

**Panel Presentation-led Public Dialogue on the ongoing Revision of the Ethiopian Commercial Code and Liberalizing the Ethiopian Financial Sector:
 Panel Presentations' Summary**

Background

Ethiopia's ambition to become a middle-income economy and deliver shared and sustained prosperity is driven by the government's Ten-Year Perspective Development Plan (2021 – 2030), which supplements the existing vision for a Home-grown Economic Reform agenda.

The country, however, faces significant challenges in this path, including high inflation rates and a long-standing debt and foreign currency crisis, among others.

To alleviate these problems, a gradual process of private-sector led liberalization has begun in some sectors, including in logistics and telecommunications, marking an important shift away from the largely state-led development pursued in recent decades.

The Ethiopian financial sector is one of the sectors that is prioritized under the Government's liberalization reform program, and it is reported that the Council of Ministers has recently approved the liberalization of the sector. If the bill is passed by the House of Peoples' Representative (HoPR), Ethiopia will open its financial market to multinational financial institutions.

While allowing foreign banks to operate in the country is not detrimental in and of itself, liberalizing the sector at this point in time will certainly have consequences for local banks as well as the entire

economy. Thus, it is crucial to explore the pros and cons of liberalizing Ethiopia's financial sector and the lessons from other developing countries.

In a related development, a steering committee tasked with revising the country's commercial code in use since the 1960s E.C. is underway. So, what is the rationale of revising the code and what has been done so far and what is the way ahead?

To ensure a better understanding of the code revision process and explore the pros and cons around liberalizing the financial sector, Forum for Social Studies (FSS) organized a high-level panel-led public discussion on Thursday, April 7, 2022, at Azzeman Hotel, Addis Ababa.

The panel consisted of: (1) Ato Belayhun Yirga, Director General, at the Ministry of Justice (MoJ); (2) Dr. Eyob Tesfaye, current board member of the National Bank of Ethiopia (NBE) and with a strong background in the Ethiopian financial sector; and (3) Professor Alemayehu, a macroeconomist and senior lecturer at Addis Ababa University (AAU), who has recently completed a study on Ethiopia's banking sector.

This policy presentation is based on the presentations of the panelists and the discussion that followed. It is intended to summarize the core points raised and present policy recommendations to the government.

**PART I: Ongoing Revision Work of the Ethiopian Commercial Code of 1952
 (By Belayhun Yirga)**

1. Need for Commercial Codes-General:

Recognizing that any business entity has to interact with many individuals and entities (suppliers, loaners, buyers or those who, for some other reason, are entitled to claim payment, employees, and managers, shareholders, competing business entities, any Government bodies including the body authorized to collect taxes on behalf of the government); and realizing the need for a system that governs this

interaction with various individuals and groups, commercial codes are formulated for two general reasons/purposes:

- To ensure a legal framework in which business entities can create wealth and become profitable in the process of their dealings with multi-pronged parties.
- To ensure the necessary legal protection for legitimate and acceptable interests and rights of any party that deals with the business entities.

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2. Rationale for Revising the Ethiopian Commercial Code

Several reasons for revising the Commercial Code were identified. The primary justification for overhauling the Ethiopian Commercial Code (ECC) of 1952 E.C. is that the ECC has outlived the estimated life span given to it by its drafters. Second, commercial practice has proved that there are provisions in the ECC that are open for interpretation, difficult to implement and not compatible with current realities of the country. Third, the changes taking place in the rest of the world, especially those occurring in investor countries need to be reflected in the country's commercial code. Last is the need to be internationally competitive, to enact a law that looks 20-30 years ahead and is perceived as modern in the eyes of investors, and to sufficiently reflect development in information and communication technology.

While the aforementioned constitute the overarching justifications for the revision of the Ethiopian Commercial Code of 1952 E.C., what follows is a list of the problems that the revised version promises to solve:

- Concepts in the commercial code such as registration of business, registration of trade name, mortgage of a business and other matters were not compatible with sectoral law enacted from time to time regarding the same;
- Obsolete concepts of bookkeeping and accounting; incompatibility with financial standards enacted by another legislation five years back;
- Absence of sufficient minority interest protection preventing investors from raising capital in majority dominated companies and at the same time causing the country to score lowly in World Bank rankings and other similar institutions that compare countries on their suitability for investors, thereby limiting the country's ability to attract foreign investors;
- Gaps in the ability of investors to control their companies;
- Muteness on how private limited companies are to be liquidated in particular not addressing appointment, power and responsibilities of liquidators, the distribution of profits and losses;

- Deficiency of provisions dealing with protection of creditors and minority shareholders in transactions among related parties;

- Gaps in sections of the Code dealing with merger, division, and change of form of companies;

- Lack of clarity in the implementation of book (Bankruptcy proceedings) and in the role of various entities;

- 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;

- The absence of company forms used in other jurisdictions;

- The outdated nature of the rules in the code, preventing company management and third parties from using technology to facilitate their communication;

- The absence of sufficient provisions dealing with the rights of creditors transacting with branches of foreign companies to obtain information about such companies;

- The absence of provisions dealing with Deposit certificate, Customs Receipts, Delivery orders, etc. as negotiable instruments as is the case with other jurisdictions;

- Lack of clarity in the use of checks and other payment instruments;

- The absence of provisions dealing with investment banking and any guidance on how it works with existing banking operations;

- The absence of provisions that take into account electronic payment mechanisms, mobile banking, internet banking, which are already being implemented in the economy;

- 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;

- The lack of mechanism to enable the business to transfer its ongoing concerns to avoid bankruptcy;

- The lack of mechanism that enables companies to undertake temporary restructuring to avoid bankruptcy; and

- The 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 party.

3. Key Changes Made :

i. The Term 'Traders' Defined More Expansively:
The new version has followed the same approach as the old one in defining what constitutes 'traders'

who 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 Ethiopian Commercial Code (ECC) have been kept intact and 16 more activities have been added. The New Commercial Code (NCC) has also clearly indicated that the list is 'illustrative' rather than 'exhaustive' by using the words: "among others" or other similar activities as stated in the Amharic version of the same provision.

ii. Considering Holding Companies as Traders:

The NCC has recognized holding companies as traders, whereas the ECC had not provided much detail with regards to the definition and regulation of such companies except devoting a few provisions with regards to their accounts. 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 services but merely holds shares in other companies by injecting capital into such companies.

iii. Book-keeping Streamlined: 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.

iv. Registration and Online Register: The NCC upholds 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. Whereas the ECC assigns any disputes arising between the applicant and the official in charge of the register, the NCC makes a clear reference to the competent courts of law.

v. Change in 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. In the ECC it was regarded as a non-commercial association, which hardly exists in practice. Moreover, the NCC introduces two new business forms: the Limited Liability Partnership (LLP) and the One Person Company (OPC). The latter also acknowledges the structuring option of setting up Groups of Companies including Wholly Owned Subsidiary. A broadened definition is provided for Branch Company as well.

vi. Groups, Subsidiaries and Branches: The NCC provides a definition for a Group as consisting of a

set of companies comprising 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 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 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.

The Branch Company 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 also have its own manager, who is expected to fulfil 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; if 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.

vii. Mergers and Divisions: Unlike the ECC, the NCC has introduced definitions 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 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 are 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 light of their compatibility with the competition law regime which governs them currently.

viii. Changes Introduced 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. With respect to the PLC form, some of the changes are as follows:

- The right of members of a PLC to form a Board as a management body is clearly recognized;

- The minimum per 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.

ix. **Bankruptcy and Schemes of Arrangement**

This part of the ECC has hardly been practiced in its duration. Nonetheless, 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 are more for the future, in that they will be refined as the practice develops and the market grows. Some of the most important changes are:

- *Changes 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 Preventive Restructuring Proceedings (PRP) and Reorganization Proceedings (RP) before a business enters into Bankruptcy Proceedings (BP).

- *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.

- *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 suspicion 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 18 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 illustrating the kind of matters linked to these proceedings. The NCC also outlines the possible scenarios of proceedings where group companies are involved as well as the circumstances under which Ethiopian courts assume international jurisdiction in these proceedings. The NCC recognizes and gives effect to foreign judgments relating to PRP, RP and BP.

- *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.

4. Way Ahead:

- Developing codes for financial services
- Raising public awareness of the New Commercial Code (NCC)
- Supporting the introduction of systems

(Compiled by Abera Woldekidan, FSS Media and Communications Specialist, on the basis of video-audio recordings)