Pt. 2) 144.
[70] [2012] FWLR (Pt. 622) 170.
[71] *Hygeia HMO v Simbo Ukiri* Unreported Suit No. NICN/LA/454/2013; *The La Casera Co. Ltd. v Mr. Prahlad Kottappurath Gangadharan* Unreported Suit No. NICN/LA/533/2013 Judgment delivered on 17th March, 2016.

protecting in the instant case.[72] The Court also reasoned, assuming there exists a legitimate interest to be protected, was the restraint, imposed by the claimant on the defendant, reasonable and therefore enforceable? The reasonability of such a restraint is on a tripod basis, i.e. it must be reasonable in the interest of the claimant, defendant, and the public. It answered this question of the reasonableness of the restraint in the negative. The restraint was against the interest of the defendant and the public as it prevents him from putting his skills to the benefit of the public. The Court, therefore held that "I find and hold that the said restraining clause is unreasonable, contrary to public policy and therefore an illegal and invalid contract which the Court will not and cannot enforce."[73]

Having resolved issue 1 which is the fulcrum of the suit against the claimant, all other reliefs which rest on it, were dismissed.[74] On the Counter-claim of the defendant, the court found that the claimant/respondent did not controvert the evidence of the defendant/counter-claimant on the failure to pay his October 2013 salary as the notice of termination was with immediate effect hence, since the fact not challenged are deemed admitted, the claim succeeds. On the claim for one month's salary in lieu of notice, the court found that the immediate termination of the employer failed to take cognizance of the payment of salary in lieu of notice hence, the defendant/counter-claimant was also entitled to it therefore the claim also succeeds. The claims for interest and cost of the action also succeed accordingly.[75]

This decision has reiterated as well as raised salient issues relating to the validity and enforceability of restraint of trade/employment agreements are concerned under Nigerian law. The influence of the common law on Nigerian law cannot be emphasized thus, it would seem that from the grave, the common law still rules and reigns particularly in the area of contract and more particularly, labor and employment law. The Court dealt with issues that an employer must take cognizance of when executing a restraint of trade agreement as per when and how. The preceding section deals with these issues as matters arising from the decision.

[72] *IrokoTV v Michael Ugwu* Unreported Suit No. NICN/LA/169/2015 Judgement delivered on the 12th day of November, 2020 per Coram J.D. Peters J. P. 15.
[73] *Ibid* P. 16.
[74] *IrokoTV v Michael Ugwu* Unreported Suit No. NICN/LA/169/2015 Judgement delivered on the 12th day of November, 2020 per Coram J.D. Peters J. Pp. 17-18.
[75] *IrokoTV v Michael Ugwu* Unreported Suit No. NICN/LA/169/2015 Judgement delivered on the 12th day of November, 2020 per Coram J.D. Peters J. 17-19.

5. MATTERS ARISING

The defendant had contended that the Employee Non-Disclosure Agreement is invalid, null, and void and therefore, unenforceable because it was not executed alongside the main contract but the claimant, had waited for him to accept the contract, relocated his family from the UK to Nigeria and was subsequently confronted with the Employee Non-Disclosure Agreement. At this point, he had no choice but to sign it under "duress" as he had altered his position to an extent that, to do otherwise would have been a great hardship to him.[76] The way and manner the claimant adopted in executing the Employee Non-Disclosure Agreement amount to unfair labor practice which is contrary to public policy having fettered the discretion of the defendant as far as signing same were concerned. This argument is profound and worthy of note by an employer who might wish to execute a restraint agreement with an employee.

The court, making findings on the above, reasoned thus:

> The claimant suddenly realized the need for it (i.e. the Employee Non-Disclosure Agreement) in some two months into the defendant's employment with it. That was also two months after the defendant had altered his position in relocating to Nigeria from his base in the United Kingdom along with his family. I dare say that by his conduct, the claimant intended to put the defendant in a difficult position of a *faith accompli* in which the defendant would have no choice but to dance to whatever the dictates of the claimant might be. The question is what were the options available to the defendant who relocated with his family from the United Kingdom to Nigeria on the basis of an employment agreement only to be confronted with a different scenario least expected? Such a practice amounts to changing the rules in the middle of a game. It is not a fair practice. It is not a fair labor practice. It is an unfair labor practice that this court is by the Constitution empowered to pronounce upon.

Going by the above findings, the Court has laid down the rule that, where an employer is desirous of executing a restraint of trade/employment agreement, the same must be contemporaneously executed with the main contract. This is to give the employee, an unfettered opportunity, to access his position and to either accept the two after careful consideration or reject both. Where an employer presents an employment contract and based on the terms and conditions therein, the employee accepts and alters his position in a bid to effectuate the contract, any subsequent alteration that places the employee in a position of no choice but "you

[76] *Ibid.* p. 6.

must accept" is an unfair labor practice which is against equal and fair bargaining which is the bedrock of contractual transaction. Hence, such an agreement will be declared invalid, null, and void and therefore, unenforceable.

Another issue that arises from this decision is the right to work. The Court warned that the making of a covenant in restraint of trade by an employer must take cognizance of the fact that, the same cannot be used to render an individual redundant. Where this is the case, the covenant will be against public policy as the Holy Writ enjoins all humans that "whoever will not work, should not it." Work is an intrinsic part of human life and every person must be accorded the opportunity to work. International legal instruments recognize this salient fact. The International Covenant on Economic, Social, and Cultural Rights (ICESCR) recognizes the right to work not just economic, social, and cultural rights but also civil and political rights. Article 6(1) of the ICESCR states that the right to work includes the right of everyone to the opportunity to gain his living by work which he freely chooses or accepts.[77] Any restraint agreement that impedes the right to work, thereby robbing the nation of revenue generated from taxes, is against public policy and will not be enforced as was held in the cases of *Dr. Shirish Tanksale v Rubee Medical Centre Ltd.*[78] and *Nnadozie v Mbabwu.*[79] Aside from the Holy Writ providing that, "he who does not work, should not eat" the first obligation placed on man after creation and placement in the Garden of Eden, was to "work the ground and keep it in order."[80] The implication of this is that from creation, man is expected to work and work has become an intrinsic aspect of man's life and well-being, the State must therefore ensure that no human action, unjustly interferes with this inalienable expectation of man. It is therefore imperative that, in executing a restraint of trade agreement, the employer must do so, bearing in mind the inalienable right of man to work and that there is dignity in labor. Any attempt to sequestrate this right will be declared illegal, null, and void by the Courts.[81]

It is apposite to note that under the Companies and Allied Matters Act (CAMA) 2020, Directors of a company pursuant to their duty of fidelity consequent on their fiduciary relationship, are

[77] Rebecca M. M. Wallance and Kenneth Dale-Risk, *International Human Rights: Text and Material* (London, Sweet and Maxwell, 2001) 625.
[78] (2013) LPELR-21445 (CA).
[79] [2008] All FWLR (Pt. 405) 1613 at 1639.
[80] Genesis 2:15 The Holy Bible Message Translation.
[81] *Onyiuke v Okeke* (1976) 10 NSCC 146; *Onwuchekwa v Nigerian Deposit Insurance Corporation* [2002] All FWLR (Pt. 101) 1615.

perpetually restraint from using information they became aware of by virtue of their directorship. Section 306 (4) (5) of CAMA 2020 (280 (4) (5) of CAMA 2004) prohibits a director from making a secret profit or misuse of the company's information. The inability of the company to perform any functions or duties under its articles and memorandum shall not constitute a defense to any breach of the director's duty. The duty not to misuse corporate information shall not cease by the director or an officer that has resigned from the company, and he shall still be accountable and can be restrained by an injunction from misusing the information received by virtue of his previous position. This is somewhat of a statutory restraint. In fact, it will be safe to argue that this provision extends to where a director has ceased being employed in the company to set up another company or join an existing company to use the information gotten from the previous company in the new one. This was the decision of the Canadian Supreme Court in *Canadian Aero Service Ltd. v O Malley*[82] In this case, the director got corporate beneficial information by virtue of his position. He resign from his employment and form another company, and sued the information from the former company to win a bid. The former company sued for breach of his statutory duty not to misuse corporate information during and even after his employment and the Supreme Court held that he was under an obligation to not use the information. The restraint on him subsists after the end of the employment contract.[83] Once a director ceases from being in the employ of the company, any information acquired must not be used subsequently for another company save with full disclosure.[84] While this prohibition may seem harsh, its utilitarian value is not far-fetched. It seeks to prevent a situation where a director who is in possession of material information, in order to make a profit, brings his/her employment to an end, set up another company, and uses the information.[85] If this is allowed, it is capable of causing business strains which will have adverse effects on the economy.[86]

[82] (1973) 40 BLR 371.
[83] Joseph E O Abugu, *Principles of Corporate Law in Nigeria,* (Lagos: MIJ Professional Publishers Ltd., 2014) 511-512.
[84] Chris C Wigwe, *Introduction to Company Law and Practice* (Accra: Mounterest University Press, 2016) 240.
[85] Olakunle Orojo, *Company Law and Practice in Nigeria,* 5th ed. (Durban: LexisNexis, 2008) 267.
[86] D J. Bakibinga, "Directors' Duty to Avoid a Conflict of their Interests and Duty to the Company" (1990) 3(14) *The Gravitas Review of Business and Property Law,* 63-72.

6. CONCLUSION AND RECOMMENDATIONS

From the discussion above, it is trite that, parties are at liberty, within the ambit of the law, to contract and the law, will enforce such contract even though the same may occasion hardship to a party thereof. Generally, covenants in restraint of trade, particularly post-employment ones, is *prima facie* unenforceable under Nigerian law as the same is regarded to be against a public policy which entails the generally acceptable standard within a particular society which all persons, are expected to adhere to in the conduct of their affairs for the general good.[87] However, where the employer, ably demonstrates, a sufficient and cogent interest that requires protection such as trade secret and the same being reasonable, a restraint of trade clause, covering such interest, will be enforced. Where an employer is desirous of utilizing restraint of trade clause, the same must be brought to the knowledge of the employee contemporaneously with the main contract to enable the employee to decide and not when he has altered his position to his/her detriment rendering him/her unable to bargain. Where such is the case, the clause/agreement shall be rendered null and void as the same amounts to an unfair labor practice and has placed the employee in a position where he/she cannot object to such a clause/agreement without being exposed to avoidable substantial hardship.

In determining the enforceability or otherwise of a restraint of trade clause, the court has to create a balance between three contending interests to wit: the interest of the employer, the employee, and the general public. Employers resort to restraint of trade to protect their business from increasing competition, particularly in a volatile economy like that of Nigeria. The rank of the employee which may determine the kind of information/interest of the employer's business he/she is exposed to is a major determinant in determining the validity and enforceability or otherwise of a restraint of trade clause. Thus, each case will be decided based on its peculiar fact although, judicial precedent, may serve as a guide.

From the findings above, it is recommended that trade unions and other employee rights organizations, should publicize and enlighten employees about the existence and issues settled by this decision to enable them to exploit it. Also, in the event that there is an appeal against the decision to the Court of Appeal which is the final court vested with jurisdiction over labor disputes in Nigeria, the decision should be affirmed as it is a welcomed development and has

[87] Emmanuel J Uko (no 9) *Op. cit.* 34-46.

created a balance between the various competing interests in cases of restraint of trade in Nigeria.

Examining the Income Tax Jurisdiction Rules of the Federal Income Tax Law of Ethiopia *vis-a-vis* the Doctrines of Income Taxation Power of States

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Abstract

Although there are no restrictions under international law on how countries do exercise their taxation power, they do not, however, assume tax power over a certain income arbitrarily. States, rather, design their tax jurisdiction rules in consideration of different doctrines of taxation. These doctrines of taxation are ideals or indexes of a good income tax system. Thus, examining the Ethiopian income tax laws in light of these doctrines of taxation is important to know the current position of the country's income tax system. Accordingly, the aim of the Article is to evaluate whether the Ethiopian income tax law has been designed in consideration of the doctrines of taxation. To this end, following a qualitative research approach the relevant provisions of Ethiopia's Federal Income Tax Proclamation no.979/2016, and pertinent literature have been analyzed and synthesized. Finally, the paper concludes that, in principle, the Ethiopian income tax proclamation has largely designed tax jurisdiction rules in consideration of the sovereignty, and economic allegiance theories. And, as can be understood from the withholding schemes of the law, the jurisdiction rules of the Ethiopian income tax law have also considered the realistic doctrine.

Keywords: Doctrines of Taxation/Ethiopia/Income Tax/Tax Jurisdiction/

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1. Introduction

Commonly, States assume tax power based on residence and source principles.[1] Yet, in the taxation of income based on these principles, states do not design their jurisdiction rules in an arbitrary manner. They mostly attached their tax jurisdiction to a certain connecting factor. Accordingly, states designed the scope of application of their income tax laws and structure their jurisdiction rules in consideration of different doctrines of taxation such as sovereignty doctrine, economic allegiance, benefit doctrine, and realistic doctrine. The Income-tax jurisdiction of Ethiopia is based on the personal and territorial base jurisdiction. However, whether the Ethiopian income tax law is designed in consideration of the doctrines is not examined yet. However, discussing the taxation doctrines, indexes or ideals of a good tax system will have importance since taxation is the main source of government revenue, directly linked with investment or even for academic discourse. The aim of the Article is, therefore, to evaluate whether the Ethiopian income tax law is designed in consideration of the doctrines of taxation. To achieve its ends, the article analyses the Ethiopian income tax proclamations, different books, and journal articles dealing with the theoretical underpinnings and the international experiences regarding tax jurisdiction in a qualitative research approach and document analysis method.

These sets of themes in the article are organized under four sections. Section one provides the type and notion of doctrines of taxation. Section two presents a brief overview of the concept of tax jurisdiction in general and the tax jurisdiction rules of the Ethiopian federal income tax proclamation[2] (FITP) in particular. Section three examines the place of doctrines of taxation under the FITP. In this section, the Authors evaluate the income tax jurisdiction rules of the income tax proclamation in light of the notorious doctrines of taxation. Finally, the paper makes concluding remarks.

2. Doctrines of Income Taxation Power

There are no restrictions under international law to the legislative jurisdiction to impose and collect taxes.[3] States do not arbitrarily assume tax power over a certain income. Instead, States

[1] Irish Charles R., International Double Taxation Agreements and Income Taxation at Source, International and Comparative (1974)23 Law Quarterly 292.
[2] Federal Income Tax Proclamation No.979/2016, Federal Negarit Gazetta (2016), Proc.No.979/2016.
[3] William W. Park, Fiscal Jurisdiction and Accrual Basis Taxation: Lifting the Corporate Veil to Tax Foreign Company Profits (1979)70 Colombia Law Review 1609.

assume tax jurisdiction with definite rationales or doctrines.[4] These doctrines of taxation are ideals or indexes of a good income tax system. Hence, States design the income tax Jurisdiction rules in consideration of the doctrines of the taxing power. Also, States designed income tax rules in consideration of tax administrations. In this section, the Authors discuss the key doctrines behind the assumption of income tax jurisdictions or taxing rights of States with respect to income.

2.1. The Sovereignty Doctrine

The Sovereignty doctrine is based on the notion that sovereignty is the collection of rights and competencies which go to make up the State.[5] The argument in support of the sovereignty doctrine is founded on the premise that since jurisdiction derives from sovereignty, jurisdiction can only extend as far as sovereignty exists. According to this doctrine, jurisdiction is the right and competence of the State to affect the rights of persons through the exercise of judicial, legislative, and administrative powers, which includes the power to make and enforce laws, including tax laws.[6] Accordingly, the scope of the State's fiscal jurisdiction depends on the aspect of sovereignty concerned. Consequently, state jurisdiction will emanate from national sovereignty or territorial sovereignty. National sovereignty applies to citizens and residents of the State.

National sovereignty, thus, allows the State to apply its jurisdiction, including the imposition of taxes, on its citizens and residents with respect to their worldwide income. Understandably, territorial sovereignty, by contrast, is defined by reference to the geographical boundaries of a State, by reference to which the State can make fiscal assertions over non-residents. In this respect, unlike citizens and residents, the taxation of a non-resident person must therefore depend upon the physical presence of the non-resident person within the territory of the taxing State or upon the existence of some property or interest belonging to him upon which the tax may be levied.

2.2. The Benefit Doctrine

[4] Ibid.
[5]NivTadmore, Source in the Digital Age (Clayton Utz, 2012) 2. ‹https://www.claytonutz.com/ArticleDocuments/178/Clayton-Utz-Taxation-Source-in-the-Digital-Age-2012.pdf.aspx?Embed=Y› accessed on April 2022.
[6] Jeffery, Ramon J. The Impact of State Sovereignty on Global Trade and International Taxation (1999) Kluwer Law International 26.

The underlying assumption of this theory is that the State has the right to tax those who derive income using the benefits the State offers. The argument in support of the benefits doctrine is founded on the premise that a large part of the cost of government is traceable to the necessity of maintaining a suitable and secured environment or infrastructure by which a person would create an income.[7] In other words, if a person uses or consumes the public goods and services provided by the State, the latter shall have jurisdiction over the person. Without using public goods and services persons (physical and legal) could not derive income or preserve and maintain their property. As a result, according to this theory, as the State has a contribution to generating a certain income, the State shall assume jurisdiction over the income.[8] Although, one of the features of tax is the absence of quid pro quo, in some respect, the income tax jurisdiction rules of States are designed in consideration of the benefits doctrine.

2.3. The Economic Allegiance Doctrine

According to this doctrine, taxes should be levied where the taxpayer and the corresponding income possessed stronger economic allegiances. This theory alleged that the State where economic activities take place and value is created shall secure its taxation power.[9] Thus, in this doctrine the concept of economic allegiance is important. Economists outlined the following four questions by reference to which economic allegiance is to be determined: Where is the yield physically or economically produced? Where are the final results of the process as a complete production of wealth actually to be found? Where can the rights to the handing-over of these results be enforced? Where is the wealth spent or consumed or otherwise disposed of? As can be understood from each of the questions, essentially, the main factors comprising economic allegiance are (i) the origin of the wealth (i.e., source) and (ii) where the wealth was spent (i.e., residence).[10] Accordingly, this doctrine considers the place of residence and the place of origin are regarded as the main indicator of economic allegiance.[11] In light of this doctrine, residents have economic allegiance with their resident country as they have a closest

[7] Skaar Arvid A, Permanent Establishment Erosion of a Tax Treaty Principle (Kluwer Law and Taxation Publishers 1991).
[8] Niv Tadmore, Source in the Digital Age (Clayton Utz, 2012) 2. <https://www.claytonutz.com/ArticleDocuments/178/Clayton-Utz-Taxation-Source-in-the-Digital-Age-2012.pdf.aspx?Embed=Y> accessed on April 2022.
[9] OECD, OECD/G20 Base Erosion and Profit Shifting Project – Explanatory Statement – Final Reports, Paris, (2015), < http://www.oecd.org/ctp/beps-explanatorystatement-2015.pdf>accessed on May 2022.
[10] OECD, Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce? Final Report, (2005) 11.
[11] Moisés Zúñiga Vargas, Does the Substance over Form approach implemented as a result of the BEPS package reconciles the Permanent Establishment definition with the existence of economic allegiances? Master Thesis

economic link in consuming public goods and services and to the source State to the extent of the income arising from its territory. For example, the existence of a permanent establishment serves as evidence of economic allegiances with the source State that is sufficiently strong to justify its taxation rights. And, preparatory or auxiliary activities should not constitute a sufficiently strong economic allegiance to justify the taxation rights of the source State. Yet, the economic allegiance doctrine does not require a physical presence in a State to sanction taxation.[12] Production of wealth focuses upon "the community the economic life of which makes possible the yield." The production of yield may have one physical location and another economic location.[13]

2.4. The Realistic Doctrine

The sovereignty doctrine suggests that without jurisdiction there is no power to tax. The realistic doctrine suggests the opposite, namely without the power to tax there is no jurisdiction. "No rules of international law exist to limit the extent of any country's tax jurisdiction", and therefore, a State's tax jurisdiction is effectively defined by reference to its enforcement competence.[14] The realistic doctrine, due to its very nature, connotes pragmatism and may be best understood on that basis. States do not exercise tax jurisdiction in a vacuum, and the ability to enforce or collect does not necessarily entail assertion, enactment, or enforcement. States must co-exist and exercise self-restraint, and thus must also place a limit on their tax jurisdiction. In light of this doctrine, in the design of tax jurisdiction rules, States shall not only rely on the economic or personal link between a person and a country. Instead, States shall be concerned about enforcing and collecting taxes. Given that States do not, in general, enforce each other's fiscal assertions or judgments, under the realistic doctrine the taxation of non-residents (who have no physical presence or readily accessible assets in the taxing state) often relies on withholding tax.[15] Withholding tax has been regarded as an effective enforcement method that enables the state to pursue assertions against non-residents by imposing intra-territorial measures.

[12] Niv Tadmore, *supra* 8, 5.
[13] Ibid.
[14] Martin Norr, Jurisdiction to Tax and International Income (1962)17 Tax Law Review 431.
[15] Irish Charles R, International Double Taxation Agreements and Income Taxation at Source, International and Comparative Law (1974) 23 Quarterly 296.

3. Overview of the Concept of Tax Jurisdiction in General and the Tax Jurisdiction Rules of the Ethiopian Federal Income Tax Proclamation No. 979/2016

3.1. The Concept of Tax Jurisdiction in General

The jurisdiction to impose income tax is based either on the relationship of the income (tax object) to the taxing State (commonly known as the source or situs principle) or the relationship of the taxpayer (tax subject) to the taxing State based on residence or nationality.[16] International taxation issues revolve around two main concepts that are also fundamental reasons/causes of international juridical double taxation. These two concepts are known as the concept of source and the concept of residence. Both concepts arise from domestic tax law provisions, which distinguish between two types of taxpayers; non-residents and residents.

The first category of taxpayers would generally have limited nexus (connection) with the country in question; however, the income received by these taxpayers will have an economic link or will originate in the particular country. This country wishes to levy tax on this taxpayer, however only in respect of the income originated therein (having source in this country), referred to as source taxation and sometimes known also as limited tax liability.[17] The second category of taxpayers or residents would have a close personal and economic connection (nexus) with the country in question and the country chooses to tax this taxpayer on his/her worldwide income referred to as worldwide taxation and sometimes known also as unlimited tax liability.[18] These two concepts are further explained in the sections below. Thus, most countries exercise their jurisdiction to tax by reference to factors that assume a sufficient connection between the relevant country and the taxable person and/or the taxable income.[19] And, taxation systems based on a sufficient connection between the relevant country and the taxable person apply the principle of residence-based taxation. [20]

Due to the proliferation of international trade since the Second World War, the issue of international tax becomes a challenge.[21] To overcome this problem generally, two basic rules

[16] UN, Committee of Experts on International Cooperation in Tax Matters, Revision of the Manual for the Negotiation of Bilateral Tax Treaties, Seventh session, Item 5 (h) of the provisional agenda, final report, Geneva, (2011) p.9.
[17] Ibid.
[18] Ibid.
[19] UN, Committee of Experts on International Cooperation in Tax Matters, Revision of the Manual for the Negotiation of Bilateral Tax Treaties, Seventh session, Item 5 (h) of the provisional agenda ,Geneva, (2011) p.11.
[20] UN, Committee of Experts on International Cooperation in Tax Matters, Revision of the Manual for the Negotiation of Bilateral Tax Treaties, Seventh session, Item 5 (h) of the provisional agenda ,Geneva, 2011)p.10.
[21] Richard J. Vann, International Aspects of Income Tax, in *Tax Law Design and Drafting* (1996)2Victor Thuronyi (ed.), International Monetary Fund 686-687.

of tax jurisdiction of countries existed. The first one is the taxation of persons from outside a country who work, enter into transactions, or have a property (income) in the country.[22] That is the source rule. The second one is the taxation of persons who belong to a country and work, enter into transactions, or have a property (income) abroad.[23] This is the residence rule.

Residence denotes the concept of a person's belongingness to a country.[24] On the other hand, a source indicates whether a particular income is sourced inside or outside of the country.[25] In income tax, the applicable rule is the taxation of the domestic income of non-residents and taxation of the worldwide income of residents.[26] Double taxation of the same income and non-taxation of the income are the challenges of international taxation faced through applying the source and residence rule of income tax jurisdiction.[27] These negatively affect international trade transaction and results in loss of national revenue as well as international welfare.[28] To avoid such a problem there reaches an international consensus to tax the worldwide (domestic and foreign) income of residents and the domestic income of non-residents.[29]

The concept of residence rule of taxation is dependent on the principle that people and firms should contribute towards the public services provided for them by the country where they live, and levied against their worldwide income.[30] A person is a resident of a country if the person has close personal and economic relations with that country, with the possibility to be a resident of one or more countries at the same time.[31] In defining the residence of individuals two major approaches are applied.

First, the physical presence test is based on the number of days a person spends in the country during the tax year (usually the 183 days or six-month period in the fiscal year), the 12-month period, or over a period of preceding years.[32] There is a variation among States in the

[22] Ibid.
[23] Ibid.
[24] Ibid.
[25] Ibid.
[26] Ibid
[27] Ibid
[28] Ibid
[29] Reuven S. Avi-Yonah, International Tax as International Law: Analysis of an International Tax Law regime, Cambridge University Press (2007) pp.4-5.
[30] Source and Residence Taxation, Tax Justice Briefing (tax justice network,2005) p.1. <https://www.taxjustice.net/cms/upload/pdf/Source_and_residence_taxation_-_SEP-2005.pdf >
[31] Richard J. Vann, International Aspects of Income Tax, in Tax Law Design and Drafting(1996)2Victor Thuronyi (ed.), International Monetary Fund p.695.
[32] Roy Rohatgi, *Basic International Taxation: Principles of International Taxation*, Richmond Law & Tax Ltd., Second Ed.2005) Vol.1, p.200.

calculation of such a period, and the methods of calculation such as the actual days of physical presence or the duration of the activity.[33] The second approach to defining residence is the facts and circumstances approach where all facts are weighted (though no definitive circumstance) to determine residence.[34] These include considerations such as the center of vital interests, family ties, retention of a house or availability of living accommodation, the residence of the family, permanent home, habitual abode, personal or economic relations, etc. though variation exists among nations.[35]

To determine the residence of companies or legal entities various connecting factors are applied. The most common determinants are the place of incorporation or legal seat, and/or the location of management or real seat.[36] In this regard, tax residence based on the statutory seat is almost obvious, but there exist different perceptions and legal definitions for the location of management or real seat. Management can signify either the central management and control (which is the ultimate level of policy decision-making or supervision) or operational management (which denotes the day-to-day management or effective management) of the business.[37] Countries apply either of the dimensions of management.[38]

On the other hand, the concept of source rule of taxation is based on the view that the country which provides the opportunity to generate income or profit should have the right to tax.[39] In determining the income tax jurisdiction the source rule identifies the place where the income arises and the country which has a tax right over it.[40] That is based on the ability to identify income and its recipient, quantify it, and enforce its taxing rights.[41] Generally, the active business income follows the place of operations from which the income or profits arise while passive income is sourced in the country of the payer unless it is effectively connected with the business activity in the State.[42]

3.2. Income Tax Jurisdiction under FITP of Ethiopia

[33] Richard J. Vann, International Aspects of Income Tax, in Tax Law Design and Drafting (1996)2Victor Thuronyi (ed.), International Monetary Fund, p. 697-699.
[34] Roy Rohatgi, *supra* 31, p.200.
[35] Richard J. Vann, *supra* 33, p.696; Roy Rohatgi, *supra 31*, p.200-209.
[36] Ibid.
[37] Ibid.
[38] Ibid.
[39] Source and Residence Taxation, Tax Justice Briefing (tax justice network, 2005) <https://www.taxjustice.net/cms/upload/pdf/Source_and_residence_taxation_-_SEP-2005.pdf >
[40] Roy Rohatgi, *supra 31*, p.222.
[41] Ibid.
[42] Ibid.

The law-maker in Ethiopia and elsewhere in the world usually defines the scope of application of certain legislation. Such an act is important to properly understand the law and implement it in accordance with the intention of the lawmaker. In line with this, the FDRE Income Tax proclamation has tried to define its scope of application. Income itself has no fixed place – it can be anywhere and nowhere. There are two bases of jurisdiction: personal and source /territorial jurisdiction. Personal jurisdiction can be based on nationality (in very few countries) or residence (in most countries).

Ethiopian income tax jurisdiction was territorial prior to 2002 but has since then become residence-based. The current income tax proclamation put its scope of application clearly under art 7 of the proclamation. As per the provisions of the law, the income tax proclamation will apply in the two scenarios. First, the proclamation applies to residents of Ethiopia with respect to their worldwide income. Secondly, the proclamation applies to non-residents with respect to their Ethiopian source income. Hence, the income tax jurisdiction of Ethiopia has recognized two bases of jurisdiction; i.e. the personal and the territorial base jurisdiction. The proclamation clarifies the concept of residence by defining the factors to be considered in the determination of individual residence and corporate residence. So, as per the ITP, a resident of Ethiopia is a resident individual, a resident body, the government of the Federal Democratic Republic of Ethiopia, and any regional State or city government in Ethiopia.[43] In determining the individual residence the law puts two identifiers: physical presence and domicile. Yet, the proclamation does not define the term domicile in itself. However, the civil code of Ethiopia defines the domicile of a person as the place where a person established the principal seat of his business and of his interests, with the intention of living there permanently.[44] When the place of work is not the same as the place of family or social life the latter place is considered the place of domicile.[45] Unlike residence, no person can have more than one domicile at the same time, or the principle of unity of domicile applies.[46]

Physical presence requires evidence of the presence in a country for an aggregate of 183 days in a period of 12 calendar months. What does presence mean? Should the tax authority consider days of arrival and days of departure? Part of the day, weekends, national holidays? Days of transit? For which tax period is an individual considered a resident? For both tax periods in

[43] Proc.No.979/2016, Article 5, sub article 1.
[44] Civil Code of Ethiopia, Proc.No.165/1960, *Negarit Gazetta*, (1960), Article 183 [Hereinafter Civil Code of Ethiopia).
[45] Civil Code of Ethiopia, Article 185.
[46] Civil Code of Ethiopia, Article 186.

which her presence falls? The regulation has come up with a clear answer in this regard. According to the regulations, departure day, holiday, leaves, etc. are considered in calculating the 183 presence days.

So, when an individual is present for more than 183 days or half a year in Ethiopia, either continuously or intermittently, in a tax year considered a resident individual.[47] With regard to the residence of legal entities, the place of incorporation or place of effective management is applicable same to the most common criterion. That is a resident body or company that is incorporated or formed in Ethiopia or its place of effective management is in Ethiopia.[48] It seems that these elements should be satisfied alternatively. This is because if we require these elements to be satisfied cumulatively, the purpose of the tax proclamation cannot be met. Legally speaking, the place where the artificial person got its personality is called a place of incorporation. Accordingly, that entity will be regarded as the resident of the State where the incorporation is hosted. Place of effective management – is probably the most substantial link for establishing a residence. According to Model Tax Treaties (e.g., OECD Model Tax Treaty), the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity‘s business as a whole are made in substance.

It all depends on the facts and circumstances of each case. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any given time.[49]

In international tax treaties, the place of effective management is often used as a tie-breaker in cases where a business organization is a resident of multiple countries. Registration (or incorporation) may make an entity a resident of multiple countries, but a place of effective management will make it a resident of only one. Determining the place of management would be difficult unless there is a specific rule as to the type of management and the frequency of management to be held in the country in question. The UN model takes the following circumstances into account when establishing the place of effective management; the place where a company is actually managed and controlled, the place where the decision-making at

[47] Proc.No.979/2016, Article 5(2-4).
[48] Proc.No.979/2016, Article 5(5, 6).
[49] OECD, commentaries on the articles of the model tax convention (2010) 88. <https://www.oecd.org/berlin/publikationen/43324465.pdf> accessed on June 2022.

the highest level on the important policies essential for the management of the company takes place, the place that plays a leading part in the management of a company from an economic and functional point of view and the place where the most important accounting books are kept.[50]

Concerning the source rule tax jurisdiction according to article 6 of the income tax proclamation, generally, the active business income operated in Ethiopia is considered as Ethiopia's source income. And with regard to passive income derived if the payer is in the country of Ethiopia, it is Ethiopian source income. In addition, passive income which is effectively connected with business activity in Ethiopia is also an Ethiopian source of income. The details of the source rule of jurisdiction are provided based on the income or profit type which is also discussed below. Any income which is not an Ethiopian source of income is a foreign income.[51]

3.2.1. Employment Income or Schedule 'A' income

It is an income of any kind received by the employee from the employer.[52] Employee means an individual engaged, whether on a temporary or permanent basis to perform services under the direction and control of the employer, who engages or remunerates the employee.[53] It includes salary, wages, an allowance, bonus, commission, gratuity, or other remuneration received by an employee in respect of past, present, or future employment, fringe benefits, severance payment, compensation, and golden handshake payment.[54]

In determining the income tax jurisdiction we should test the source and residence dichotomy in the employment income. Literature shows the income tax jurisdiction of employment income will be determined based on the source of income which is derived usually from a place where employment is carried out.[55] If such employment is carried out in several places, the income may be apportioned between those places.[56] In the same vein in Ethiopia, the income tax jurisdiction of employment income is determined based on the source of income. Accordingly,

[50] UN, articles of the United Nations model double taxation convention between developed and developing countries (2011)94<https://www.un.org/esa/ffd/wp content/uploads/2014/09/UN_Model_2011_Update.pdf> accessed on March 2022.
[51] Proc.No.979/2016, Article 6(5).
[52] Proc.No.979/2016, Articles 2 (9), 10, 12.
[53] Proc.No.979/2016, Article 2(7-7)
[54] Proc.No.979/2016, Article 12 (1 a-c).
[55] Richard J. Vann, *supra* 33, p.711.
[56] Ibid.

employment income derived by an employee shall be an Ethiopian income to extent that the employment is carried out in Ethiopia, wherever paid; or if it is paid to the employee by or on behalf of the government of Ethiopia, wherever the employment is carried out.[57]

3.2.2. Rental Income or Schedule B income

Rental income tax is imposed on persons who acquired income by renting a building or building annually.[58] In terms of income tax jurisdiction of rental income, it is based on the source of income.[59] If the income is derived from the rental of immovable located in Ethiopia is unconditionally under the income tax jurisdiction of Ethiopia.[60] And any income derived by the rental of movable located in Ethiopia is also an Ethiopian income tax jurisdiction.[61]

3.3.3. Business Income or Schedule C income

Business income includes the gross income derived by the taxpayer in the tax year from the conduct of business, a gain on the disposal of a business asset, and any other amount included in business income.[62] In determining the income tax jurisdiction over business income it is preferred to start from the concept of permanent establishment.[63] In Ethiopia, the same UN model convention and OECD model convention permanent establishment is treated as a fixed place of business through which the business of the person is wholly or partly conducted.[64] It includes a place of management, a branch office, a factory, a warehouse, a mine site, an oil or gas well, a quarry, and others.[65] With regard to the furnishing of services including consultancy services and a building site, a construction, assembly or installation project to be considered as a permanent establishment needs one hundred eighty-three days (183) continuance.[66] Both of the permanent establishment definitions, 'fixed place of business' and 'dependent agent acting on behalf of an enterprise' require some form of geographic and temporal presence within the source country.[67]

[57] Proc.No.979/2016, Art 6(1).
[58] Id, Article 13 (1).
[59] Richard J. Vann, *supra* 33, p.703.
[60] Proc.No.979/2016, Article 6(4-b-1).
[61] Proc.No.979/2016, Article 6(4-b-2).
[62] Proc.No.979/2016, Article 4(4) cum. Article 21.
[63] Richard J. Vann, p.703.
[64] Proc.No.979/2016, Article 4.
[65] Proc.No.979/2016, Article 4 (2).
[66] Proc.No.979/2016, Article 4 (2-c, 3).
[67] Ertuğrul Akçaoğllf, International Taxation of Electronic Commerce: A Focus on the Permanent Establishment Concept, Yıl, (2002)150.

The permanent establishment is the concept to refer to active business operation in a given country and giving the source country the primary right to tax the profits from that operation.[68] This concept relieves a taxpayer from paying tax to the resident country on the income derived by the active business operations in another country, either through the tax exemption method or foreign tax credit method.[69] Where no permanent establishment exists within the source country, business profits derived from that country are subject to tax solely in the residence country.[70]

The source rule applies in determining the income tax jurisdiction of business income through association with the permanent establishment.[71] The same rule works in the income tax jurisdiction of Ethiopia. Business income derived by a resident of Ethiopia conducted in the permanent establishment of Ethiopia is considered an Ethiopian source of business income.[72] A business conducted, disposal of goods, merchandise of the same or similar kind, and any other business activity of the same or similar nature by a non-resident through a permanent establishment in Ethiopia is an Ethiopian source of income.[73]

3.2.4. Other Incomes or Schedule D Income

A. Taxation of Technical Fees

Under Articles 51 and 52 of the FITP a non-resident who derives an Ethiopian source (which manifestly though not exclusively applies a source rule) technical fee is subject to a 15 percent tax from the gross income.[74] In the case of technical services, modern methods for the delivery of services allow non-residents to perform substantial services for customers in the other country with little or no presence in that country. This ability to derive income from a country with little or no presence there, combined with concerns about the base-erosion and profit-

[68] UN Model Double Tax Convention between Developed and Developing Countries, (2011) [Hereinafter UNDTC) articles 4, 5, 7; The U.S. Treasury Department United States Model Income Tax Convention, Articles 4, 5, 7 [Hereinafter U.S. Model Treaty]; OECD Model Tax Convention (2003) [Hereinafter OECD MTC], Articles. 4, 5, 7; Reuven S. Avi-Yonah, The Structure of International Taxation: A Proposal for Simplification (1996)74 Texas Law Review pp1301-1307.
[69]UNDTC, Article 3; OECD, Article 23.
[70] Ertuğrul Akçaoğllf, *supra* 67, p.130.
[71] Richard J. Vann, *supra* 33, p.703.
[72] Proc.No.979/2016, Article 6 (2).
[73] Proc.No.979/2016, Article 6 (3).
[74] Proc.No.979/2016, Article 2(23). Technical fee is legally defined as "a fee for technical, professional, or consultancy service, including the fee for provision of services of technical or other personnel".

shifting aspects of technical services, justify the absence of any threshold requirement as a condition for a country to tax fees for technical services.

Taxation of technical fees sourced in Ethiopia is not taken for granted rather it is dependent on the fulfillment of certain conditions.[75] That is the technical service supplier has to be non-resident and not through the permanent establishment in Ethiopia, and the technical service recipient has to be a resident of Ethiopia (other than in relation to the business conducted by the resident through the permanent establishment outside of Ethiopia) or a non-resident through the permanent establishment in Ethiopia.[76] In addition, the technical fee payment to the non-resident service supplier has to be made by the related person to the recipient or recharged by the related person to the recipient.[77] The law expressed the payer of the technical service to be only the related person of the technical service recipient, who is a resident of Ethiopia or non-resident through the permanent establishment in Ethiopia. But, for a stronger reason, the payer can be the technical service recipient under this provision. It should be taken into account that technical service recipient in Ethiopia is privileged since the payment for the technical service is deductible and hence erodes the tax base of Ethiopia. The law emphasizes a related person as a payer of a technical fee to avoid any tax base erosion. Consequently, Ethiopia is entitled to tax fees or payments for technical services performed in Ethiopia if the payer wherever located is related to the technical fee recipient in Ethiopia. In many cases, such closely-related party services present the most serious risk of eroding a country's tax base. If these conditions are not met, no (withholding) tax[78] is due.

FITP allows fees for technical services to be taxed on a gross basis. Many developing countries have limited administrative capacity and need a simple, reliable, and efficient method to enforce tax imposed on income from services derived by non-residents. A withholding tax imposed on the gross amount of payments made by residents of a country, non-residents with a permanent establishment or fixed base in a country, or a related person is well established as an effective method of collecting the tax imposed on non-residents. Such a method of taxation may also simplify compliance for enterprises providing services in Ethiopia since they would not be required to compute their net profits or file tax returns.

[75] Proc.No.979/2016, Article 52.
[76] Ibid.
[77] Ibid.
[78] Proc.No.979/2016, Article 64(5).

However, to levy a 15 percent fixed tax over the gross income of the technical service based on the FITP such technical fee accrued or arose has no attribution to "business carried on by the non-resident through the permanent establishment in Ethiopia".[79] If such attribution occurs the technical fee gained from Ethiopia is a business income, which will be taxed as business profit tax under schedule C or the repatriated profit tax under Schedule D as the case may be.[80] The taxability of the technical fee derived from Ethiopia, once assumed it constitutes business profit, will depend on whether or not the beneficiary is deemed to "business carried on by the non-resident through the permanent establishment in Ethiopia".

B. Dividends, Interest, and Royalties

Tax treaties based on OECD or U.S. Models strictly limit the taxes imposed by the source country on passive income (such as income from dividends, interest, and royalties), leaving the primary right to tax that income to the residence country.[81] Dividends are usually sourced under domestic law, and tax treaties by the residents of the company paying them.[82] In Ethiopia also dividends are determined based on source and a dividend paid to a person by an Ethiopian resident is considered an Ethiopian income tax jurisdiction.[83]

Interest under tax treaties also uses a basic residence of the payer criterion, but where the interest is borne by the permanent establishment in connection with which the indebtedness is incurred, the interest is sourced by the location of the permanent establishment.[84] Taken together, these rules on interest mean effectively that it is the place where the economic activity giving rise to the payment of the interest occurs that is its source.[85] Interest source rules under domestic laws show some variation from this pattern, most commonly adding the case where the interest relates to a loan that is secured by property situated in the country, but tax treaties generally override this rule.[86] In relation to this, in Ethiopia, the source rule applies in determining the income tax jurisdiction of interest as income. That is an interest paid to by the

[79] Proc.No.979/2016Article 51(2).
[80] Proc.No.979/2016Article 51(2), 62.
[81] OECD MTC, Articles. 10-12; U.S. Model Treaty, Articles 10-12; UN Model Treaty, Articles. 10-12.
[82] Richard J. Vann, *supra* 33, p.706.
[83] Proc.No.979/2016, Article 6 (4-a).
[84] Richard J. Vann, *supra* 33, p.706.
[85] Ibid.
[86] Ibid.

resident of Ethiopia or by non-resident as expenditure of business conducted under the permanent establishment within Ethiopia is considered as Ethiopian source income.[87]

With regard to royalties, they replicate the interest source rule for royalties, that is, the residence of the payer with the permanent establishment qualification.[88] In Ethiopia also concerning royalties the same rule to the interest applies.[89]

C. Gains and Others

Gains from the disposal of immovable assets situated in Ethiopia and a membership interest in a body if more than 50 percent value of such interest is derived from immovable in Ethiopia are within the income tax jurisdiction of Ethiopia.[90] In addition, gains from the disposal of shares in, or bonds issued by, the resident company are treated as the source income of Ethiopia.[91]

Insurance premium relating to the insurance of risk in Ethiopia is the source income of in Ethiopia.[92] Income from games of chance, sporting events, or performances held in Ethiopia is also Ethiopia's source of income.[93]

4. Examining the FITP of Ethiopia in Light of the Doctrines of Taxation

As stated in section two of this Article, countries do not design their tax laws capriciously; they have instead designed tax jurisdiction rules based on defined nexus with the income or the person who obtained an income. In this section, the Authors evaluated the FITP of Ethiopia in light of the doctrines of taxation.

4.1. The Place of Economic Allegiance Doctrine under FITP

As noted before, the rules of the income tax are designed with certain theories or justifications of taxation. In terms of jurisdiction, the Ethiopian income tax law follows both the residence principle and the source principle. Generally, the income tax proclamation does adopt these principles in consideration of nexus with the country. Unless the income is derived from Ethiopia or the person is connected with Ethiopia, the government would not tax an income.

[87] Proc.No.979/2016, Article 6(4-g).
[88] Richard J. Vann, *supra* 33, p.707.
[89] Proc.No.979/2016, Article 6 (4-g).
[90] Proc.No.979/2016, Article, 6(4-c(1-2)).
[91] Proc.No.979/2016, Article 6(4-c(3)).
[92] Proc.No.979/2016, Article 6(4-d).
[93] Proc.No.979/2016, Article 6(4-e-f).

Here, one may wonder why the law considers these principles as a base for taxing right. Without prejudice to other theories of taxation, the tax jurisdiction principles have relied on economic allegiance theories of taxation. The income tax proclamation based itself on the resident principle which is, among others, justified by economic allegiance arguments, specifically, that taxation is a means of financing public goods.[94] By the same token, the source-based principle of the income tax proclamation is justified by the economic allegiance arguments, specifically; in making up the income the country has its own contribution.

Having said this much about the relationship between the income tax principles in relation to the theories, it has paramount importance to examine the character of the income tax rules in light of the theories of taxation.

In assuming tax jurisdiction on employment income, a person (worker), who generates income from a rendering of technical service, will be the subject of Schedule 'A' only where the provision of the service is conducted in Ethiopia or the income is paid by the Ethiopian government or on behalf of the Ethiopian government.[95] This specific taxing right of employment income, among others, could be justified by the economic nexus argument. Because, as noted above, when a person has been undertaking employment activity in Ethiopia, in one way or another the person will consume the public goods and services provided by the Ethiopian government. However, the second index of employment income source rule could be justified by the sovereignty doctrine.

When we see rental income, the taxing rights occur only where the property is situated in Ethiopia. The situation of the property is a connecting factor to claiming tax by the Ethiopian government. Understandably, this rule has based itself, among others, on economic rationales. A person to drive rental income the property must be leased. Thus, in order to derive a rental income, the property has to be existed in safe. And, for the proper existence of the property, law and order as well as national security are important. The State has a contribution to the creation of that particular rental income. Moreover, the existences of infrastructure are critical in leasing property. Hence, the contribution of the State in this regard is also vital. Therefore, the rental income tax jurisdiction rule of ITP relies on the economic allegiance doctrine of taxation.

[94] Omri Marian, Jurisdiction to Tax Corporations (2013), 54 B.C. L. Rev. 1613, <http://scholarship.law.ufl.edu/facultypub/359 >
[95] Proc.No.979/2016, Article 6.

Non-residents are required to pay tax under the schedule of *business income* if and only if they have generated income through a permanent establishment.[96] As indicated under different pieces of literature, the most important and obvious effect, both from legal and practical viewpoints, is that the permanent establishment principle under tax treaties is decisive in determining a non-resident enterprise's tax obligation due to business activities with economic allegiance to more than one country – through a branch office, representative, project office or even the simple signing of a contract.

As far as Schedule D is concerned, the hubs for tax jurisdiction are diverse depending on the type of income. Both residents and non-residents could be taxed under schedule. As regulated under Art 6 of the ITP, non-residents without permanent establishment are required to pay tax on the interest, a royalty, management fee, technical fee, or other income if the following pivots have occurred cumulatively. First, if the income is paid to the person by a resident or non-resident with the permanent establishment for its business operating in Ethiopia; and secondly, if the income, paid to the non-resident person, is regarded as expenditure of the payer in relation to its business in Ethiopia. The rationale for the taxation of these non-resident persons is largely economic allegiance. From the tax jurisdiction rules stated above, it is possible to understand that economic nexus has been considered as a justification for taxation. The law for example the interest must be paid for the business operating in Ethiopia. From the rationale of exclusion of interest paid to businesses outside Ethiopia, it is possible to understand that the reason for the claim of taxation is an economic connection. As long as the business is operating in Ethiopia by consuming public goods and national security, the person who derives from such business needs to pay a tax to the Ethiopian government. Unless the Ethiopian government provides public goods, the business will not function and the interest income would not occur. Thus, there is an economic connection between the Ethiopian government and the non-resident person who derives the income.

4.2. The Place of Realistic Doctrine under FITP

As noted above, the realistic doctrine, due to its very nature, connotes pragmatism and may be best understood on that basis. Since the doctrine is based on the actual competence of the State to collect taxes, source taxation of non-residents needs some qualifications in the design of jurisdiction rules. In formulating the circumstances in which a State will tax when confronted with a foreign element the State is not concerned with the question of whether or not it should

[96]Proc.No.979/2016, Article 6(3)

exercise fiscal jurisdiction it in fact assumes that. Operating from this premise it is concerned with exercising its jurisdiction in an effective manner. While collection from local enterprises is not problematic, collection of tax from non-resident persons without permanent establishment is not easy. Given that States do not, in general, enforce each other's fiscal assertions or judgments, under the realistic doctrine the taxation of non-residents (who have no physical presence or readily accessible assets in the taxing State) often relies on withholding tax. In this regard, when we see ITP unless non-residents have a permanent establishment in Ethiopia, they are taxed through a withholding scheme. When a non-resident person without permanent establishment derives income in Ethiopia the tax shall be paid by the payer of the income.[97] Accordingly, under the FITP, interest, a royalty, management fee, technical fee, or other income is subject to tax via withholding schemes which essentially rely on the realistic doctrine of taxation. And, as can be understood from the reading of Article 6 of the FITP, the reference point for the assumption of tax jurisdiction over an interest, a royalty, management fee, technical fee, or other income should be the payer of the income. Hence, in this respect, it is possible to contend that the ITP considers the realistic doctrine in the design of the jurisdiction rules in respect of taxing non-resident persons (who have no physical presence or readily accessible assets in the taxing State) derived income from Ethiopia's territory.

4.3. The Place of Sovereignty Doctrine under FITP

As clearly discussed above the doctrine of sovereignty lays income tax jurisdiction over nationals or residents over their worldwide income (i.e. national sovereignty) and to non-residents where the source of income is within the country's geographical territory (i.e. territorial jurisdiction). This underlines the sovereignty doctrine applies both to the residence and source rule of income tax jurisdiction. Both the source and residence rules of taxation are recognized under the income tax proclamation of Ethiopia. Hence, it is possible to assert that the country recognizes these principles, among others, based on the doctrine of sovereignty. Because, while the assumption of tax power over its residents is justified by national sovereignty, the assumption of tax power over non-residents, by reference to the geographical boundaries of a State, is based on territorial sovereignty.

The above discussion can be explained in the following illustrations. First, employment income tax jurisdiction is based on the source rule of taxation under FITP. The income tax proclamation stipulates employment income derived by an employee shall be an Ethiopian income to extent

[97] Proc.No.979/2016, Articles 6, 51.

that the employment is carried out in Ethiopia, wherever paid; or if it is paid to the employee by or on behalf of the government of Ethiopia, wherever the employment is carried out.[98] In this provision, we can evidence the sovereignty doctrine of both national sovereignty and territorial sovereignty has existed. That is for all income derived in the territory of Ethiopia by whoever performed and wherever paid. In addition, for any work performed wherever the payer is the government of Ethiopia or paid on its behalf, it is also the Ethiopian source of income since the budget for such payment is deducted from the Ethiopian government. In addition, if one considers the income from the rental of buildings, based on source rule the tax jurisdiction is exclusive to a nation where such immovables (houses or other buildings) are located. The same is true under the income tax proclamation of Ethiopia in which income derived from the rental of immovable located in Ethiopia is unconditionally under the income tax jurisdiction of Ethiopia.[99] And any income derived by the rental of movable located in Ethiopia is also an Ethiopian income tax jurisdiction.[100] This is by the mere fact that the source of income is derived in the territorial jurisdiction of Ethiopia and the sovereignty doctrine is incorporated under the income tax proclamation of Ethiopia. Moreover, as it is most commonly used the income tax jurisdiction of Ethiopia applies to residents towards their worldwide income.[101] When we examine it with theories of income tax jurisdiction it meets with the sovereignty doctrine in its national sovereignty type. This signifies the principle of ability to pay which should be assessed based on a taxpayer's comprehensive income.

As a fourth example would taxation jurisdiction be different concerning the business income generated in Ethiopia or by Ethiopians wherever they derive it? According to the FITP, business income derived by an Ethiopian resident is considered an Ethiopian source of income unless it is attributable to a business conducted by the resident through a permanent establishment outside Ethiopia.[102] Under this first situation, the nationality jurisdiction over a person is exemplified, which is a legal connection (such as domicile or incorporation). In addition, income derived from businesses conducted, disposal of goods, merchandise of the same or similar kind, and any other business activity of the same or similar nature by a non-resident through a permanent establishment in Ethiopia, is an Ethiopian source of income.[103] Under this second situation, even if a person is not a resident of Ethiopia, Ethiopia has territorial

[98] Proc.No.979/2016, Article 6(1).
[99] Proc.No.979/2016, Article 6(4-b-1).
[100] Proc.No.979/2016, Article 6(4-b-2).
[101] Proc.No.979/2016, Article 7.
[102] Proc.No.979/2016, Article 6 (2).
[103] Proc.No.979/2016, Article 6 (3).

jurisdiction over income derived within its territory earned by a resident of another country. In this case, the territorial jurisdiction over a person is exemplified, which is a factual connection (i.e. whether a person is actually resident in Ethiopia and the income is not attributed to that person's permanent establishment abroad). This is sometimes referred to as source jurisdiction because the source of income is in Ethiopia. A territorial connection justifies the exercise of taxing jurisdiction because the taxpayer is expected to share the costs of running a country which makes possible the production of income, its maintenance and investment, and its use through consumption.

Taxation of income based on territorial jurisdiction takes one of two forms. A country typically asserts full jurisdiction over business profits generated within that country by a non-resident, taxing those profits earned in the same manner as if earned by a resident of that country because it has a more significant connection.[104] In this case, expenses associated with generating such income are normally deductible. On the other hand, non-business, investment income, such as dividends, interest, royalties, and rent, typically is subject to limited jurisdiction because the only connection may be the payer's residence.[105] Such income is taxed by a country in which a payer resides on a gross basis with a lower rate than business income. This finds true under the FITP of Ethiopia where business income by resident and non-resident of Ethiopia, in its Ethiopian source income is taxable at a 30 percent flat rate for a body and up to 35 percent for individuals[106] while investment income like interest, royalties, dividends, and rent is taxable at a lower rate which ranges between 5 percent to 15 percent.[107]

Based on the above examples, one could say that income sourced to a certain jurisdiction is geographically located in that jurisdiction in much the same way as an individual can be geographically located in a jurisdiction for purposes of applying a residency rule.[108] Similarly, one would err by asserting that taxpayers and incomes bear the same sorts of characteristics, as in the claim that taxpayers and income both have a geographic location.[109]

4.4. The Place of Benefit Doctrine under FITP

[104] Richard L. Doernberg, International Taxation, Nutshell series, West Group Publishing Co.5th ed., (2001)10.
[105] Ibid.
[106] Proc.No.979/2016, Article 19.
[107] Proc.No.979/2016, Articles, 51, 54-56, 58.
[108] Mitchell A. Kanet, A Defense of Source Rules in International Taxation (2015)32Yale Journal on Regulation 314.
[109] Kerrie Sadiq, Jurisdiction to Tax and the Case for Threshold Reform (2005) 1,2, Journal of the Australasian Tax Teachers Association 165; Victor Zonana, Introduction: International Tax Policy in the New Millennium: Developing an Agenda, (2001)26 Brooklyn Journal of International Law 1253–54.

The basic tent of this doctrine is if the person uses public goods and services in generating income, the given State can naturally levy tax on such person. These public goods and services include infrastructures like roads or other buildings and security services. Whether this benefit doctrine is incorporated under the income tax proclamation of Ethiopia is worthy of discussion. The benefit doctrine is realized under the residence and source rule of income tax jurisdiction both to residents towards their worldwide income, and non-residents towards their Ethiopian source income. The benefits principle States that the residence jurisdiction has the primary right to tax passive (investment) income, whereas the source jurisdiction has the primary right to tax active (business) income.[110] The residence rule provides unrestricted taxation rights to the country of residence, due to the "personal attachment" of persons.[111] The country of residence (or nationality) may impose its taxes on the worldwide income of individuals or corporations due to the protection it offers to the tax subject.[112]

On the other hand, the source rule is based on providing restricted taxation rights to the countries of the source due to the "economic attachment" of persons.[113] In relation to this, the country of source reserves the right to tax the income that is derived from the economic activities within its territory. That is the non-resident is taxed in the country of the source to the benefits it received in deriving income. For example, a non-resident who invests in or carries on a United States business profits from United States government activities that create and foster general public safety, national security, a fair legal system, a transparent and safe financial infrastructure, a healthy and educated workforce, transportation and communication infrastructure, legal protection of intellectual property licensed or sold in the United States by the non-resident, and redistributive assistance to the poor that contributes to a stable social order.[114] The permanent establishment is the concept to refer to active business operation in a given country and giving the source country the primary right to tax the profits from that operation.[115] This source rule implicitly considers the benefit theory of income taxation.

[110] Reuven S. Avi-Yonah, The Structure of International Taxation: A Proposal for Simplification (1996)74 Texas Law Review 11.
[111] Roy Rohatgi, *supra 31*, p.15.
[112] Ibid.
[113] Ibid.
[114] Stephen E. Shay et al., The David R. Tillinghast Lecture "What's Source Got to Do With It?" Source Rules and U.S.(2002)56 International Taxation, Tax Law Review 90.
[115] UN and OECD Model Treaties, Articles 4,5,7; Reuven S. Avi-Yonah, The Structure of International Taxation: A Proposal for Simplification (1996)74 Texas Law Review pp.1301, 1307; Ertuğrul Akçaoğllf, International Taxation of Electronic Commerce: A Focus on the Permanent Establishment Concept, Yıl, (2002)130.

In Ethiopia, an income from business conducted, disposal of goods, merchandise of the same or similar kind, and any other business activity of the same or similar nature by a non-resident through a permanent establishment in Ethiopia, is an Ethiopian source of income tax jurisdiction.[116] This income type can be an example of incorporation and application of the benefits theory of income taxation under the income tax proclamation of Ethiopia. It is because though not explicitly mentioned under the proclamation literature shows the benefits principle applies in determining the extent and jurisdiction of income tax. Taxing non-residents is important to preserve the perceived legitimacy of residence-based taxation of similar activities carried out by Ethiopian residents. Simon argued that the existence of the corporate income tax should be justified by the benefit-based view of taxation (which is normally fair or fits with the fairness principle of taxation) and firms should pay tax according to the benefits they receive from the use of the public input.[117] Additionally, let us pick one topical example in relation to this, i.e. taxing technical fees. FITP levies tax on payment for technical services performed in Ethiopia.[118] The benefit theory of taxation is implicitly applicable to this tax (tax on payment for technical service) since the service recipient or the payer or the tax withholding agent is a resident of Ethiopia or non-resident through the permanent establishment in Ethiopia. This can be an enterprise that maintains a significant economic presence in Ethiopia, having any fixed place of business in Ethiopia or being present in Ethiopia for any substantial period. And these persons in one or another way use the public services in Ethiopia which is based on the justification for the benefit theory of taxation.

It has to be noticed that the geographical sovereignty doctrine is applicable in determining the tax jurisdiction of an Ethiopian source of business income. These source-based or benefits-based tax claims seem to conflict with modern notions that income tax should be progressive, thereby reflecting an ability-to-pay principle rather than a benefits principle.[119] However, critics show that benefits-based justifications for income taxes have largely been rejected.[120] Additionally, any net basis income tax assessed on a source basis will do a very poor job of

[116] Proc.No.979/2016, Article 6(3).
[117] Simon M Naitram, Optimal Benefit-Based Corporate Income Tax, Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association, National Tax Association, 2019)112.<https://www.jstor.org/stable/27067518 >
[118] Proc.No.979/2016, Article 51, 52.
[119] Mitchell A. Kanet, A Defense of Source Rules in International Taxation (2015)32 Yale Journal on Regulation 315.
[120] Ibid.

actually reflecting the magnitude of benefits accorded to the taxpayer by a particular jurisdiction.[121]

5. Conclusion

States assume tax jurisdiction with definite rationales and design the income tax jurisdiction rules in consideration of these doctrines/rationales of the taxing power. Commonly, the doctrines of taxation include sovereignty doctrine, benefit doctrine, economic allegiance doctrine, and realistic doctrine. These doctrines or theories help to justify the taxation power of a given State. These days, countries in the world adopt the residence and/or source rule of income tax jurisdiction. In the same fashion, Ethiopia incorporates the residence and source rule of income tax jurisdiction as a basis for levying and collecting income tax as provided under Ethiopia's federal income tax proclamation No.979/2016. According to this law, Ethiopia has worldwide jurisdiction over residents and source jurisdiction over non-residents.

A depth investigation of the federal income tax proclamation of Ethiopia shows that the four doctrines of taxation are considered in one or another way in the design of the tax jurisdiction rules of the country. As can be understood from the income tax proclamation, the tax jurisdiction rules in the taxation of income from employment and business income are mainly designed based on the sovereignty doctrine generally and personality/national sovereignty in particular. Apart from the sovereignty doctrine the law also considers, employment and business income taxes, economic allegiance, and benefit doctrines. Moreover, in the jurisdiction rules of taxation of rental income, business income, and others' incomes (Schedule D) the law base itself on the sovereignty doctrine generally and the territorial sovereignty in particular. doctrine is exemplified. Besides, the law has also considered the doctrine of economic allegiance and the benefits doctrine in the taxation of rental income, business income, and other income as the country will have to contribute to the creation of the income obtained in the Ethiopian territory or through the use of the services provided by the country. Furthermore, for income derived by non-residents taxing on the basis of withholding income tax, the law considers the doctrine realistic in view of tax administration. Since the government cannot access non-residents without permanent establishment service providers, the law uses withholding as a method of tax collection. Hence, the realistic doctrine is considered in the design of withholding taxation. Thus, by and large, the Authors conclude that the doctrines of

[121] Robert A. Green, The Future of Source-Based Taxation of the Income of Multinational Enterprises (1993)79 Cornell Law Review29.

taxation which are considered an index of a good tax system are envisaged under the FITP in designing the income tax jurisdiction of Ethiopia.

Transitional Years in Business Income Taxation under the Ethiopian Income Tax Law: A Case Comment

*Leake Mekonen Tesfay**

Abstract

Profit taxes conventionally are paid annually. However, in case of a change in taxpayers' accounting years, the time between the end of the last year and the beginning of the new year is taxed separately as a transitional year. This comment addresses the issue of whether a change in tax rates can have a similar effect of creating two separate transitional years within a tax year. To this end, a review has been made of the relevant provisions of income tax law, related literature, and comparative lesson from the U.S. experience. A dispute occurred in ERCA v MIDROC Gold (Federal Supreme Court Cassation Division, File No. File No. 130705,07 Sep. 2017) because the mining income tax rate was reduced from 35% to 25% on 26 July 2013, bifurcating the tax year of 2013. The Federal Tax Appeal Commission, the Federal High Court, the Federal Supreme Court, and the Federal Supreme Court Cassation Bench all decided that mining income taxes are paid on the aggregate annual taxable income not by dividing the year into months. Although the mining income tax law has been incorporated into the new income tax law since 2016, the relevance of the precedent in this case that tax years are indivisible endures. This author disagrees with the above decisions and argues that a clear provision in the income tax law for transitional years in case of a change in tax rates effective in the middle of tax years is necessary.

Keywords: *Business income, tax year, accounting period, tax rate, transitional tax year*

Introduction

The main theme in this article is whether tax years in the taxation of business income are divisible. It has to do with the triadic interplay between the tax year, annual taxable income, and the tax rate applicable for the determination of the annual tax due. Writing this article is oriented by a case. A dispute arose between *ERCA vMIDROC Gold*,[1] whether two tax rates can apply in the determination of MIDROC Gold Mines PLC (hereinafter MIDROC Gold)'s income tax for the tax year of 2013. The dispute followed a mining income tax rate reduction from 35% to 25% in July 2013.[2] At the heart of the dispute was whether the tax year can be divided into two in order to apply these two tax rates in this single tax year. The Ethiopian Revenues and Customs Authority (hereinafter ERCA) argued that the tax year is divisible and that the tax should be computed by applying the 35% and 25% tax rates using the proportion method and summing these two proportions for the total annual tax. MIROC Gold argued for the indivisibility of the tax year and claimed that the new 25% tax rate prevailed in the tax year.

As can be seen from the laws, the 25% rate was effective from 26 July 2013.[3] This shows that the 35% rate was effective through 25 July 2013. Accordingly, it seems imperative for the application of these two rates in the tax year to be a point of dispute. The Federal Tax Appeal Commission (FTAC), the Federal High Court (FHC), the Federal Supreme Court (FSC), and the Cassation Division of the FSC (Cassation Bench) decided for MIDROC Gold. The purpose of this comment is to examine the appropriateness of these decisions in light of the relevant provisions of the relevant law and accepted rules of statutory interpretation, particularly from the perspective of whether tax years are absolutely indivisible. Although similar experiences in this regard seem limited, the experience of the U.S.A. has also been consulted.

The article has four sections. Section one presents the facts of the case and the rulings of the judicial organs. Section two presents a brief discussion about transitional tax years in the determination of profit taxes. This section expounds that although conventionally business income taxes are paid every twelve months, there are exceptions for business income taxes to be

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[1] Ethiopian Revenues and Customs Authority *v* MIDROC Gold Mines PLC, Federal Supreme Court Cassation Division, File No. 130705, decision of 07 Sep. 2017(30 Meskerem 2010 E.C) (Unpublished) (hereinafter called *ERCA v MIDROC Gold*).

[2] Mining Income Tax (Amendment) Proclamation, Proclamation No. 802/2013, Fed. Neg. Gaz., Year 19, No. 58, (hereinafter called Proc. No. 802/2013), Article 2;Mining Income Tax (Amendment) Proclamation, Proclamation No. 23/1996, Article 2, Fed. Neg. Gaz., Year 2, No. 11, (hereinafter called Proc. No. 23/1996).

[3] Proc. No. 802/2013, *Id*., Article 3.

paid in times less than twelve months. Section three presents the author's comments and analysis of the case. It is argued here that the way the case was settled unduly applied the new tax rate retroactively and at the same time failed to strike the proper balance between the interests of the parties to the litigation. Section four presents some prospects for the future. It argues that to avoid fairness problems which are inescapable consequences of the precedent in *ERCA v MIDROC GOLD* the income tax law should be revisited to clearly provide for the application of transitional tax years in cases of change in tax rates amidst tax years. Finally, the article ends with a conclusion.

1. *ERCA v MIDROC Gold*: Summary of Facts and Court Rulings

Before 1993, mining income was taxed under the main income tax law, Proc. No. 173/1963, although with a different higher rate of 51%.[4] When the special mining tax law was introduced in 1993 by the Transitional Government of Ethiopia, the rate was provided to be 35% for small-scale mining and 45% for large-scale mining.[5] Through time, the tax rate for income from large-scale mining was consecutively reduced to 35% in 1996[6] and again to 25% in 2013.[7] The new re-amendment to the mining income tax law, which reduced the tax rate from 35% to 25%, was

[4]Tadesse Lencho, *Towards Legislative History of Modern Taxes in Ethiopia, 1941-2008*, Journal of Ethiopian Law, Vol. 25, No. 2, 124 (2012).

[5] Mining Income Tax Proclamation, Proclamation No. 53/1993, Neg. Gaz., Year 52, No. 43, (hereinafter called Proc. No. 53/1993), Article 3. When the FDRE Constitution was adopted in 1995, while the power to tax income from small-scale mining operations is given to the states, the power to tax income from large-scale mining operations is given jointly to the Federal Government and the sates. See FDRE Constitution, Article 97(8) cum Article 98(3.)

[6] Proc. No. 23/1996), supra note 2, Article 2.

[7] Proc. No. 802/2013, supra note 2, Article 2. Following the new income tax law that has been enacted in 2016, the mining taxation has been incorporated back to the income tax law, with lower tax rate of 25%. See Federal Income Tax Proclamation, Proclamation No. 979/2016, Fed. Neg. Gaz., Year 22, No. 104 (hereinafter called Proc. No. 979/2016), Article 37(3) and 100(1)(b). Whether the continuous reduction of mining tax rates for large-scale mining from 45% to 35% and further to 25% was backed by dictating economic realities seems questionable. Usually, the reasons for enacting or amending a law are highlighted in preambles or separate object clauses. Neither of the amendments to the mining tax law, however, had stated reasons. Only roughly expressed in the preambles of both amendments was the fact that amending the law was necessary. See Proc. No. 23/1996, supra note 2 and Proc. No. 802/2013, supra note 2, Preambles. Moreover, while mining taxation has been incorporated to the income tax law, it does not seem there is sufficient reason to justify taxing mining income at 25% whereas other corporate profits are taxed at 30% rate. See Proc. No. 979/2016, *Id*., Compare Article 19(1) and Article 37(3). Lowering mining tax rate is not, however, unique to Ethiopia. Studies show that African countries, generally, impose lower corporate tax rates for mining than the general tax regime, and particularly, African countries under tax Multinational Corporations involved in the mining sector. See M. Moore et. Al., *Taxing Africa: Coercion, Reform and Development*, 89-111(London: ZED Books, 2018) (hereinafter called Taxing Africa) and Bertrand Laporte, Céline De Quatrebarbes and Yannick Bouterige, *Mining Taxation in Africa: The Gold Mining Industry in 14 Countries from 1980 TO 2015*, (2017) <halshs-01545361> at 12.

effective from 26 July 2013, i.e., almost bifurcating the tax year of 2013 at the middle.[8] Following this, MIDROC Gold reported that its taxable income for the tax year of 2013 was ETB 1, 976, 578, 000.40 (One Billion Nine Hundred Seventy-Six Million Five Hundred Seventy-Eight Thousand Birr and Forty Cents). Then, having computed its tax liability at the rate of 25%, it reported that the tax due for it to pay would be ETB 494, 144, 500.10 (Four Hundred Ninety-Four Million One Hundred Forty-Four Thousand Five Hundred Birr and Ten Cents). However, after stating that it had paid ETB 500, 000, 000.00 (Five Hundred Million Birr) withholding taxes in advance, it claimed a refund of ETB 5, 855, 499.90 (Five Million Eight Hundred Fifty-Five Thousand Four Hundred Ninety-Nine Birr and Ninety Nine Cents).

ERCA's Large Taxpayers Branch Office Tax Assessment and Collection Department, however, revised MIDROC Gold's tax declaration. It divided the taxable income that MIDROC Gold reported into two proportions and computed the tax for the income generated from 01 January to 25 July (206 days) at a 35% rate on the one hand and the income generated from 26 July to 31 December (159 days) at 25% rate using proportion method. Taking the sum of these two proportions, it decided that the tax due was ETB 605, 699, 313.12 (Six Hundred Five Million Six Hundred Ninety-Nine Thousand Three Hundred Thirteen Birr and Twelve Cents). The proportional calculation it used was:

$$1{,}976{,}578{,}000.40 * 206 * 35\%/365 \ = 390{,}441{,}846.02$$

$$1{,}976{,}578{,}000.40 * 159 * 25\%/365 = 215{,}257{,}467.10$$

$$390{,}441{,}846.02 \ + 215{,}257{,}467.10 \ = 605{,}699{,}313.12$$

Then, deducting the withholding tax that MIDROC Gold declared that it had paid, the Department computed an extra tax due of ETB 105, 699, 313.12 (One Hundred Five Million Six Hundred Ninety-Nine Thousand Three Hundred Thirteen Birr and Twelve Cents). Adding late payment interest and a penalty it noticed MIDROC Gold to pay ETB 112, 773, 768.14 (One Hundred Twelve Million Seven Hundred Seventy-Three Thousand Seven Hundred Sixty-Eight Birr and Fourteen Cents) tax. MIDROC Gold appealed to the Tax Review Committee within ERCA's Head Office, which confirmed the tax decision. MIDROC Gold, then, appealed to the

[8] Proc. No. 802/2013, supra note 2, Article 3.

FTAC, which reversed the Review Committee's decision.[9] ERCA appealed to the FHC. The FHC,[10] FSC[11], and the Cassation Bench[12] respectively affirmed the FTAC's decision.

Throughout the litigation, ERCA argued that since Proc. No. 802/2013 which provided for a 25% tax rate was effective only from the time of its publication in the Federal Negarit Gazeta on 26 July 2013, Proc. No. 23/1996 which provided for a 35% tax rate was effective in the time from 01 January to 25 July. According to this, ERCA argued, these two rates were effective in their time sphere within the same tax year. It added that applying the new law, i.e., Proc. No. 802/2013 retroactively beginning from 01 January 2013 was against the provision of the Proclamation, therefore, the tax should be determined in two proportions, then, these two proportions should be summed up for the annual tax due. On the contrary, MIDROC Gold argued that since the tax rate was amended before the tax year of 2013 was finalized, the prevailing tax rate for the whole tax year of 2013 was 25%, not 35%. MIDROC Gold added that so long as the tax has to be determined based on the aggregate amount of the annual taxable income, no provision in the law allowed dividing the tax year into two fractions of time and computing the tax payable based on two different tax rates.

The FTAC, FHC, FSC, and the Cassation Bench reasoned that the mining income tax law, issued in consideration of the special nature of mining income taxation, provided for the accounting year for mining income taxation to be the Gregorian calendar year ending on 31 December. They also added that the mining income tax law provided for mining income tax to be determined on annual basis calculating the annual aggregate amount of taxable income after all allowable deductions are subtracted from the annual gross income not by dividing the tax year into months. Accordingly, they applied the 25% rate for the total annual tax. The author disagrees with the view that the tax year is indivisible and particularly with the way the case has been settled. The concern of this comment is not only the way the case was settled but the case's future implications. As it will be made clear in the discussions below, since 2016 the mining income tax law has been incorporated into the new income tax law, the precedent in this case that tax years are indivisible will have a bearing effect not only on the mining business but also on

[9] MIDROC Gold *v* ERCA, FTAC, File No. 950, decision of 13 Nehasie 2007 E.C., (Unpublished)
[10] ERCA *v* MIDROC Gold, FHC, File No. 170680, decision of 03/05/2008 E.C., (Unpublished)
[11] ERCA *v* MIDROC Golg, FSC, File No. 123093 decision of 22/09/2008 E.C., (Unpublished)
[12] FasikaTadesse, *Midroc Comes Out Victorious in Tax Dispute*, Addis Fortune, [Vol. 18, No. 914] Oct 30, 2017, availabe at https://addisfortune.net/articles/midroc-comes-out-victorious-in-tax-dispute/, accessed on 25/10/2018, (hereinafter called FasikaTadesse).

the taxation of other business income. This being as it may, is there any legal or scientific basis for the argument that tax years are indivisible? Let us see this in the next section.

2. Tax Years in Business Income Taxation: Between Annual Taxes and Transitional (Short) Tax Periods

According to conventional knowledge, taxes on the profit from business operations are paid for a twelve months period called a tax year.[13] According to this, profit taxes are assessed and determined after all deductible costs and expenses are deducted from the gross income generated in the respective tax year on annual basis.[14] This twelve months period is called the "normal tax year."[15] This normal tax year is oftentimes aligned with the calendar year or the government's fiscal year.[16] Alignment of the tax year with the government's budget year is common for those taxpayers who did not maintain books of account and records for their tax purposes.[17] However, different jurisdictions also allow their taxpayers to opt for another twelve months of tax year than the calendar year or government's fiscal year and to change their accounting year.[18] Especially, taxpayers who are required to keep books of account and records and hence have to determine their incomes and deductions accordingly are allowed to have their own taxable year coinciding with their accounting year.[19] It has to be noted here that in the change from one tax year to another, there may be lacunae for taxpayers to escape payment of taxes due, and hence tax jurisdictions do control the process of the change in tax years by setting application procedures and requirement for taxpayers to demonstrate the reasons for the change.[20]

The case for the unity of the tax year - the payment of profit taxes annually coinciding with the calendar year, the government's fiscal year, or the taxpayer's accounting year - can be defended from the perspective of the principle of simplicity in taxation.[21] The demand for simplicity in taxation is an age-old principle. For example, as early as 1662 William Petty,

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[13] Reuven S. Avi-Yonah, Nicola Sartori, and Omri Marian, *Global Perspectives on Income Taxation Law*, 77-80 (Oxford University Press, 2011) (hereinafter called Global Perspectives on Income Taxation Law)
[14] *Id*., at 77. See for example of the Ethiopia case Proc. No. 979/2016, supra note 7, Articles 18-27.
[15] Lee Burns and Richard Krever, *Taxation of Income from Business and Investment*, in Tax Law Design and Drafting (volume 2; International Monetary Fund: 1998; Victor Thuronyi, ed.,) (hereinafter called Taxation of Income from Business and Investment) at 20.
[16] *Ibid*.
[17] Global Perspectives on Income Taxation Law, supra note 13, at 77.
[18] Taxation of Income from Business and Investment, supra note 15, at 20-21.
[19] Global Perspectives on Income Taxation Law, supra note 13, at 77.
[20] Taxation of Income from Business and Investment, supra note 15, at 21.
[21] Global Perspectives on Income Taxation Law, supra note 13, at 77 & 78.

demanding proper timing to tax collection for simplicity in tax compliance, said that the 'Prince' cannot make a judgment of the proper season to demand his presents for not knowing the trade.[22] Simplicity is measured in terms of collection/administrative costs for governments and compliance costs for taxpayers.[23] The government's administrative costs include the time and money wasted in the implementation of the tax system.[24] Taxpayer's compliance costs, on the other hand, include "the value of … time spent learning tax law, maintaining records for tax purposes, completing and filing tax forms, and responding to any correspondence from the tax administration."[25] Compliance costs also include "amounts paid to others to conduct any of these tasks" on the taxpayer's behalf.[26] The principle of simplicity requires the tax law to be easily comprehensible, and provisions for exemptions, exclusions, deductions, and preferential rates in the law to be limited.[27] This promotes taxpayer compliance because taxpayers have few complex provisions to learn and comply with, and minimizes administrative costs because tax personnel has few complex provisions to understand and enforce.[28] This also broadens the tax base allowing optimal taxes to be collected with lower tax rates.[29] The simplicity of the tax law also helps reduce tax expenditures which are tax losses due to special provisions allowing exemptions, exclusions, deductions, credits, or preferential rates.[30] The determination of the tax year to be on annual basis – one way to make the tax system simple - also contributes to reducing the government's administrative costs and taxpayers' compliance costs.[31]

In another way, as exceptions to the twelve months tax year, there are cases where profit taxes can be determined and paid for a period of less than a year (less than twelve months). These exceptions may be named differently in different tax jurisdictions. For example, in the USA they are called shorter tax periods.[32] In the Ethiopian case, they are interchangeably called

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[22] William Petty (1662), *A Treatise of Taxes and Contributions*, in Steven G. Medema and Warren J. Samuels (eds.), The History of Economic Thought: A Reader, 48-49 (Rutledge, Taylor and Francis Group, 2003).
[23] Global Perspectives on Income Taxation Law, supra note 13, at 15-16; Joshua E Greene, *Public Finance: An International Perspective*, 110-111(World Scientific Publishing Co. Pte. Ltd., 2012)(hereinafter called Greene, Public Finance).
[24] Global Perspectives on Income Taxation Law, supra note 13, at 16.
[25] *Id*., at 15-16.
[26] *Id*., at 16
[27] Greene, Public Finance, supra note 23, at 110.
[28] Ibid.
[29] Ibid.
[30] Ibid.
[31] Global Perspectives on Income Taxation Law, supra note 13, at 77 & 78.
[32] See Internal Revenue Service, Department of Treasury, *Accounting Periods and Methods*, 2-3 (Publication No. 538, Rev. Nov. 1995)(hereinafter called Accounting Periods and Methods).

transitional accounting years and transitional years.[33] There may be various reasons for adopting such provisions for transitional years. On the one hand, transitional years prevent transition problems such as an extended tax year above twelve months in case taxpayers change their accounting year from one to another.[34] For example, assume that XYZ Co. PLC is an Ethiopian registered business firm involved in copper mining. It used to use the Gregorian calendar year beginning on 1st January to 31st December. If it changes its accounting year to the fiscal year beginning on 1st Hamle (July), it will have a transitional year from 1st January to June 30.[35] For the case of the transitional year in case of change in the taxpayer's accounting year, the transitional year is defined as a period "commencing at the end of the taxpayer's last complete tax year to the beginning of the changed tax year."[36] "Non-existence in the entire tax year" is also a reason for the application of a short or transitional tax year.[37] The case for this is that if a business, be it that of a sole proprietorship or a company begins operation amidst the tax year, the time from the beginning of its business to the end of the tax year will be taxed separately and independently for itself, and this is called short tax period.[38] These all show that although corporate income taxes, conventionally, are paid annually, the tax year is not an absolutely indivisible divine unity.

An issue of interest here is whether short or transitional tax years can apply to solve transition problems connected with a change in tax rates in the middle of a tax year or anytime before a tax year is finalized. Literature and comparative experience in this perspective seem scanty. However, the tax system in the U.S.A. has a solution for this. The Internal Revenue Code of the U.S.A. provides that "[I]f any rate of tax … changes, and if the taxable year includes the effective date of the change …tentative taxes shall be computed by applying the rate for the period before the effective date of the change, and the rate for the period on and after such date …."[39] According to this, "the tax for such taxable year shall be the sum of that proportion of each

[33] Proc. No. 979/2016, supra note 7, Article 2(21)(c) and Article 28(5). In the former law the term "transitional year" was used. See Income Tax Proclamation, Proclamation No. 286/2002, Fed. Neg. Gaz., No. 8, Year 34(hereinafter called Proc. No. 286/2002)(now repealed), Article 64(5);Taddese Lencho, *Ethiopia-Corporate Taxation* (IBFD, 2014) at 21.

[34] Taxation of Income from Business and Investment, supra note 15, at 21; 26 U.S. Code § 441(a)(1); Global Perspectives on Income Taxation Law, supra note 13, at 78.

[35]Example adopted from Accounting Periodsand Methods, supra note 32, at 3.

[36] Taxation of Income from Business and Investment, supra note 15, at 21.

[37] Accounting Periods and Methods, supra note 32, at 3.

[38] Ibid; 26 U.S. Code § 441(a)(2); Global Perspectives on Income Taxation Law, supra note 13, at 78.

[39] 26 U.S. Code § 15 (a)(1).

tentative tax which the number of days in each period bears to the number of days in the entire taxable year."[40] This provision clearly shows that the tax year is not indivisible. If the tax rate changes before the tax year end, possibly creating two conflicting tax rates in the same tax year, the tax year is divided into two short tax years to enforce the two tax rates, determining provisional taxes for each fraction time, and the tax due for the entire tax year is calculated by taking the summation. The term used in this provision is not "transitional tax year" or "transitional year", but rather "tentative taxes". However, whether it is called "transitional year," "transitional tax year," "transitional period," "short tax year," or "tentative taxes" does not make a difference. The effect is that the tax year is divided into two to enable the application of two different tax rates within a single tax year.

The Ethiopian income tax law has used the terms "tax year" and "accounting year" nearly interchangeably. For this, on the one hand, it defines "tax year" and it provides that while the tax year for sole proprietors is the government's fiscal year covering from Hamle 1 to Sene 30 Ethiopian calendar, with the possibility of change upon written permit by the tax authority, the tax year for corporate businesses is their accounting year.[41] With respect to the accounting years of taxpayers, it provides that sole proprietors use the fiscal year as their accounting year unless they are allowed to use a different time by the tax authority in writing whereas corporate businesses use their own accounting year.[42] It also provides that the accounting year is a twelve months period where taxpayers account for their financial balance.[43] It prohibits taxpayers from changing their accounting years except upon prior written permission from the tax authority and upon fulfillment of the conditions the latter may attach.[44] The tax authority may revoke the permission to change the accounting year if taxpayers fail observance of the conditions attached thereto.[45] With respect to the application of transitional years, the law provides that in case taxpayers change their accounting years, the time between the last tax year and the beginning of the new tax year is treated separately as a full tax year and is called a "transitional year."[46] Although the law is silent, taxpayers who begin running a business amidst a tax year will be

[40] *Id., § 15 (a)(2).*
[41] *Proc. No. 979/2016*, supra note 7, Article 2(21)(a) & (b).
[42] *Id.*, Article 28(1)(a) & (b).
[43] *Id*., Article 28(2).
[44] *Id*., Article 28(3).
[45] *Id*., Article 28(4).
[46] *Id*., Article 28(5). A similar provision was included in the former law. See *Proc. No. 286/2002*, supra note 33, Article 64(5).

taxed for a period of fewer than twelve months beginning from the date of their start-up for business to the end of the tax year, whether we call this a short tax year as is called in the U.S.A. or a transitional year.

An issue here is whether a transitional year can apply due to a change in tax rates in the middle of a tax year bifurcating the tax year. The author believes that the provision for transitional years with respect to business income taxation in cases of change in the taxpayer's accounting year shall apply to cases of change in tax rates effective amidst a tax year. For this, incorporating a clear provision in the Income Tax Proclamation through amendment may be imperative. Courts could also do this through interpretation by analogy.[47] Analogy means treating case alike if their similarity outweighs their difference.[48] As we have seen earlier, the purpose of the provision in the income tax law for a transitional tax year is to avoid transitional problems of confusion and controversy as to how the change in the accounting year shall be treated for the purpose of profit tax determination. Similarly, the determination of annual tax is the tripartite interplay between "tax year", "taxable income" and "tax rate." This means that the tax due for a tax year is computed by the multiplication of the profit (taxable income) earned in the tax year by the tax rate provided for in the law. Then, if the change of the accounting year is treated by the application of a transitional tax year, the same should similarly apply to the change of tax rate, for similar transition problems are likely to occur in cases of change in tax rates in the middle of tax years. What has to be noted here is also that although the twelve months tax year has significance for simplicity of tax administration and compliance, dividing the tax year into two fraction times in exceptional circumstances will never create any visible inconvenience. It is also practically being implemented in cases of change in taxpayers' accounting years and there is no known problem to be created when it is used in case of change in tax rates.

A typical case demanding the division of the tax year into two transitional tax periods due to a change in the tax rate was *ERCA v MIDROC Gold*. It is unfortunate, however, that the Cassation Bench has wasted its opportunity to examine the case duly from this perspective and decided it simply limited to the reading of the seemingly clear but shallow provisions of the law. The following section presents the author's analysis and comments on the case briefly.

[47] What is only prohibited is establishing crimes by analogy. See, for example, Criminal Code of the Federal Democratic republic of Ethiopia Proclamation No. 414/2004, Fed. Neg. Gazeta, Article 2(3).
[48] John H. Farrar, *Reasoning by Analogy in the Law*, in Bond Law Review, Vol. 9: Iss. 2, Article 3, 149 (1997) (hereinafter called John H. Farrar)

3. Critique on *ERCA v MIDROC Gold*

ERCA v Midroc Gold had attracted divided opinions. When it was pending in the FTAC, many of ERCA's Public Prosecutors opined that the law was plain and the tax should be calculated using the two tax rates whereas others argued that the purpose of the new law was to favor the taxpayer by lowering the tax rate, hence the tax for the whole tax year should be calculated at 25% rate.[49] The author also observed that legal officers in the Ministry of Revenue, as currently is, agreed with the decisions doubting that two tax rates can apply in a single tax year.[50]According to the author's view, there is no legal provision or science in taxation and tax law which prohibits dividing the tax year into two, and hence, the decisions of the FTAC, the FHC, the FSC, and the Cassation Bench are indefensible for the following two reasons.

First, applying the 25% rate retroactively from 01 January 2013 goes against the express provision of Proc. No. 802/2013 for it to be applicable from 26 July 2013. If the retroactive application of the 25% rate were the parliamentary intent, expressly providing so would have been possible. Although there is no prohibition of retroactivity of tax statutes in Ethiopia, according to the author's view, tax laws should not be applied retroactively, at least, in cases the legislature did not provide so. The debate in other countries, similarly, is also on the validity of retroactive tax bills enacted by the legislature.[51]There is no issue of retroactive application of tax statutes the retroactive application of which is not provided by the legislature. In our case, the parliament did not provide for the 25% rate to be applied retroactively from 01 January. A tax bill can also be made to begin application from the first day of the tax year either retrospectively or prospectively. For example Proc. No. 286/2002 was provided to prospectively apply for incomes generated from 01 Hamle 1994 E.C., i.e., for the fiscal year of 1995 E.C. whereas it was in force from 27 Sene 1994 E.C.[52] This was not the case in the case of our discussion. In this case, Proc. No. 802/2013 had been unduly applied retroactively from the beginning of the tax

[49] The author was one of the ERCA's Public Prosecutors assigned to the litigation in this case, and, had been discussing on the matter with many of the Public Prosecutors who were in the ERCA's Head Office. For a report of different opinions after the case was decided by the Cassation Bench, see FasikaTadesse, supra note 12.

[50] The author, in the due course of writing this article, has discussed on the matter with former colleagues in the Legal Service Department of the Ministry of Revenues.

[51] For an earlier analysis on the issue in the case of U.S.A. for example, see Ralph R. Neuhoff, *Retrospective Tax Laws*, 21 St. Louis L. Rev. 001 (1935). There are also arguments that retroactive tax norms that affect taxpayers' rights are contrary to the principle of legal security in taxation. On the limits of the retroactive tax laws, see Agustin Jose Menendez, *Justifying Taxes: Some Elements for a General Theory of Democratic Tax Law*, 282-288 (Springer Science + Business Media Dordrecht, 2001).

[52] Proc. No. 286/2002, supra note 33, Article 120.

year of 2013, based on a wrong understanding that the tax year is indivisible and two tax rates cannot apply in one tax year.

Second, the FTAC, the FHC, the FSC, and the Cassation Bench failed to balance the interest of ERCA (tax authority) and MIDROC Gold (taxpayer). Balancing is settling conflicts between fundamental principles, both accepted in the legal system, by determining the proper boundary between them.[53] Its essence is that it is settling conflicts, not in an "all or nothing" approach or giving a zero value to either of the conflicting values.[54] The government's legal power to levy and collect taxes on the one hand and taxpayers' legal right to pay only taxes due according to law always conflict.[55] The case of our discussion is a manifestation of the conflict between the government's power to tax and the taxpayers' rights regarding the enactment, application, and interpretation of taxing bills. However, while striking a balance between the interests of ERCA, i.e., collecting taxes according to the law, and MIDROC Gold, i.e., paying taxes due only according to the law was required and simply possible, neither of the FTAC, the FHC, the FSC, and the Cassation Bench tried to. In this case, ERCA lost totally and MIDROC Gold took all. What has to be understood, however, is that this precedent, unless changed, may disadvantage taxpayers. For example, if the tax rate increases in the future in a similar way, taxpayers will be taxed according to the higher rate for the whole tax year. This argument was raised by the ERCA. The FTAC, the FHC, the FSC, or the Cassation Bench did not try to understand the issue.

An issue possible to arise here is whether these judicial organs can balance conflicting interests appearing before them for their decision apart from interpreting and applying the law. This question may relate to the constitutional debates on the role of the judiciary in legal engineering. However, without needing to delve into these debates, although the judicial business of balancing conflicting interests, oftentimes, is raised in connection to constitutional interpretation, it suffices to say here that balancing is also important in the day-to-day judicial duty of adjudication. It is part of any legal system and is effectuated by choosing the decision that yields the greatest benefit from among two or more possible ways of legal construction.[56] If we adhere to the legal model of judicial responses to legislative ambiguity, as the purpose of the

[53] Aharon Barak, *The Judge in A Democracy*, 164-167 (Princeton and Oxford: Princeton University Press, 2006) (hereinafter called The Judge in A Democracy).
[54] Ibid.
[55] For an historical account on this, see Chantal Stebbings, *The Victorian Taxpayer and the Law: A Study in Constitutional Conflict* (Cambridge University Press, 2009).
[56] See Alexander Aleinikoff, *Constitutional Law in the Age of Balancing*, in The Yale Law Journal, Vol. 96, Number 5, 943, (April 1987).

law is to govern human activity, the goal of legal interpretation is to bridge the gap between the law and social behavior.[57] In bridging the gap, judges are required to choose the way of statutory construction that best resolves the dispute before them giving due weight and examination to all possible reasons when the law is indeterminately leading to more than one infallible interpretation with different outcomes.[58] Through this, they can come to a conclusion that best balances the conflicting interests involved in the cases they are faced with to settle.

As already stated above, when the case of our discussion, *ERCA v MIDROC Gold*, was underway, some argued that the relevant law was clear, and so needed no interpretation, and that the case has to be decided in favor of the tax authority. For the author, however, the relevant legislation creates ambiguity not only as to which tax rate would apply to the tax year of 2013 but also in the process of determination of the taxable income. The taxpayer (MIDROC Gold) argued that before thinking about the applicable tax rate the annual taxable income should be determined by deducting all allowed deductions from the gross sales. Then, it goes, the issue of which tax rate to apply upon the taxable income of the tax year should follow, for which it argued the newly proclaimed 25% should prevail over the prior 35%. The tax authority (ERCA), on the other, argued that so long as there are two legally binding tax rates, we should divide the taxable income of the year along the line of the time these rates are applicable as per the law and determine the tax due applying these two rates respectively. Each party uses the law to support its interest. Pursuant to the provisions of the law, both arguments are not easily fallible. A certain way of construction was required to put a dividing line between these interests.

Now, the question comes: how should have the case been settled? Perhaps, the issue would not have occurred had the legislature provided for Proc. No. 802/2013 to be applicable either retroactively from the beginning of the tax year of 2013 or proactively from the beginning of the tax year of 2014. Now, the issue is how to fill this gap. Similar to interpretation in law, the interpretation of tax statutes is subject to debate.[59] On the one hand, based on the view that the

[57] See The Judge in A Democracy, supra note 53, at 3-19 and Aharon Barak, *A Judge on Judging: The Role of a Supreme Court in a Democracy*, in Harvard Law Review, Vol. 116: 16,28-36 (2002). It is also important not to forget the attitudinal model to judicial responses to legislative ambiguity which holds that judges do exploit legislative ambiguity in the sense they "decide cases in ways that further their ideological preferences." For the review of legislative ambiguity and the judicial responses to it, see Adam C. Pritchard and Joseph A. Grundfest, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, in Stanford Law Review, Vol. 54: 627,637-650 (Apr. 2002).

[58] Steven J. Burton, *Judging in Good Faith*, 3-34 & 38-61 (Cambridge University Press, 1992)

[59] The debates on interpretation in law vary between Textualism (New Textualism), Intentional-ism (Originalism) and to Purposive-ism regarding the substantive approaches of interpretation and between Strict Constructionist Rule,

taxpayer is a party weaker than the government as in penal laws, there is an argument that doubts in tax statutes should benefit taxpayers.[60] On the other, especially in connection to combating tax shelters, there is an argument for the purposive approach to the interpretation of tax statutes.[61] The author will never delve into the details of the arguments about whether or not the taxpayer is always weaker than the tax authority (government). Chinua Asuzu, one who opposes the argument in favor of taxpayers asked: "Is it necessarily correct to say that the taxpayer is always weaker than the Government? Is the Microsoft Corporation weaker than the Government of South Sudan?"[62] His allegation is true. Let alone in a young state like South Sudan, the lack of equipped human resources is one of the challenges for African countries to tax Multinational Corporations, especially those involved in the mining sector.[63] This being so, what has to be noted is that "there are no special principles of construction applicable only to fiscal legislation[s]."[64] Tax disputes can be settled using the approaches and canons of interpretation used in the interpretation of other statutes.

Accordingly, for the settlement of this case, the tax year of 2013 should have been divided into two transitional years. As already said above, in Proc. No. 286/2002, which was in force while the case was in litigation, it was provided that if the taxpayer's accounting year is changed from the Ethiopian budget year to the Gregorian calendar year or vice versa, the time between the last tax year and the beginning of the new tax year is taxed separately and named as a *transitional year*.[65] Similarly, the provision in the income tax law for a transitional tax year, which, as argued above is applicable to cases of change in tax rates, should have been applied to the change in the mining income tax rate in the case of our discussion. This argument is supported by the contrary reading of the provision in the mining tax law, which provided that

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Literal (Plain Meaning) Rule, Golden Rule, Mischief Rule and Rules of Analogy regarding the technical canons of interpretation. For example, see Aharon Barak, *Purposive Interpretation in Law*, 12-12 (Princeton and Oxford: Princeton University Press, 2005); The Judge in A Democracy, supra note 38; Chinua Asuzu, *Remember Lot's Wife! Interpretation of Tax Statutes*, available at http://ssrn.com/abstract=1920702, retrieved on 17/10/2018, (hereinafter called Remember Lot's Wife); and John H. Farrar, supra note 48.

[60] Florence N. Dollo, '*Tax Legislation and the Lawyer's Training Needs- An African Perspective'*, cited in Remember Lot's Wife, *Id*., at 25.

[61] Shannon Weeks McCormack, *Tax Shelters and Statutory Interpretation: A Much Needed Purposive Approach*, University of Illinois Law Review, Vol. 2009, No. 3.

[62] Remember Lot's Wife, supra note 59, at 26.

[63] Taxing Africa, supra note 7, at 106.

[64] Vinelott J (1982), *Interpretation of Fiscal Statutes*, cited in Remember Lot's Wife, supra note 59, at 24.

[65] Proc. No. 286/2002, supra note 33, Article 64(5), emphasis added.

other tax laws cannot be applicable to matters covered by the mining income tax.[66] A contrary argument can be raised here that the provision for transitional years resulting from the income tax law could not apply to the taxation of mining incomes. Because, the mining tax law, had provided for the tax year to be the Gregorian calendar year beginning on 01 January and ending on 31 December for the purpose of mining income taxes.[67] However, it did not make a difference with respect to the fact that corporate profit taxes are payable annually.[68] It can easily be understood that the provisions in both laws for profit taxes to be paid on annual basis were provided with a presupposition that there will be a single tax rate applicable to the tax year without any controversy. Therefore, the unity of the tax year did not apply to cases where controversy arises due to the existence of two legally binding tax rates competing for application in a single tax year. According to this, the provision in the mining income tax law for the tax year to be the Gregorian calendar year did not preclude a change of tax rates in the middle of a tax year and the resultant controversy as to which tax rates could apply. Hence, the solution is the application of a transitional year by dividing the tax year into two using the date when the new law was proclaimed as a dividing line.

According to this, the tax year of 2013 should have been divided into two transitional tax years; the tax for the income earned between 01 January and 25 July should have been computed at a 35% rate, and the income earned between 26 January and 31 December at 25% tax rates respectively; and the total tax due for the tax year should have been the sum of the amounts determined for these transitional tax years. In this way, it was possible to avoid the undue retroactive application of the new law on the one hand and to strike a balance between the interests of the parties to the case on the other. More importantly, this would have been a precedent enabling us to avoid possible similar future controversies.

Lastly, a point that has to be raised is the misunderstanding on ERCA's part. According to the author's understanding, if the times from 01 January to 25 July and from 26 July to 31 December were treated separately as transitional tax years, the tax should have been computed by determining two separate taxable incomes for each transitional tax year vouching all transactions conducted within these transitional tax years, not by using proportion method. As already said earlier, however, ERCA, improperly, took the annual taxable income that MIDROC

[66] Proc. No. 53/1993, supra note 5, Article 14
[67] Id., Article 2(2).
[68] Compare Article 4 of *Proc. No. 53/1993, Id*., with Article 18 of *Proc. No. 286/2002*, supra note 33.

Gold reported as an aggregate amount and divided it proportionally into two based on the number of days of the tax year. In addition to this, even throughout the litigation, although ERCA argued for the tax year to be divided into two and the two tax rates to be applied respectively, it did not expressly argue that the times from 01 January to 25 July and from 26 July to 31 December should be treated as "transitional tax years."Moreover, it did not argue that its argument was supported by the analogical interpretation of the provision for a transitional tax year in the income tax law in case of a change in the taxpayer's accounting year. Because of this, ERCA's argument to divide the tax year into two was seen as strange by the law. Had ERCA applied the treatment of transitional tax years properly in determining the tax and expressly argued for in the litigation, the author thinks, this might have helped the FTAC, the FHC, and the FSC or at least the Cassation Bench to think of the nature of the case.

4. Future Implications of *ERCA v MIDROC Gold*: The Need for Transitional Years in Business Income Taxation

ERCA v MIDROC Gold has an inescapable implication for the future. Whether the tax year can be divided into two in cases of change in tax rates amidst tax years will possibly continue to be an issue. Following the enactment of the new income tax law in 2016, the taxation of mining income has been incorporated back into the income tax law, however, with a lower tax rate of 25%.[69] On another way, to avoid possible controversies in case of disparity between the fiscal year and taxpayers' accounting year, the law provides that in case the taxpayers' accounting year did not conform to the fiscal year, the law applicable to the accounting year is the law applicable to the budget year finalized within the taxpayer's accounting year.[70] This provision is a new introduction by the new law. There was no similar provision in the former law. As one can easily grasp from its letter, this provision is a precursor to the possibility that disputes may arise due to the enactment of laws with an effective date beginning from the Ethiopian budget year. Let us use an illustration for this provision. Assume ABC Co. S.C. is a company running a telecommunication services business in Ethiopia. Its accounting year is the Gregorian calendar year beginning from 01 January to 31 December. On 30 Sene E.C., the Ethiopian government enacted a new tax law effective from the next day, i.e., 01 Hamle E.C. According to this

[69] See Proc. No. 979/2016), supra note 7, Article 37(3) and 100(1)(b).
[70] *Id*., Article 28(6).

provision, the new law will not apply to ABC Co. S.C.'s profit tax for the accounting year ending in the next 31 December. The older law will apply.

A little bit tricky issue can be raised here: does this provision apply for a change in law varying the preexisting provisions on imposition of taxes, exemptions, or tax rates whether by increasing it or reducing it? The rough answer for this is, inescapably, yes. According to this, the provision may seem to solve all possible controversies regarding the application of transitional tax years. However, the implementation of this provision will create two basic problems. The first possible problem arises when a new tax law is issued to be effective in the middle of the tax year dividing the accounting year of even those taxpayers using the fiscal year as their accounting year. Because no one will be certain that the legislature will always make its tax laws applicable from the beginning of the government's fiscal year. In this case, the dispute becomes unavoidable as to which law applies for the tax year. Resolving such the issue will not be possible unless there is a clear provision in the law or unless we can have a well-developed precedent that in case of similar disputes the tax year is divisible into two transitional years and both tax rates apply respectively, whether we call them transitional years, short tax years, temporary tax years or else. What is all needed is transitional problems like this should be solved by dividing the tax year and applying the relevant laws respectively.

The second possible problem relates to those taxpayers using an accounting year different from that of the fiscal year. In like cases, a dispute is potential because of the difference in the amount of tax to be due when assessed based on the old and new law. The best example of this can be the case of our discussion, *ERCA v MIDROC Gold*. To see the possible controversy, let us assume that the above provision was applicable to the case. Proc. No. 802/2013 with a 25% tax rate was effective from 26 July 2013, which is only days after the beginning of the fiscal year of the 2006 Ethiopian calendar. Needless to mention, the former law, i.e., Proc. No. 23/1996, with 35% was effective through 25 July 2013, which is only days after the end of the fiscal year of 2005 E.C. The debate in the case was which tax rate applies to the taxpayer's accounting year of 2013. It is also clear according to the newly introduced provision that the fiscal year finalized within the taxpayer's accounting year of 2013 was the fiscal year of 2005E.C., whereas the fiscal year of 2006 E.C. unquestionably, goes beyond the taxpayer's accounting year of 2013. According to this, it becomes clear that the former law providing for the 35% tax rate would apply. Therefore, it would have been taxed at a rate of 35% for the whole tax year of 2013.

Speaking from the letter of the law, this does not seem to have a problem. Because the law is clear. The problem with this provision, however, is not only that the taxpayer would claim to be taxed according to the latter law, simply because the latter law is advantageous to it. It will also raise the question of inequality in case of similar changes in the law in the future. Let us assume that a similar case to the case in the future. According to this those taxpayers using the Ethiopian fiscal year as their accounting year will be favored by the change in the law because they will be taxed according to the new law providing for a lower tax rate of 25%. Whereas those taxpayers using the Gregorian calendar years as their accounting year will be disadvantageous, because the new law issued in the middle of their accounting year will never apply to that accounting year, rather, the old law provides for a higher tax rate of 35% will apply for them to end of that accounting year. The six months period covered by the change in the tax rate goes advantageous to those taxpayers using the fiscal year as their accounting year and disadvantageous to those taxpayers using the Gregorian calendar year as their accounting year. The former pay less and the latter pay more, but for the same span of time.

To show the problem in terms of the amount of tax, let us see one hypothetical case once again. Assume the Ethiopian Parliament amends the income tax law to reduce the tax rate for companies involved in sectors than mining from 30% down to 25%, in order to make it equal with the income tax rate for mining companies to be effective beginning from 01 Hamle 2015 E.C (i.e., 08 July 2023). Assume also that EFG Co. PLC uses the Gregorian calendar year as its accounting year and earns a taxable income of 1, 976, 578, 000.40 (One Billion Nine Hundred Seventy-Six Million Five Hundred Seventy-Eight Thousand Birr and Forty Cents) ETB in its 2023 accounting year, i.e., the period from 01 January 2023 – 31 December 2023. According to the above provision, its income tax will be:

$$1,976,578,000.40 * 30\% = 592,972,400.12.$$

On the other side, the income tax for a company that uses the Ethiopian fiscal year as its accounting year for the tax year of 2016 E.C. fiscal year will be:

$$1,976,578,000.40 * 25\% = 494,144,500.10.$$

Unavoidably, EFG Co. PLC has to be taxed at a 30% rate for the time from 01 January 10 July 07, 2023, G.C.; however, it is visible that these two taxpayers pay different amounts of tax for the same span of six months time (i.e., the six months from 08 July to 31 December). This

inequality can be rectified by dividing EFG Co. PLC's accounting year of 2023 into two and letting it pay for two transitional years separately, its total annual tax being the sum. According to this, the tax for the time from 01 January to 07 July will approximately be:

$$1{,}976{,}578{,}000.40 * 30\% * \frac{187}{365} = 303{,}797{,}331.02.$$

Similarly, the tax for the time from 08 July to 31 December will approximately be:

$$1{,}976{,}578{,}000.40 * 25\% * \frac{178}{365} = 240{,}980{,}057.58.$$

The total income tax payable for the entire tax year, then, becomes:

$$303{,}797{,}331.02 + 240{,}980{,}057.58. = 544{,}777{,}388.60.$$

The 5% difference between the 30% and 25% tax rates leads to a difference of about 48,195,011.52 ETB in the amount of total annual tax., i.e.,

$$592{,}972{,}400.12 - \ 544{,}777{,}388.60 = 48{,}195{,}011.52$$

If the change was to bring about an increase in the tax rate, the disadvantage goes vice versa. The problem raised in relation to changes in tax rates also applies to changes in the provisions providing for the impositions of tax or exemptions, and to changes in allowed deductible costs and expenses affecting the amount of tax payable as well, if such changes in the law occur. The problem affects companies involved in the mining sector and in other sectors alike. The transitory provision in the new income tax law does not fully rectify these problems. Article 101(1) of Proclamation No. 979/2016 reads: "Subject to the Tax Administration Proclamation, the laws hereby repealed shall continue to apply for the tax year preceding the tax year in which this proclamation enters into force". According to this, as this law was enacted in August 2016, it might be said that the repealed law (i.e., Proc. 286/2002) applies to the entire tax year of 2016. However, Article 103 of the proclamation makes it clear that the proclamation "shall apply on income derived as of 8th day of July 2016". This means it came into force as of 01 Hamle 2008 E.C., unavoidably bifurcating the tax year of those taxpayers using the Gregorian calendar as their tax year. Interestingly, the proclamation has effectively avoided disputes similar to *ERCA v MIDROC Gold* because it has adopted the 25% tax rate for mining income and the 30% tax rate for other companies from the laws it repealed. However, controversies are probable in future

increases or decreases in tax rates, as one cannot be certain that the legislature will retain the 30% and 25% tax rates forever.

The solution for this anomaly is dividing the tax year into two short/transitional tax periods according to the time of the change in the law and applying both the old and the law respectively. It has to be clear that this will not create any intolerable costs and inconveniences both in the eyes of the taxpayers and the tax administration as it will be an exception to the unity of the tax year applicable in exceptional cases of change in tax laws effective in the middle of tax years. It is not also a new introduction, as it is already known in the case of changes in taxpayers' accounting year. It is the conviction of this author that dividing the tax year into transitional years in such exceptional instances could be developed through judicial interpretation, most importantly through the binding interpretations of the Cassation Bench. It is unfortunate, however, that the Cassation Bench, contrarily, established a precedent through its interpretation in *ERCA v MIDROC Gold* for the indivisibility of the tax year. Whether the Cassation Bench can change its precedents by giving different interpretations in future similar cases has become doubtful.[71] To avoid similar controversies and particularly the inequality problems raised above, revisiting the income tax law to incorporate clear provisions for transitional years in cases of change in tax rates effective in the middle of tax years bifurcating the tax year into two and creating two different tax rates competing for application in the tax year is imperative. If there is a view that cases like *ERCA v MIDROC Gold* are rare and not pressing to amend the existing law, the recommendation may be considered for future revisions. This author, however, holds that cases like *ERCA v MIDROC Gold* are not necessarily rare. We know only *ERCA v MIDROC Gold* because we have no studies about how other mining companies reacted to the reduction of the mining income tax rate in 2013.

Conclusion

Conventionally, business income taxes are paid annually. Exceptionally, however, when the taxpayer's accounting year changes from the Ethiopia Budget year to the Gregorian calendar year and vice versa, according to the income tax law, the time between the last tax year and the

[71] Compare Article 10(4) of the Federal Court Proclamation No. 25/1996 (as amended by the Federal Courts Proclamation Re-amendment Proclamation, Proclamation No. 454/2005 (now repealed) with Article 10(2) of the Federal Courts Proclamation No. 1234/2021. In the former, the Cassation Bench was expressly allowed to change its precedents whereas in the latter that express power has been omitted.

beginning of the new tax year is separately treated as a transitional year. This shows that the tax year is not indivisible. Indeed, the tax year can be divided into transitional years to accommodate such instances of exceptional nature. The law is not clear whether a change in tax rates amidst the tax year can have a similar effect of dividing the tax year into transitional tax periods. The author in this comment argues that revisiting the Income Tax Proclamation is demanding to include a clear provision to the effect that the tax year be divided into two in case of change in tax rates dividing the tax year into two and creating two effective tax rates within the tax year. Courts, especially the Cassation Bench, could have established a precedent to this effect through interpretation. However, the Cassation Bench missed such an opportunity in *ERCA v MIDROC Gold*. In this case, the FTAC, the FHC, the FSC, and the Cassation Bench decided that mining income taxes are payable annually not by dividing the tax year on monthly basis. In effect, the Cassation Bench establishes a precedent that tax years are indivisible. The author disagrees with these decisions. He argues that the provision for transitional tax periods in case of change in taxpayer's accounting year should apply to cases of change in tax rates as in this case by analogy. Therefore, an express provision to this effect is imperative either through an amendment to the income tax law or incorporating a similar provision in future revisions.

Jimma University School of Law Legal Aid Center 2021/2022 Report: The Success Stories and Challenges

Beki Haile Fatansa*

Introduction

It is believed that peoples' right to human rights in general and rights to due process, fair, and right to speedy trial and hearing should not depend on an individual's pocket power. On the other hand, justice has never been equal for the rich minority and the poor majority as they are unable to hire a lawyer for their case. What makes the problem bad to worse is that it is women, children, prison inmates, HIV/AIDS victims, and veterans who are unable to seek and enforce their basic constitutional and human rights.

Jimma University School of Law Legal Aid Center (hereinafter 'JUSL-LAC') was established to nut out the gap between access to justice and indigence as its main objective among others. Although it is a long-aged experience in the developed world to help the poor by establishing such kinds of centers, JUSL-LAC is the first of its kind in South, Southwest, and West Ethiopia, and is one of a handful number of pioneers in the nation.

In addition to the academic staff of Jimma University School of Law and the full-time employed lawyers for the centers outside of Jimma town, JUSL-LAC runs its daily business by utilizing clinical students and volunteers who study law at the University. Each volunteer and clinical student is expected to contribute four hours per week and academic staff members are expected to handle and supervise clients' cases.

Currently, JUSL-LAC is rendering legal services at **eleven (11)** centers in Jimma Zone namely, *Jimma main office, Jimma Woreda Court, Jimma High Court, Jimma Zone prison administration, Agaro, Gera, Shabe, Dedo, Serbo , Omo Nada and* ***Setemma*** and is keen to keep up the already started good work. JUSL-LAC opened its 11th center at **Setemma** Woreda, in the year 2021.

* Director of Jimma University School of Law Legal Aid Center

1. **Background**

Jimma zone is one of the largest zonal administrations in Oromia regional state with an estimated total population of three million. Half of the total population is women. Jimma University (hereafter **'JU') is** a public higher educational institution established in December **1999 by** the amalgamation of Jimma College of Agriculture (founded in **1952)** and Jimma Institute of Health Sciences (established in **1983)** to contribute its best to the academia world and serve the population of the zonal administration in many spheres. The two campuses are located in Jimma city **335** km southwest of Addis Ababa with an area of **167** hectares.

Jimma University is Ethiopia's first innovative Community Oriented Education Institution of higher learning. In line with this philosophy, Jimma University School of Law Legal Aid Center (hereafter JUSL-LAC) was established based on the unanimous decision of the Academic Commission of the then Law Faculty (now School of Law) on Dec 25, 2008, primarily with the vision of providing free legal services to indigents and *vulnerable groups like the poor, women, veterans, HIV/AIDS victims and children in and around Jimma town on one* hand, and to expose students Law School to the practical aspect of the law on the other hand.

Justice is the major concern of our democracy that we cannot take for granted. Our laws guarantee basic rights and protection for all of us – not just those who can afford to hire a lawyer. The Constitution also requires that justice should be available without unnecessary delay. By contrast, we usually find family cases in which women's rights are violated, children abused by trafficking and domestic ill-treatment, and other classes of society adversely affected by the system. On the contrary, the people have failed to defend the injustice, and even when they want to do so, they face many tackles. These problems resulted because of the deep-rooted financial problem the society is trenched in. Indeed, vulnerable people who have the means to pay for a lawyer also face the problem of getting access to justice. Providing free legal service to these vulnerable groups means the difference between food on the table and hunger, life and death penalty, shelter and homelessness, economic stability and insolvency, and productive work and unemployment.

The initiative to establish JUSL-LAC came up because of this apparent growing need for our society to have access to justice. The Civil Procedure Code and FDRE Constitution have made

an attempt to help the poor to have access to justice by allowing suit by pauper and bestowing the right to get appointed council respectively.

But this attempt alone does not suffice to watch justice in motion. **First**, allowing a suit by a pauper in a civil matter by itself alone is not a guarantee to have access to justice. It simply means that one can bring his/her claim to court without paying court fees. Although it is one step in creating access to justice, it is way far from creating access to justice in its full sense. The person should be able to effectively defend his/her rights upon initiating a civil suit. This can be done if the person gets legal support even after s/he institutes her claim. In civil matters, our laws (like the laws of other nations) do not provide a duty that the government shall appoint a counsel for a needy person in civil matters. Therefore, the attempt to create access to justice for the needy in civil matters is very limited.

Secondly, the Constitutional guarantee that accused persons have the right to be represented by a state-appointed counsel if they do not have financial means, and thereby a miscarriage of justice may happen is hampered by the government's limited resources. Besides, the law provides legal assistance when the accused has no sufficient financial means – it does not address other vulnerable groups such as women, children, HIV/AIDS victims, veterans, and disabilities who are usually underserved. Therefore, the constitutional guarantee to create access to justice in criminal matters is hampered by a lack of resources and a lack of comprehensive focus on all types of vulnerability. It is with the aim of achieving these objectives that the JUSL-LAC is established.

Apart from helping society, the JUSL-LAC would help the students to know how the law is being practiced. Law students should be able to acquire practical knowledge to be able to serve society in the future and be able to cope with the dynamic world under a tornado of change. Traditionally, law students were not exposed to the practice of law. This had been making the students unable to live up to what is expected from them. The Justice and Legal Systems Reform Institute of Ethiopia (which is renamed the Federal Justice and Legal Research and Training Institute) have also noticed this problem and has spearheaded the inclusion of practical courses in the Ethiopian Law School Curriculum.

For prospective law graduates, trying to serve society without having a glimpse of the legal practice could be like trying to walk while you don't have one leg. Providing free legal services to society without equipping graduates of law with practical legal knowledge would not solve the

legal problems of society in the long run. Doing so would be like '*hitting a snake on the tail – not on the head'.*

Indeed, creating access to justice for the needy should be coupled with producing competent legal professionals who work in the justice system. The last decade's practice in legal education in Ethiopia shows that law students were being taught merely based on theory. In this type of legal education, it is difficult to produce law graduates who understand the legal problems of society and who put their effort into solving those problems rather than watching as a passerby. When graduates are theory-based, they will have a reduced capacity to create access to justice and play a role in the democratization process of the nation.

Indeed, this is why the vision of JUSL-LAC should be both creating access to justice for the needy and equipping law graduates with practical legal knowledge. The experienced law students acquire by working at JUSL-LAC would make them agents of change in the Ethiopian legal system, and would give them exposure to see legal problems of the society ahead and makes them aspire to solve the problems upon their graduation.

In order to remedy the problems stated in the above paragraphs, and reach out to the ardent hope and fervent desire of society, further justice for all initiatives is still required. The best, actually the prominent, initiative is to employ the ripe and talented skill of Junior lawyers, law school instructors, and students in order to cast this prevailing problem aside. Thus, organizing to make use of this skilled manpower by sustaining, the existing centers, and opening new legal aid centers has paramount importance in the lives of hundreds of thousands of people JUSL-LAC aspires to serve.

Having these multifaceted goals JUSL-LAC has been rendering its cherished legal service at **eleven centers** including the one at the head office. Initially, service delivery was started by opening two centers at Jimma Zone High Court and Jimma Woreda Court. However, the number of centers was increased to *six* in the year 2003 E.C. by opening new centers in Agaro, Dedo, Serbo, and Jimma Zone Prison Administration. In 2008 E.C., new centers opened at Gera, Omo Nada, and Shabe Woreda courts. This year, on September 2021, JUSL-LAC opened a new center at **Setemma** Woreda in collaboration with IOM. Currently, the center has a total of **eleven (11)** centers

2. Organizational Structure of the Center

To enable the center to attain its objective and contribute effectively to the furtherance of access to justice, the organizational structure of **JUSL-LAC** was framed into different structures. On the top of the organizational structure is the director who is empowered to supervise the day-to-day activities and operation of the Center. Under the director, there are two vice directors, one vice director for service provision and quality management with the power and the duty to manage and coordinate the different activities of the Centers and the other vice director for research and capacity building with the power and duty to direct and conduct capacity building activities for service providers, beneficiaries, and organs involved in the administration of justice; to direct and conduct researches related to the vision and mission of the Center, and to conduct promotions about the availability of free legal service and build the public image of the Center.

3. Partners

JUSL-LAC is currently working with Addis Ababa University Center for Human Rights, Ethiopian Human Rights Commission, Oromia Supreme Court, and Oromia Justice Bureau as its partners. Addis Ababa University Center for Human Rights is working on Joint Project with the center as a funder on Human Rights Protection and Promotion, while the Ethiopian Human Rights Commission has also been the main funder of the center. The Oromia Supreme Court also supports the center with service-delivering offices and some finance. Oromia Regional State Attorney General supports the center by giving and renewing advocacy licenses.

4. Linkages with the Stakeholders

To be effective, legal aid service requires the cooperation and coordination of various stakeholders. Accordingly, JUSL-LAC has many stakeholders with which its cooperations are vital in the accomplishment of the center's objectives. Accordingly, Jimma zone high court, different woreda courts, Jimma zone Justice office, different woreda justice offices, Jimma zone

prison administration, police offices, woreda labor, and social affairs offices, women and children affairs offices, Ethiopian human rights commission Oromia branch office and kebele administrations are among the main stakeholders with which JUSL-LAC has a linkage.

5. The Services provided by the Center

There are three main activities that JULAC provides. These are legal services, legal education, and research and capacity building.

1. Legal Services

These services are those services that in one way or other connected with justice sectors and administrative government organs. Through its legal services, the Center provides the following major services to its clients

- Free Legal Counsel
- Writing Statement of Claim
- Writing Statement of Defense
- Writing r different applications to the court and other organs
- Advocacy (Representation before the court)
- Mediation (with the view to reaching amicable solutions)

So far the Center is offering these legal services to the population in its **eleven (11**) service centers located in seven towns (Dedo, Serbo, Agaro, Shebe, Gera, Omo Nada, Setemma, and Jimma). In seven of the service centers, at Dedo, Serbo Shebe, Gera, Omo Nada, Setemma, and Agaro, the Center has managed to employ a junior lawyer to run the services. The Center however relies on School of Law students to run the services at Jimma Woreda Court, Jimma zone High Court, and Jimma Zone prison Administration. The students are assisted by the academic staff of the School. The Center's office located in the JU Main campus functions as a coordinating center for all the services and functions.

2. Legal Education (Awareness Raising Program)

The Center understands that the majority of abuses and human rights violations suffered by the vulnerable parts of the population are the result of a lack of awareness, especially of the rights of these groups. Accordingly, it strongly believes that ensuring respect for their rights can better be

realized through effective and broad-based community legal education programs. Thus far the Center has relied on the Jimma University Community Radio in which it has been able to run four hours-long awareness raising program per week in two languages (Amharic and Afan Oromo) but there are critical limitations both in terms of the structure, breadth, effectiveness, and sustainability of running the program through this medium.

Accordingly, different laws related to Prisoners' Rights, Child and Woman's Rights, Human Rights Laws, Procedural law and Self-Advocacy skills, Oromia Land Law, Family Law, Law of Property and Succession, Employment and Labor Law, Tort Law, Anti-Corruption Law, Administrative law and good governance, Law of Contracts and Commercial Laws have been broadcasted through the community radio so as to enhance the society's basic knowledge on those subject matters.

The Center, however, aims to run the program effectively by utilizing various available means and media such as community organizations, centers, and other channels with broad audiences but this requires the availability of adequate financial and infrastructure (including transportation) supports.

3. Research and Capacity Building

It is crucial that legal service and legal education programs at the Center be supported by appropriate evidence. Research is therefore a critical part of its strategic approach as it helps to identify the need and areas of focus for its services. In addition, it also helps engage the community and stakeholders in addressing the problems in a more effective and sustainable manner. In addition, research also plays a crucial role in empowering and building the capacity of the community, stakeholders, and the Center itself in dealing with the root causes of the problem of human rights violations and lack of access to justice for vulnerable members.

Thus far there is no baseline research conducted not just in Jimma Zone but in the whole Country in relation to the state of need for free legal aid services. There is also no standard developed in relation to providing the service. In fact, the level of awareness of the idea of free legal aid and its role is at a critically low level in the Country. The Center aims to address these problems by using research and capacity building as its strategic approach. To this end, the following are areas in which the Center needs strong support for its areas of activities

- organizing thematic and generic conferences and workshops and training programs

- ❖ publication
- ❖ conducting baseline survey for legal aid service needs in Jimma Zone
- developing standards and guidelines for the provision of services

In this regard, due to high budgetary constraints, the center has only managed to develop standards and guidelines for service provision.

6. Service Delivery Mode and Service Quality Management System

JUSL-LAC employs different modes of service delivery. The service delivery model varies purposely to attain the objectives of the center, which are community services and equipping law students with practical skills. For centers found in Jimma city, JUSL-LAC uses fourth and fifth-year law students to deliver the services and in those centers outside of Jimma town, the center uses junior lawyers as they are at a distant place from the university.

Besides, the center also uses volunteer law school staff and licensed lawyers. The center doesn't compromise the service quality and employs different service quality controlling mechanisms to these ends. Accordingly, the center has daily and weekly meeting with the students and it has also developed strict reporting.

7. Summary of overall activities

The **JUSL-LAC** service shows tremendous progress from time to time in quality and accessibility and currently, thousands are benefiting from the service of the center annually. Resisting all the challenges it faced, the center has managed to reach **one thousand seven hundred ninety-one (3285)**. The service distributions were counseling **1440**, ADR/ mediation **180,** document preparation **1072,** and representation **593.** Out of the total cases it represented and disposed of **by** the court, the center won **70** and lost only three. The cases the center won were represented and litigated **by** fifth-year law students. The service fee the center provided is estimated to be **5,516,000ETB (Five million and five hundred sixty thousand birr).** The winning rate of the center is **99.5 %.** This is mainly due to the fact clients who come before the center have strong cases but lack only the financial capacity to litigate before the court. An estimated 450,000 people have benefited from the Radio program and over 2,000 brochures were

distributed on various legal issues. The types of services rendered and the beneficiaries together with the centers that have provided the legal service have been summarized as follows.

Type of legal Service	**Jimma Woreda**	**Jimma Zone High Court**	**Head Office**	**Jimm Zone Prison**	**Agaro**	**Serbo**	**Dedo**	**Gera**	**Shebe**	***Omo Nada***	***Setemma***	***Total***
Counseling	350	250	330	150	40	45	60	50	55	70	**40**	**1440**
ADR	60	12	40	-	15	10	9	10	9	10	**5**	**180**
Documents	350	118	158	142	70	54	37	29	39	40	**35**	**1072**
Representation	170	104	150	22	33	19	16	18	28	23	**10**	**593**
Total	930	484	678	314	158	128	398	342	397	372	**157**	**3285**

7.1. Some of the Cases the Center Represented and Won in 2021/22

Our center, in its different centers, has represented hundreds of cases on behalf of its clients some of which are disposed of while the rest are still pending. The number of cases has been increasing year to year and this year too. In the year 2020/2021 alone, until the time of the report about 75 cases have been decided in our favor. These cases were those whom our fifth-year law students and lawyers in different centers have represented the clients and won at Jimma Woreda Court, Jimma Zone High Court, Agaro Woreda Court, Serbo Woreda Court, Shabe Woreda Court, and Omonada Woreda Court.

Some of the Cases Represented by the Center

	Name of the client and story of his/her case	Sex	Type of the case	Court entertained	File no.	Judgment/award
1	**Hafiz A/Jihad** ✓ The migrant returnee who just come back from Dubay. The beneficiary has returned back, unfortunately, found his marriage on the verge of divorce and took the matter to the court.	M	Family, Property	Jimma Town Woreda Court	42304	Able to gain a house estimated to be 1 million and Five hundred thousand (1,500,000 ETB) from the division of common property due to divorce.
2	**Fadila Ahmed and Kazina A/Jihad** ✓ Their case was regarding a nuisance created on their property. ✓ Our center takes filed a possessory action	F	Property	Jimma Town Wored Court	45702	The beneficiary won the case and it is decided that the nuisance be ceased and the cost they incurred to be reimbursed.
3	**Faiz Temam** √ The beneficiary lives in Jimma town and was planning to migrate. While his mother and stepfather are divorced, his stepfather claims Faiz's house to be his. He approached our center and the center provides her with pleading writing and	M	Family/ Property	Jimma Town W/Court	35678	It is decided that the property claimed by his stepfather belongs to Faiz. The property is estimated to

	representation.					have a value of 550,000 ETB.
4	**Nasra A/Bulgu**	F	Property	Jimma Town W/court		The court decision over the matter is in favor of the beneficiary who is a client of our center.
5	**H/Naga A/Jobir**	F	Property	Karsa W/Court	59520	The case was decided in our favor of intrusion in the possession of our client has stopped.
6	**Yusra A/Macca**	F	Succession/ Property	Karsa W/Court	37659	Finally, the case was decided in favor of our client and our client managed to take part in the succession.
7	**Burtukan Bekele**	F	Labor/Employment	Karsa Woreda Court	30070	Our client won the case and got different payments after the termination of her employment contract.

7.2. Subject matters on which legal awareness education has been delivered through JUFM

Based on the assumption that at least 10% of the population the FM Radio reaches would listen to the broadcast, the total number of the beneficiary is estimated to be about 450,000.

Despite the challenges it faced in terms of human power as well as financial constraints, the center managed to render awareness creation radio programs on the following subject matters.

Airing Time and Broad Cast Language	Total subject matters on which legal awareness has been created.							total
	Prisoner's Right	Child and Women's Right	Tort Law	Family law	Labor Law	Illegal Human Traffickin g	Land Laws	
Afan Oromo	2 hours	3 hrs	2 hours	3 hours	3 hours	3 hours	2 hours	18 hours
Amharic	2 hours	3 hrs	2 hours	3 hours	3 hours	3 hours	2 hours	18 hours
Total	4	6	4	6	6	6	4	36 hours

8. Challenges faced by the center

Despite the challenges surrounding it, JUSL-LAC is rendering exemplary community service and equipping law students with practical skills. There are a number of challenges that hinder the center's service delivery. Unlike the preceding years, the center encountered the most challenging year in the year 2021/2022, due to the universities decision not to hire workers on a contract basis. Such a decision has highly affected the center, especially after the quarter of 2014 E.C., as many lawyers of the centers left their job and the centers' work was inactivated. Among others, the followings are the major challenges,

- **Financial Constraints** - the existing finance is not sufficient, timely, and is not sustainable.
- **High turnover**- there is a high turnover of center lawyers due to very low salaries.
- **Transportation** – lack of adequate transportation for students and supervisors
- **Lack of phone service**- particularly for center lawyers in order to communicate with their clients
- The universities decision not to hire workers on a contract is also the main challenge that the center faced in the year 2021/2022.
- **Absence of secretaries**- specifically outside Jimma city where lawyers are carrying out the legal service and other jobs (particularly typing and reporting) lonely.
- **Busy schedule**- from the coordinators of the center and the service providers, compared to the increasing number of service seekers.
- Lack of responsiveness from some stakeholders.

Summary

The center is providing legal services such as counseling, preparation of pleadings, and representation on litigations for children, women who are victims of domestic violence, people living with HIV, people living with disabilities, etc. In addition, the center admits students to clinical courses and externship programs and they acquire basic knowledge of the practical world. Moreover, the center is providing basic legal education to hundreds of thousands of

residents of Jimma Zone via Jimma Community FM Radio. Capacity-building training is also one of the functions of the center to enhance the knowledge of the center's lawyers.