

Ethiopian Commercial Code-Key Changes

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I. Introduction

These notes are prepared to inform our clients and others about the changes introduced by the amendment of the Existing Commercial Code (“ECC”) effective since September 11, 1960 and the New Commercial Code (“NCC”) to be effective on the date of its publication in the official gazette for the publication of laws in Ethiopia, the Negarit Gazette, which may take place in 2 or 3 months. We note that the changes highlighted in this note are based on the latest draft of the NCC, which are subject to confirmation at the publication of the NCC. It is a bit of a misnomer to refer to the amendment as the NCC since the entire ECC has not been replaced. The ECC consists of the books indicated below:

- Book I Traders and Businesses Articles 1-209
- Book II Business Organizations Articles 210-560
- Book III Carriage and Insurance Articles 561-714
- Book IV Negotiable Instruments and Banking Transactions Articles 715-967
- Book V Bankruptcy and Schemes of Arrangement Article 968-1170
- Book VI Transitory Provisions Articles 1171-1182

The amendment has replaced only Book I, Book II, and Book V. The articles in the other books will remain effective.

The work of reviewing the ECC has been going on for over three decades under various committees and institutional compositions to finally get to the date, March 25, 2021, of its approval by the House of People’s Representatives as Proclamation No. 1243/2021. The length of the time it has taken to amend the ECC testifies to the enormity of the challenge associated with the change of a basic and broad code such as the ECC. The characterization of the changes as significant or ground-breaking or simply as consolidation of existing practice that is not informed by the latest thinking and development elsewhere is to be decided by the unfolding interactions of the business community and regulators. The ECC is also introduced at a critical juncture whereby the Ethiopian government takes other initiatives aimed at changing its overall legal environment for business such as the investment laws, business registration and licensing laws, securities laws, the law on commercial arbitration, drafts dealing with the establishment of financial market/stock exchange, and other laws and drafts pending reform. To what extent the ECC, as a basic code, is aligned with all these initiatives and embodies basic principles to be used as an umbrella law remains to be seen as they start to be tested by practice.

While it is difficult for us to capture the entirety of changes reflected in the NCC in these notes, we have made effort to identify the key ones to which our clients and others need to pay attention. Readers are encouraged to get detailed legal advice in an area of interest for their businesses and if they get a framework to direct their attention to the changes, then, our objective is met.

II. The Rationale for Enacting the NCC

The explanatory note sent by the Attorney General Office together with the draft articles of the NCC states the justification for the timeliness of overhauling the ECC and making changes. The first justification is that the ECC has outlived the estimated life span given to it by its drafters. One would note that Professor Jean Escarra, professor of comparative commercial law of the University of Paris and chairman of the Commission for the revision of the French Commercial Code at the time, drafted Books II, IV and V whereas, following his death in 1955, Professor Alfred Jauffret of the University of Aix-Marseille in France drafted the text of Books I and III.

A second justification is, commercial practice proves that there are provisions in the ECC that are open for interpretation, difficult to implement and not compatible with current realities of the country. A third justification is, changes taking place in the rest of the world, especially those occurring in investor countries, need to be reflected in the ECC. Other justifications cited in the explanatory notes include the need to be

internationally competitive, to enact a law that looks forward to 20-30 years and perceived as modern in the eyes of investors and to sufficiently reflect development in information, and communication technology.

While the foregoing are the overarching justifications for the enactment of the NCC, the list of the problems identified during the consultation process of stakeholders noted in the explanatory note and produced below gives readers an insight into the problems that the NCC promises to solve:

1. Concepts in the Code such as business registration, trade name registration, mortgage of a business and other matters were not compatible with sectoral law enacted from time to time regarding the same;
2. Outdated concepts of bookkeeping and accounting; incompatibility with financial standards enacted by another legislation five years back;
3. Lack of sufficient minority interest protection preventing investors to raise capital in majority dominated companies and at the same time causing the country to get low rank in World Bank and other similar institutions that compare countries on their suitability for investors, thereby, limiting the country's ability to attract foreign investors;
4. Loopholes in the ability of investors to control their companies;
5. Silence over how private limited companies are to be liquidated in particular not addressing appointment, power and responsibilities of liquidators, the distribution of profits and losses;
6. Lack of provisions dealing with protection of creditors and minority shareholder in transactions between related parties;
7. Gaps in sections of the Code dealing with merger, division, and change of form of companies;
8. Lack of clarity in the implementation of book V (Bankruptcy proceedings) and in the role of various entities;
9. The presence of clauses dealing with current accounts and similar other matters (e.g. Articles 925-937) that have never been implemented even after more than 60 years of the Code's existence;
10. The absence of company forms used in other jurisdictions;
11. The outdated nature of the rules in the code preventing company management and third parties to use technology to facilitate their communication;
12. The absence of sufficient provision dealing with the rights of creditors transacting with branches of foreign companies to obtain information about such companies;
13. The absence of provisions dealing with Deposit certificate, Customs Receipts, Delivery orders, etc. as negotiable instruments as is the case with other jurisdictions;
14. Lack of clarity in the use of checks and other payment instruments;
15. The absence of provisions dealing with investment banking and any guidance on how it works with existing banking operations;
16. The absence of provisions that take into account electronic payment mechanisms, mobile banking, internet banking, which are already being implemented in the economy;
17. The lack of clarity of application of the Scheme of Arrangement sections of the Code and lack of protection for investors to enable the company to survive;
18. The lack of mechanism to enable the business to transfer it as ongoing concern to avoid bankruptcy;
19. The lack of mechanism that enables companies to undertake temporary restructuring to avoid bankruptcy; and
20. Lack of clarity and gaps in setting forth bankruptcy procedures, effect, beneficiaries, distribution of income during the proceedings, and exemption from liability of the bankrupt person.

It is important to note here that to what extent the NCC has met its rational and objectives and fills in the gaps indicated in the table above remains to be seen as the provisions of the NCC starts to be implemented by businesspersons, the institutions in charge of regulation of business and interpreted by courts of law. There are also issues surrounding negotiable instruments, investment banking, electronic payments and other forms of payments that have not been addressed by the NCC.

III. Key Changes on Book I: Traders and Businesses

Traders Defined Expansively: Book I is the least changed section of the ECC as the NCC has retained almost all provisions. To start with, the NCC has followed the same approach in defining who are traders that are governed under it but expanded the list of business activities that would characterize a person undertaking them professionally and for gain as a trader. All of the activities listed in the ECC have been kept intact and 16 more activities have been added. The NCC has also indicated clearly that the list is

illustrative rather than exhaustive by using the words: “among others” whereas the Amharic version of the same provision states “other similar activities.” which has the same effect.

Holding Companies as Traders: The NCC has recognized holding companies as traders. The ECC had not provided much details with regards to the definition and regulation of such companies except devoting a few provisions with regards to their accounts. One notes that the Commercial Registration and Business Licensing Proclamation No 980/2016 defines a holding company as a limited liability business organization incorporating two or more limited liability companies, that has a special registration certificate. The NCC expands this definition by pointing out that a Holding Company is a trader governed under the NCC even though it does not necessarily produce goods or service but merely holds shares in other companies by injecting capital into such companies.

Streamlined Book-keeping: The NCC retains the key obligation of traders to keep books of account exempting what it refers to “petty traders” to be defined in a special law. The NCC retains the duty to keep books of account for 10 years but recognizes the possibility to keep books of account supported by modern technology. It eliminates the provisions detailing how journals, balance sheet and inventories are to be organized.

Registration and Online Register: The NCC retains the obligation of registration. As the framework in the ECC presupposes a unitary state and is outdated, the NCC introduces registrations at two levels: The Federal Register and the Regional Register. It also imposes an obligation on the Ministry of Trade and Industry to establish a federal level electronic database accessible to the public online. The ECC assigns any disputes arising between the applicant and the official in charge of the register regarding entries in the commercial register for resolution by the registering entity whereas the NCC makes a clear reference to the competent courts of law.

IV. Key Changes on Book II: Business Organizations

Change of Business Forms: The NCC makes changes to the six forms of business organizations recognized by the ECC. First, it removes what is known as the Ordinary Partnership form. This was already hinted as unnecessary by the drafters of the ECC themselves as it is essentially conceptualized as a non-commercial association. It hardly exists in practice. Second, it introduces two new business forms: the Limited Liability Partnership (LLP) and the One Person Company (OPC). Third, it acknowledges the structuring option of setting up Groups of Companies including Wholly Owned Subsidiary. A more nuanced definition is provided for Branch Company as well.

The LLP Form: The LLP is an improvisation on the Limited Partnership already contained in the ECC and different in sense that all of the partners, whether participating in management or not, have limited liability. The LLP is intended for providing an opportunity for professional service firms (e.g. lawyers, accountants, auditors, architects, etc.) to organize in a corporate form at the same time enjoying limited liability to the extent of only their contribution to the capital of the LLP. It is not clear how the tax law will treat the LLP form and whether it will enjoy the tax treatment accorded in the jurisdictions where it is prevalent.

The OPC Form: The OPC is formed just by one person making a declaration in a form prescribed by the law. It enjoys a legal personality autonomous or separate from the person forming it and its liability is limited to the extent of the contribution that the person makes into the company. Liability does not extend to any other property and this feature makes this form very suitable to sole proprietors. It seems the intention of the law is to offer an opportunity to natural persons who are sole proprietors to set up an OPC if they wish to and may not extend to apply to a corporate entity (an artificial person). The person forming the OPC may himself be the manager or he/she may appoint another person as manager. It is important to note here the prohibition that one person cannot establish more than one OPC although it is not clear why this is the case. The NCC states that its provisions governing a private limited company shall apply as appropriate, to OPC without prejudice to the special rules.

Group, Subsidiaries and Branch: the NCC provides a definition for a Group as consisting of a set of companies comprising of the parent company and all its national and foreign subsidiaries, unless otherwise indicated, whereas a Subsidiary is defined as a company subjected to the control of another company, the “Parent” company, either directly or indirectly through another subsidiary. The NCC defines control as the power to govern, alone or with other shareholders, the financial and operating policies of a subsidiary. One of

the situations in which a parent company is considered to have control over a subsidiary is where a company owns, directly or indirectly, more than half of the voting rights in that subsidiary. As a variation of a subsidiary company, a Wholly Owned Company is defined to mean a company with no other shareholders except its parent company and any other subsidiary of its parent company, or persons acting on behalf of its parent or such subsidiaries. In principle, a subsidiary has a separate legal personality from its parents. While the NCC presumes that a Wholly Owned Company is governed by the parent and takes instruction from it, it requires a not-wholly-owned subsidiary to disclose in the Commercial Register kept by the Ministry of Trade and Industry or another pertinent authority whether its management is directed by the parent. The advantages of setting up as in any of these forms is not self-evident given that the tax law is yet to take them into consideration, and it is not clear what tax advantages lie in any of them.

The Branch company, unlike subsidiaries, is not considered as autonomous and does not have its own legal personality. It is defined as a fixed establishment of a foreign business organization or a similar entity that is staffed and set up to pursue economic activity for gain on behalf and for the account of the said business organization or similar entity for a definite or indefinite period. It can have its own manager, who is expected to fulfill the eligibility requirements for directors of a share company. A Branch will be cancelled from registration if its parent is dissolved; its parent decides to close it; the branch manager has failed to file, as soon as reasonably possible, accounting documents and other statements regarding the foreign business organization or entity and a branch creditor establishes that its claim cannot be satisfied out of the foreign business organizations assets within Ethiopia.

Merger and Divisions: Unlike the ECC, the NCC has introduced definition of merger and divisions explicitly and provided for the various ways that they take place. A merger or division plan is required with contents prescribed by the law and the plan has be drawn up by an independent expert. Merger or division needs to be publicized in a newspaper with national circulation. The effects of merger or division is also clearly stated. The NCC has made it clear that the company that does not survive a merger does not need to go through the process of liquidation. The detailed provisions of the section dealing with merger and division have to be seen in the light of their compatibility with the competition law regime which governs them currently.

Changes on Existing Forms of Companies: the NCC has introduced a number of changes to the provisions relating to Private Limited Companies (PLCs) and Share Companies. These changes are of various levels of depth and importance and it is not the purpose of this note to reflect all of the changes. With respect to the PLC form, though, it is important to note down some of the changes as below:

- The right of members of a PLC to form a Board as a management body is clearly recognized;
- The minimum par value of a share has been increased from ETB 10 to ETB 100 (this is the same for share companies);
- Meetings via video conference or other means of communications have been recognized as legitimate;
- Recognition of pre-emption rights for shareholders when an offer is made by a non-shareholder; and
- A company is permitted to buy back its shares.

V. Key Changes on Book IV: Bankruptcy and Schemes of Arrangement

Least Practiced but Most Changed: This book of the ECC has hardly been practiced in its lifetime. However, even to the extent that it has been, there have been problems arising from excessive delay, lack of clarity of the roles of the various parties involved in the process and lack of clarity in the provisions of the ECC itself. Therefore, the changes made in this Book, however wide ranging and through, are more of futuristic in that they will be refined as the practice develops and the market grows. We highlight below some of the most important changes.

Change in the rationale of the law: The NCC has reoriented the Ethiopian bankruptcy system's outlook, conveying that priority is given to rehabilitation or rescuing the troubled business, and liquidation is the last option.

Articulation of Objectives and Increased Survival Opportunities: While the ECC focuses more on bankruptcy proceedings and devoted scanty attention for Schemes of Arrangement for a business in difficulty, the NCC replaces the Schemes of Arrangement and enriches it by expanding the options by introducing the following proceedings: Preventive Restructuring Proceedings (PRP) and Reorganization

Proceedings (RP) before a business enters into Bankruptcy Proceedings (BP). While all of the three proceedings share a common objective i.e. to promote economic stability, maximize the value of the estate of the debtor and ensure legal certainty through efficient, effective and timely procedures, each of them also has a unique focus clearly stated in the NCC. The NCC deals with each proceeding in detail in separate sections of the legislation.

Adopting the unitary approach: In the ECC, two separate proceedings may lead to liquidation or scheme of arrangement (reorganization) depending on the applicant's relief. However, in the NCC, a single proceeding leads the business through RP and BP.

Consolidation of the Regime: The NCC is applicable to banks, other financial institutions and state-owned enterprises (SOEs) subject to special features indicated in specific laws applicable to these entities. This is deliberately done with the knowledge that the regime has been fragmented across various laws that were enacted catering to needs arising after enactment of the ECC.

Clarifying the Concept of Suspension of Payments: The proceedings are initiated when the debtor is determined to have suspended its payments. The ECC defines this date very broadly whereas the NCC presumes suspension of payments to occur when the debtor is unable to pay its debts which are due and payable with its liquid assets, which include credit reserves, overdraft and similar facilities available to the debtor. The need to provide a default notice to the debtor by the creditors is also emphasized in the NCC. The NCC defines the period of suspension to cover the period between the date of suspension of payment determined by a court and the opening of the reorganization or bankruptcy proceedings and limits it not to exceed a maximum of eighteen months, as opposed to 24 months in ECC. It also makes a workable distinction between pre-insolvency and post insolvency claims. It maintains the execution of ongoing contracts with the exception of employment contracts; banking and insurance contracts; administrative contracts; and contracts concluded in the framework of financial markets, including stock exchange which are all subject to special laws applicable to them.

Detailed Jurisdiction Provisions: The NCC grants the Federal High Court, of the place where the individual's principal place of business or the registered office of the company or the legal person is situated, jurisdiction to decide matters relating to PRP, RP, BP and sets forth by way of illustration the kind of matters linked to these proceedings. The NCC also provides the scenarios of proceedings where group companies are involved as well as the circumstances under which Ethiopian courts assume international jurisdiction in these proceedings. Interestingly, the NCC recognizes and gives effect to foreign judgments relating to PRP, RP and BP. Even though the NCC sets forth nine preconditions to be fulfilled by the person seeking recognition, it is interesting to note that the precondition of reciprocity as embodied in the Ethiopian Civil Procedure Code dealing with the recognition of foreign judgments is not one of them paving the way for a diligent judgment creditor to seek recognition and enforcement in Ethiopia.

More Elaborated Rules of Priorities of Creditors: Unlike the ECC, the NCC sets forth detailed rules regarding the priority of creditors in the context of each of the proceedings (PRP, RP, BP) by differentiating among secured and unsecured creditors.

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