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# **Taking Security in Ethiopia**

## **A Comparative Guide for Investors**

## ABOUT THIS GUIDE

In light of Africa's sustained economic growth over the last decade, the continent has become an increasingly attractive destination for investment.

However, to a foreign investor, assessing legal risk requires an understanding of the laws and the legal system particular to the jurisdictions in which the investment is being made.

*Taking Security in Ethiopia - A Comparative Guide for Investors* provides an overview of the types of assets over which security can be taken in Ethiopia, the different types of security, as well as the related procedures for the perfection and enforcement of such security.

This Ethiopia guide forms part of a wider series focusing on the most active jurisdictions in Africa, and was prepared with the help of Ethiopian firm Signum Advocates.



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# ETHIOPIA

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## TYPES OF SECURITY INTERESTS

### What categories of assets are typically provided as security to lenders in Ugandan financings?

#### Shares

Security over shares can be taken by way of a share pledge agreement.

#### Bank Accounts

Security over the proceeds of a bank account can be taken by way of agreement between creditor and pledgor (subject to the prior approval of the account bank — which is generally a purely administrative process). The pledgor will typically transfer a sum of money equal to the value of the security interest into a blocked account.

#### Land

In general, security cannot be granted over land because there is no private ownership of land in Ethiopia. However, an investor can provide security over a leasehold land interest by way of mortgage, provided that any such mortgage in respect of urban land is limited to the extent of the lease amount already paid.

#### Contractual Rights

There is no explicit legislative provision that allows security to be taken over contractual rights in general, except for security taken over public contracts from a contractor or subcontractor approved by the administrative authorities. It is also possible that security over contractual rights can be granted by way of an assignment, unless such assignment is forbidden by law, the contract, or the very nature of the transaction. The pledgor must provide consent in order for the creditor (also in its capacity as assignee) to take possession of the asset received in pledge.

#### Insurance Proceeds

Security over a life insurance policy at surrender value can be taken by way of pledge agreement or endorsement at the back of the insurance policy.

#### Authorisations and Licenses

There is no law regarding the creation of security interests over rights arising under authorisations or licences.

#### Intellectual Property

Security can be taken over patents, copyrights and other intellectual properties by way of business mortgage. However, there is no legislation governing the ability to take security over incorporeal rights of intellectual property separated from the relevant good or tangible asset. There are no provisions for taking security over patents and copyrights in Ethiopian legislation.

#### Personal Property and Tangible Assets

Security can be taken over personal property and tangible assets.

### **Can security be taken over future assets?**

Security cannot be taken over future assets.

### **Can security be taken generally over all of a person's/entity's assets or is it necessary to take security over each individual asset, or each class of assets, separately?**

Security can be taken over all or part of a group of assets depending on the terms agreed by the parties. Pledges can be used for movable assets, and mortgages can be used for fixed assets (and may cover multiple fixed assets under a single mortgage).

### **Are there any restrictions on who can legally grant/hold a security interest?**

As a general rule, any person that has the capacity to dispose of an asset or right can grant a security interest in that asset or right. However, there are some restrictions on the issuance of security depending on the issuer and the security instrument. For example, debentures cannot be issued by individuals; companies with capital that is not fully paid; and companies that have not issued a balance sheet in respect of their first financial year. Private limited companies cannot issue transferable securities in any form. Farmers and pastoralists cannot use their land as security when taking a mortgage, subject to regional nuances.

Are security trustees or security agencies recognised under Ethiopian law? If so, do any steps need to be taken to ensure the enforceability of a security trustee's or a security agent's right in the secured property?

Although the concepts of a "security trust" or "security agency" are not expressly provided for under Ethiopian law, pursuant to the law of contracts and agency, the relevant parties are free to agree and enter into a private contract in which one or more individuals or entities are identified or nominated as security agents to hold security for lenders. Further, the parties to the security agreement can agree to allow the third-party security agent to handle possession of the pledged property.

### **What about third-party security?**

Under Ethiopian law, a person can grant security over his/her assets to secure the existing, future, or conditional obligations of a third party through agreement of suretyship, pledge, or mortgage. However, a person can secure a third party's debt by way of mortgage only in cases where he or she is entitled to dispose of the immovable asset gratuitously at the time of such mortgage agreement.

# PERFECTING SECURITY INTERESTS AND PRIORITY

## Are there any asset-specific perfection requirements?

### Bank Account

To perfect a security interest in a bank account, a notice of the security must be given to the account bank, which then provides its approval to validate the security. Moreover, the account bank can issue a letter of guarantee on behalf of the pledgor to the creditor. For example, the bank may provide a letter on behalf of the bank account holder to secure the appropriate discharge of security. The pledgor typically deposits a sum of money equal to the value of the secured amount to a blocked account, which cannot be accessed until the security is discharged. During such time, the account bank will continue to pay interest on the blocked account.

### Shares

To take security over shares, an entry should be made in the register kept at the head office of the company. The shareholders themselves (i.e., not the pledgee) must represent the pledged shares at the annual general meeting of the company.

### Contractual Rights and Life insurance

Security over any instrument bearing a contractual claim can be taken in a similar fashion to the assignment of rights by analogy in the Civil Code through a separate agreement. Life insurance must be delivered to the pledgee or the third party named in the contract of pledge if the claim or right pledged is established by such instruments.

### Land and Other Immovable Properties

Under Ethiopian law, mortgages over a lease (periodical usufruct), right of land, or any other immovable asset such as real estate must be registered at the applicable lands or immovable properties registry. There is no applicable time limit, although mortgages are only effective upon registration, and the date of registration determines the order of priority between the mortgages. Notably, the registry authorities are obliged to register the mortgage immediately when all legal formalities are satisfied.

### Personal Property

- **Pledge:** Under Ethiopian law, a pledge requires the transfer of actual or constructive possession of existing movable property.
- **Mortgage:** Any mortgage agreement should be in written form and should specify, in Ethiopian currency, the amount secured by the mortgage agreement. A special power of attorney is necessary in instances in which the agent is required to sign on the client's behalf. The registration of a mortgage is effective for 10 years from the day that the entry was made.
- **Business Mortgage:** Businesses consisting mainly of goodwill; incorporeal elements such as copyright and patents; and corporeal elements such as goods, should be registered by the appropriate federal or regional authority and given a business licence in order to be eligible for mortgage.
- Any business mortgage should be registered upon the request of an interested party by filing the two copies of the registration application form that are prepared by the registration authority. The applicant should also attach the contract and any other evidence that forms the basis of the registration request.

## What are the fees, costs, and expenses associated with creating and perfecting security in Ethiopia?

### Stamp Duty

- Stamp duty is payable on all security deeds at the rate of 1% on the value secured by the security document. The stamp duty is payable before or on the date of signing of the security deed. The debtor bears the stamp duty cost unless otherwise agreed. In exceptional circumstances, an exemption from paying stamp duty may be obtained from the Minister of Finance upon application.
- Stamp duty should also be payable on notarial acts, contracts, agreements, and memoranda thereof, at the nominal flat rate of 5 Ethiopian birr (ETB). Separately, power of attorney stamp duty is charged at the nominal flat rate of ETB35, bonds at the rate of 1%, and documents of title to properties at the rate of 2% (as applicable).
- The amount of stamp duty is calculated using an applicable average value of the stock or security at such time as the instrument is created if an instrument is chargeable with stamp duty on an ad-valorem basis in respect of any stock or of any marketable security.
- Any person executing or signing (excluding witnesses) a stamp duty chargeable document who does not pay or fraudulently seeks to avoid paying stamp duty may face criminal punishment in the form of: (i) a fine of an amount between ETB25,000 and ETB35,000; and (ii) a term of imprisonment between 10 and 15 years. Further, the security document may not be validly registered and will be deemed inadmissible in the Ethiopian courts.
- Fees for the registration of a mortgage and related services, which can be determined by the appropriate authority, are payable based on the Commercial Code.

# INSOLVENCY/BANKRUPTCY PROCEEDINGS

## Overview

Bankruptcy in Ethiopia is governed by the fifth book of the 1960 Commercial Code.

- The scope of application of the bankruptcy legal regime covers any trader as defined in Art. 5 of the Commercial Code and any commercial business organizations, excluding joint ventures. Commercial business organizations include: private limited companies, companies limited by shares, limited liability partnerships, and general partnerships.
- The insolvency of public companies differs from the insolvency of their private counterparts due to the special features of public companies. Such special features include: (i) their establishment by regulation, rather than memorandum of association; (ii) the determination of their composition by the board and special law, rather than the commercial law; and (iii) their state ownership, rather than private ownership. However, the umbrella insolvency provisions of the commercial code apply to public enterprises.
- Bankruptcy can be instituted by way of petition made by: the debtor, one or more creditors, the public prosecutor, or the court itself.
- The competent court may declare bankruptcy of a company if there is suspension of payment or if the company is no longer able to meet its commitments relating to its commercial activities. The factual declaration of bankruptcy without court judgment has no legal effect in Ethiopia.
- There is no provision for a discharge in Ethiopian bankruptcy law. A bankruptcy proceeding cannot be closed and the debtor is not restored to his or her full rights unless the debtor proves that either: (i) all the creditors who have proved claims have been paid, or (ii) the trustees have been deposited with a sufficient amount to pay all creditors.

## Are “company rescue” or reorganisation procedures available?

Yes, such procedures are available under the Commercial Code in the form of a ‘composition’ or a ‘scheme of arrangement’, but the procedures are burdensome and sometimes difficult to implement.

## Are there any entities excluded by law from bankruptcy proceedings?

Non-commercial business organizations, i.e., ordinary partnerships, are excluded from Ethiopian bankruptcy law.

## Are any governmental or other consents required in connection with an out-of-court enforcement of security?

No court, governmental, or other consents are required for enforcement of security.

## Are there any restrictions on who can enforce a security interest over assets located in, or governed by the laws of, Ethiopia?

There are no such restrictions.

## Will the commencement of insolvency proceedings against a grantor of security affect the ability of a secured party/creditor to enforce the security interests granted to it by that company?

No, a secured creditor will still be able to enforce its security. In the case of a pledge, the trustees may at any time pay for and redeem the property pledged for the benefit of the estate.



## **Are there any preference periods, claw-back rights, or preferential creditors' rights that creditors should be aware of?**

There are no preference periods. In fact, all proceedings for proving debts must be concluded no later than five months from the date of the judgement in bankruptcy. Such period may be extended by the commissioner in exceptional cases. Claw-back rights depend on the nature of the transaction and the good faith of the parties. For instance, the rights of creditors of a bankrupt party cannot be affected by the following transactions if such transactions are performed between 15 days before the date of suspension of payments (factual bankruptcy) and the date of adjudication of bankruptcy (real bankruptcy):

- Gratuitous assignments
- Payments of debts not due whether in cash or by assignment, sale, set-off, or otherwise
- Payments of debts due otherwise than in cash, by negotiable instrument, or by transfer to a bank
- Securities set up on the property of the debtor in respect of debts contracted before the setting up of such securities

Moreover, the trustees might request the invalidation and raise a claw-back right of payments made by the debtor for all acts of consideration entered into by the debtor after the date of factual bankruptcy, if the counterparties receiving payment or dealing with the debtor had prior knowledge of the factual bankruptcy.

## **Can debt a company owes a creditor be contractually subordinated to debt that company owes another creditor? Are contractual subordination provisions that are agreed among creditors legally recognised on the insolvency or bankruptcy of the company?**

No, there is no contractual subordination in Ethiopian law.

## **How is priority among secured parties determined on the insolvency of the debtor?**

After the deduction of costs, expenses, and sums applied for the support of the debtor or the debtor's family, the priority of creditors can be selected among secured parties by the decision of the commissioner when the trustee brings the list of creditors. Hence, the preference is:

- Taxes and labour-related obligations
- Prior secured creditors
- Preferred creditors
- Unsecured creditors

## FOR MORE INFORMATION

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