Introduction

Law, which indulges certain desirable values and shapes society towards those values, is normative in its nature. Contract as a subject matter of law has its own normative values. Facilitating business transaction, protecting security of transaction, encouraging certainty, and predictability so that there are efficient economic transactions are the prominent characterizing purposes of contract law. Contract law like other laws shall also go in line with relevant constitutional provisions.

Proclamation No. 639/2009 casts doubt if it actually encourages economic efficiency and if it is constitutional on the account of rule of law, separation of powers and independence of judiciary. This article attempts to examine and explore the proclamation, against economic purpose of contract and constitutional principles.

In doing so, the purpose of formal requirement and Formality of Contract of Mortgage under the Civil Code are discussed in the first part under formal requirement in general. Then, Economic and Legal glitches of proclamation No. 639/2009 covers formality under the amendment proclamation and its purpose, application of the amendment proclamation vis-à-vis the Civil Code, application of the amendment proclamation vis-à-vis res judicata, economic efficiency under the amendment proclamation, and Constitutionality of the Amendment proclamation.

1. Formality requirement in general

1.1. Form and its purpose

Form is the framework or observance, which juridical acts are articulated by, so that they can be recognized, enforced or given any other legal effect. Written form, the instruments of writing,
the number of witnesses, particulars to be included, publication, registration and signature are among the elements of form.

Formal requirements are warranted, among the different reasons, for their evidential, cautionary, channeling and protecting third parties purposes. Contracts, which are made in writing, can be easily proved by producing the written contract. This is important when the details of the contract might be forgotten by the witness, the probability of controversy is high taking objective circumstances in to account, and when the contract is for long period of time.

The evidential purpose of formal requirement lies in the need to strike a balance between transaction cost and probability of controversy to be proved. Whether certain contractual relationship should be in written form, attested by two, three or more witness, notarized or registered shall take into account the transaction cost of doing so, the possibility of controversy and the vested interest in the contract. High transaction costs, less magnitude of vested interest and less possibility of controversy, discourage formal requirements. The higher the interest incorporated in the contract is, the higher the possibility of erosion of trust and denial among the contracting parties is. It would be so reasonable to say that stringent formal requirement should be ordered when the possibility of controversy among the contracting parties is high owing to higher interest in the contract. No formal requirement is expected in a contract of sale of a needle since the vested interest is low and it has high transaction cost compared to the benefit of the contract and there is less possibility of controversy with reference to sale of a needle.

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2 *Ibid*

3 *Ibid*


6 Allen and Cutter, *Supra note 5*, P. 95
Indeed, formal requirement sometimes reduce transaction cost in contracts, like contract of adhesion. This is because the form is prepared with the terms and stipulations without negotiation; the transaction cost of negotiation is minimized. In most other types of contract, however, there is cost of transaction, be it small or large, once form is required.

In addition to evidentiary purpose, form can also make contracting parties take the contract seriously and comply with necessary cautionary requirements. Formalities deter hasty, premature and ill-considered contracts. This function of form is believed to be in the interest of the contracting parties and it deters their carelessness. The magnitude of the vested interest and transaction cost are not negligible in this function of form since no excess care is necessary for trivial things like sale of needle. However, limiting the freedom of form of the contracting parties for the sake of cautionary function is moot if it is in line with the interest of the contracting parties.

Furthermore, formality serves channeling function. Form is believed by certain scholars to signal the enforceable and non-enforceable promises. When agreements fail to be made in a certain form, the parties do not have the intention of being bound. If they had the intention of being legally bound or legally binding someone, they could have done it in reliable formality. It avoids confusion between the expression of mere intention and legally binding promise as binding promises will be made in the specified form.

7 Shavel, Supra note 5. Events which have minimal importance and less probability of occurrence should not cause relatively higher transaction cost. Richrd Craswell, in his Contract Law: General Theories, argued that low probability of dispute discourage incurring transaction cost.


10 Fekadu, Supra note 1, p.’ 5

11 Ibid, p. 5

12 Ibid p. 6 See also Guest, Supra note 9, p. 263
The other most important purpose of formal requirement especially registration with regard to mortgage contract is protecting the interest of third parties.\textsuperscript{13} Owing to impossibility or high transaction cost of having information, contracts that affect third parties might be concluded.\textsuperscript{14} People cannot have information about all contracts, which may affect them. It is impossible or difficult for someone to know whether there is contract about a house, which he wants to buy if formality with the purpose of providing information is not required. If a contract of sale of a house is valid without registration, there is no legal protection for other parties, who might buy the house again. Formality with the purpose of informing potential contracting parties\textsuperscript{15} can, accordingly, relieve the negative externality of contract on third parties.

Negative externality cost can practically be more exemplified when one individual mortgages his property to several creditors for a debt more than its value. If a house worth Birr 300,000 is, for example, mortgaged to Alem, Abebe and Diriba a debt in the amount of Birr 300,000 each, the contract between Alem and the owner has negative effect on the right of Abebe and Diriba. Unless the first contract is registered, it might be burdensome to know that there is prior contract of mortgage or it might require high cost of having information about the unregistered contract. If it is possible at all, it can be made by assessing all the contracts, which are concluded before. Any of the mortgagees will inevitably be negatively affected, since they will lose Birr 600,000. Either all will share the loss or will shift to any of them. The contract of each of the mortgagee has negative externality cost on one another or any one of them.

Putting certain formal requirement on such contract of mortgage can regulate the possible negative externality cost of contract that spills over the third parties. Formality avoids the negative effect of a contract of mortgage on other potential mortgagees, buyers or other potential contracting parties if it is designed in a way that informs the other potential mortgagees or buyers that there exists an encumbrance on the object of contract. This can be easily achieved by making registration a mandatory formal requirement of mortgage contract. If the contract of

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\textsuperscript{14} Allen and Cutter, \textit{Supra note 5}, p. 208
\textsuperscript{15} Yohannes, \textit{Supra note 13}, p.47
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mortgage is registered, potential mortgagees and buyers will have the information about the existence of an encumbrance. This will help them choose either lesser right than the previous mortgagee or give up the contract.

1.2. Formality of Contract of Mortgage under the Civil Code

As formal requirement has multidimensional purpose, it has been put as an overriding element of contract once it is provided by law or the contracting parties. As a rule contracting parties have freedom of form. Article 1719 of the Civil Code states, “Unless otherwise provided, no special form shall be required and a contract shall be valid where the parties agree.” It is only if formality is provided for by law or stipulated by the contracting parties that formal requirement is an element of contract.

When the law requires certain formal requirement, it shall be complied with. Article 1719 (2) of the Civil Code shows that a contract, which is not made in a legally provided form, shall not be valid. Article 1720 (1) of the Civil Code also shows that a contract, which is not made in a specified form, is considered as a mere draft. These provisions indisputably show that non-compliance of formal requirements (provided legally or by agreement) denies the contract legal effect. This is because a mere draft does not have the effect of contract. It does not create obligation between the contracting parties.

In conformity with this, there are certain provisions, which stipulate special formal requirements for the validity of certain contracts in the Ethiopian Civil Code and other codes. Article – 1723 of the Civil Code provides thus: “A contract creating or assigning rights in ownership or bare ownership on an immovable or an usufruct, servitude or mortgage of an immovable shall be in writing and registered with court or notary.” Contract of mortgage is, according to this provision, required to be in writing and registered with court or notary. There have been controversies on whether registration under Article 1723 is a mandatory requirement since some courts decided that registration is not a validity requirement as far as it does not affect third parties pursuant to the special provision of Article 2878, which prevails over the general
provision of Article 1723. The Supreme Court has decided that the registration requirement under Article 1723 is a mandatory requirement as it is different from the registration requirement provided under Art. 2878. Article 1723 is about registration in court or notary while Article 2878 is about registration in register of Immovable. The term registration employed under article 1723 is “misnomer”. It should have been termed as authentication. It can, therefore, be safely concluded that registration (authentication) in court or notary is a mandatory validity requirement for mortgage contract pursuant to Article 1723 of the Civil Code.

This seems to get its justification from the protection of third parties or avoiding negative externalities. To the contrary it is contended that registration under Article 1723 aims at conservation not publicity and protection of third parties. Article 1989, which prioritizes parties as of the date of authentication, shows, however, protection of third party under registration (authentication) of Article 1723. Be that as it may, Article 3045 (1) of the Civil Code also elucidates that a contract or other agreement creating mortgage shall be of no effect unless it is made in writing. It can be inferred from this that in addition to written form, registration under Article 3052 of the Civil Code is a mandatory formal requirement of contract of mortgage. The requirement of registration seems not only to protect third parties but also the contracting parties.

The protection of third parties through the requirement of registration is unequivocally put under Article 3057 (1) of the Civil Code. According to this provision, entry of registration after third party has acquired rights by registration or after an action for the attachment of the immovable is brought does not have effect. Neither does it after the mortgagor is declared bankrupt. Article

16 See, the decision of Federal Supreme Court in Mulushewa Tefera et al. v. Habte Zerga et. al, as cited as Yohannes at Supra note 13, p.51
17 Ibid
18 Yohannes, Supra note, 13, p. 47
19 Ibid, p.58
20 Ibid
21 Fekadu, Supra note 1, p.4
22 Yohannes, Supra note 13, pp. 31-68
3080 of the Civil Code, which ranks plural creditors according to the date of registration, is also typical indication of legislature’s attempt for the protection of third party interests.

2. Economic and Legal glitches of proclamation No. 639/2009

2.1. Formality under the Amendment proclamation and its Purpose

The House of Peoples Representatives has enacted an amendment proclamation, which makes registration by a court or notary not to be a validity requirement when the contract of mortgage is with banks or micro financing institutions. Art.2 of the Proclamation 639/2009 supplied for the addition of sub-article (3) to the existing art.1723 of the Ethiopian Civil Code. Sub-article (3) provides thus:

“Notwithstanding the provisions of sub-article (1) of this article, a contract of mortgage concluded to provide security to a loan extended by a bank or a micro-financing institution may not require to be registered by a court or notary”.

The general purpose of this amendment proclamation is to make the law conform to the practice not the practice with the law. This can be inferred from the preamble which in part states,

“Whereas the invalidation of the existing contracts of mortgage concluded under the prevailing practices of banks and micro-financing institutions for not being notarized, as provided in the Civil Code, may leave most of the existing loans unsecured with serious threat to the existence of the banks and micro-financing institutions and to the countries over all economies”

According to this, it is the act of the banks and micro-finance institutions that were entering into contracts contrary to the Civil Code that necessitated an amendment. An amendment, which follows practice that clearly violates the law, is violation of the overriding principle of rule of law. It is practice, which should intransigently follow the law not the other way around. Laws may be enacted if they are justified and believed to be socially desirable taking into account

23 Proclamation number 639/2009 refers to the Amendment proclamation which was enacted to add Sub article (3) to Article 1723 of the Ethiopian Civil Code.
different purposes. Enacting law to uphold wrong practices is not only contrary to the principle of rule of law but also drifts away from the responsive nature of law.

The preamble of the proclamation puts forward the purpose of the amendment of Article 1723 of the Civil Code to be avoiding the negative impact of the formality under the Civil Code on the efficiency of the loan provision service. The reason for the enactment of the amendment proclamation, as it can be inferred from the preamble, is to make the loan service made by the banks and micro-financing institutions efficient. Banks and micro-financing institutions are protected to give loan service efficiently at the expense of other efficiency. If banks are delivering efficient loan services it does not necessarily mean that the transaction of loan contract is efficient. In deed banks and micro-financing institutions may be protected so that they will earn profit. However, efficiency of loan contract requires among other things internalizing transaction cost by the parties to the loan contract, certainty, predictability and encouraging reliance\(^{24}\). There shall not be negative externality cost, which spills over other third parties if the loan contract shall be efficient. Efficiency of loan services by externalizing transaction cost or making third parties incur negative externality is not efficient. Even though there might be individual efficiency with reference to the bank or micro-finance, it is open for social inefficiency, which is required to be addressed as a purpose of formal requirement.

2.2. Application of the amendment proclamation vis-à-vis the Civil Code

Based on the justification, which favors only one party as indicated on the preamble, sub article (3) has been added to Article 1723 of the Civil Code under Article 2 of Proclamation. It is stated as: “3/ Notwithstanding the provisions of sub-article (1) of this article, a contract of mortgage concluded to provide security to a loan extended by a bank or a micro-financing institution may not require to be registered by a court or notary”.

The central object of the proclamation is enshrined in this sub article. It protects banks and micro-finance institutions by making a contract of mortgage valid although it is not registered in

\(^{24}\) Reliance is change of behavior depending on contract. If someone buys petroleum oil believing that he will have a car relying on contract of sale of car, this is reliance.
a court or notary. Close reading of this provision in line with other provisions of the Civil Code is perplexing if the unregistered (unauthenticated) contract of mortgage will have effect on third parties. It also casts doubt if it is in line with the normative rational of contract and formal requirement. Whether unregistered contract of mortgage, according to sub-Article 2 of proclamation, is binding only upon the contracting parties or it affects third parties is incomprehensible. Resorting to general contract provisions might lead someone to validly conclude that the provision is binding only on the contracting parties.

In principle contracts including mortgage contract will have effect only between the contracting parties without affecting third parties.25 The provisions in the effect of contract back up the protection of third parties. Article 1731 connotes that a contract has the effect of law between the contracting parties. This provision indicates the incorporation of common law privity principle26, which excludes the effect of contract on third parties. The incorporation of privity principle is also evident under Article 1952 (1), which states, “Except in cases provided in this code, contracts shall produce effects only as between the contracting parties.” This provision emphatically sets aside the effect of contract, including mortgage contract, on third parties.

Specially, Article 1989 (2) of the Civil Code shows that contracts may be “set up against third parties who acquire a right in respect of such thing as from the time their date is authenticated.” Unregistered (unauthenticated) contract of mortgage concluded by banks or micro-financing institutions cannot be preferred to any authenticated contract according to the connotation of this provision.

Banks and micro-financing institutions without registered contract cannot be tantamount to preferred creditors as provided under Article 1990. This provision makes us refer to special mortgage provision. Close reading of special provisions of mortgage also supports the purpose of protection of third parties by providing registration as effective formal requirement. Article 3089

25 Article 1675, denotes that the obligation created, varied, modified extinguished is effective between the contracting parties only.

of the Civil Code states, “registered rights in rem on an immovable mortgaged shall not affect the mortgagee where such rights have been registered after the mortgagee has registered his mortgage.” The protection of third parties is strengthened by 1641 of Civil Code, which prioritizes the party whose rights are registered first in case of conflict between two registrations. The general contract provisions, which are applicable on contract of mortgage, and the special provisions of contract of mortgage elucidate that mortgage contract affect third parties as of registration not as of formation.\textsuperscript{27}

Even though registration under Article 1723 and 1556 are different, their effect with regard to third party is similar. Early authenticated contract is preferred to later authenticated contract according to Article 1989 (2). Early registered contract of mortgage in the register of immovable is preferred to the ones registered later on. However, registration made according to Article 1556 is prioritized to registration (authentication) made in accordance to 1723.\textsuperscript{28} This is because Article 1556 is about property rights and Article 1723 is about contractual rights.

Interpreting Article 2 of the amendment proclamation in conformity with general contract and contract of mortgage provisions also strengthens the purpose of contract in general and contract of mortgage in particular. Protecting banks and micro-financing institutions in such a way that they are preferred to other unsecured creditors and later secured creditors, who does not have information about the transaction with banks or micro-financing institutions, is against the purpose of contract in general and the purpose of mortgage in particular.

One of the basic purpose of contract is protecting certainty, predictability and thereby security of transaction. Contracting parties who entered into contract with reference to a mortgaged property shall be given information to help them predict the effect of their contract. Making registration an element of contract of mortgage can make this information available.\textsuperscript{29} Giving priority right to

\textsuperscript{27} Article 1989 and 1990 of the Civil Code

\textsuperscript{28} See Article 1989 and 1990 of the Civil Code

\textsuperscript{29} Yohannes, \textit{Supra Note} 13 p. 47
banks and micro-financing institutions, at the expense of the right of third parties who acted without information about the previously formed contract of mortgage erodes predictability, certainty and security of transaction. Thus interpreting article 2 of the amendment proclamation in conformity with the purpose of certainty, predictability and security of transaction requires protecting uninformed third parties (contracting party who does not know the existence of other contract which might affect him) by denying priority right for unregistered contract of mortgage. Protecting the interest of third parties is also one of the purposes of contract law in general and contracts of mortgage in particular. The possibility of mortgaging one property to more than one is surefire evidence of the possibility of negative impact of one mortgage contract on other mortgage contract with reference to one object of contract. Registration can avoid the problem of third party interest that arises from the possibility of mortgaging one property to more than one party. Interpreting Article 2 of the amendment proclamation in conformity with the purpose of protecting third parties as a purpose of contract in general and mortgage contract in particular requires protecting of uninformed third parties by taking registration date as a reference time of prioritizing.

The general contract and contract of mortgage provisions, along with the purpose of general contract and contract of mortgage, lead us to conclude that Article 2 of the amendment proclamation states that a contract of mortgage with banks and micro-financing institutions is valid without registration leaving the right of the third parties intact. However, the above interpretation deviates from the derived intention of the legislature and renders the proclamation completely redundant. The intention of the legislature, as it can be inferred from the preamble to the proclamation, is to protect banks and micro-financing institutions from the existing unsecured loan. The protection of third parties does not seem to be its concern from the preamble. It is also impracticable to extend additional protection to banks and Micro-financing institutions without affecting the rights of third parties.

30 Contracts that affect third parties should not be enforced and the legislature should regulate contracts that affect third parties. See Shavel, Supra note 5 p.20

31 See the provisions of the Civil Code Article 3081ff.
It is plain fact that before the enactment of this amendment proclamation, the loan of banks and micro-financing institutions was secured by the assets of the debtors by the mere fact that there is loan contract. This right to attach the assets of the debtors does depend on the loan contract pursuant to Article 1988 of the Civil Code even though there is no contract of mortgage. In such circumstance, banks and micro-financing institutions are not secured creditors. They are considered normal creditors. Other creditors whose claim is secured by registered mortgage will be given priority. The banks and micro-financing institutions will share from the asset of the debtor equally with other unsecured creditors. The right of banks and micro-financing institutions to attach the assets of the debtor without affecting the rights of third parties existed before the amendment proclamation.

Article 2 of the proclamation cannot be effective without affecting third parties. Since protecting third parties within this proclamation is unlikely, making the right of third parties exception to Article 2 of the proclamation renders the whole proclamation inapplicable. Validating contract of mortgage without registration in a manner that does not prioritize the mortgagees is redundancy as the previously existing legal environment had such function. In no circumstance can the redundancy of this provision be the intention of the legislature.

If it were not to fetch further security for banks and micro-financing institution in a way they are preferred to other unsecured creditors (third parties) and equated to secure creditors (third parties), the existing legal environment without the proclamation would have been enough. Interpreting Article 2 of proclamation in away third parties are protected is not only against the intention of the legislature but also against positive canon of interpretation. Positive interpretation provided under article 1737 of the Civil Code does not allow interpretation, which renders provisions redundant. It rather requires interpretation of a provision capable of two meanings in a way it becomes effective. Protecting third parties within article 2 of the proclamation makes the provision redundant and ineffective. Indeed Article 1737 is a canon of interpretation applicable to contractual stipulations. Nevertheless, applying this on legal provisions with reference to contract is persuasive. This is because contractual stipulations are tantamount to law in their effect pursuant to article 1731.
Therefore, Article 2 of the amendment proclamation seems to either protect banks and micro-financing institutions at the expense of third parties or be redundant. Its redundant nature can be seen as wasting resources and perplexing the existing legal system in relation to that specific area. If it takes the other obnoxious feature, the provision can be commented on for its failure to protect certainty, predictability security of transaction and avoid negative externality of contract of mortgage with banks.

2.3. Application of the amendment proclamation vis-à-vis res judicata

The amendment Proclamation runs against not only the right created in mortgage contract but also the principle of res judicata. Article 3(2) of the proclamation reverses finally decided court judgments retroactively. Application of this provision seems to be against the principle of res judicata. It cannot be a justified ground for review according to the Civil Procedure Code since review is narrowly allowed when perjury, forgery, bribery and other similar acts are committed. Procedural application of this reversal effect of the amendment proclamation is, therefore, among the points of procedural controversies in the application of the proclamation into practice.

Article 5 of the Civil Procedure Code, precludes issues or suits which were heard and finally decided between the same or parties under the same title. Certain issues, which were not heard and decided, can also be precluded when certain conditions are met. Article 5(2) precludes any matter, which might and ought to have been made a ground of defense or attack in the former suit. This elucidates that the matters that are excluded by res judicata are not heard and decided, but they might and ought to have been raised. Possibility of being raised at the time of the former suit is a condition for the application of res judicata on matters, which were not raised, in the previous litigation.

Thus the scope of res judicata in Ethiopia in comparison to civil and common-law legal system is narrow. In common law legal system, res judicata is considered to have killed the cause of action. A valid final judgment made by court having jurisdiction extinguishes the cause of

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No litigation is allowed based on the finally decided cause of action. The cause of action is replaced by judgment on which parties can rely to enforce their substantive rights. Once a final court decision is given with regard to certain cause of action, a matter which could not have been or ought not to have been ground of defense cannot be re-litigated if the cause of action is similar with the previously decided case. This is because the cause of action is killed.

In civil law tradition, a cause of action is precluded on the reason that the judgment made by competent court having jurisdiction is presumed to be correct. It is this irrefutable presumption that precludes the cause of action. New facts may arise from the cause of action that the court was not aware of, however; the presumption is still irrefutable. In both legal systems, the scope of res judicata extends to preclude a cause of action, which is finally decided.

In Ethiopia, however, as it has been seen, unless the issue or matter might or ought to have been made a ground of defense or attack, res judicata is not a bar. It does not exclude issues that might not or ought not to have been a ground of defense or attack although it arises later from the same cause of action. Article 5 (2) excludes only issues that could have or ought to have been raised. The possibility of being raised at the former suit is a requirement to be barred by res judicata. Therefore, the cause of action survives if defense or attack could not have or ought not have been raised.

Cases that come under Article 3(2) of the proclamation are not barred by res judicata according to Article 5 of the Civil Procedure code. Article 5 (2) allows re-litigation if the issues might not or ought not to have been a ground of defense or attack at the formerly decided cases, which

33 *Ibid*

34 *Ibid*, See also Adane Kebede, Resjudicata as Employed in the Revival of Ethiopian Legal System upon the Culmination of Tigrean Sirit System, (un published thesis, Addis Ababa, Faculty of Law), pp. 63-65

35 *Ibid* p. 67

36 *Ibid*

37 Article 5 (2) of the Civil Procedure Code

38 *Ibid*
arise later from the same cause of action. The ground of defense or attack to validate already invalidated cases is Article 3(2) of the proclamation. The issue of law in relation to Article 3 (2) of the amendment proclamation might not or ought not to have been a ground of defense or attack in the cases decided before its enactment. This provision could not have or ought not to have been raised in the cases decided before the enactment of the proclamation. Therefore, finally decided court judgments, which can be re-litigated under Article 3(2) of the proclamation, are in line with the application of res judicata as employed under Article 5 of the Civil Procedure Code.

All the same, if the principle of res judicata employed in the Civil Procedure Code had not had any room for re-litigation, the proclamation would have prevalence effect for two reasons. First of all the proclamation is substantive law, which is enforced by procedural laws. Substantive laws prescribe rights and duties. The procedural laws are enacted to implement substantive laws. In no circumstance can procedural laws, in the Civil Procedure Code erode the substantive laws in Civil Code. Therefore, when the principle of res judicata is in clear contradiction with substantive law, like Article 3(2) of the proclamation, the substantive law shall be given effect since procedural laws shall not deny effect the substantive laws.

Indeed substantive provisions can be found in procedural legislations and procedural provisions can be again found in substantive legislations. Article 3 (2) of the amendment proclamation is substantive in its nature because it validates previously invalidated contract of mortgage without saying anything about the procedure.

Moreover, the proclamation is later special law in that it was enacted after the enactment of the Civil Procedure Code. Res judicata in the Civil Procedure Code is prior general law. When later special law contradicts with prior general law, canon of interpretation dictates that the later law

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prevails over the prior law.\textsuperscript{40} Therefore, Article 3(2) of the proclamation can be applied even against the principle of res judicata, if res judicata were against Article 3 (2) of the proclamation.

2.4. Economic efficiency Under the Amendment proclamation

Efficiency is an economic term, which refers to maximizing utility (satisfaction) at least cost.\textsuperscript{41} Economic analysis of contract can illustrate efficiency of contract rules more than any discipline. According to this interdisciplinary subject matter, contract law can facilitate efficient transaction by encouraging optimal cooperation, optimal commitment to perform, and optimal reliance, providing efficient default rules and regulating market failure of contract.\textsuperscript{42}

The amendment proclamation runs against most of the purposes of economic analysis of contract. The misleading efficiency provided in the preamble suffers from inefficiency by the provisions, which result in negative externality cost, discouraging optimal cooperation, and optimal reliance.

Albeit the possibility of interpretation in line with the purpose of law, protecting banks and micro-financing institutions at the expense of third party interest erodes certainty, predictability and security of transaction. This is because the uninformed party who secured his claim by registered mortgage is being put behind the banks and micro-financing institutions suddenly since the contract of mortgage of banks and micro-financing institutions is not required to be registered in order to make information available. No parties other than banks and micro-financing institutions will be certain as to the effect of their contract of mortgage since they cannot have information about the encumbered rights of banks and micro-financing institutions. Nor will they be protected having regard to the date of registration.

\textsuperscript{40} See Tesfay Abate, \textit{Supra note} 39, p.103

\textsuperscript{41} Allen and Cutter, \textit{Supra note} 6, p. 10

\textsuperscript{42} \textit{Ibid}, pp.184-211
Erosion of certainty, predictability, and security of transaction have potential danger on optimal cooperation and optimal reliance.\textsuperscript{43} No parties other than banks and micro-financing institutions will enter into a contract of mortgage for fear that the object is mortgaged to banks and micro-financing institutions without being registered. Or at least they are severely discouraged. Nor will they be motivated to enter into further contracts relying on their contract of mortgage.\textsuperscript{44} Optimal cooperation and optimal reliance are, thus, to be eroded owing to the cumulative effect of exclusion of registration and trade-off effect on the interest of third parties.

Unprotected third party in the valid unregistered mortgage also depicts the failure of the law to regulate market failure.\textsuperscript{45} The unprotected third party may suffer from the negative externality of unregistered contract of mortgage. The negative externality of unregistered contract of mortgage could have been avoided through regulating the contract by imposing the system of registration as a mandatory formal requirement at least when the interest of third party becomes an issue.\textsuperscript{46} Failure to do so leaves market failure owing to negative externality unregulated and this is clear violation of efficiency, which is the purpose of contract.

The retroactive application of the proclamation has also similar clash with efficiency. Article 3(1) provided thus: \textit{“The validity of any contract of mortgage prior to the effective date of this proclamation, to provide security to loan extended by bank or micro-financing institution, may not be challenged for not being registered by a court or notary in accordance with Article 1723 of the Civil Code.”}

The aforementioned provision revisits previous juridical acts and validates an invalid contract contrary to certainty, predictability and security of transaction. Commitment to cooperate would inevitably be discouraged in a way that results in erosion of certainty and trust on the existing


\textsuperscript{44} Reliance or entering into further transactions requires high probability of performance as it can be seen in Allen & Cutter, \textit{Supra note 5}, p.194

\textsuperscript{45} \textit{Ibid}, pp. 206-208

\textsuperscript{46} Allen and Cutter, \textit{Supra note 5}, p.20
laws. This is attributable to the possibility of enactment of laws that deny the effect of the existing laws as connoted obliquely in the aforementioned provision. No one can be sure if the effect of the existing law will not be reversed by an upcoming enactment. Lack of certainty on the existing laws makes the conclusion of predictable contract and relaying on the existing law difficult since the existing laws can be repealed in a way they are not effective as of their enactment. Lack of trust on laws erodes certainty about enforcement, security of transaction and thereby willingness for cooperation.47

Moreover, it erodes the economic merit of res judicata. Res judicata avoids backlog and delay, as it is a means of litigation preclusion. Res judicata excludes previously litigated cases. If previously determined matters and issues are allowed to be re-litigated, the number of cases in courts increases. The increment in the number of cases creates backlog and delay. Res judicata does not allow such re-litigation and thereby avoid backlog and delay.

Backlog and delay actually affects access to justice and speedy trial and makes inefficient use of resource. When the number of undecided cases increases, the time required to decide one case also increases. This prevents others from bringing their case to the courtroom for fear that there is delay and thereby access to justice is prevented. Even though some of them might bring their case, those whose case is decided after long period of time owing to lack of res judicata, are also denied of the right to speedy trial. This is an unjust result as “justice delayed is justice denied”. In addition to backlog and delay, res judicata also avoids lack of certainty in business. If parties are not certain that their case, which is finally decided, will not revive, they will be reluctant to invest the capital which they obtain as a decree because if the judgment is reversed they may be required to pay back the money they invested. In addition to that their confidence in the court would be eroded in a manner it results in erosion of certainty, predictability and security of transaction.

47 See Allen and Cutter, Supra note 5, p. 184, who asserts enforcement is an incentive for cooperation and lack of certainty about enforcement affect cooperation
Res judicata also protects individuals against multiplicity of litigation and promotes distributional justice.\textsuperscript{48} In the absence of res judicata, certain party would re-litigate a case infinitely. The parties will repeatedly required to appear before the court for one case. Some others will not have access to justice or speedy trial due to delay attributable to re-litigation. Those who are re-litigating are consuming more court service and those who do not bring their case once are not, however, consuming even when they are justified to do so and this results in unequal consumption of court services.\textsuperscript{49} Res judicata, by excluding previously decided cases, promotes equal consumption of court service. Equal consumption of court service promotes distributional justice, which has social values.\textsuperscript{50}

It is sound to assert that individual consumers of court service are assumed to be rational. Accordingly, they want to maximize their benefit. They will choose re-litigation if profit is maximized. To maximize their profit of re-litigation, they are required to re-litigate it at minimum cost. They are also required to consider the probability of getting that profit. This is because no rational party is expected to choose re-litigation having greater risk of losing the case unless there is greater profit to make him gamble or carry that risk. The party generally considers the probability of the benefit and the amount of benefit on the one hand and the individual cost of litigation and probability of losing the case on the other.\textsuperscript{51}

Individuals, however, weigh only their individual cost of re-litigation in deciding whether to choose re-litigation or not without considering social cost of re-litigation.\textsuperscript{52} Therefore, the government is expected to assess social cost of re-litigation without relying on the economic assumption of rationality of consumers because court service consumers may choose re-litigation due to unnecessary feelings like retaliation and rage.

\textsuperscript{48} Ibid PP.418-419
\textsuperscript{49} Ibid
\textsuperscript{50} Ibid
\textsuperscript{51} Ibid, see also Shavel, Supra note 5, p.9
\textsuperscript{52} Ibid, pp.424-426
When social cost of re-litigation is more than social benefit of re-litigation, social benefit of re-litigation should be foregone and there should be res judicata. Social benefit of re-litigation and res judicata are considered to be two commodities; where one is foregone, it becomes opportunity cost of the other. Re-litigation (the opportunity cost of res judicata) has some values. Best example of it is correcting erroneous court judgments. When such judgments are corrected, persons who do not deserve deterring punishment will not be deterred. Those who deserve deterring punishment would be deterred. This would minimize accidents, breach of contract, promote business, and deter other wrong full acts. The incentive, which was given to those who do not deserve it, would be taken back and would be given to those who deserve it. This motivates socially desirable cases to be brought to courts.

Re-litigation to be socially desirable, its social benefit multiplied by its probability of happening should be greater than its social cost [benefit of res judicata]. Though the benefit of re-litigation may be high, it becomes, generally, negligible when it is multiplied by its lower probability. The benefits of res judicata are, however, high even when it is multiplied by its probability. Therefore, re-litigation is not justified, as its benefit multiplied by its probability is less than its cost [benefit of res judicata]. Res judicata is, however, justified as its benefits are greater than its cost or opportunity cost [benefit of re-litigation]. Therefore, res judicata should be preserved at the expense of its opportunity cost, the benefit of re-litigation, as it maximizes social benefit.

Article 3 (2) of the proclamation paves a way by which finally decided cases can be re-litigated. The provision denies effect for finally decided court decisions to invalidate a contract of mortgage on the ground that the contract was not registered in court or notary according to Article 1723 of the Civil Code. If previously decided cases shall be of no effect, re-litigation of such cases is inevitable. When previously decided cases are re-litigated the benefits of res judicata are forgone to get the benefits of re-litigation. Re-litigation of cases on the ground of Article 3(2) of the proclamation can be made without affecting Article 5 of the Civil Procedure

53 Ibid, pp.418-419
Code. Even though its applicability in line with Article 5 might be contested, its application at any circumstance is beyond gainsay.

In this special circumstance, the possibility of reversal of the case to be re-litigated is relatively high when it is compared with other res judicata cases. This is attributable to the fact that the validating effect of Article 3(2) of the proclamation increases the possibility of reversal. The benefit of re-litigation is also expected to be high as the security of banks and micro-financing institutions will be protected. The cost of re-litigation is, however, very high since re-litigation denies the social benefit of res judicata. The re-litigation effect of Sub Article (2) of the proclamation is expected to result in backlog and delay, violate access to justice, violate the right to speedy trial, contravene distributional justice, erosion of certainty, predictability, and security of transaction and affect third party interest if it is to be effective against third parties. Therefore, the proclamation also takes away the social benefit of res judicata for the sake of efficiency of banks and micro-financing institutions.

2.4. Constitutionality of the Amendment proclamation

Serious constitutional issues can be raised with regard to the reversing effect of provisions. Article 3(2) by over-looking the separation of powers and independence of judiciary reverses court decision. The provision states: “Any court decision, rendered prior to the effective date of this proclamation, to invalidate a contract of mortgage concluded to provide security to a loan extended by banks or micro-financing institution, for not being registered by a court or notary in accordance with article 1723 of the civil Code shall have no effect. Any such case pending before any court as of the effective date of this proclamation shall also be terminated.”

Separation of powers, as a constitutional principle, states that the legislature, executive and judiciary shall functionally and institutionally be separated.\(^{54}\) Member of one of the governmental organ shall not be member of the other organs and one governmental organ shall

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\(^{54}\)Roddee, Anderson, Cristol, Introduction to Political Science, (2\(^{nd}\) edition, ------), p.428
not perform the function of the other governmental organs.\textsuperscript{55} Although members of the parliament can be members of the executive in parliamentary form of government, this feature of such form of government is an indication of fusion of powers.\textsuperscript{56} The principle of separation of power does not, accordingly, allow the legislature to undergo judicial functions like interpreting laws and reversing any court decision.\textsuperscript{57} Reversing final court judgment is clear judicial power as the court is left with no function to do. The legislature indeed can enact interpretational laws.\textsuperscript{58} This power does not, however, empower the legislature the power to reverse an already finally decided court cases.\textsuperscript{59} Check and balance is not extended enough to reverse court judgments. The legislature can check the court by amending laws not decisions. Enacting laws, which are applicable retroactively, to amending or reverse court judgment, contradicts both separation of powers and check and balance.\textsuperscript{60}

When 3(2) of the proclamation is observed in light of Article 50 (2) of the Ethiopian Federal Democratic Republic (EFDRE) Constitution, its unconstitutionality, for it erodes separation of powers, is evident. Article 50(2) of the Constitution shows the existence of legislature, executive and judiciary. Institutional separation of powers can be inferred from this constitutional provision. The legislative organ is empowered only to enact laws and keep an eye on their implementation. The executive and judiciary are also empowered to do their respective constitutional function. They are separated not only institutionally but also functionally.

Article 55(1) clearly connotes that the house of peoples representatives “shall have power of legislation”. The FDRE Constitution not only states the power of legislature but also the power of

\textsuperscript{55} C.F Strong, Modern Political Constitution, (197)\textsuperscript{2} pp. 211-212

\textsuperscript{56} Roddee, Anderson, Cristol, Introduction to Political Science, Supra note 54, p.122

\textsuperscript{57} Michael Allen and Brian Thomson, Cases And Materials on Constitutional and Administrative Law, (4\textsuperscript{th} ed.----) p.35

\textsuperscript{58} John L. Hale And Robin Hale V. WellPoint School District Decision of Supreme Court of the State of Washington No 80771-0, at http://www.courts.wa.gov/content/Briefs/ See also Tesfay Abate, Supra note 39, p.140

\textsuperscript{59} Barnett, Supra Note 33, p.196

\textsuperscript{60} See, the case of John L. Hale and Robin hale Versus WellPoint School District, Supra note 58. The court has decided that applying amendment laws in a way court decisions are reversed contravenes separation of powers.
courts. Article 79(1) clearly shows that judicial power is allotted to courts. In light of this Article 80(1) shows the highest judicial power is vested on federal Supreme Court. These two provisions cumulatively show judicial power is vested on courts and the highest power of courts is exercised by Supreme Court. The Constitution clearly elucidates the separation of powers institutionally and functionally. The reversing effect of the amendment proclamation without any legal ground is unconstitutional because it erodes the principles of separation of powers.  

The judicial function of reversing judgments, which is finally exercised by the Supreme Court as enshrined in the constitution, has been snatched by the law-making organ.

In connection with this the independence of the judicially is endangered owing to the effect of Article 3(2) of the proclamation on separation of powers. First and foremost, separation of power is threshold for independence of judiciary. It is if there are separate government organs that the independence of judiciary is discussed about. In the absence of separation of power, the tenet of independence of judiciary and its standards cannot be issues of discussion. The existence of judiciary as an institution with distinct function is precondition for independence of judiciary. Any effect on separation powers is directly related to independence of judiciary. Article 3 (2) of the amendment proclamation transgresses separation of powers and erodes independence of judiciary to that extent.

Moreover, quashing court decision decided in accordance with the law retroactively erodes directly their independence and confidence in their profession. Empowering the court is one of the ways by which independence of judiciary can be secured. Implementing court orders and decisions are indications of independence of judiciary and judicial sovereignty. Article 3 (2) denies enforcement of court decisions retroactively contrary to the principle of separation of

61 Barnett, Supra note 32, pp.20-22

62 Ibid

63 Ibid, page 35. Independence of judiciary is justified on its role of promoting liberty and liberty is also highly related to separation of powers according to the legal thinkers like Montesquieu.

64 John Alder, Constitutional and Administrative Law (1989), p. 271
powers. If the legislature can amend previously decided court judgments, courts do not have the highest judicial power leave alone independence.\textsuperscript{65}

Courts are required to “exercise their functions in full independence” and “to be directed solely by the law.”\textsuperscript{66} Denying effect to their decision retroactively without predictable reason connotes disapproval of their function and erodes the confidence of judges. Reversal of court judgment has unequivocal connotation of inefficiency in the reversed judgment. Courts, while their decision was in conformity with the laws, they are obliquely told that they had been inefficient in their decision. Moreover, it might connote that their function is nominal without effect in the absence of legislative will. Above all if their decision is subjected to reversal by the legislature, it is questionable if there can be circumstance where courts decide against clear will of the legislature and in accordance with the law because the legislature can reverse it by its law making power. No rational judges want to see the reversal of his judgment. The unconstitutionality of Article 3(2) of the amendment proclamation is also evident for its oblique impact on independence of judiciary as enshrined in the Constitution.

Erosion of independence of judiciary and public trust on courts has a negative effect on business transaction. Dependency of judges makes judicial decision unpredictable. Citizens will face difficulty of acting according to the law and possible court judgment since the possible court judgment is unpredictable to the extent of the dependency and can be changed by the legislature retroactively. Uncertainty and unpredictability of effect of laws and judicial decisions results in unsecured transaction.

\textbf{Concluding Remarks}

The role of law in development of one nation is pivotal. Contract law is among the leading subject matters of law aimed at enhancing development by encouraging efficient business

\textsuperscript{65} Barnet \textit{Supra note} 32, p 20-22.

\textsuperscript{66} The Constitution of the Federal Democratic Republic of Ethiopia, Article 79(3)
transactions. This objective can be met by making contract laws responsive to certain principles and values.

Formality requirements are provided in a way they are responsive to the evidential, cautionary, channeling and protecting third parties purposes. Proclamation 639/2009 aims at protecting banks and micro-financing institutions on the guise of efficiency. Its application inconformity with the previously existing laws of formality retaining the intention of legislature behind the purpose of its enactment comes up with doubled-edged perplexity. Its application inconformity with the existing laws renders the proclamation entirely redundant. The other application of it results in negative externality, erosion of certainty, predictability and thereby erosion of security of transaction.

Owing to the negative externality, lack of certainty and predictability, the efficiency purposes of contract like optimal cooperation, reliance and regulating market failure are severely damaged. The problem of efficiency of contract is worsened by uncertainty and unpredictability attributable to the retroactive application of the proclamation and reversal of previous court judgments. The reversal of court judgment contravenes with the efficiency principles enshrined in the economic analysis of res judicata.

It is also unconstitutional since it erodes separation of powers and independence of the judiciary. The judicial function of interpretation and applying laws to specific cases is snatched away. This has an indirect effect on the independence of the judiciary. The reversal of previous court judgments also compromises independence of the judiciary since failure to implement court judgments directly erodes independence of the judiciary. Erosion of judicial confidence on their function and public trust on judges indirectly affects independence of judiciary.

The immense effect of lack of certainty, predictability and unsecured transaction can spill over to international transactions. Investors and actors of international transaction, inevitably consider legal certainty to decide to invest or make transaction. Taking these into account immediate repeal or amendment of proclamation 639/2009 is recommended.