

## ETHIOPIA: A NEW COMMERCIAL CODE

Investors looking to enter the Ethiopian market or deepen their presence should seek to familiarise themselves with some recent legislative changes of the country's commercial law that are set to significantly alter the legal landscape for both local and international players.

Chief among those is the new commercial code (the "**NCC**"), approved by the House of Peoples Representatives on 25 March 2021. It replaces the former code that had been in force for 62 years (the "**1960 Code**"). In this briefing, prepared by Anthony Giustini and Nadezhda Varbanova (from Clifford Chance)<sup>1</sup> and Tadesse and Dadimos LLP ("**TDL**"), we look at the key changes brought about by the NCC.

It is worth noting that the NCC only replaces Books I, II and V of the 1960 Code (which cover traders, business organisations and insolvency). Books III (on carriage and insurance) and IV (on negotiable instruments and banking transactions) of the 1960 Code will remain in force until they are eventually replaced by the Financial Services Code, which is yet to be approved by the House of Peoples Representatives.

### BUSINESS ORGANISATIONS

#### Introducing One Person Private Limited Companies ("**OPPLC**")

The 1960 Code only provided for two types of companies – share companies (the equivalent of the English public limited company) and private limited companies ("**PLC**") (the equivalent of the private company limited by shares). The former requires a minimum of five members in order to be created, while the latter a minimum of two, leading in practice to many issues linked to the artificial association of partners for the sole reason of meeting the minimum number of shareholders. This requirement was particularly challenging for

#### Key issues

- NCC – long awaited reform of Ethiopia's commercial law is now a reality, almost
- First steps towards single-member companies but more legislative action is probably needed to support investments through holding companies
- Concept of groups of companies now recognised
- Provisions that regulate branches of foreign business organisations
- Steps to increase corporate transparency and ease of doing business
- Formal prohibition of the issuance of bearer shares
- More context for in-kind contributions in certain business organisations
- Enhanced role of technology in corporate life
- Fundamental changes to how companies are managed
- Rules with respect to takeovers and share transfers as concerns share companies – hopes for a boost of M&A activity
- Overhaul of the country's insolvency regime

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foreign investors who were expected to find partners. The NCC appears to solve this by allowing, in Title VII, the formation of companies by the unilateral declaration of a single member, referred to as OPPLC. However, further measures may be necessary because although the NCC does not expressly state that OPPLC can only be established by a natural person, the provisions governing OPPLC seem to imply that OPPLC is only allowed to be established by a natural person (and thus the code does not unequivocally support investments through holding companies).

### **Recognition of "groups" of companies**

Another feature of the NCC is that Ethiopian law now recognises the concept of "groups of companies", which may be of interest to investors wishing to set up multiple entities in the country (art. 550). To that effect, the NCC defines a "group" as an economic entity comprising a parent company and both domestic and foreign subsidiaries. It also defines the terms "subsidiary", "parent company", "wholly owned company" and "control", thus providing the framework for group companies and certain governance practices (art. 551 and seq.).

Furthermore, the NCC provides for a holding company to have the right to access information on its subsidiary (art. 557) and give instructions to the management of its subsidiary (art. 556), and the right to redeem the shares of a shareholder with less than 10% of the shares (art. 558).

### **Recognition of branches of foreign business organisations**

In contrast with the 1960 Code, the NCC introduces provisions that regulate branches of foreign business organisations. The NCC allows foreign business organisations to carry out their business through their branches in Ethiopia, provided the branch (i) is registered in the Commercial Register kept by the Ministry of Trade and Regional Integration and (ii) has its own manager.

The NCC defines a "branch" as a fixed establishment of a foreign business organisation 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 organisation or similar entity for a definite or indefinite period (art. 578 and seq.). According to the NCC, a branch does not have an autonomous legal entity distinct from that of the entity that owns it. In addition, the rights and obligations arising from its activity are part of the assets of the entity that owns it.

## **CERTAIN ASPECTS OF COMPANY FORMATION AND OPERATION**

As a general matter, the drafters of the NCC have taken a number of steps to increase corporate transparency and ease of doing business in the country.

### **Requiring only a Memorandum of Association (MOA) for company formation**

Whereas in the 1960 Code it was required that a company have both a memorandum of association and articles of association (AOA), only the former is required under the NCC, thus significantly simplifying the company creation process in Ethiopia.

## Prohibition of the issuance of bearer shares

Under the 1960 Code, shareholders could either request bearer shares or registered shares. In an attempt to provide meaningful regulation and to improve anti-money laundering efforts, the NCC formally prohibits the issuance of bearer shares and only allows the issuance of shares registered in the name of the shareholder (art. 267). The NCC further requires that holders of bearer shares convert their shares into registered ones via application made to the issuing company within three years from the date of publication of the NCC in the Federal Negarit Gazeta. Bearer shares that are not converted within this time will cease to confer membership rights to their holders.

## In-kind contributions

Unlike the 1960 Code, the NCC illustrates what constitutes an in-kind contribution. According to the NCC, an in-kind contribution can be in the form of money, movable or immovable property, skill, trademark, goodwill, patent, lease right, usufruct, or other contributions. However, members of PLCs, shareholders of share companies and limited partners in limited partnerships cannot contribute skill as an in-kind contribution. This prohibition is provided mainly to protect creditors in so far as the liability of members, shareholders and limited partners, which only extends to their contribution, skill or service, will be of no value to creditors. Hence, they are required to contribute something which has monetary value.

## Catching up with technology

Finally, in a sign of recognition of the technological changes that have occurred since 1960, companies are now required to have a website (art. 492 and seq.) and board meetings may be held via electronic means (art. 309 and 520).

## COMPANY MANAGEMENT

Some of the most fundamental changes to the country's business landscape brought about by the NCC are in relation to how companies are managed. We examine below some key changes.

### Share companies

The NCC allows non-shareholders to become directors so long as their number does not exceed a third of the total number of directors (art. 296). This aligns with international best practice in so far as the board may now include independent and/or professional board members.

It is mandatory to establish an audit committee in the board of directors consisting of members of the board alone. A director who takes part in the day-to-day management of the affairs of the company cannot become a member of the audit committee (art. 301(3)).

In another departure from the 1960 Code, a share company may (without this being mandatory) now provide in its MOA for a supervisory board (in addition to the executive board) (art. 331). Interestingly, the NCC does not introduce mandatory employee representation in the board – a practice often associated with two-tiered boards.

## **Private limited companies (PLCs)**

In relation to PLCs, the main revision is that they now have the option of choosing to be managed by a board of directors (art. 518) rather than by one or more managers under the 1960 Code. A PLC must still have a general manager, but where it has elected to have a board of directors, the general manager must be chosen by the board (art. 514).

Moreover, where the 1960 Code was silent about the pledging or the giving of shares of a PLC in usufruct, the NCC, explicitly permits shares of a PLC to be pledged or given in usufruct. In such a case, the right to vote at meetings is, unless otherwise agreed, exercised only by the pledgor or the person who gave it in usufruct (art. 505).

On a further note, it is now a mandatory requirement for PLCs to have an independent and impartial auditor when they are composed of ten members or more or possess a total asset value in excess of ten million Ethiopian Birr (art. 518).

## **TAKEOVERS AND SHARE TRANSFERS**

With respect to takeovers and share transfers, the NCC has introduced a number of rules specifically regarding share companies which should, in theory, open the door to further inbound M&A activity.

For instance, where a bidder is making an offer for 50% or more of the shares in a company, such bidder is required to make a tender offer to all the shareholders (art. 293).

The NCC also contains "squeeze out" and "sell out" provisions. The NCC entitles a parent company controlling more than 90% of the shares and votes of a subsidiary to purchase the remaining shares (art. 558). Likewise, if a parent company owns directly or indirectly more than 90% of the shares with voting rights in a subsidiary, the other shareholders can request their shares be purchased by the parent company (art. 562). The shareholders of a subsidiary can request in court that the parent company or another person designated by it purchase their shares.

## **INSOLVENCY**

### **Insolvency procedures**

Ethiopia's lawmakers have also overhauled the country's insolvency regime by adding a new insolvency procedure and replacing the "schemes of arrangement" and "composition" procedures in the existing legal framework by "reorganisation proceedings".

In addition to bankruptcy proceedings, creditors may now employ "preventive restructuring proceedings" or "reorganisation proceedings" (art. 588). The stated objective of preventive restructuring proceedings is to ensure that, with the unanimous consent of affected creditors, viable debtors in financial difficulties are able to contractually, at an early stage, restructure their debt and continue operating, or prepare for the sale of the business as a going concern (art. 617 and seq.).

Meanwhile, under reorganisation proceedings, the consent of a qualified majority of affected creditors is sought to either restructure the debts and operations of the debtor in a reorganisation plan or conduct the sale of the

company's business as a going concern to the benefit of its creditors (art. 635 and seq.).

Apart from the above, the NCC includes a special proceeding for small and medium enterprises. It applies to both reorganisation and bankruptcy proceedings: the "simplified proceeding" (art. 816 and seq.). It replaces the existing, yet very impractical "summary procedure" under the 1960 Code, and aims to allow the opening of simplified bankruptcy proceedings for companies which cease payments provided that: (i) the value of their assets in the balance sheet of the last twelve months is less than twenty million Ethiopian Birr, or (ii) their last twelve months' turnover is less than five million Ethiopian Birr as adjusted for inflation; or (iii) their total number of employees is less than ten.

### **Bankruptcy remoteness**

The NCC further regulates jurisdictional issues and remoteness in bankruptcy proceedings (art. 601). There were no such rules in the 1960 Code. Accordingly, each member in a group is treated as separate and, therefore, deemed independent from other member companies in the group. Consequently, extending a proceeding to other member company(ies) of a group is not possible.

### **Cross-border insolvency and jurisdiction**

Finally, in departure from the 1960 Code, which did not regulate international bankruptcy, the NCC has expressly adopted the principle of "centre of main interest test" for the adjudication of cross-border insolvency, and also provides that a judgment opening preventive restructuring proceedings, reorganisation proceedings and bankruptcy proceedings with respect to a debtor having its centre of main interest in Ethiopia shall have universal effect (art. 602). In addition, the NCC provides that Ethiopian courts have jurisdiction to open territorial proceedings if an establishment of a debtor is in Ethiopia, and in this regard, the effect of territorial proceedings of the debtor having an establishment in Ethiopia is restricted to the assets of the debtor situated in the territory of Ethiopia.

Moreover, a related concern with cross-border insolvency is the recognition and enforcement of foreign judgments in relation to bankruptcy. While the 1960 Code did not contain provisions on recognition and enforcement of foreign proceedings and insolvency related judgments, the NCC sets forth the conditions to be fulfilled for the recognition and enforcement of foreign judgment, as well as the documents a person must submit along with its application for enforcement of the proceedings in Ethiopia (art. 603).

## **CONCLUSION**

The changes introduced by the NCC bring the country's legal landscape further in line with international standards. More flexible group structures, the introduction of a degree of independence for company management and standardised M&A rules, as well as an overhaul of the insolvency regime should be of interest to foreign investors. Of course, it remains to be seen whether the changes in commercial legislation will result in the levels and types of investment the Ethiopian state is hoping to attract, but the NCC definitely goes a long way in providing some certainty to local and international businesses.

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