JIMMA UNIVERSITY

COLLEGE OF LAW AND GOVERNANCE

SCHOOL OF LAW

# RECOGNITION OF FOREIGN COMPANIES UNDER THE NEW COMMERCIAL CODE OF ETHIOPIA: ITS IMPLICATION TOWARDS ATTRACTING FDI

***A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENT OF LL.M. DEGREE IN COMMERCIAL AND INVESTMENT LAW***

**TAMRAT ARARSO**

**ADVISORS:**

**PRINCIPAL ADVISOR- YUSUF IBRAHIM (Ph. D)**

**CO- ADVISOR- W/GEBRIEL DAGNE (LL.M)**

**JANUARY, 2022**

**JIMMA, ETHIOPIA**

## Declaration

I, TAMRAT ARARSO EDEMO, hereby declare that this thesis titled "Recognition of Foreign Companies under the New Commercial Code of Ethiopia: Its Implication towards Attracting FDI" is my original work and it has never been submitted to any other institutions. I also declare that any sources and materials used in this thesis have been duly acknowledged and cited.

Name of Student – Tamrat Ararso

Signature………

Date……………

Advisors: Yusuf Ibrahim (Ph.D.)

Signature…….

Date……………

Mr. W/Gebriel Dagne (LL.M)

Signature……….

Date…………….

## Acknowledgment

I am grateful to my research advisors Yusuf Ibrahim (Ph.D.) and W/Gebriel Dagne (LL.M) for their relevant advice, feedback, and guidance that played the role in shaping this thesis. I would like to thank also all those who gave me valuable research ingredients during this study. Moreover, I am grateful to my wife Tsega Zekiwos for her continuous encouragement and support throughout the whole process of this study. In seize of this opportunity, I would like to thank Firaol Tafesse, Mekasha Kassa, and Mihiretu Yohannes for their great help. Finally, my heartfelt gratitude goes to all of my relatives, and friends who assisted me materially and/or morally.

## Acronyms

Art.- Article

ECJ- European Court of Justice

EEC- European Economic Community

EIC- Ethiopian Investment Commission

EU- European Union

FDI- Foreign Direct Investment

GDP- Gross Domestic Product

HCCH- Hague Conference on Private International Law

IPDC- Industrial Park Development Corporation

NBE- National Bank of Ethiopia

NCC- Nordic Construction Company

OECD- Organization for Economic Co-operation and Development

Para. –Paragraph

Proc. – Proclamation

PLC- Private Limited Company

TFEU- the Treaty on the Functioning of European Union

UK- United Kingdom

# Abstract

*To harvest the benefits of FDI, especially developing countries, allow companies incorporated abroad to expand their business to their jurisdiction by transferring their real seat. The manner of the allowance depends on the types of recognition rules adhered to by them. The pure version of incorporation theory enables countries to attract more foreign companies, but it could lead to regulatory competition race to the bottom. Almost no country in the world follows this theory. Thus, the doctrine remains only in theory. On the other hand, the real seat theory prevents countries from attracting foreign companies as it is inherently an obstacle to the attraction of foreign companies. The incorporation theory subject to exception, on the other hand, is a recognition rule which could able to avoid the negative effects of the two theories. Thus, this rule enables countries that adopt it to attract foreign companies and harvest their benefits while the interests of creditors, shareholders, and the general public are protected. Realizing the regulatory obstacle nature of the real seat theory, many countries of the world cease to apply it and replace it with incorporation theory subject to exception under the private international law of companies. However, though it is an obstacle to the immigration of foreign companies, Ethiopia still adheres to this theory statutorily. This legal hurdle, combined with other factors affecting the attraction of FDI, has prevented foreign companies from migrating to Ethiopia. Despite Ethiopia seeking to attract FDI to harvest its benefits and facilitate its economic development in particular and becoming a middle-income country in general by 2030, it adopts the real seat theory under the Commercial Code, which discourages the immigration of companies incorporated abroad. After examining the legal and practical problems of foreign companies recognition rules and the legislative text of EU as a regional arrangement and some jurisdictions through mixed (doctrinal and empirical) research types, this study recommends concerned bodies to reconsider the Private International law of companies for recognition of foreign companies under the New Commercial Code of Ethiopia.*

**Key words:** Commercial Code of Ethiopia, Recognition rule, connecting factor, foreign companies, legal personality, applicable law

# Contents


Declaration ..... i

Acknowledgment ..... ii

Acronyms ..... iii

Abstract ..... iv

CHAPTER ONE ..... 8

1. INTRODUCTION ..... 8

1.1. Background of the Study ..... 8

1.2. Statement of the Problem ..... 14

1.3. Objectives of the Study ..... 16

1.3.1. General Objective ..... 16

1.4. Research Questions ..... 17

1.5. Significant of the Study ..... 18

1.7. Limitation of the Study ..... 19

1.8. Research Methodology and Methods ..... 19

1.8.1. Research Type and Design ..... 19

1.8.2. Sources of Data ..... 20

1.8.3. Sampling Methods ..... 21

1.8.3.1. Sampling Area ..... 21

1.8.3.2. Sampling Techniques and Sample Size ..... 21

2. Recognition of Foreign Companies and Real Seat Theory as a Regulatory Obstacle for the Attraction of FDI ..... 23

2.1. Introduction ..... 23

2.2. Theories of Recognition under Private International Law of Companies ..... 23

2.2.1.1. Justifications of the Real Seat Theory ..... 25

2.2.1.2. Disadvantages of the Real Seat Theory ..... 28

2.2.2. The Incorporation Theory ..... 29

2.2.2.1.1. The Pure Version of Incorporation Theory ..... 30

2.2.2.1.2. The Incorporation Theory Subject to Exception ..... 31

2.2.2.2. Recognition of the Law Applicable to the Internal Affairs of the Foreign Company ..... 32

2.2.2.2.2. Incorporation Theory Subject to Exception ..... 32

2.2.2.3. Justifications for the Applying/Adhering of the Incorporation Theory ..... 33

2.2.2.4. Advantages of Incorporation Theory ..... 34
2.2.2.5. Disadvantages of Incorporation Theory ..... 35
2.2. Real Seat Theory as a Regulatory Obstacle for the Attraction of FDI ..... 39
2.3. Incorporation Theory Subject to Exception for Recognition of Foreign Companies: Its Contribution for the Attraction of FDI ..... 39
CHAPTER THREE ..... 42
3. Incorporation Theory Subject to Exception for Recognition of Foreign Companies: Legal Frameworks and Experiences from Some Notable Jurisdictions ..... 42
3.1. Introduction ..... 42
3.2. Justifications for Selection ..... 42
3.4. Regional Legal Frameworks on Recognition of Foreign Companies ..... 44
3.4.1. European Union ..... 44
3.4.1.1. The Treaty on the Functioning of the European Union (TFEU) ..... 44
3.4.1.2. The EEC Convention on the Mutual Recognition of Companies of 1968 ..... 46
3.4.1.3. Jurisprudence of the ECJ on Recognition of Foreign Companies ..... 46
3.4.1.3.1. The Centros Case ..... 47
3.4.1.3.3. The Inspire Art Case ..... 50
3.5. Recognition of Foreign Companies: Experiences from Some Notable Jurisdictions ..... 52
3.5.1. India ..... 52
3.5.2. Philippine ..... 55
3.5.3. Belgium ..... 57
CHAPTER FOUR ..... 58
4. Real Seat Theory as a Regulatory Obstacle for the Attraction of FDI in Ethiopian Foreign Companies' Recognition Rule and Incorporation Theory Subject to Exception ..... 58
4.1. Introduction ..... 58
4.2. The Real Seat Theory as a Regulatory Obstacle in Ethiopian Foreign Companies Recognition Rule ..... 59
4.3. Real Seat Theory Recognition Rule under the New Commercial Code of Ethiopia ..... 60
4.3.1. Rules on Recognition of Legal personality ..... 61
4.3.1.1. Obligations under the Commercial Code Provisions ..... 62
4.3.1.1.1. Reincorporation in Ethiopia ..... 62
4.3.1.2. Obligations Imposed by other Laws ..... 63
4.3.1.2.1. Obligation Imposed by Investment Proclamation ..... 63

4.3.1.2.1.1. Fulfilling Minimum Capital Requirement ..... 63
4.3.2. Rules on Recognition of the Law Applicable for the Internal Affairs ..... 64
4.3.2.1. Duty to Fulfill Rules Obliging to Record the Decision of the General Meeting of Shareholders in the Commercial Register ..... 65
4.3.2.2. Duty to Respect Provisions of Share Company Relating to the Responsibility of Directors 66
4.3.3. Protection of Public Laws Enacted to Protect the Public Interest ..... 66
4.4. The Practice of Ethiopian Investment Commission in Recognition of Foreign Companies ..... 68
4.4.1. Recognition of Legal Personality ..... 68
4.4.2. Recognition of the Law Applicable for the Internal Affairs of the Foreign Companies ..... 69
4.4.3. Protection of Public Laws Enacted to Protect the Public Interest ..... 71
4.5. Is Companies Incorporated Abroad Recognized under New Investment Proclamation? ..... 71
4.6. Real Seat Theory as a Regulatory Obstacle for the Attraction of FDI in Ethiopian Foreign Companies' Recognition Rule ..... 74
4.7. Incorporation Theory Subject to Exception for Recognition of Foreign Companies under the New Commercial Code of Ethiopia ..... 75
4.7.1. Is It Necessary to Adopt Incorporation Theory Subject to Exception Currently? ..... 75
4.7.2. Insight of Partakers as to the Adoption of Incorporation Theory Subject to Exception ..... 77
4.7.3. The Adoption of Incorporation Theory Subject to Exception for Recognition of Foreign Companies under the New Commercial Code of Ethiopia ..... 78
5. FINDINGS, CONCLUSION, AND RECOMMENDATIONS ..... 79
5.1. Findings ..... 79
5.2. Conclusion ..... 81
5.3. Recommendations ..... 83
BIBLIOGRAPHY ..... 87

# CHAPTER ONE

## 1. INTRODUCTION

### 1.1. Background of the Study

Foreign Direct Investment (hereinafter FDI), plays a fundamental role in the process of advancing the economic development of host countries, especially for developing nations. Economic development is a broad concept that encompasses the process of improving the well-being of the population which is generally termed as human development and increasing Gross Domestic Product (GDP) per capita of a particular country[1]. It is about transforming the lives of the people and the structure of the economies of the country by introducing mechanized and updated technologies[2].

However, host countries to reap the benefits of FDI should adopt the recognition rule which grants recognition for the legal personality and the law applicable to the internal affairs[3] of companies incorporated abroad and seek to establish a business in their jurisdiction by their Private International Law of companies in a manner that the interests of their citizens (creditors and shareholders) and the general public are protected. Countries adopt this type of recognition rule to protect the interests (profitability and competitiveness) of such companies to attract and make them invest in their jurisdiction and to reap their advantages to advance their economic development.

---

[1] Daphne T. Greenwood & Richard P.F Holt, Local Development in the 21st Century: Quality of Life and Sustainability (2010) at p.13.

[2] Nabil Md. Dabour, The Role of Foreign Direct Investment (FDI) in Development and Growth in OIC Member Countries, 21 (3) Journal of Economic Cooperation, 27 (2000) at p.27-28.

[3] Law applicable to the internal affairs (lex Societatis) is a law which regulates all statutory issues of a company: foundation-setting up, validity, functioning/ structure and the end- winding up/liquidation. Usually it is not applicable to tort responsibility and insolvency proceedings.

For this research, the notion of recognition refers to the way[4] how countries determine the nationality and the law applicable for the internal affairs of companies incorporated abroad and seeks to operate business activities in their jurisdiction by transferring their real seat[5].

This depends on the connecting factors[6] they have used. It is known that the manner by which the rules adopted for recognition can able to make the host state and the foreign company harvest the benefits of foreign investment by providing guarantees to their respective competing interests[7]. For the host states, it can able to protect its citizens who engage in business transactions with the foreign companies, open a door to apply its Company law provisions to regulate the internal affairs to protect its citizens who acquire shares in the foreign company, and protects the interest of the general public by obliging foreign companies to respect the host state's public laws. For the foreign companies, on the other hand, it allows them to retain their legal personality and to apply the home state's Company law to regulate their internal affairs by granting recognition. In doing this, it saves foreign companies from dissolution in the home state and pay huge tax because of such dissolution and liquidation, and incurring organizational cost in the host state because of reincorporation. Moreover, it also allows founders of the foreign companies to choose the place of incorporation which have lax Company law (party autonomy). As international jurisprudence discloses, this approach of recognition of foreign companies has been applied by less industrialized economies that are at the stage of transformation to the age of industry[8].

Generally, depending on the connecting factor they have used, countries of the world adhere to two theories with regard to granting recognition for the legal personality and the law applicable

---

[4] If countries have used the registered office as a connecting factor to determine the nationality of companies, then the legal personality and the law applicable to the internal affairs of companies incorporated abroad are recognized in those jurisdictions. On the other hand, if countries have used the real seat as a connecting factor to determine the nationality of companies, then the legal personality and the law applicable to the internal affairs of companies incorporated abroad are denied.

[5] CARSTEN GERNER-BEUERLE, *Infra Note* 11 at p. 3. The term real set refers to the place where the central management decisions are being implemented on a day-to day basis. It is also called as administrative seat or head office

[6] A connecting factor is a legal term developed by Private International Law of Companies in order to determine which one of the competing national laws would be applicable to a certain legal situation. It directs to the applicable law of a national legal order with which a certain entity has the closest connection.

[7] For example, see the discussion on Chapter Two, Section 2.2.2.1.2., and Section 2.2.2.2.2. below, about how recognition is granted.

[8] Dagmar Coester-Waltjen, German Conflict Rules and the Multinational Enterprise 6 (197) GA. J. INTR'L & COMP. L., 1976, at p. 210-211

to the internal affairs of companies incorporated abroad and seek to immigrate into their jurisdiction to operate business activities by transferring their real seats. These are the real seat theory and the incorporation theory[9]. However, though this is the main division, note that many jurisdictions today adopt one of these theories with certain specific distinctions which eventually make such private international law regulation in every jurisdiction unique[10]. The real seat theory uses the real seat (head office or principal place of business) as a connecting factor to determine the nationality and the law applicable to the internal affairs of companies[11]. Therefore, according to this theory, the legal personality and the law applicable for the internal affairs of companies incorporated abroad who seek to operate business activities in a particular country that adheres to the real seat theory by transferring their real seat cannot be recognized[12]. As the Company law of the host state directs to its own set of substantive company law rules because of the connecting factors it has used, the company should reincorporate following the Company law of the host state. The reincorporation results in the foreign company losing the legal personality that it has acquired in the home state and makes it acquire a new legal personality by the company law of the host state[13]. The reincorporation also results in the Company law provisions of the home state being denied and the host state's Company law to be applied to govern the internal affairs of such companies[14].

Therefore, the use of the real seat as a connecting factor to determine the nationality of immigrating companies by this theory results in the legal personality of companies duly formed in the home country being denied by the host state. In its stricter form, the theory imposes other requirements (for example, fulfillment of minimum capital requirement) and obliged those companies incorporated abroad in the form other than the forms of business organizations recognized by a particular host state, to be dissolved in their home state and reincorporate in the

[9] Carsten G. Beurle, Federico M, Edmund S. and Mathias S., Final Report of the European Commission: Study on the Law Applicable to the Company, Luxembourg: Publication Office of the European Union, 2016 at p. 13

[10] Massimo Benedettelli, Five Lay Commandments for the EU Private International Law of Companies', 17 Yearbook of Private International Law 209 (2015/16) at p. 217-8

[11] CARSTEN GERNER-BEUERLE, JR., ET AL., MAKING THE CASE FOR A ROME V REGULATION ON THE LAW APPLICABLE TO COMPANIES, (ECGI WORKING PAPER SERIES IN LAW, 549/2020, OCT 2020), at p. 3 Available http://ssrn.com/abstract_id=3720574 and https://ecgi.global/content/working-papers. (Accessed on September 15, 2021)

[12] Sinisa Petrovic Jr. & Tomislav Jaksik, Right of Establishment and Corporate Mobility- An outline of Issues, 636 (2011) at p. 643

[13] *Id.*

[14] *Id.*, at p. 641

host state in accordance with only the forms of business organizations recognized in the host country. Furthermore, the doctrine asserts that only the laws of the state in which the companies have established their real seat should regulate the internal affairs. Thus, the Company law of the home state is also not recognized according to this theory.

The incorporation theory, on the other hand, uses only the place of incorporation (registered office) as a connecting factor to determine the nationality and the law applicable to the internal affairs of companies incorporated abroad and seeks to operate business activities into a particular jurisdiction[15]. Therefore according to this theory, the legal personality and the law applicable to the internal affairs of companies incorporated abroad who seek to operate business activities in a particular country that adheres to the incorporation theory (host state) by transferring their real seats are recognized[16].

Hence, once companies have duly formed by satisfying the formation requirements in their state of incorporation, the host state grants recognition for the legal personality and the Company Law of the home state as a law applicable for the internal affairs of the companies' without reincorporation and imposing additional obligation by the host country. Therefore, the legal personality and the law applicable to regulate their internal affairs are recognized in the host state's jurisdiction. But the application of this doctrine in its pure form does not take into consideration the impact of recognition on the interest of nationals of the host state who will engage in business dealing with the company or those who acquire shares in the foreign company[17]. As a result, it attracts FDI at the expense of the interests of citizens of the host state which is not a preferable approach.

Despite the increasing role of foreign companies in the host state's economic development, the real seat theory denies recognition for the legal personality and the law applicable for the internal affairs of such companies. Foreign companies, who need to invest in a country that adheres to the real seat theory, are required to be dissolved in their home state and reincorporated in the host

[15] Marc V. De Looverbosch, Real Seat Theory v. Incorporation Theory: The Belgian Case for Reform, Int'l Company & Common L Rev, 2016, at p. 3
[16] *Id.*
[17] Sinisa Petrovic Jr. & Tomislav Jaksik, Supra Note 12 at p. 641. See also the discussion on Chapter 2, Section 2.2.2.1.1., and Section 2.2.2.2.1. below.

state[18]. While the dissolution of their existing legal personality exposes them to pay huge taxes for the home country the reincorporation exposes them to incur expenses for new establishment in the host state[19]. Furthermore, denying recognition for the foreign law affects their right to choose lax company law that reduces organizational costs (party autonomy). As these reduce their profitability and competitiveness at the international level, they are discouraged to invest in such countries[20]. Thus, denying recognition limits the role of foreign companies in the process of advancing the host states economic development. In other words, in reaping the benefits of international investment denying recognition for the legal personality and the law applicable for the internal affairs of such companies becomes a problem.

To overcome the problem of denial of recognition for the legal personality and the law applicable for the internal affairs of foreign companies, international legal instruments such as the 1956 Hague Conference on PIL (but not entered into force), regional instruments such as the TFEU, Case laws of ECJ and jurisdictions across the world such as India, Philippines, and Belgium have applied the incorporation theory subject to exception.

India adheres to the incorporation theory subject to the exception after it has amended its Companies Act in 2013. Philippine adheres to the incorporation theory subject to exception after it has revised its Corporation Code in 2019. But many member states of the European Union adhere to the real seat theory at the beginning shift to the incorporation theory subject to exception very recently, by subjecting themselves to the TFEU and the Case-law of the ECJ. The incorporation theory subject to exception allows the legal personality to be recognized by the host state when the foreign companies disclose their status to the host state's nationals who engage in business dealing with the foregin companies, and the applicable law unless protection of host state's nationals who acquires shares in the foreign companies requires denying recognition for the home state's Company Law and applying the host state's Company law.
At the international level, there is no multilateral agreement that governs the issue of recognition of foreign companies. Due to this reason, the concept recognition of foreign companies is

[18] Christiana HJI Panayi, Corporate Mobility in Private International Law: Debunking Some Myths (Legal Studies Research Paper No. 26/09.Queen Mary University of London, 2009) at p. 11.
[19] *Id.,* at p. 12
[20] *Id.*

governed at the national level by domestic Private International law of companies or courts of foreign association[21].

Currently, many European continental countries[22] who deny recognition for the legal personality and the law applicable to the internal affairs of companies incorporated abroad in the past now have started to grant recognition. But Ethiopia still adheres statutorily to the stricter form of the real seat theory and denies recognition for the legal personality and the law applicable for the internal affairs of companies incorporated abroad. This position of Ethiopia discourages foreign companies from coming and investing in its territory. This will deprive Ethiopia of all the benefits of foreign investment. For example, it loses foreign currency earnings from foreign investment, unable to transfer modern technologies and skills. It also loses other benefits, such as the job opportunities created by foreign companies. These are among the key objectives that Investment Proclamation has sought to achieve[23].

As of this, many countries[24] of the world realize the problem of the application of the real seat doctrine and shift towards the application of the incorporation doctrine subject to exception to relieve the problem; but, the private international law rules for recognition of foreign companies under the New Commercial Code of Ethiopia are still unchanged[25]. In the existing status quo, the legal personality and the law applicable for the internal affairs of companies incorporated abroad are not recognized under the New Commercial Code of Ethiopia.

Because of that, companies incorporated abroad are forced to be dissolved the legal personality that they have acquired in the home state and reincorporate in Ethiopia. Furthermore, these companies are required to govern their internal affairs only in accordance with the Commercial Code provisions and other private laws which the code requires to be applied for them (for example, investment proclamation No. 1180/2020)[26]. This is why the New Commercial Code on Title Eleven Chapter Two has not yet revised book two of the old commercial code in which

---

[21] Eric Stein, Conflict of Laws Rules by Treaty: Recognition of Companies in a Regional Market, 68(7) MICH. L. REV. 1327 (1970), at p.1330.

[22]The Netherlands, France and Germany who adhere to the real seat theory in the past have already shifted to adhere to the incorporation theory subject to exception.

[23] See Ethiopian Investment Proclamation No. 1180/2020 Art 5 (2&3)

[24] Recently, Belgium has also begun to adhere to the incorporation theory subject exception since 2019. See New Code of Companies and Associations: From Real Set Theory to Incorporation Theory. Available at https://www.eubelius.com/sites/default/files/09_corporate_mobility.pdf (accessed on September 15, 2021).

[25] THE NEW COMMERCIAL CODE OF ETHIOPIA, Proclamation No.1243/2020 (herein after referred to as 'THE NEW COMMERCIAL CODE'), Art. 584 and 586

[26] Foreign Companies who seek to establish business activities in Ethiopia are required to fulfill the minimum capitalization rule. See Investment Proclamation, *Supra Note* 23 Art. 9(1-3).

recognition of the legal personality and the law applicable for the internal affairs of foreign companies is governed. Thus, this unrevised part of Title Eleven Chapter Two of the New Commercial Code creates legal challenges for companies incorporated abroad and discourages them to come and invest in Ethiopia. This can make Ethiopia unable to harvest the benefits of FDI that can contribute to the whole economic transformation of the country in particular and become a lower-middle-income country in general by 2030[27].

## 1.2. Statement of the Problem

The real seat theory assures that determination of the existence of the legal personality and the law applicable for the internal affairs of companies incorporated abroad must be regulated by the law of the place of the real seat[28]. In other words, the theory allows the host state to oblige the foreign companies to be reincorporated following its Company law provisions and acquire new legal personality, and use only its Company law rules for the regulation of their internal affairs.

When we look at the New Commercial Code of Ethiopia which incorporates the stricter form of the real seat doctrine under Art 584 obliges those business organizations incorporated abroad or sole proprietorship established outside Ethiopia who has established business in Ethiopia by transferring their real seat should be subject to the Commercial Code provisions and other laws of Ethiopia. Subjecting the foreign companies to the Commercial Code provisions and other laws of Ethiopia can have the following several consequences;

First, denying recognition for the legal personality the companies have acquired in their home state. As a result, the companies lose their legal personality, are unable to sue and be sued in Ethiopian courts, and cannot operate any juridical act including business activities in the country. However, if the companies prefer to operate a business in Ethiopia, they should be dissolved in their home state and reincorporate and acquire a new legal personality in Ethiopia. The dissolution in the home state and the reincorporation in Ethiopia (as a host state) make them to pay huge taxes because of liquidation/winding up and organizational cost because of restructuring respectively. The effect does not end there. The article clearly states that in addition to the provisions of the Commercial Code, foreign companies must comply with the provisions

[27] In September 2015 Ethiopia has adopted the 2030 Agenda for Sustainable Development and Sustainable Development Goals (SDGs). According to this policy brief, Ethiopia has a prospect of becoming lower-middle income country by 2030.

[28] Carsten Garner, Supra Note 11

of other laws. In this regard, the Investment Proclamation[29] is one of the most important laws that provide requirements for recognizing the legal personality of foreign companies. Thus, to be recognized as a legal person in Ethiopia, they must also meet the minimum capital requirement which discourages business significantly[30].

Second, denying recognition for the Company law of the home state where the companies have incorporated as a law applicable for their internal affairs. This affects the interest of the founders of the companies to choose a law favorable to their business.

Furthermore, the Code once again enshrined the worst requirement of the real seat doctrine under Art. 586. According to this provision, firms/business organizations incorporated abroad with different forms than recognized under Art. 174 of the Commercial Code are under a duty to respect the provisions of the Commercial Code concerning share companies (i.e., the foreign company should fulfill/respect the rules on entry into the commercial register of resolutions of the general meeting of shareholders and rules that regulate the responsibility of directors). This could be seen as evidence that the Code prohibits founders of foreign companies to choose and establish a suitable form of organization for their business activities[31]. Hence, this could be seen as a discouraging factor for entities who want to come and invest in Ethiopia with different forms of an establishment[32].

Thus, the real seat doctrine adopted under the New Commercial Code can be considered as a legal obstacle and harms the interest of foreign companies for the following major reasons. First, the measures taken by the theory for the protection of Ethiopian nationals who could be creditors of the foreign companies are not proportional, not the subject of Company Law[33], and unjustified. Second, deny the founders' right to party autonomy by applying only the Commercial Code provisions as a law applicable for the internal affairs of the foreign companies justifying shareholders protection despite no Ethiopian nationals have acquired a substantial

[29] Investment Proclamation, Supra Note 23
[30] Id., Art. 9 (1-3)
[31] Government regulation and control is one among the important factors that founders take in to consideration when they select the form of business organization for their intended activities. For example, founders may choose partnership rather than share company because more heavily legal obligations are embodied under provisions that regulate share companies than partnerships.
[32] For example, business organization established as cooperative societies or economic interest group. Cooperative societies though they are not profit oriented, sometimes they may engage in profit making activities.
[33] The issue of creditors' protection is not the subject of Company law rather it is governed by Insolvency law.

amount of shares in the foreign companies that establish branches in Ethiopia. Third, deny recognition for both the legal personality and the applicable law justifying protection of public interest despite the issue being out of the domain of the law applicable for the internal affairs of companies.

All these discourage foreign companies to invest in Ethiopia and will make Ethiopia unable to harvest the benefits of FDI. Therefore, the Ethiopian Commercial Code adopts the real seat doctrine for recognition of foreign companies without taking into account its discouraging nature for attraction of FDI simply justifying protection of the interest of creditors, shareholders, and the general public for the adherence of such theory. But economic development also strongly justifies recognition of foreign companies.

Thus, as a matter of principle, to adopt a good rule on recognition of foreign companies, issues such as the level of industrialization of a particular country, the level of economic development, its desire to attract FDI, the proportionality of the measures taken to protect the interests of the host state's nationals who could be creditors of the foreign company, and the percentage of shares held by host state's nationals in the foreign companies should be determined clearly. Proper determination of these issues helps the host state to have a recognition rule that can attract FDI without leaving the interest of its citizens who are creditors and shareholders in the companies to be exposed to risks caused by the lack of information about the companies' status and by the application of foreign law for the internal affairs respectively. However, the manner of incorporation of the provisions for recognition of foreign companies under the New Commercial Code in determining these issues to have proper rules of recognition is questionable.

## 1.3. Objectives of the Study

### 1.3.1. General Objective

The general objective of the study would be to examine the impact of the rules on the recognition of foreign companies under the New Commercial Code of Ethiopia for the attraction of FDI.

### 1.3.2. Specific Objectives

1. To explore the impact of foreign companies' recognition rules under the New Commercial Code of Ethiopia for the attraction of FDI.

2. To assess proper rules for recognition of the legal personality of companies incorporated abroad to formulate the Commercial Code provisions in a way that able to protect the interest of the companies and Ethiopian nationals who engage in business dealing with foreign companies.

3. To investigate the legal challenges that foreign companies who have a different form than the forms recognized under the Commercial Code have faced when they come to operate a business in Ethiopia.

4. To examine the practice of EIC about granting recognition to foreign companies

5. To assess foreign companies currently invest in Ethiopia, if any, that Ethiopian citizens have acquired shares that could justify the application of Commercial Code provisions for regulating their internal affairs of such companies rather than the foreign law.

6. To investigate whether violations of laws enacted to protect the public interest justify denial of recognition for the legal personality and the law applicable for the internal affairs of the foreign companies.

7. To examine whether it is proper Ethiopia's adherence to the real seat theory in its current economic status.

## 1.4. Research Questions

1. How the rules for the recognition of foreign companies under the New Commercial Code of Ethiopia can be an obstacle for the attraction of FDI?

2. Is the rules for recognition of the legal personality of companies incorporated abroad under the New Commercial Code of Ethiopia has formulated in a way that can protect the interest of the companies and Ethiopian citizens who engage in business dealing with such companies?

3. What are the legal challenges that would be faced by foreign companies who have a different form than the forms recognized under the Commercial Code when they come to operate a business in Ethiopia?

4. How does the EIC practically grant recognition to foreign companies?

5. Are there foreign companies that currently invest in Ethiopia that Ethiopian nationals have acquired shares?

   a. If yes? How much percentage out of the total stocks do they own?

b. Does the amount they own justify denial of recognition of the Company Law of the home state and apply the Commercial Code provisions to regulate the internal affairs of the companies to protect their interest?

6. Do violations of public laws (tax law, labor law, etc.) by foreign companies justify denial of recognition for the legal personality and applicable law?

7. Is it proper for Ethiopia's adherence to the real seat theory for recognition of foreign companies at the current level of economic development?

## 1.5. Significant of the Study

The study is aimed at analyzing the rule on recognition of foreign companies under the New Commercial Code of Ethiopia and its implication for the attraction of FDI. Hence, it aids academics and future studies because there is not much published on the topic. It also intensifies scholarly debate as to where Ethiopia's standing position should be between the two extreme theories (incorporation and real seat) from the viewpoint of its current economic development level and the desire to attract FDI. Second, it enables foreign companies that their legal personality to be recognized in Ethiopia and to have a right to legal standing in Ethiopian courts (to sue and be suede), and to exercise the right to party autonomy. Third, it helps Ethiopia in having a recognition rule with a good level of legal certainty and cost-effective to immigrating companies in particular and business-friendly in general. Fourth, it could provide a clear legislative guide to EIC on how to grant recognition to foreign companies. Furthermore, it could avoid confusion on workers and legal expertise of the institution as to whether the foreign companies' recognition rule is in the Commercial Code? Or the Investment Proclamation?

It also helps the lawmakers to formulate a good recognition rule that allows foreign companies to transfer their real seat to Ethiopia without incurring costs due to dissolution in the home state and reorganization in Ethiopia while the interests of Ethiopian nationals who deal with the foreign companies and acquire a substantial amount of shares in the foreign companies, and the interests of the general public are protected. In other words, it will contribute for the lawmakers in time of amending the private international law part of the New Commercial Code of Ethiopia to avoid the legal obstacles of the real seat theory to attract FDI and make Ethiopia one of the leading FDI destinations in Africa. In doing so, the thesis will have a contribution to the better inflow of FDI and faster the economic growth rate of Ethiopia to bring the whole economic development of the

country, improve the social and economic life of Ethiopian people, and attain the vision of becoming a middle-income country in the year 2030. Finally, this work will have a contribution to improving the rules of recognition of foreign companies by conveying where exactly the obstacles of recognition of foreign companies are. Thus, it may serve as a source for the government and stakeholders to figure out possible solutions to the problem that will be pointed out in the research.

## 1.6. Scope of the Study

This study will focus on foreign companies that have come to invest in Ethiopia, for their possibility to have fewer impediments for their establishment in the future and to enhance their contribution to the country's economic development. This study is only limited to rules that govern the recognition of foreign companies under the New Commercial Code of Ethiopia, and policies for attracting FDI and the country's economic development. Delimitation for this study is also foreign companies that operate a business in Ethiopia by transferring their real seat rather than the registered office.

## 1.7. Limitation of the Study

Since this thesis discusses the recognition of foreign companies under the New Commercial Code of Ethiopia and its implications towards attracting FDI, there will be a shortage of available literature written on this subject matter by investigating Ethiopian laws in general and the Commercial Code provisions governing recognition of foreign companies and their effects on attracting FDI in particular.

Regarding rules governing the recognition of foreign companies, no literature has been written until now. Once again, the issue of recognition of foreign companies is little known and experienced in Ethiopia, there is hardly any work available on the subject matter

## 1.8. Research Methodology and Methods

### 1.8.1. Research Type and Design

Taking into account the research questions and the objective of the study, the method that better enables the researcher to answer these questions and achieve the desired goal is a mixed (doctrinal and empirical) type of research method.

Doctrinal research type was employed to make legal analysis and provide an in-depth understanding of the specific issue of the study, and thereby broaden the knowledge on the Private International Law of Companies under the New Commercial Code of Ethiopia concerning granting recognition for companies incorporated abroad and seek to expand their business to Ethiopia by transferring head office or principal place of business. More, the using of some fact-based opinions as to whether Ethiopian nationals were acquired shares in the foreign companies that currently operate in Ethiopia and, some objective and subjective opinions of key informants as to whether the current economic development level is the right time for Ethiopia to adhere real seat theory ground_ making the research empirical type.

As far as the research design is concerned, the research is inherently descriptive as it mainly focuses on describing the meaning of recognition rules to analyze the recognition rule adopted under the New Commercial Code of Ethiopia. Again, it is normative as it offers concrete lines of reforming the laws to avoid regulatory obstacles and making the country ease for doing business and able to attract FDI. The trend of some notable jurisdictions was seen to draw some sort of lessons to Ethiopia. Though the selected countries differ from Ethiopia based on the legal system and level of economic development, all of them seek to attract FDI like Ethiopia. Furthermore, India and the Philippines are selected because they have a well-crafted recognition rule. As many civil law countries themselves such as the Netherland, Germany, and Belgium take a lesson from common law jurisdiction, Ethiopia has also followed the same trend though the legal system of the selected countries differs from Ethiopia. In addition to the countries' experience, an attempt has been made to discuss the experience of the European Union as a regional law. The TFEU as primary legislation and the case-law of the ECJ as secondary legislation is discussed mainly for the reason that the major recurring themes in the real seat theory are more elaborated by these laws. Furthermore, the Convention of 1 June of 1956 of the Hague Conference on Private International Law is taken as an international legal framework. Though the convention is left at a draft level, it has influenced the Private International Law of many countries and has got the status of international customary law.

### 1.8.2. Sources of Data

Primary and secondary sources of data were used in the research to make quality analyses. Primary sources include legislative instruments (domestic legislations, regional and international

instruments). Furthermore, data from the interviews, books, journal articles, cases, and the internet were also used as secondary sources.

## 1.8.3. Sampling Methods

### 1.8.3.1. Sampling Area

In Ethiopia, the authority for granting work permits to foreign companies is vested in the EIC. As such, the Commission is selected as a major data-gathering area. Although licensed companies operate in different parts of the country, most of them operate in industrial parks. In Ethiopia, there are 13 industrial parks. Thus, to gather data that shows the role of foreign companies in the economic development of the country, the researcher purposively select one industrial park established in Jimma town. The researcher deliberately selected Jimma Industrial Park Development Corporation only taking into account the time, resources, distance of other parks, and considering the availability of sufficient information from the Commission about the benefits of foreign companies in the remaining twelve industrial parks. As part of the study, how recognition is practically granted by the commission and whether Ethiopian nationals hold shares in the foreign companies operating in parks across the country is examined.

### 1.8.3.2. Sampling Techniques and Sample Size

In this study concerning the interview, the researcher employed the purposive sampling technique. The purposive sampling technique is typically used in qualitative research, involving the identification and selection of individuals that are proficient and well informed with the matter under the study.

As far as the sample size is concerned, three (3) key informants from the EIC and one (1) from the Jimma Industrial Park Development Corporation (IPDC) were selected. Thus, the sample size is four (4) persons. Among the informants, three are found in Addis Ababa while one is found in Jimma town.

## 1.8.4. Tools of Data Collection

In collecting data from primary and secondary sources, the researcher engaged in a desk-based review. Furthermore, the researcher has collected data through the interview which helps to gather in-depth information. A semi-structured interview was employed to collect data from respondents. This was because owing to nature to address key themes than specific questions, a

semi-structured interview was the most effective method of collecting data from respondents; gave the researcher certain flexibilities to respond to answers from the informants.

### 1.8.5. Methods of Data Interpretation and Analysis

The data is analyzed and interpreted using the qualitative method. This is because the qualitative method is the best method to analyze data obtained through desk-based reviewing of primary and secondary sources and data obtained through semi-structured interviews.

### 1.8.6. Ethical Considerations

The research took into account ethical considerations. The respondents for the interview were approached only after being informed of their free, full, and informed consent. Also, the respondents were informed that any information taken from them would solely use for the study. Furthermore, proper citation and referencing were made for any information obtained from any source.

## 1.9. Organization of the Study

The thesis will be organized into five chapters. The first part will be the background of the study, statement of the problem, objectives of the study, research questions, significance, and scope of the study, methodology, and limitations of the study.

Under chapter two, the two major doctrines on recognition of foreign companies, the incorporation and the real seat theory, their justification, advantages and disadvantages, and their implications towards attracting FDI are discussed. Furthermore, the incorporation theory subject to exception which is practically implemented by many counties is also assessed.

In the third Chapter, some international and regional legal frameworks of recognition of companies and the legal frameworks and experiences of some notable jurisdictions which adopt the incorporation theory subject to exception are discussed.

Under the fourth Chapter, the rule on recognition of foreign companies under the New Commercial Code of Ethiopia and its implication for the attraction of FDI will be assessed in detail both from the legal and practical point of view. Finally, the last part of the paper includes the conclusion and recommendations as a result of the assessment and findings of the research.

# CHAPTER TWO

## 2. Recognition of Foreign Companies and Real Seat Theory as a Regulatory Obstacle for the Attraction of FDI

### 2.1. Introduction

The role of FDI for the economic development of countries has increased from time to time. Due to this, states, especially developing ones, seek to attract FDI to promote their economic development. In particular, they need it for transforming financial resources, new management techniques and, new technology and innovation[34]. Furthermore, they seek it for the creation of jobs and for the assistance of the productive capacity of local firms to help their effort of accessing a new international market[35]. To harvest, these advantages of FDI countries have adopted a recognition rule for companies who have incorporated abroad but seek to expand the business operation into their jurisdiction by establishing a head office or principal place of business. Thus, under this chapter, the two important theories of recognition of foreign companies, their respective advantages, and disadvantages, mechanisms implemented to avoid the disadvantages of incorporation theory, and legal obstacles associated with real seat theory for the attraction of FDI will be discussed.

### 2.2. Theories of Recognition under Private International Law of Companies

Depending on the connecting factors they have used as a criterion to grant recognition for immigrating foreign companies to the host state's jurisdiction, there are two important conflicts of laws theories: the incorporation theory and the real seat theory[36]. In what follows, I will discuss these theories in detail.

---

[34] The OECD, Policy Brief on the Social Impact of FDI, (2008), Available at https://www.oecd.org/els/emp/The-Social-Impact-of-foreign-direct-investment.pdf, (Accessed on September 11, 2021)

[35] *Id.*

[36] Though the main division of recognition rule is between incorporation and real seat theory, this division cannot represent all of the peculiarities of national regimes. This is because, since the rules for recognition of foreign companies are enshrined under the Private International Law of Companies which is established only at national level, countries may adopt divergent rules for issues arise regarding recognition of foreign companies. See also Massimo Benedettelli, *Supra Note* 10. See also Paschaladis Paschalidis, *Infra Note 45*, at p. 53-58.

### 2.2.1. The Real Seat Theory

This theory connects a company to the law of the state in which the company has its real seat to grant recognition for the legal personality and the law applicable to the internal affairs of the foreign company[37]. Thus, according to this theory, the legal personality of a company that is incorporated and dully formed in another state could not be recognized in the real seat host state. Rather under this theory, the existence and dissolution (legal personality) and other internal affairs of the foreign company are determined by the law of the real seat host state. The major negative consequence of this theory is that the real seat host state denies the legal personality of a company that is formed in another state but which have their effective management and control or principal place of business in their jurisdiction. As a result, such companies lack the legal personality and capacity that they acquire in the country of origin.

Thus, to operate a business in such countries, the foreign companies need to reincorporate in the host state jurisdiction if not they lose their limited liability status and members of the company may be personally liable for the debts of the company[38]. In addition to this, they will be prohibited from engaging in business activities.

The reincorporation results in, inter alia;

1) Incurring organizational costs; foreign companies which appear to establish a business in the real seat host state are required to file for registration. The registration results in re-creating a new legal personality in the host state by denying the identity the company has acquired abroad, in the country of incorporation. This re-structuring of the company demands additional expenses because the existed legal personality was already denied to operate juridical acts including business activities[39].

2) In many cases when registration takes place, in addition to creating a new identity, the foreign association is forced to change its form to only the form recognized by the host state when the form of the business association is different from the forms specified in the host state company

---

[37] See: https://europa.eu/epso/doc/en_lawyling.pdf (Accessed on September 16, 2021). The real seat theory is one of the two conflicts of laws theories currently in use in the area of recognition of the legal personality and the law applicable to its internal affairs of foreign companies. See also Werner F. Ebke, The "Real Seat" Doctrine in the Conflict of Corporate Laws, 36 (3) INT'L LAW 1015 (2002) at p. 1015

[38] *Id*, Werner F. Ebke, at p. 1025

[39] Dagmar, *Supra Note* 8, at p. 200

law[40]. In other words, when the corresponding forms of business organization of a foreign business association are absent in the host state's Company Law, the foreign company is forced to change its form only to the forms recognized under the host state Company laws. But the required business form will not be preferred by the shareholders (founders) of the company. This is because the business structure of a particular company has a direct relationship with the business activity intended to be performed, the capacity of the founders, and other related factors.

3) Transfer of central administration or principal place of business to the real seat state always presupposes the transfer of registered office together[41]. When the foreign company does the same accordingly, the home state has required the company to be dissolved and liquidated before transferring its registered office to the host state jurisdiction. The dissolution may require the company to pay huge taxes in its home state[42].

4) As fulfilling the obligation of reincorporation, the foreign company may be obliged to allocate the minimum capital required for foreign investors.

Under this theory, in addition to denying the legal personality, the law of the country where the company has been incorporated is also denied[43]. Thus, only the state in which the company has its real seat has the power to regulate the company's internal affairs. In other words, the corporate problems of a foreign company are treated by the law of the place of the real seat.

#### 2.2.1.1. Justifications of the Real Seat Theory

The followings are some of the rationales forwarded by the proponents of the real seat theory and some of the civil law countries that adhere to the doctrine.

1)The theory is premised on the assumption that the real seat State is usually the State that is most strongly affected by the activities of the company and should, therefore, have the power to

[40] *Id.*
[41] Christiana Panayi HJI, *Supra Note* 18, at p. 16
[42] *Id.,* at p. 13
[43] Ebke, *Supra Note* 37

govern its internal affairs[44]. In other words, it is based on the idea that the real seat host state has the power to regulate all the activities carried out in its territory.
However, it is necessary to consider that this argument of the real seat theory is not true. The theory reaches on this wrong assumption because it commits a logical fallacy of hasty generalization. This is because the theory fails to differentiate the situations when activities of foreign companies will affect the interest of the host state that necessitates the application of its law. For example, to protect the problems that happened on the external affairs of the foreign company with the host state's government would not necessitate the host state to apply its laws for the internal affairs of the foreign company.

2) The second major justification forwarded by the proponents of the real seat theory is that this rule prevents fraud on or abuse of the law by letter box companies[45].

But this justification did not last long in prohibiting letterbox companies to operate a business outside the country of incorporation. First, despite the strong reaction of other French courts, the court of Lille allows for the first time letterbox companies to operate a business in France.

Accordingly, the right of letterbox companies to operate a business outside their home country is clearly articulated in the West Canadian Case[46], wherein the court states that:

> "The needs of commerce and part autonomy allowed businessmen to incorporate the company whatsoever, provided that the establishment of the company is serious and not fictitious…"

Second, fraud or abuse of law may be committed by letterbox companies. These companies will commit an abuse of public laws such as labor law, tax law, and media law. Violation of these laws is out of the domain of matters of internal affairs of the company[47]. Hence, the solution for

---

[44] Robert R. Drury, The Regulation and Recognition of Foreign Corporations: Responses to the "Delaware Syndrome", Cambridge Law Journal 1 (1998) at p. 7. Available at https://www.jstor.org/stable/4508425 (Accessed on September 25, 2021).
[45] PASCHALADIS PASCHALIDIS, FREEDOM OF ESTABLISHMENT AND PRIVATE INTERNATIONAL LAW FOR CORPORATIONS (Oxford University Press in Private International Law Series), 2012, at p. 60. The real seat doctrine itself was first adopted by French courts at the end of the 19th Century to prevent the use of English letterbox companies by French businessmen.
[46] Trib civ Lille (1) 21 May 1908, Vanverts c West c West Canadian Collieries Ltd (1909) 36 JDI 191,194. As Cited by Id, at p. 430. This Decision is parallel with the decision of Centros. See *infra Note*, 121. Here Letterbox companies are companies incorporated in a particular country but operate all its business outside that country.
[47] Paschaladis, Supra Note 45, at p. 179

resolving the problems created by engaging in arrangements that can result in violation of such public laws is subjecting such foreign companies to the respective violated laws. Therefore, instead of doing this, applying the host state's company law for the internal affairs of the foreign company cannot be a solution for preventing fraud or abuse of law. In other words, arrangements of letterbox companies are said to constitute abuse if and only if it violates the public law provision rather than private law provision, in this case, company law provisions that govern internal affairs of the company[48].

3) It prevents creditors of the company[49]; companies may be incorporated in a jurisdiction that has a lax company law regime. For example, a foreign company may be incorporated outside the country where the principal place of business is located to escape from minimum capital requirements[50] of the host country and this will affect creditors of the company who are nationals of the host state[51]. This argument is not true for several reasons:

First, minimum capital requirements would not provide real protection to creditors[52]. This is because minimum capital requirements are not of a size appropriate to ensure creditors' protection. As such they have generated few benefits for creditors. It is hard to see how small sums of money that companies maintain initially are enough to protect creditors, especially when a company can incur liabilities that amount to millions.

Second, creditors are protected by insolvency law[53]. The second and broad argument is that creditors are not protected by company law. Creditors are mainly protected by insolvency law.

Third, it is not proportional to justify creditors' protection for the minimum capital requirement[54]. Thus, to protect creditors, it is enough to impose an obligation on the foreign company to reincorporate in the host state to provide information about its status, i.e.as it is a foreign company and governed by foreign law. Thus, once nationals of the host state are aware that the company is governed by foreign law, he/she takes the risk if they enter into any

---

[48] Id. Also see Centros infra note, 121. In this case the ECJ has decided that the fact that Centros incorporated in England for the mere and explicit purpose of evading the Danish provision on minimum capital requirements was not though to constitute an abuse.

[49] HJI Panayi, *Supra Note* 18.

[50] Minimum capital requirements are funds that a company must preserve as a minimum requirement in order to ensure that the company has enough assets to pay its creditors in the event of insolvency or financial instability

[51] See Centros case *Infra Note*, 121

[52] Paschaladis, *Supra Note* 45, at p. 185

[53] Thomas Bachner, Creditor Protection through Insolvency Law in England, 2006, 431

[54] C-55/94 Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procurator di Milano [1995] ECRI- 04165

contractual agreement[55]. This is because nobody is obliged to enter into a contract with a foreign company. Therefore, measures taken beyond this will be considered as not proportional and will not be allowed.

4) Furthermore, incorporating in a jurisdiction that has lenient company law regimes will affect the interest of nationals of the host country who participate as shareholders in the foreign company.

This argument is true if and only if the host states citizens participate as a shareholder in the foreign company. Therefore, the host state should apply its own company law rules for the internal affairs of the foreign company based on the preconditions that to what extent its citizens have acquired shares in a particular foreign company[56].

5) The last justification forwarded by the proponents of the real seat theory is that as companies have an intimate connection with the economic, political, social, and cultural life of the state of the real seat, its company law should govern the internal affairs of the foreign company[57]. For example, the offices are located in that state, the shareholders meet there, most of the managers, shareholders, and creditors also live in the host country[58].

However, this argument does not work in today's business environment. In this era, due to technological advancement shareholders' meetings can be conducted online, they don't want any kind of physical presence to the whole shareholders meeting at the place of the real seat[59]. Shareholders of a foreign company come from different origins and they live in countries independent of the country where the company has its central management and control or principal place of business[60].

### 2.2.1.2. Disadvantages of the Real Seat Theory

**Legal uncertainty;** in the current globalized business world, companies may be decentralized and operate in more than one jurisdiction[61]. Therefore, it is often difficult to determine the

---

[55] GERNE-BEUERLE, ET AL., THE ILLUSION OF MOTION: CORPORATE (IM) MOBILITY AND THE FAILED PROMISE OF CENTROS, 426 (2019) at p. 431. See also Centros *Infra Note*, 121 Paragraph 36

[56] For example, see Indian Companies Act, Infra Note 140

[57] Dagmar, *Supra Note* 8, at p. 206

[58] *Id.*

[59] Anatoli van der Krans, The Virtual Shareholders Meeting: How to make it Work?, 2(1) Journal of International Commercial Law and Technology 32, 2007, at p. 32

[60] *Id.*

[61] HJI Panayi, *Supra Note* 18, at p. 3.

location of the company's real seat and even impossible if the company has two headquarters[62]. This produces, at the very least uncertainty about the applicable law.

**An obstacle for cross-border transfer of companies' seats;** the host state's non-recognition of foreign companies which transfer their center of administration or principal place of business to its jurisdiction is thought to be a draconian sanction of the real seat theory[63]. This is because a real seat State will not allow a company duly formed in another State to transfer its actual center of administration or principal place of business to it (i.e. to immigrate) without dissolution in the home State and reincorporation in the host State[64]. If not they lose their limited liability status[65]. The totality of problems above also can be considered as an obstacle. Hence, does not meet the requirements of international trade.

### 2.2.2. The Incorporation Theory

Contrary to the real seat theory, this theory connects a company to the law of the jurisdiction in which the company has been incorporated[66]. But as the Conflict of laws rules on recognition of companies will still be a part of the respective statutory system and will thus remain subject to change by national lawmakers, there are slight variations to this theory within jurisdictions[67].

Below, I will discuss how the legal personality and the law applicable to the internal affairs of foreign companies will be recognized under the two major versions of the incorporation theory.

---

[62] Dagmar, *Supra Note* 8, at p. 207

[63] HJI Panayi, *Supra Note* 18, at p. 10

[64] *Id.*, at p. 16

[65] *Id.,* at p. 10

[66] GOWER-DAVIES, PRINCIPLES OF MODERN COMPANY LAW (6th Ed. 1997), at 14 Also see EDDY WYMEERSCH, THE TRANSFER OF THE COMPANY'S SEAT IN EUROPEAN COMPANY LAW, EUROPEAN CORPORATE GOVERNANCE INSTITUTE WORKING PAPER SERIES IN LAW NO. 08 (2003), at p. 8 Available at: http://ssrn.com/abstract=384802 and www.ecgi.org/wp. (Accessed on September 13, 2021)

[67] Carsten Gerner, *Supra Note* 11. Note that: the difference mentioned here is on granting recognition for the law applicable to the internal affairs of the foreign company. But with regard to granting recognition for the legal personality of foreign companies most countries including countries which are pioneers and have adhered this theory for a long period of time such as UK and Netherlands put the pre-condition of reincorporation in the host state jurisdictions for the purpose of providing information for the host country citizens who deal with these foreign companies. But unlike in the case of real seat theory the reincorporation here does not result in recreating the new legal personality of the foreign company. For example, see the discussion on Chapter Three Section 3.5.

### 2.2.2.1. Recognition of the Legal personality of Foreign Companies

With regard to granting recognition for the legal personality of a foreign company, incorporation doctrine can be classified into two: pure version of incorporation theory and incorporation theory subject to exceptions[68].

#### 2.2.2.1.1. The Pure Version of Incorporation Theory

The basic aspect of this form of incorporation doctrine is that it has used the place of incorporation as a connecting factor *without putting the requirement of reincorporation to grant recognition for the legal personality of a foreign company*[69]. It dictates that once a company has duly formed by satisfying the formation requirements in its state of incorporation, then it is recognized in the host state jurisdiction[70]. Therefore, under this version, the existence and dissolution of a company (its legal personality) are determined by the law of the state of incorporation. The immediate result of this rule is that incorporation host states accept companies that are formed in other states but which have their effective management and control or principal place of business in their jurisdiction[71]. Thus, the legal capacity and legal personality of such companies are recognized without any need for reincorporation. However, in reality, the theory is more academic than practical in terms of its applicability for granting recognition for the legal personality of foreign companies. This is because many countries that adhere to the incorporation theory, even the UK and the Netherlands which are often referred to as classic incorporation theory countries, put the pre-conditions of reincorporation when they grant recognition for the legal personality of foreign companies that immigrate to their jurisdiction by transferring either their actual center of administration or principal place of business[72].

---

[68] Here the only requirement or pre-condition to classify incorporation theory as a pure form and as a clearly provided exception is the 'requirement of reincorporation' which unlike the real seat theory it does not result in losing in the legal personality of a foreign company which the company has been acquired in the state of incorporation and creating new legal personality according to the Company law of the host state jurisdiction.

[69] HJI Panayi, *Supra Note* 18, at p. 7. Here, the concept of reincorporation refers to registration in the host sate's jurisdiction for the purpose of providing information about the foreign status of the company for the citizens of host country who will deal with that company.

[70] Gijs Fibbe, EC Law Aspects of Hybrid Entities (Doctoral Series), (2009) at, p. 22.

[71] *Id.* at, p. 21.

[72] See the discussion of Recognition of the legal personality of Foreign Companies in Section 2.2.2.1.2., below

#### 2.2.2.1.2. The Incorporation Theory Subject to Exception

Like the pure version of incorporation theory, this version of incorporation theory has used place of incorporation as a connecting factor to grant recognition for the legal personality of foreign companies. However, contrary to the above version of incorporation theory, incorporation theory subject to exception is a form of recognition rule which states that the legal personality of a foreign company can be recognized in the host state if and only if the company is reincorporated in the host state jurisdiction[73]. Protection of persons dealing with such foreign companies carrying on business in the host state jurisdiction is one of the frequent conditions that justify the reincorporation of the foreign company to grant recognition in the host country[74]. Thus, such foreign companies with a significant presence through a branch office or a principal place of business have to register in the company registry and are under certain reporting obligations to ensure minimum information is provided to persons dealing with them[75]. But the reincorporation required does not result in re-creating the legal personality acquired in the country of incorporation. Today, in many European countries, recognition of foreign companies is obtained ipso jure; i.e., without the need for any further steps such as filing for registration, paying of fees, or applying for a decree. But it will be reincorporated only to disclose itself for persons dealing with it[76].

For example, in the UK and Netherlands, non-incorporated companies with significant presence through a place of business or a branch are required for reincorporation[77]. However, reincorporation does not re-create the company; it merely subjects it to some legal obligations in the UK and Netherlands. Moreover, in Germany, to be recognized, it is not necessary that the type of foreign companies be under German law or be similar to corresponding German institutions[78]. Thus, the business trust of American law, therefore, will be recognized in Germany, although there is no corresponding institution known under German law.

---

[73] Carsten Gerner, *Supra Note* 11 at p. 428
[74] *Id,* at p. 429
[75] *Id.*
[76] Dagmar, *Supra Note* 8, at p. 199
[77] HJI Panayi, *Supra Note* 18
[78] Dagmar, *Supra Note* 8. See also Werner F. Ebeke, *Supra Note* 37, at p. 1022

#### 2.2.2.2. Recognition of the Law Applicable to the Internal Affairs of the Foreign Company

Like the classification in granting recognition for the legal personality of the foreign company, incorporation doctrine once again classified into the pure version of incorporation theory and incorporation theory subject to exception concerning granting recognition for the law applicable for the internal affairs of the foreign company. Both versions will be discussed in detail as follows.

##### 2.2.2.2.1. The Pure Version of Incorporation Theory

In addition to legal personality, the pure form of incorporation theory also grants recognition for the law of the country where the company has been incorporated as a law that governs other internal affairs of the company (lex societatis) without leaving any exceptional circumstances for the application of the host state's Company law[79]. Thus, if a company that has been validly incorporated under the law of a foreign country seeks to transfer its administrative office or principal place of business to the host state jurisdiction which adheres to the purest form of incorporation theory, this theory suggests the host state recognize the company as a legal entity governed exclusively by foreign corporate law without imposing aspects of its internal corporate law on that company[80]. In other words, the corporate problems of such foreign companies are treated only by the law of the place of incorporation. This is irrespective of any activity, minimal or substantial, persuaded in the home state. Hence, according to this version, founders of the company are allowed to cherry-pick jurisdictions that have rules most suitable for their business need (lax company law)[81] and other countries are prohibited from putting any limit on the applicability of such foreign law[82]. However, in this form, the incorporation theory cannot be found in any jurisdiction.

##### 2.2.2.2.2. Incorporation Theory Subject to Exception

As stated above, the pure version of incorporation theory which grants recognition for the foreign law without putting any exceptional circumstances where the host states Company law

---

[79] Gerner-Beuerle, ET AL., *Supra Note* 55

[80] *Id.*

[81] In choosing jurisdictions that have lax Company law, founders of the companies take in to consideration issues such as minimum capital requirement, directors' liability and employee participation. For example, founders of the company may choose a jurisdiction that its Company law exempts managers from liability for breaching their fiduciary duty or that did not protect minority shareholders.

[82] GERNER-BEUERLE, ET AL., *Supra Note* 55 at, p. 427

could be applied to regulate the internal affairs of the foreign company has not been adopted by any jurisdiction. This is because all jurisdictions apply certain aspects of their internal corporate law to foreign companies to protect their citizens who participate as shareholders in the foreign companies[83]. In other words, though this version of incorporation theory allows founders of the foreign company to incorporate their company under the company law of a jurisdiction that they have preferred, it also permits host states to apply their Company law provisions when protecting their citizens who acquire shares in the foreign companies justifies such application[84]. Therefore, according to this version of incorporation theory, the application of host states company law for the internal affairs of the foreign company is allowed if and only if a substantial amount of shares of a particular foreign company are acquired by the citizens of the host country, if not, the host state regulate the internal affairs of such foreign company by the Company Law of the home state.

#### 2.2.2.3. Justifications for the Applying/Adhering of the Incorporation Theory

Different justifications have been forwarded by different countries for adherence to the incorporation doctrine. Among the common justifications include inter alia;

**(a) Having an interest in a liberal approach to trade;** this doctrine has originated from trading nations keen to adopt a liberal open approach, with the freedom to trade and to do business very much in mind[85]. For example, until 30 April 2019 Belgium had adhered to the real seat theory. However, by the reformed New Code of Companies and Associations which has entered into force since 1 May 2019, it has discontinued its real seat approach and adopted the incorporation approach instead[86]. One of the major justifications that Belgium has adopted the incorporation theory is that this theory best corresponds to the needs of modern business[87].

**(b) Being less industrialized countries;** different states in the USA have strict laws before they become industrialized nations. These smaller and sparsely industrialized states had begun the application of incorporation doctrine to enact laws very favorable to the founders of a foreign

---

[83] *Id*., at p. 428

[84] The Indian Companies Act., *Infra Note,* 137

[85] Robert R. Drury, *Supra Note* 44 at p. 182

[86] In Belgium the New Code of Companies and Associations which entered in to force since May 1 2019 has change over from the Real Seat theory to Incorporation Theory., Available athttps://www.eubelius.com/sites/default/files/09_corporate_mobility.pdf (Accessed on September 20, 2021).

[87] See https://corporatefinancelab.org/2017/02/21/real-seat-theory-vs-incorporation-theory-the-belgian-case-for-reform/ (Accessed on September 20, 2021)

company[88]. The risk they took by this was small because it was unlikely that there would be much business or many creditors or shareholders within their states[89]. Thus, they gained taxes and fees without the fear of a possible disadvantageous impact on their entire economic system.

### 2.2.2.4. Advantages of Incorporation Theory

Both the aforementioned versions of incorporation theory will provide the following advantages for both the immigrating foreign companies and the host country.

**(1) Certainty;** currently, with the advent of globalization, the business activities of MNCs have increased globally. However, these MNCs faced challenges from the host states concerning the recognition of their legal personality and the law applicable to their internal affairs. This is because many countries use other conflict rules or connecting factors to regulate the issues of recognition. The use of connecting factors other than the place of incorporation makes foreign companies uncertain to what extent they are recognized and which county law governs their internal affairs[90]. Thus, in this regard, it is argued that the incorporation doctrine provides certainty and maximum uniformity in the choice of law[91]. This is because it is easy and clear to ascertain the state of incorporation. Each forum concerned with the legal personality and applicable law will arrive at the same result. The incorporation theory, therefore, promotes the idea of simplicity, predictability, and legal certainty[92]. This is because the decisive factor for recognizing a company that of incorporation is objectively verified.

**(2) Practicability;** furthermore, it has been stressed that this rule enables the corporation to move its seat freely without legal consequences[93]. In other words, the cross-border transfer of a company's actual center of administration or principal place of business does not lead to loss of legal identity and legal capacity. Rather foreign companies are recognized and their internal organizations are respected. Thus, this theory guarantees great practicability which is a necessary condition in international commerce (investment)[94].

---

[88] Dagmar, *Supra Note* 8, at p. 210
[89] *Id.*
[90] *Id.,* at p. 207
[91] *Id.,* at p. 204.
[92] STEPHAN RAMMELOO, CORPORATIONS IN PRIVATE INTERNATIONAL LAW: A EUROPEAN PERSPECTIVE (Oxford University Press in Private International Law Series), (2001) at p. 17
[93] Dagmar, *Supra Note* 8, at p. 205
[94] *Id.*

**(3) Party Autonomy;** it is argued that only the incorporation doctrine gives due respect to the principle of party autonomy in corporate matters, by enabling the founders to choose the state of incorporation[95]. In other words, this theory effectively allows the founders of the company to choose the most appropriate (usually less restrictive) company law regime. Once this choice is made, it is maintained throughout the company's life, irrespective of where its actual activities take place.

**(4) Liberal Recognition Practice;** the liberal recognition practice which is facilitated by this rule is another point that the representatives of this theory emphasize because this is said to be a desirable contribution to international economic relations[96].

**(5) Facilitate the inflow of Foreign Direct Investment;** last but not least, a considerable advantage of the incorporation theory is that it has promoted the economic development of the countries that have adopted it. The Netherlands is a good example of civilian jurisdictions that adopted the incorporation theory to encourage foreign investment[97].

## 2.2.2.5. Disadvantages of Incorporation Theory

### A) Incorporation Theory could be a Cause for abuse of host state's public law[98] by Creating Letterbox Companies[99]

Despite its enormous advantages mentioned above, however, it is argued that the incorporation theory facilitates abuse through the creation of letterbox companies[100]. As a principle, letterbox companies are legal if they are duly formed in a particular country, and as such have a right that their legal personality and the company law of their home state be recognized. *Their nature of*

---

[95] *Id.* See also Stephan Rammeloo, *Supra Note* 92

[96] *Id.*

[97] Paschaladis Paschalidis, *Supra Note* 45 at p. 60. See also Marc Van, *Supra Note* 15, at p. 5.

[98] Tax law, Labor Law and Media Law are some among the host state's public law that frequently abused by letterbox Companies. Note that: Not every evasion of any provisions of national law suffices to constitute an abuse. It should be ensured that only provisions that are aimed at safeguarding an interest pertaining directly to the state itself, as in the tax, media or employment cases, can qualify for consideration under the abuse doctrine. Minimum capital requirements and other corporate rules that have a purely internal effect, not affecting the state or the general public, should by themselves not qualify for consideration under the doctrine of abuse.

[99] Letterbox Companies also named as Pseudo-Foreign Corporations, Mailbox Companies, Brass-Plate Companies, Shell Companies or Pro forma-Companies. This notion has no clear definition. The reason probably is that the task of providing such definition is rather difficult. There is a great deal of distance between a mere letterbox and the real seat. It is not clear where one should draw the line. This is why national courts, the ECJ and other EU institutions have failed to provide a definition for the term in question. However, though the term lacks clear definition, it is possible to reasonably conclude that any company that just maintains a registered office, which is nothing more than a postal address, is unquestionably a letterbox company. Thus, any corporate presence in a jurisdiction that does not actually pursue a real economic activity should be classified as a letterbox company.

[100] Stephan Rammeloo, *Supra Note* 92

*being a letterbox by itself does not constitute abuse to preclude them from exercising such right*[101]. Consequently, host states where actual activities of the company take place, are under an obligation to recognize the legal personality they have to acquire in their home state and the company law of the home state as the law applicable to their internal affairs.

While this is the principle, sometimes letterbox companies may be designed purposefully to circumvent legal obligation that results in affecting the interest of the host state. In doing so, they will violate some legislations which are enacted to regulate the activities of such companies to protect the interest of the host state. For example, consider the decision of ECJ on the TV10 case[102]. TV10 was a case in which a public limited company had been incorporated in Luxembourg to avoid Dutch rules on broadcasting that applied to Dutch broadcasting companies. Thus, the doctrine of abuse is an approach developed for tackling the abuse of letterbox companies in such circumstances[103]. When letterbox companies in a particular business sector are arranged as such, the government of the host state could rely on the doctrine of abuse to justify the characterization of such letterbox company as one of the companies engaged in circumvention of its public law. In such a case, the host state's government can oblige them to respect the violated law by applying the doctrine of abuse. This reveals that the abused statutes are out of the domain of the company law regime[104]. As a result, the host state can apply the real seat rather than the place of incorporation as a connecting factor to determine the law applicable to the created abuse. Accordingly, the host state can apply its domestic law for that particular abuse. As the issue (the abuse) is completely different from the company law issue, it could allow the host state to grant recognition for the legal personality and the applicable foreign company law while applying its domestic law for the regulation of the created abuse. Thus, adopting the doctrine of abuse helps the host state to reap the advantages of incorporation theory by tackling the challenges (abuse of host state's public law) created by letterbox companies.

**B) Incorporation Theory could be a Cause to Regulatory Competition Race to the Bottom**

[101] See the decision of the ECJ on Centros Case, *Infra Note* 121

[102] Case C-23/93 TV10 [1994] ECR I-4796

[103] Id. In this case the ECJ found that the Dutch government could rely on the abuse doctrine to justify the characterization of TV10 as a Dutch broadcasting company for the purpose of subjecting it to the statute the provision of radio and television programs, the Mediawet.

[104] Paschaladis Paschalidis, *Supra Note* 45 at p. 179-180

The second disadvantage of the incorporation doctrine forwarded by the opponents of this doctrine is that adopting this doctrine will result in regulatory competition which could lead to a race to the bottom[105]. The concept race to the bottom refers to a competitive situation where a state attempts to relax regulatory measures by undercutting competition's price by scarifying a quality standard[106]. In the context of recognition theories, the concept will arise in two circumstances. First, when a host state adopts a recognition rule which allows the legal personality of companies incorporated abroad to be recognized in its jurisdiction without reincorporation and makes the host state's citizens who are creditors of the company to be affected, especially if there is a lack of information relating to the law applicable to the company incorporated abroad[107]. Second, if the host state's recognition rule accepts the law of the country where the company has incorporated as applicable law for the internal affairs of a company without leaving any room for applying its own company law rules in the case when its citizens participate as shareholders in the foreign company[108]. The regulatory completion here presupposes the acquisition of a certain percentage of shares of the foreign companies by the citizens of the host state.

Therefore, if the host state adopts a recognition rule which enables it to attract FDI and expand its international relation or any advantages that can be brought by incorporation doctrine, by scarifying the benefits of its citizens who are creditors of the company and citizens who have acquired shares in the company, that recognition theory can be regarded as a theory that can result in a regulatory competition that could lead to the race to the bottom[109]. Thus, as these are the basic aspect of a pure version of incorporation theory, it could be concluded that this version of incorporation doctrine can result in a regulatory competition that could lead to a race to the bottom.

However, the question that should be answered here is that what will be the effect of regulatory competition that has resulted from the second version of incorporation doctrine, incorporation theory subject to exception?

---

[105] HJI Panayi, *Supra Note* 18

[106] Available at https://jeanmonnetprogram.org/archive/papers/01/012701-03.html (Accessed on September 26, 2021).

[107] See the Discussion on Section 2.2.2.1.1. above

[108] See the Discussion on 2.2.2.2.1. above

[109] This conclusion is reached from the Cumulative discussion of Section 2.2.2.1.1., and Section 2.2.2.2.1. above

As stated in the above sections,[110] incorporation theory subject to exception enables host states to put limits in granting recognition for both the legal personality and the applicable law of the foreign company to protect citizens of the host country who participate as creditors and shareholders respectively. In other words, it does not try to achieve its objectives of attracting FDI or other advantages of incorporation doctrine at the expense of the interests of its citizens who participate as creditors and shareholders in the foreign company. Therefore, this version of the incorporation doctrine cannot result in regulatory completion which could lead to a race to the bottom. Rather it enables the host state to achieve two major goals.

First, it permits the host state to bring foreign companies to its territory and achieve the economic development goals that it seeks through FDI. This is because as frequently stated above, this version of incorporation theory allows inter alia;

a) Founders of the company to choose better organizational form which is suitable to their business need. This is because apart from obliging to reincorporate[111], the host state does not force to change its structure (form) to either of the forms of business organizations recognized under the host state's Company law. Thus, this theory makes foreign companies arrive at the host state jurisdiction with different forms which will expand the business activities of the host country.

b) For legal arbitrage, a legal technique whereby founders of the company have used to select for the statutory seat which enables them to avoid direct and indirect costs during the establishment of the company which enables firms to minimize the legal cost of doing business. As a whole, all these simplify the cross-border mobility of companies and enhance the profitability, geographical flexibility, and competitiveness of foreign companies at the international level.

Second, in addition to attracting foreign companies who are the main drivers of FDI, this theory also enables the host state to protect its citizens who are creditors and shareholders of a foreign company. This is because the rule leaves room for the host state to apply its own company law rules.

[110] See the discussions made under section 2.2.2.1.2., and section 2.2.2.2.2., above cumulatively.

[111] Reincorporation here does not resulting in losing of the company's legal personality that it acquire in the country of incorporation and creating new legal personality in accordance with host states company law.

## 2.2. Real Seat Theory as a Regulatory Obstacle for the Attraction of FDI

As discussed in Section 2.2.1. above, according to the real seat theory, the legal personality and the law applicable for the internal affairs of the foreign companies are not recognized. Therefore, if companies seek to operate business activities by transferring their real seats to a particular country (host state), they should be reincorporated following that state's company law.

As the reincorporation presupposes dissolution of its legal personality in the home state jurisdiction, all these can expose the company to incur costs such as paying off huge tax for the home state due to its dissolution and liquidation and also organizational cost in the host state. Furthermore, in countries that adhere to the stringent form of this theory, they will be forced to change their form and structured as only the form of business organizations recognized under the Company law of that particular host state jurisdiction, and also required to fulfill minimum capitalization rules.

With regard to the lex societatis, since it is prescribed that only the company law of the host state regulates the internal affairs of the company, the founders' right to choose lax company law which serves their interest (party autonomy) could not be respected. Thus, the real seat theory which contains all these draconian requirements will discourage foreign companies not coming and investing in a particular country that adopts this form of recognition rule. Accordingly, it could be an obstacle to the inflow of FDI in that particular country.

## 2.3. Incorporation Theory Subject to Exception for Recognition of Foreign Companies: Its Contribution for the Attraction of FDI

As mentioned in Section 2.2.1.1. above, the real seat theory denies recognition for the legal personality and the law applicable for the internal affairs of the foreign companies justifying: first protection of the interest of citizens of the host state (creditors) who deal business transactions with the foreign company without knowing that the company is a foreign origin. Second, to protect the interest of citizens of the host state who acquire shares in the foreign company, and thirdly, to protect the interest of the host state (the public interest). If these are the reasons for the adherence of the real seat theory, valid questions that will be arise are: first, what if the foreign company has disclosed its status as it was a foreign company to the citizens of the host state who will deal business transaction with it?, second, what if it is affirmed that obliging the foreign company to change its form only to either of the types of business organizations

recognized under the host state's company law has no any purpose?, third, what if it is affirmed that minimum capital requirement is minimal to protect the interest of creditors in particular and creditors protection is governed by Insolvency law and it is beyond the scope of company law in general?, Fourth, what if the host state's citizens did not acquire shares at all or have acquired only a minimal percentage of shares that advantage of recognition overweight protection of such shareholders?, and fifth, what if protection of the public interest of the host state by subjecting the company to laws that are enacted to protect such interests is out of the scope of laws applicable for the internal affairs of the foreign company and cannot be justified for denying recognition of the foreign company?

All the issues raised above demonstrates that the real seat theory denies the legal personality of the foreign company, forced to change its form only to the forms of business organizations recognized under the host states Company law and impose minimum capitalization rule for unjustified and unnecessary reasons. Furthermore, it denies recognition for the foreign company law (home state law) and allows the application of the host state Company law for the internal affairs of the foreign company without the existence of the purpose it seeks to achieve.

On the other hand, when we consider the pure version of incorporation theory, discussed in Section 2.2.2.1.1. and Section 2.2.2.2.1. above respectively, adopting this version of incorporation theory could result in regulatory competition race to the bottom. This will open a door that citizens of the host state who engage in business dealing without knowing that the company has a foreign status, and citizens of the host state who acquire a substantial amount of shares in the foreign company would be affected.

Therefore, to avoid the negative effects of both doctrines and to be able to attract FDI while the interest of the creditors, shareholders, and the general public have protected, it is advisable to adopt the incorporation theory subject to exception. Concluding this is the right approach of recognition, it is important to answer the question of what proportional obligation should be imposed on the foreign company to protect the interest of the host state's citizens who engage in business dealing with the foreign company? how much percent out of the total shares of the foreign company be acquired by the host state's citizens? What if the adoption of this version of incorporation theory opens a door for the creation of letterbox companies? How it could prevent the violation of public laws from companies formed by such kinds of arrangements? To answer these questions it is important to differentiate the two categories of recognition of foreign

companies: recognition of legal personality and recognition of the law applicable for the internal affairs of the foreign companies.

A) **Recognition of Legal Personality**

When recognition is granted for the legal personality of companies incorporated abroad, it is possible to protect the interest of the host state's citizens by imposing an obligation of disclosure on the foreign company. This means that when the foreign companies immigrate to a particular jurisdiction, the company should disclose its status that it is a foreign company for citizens of the host state who could engage in business dealing with it. As this way protects the interest of creditors without denying the legal personality of foreign companies, it enables to attract foreign companies while at the same time protecting the interest of its citizens who engage in business dealing with the foreign company. Thus, any additional measures such as reincorporation, changing the form of legal personality, and imposing minimum capital requirements are not necessary.

**B) Recognition for the Law Applicable for the Internal Affairs of the Foreign Companies**

When recognition is granted for the law applicable for the internal affairs of the foreign company, it is necessary to base on the amount of shares acquired by the host state citizens. If citizens of the host state did not acquire any shares or acquire only a minimal amount of shares, it is advantageous to grant recognition for the foreign Company law and if a host states citizens hold a substantial amount of shares, it is advisable to apply the host states company law in case when a dispute arises.

**C) The Doctrine of Abuse**

If the adoption of this doctrine opens a door for the creation of letterbox companies, and if such companies accordingly violate a particular public law of the host state, the host state can directly oblige the foreign company to respect the violated public law. Thus, violation of public law cannot be a reason for denying the law applicable for the internal affairs of the foreign companies, which is foreign proper law. This is because public laws are out of the domain of company law regimes.

# CHAPTER THREE

## 3. Incorporation Theory Subject to Exception for Recognition of Foreign Companies: Legal Frameworks and Experiences from Some Notable Jurisdictions

### 3.1. Introduction

Laws for the recognition of foreign companies are not a recent phenomenon. Starting from the period of colonization many countries have allowed companies incorporated abroad to operate investment undertakings in their jurisdiction by providing recognition for some of their important aspects without imposing their own company law rules as part of their Private International Law of companies. Though there is no well-developed multilateral rule at the international level, some intergovernmental organizations and regional arrangements have developed rules on the recognition of foreign companies.

Currently, many developing countries who seek to attract FDI, have adopted this version of incorporation theory. In addition to these counties, even some regional arrangements have opted to adopt this theory to create economic integration that finally results in the economic development of the whole region. To make profound improvements, it is necessary to take note of certain foreign developments and create conditions for foreign companies to contribute to the country's economic development. This chapter is an attempt to do that. In doing so, the researcher does not believe that a country shall transplant foreign improvement (s) on rules for recognition of foreign companies wholly or verbatim. Rather, it is for a certain national jurisdiction to take foreign lessons after thoroughly correlating with its context.

### 3.2. Justifications for Selection

The Hague Conference on Private International Law of 1956 is selected that though it is a draft law most countries adopt the recognition rule enshrined in this legal framework. As a result, it has wide acceptance and acquire the status of international customary law. The TFEU, the 1969 Convention on Mutual Recognition of Companies, and the Case laws are selected because the close analyses of them help in broadening the knowledge especially the regulatory obstacle nature of real seat doctrine, and crafting a good recognition rule at the end. In choosing countries, their legal system whether they are civil law or common law origin has not been taken

into account. Rather their developmental level, their desire to attract FDI, and the way their recognition rule is well crafted have been taken into consideration.

## 3.3. International Legal Framework for Recognition of Companies

### 3.3.1. The Convention of 1 June 1956 of the Hague Conference on Private International Law

The Hague Conference on Private International Law (HCCH) is established in 1893 as an autonomous legislative intergovernmental organization. Its mission is to establish and adopt International Hague Conventions, Protocols, and Soft Law Instruments for the progressive unification of rules of private international law in a cross-border situation[112]. Starting from 1902 to the present day, the institution has adopted around 46 conventions.

The Hague conference's outstanding work concerning the recognition of the legal personality of foreign companies, associations, and institutions takes place in 1956. In this year, the organization had adopted a convention that was able to answer the question of business entities getting into commercial relationships across borders. The Convention is aimed to achieve mutual recognition of companies incorporated and duly formed, and have a registered office within another contracting state. It specifically provided the recognition of legal personality under Art.1 as:

> "Legal personality acquired by a company, association or foundation under the law of the contracting state in which the registration or publicity formalities have been completed and where the registered office is situated shall be recognized as of right in the other contracting state, provided that it includes, in addition to the capacity to institute legal proceeding at least the capacity to possess property and to conclude contracts and other legal acts."
>
> "Legal personality acquired without the formality of registration or publicity will under the same condition be recognized as of right if the company, association or foundation has been constituted according to the law which governs it."

[112] Available at https://ehne.org/fr/Hague_Conference_on_Private_International_Law (Accessed on September 26,2021)

Though this is the principle, the contracting states have the right to deny recognition if the granting of recognition for a company formed by the law of other member state results in violation of public interests[113].

## 3.4. Regional Legal Frameworks on Recognition of Foreign Companies

### 3.4.1. European Union

Being established by the Treaty of Maastricht in 1992, the EU[114] ratified the Treaty of Lisbon in 2007 which is entered into force on 1 December 2009. This Treaty currently governs the Union. One of the primary goals of the Union is to build a prosperous Europe by creating economic integration among its member states. To achieve this, it has legally established a common internal market to facilitate the creation of this economic integration. The right to set up companies is part of the common internal market. As a result, the Union has enacted primary and secondary legislations to enforce the right to the establishment of companies. While the Treaty on the Functioning of the European Union (TFEU) is among the primary legislations, the Case-law of the ECJ is important Secondary legislations that play a great role in filling the gap of the Treaty. Thus, next, I will try to show how these two laws are obliged member states to recognize foreign companies when companies exercise the right to establishment granted by the Treaty.

#### 3.4.1.1. The Treaty on the Functioning of the European Union (TFEU)

In European Union, companies' right to recognition by the host state during cross-border mobility is primarily safeguarded under freedom of establishment, as enshrined in articles 49 and 54 of the Treaty.

Although it is not stated explicitly, the Treaty adopts a recognition rule that has the same effect as the incorporation theory subject to exception. To begin with, the treaty has used the registered office or place of formation of the company rather than the real seat as a connecting factor in granting recognition for the legal personality and applicable law for companies incorporated in other member states as a principle. This is stipulated under Art 54 Para. 1.

Article 54 Para. 1 read as follows:

"Companies or firms formed in accordance with the law of a Member State and that "have their registered office […]" within the Union has the right to freedom of establishment."

---

[113] See Art. 8 of the Convention of 1 June 1956 of the Hague Conference on Private International Law

[114] EU is a regional institution which comprises of 28 European countries, now reduced to 27 when UK leaves

Thus, the reading of article 54 affirmed that once the companies are duly formed according to the member state's Company law and have a registered office there, they can establish a business in other member states without any need of reincorporation. In other words, the host states give recognition for such companies. Hence, companies that have registered office or place of incorporation within the Union have the right to be recognized by states other than the state whereby the company's registered office is located. To achieve this goal, the Treaty under Art. 49 prohibit member states from denying recognition for foreign companies who could establish a business in their jurisdiction by saying that:

> "Restriction on the freedom of establishment of companies who are nationals of the member states that set up […] branches […] in the territory of another member state is prohibited."

Among the measures prohibited by Art. 49 Para. 1 are any measures that will result in unequal treatment. Therefore, any discriminatory measure which has been taken by the host state that would benefit the residents of a particular member state or residence of another member state is prohibited. Art. 49 Para. 2 has been broadened beyond discrimination to unjustified restrictions[115]. One important question raised here is that is the prohibition against the host state has no exception? The answer to this question is given by the ECJ in the Gebhard case of 1995[116]. Thus, the Court said that:

> "National measures liable to hinder or make less attractive the exercise of fundamental freedoms must fulfill four conditions. First, they must be applied in a non-discriminatory manner. Second, they must be justified by imperative requirements in the general interest. Third, they must suitable for securing the attainment of the objective which they pursue, and finally, they must not go beyond what is necessary to attain it."

Therefore, any national measures that restrict the freedom of establishment to be just, must fulfill these four key points.

As the meaning of the scope of companies or firms is concerned, the Treaty under Art 54 Para. 2 includes profit-making firms both under Civil or Commercial law. It says:

[115] Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano [1995] ERC I-04165

[116] *Id.*

“Companies or firms’ means companies or firms constituted under Civil or Commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making”

#### 3.4.1.2. The EEC Convention on the Mutual Recognition of Companies of 1968

The EEC has a strong desire for companies to operate freely in its member states without any problem. But this can only be achieved by having a binding legal framework that obliges countries to recognize the legal personality of companies[117]. However, this freedom cannot be achieved within the community unless there is a reliable legal guarantee for recognition of the legal personality of such companies. As the obligation on member states on the Treaty[118] seems to be implicit, the Treaty allows them in Art. 220 to explicitly negotiate about securing mutual recognition of companies with the meaning of Art 58 of the Treaty. Accordingly, the EEC Convention on the mutual recognition of companies was adopted on 29 February 1968. The Treaty under Art. 1 obliges member states to grant recognition for companies duly formed in another member state[119]. However, the Convention also puts exception when the host member states apply their own Company law rules in exceptional circumstances[120]. Though the Convention does not enter into force, the ECJ’s case law has in the meantime to a certain extent establish some of the intended principles as envisaged under the Convention from 1968.

#### 3.4.1.3. Jurisprudence of the ECJ on Recognition of Foreign Companies

As mentioned above, the Case Law of the ECJ is one of the secondary legislation of the EU. The provisions of the TFEU are put in general terms and sometimes need an interpretation. Thus, concerning the recognition of foreign companies in cross-border mobility, the ECJ had passed important decisions. It is noticed that when the court entertains the cases, it considers the following. First, it uses the place of incorporation as a connecting factor. Second, it prohibits the host member states to deny recognition by justifying reincorporation, disproportional and unjustified measures. Thus, below I will examine how these requirements of incorporation theory subject to exception are applied by the Court of Justice.

---

[117] Gijs Fibbe, *Supra Note* 70, at p. 26
[118] The Treaty of Rome Ratified in 1957
[119] See Art. of the EEC Convention on the Mutual Recognition of Companies of 1968
[120] *Id.*

#### 3.4.1.3.1. The Centros Case[121]

**The Facts of the Case and the Ruling of the ECJ**

Two Danishes who reside in Denmark established Centros, a PLC, under UK Company law. However, since its formation, the company did not trade in England. All of the business of the company was conducted through a Danish branch. The founders request the Danish authority to grant recognition for the legal personality of the company and to register it to provide information about the company's status to Danish nationals. However, the Danish Commercial Registry refused to register the company justifying that:

1) The founders incorporate the company in UK Company law solely to avoid the minimum capital requirement. If so, the action is unlawful circumvention of the Danish minimum capitalization rule and can result in denial of the recognition.

2) As Centros does not trade in the UK, the establishment in Denmark cannot be considered as a branch office that suffices recognition for its legal personality.

3) The minimum share capital is a means to protect creditors of the company who traded with it. Failing to satisfy such requirements will affect the interest of such creditors.

Centros on the other hand, argues the decision of the authority affects its right to freedom of establishment.

Then, the court examines whether the decision of the authority is compatible with the freedom of establishment under articles 49 and 54 of the TFEU. To do this, the court framed the following questions.

a) What pre conditions must be fulfilled for a company dully formed in another member state to be recognized in transferring its principal place of business in exercising the right to freedom of establishment enshrined under the TFEU?

b) Is the founders' action of choosing a UK Company law regime that does not require minimum capital requirement for the formation of PLC constitutes an abuse of Danish national legislations?

c) Is the Centro's failure to conduct any business in the UK by itself can be a ground for Danish authority to deny recognition and restrict its freedom of establishment by refusing to register the company in Denmark?

[121] Centros Ltd. v Erhvervs-og Selskabsstyrelsen [1999] ERC I-1459

In answering the first question, the court argued that a company formed by the laws of the member states who have registered office within the member states can have the right to recognition when it transfers its principal place of business into another member state[122]. In this regard, it is immaterial to justify that the company was formed in the home member state only to establish its entire business in the other member state. Therefore, the only pre condition to be recognized in the second host state jurisdiction is having of registered office within the member state[123].

For the second question, the court argues to the contrary. It concludes that the nationals of the member states who wish to set up a company can choose a member state whose rules of company law seem to him/her the least restrictive and set up the branches in other member states[124]. Doing this by itself does not constitute an abuse of the right to freedom of establishment. Rather doing this is a right guaranteed by the Treaty. Thus, as avoiding minimum capital requirements cannot constitute abuse, the authority's refusal is incorrect[125]. Accordingly, the court concluded that abuse is justified for public laws which are out of the Company law regimes[126]. Furthermore, the court ruled that the provision requiring a minimum capitalization rule is unjust. It was not a suitable remedy, according to the Court, to secure the protection of creditors, and in any case, less onerous measures could have been used to achieve this purpose[127].

In answering the final question the court argued that formation according to the laws of a member state was sufficient to trigger the right to recognition and enable a company to set up a branch in another member state. The fact that the entire business was to be conducted through a branch was irrelevant and cannot be a ground for denying recognition of the company that transfer its principal place of business[128].

[122] *Id.* Paragraph 17
[123] *Id.*
[124] *Id.* Paragraph 18
[125] *Id.*
[126] *Id.*
[127] *Id.*
[128] *Id.* Paragraph 16

**3.4.1.3.2. The Uberseering Case[129]**

**The Facts of the Case and the Ruling of the ECJ**

The Uberseering case arose from a contractual dispute. Uberseering BV, a company incorporated in the Netherlands, transferred its principal place of business to Germany. Soon after, it filed a lawsuit on the non-performance of a contract against the Nordic Construction Company (NCC) at the lower court of Düsseldorf, Germany.  It claims the construction company to pay compensation as the work it performed is defective. However, the lower court had dismissed the case arguing that according to German's version of real seat theory, though the company is incorporated and duly formed in the Netherlands, the transfer of its principal place of business from the Netherland to Germany does not result in granting recognition for its legal personality in Germany unless the company is reincorporated following formation formality under Germany law. As a result, it lacks legal personality and consequently, could not sue in its capacity as a Dutch corporation in German courts. Uberseering appealed! But the appellate court confirmed the decision.

Uberseering BV finally appealed to the Federal Supreme Court arguing that the decisions of the lower courts represent a restriction on its right to freedom of establishment, and it was prohibited by Art. 49 and 54 of the TFEU. The German supermen court submitted the case for the ECJ for a preliminary ruling in March 1999 on the following two specific questions.

a) Is the refusal to recognize the legal capacity of a company validly incorporated in another member state and prohibiting it to bring legal proceedings was incompatible with freedom of establishment?

b) Is the refusal to recognize the law of the state of incorporation as a law applicable to internal affairs was incompatible with the right to freedom of establishment?

The court found that the refusal to grant recognition for the legal personality of a validly incorporated company and subsequent prohibition of the company from bringing the legal proceeding in German courts constitute a restriction to the right of freedom of establishment[130]. The justification of the restriction by the national court, protection of creditors, minority

[129] Uberseering BV v Nordic Construction Company Baumamagement GmbH (NCC) [2002] ERC 1999 I-9919

[130] *Id.*

shareholders was not sufficient enough to overrule Art. 49 and 54 of the TFEU[131]. Furthermore, regarding public interest protection, the court said that restriction on freedom of establishment cannot be justified by overriding rules of public interest, as protection of public interest is out of the area of rules that govern companies' internal affairs[132].

In this decision, the court did not intend to acknowledge a member state as having the authority to subject corporations duly incorporated in other member states that have transferred their seat to its territory to comply with its domestic company law. Thus, the court concludes that as far as a company is founded in compliance with the legislation of a member state of the Union, the receiving country (host state) must recognize the legal personality and legal capacity to be a party in legal proceedings, if not it is incompatible with Art.49 and 54 of the TFEU. Thus, the court concluded that as far as the registered office of the company was found within the member state of the Union, the company must be recognized to exercise freedom of establishment.

The court did not answer the second question. It does not elaborate on which legislation, host country (in this case Germany), or country of origin (the Netherlands) should be applied after the recognition. This is because as the question is stated in a broad term, it indirectly makes the German conflict of laws rules which is the real set theory to be questionable. Thus, in this case, the court emphasized the issue of non-recognition and lack of standing rather than the general restriction imposed by a real seat host state. Although the court refrained from answering the second question, the question was soon raised in another case, the Inspire Art case, which is discussed as follows.

#### 3.4.1.3.3. The Inspire Art Case[133]
#### The Facts of the Case and the Ruling of the ECJ

The facts here were similar to Centros. Inspire Art Ltd. was a limited-liability company incorporated under UK Company law but since its formation, it carried all its business activities through a branch established in the Netherlands. This is because the company has no intention to commence business in the UK. The only reason that Inspire Art was incorporated in the UK was to take advantage of the less onerous English company law, in particular the rules on minimum share capital. A branch office of the company was registered at the Amsterdam Chamber of

---

[131] *Id.* Paragraph 87-88
[132] *Id*. Paragraph 89-90
[133] Inspire Art Ltd. v Kamer Van Koophandel en Fabrieken voor Amsterdam [2003] ERC 20003 I-10155

Commerce without indicating that Inspire Art was a pseudo foreign company according to Art. 1 of the Netherlands Law on Formally Foreign Companies of 17 December 1997.

The Chamber of Commerce requested the District Court to register Inspire Art in compliance with Art. 1 of Netherlands Law on Formally Foreign Companies of 17 December 1997. This addition in the Commercial Register meant that Inspire Art Ltd. would have to comply with more rigid legislation, such as minimum capital requirement and the disclosure of documents.

The District Court decided that Inspire Art Ltd. was formally a foreign company and referred the following questions to the ECJ.

A) If the TFEU's Articles 49 and 54 forbid a member state from putting additional requirements on a company's branch office on its territory.

b) The second question concerned the interpretation of Article 46 of the TFEU, which stated: "Can additional requirements imposed based on public laws be justified by reasons advanced by the national legislator, or would this constitute a violation of the right to freedom of establishment?"

Firstly, the Court dictates that the disclosure requirement is not proportional and unjustified[134].

On the second preliminary question, the Court concluded its judgment on the general interest reservation by referring to prior decisions and emphasizing:

> "The obstacles to the Treaty-guaranteed freedom of establishment created by national law provisions, such as minimum capital, joint and several liabilities of directors cannot be justified under Art. 46 of the TFEU, or on the ground of protecting creditors, combating improper recourse to freedom of establishment, ensuring fairness in business dealings, or ensuring efficiency of tax inspections/audit."[135]

In particular, the Court explained that Inspire Art Ltd. presented itself as a foreign company to provide sufficient information to creditors that Inspire Art Ltd. is subject to different legislation than companies formed under Dutch law, which are subject to limited liability[136]. Therefore, the Chamber of Commerce should grant recognition to UK Company law to regulate the companies' internal affairs.

[134] *Id.* Paragraph 2

[135] *Id.* Paragraph 142

[136] *Id.* Paragraph 135

## 3.5. Recognition of Foreign Companies: Experiences from Some Notable Jurisdictions

This section details the Company Acts of some notable jurisdictions that can convey a good experience to Ethiopia. However, one thing to note here is that when Ethiopia learns from the experiences of these countries, it does not mean that it learns the same thing from each jurisdiction. This is because each country's private international law varies to some extent especially the way how the rule on recognition is crafted though they have common features. As a result, Ethiopia should be selective in each rule from each country. However, the common denominator that the three countries can share to Ethiopia is the use of place of incorporation/registered office as a connecting factor in the private international law of companies.

### 3.5.1. India

#### A) Rules on Legal Personality

In India, the legal personality of foreign companies incorporated outside India who seek to expand the business to the country is recognized. This is because the Act has used place of incorporation/registered office as a connecting factor[137]. That is why in this provision, instead of saying that the companies have been reorganized; provide the full address of the company or the registered office. As a result, rather than requiring the companies to be reincorporated and acquire a new legal personality per its provisions, the Act requires the companies to submit the address of the registered office in the country of incorporation for the registrar. The Act stipulates this obligation of foreign companies as follows:

> "Every foreign company shall, within thirty days of the establishment of its place of business in India, deliver documents to the registrar for registration the full address of the registered or principal office of the company."[138]

The Act in this provision uses the registered office as a connecting factor to determine the nationality of companies. The immediate consequence of the provision is that the legal personality of companies incorporated abroad is recognized. So, the main task the Act requires from them is to provide the registrar with the documents that the registered office of the

[137] The 2013 Revised Company Act of India, Sec. 380 (1-b).

[138] *Id.*

companies is located. To conclude, the legal personality of companies incorporated abroad who establish a principal place of business in India is recognized.

However, the recognition of a legal personality is not without any precondition. To protect the interest of Indian nationals who would engage in business dealing with such companies, the Act imposes a duty on the companies to disclose information in a manner that anyone who would engage in business dealing with them could understand their status. In imposing this obligation the Act set out detailed requirements that the companies should fulfill as follows:

In displaying its name, etc., every foreign company shall[139]:

(a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English character, and also in characters of the language or one of the languages in general use in the locality in which the office or place is situated;

(b) cause the name of the company and the country in which the company is incorporated, to be stated in legible English characters in all business letters, billheads and letter paper, and all notices, and other official publications of the company; and

(c) If the liability of the members of the company is limited, cause notice of that fact;

(i) To be stated in every such prospectus issued and in all business letters, bill-heads, letter paper, notice, advertisement and other official publications of the company, in legible English characters; and

(ii) to be conspicuously exhibited on the outside of every office or place where it carries on business in India in legible character and also in the legible character of the language or one of the languages in general use in the locality in which the office or place it situate.

Thus, by obliging the companies to disclose their status as they were foreign companies in the above way, the Act enables Indian citizens to make the right decision before they engage in business dealing with the foreign companies.

**B) Rules on Applicable Company Law**

Similar to the legal personality, the law applicable to the internal affairs of foreign companies who seek to expand business in India is also recognized[140]. Thus, the companies are allowed to govern their internal affairs by the law of the place of incorporation. In other words, founders of

[139] *Id.* Sec. 382

[140] *Id.* Sec. 379

the companies have the right to incorporate the company in a country as their choice i.e., party autonomy is respected. However, this right is not without any exception. If Indian citizens or domestic companies of India acquire a substantial amount of shares of the foreign company, provisions of the Act come to apply to protect the interest of such citizens or domestic companies. The Act states this situation as follows:

> "Where not less than fifty percent of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company are held by one or more citizens of India and or by one or more companies or bodies corporate incorporated in India, whether singly or in aggregate, such company shall comply with the provisions of this Chapter and such other provisions of this Act as may be prescribed concerning the business carried on by it in India as if it were a company incorporated in India."[141]

Thus, the provision grants recognition in two ways. First, when Indian citizens or domestic companies of India do not acquire shares in the foreign company. Second, though they acquire shares, the amount is minimal that the advantage of granting recognition or respecting the right to party autonomy and attracting FDI overweight from protecting shareholders' interest who acquire minimal amount of shares in the foreign companies. However, if the Indian citizens or companies incorporated in India acquire a substantial amount of shares in the foreign companies, the Act allows its provisions to be applied to protect the interest of such citizens or domestic companies.

**C) Rules on Public Laws**

When we see Art 379 of the Act, it enshrines rules of recognition about only laws applicable to the internal affairs of foreign companies. From this, it can be inferred that laws enacted to protect the public interest such as tax law, employment law, etc. are out of the domain of laws applicable for internal affairs. As a result, violation of such laws cannot be a ground to deny recognition for both the legal personality and the law applicable for the internal affairs of the foreign companies. Thus, violations of such laws are applicable independently. In other words, public laws are crafted in a manner that their violation could not be a ground for denying the legal personality and applicable law.

---

[141] *Id.*

### 3.5.2. Philippine

### A) Rules on Legal Personality

Like India, the legal personality of companies incorporated abroad is also recognized in the Philippines[142]. However, the rule in the Corporation Code of Philippines is crafted more unequivocally than the Indian Company's Act. As emphasized and repeatedly stated in the thesis, using the place of incorporation/registered office as a connecting factor is the main profile as to whether a particular country grants recognition for the legal personality of companies incorporated abroad or not. The Philippine Corporation Code, however, explicitly states as it grants recognition to foreign companies in addition to using a place of incorporation or registered office as a connecting factor[143]. The Code defines what foreign corporation means and their rights of transacting business in the Philippines as follows:

> "For the purpose of this Code, a foreign corporation is one formed, organized or existing under laws other than those of the Philippines'….It shall have the right to transact business in the Philippines after obtaining a license for that purpose in accordance with this Code and a certificate of authority from the appropriate government agency."[144]

Thus, as shown in the provision the legal personality of companies incorporated abroad are recognized. As a result, the companies are not required to reincorporate and acquire a new legal personality by the Filipino Corporation Code. Rather the companies can directly take a license from the concerned government organs to engage in a business transaction. But though they are not required to reincorporate, they are under a duty to provide documents as to the address of the registered office of the company in the state of incorporation. In addition to other similar obligations, the Code imposes this obligation as follows:

> "A foreign corporation apply for a license to transact business in the Philippines shall submit to the Commission a copy of its article of incorporation and bylaws, in accordance with the law, and their transaction to an official language of the Philippines, if necessary. The application shall be under oath and, unless already stated in its article of

[142] The 2019 Revised Corporation Code of Philippines Sec.140.

[143] *Id.*

[144] *Id.*

> incorporation, shall specify the address, including the street number, of the principal office of the corporation in the country or state of incorporation."[145]

After being recognized in this way, they can engage in business operations with the license/permission of the relevant authority. However, unlike the Companies Act of India, the Code does not specifically oblige the companies to exhibit on the outside of every office or place where they carry on business in the Philippines. But Filipino citizens still have had a chance to examine the status from the documents submitted to the Commission.

**B) Rules on Applicable Law**

In addition to legal personality, the law applicable for the internal affairs of foreign companies is also recognized in the Philippines. In this regard the Code says as follows:

> "A foreign corporation lawfully doing business in the Philippines shall be bound by all laws, rules, and regulations applicable to domestic corporations of the same class, except those which provide for the creation, formation, organization or dissolution of corporations or those which fix the relations, liabilities, responsibilities, or duties of stockholders, members, or officers of the corporations to each other or the corporation."[146]

As shown in this article the law of the country where the companies are incorporated is recognized as a law applicable to the internal affair of the company.

**C) Rules on Laws Enacted to Protect the Public Interest**

As stated under Section 146 above, except for the laws that regulate internal affairs, foreign companies are bound by all the laws, rules, and regulations that bound the domestic corporations. Though not mentioned specifically, it is presumed that laws enacted to regulate public interests are under such a category. Thus, the section makes public laws to be out of the domain of laws that regulate the internal affairs of companies, and violation of such laws cannot be a ground to deny recognition. In other words, the public laws are crafted in a manner that their violations cannot be a ground to deny the legal personality and the law applicable to the internal affairs of

[145] *Id.* Section 142 (b)
[146] *Id.* Section 146

foreign companies. If violations to such laws happen, the pertinent authority applies the respective violated laws accordingly.

### 3.5.3. Belgium

Until 30 April 2019, Belgium uses the place of administration or principal place of business as a connecting factor to determine the nationality and the law applicable to the internal affairs of companies[147]. However, by considering the benefits of adopting registered office as a connecting factor to determine the nationality of companies and applicable law from its neighboring countries who have already been adhering to the incorporation theory for a long time such as the UK, the Netherlands, Switzerland, the US, Ireland and, for several years now, Germany, i.e. making once jurisdiction attractive to foreign companies, it also has started to adhere the incorporation theory since 2019[148]. Accordingly, it adopts the registered office as a connecting factor under Art. 2:148 of the New Companies and association Code which has entered into force on 1 May 2019. As a result, the legal personality of companies incorporated abroad is recognized in Belgium. Moreover, the companies' internal affairs are governed by the Companies and Association law of the jurisdiction in which the seat they specify in their articles of association is located. Hence, under the New Code, companies have the right to party autonomy, i.e., they can choose the company law which applies to them depending on their own needs and preferences[149]. The better thing is that the registered office as a connecting factor is valid only for the determination of laws applicable for the internal affairs of the companies while all other legal fields such as tax law, environmental law, and employment laws continue to use the real seat as a connecting factor[150]. This is to means that these laws which are enacted by the Belgian legislator to protect the public interests are out of the domain of laws applicable for internal affairs and their violation cannot be a ground to deny the legal personality and applicable law for companies incorporated outside Belgium.

[147] Art. 111 of the of 16 July 2004 Holding the Code of Private International Law

[148] New Code of Companies and Associations: From Real Set Theory to Incorporation Theory. Available at https://www.eubelius.com/sites/default/files/09_corporate_mobility.pdf (accessed on November 26, 2021)

[149] *Id.*

[150] *Id.*

## CHAPTER FOUR

# 4. Real Seat Theory as a Regulatory Obstacle for the Attraction of FDI in Ethiopian Foreign Companies' Recognition Rule and Incorporation Theory Subject to Exception

## 4.1. Introduction

To make foreign companies play a significant role in the process of achieving the economic development and, objectives set under-investment Proclamation and other developmental plans, the EIC grants permission to foreign companies incorporated abroad who seek to expand their business activities to the country by transferring either the registered office (subsidiary companies) or the real seat i.e., head office or principal place of business (a foreign branch). However, as interviews from the EIC reveal, foreign companies mostly prefer to operate investment activities through setting up a branch rather than subsidiary companies unless the investment area that they will engage is exclusively reserved for investing jointly with the domestic investors[151].

As discussed in the preceding Chapters, the effectiveness of foreign companies recognition rule can be evaluated depending on its formulation in a manner that can lay a good ground for foreign companies able to establish their branch office/principal place of business easily in a particular country and able that country to harvest the benefits while the interest of its nationals who are creditors and shareholders of the company, and the general public interests are protected[152]. However, the real seat theory does not serve as such a kind of recognition rule for countries that adopt it.

Thus, this Chapter is devoted to assessing the real seat theory as a regulatory obstacle for the attraction of FDI in foreign companies' recognition rules in Ethiopia and proposes the incorporation theory subject to exception as a way out. Recognition of foreign companies legal framework, evidence that envisages the necessity of adopting incorporation theory subject to exception**,** perception of stakeholders, the practice of EIC in dealing with recognition of foreign companies in the existing legal framework (the real seat approach) as well the need for replacing

[151] Interview with Ato Ermias Melese, senior legal advisor at Ethiopian Investment Commission, on November 8, 2021

[152] It is only the recognition rule of Incorporation theory subject to exception that able to serve as such kind of recognition rule and able to protect all the competing interests of the stated parties. See the discussions on Chapter 2, Section 2.2.2.2.2.

the real seat theory by incorporation theory subject to exception under the New Commercial Code of Ethiopia will also be assessed.

## 4.2. The Real Seat Theory as a Regulatory Obstacle in Ethiopian Foreign Companies Recognition Rule

In this Era of globalization, as its role is minimal for the attraction of FDI most countries of the world do not use real seat theory to grant recognition for companies incorporated abroad and seek to expand the business to their jurisdiction. Especially, developing countries seek FDI for technology transfer, to create job opportunities, to solve their country's foreign currency shortage in particular, and to facilitate their country's economic development in general[153]. Similarly, as a developing country, Ethiopia also seeks to attract FDI to harvest its benefits to achieve the above-mentioned purposes. Most importantly, Ethiopia needs to be a lower-middle-income country by 2030[154]. Thus, FDI plays a great role in facilitating a journey to this end. However, despite firmly needing the contribution of FDI to achieve the plan, *it adopts the real seat theory which is assured as a legal rule which discourages the immigration of foreign companies to the country* and makes the mentioned goals not to be reached within the prescribed period.

In an interview with the author to find out if the real seat theory is a barrier to foreign companies coming to Ethiopia and doing business, a lawyer described the challenge of the concept as follows:

> *"Of course, the real seat theory, which applies to grant recognition for companies that expand their principal place of business outside their home country, has many drawbacks. Granting recognition in accordance with the real seat doctrine results in denying recognition for both the legal personality of companies duly formed in a foreign country and the law of the country where they are incorporated as a law applicable to their internal affairs. Thus, when the real seat theory is applicable to grant permission for foreign companies, foreign companies feel uncomfortable as granting recognition by applying this theory jeopardizes their economic interest and the right to party autonomy. If this initiates them not to come and invest in Ethiopia, the country will lose the benefits of FDI to accelerate its economic development. So, when foreign companies apply to the*

[153] The Role of FDI in Economic Growth Available at https://www.articlelibrary.com/economics/role-of-foreign-direct-investment-in-economic-growth/40257 (Accessed on November 10, 2021).

[154] ISS, Policy Brief Key to on the Horn Ethiopia's Prospects to 2030 at p. 3, (2017), Available at https://media.africaportal.org/documents/policybrief102.pdf (Accessed on November 10, 2021).

*Commission for a license to do business in our country, it is very difficult to apply the theory in practice though the law says so."*[155]

Therefore, though the Commercial Code adopts the real seat theory, the EIC does not apply the doctrine in practice to grant recognition to foreign companies that seek to expand their business to Ethiopia. The Commission believes that applying the theory exposes foreign companies to incur costs and discourages them to come and invest in Ethiopia[156]. Next, I will discuss the real seat theory recognition rule under the New Commercial Code of Ethiopia, how the pre-conditions embodied in it could affect the interests of foreign companies and discourage them not to expanding their business to Ethiopia, and the justifications for its adoption. The assessment of the author made in the EIC how recognition is granted practically will be discussed in the latter pages.

## 4.3. Real Seat Theory Recognition Rule under the New Commercial Code of Ethiopia

The Ethiopian legal system has a civil law tradition and laws are almost codified as opposed to the law, which is derived from judicial decisions. Rules on recognition of foreign companies are embodied in the Commercial Code under Title Eleven Chapter Two[157]. Under the Code, the real seat theory recognition rule is adopted. This is because the Code has used real seat (head office or principal place of business) as a connecting factor for the determination of the nationality and the law applicable for the internal affairs of companies[158]. As a result of using the real seat as a connecting factor, the legal personality of companies incorporated and lawfully formed abroad, as well as the law applicable to their internal affairs, which is foreign proper law, is not recognized in Ethiopia[159]. Thus, the rules under the Code is full of legal obstacles, put pre conditions which can affect the economic interests and the right to choose lax company law of foreign companies and prevent them from expanding their business to Ethiopia.

---

[155] Interview with Ato Ahmmed Yusuf, Director License and Registration Directorate, at Ethiopian Investment Commission, on November 8, 2021.
[156] *Id.*
[157] The New Commercial Code of Ethiopia, *Supra Note* 25, Art. 584
[158] *Id.*
[159] *Id.*

Like other civil law countries, the drafter of the Commercial Code of Ethiopia of the 1960s adopts the real seat theory to grant recognition to companies incorporated abroad and seek to operate a business in Ethiopia by transferring their real seat. However, many countries which adhere to the real seat theory in the past have now stopped implementing it[160]. But Ethiopia still adheres to this theory. The revised New Commercial Code which is entered into force in 2020 does not change the status quo of the rules on recognition of foreign companies. Thus, below I will try to show the rules on recognition of legal personality and the law applicable for their internal affairs is formulated in the real seat theory and their corresponding negative effects on foreign companies who seek to expand their business to Ethiopia.

### 4.3.1. Rules on Recognition of Legal personality

As mentioned above, under Art. 584 of the New Commercial Code, *the Code has used the real seat (head office or principal place of business) as a connecting factor to determine the nationality of companies.* The immediate consequence of using the real seat as a connecting factor to determine the companies' nationality is that the legal personality of companies incorporated and duly formed abroad, and who operate business activities in Ethiopia by transferring either their head office or principal place of business is not recognized in Ethiopia. In other words, such foreign companies lack the legal personality and capacity that they have acquired in the country of incorporation. As a result, they lose their limited liability status and members of the company become personally liable for the debts of the company. In addition to this, they would prohibit from performing any juridical acts including engaging in business activities in Ethiopia. However, if the foreign companies prefer to operate a business in Ethiopia, the companies are under a duty to acquire a new legal personality by the Commercial Code provision. In addition to the Commercial Code, the provisions of other private laws of Ethiopia that companies incorporated abroad are required to respect are directly or indirectly related to the formation and internal affairs. Next, I will discuss some of the provisions of the Commercial Code and other laws (Investment proclamation as private law and other public laws) and how the provisions impose burdens on foreign companies that could expose the companies to incur costs and make the measures to be considered as regulatory obstacles for foreign companies that seek to expand their business to Ethiopia.

---

[160] For example, France, Germany, the Netherlands. Recently, Belgium also ceases to adhere to the real seat theory in 2019.

#### 4.3.1.1. Obligations under the Commercial Code Provisions

##### 4.3.1.1.1. Reincorporation in Ethiopia

Like other countries that adhere to the real sea theory, foreign companies incorporated abroad that seek to establish a branch in Ethiopia should be reincorporated and acquire a new legal personality by the Commercial Code provisions. This is because the Code uses head office or principal place of business as a connecting factor to determine the nationality of companies or the company law of the state in which the formation and internal affairs of companies are regulated. The Commercial Code adopts this rule under Art 584 by saying that:

> "Business organizations incorporated abroad or sole proprietorship established outside Ethiopia and whose head office or principal place of business is in Ethiopia shall be subject to the relevant provisions of this code and other laws of Ethiopia."

In the jurisprudence of companies' nationality determination, head office or principal place of business is one major connecting factor that states have adopted under their Private Internal International law of Companies to determine the nationality of companies[161]. As companies are different from natural persons, they exist by the company law of the state that regulates their formation and internal affairs[162]. Therefore, if countries under their Private International Law of Companies use head office or principal place of business as a connecting factor, the companies incorporated abroad are required to reincorporate in such jurisdiction[163].

When we come to the Private International Law of Companies of Ethiopia the same principle is adopted. As stated under the above provision, the Code uses head office or principal place of business to determine the legal system in which the formation and internal affairs of the companies are regulated. Second, though the article does not specifically mention the provisions of the Code that apply to companies' formation and regulation of internal affairs, it is unquestionable that the phrase "relevant provisions of this code" includes these provisions. Therefore, in Ethiopia too, the legal personality of companies incorporated abroad is not recognized rather they should be reincorporated by the provisions of the Commercial Code that govern company formation.

Therefore, the first obligation imposed by this provision is that foreign companies must drop the legal personality that they have acquired in the country of incorporation and should acquire a

[161] Carsten Gerner, *Supra Note* 11

[162] *Id.*

[163] *Id.*, at p. 4

new legal personality per the Commercial Code provisions. Thus, to acquire a new legal personality, the company must draw a memorandum of association per Art. 173 of the Commercial Code by selecting the corresponding form of business organization recognized under Art. 174 of the Commercial Code. Finally, they should enter into the commercial register and acquire a new legal personality under Ethiopian law. The acquiring of a new legal personality in Ethiopia exposes foreign companies to incur organizational costs. As reincorporation in Ethiopia also requires the transfer of registered office as well, the home state requires the company to be dissolved and wind up irrespective of the recognition rule that it adheres to. The dissolution exposes to pay huge tax in the home state[164].

#### 4.3.1.2. Obligations Imposed by other Laws

In addition to reincorporation and acquiring a new legal personality following Ethiopian law, foreign companies incorporated abroad also are under a duty to fulfill obligations imposed by other laws of Ethiopia. Commonly known Ethiopian private law which imposes an obligation on companies incorporated abroad is Investment Proclamation[165].

#### 4.3.1.2.1. Obligation Imposed by Investment Proclamation

#### 4.3.1.2.1.1. Fulfilling Minimum Capital Requirement

The other legal obligation that foreign companies are required to fulfill to operate a business in Ethiopia by transferring their real seat (head office or principal place of business) is the minimum capital requirement[166]. The Commercial Code imposes this obligation by saying that:

> "Business organizations incorporated abroad or sole proprietorships established outside Ethiopia…shall be subject to relevant provisions of other laws of Ethiopia."[167]

Thus, in addition to reincorporating and acquiring a new legal personality, the companies incorporated abroad are under a duty to fulfill obligations imposed by other laws of Ethiopia. Accordingly, among the commonly known Ethiopian laws that impose an obligation on companies incorporated abroad is Investment Proclamation. Under this Proclamation, companies incorporated abroad are under a duty to fulfill the minimum capitalization rule. However,

---

[164] Christiana Panayi HJI, *Supra Note* 18, at p. 13
[165] Investment Proclamation, *Supra Note* 23
[166] Investment Proclamation, *Supra Note* 23, Art 9 (Sub Art. 1-3)
[167] Commercial Code of Ethiopia, *Supra Note* 25, Art. 584

minimum capital requirements discourage business significantly[168]. Though it is presumed that this capital protects creditors, it is proved that such a requirement fails to achieve its goal of safeguarding creditors from poorly formed and likely insolvent companies[169]. This is because minimum capital is frequently a fixed amount that disregards a company's economic operations, size, or risks. As a result, enforcing mandatory disclosure of the information is a preferable method to make markets more efficient and safeguard creditors[170]. This is why 99 of the 198 countries studied in Doing Business 2014 have no minimum capital requirements, and 39 of those have done so in the last seven years[171]. It is also affirmed that creditors' protection is the issue of insolvency law rather than company law[172]. In addition to creditors' protection, the practice also imposes the minimum capital requirement to examine the financial capacity, especially the solvency status of investors[173]. However, their financial capacity could be examined from documents brought by them that state their financial resource.

#### 4.3.2. Rules on Recognition of the Law Applicable for the Internal Affairs

The second effect of using real seat (head office or principal place of business) as a connecting factor under Art. 584 is that the Company law of the country where the companies are incorporated is not recognized as a law applicable for the internal affairs of the foreign companies. Instead, the provisions of the Commercial Code apply. The Code states:

> "Business organizations incorporated abroad or sole proprietorship established outside Ethiopia and whose head office or principal place of business in Ethiopia shall be subject to the relevant provisions of this Code."

Therefore, companies who seek to expand their business to Ethiopia are under a duty to regulate their internal affairs such as foundation/setting up, functioning/structure, and winding up/liquidation by the Commercial Code provisions. In other words, the corporate problems of

---

[168] Why are Minimum Capital Requirements a Concern for Entrepreneurs? Available at https://www.doingbusiness.org/en/reports/case-studies/2013/why-are-minimum-capital-requirements-a-concern-for-entrepreneurs (Accessed on November 6, 2021)
[169] *Id.*
[170] *Id.*
[171] World Bank Group, Comparing Business Regulations for Domestic Firms in 189 Economies 41 (11th Edn) (Doing Business 2014) Available at https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB14-Full-Report.pdf (Accessed on November 9, 2021)
[172] Thomas Bachner, *Supra Note* 53
[173] Interview with Ato Antene Wolde, Regulation Team Leader at EIC, Interview Conducted on November 8, 2021.

foreign companies are treated by the Commercial Code provisions. This is why the law of the place of the real seat is located in Ethiopia.

As the purpose of the doctrine and the experience of other countries shows, countries adhere to the real seat theory to protect their citizens who acquire a substantial amount of shares in the foreign companies in particular and when their country become industrialized in general[174]. If this is the case, the valid questions that could raise here are: First, is Ethiopia an industrialized country? Second, are Ethiopian nationals have acquired a substantial amount of shares in the foreign company? Thus, when the current economic development level of the country and the participation of Ethiopian nationals as shareholders in companies incorporated abroad and who establish the principal place of business in Ethiopia is evaluated, the recognition rule adopted under the Commercial Code does not correspond to such facts.

Ethiopia is not an industrialized country[175]. Rather it is a country that is on the way to that development. Currently, it is one of the fastest-growing countries in the world[176]. The Ethiopian government identified industrialization as a means to transform the economy, reduce poverty, provide jobs, and achieve the ambition of transforming the economy to lower-middle-income status by 2030[177]. Therefore, to reach this plan it needs a recognition rule that encourages foreign companies to come and invest in Ethiopia. When we see the participation of Ethiopian nationals as shareholders in the foreign companies who currently establish the principal place of business in the country, no Ethiopian nationals are have acquired shares in such companies[178].

#### 4.3.2.1. Duty to Fulfill Rules Obliging to Record the Decision of the General Meeting of Shareholders in the Commercial Register

Companies incorporated abroad or business organizations established outside Ethiopia are under a duty to respect the provisions of the Commercial Code on recording the resolution of the

---

[174] This is because nationals in industrialized countries acquire shares in foreign companies. Due to this reason the countries adopt recognition rule which able to protect the interest of their nationals who acquire shares in the foreign companies. On the other hand, if in their nationals does not acquire shares in the foreign companies and if they are not industrialized they favor to adopt recognition rule which attract foreign companies. As it was unlikely that their nationals acquire shares in the foreign companies, the risk they took by this was very minimal. See Dagmar, *Supra Note* 8 at p. 199.

[175] Still the Ethiopian economy is based on agriculture rather than manufacturing. There are very few manufacturing companies in Ethiopia. Currently, there are only 13 operational Industrial parks in the country.

[176] See https://www.worldbank.org/en/news/feature/2019/11/18/ethiopias-industrial-parks-are-making-jobs-a-reality (Accessed on November 8, 2021)

[177] *Id.*

[178] Interview with Ato Antene Wolde, *Supra Note* 173

general meeting of shareholders in the commercial register, in the case when the corresponding form of business organization is not recognized under the Code. Art. 586 of the Code says:

> "Firms incorporated abroad, having a form which differs from those provided for under this law, shall be subject to the provisions of this law concerning share companies, as appropriate, regarding entry into the commercial register of resolutions of the general meeting of shareholders.."

According to this article, if a firm's/business organization's form of incorporation differs from those the Commercial Code recognizes, i.e., differs from those provided for and covered by the Commercial Code, the foreign business organization must be governed by the law of share companies. This means that the foreign firm/company must meet the governing bodies of the shareholders meeting. A valid question that could be raised here is what if the form of business organization is a partnership or a cooperative business organization? Is it possible and logical to oblige a business organization established abroad in the form of partnership or cooperatives to be governed by the provisions of share companies? The Code has no answer to these questions.

#### 4.3.2.2. Duty to Respect Provisions of Share Company Relating to the Responsibility of Directors

In addition to respecting rules on entry into the commercial register of resolutions of the general meeting of shareholders, the business organization is also obliged to respect the provision of Share Company which regulate the responsibility of directors, in the case when the firm's/business organization's form of incorporation differs from those the Commercial Code recognizes. The article says:

> "Firms incorporated abroad, having a form which differs from those provided for under this law, shall be subject to the provisions of this law concerning share companies, as appropriate,… the liability of directors."

Therefore, the Code's requirements could pose a threat to entities seeking to invest in Ethiopia under various types of establishment. This is because; the companies could not be interested to be subjected to such provisions.

### 4.3.3. Protection of Public Laws Enacted to Protect the Public Interest

The concept of public law can have a broad meaning. However, for this thesis, it refers to laws that are enacted by the government to protect the interest of the general public such as tax law, labor law, environmental law, etc. Thus, foreign companies incorporated abroad who expand

their business to Ethiopia are under a duty to respect such laws. However, the usual question that rises in this regard is how the effect of violation of these laws is crafted. In other words, is public laws are crafted in a manner that their violation by companies incorporated abroad results in denial of recognition for their legal personality and the law applicable to their internal affairs? As the experience of the Philippines[179] and the jurisprudence of the case-law[180] of the ECJ shows, public laws are out of the domain of the law applicable for the internal affairs of the foreign companies and their violations cannot be a ground for denial of recognition for the legal personality and the law applicable for the internal affairs of the foreign companies.

When we come to the Ethiopian case, companies incorporated abroad are under the duty to respect laws enacted to protect the public interest. But the question that is raised here is how they are formulated? Are their violation results in denial of recognition of the legal personality and the law applicable for their internal affairs? This can be seen from the way how they are crafted under Art. 584 of the Commercial Code. Art. 584 say as follows:

> "Business organizations incorporated abroad or sole proprietorships established outside Ethiopia and whose head office or principal place of business is in Ethiopia shall be subject to the relevant provisions of this code and other laws of Ethiopia."

As clearly envisaged under this article, foreign companies are under a duty to respect both the Commercial Code provisions and other laws of Ethiopia. Among the laws referred to by the phrase 'other laws of Ethiopia' are public laws that are enacted by the Ethiopian government to protect the public interests such as tax law, labor law, etc. Therefore, companies incorporated abroad are under a duty to respect these public laws. But the question that arises here is that, is a violation of these public laws by foreign companies can be a ground to deny recognition for their legal personality and the law applicable for their internal affairs? From the way that the rule is crafted under this article, the answer could be yes! This is because, first, it uses the real seat (head office or principal place of business) as a connecting factor to determine both laws, i.e., the Commercial Code provisions which are considered as a law applicable for the internal affairs of the foreign companies and public laws[181]. Second, the article does not formulate the effects of

---

[179] Revised Corporation Code of Philippines, *Supra Note* 142
[180] Case C-23/93 TV10 [1994] ECR I-4796, *Supra Note* 102
[181] Public laws are among the laws which are included in the phrase 'other laws of Ethiopia'.

violations to these public laws would be on recognition of the legal personality and the law applicable to the internal affairs of the foreign companies[182]. Therefore, it is possible to conclude that rules governing recognition of foreign companies who establish the principal place of business in Ethiopia are formulated in a manner that violation of laws enacted to protect the public interests could be a ground for denial of recognition for their legal personality and the law applicable to their internal affairs. As I will discuss in the following pages, the practice of EIC is unclear in this regard.

## 4.4. The Practice of Ethiopian Investment Commission in Recognition of Foreign Companies

As discussed above, the real seat theory is boldly recognized in the recognition rule of foreign companies under the New Commercial Code of Ethiopia. This has the message for the EIC that it should deny recognition for the legal personality and the law applicable for the internal affairs of the foreign companies. It should enforce foreign companies to be reincorporated and acquire a new legal personality by the Commercial Code. Furthermore, it also grants a mandate for the Commission to oblige the companies to govern their internal affairs by the provisions of the commercial code and to respect other public laws of Ethiopia. When the business organization's form differs from those provided for and covered by the Commercial Code, they are under a duty to subject themselves to provisions of share companies regulating entering the decision of the general meeting of shareholders and liability of directors. However, the day-to-day activities of EIC are not guided by the doctrine. Below, I will discuss how the EIC practically grants recognition for companies incorporated abroad and transfer their principal place of business (branches) to Ethiopia.

### 4.4.1. Recognition of Legal Personality

Practically, the legal personality of companies incorporated abroad and transferring their principal place of business to Ethiopia are recognized. As experts of EIC, the Commission does not require foreign companies to be dissolved in their home state (lost their original legal personality) and reincorporate and acquire new legal personality under the Commercial Code provisions.

[182] However, if one considers Sec. 146 of the Revised Corporation Code of Philippines, it clearly excludes other laws including public laws from laws applicable for the internal affairs of the foreign company. As such violation of such laws cannot be a ground to deny the applicable foreign law.

An expert explains the existing practice of recognition of the legal personality of companies incorporated abroad who transfer their principal place of business to Ethiopia as follows:

> *"…In the current practice, when foreign companies apply to establish their principal place of business in Ethiopia, we grant recognition for their legal personality they have acquired in the country of origin. What we check is only whether they are duly formed in the country of incorporation. Our work is also legally correct because, the New Investment Proclamation, Proc. No. 1180/2020 under Art. 2(6-c) and 8 (1-b) says foreign companies incorporated abroad are recognized in Ethiopia. This is the only legal authority we rely on to grant recognition for the legal personality of foreign companies. Apart from this, nobody who works in the Commission knows that Ethiopia adheres statutorily to the real seat theory and as such deny recognition for the legal personality of foreign companies, as you have said."*[183]

However, though the legal personalities of companies incorporated abroad who seek to operate a business in Ethiopia are recognized, they are under a duty to fulfill the minimum capitalization rule. An expert states the justification of imposing minimum capital requirements as follows:

> *"…We impose minimum capital requirements, to check whether the foreign companies have a potential or have enough capital to operate the economic activities that they apply to engage. But not for creditors' protection. They also deposit the money in an open account opened by their name and they can immediately withdraw and use the money when they commence business."*[184]

However, though the interviewee brought as a justification, it is also proved that this capital cannot be brought as sufficient evidence to check the financial capacity of investors.

#### 4.4.2. Recognition of the Law Applicable for the Internal Affairs of the Foreign Companies

In addition to the legal personality, the law applicable for the internal affairs of foreign companies was also recognized in Ethiopia. In explaining the current practice, a legal expert says as follows:

---

[183] Interview with Ato Antene Wolde, *Supra Note* 173
[184] *Id.*

*"…When foreign companies apply to establish a principal place of business in Ethiopia, first we check as to whether the companies are duly formed or not to grant recognition for their legal personality. If they are properly formed we grant recognition. As their legal personality is formed by the foreign country's company law, we also grant recognition for the laws that create them as laws applicable to internal affairs. If the companies are unwilling to regulate their internal affairs by the Commercial Code provisions, they have the right to do so and we do not force them to regulate their internal affairs by the Commercial Code provision. Apart from this, we do not know of the existence of the Commercial Code provisions, which prohibit the recognition. To me, this is a new issue and if the Commercial Code considers our practice as incorrect, I do not agree with the rule embodied in it and as to me it should be amended if so."*[185]

In further strengthening the assertion of the above legal expert, another legal expert forwards his view in supporting the practice of the Commission rather than the Commercial Code provisions. He commented:

*"The principal place of business is a branch of foreign companies; it has no independent legal personality. It is not seen when Ethiopian nationals acquire shares in such kinds of foreign companies that currently operate a business in the country. Rather Ethiopian nationals acquire shares only on companies that are established in Ethiopia jointly with the foreign investors. Thus, though the Commercial Code intends to protect shareholders who acquire shares in the foreign company that establish branches in the country, there are no Ethiopian nationals who acquire shares in such kind of foreign companies."*[186]

With regard to measures imposed on companies incorporated abroad who have different forms than the forms of business organizations recognized under Art.174 of the Commercial Code an expert states:

*"…Until today no business organizations whose forms of incorporation are different from those recognized by the Commercial Code have come to Ethiopia. Still, foreign companies who transfer their principal place of business are similar to either of the*

[185] *Id.*

[186] Interview with Ato Ermias Melese, *Supra Note* 151

*forms of business organizations recognized in the Code. However, if there are companies that seek to transfer their principal place of business to Ethiopia but whose corresponding form of business organization is not recognized under the Commercial Code, obliging such company to be governed by the provisions of share companies which regulate the entrance of the decision of the general meeting of shareholders and liability of directors is not just. For example, it is not logical if a partnership established abroad which is different from the types of partnership recognized under the code to respect such provisions of Share Company for the mere fact that it is different from the types of partnerships recognized under the New Commercial Code of Ethiopia. Rather it is better to grant recognition for the foreign law. This is because currently immigration of companies incorporated abroad or business organizations established outside Ethiopia is increased greatly. These companies or business organizations have come from different countries. The Company law of these different counties has also differed greatly. Therefore, it is not proper to expect companies or business organizations that come from these different countries always would be similar with the business organizations recognized under our Commercial Code."*[187]

### 4.4.3. Protection of Public Laws Enacted to Protect the Public Interest

Companies incorporated abroad are under a duty to respect laws enacted for public interest in Ethiopia such as tax law, labor law, environmental law, and others. In the real world, violation of these laws cannot be a ground for denying recognition for the legal personality and the law applicable for the internal affairs of the foreign companies[188]. Rules for granting recognition for companies incorporated abroad and public laws enacted to protect the public interest are laws that have different goals to achieve. Therefore, violation of public laws cannot be a ground to deny recognition of the legal personality and the applicable law[189].

## 4.5. Is Companies Incorporated Abroad Recognized under New Investment Proclamation?

As I have tried to show the practice of EIC in the above discussion, an expert has brought Art. 2 (6-c) and Art. 8 (1-b) of the Investment Proclamation as an authority for the reason why the

[187] *Id.*
[188] *Id.*
[189] *Id.*

Commission grant recognition for the legal personality and the law applicable for the internal affairs of the foreign companies. However, valid questions that can be raised here are: First, is Art. 2 (6-c) of the Investment Proclamation by itself could be enough to be brought as a legal ground to grant recognition for companies incorporated abroad? Second, is it possible to justify Art. 8 (1-c) of the Proclamation to grant recognition to foreign companies? Is this Article stand and interpreted independently? What will be the result if this article is interpreted together with sub-article 3 of the same article? However, such provisions only seem to grant recognition to foreign companies but really not. In the discussion below I will try to prove or disprove whether these provisions brought by the EIC as an authority to grant recognition for the legal personality and the law applicable for the internal affairs of the foreign companies really grant recognition or not.

Under Investment Proclamation, Art. 2 (6-c) and cumulative reading of sub-articles (1-b) and (3) of Art. 8 are the only articles that describe foreign companies incorporated abroad are recognized in Ethiopia.

First, when we look at Art. 2 (6-c), it has put in the general part of the proclamation and its primary purpose is to remind that companies incorporated abroad are one among investors that are classified under the category of foreign investors. It says:

> "An enterprise incorporated outside of Ethiopia by any investor is a foreign investor"

Thus, when we look at this article, it is apparent that foreign companies incorporated abroad are recognized to operate a business in Ethiopia. However, a close look of the article reveals that the article only demonstrates that companies incorporated abroad are under the category of foreign investors and does not provide any detailed rules and procedures about how recognition is granted to such companies. Therefore, this provision cannot be a ground for granting recognition for companies incorporated abroad. As this provision is one legal authority that the EIC has based to grant recognition for companies incorporated abroad[190], it is possible to conclude that the commission grants recognition for companies incorporated abroad based on improper legal ground.

Second, when we look at Art. 8 (1-b) of the proclamation, this sub-article also seems that it grants recognition for foreign companies. The article read as follows:

> "Investment may be carried out by enterprises established… abroad."

[190] Interview with Ato Antene Wolde, *Supra Note* 173

The literary reading of this provision seems that foreign companies incorporated abroad are recognized in Ethiopia. However, the provision does not be crafted to be read independently. Therefore, justifying this article to support an argument that foreign companies are recognized in Ethiopia will result to reach in the wrong conclusion. Because this sub-article is crafted to be read cumulatively with sub-Art. 3 of the same article. While this is the case, considering this provision as an authority that companies incorporated abroad are recognized in Ethiopia by reading the provision independently, could lead to the wrong conclusion. This is what the EIC does[191]. However, whether companies incorporated abroad are recognized in Ethiopia or not will be revealed if and only if it is read out cumulatively with sub-article 3. The meaning of the cumulative reading of Art.8 (1-b) and (3) would be read as follows:

> "Investment may be carried out by enterprises established… abroad." &
>
> "Any enterprise registered in Ethiopia having been established abroad shall be governed by the Commercial Code of Ethiopia and other laws applicable to enterprises."

The cumulative reading of this article gives an insight that foreign companies are not recognized in Ethiopia. This is because though sub-article 1-b seems to allow companies incorporated abroad to carry out investment in Ethiopia by granting recognition for their legal personality and the law applicable to their internal affairs, sub-article 3 limits such rights by saying that such companies must be governed by the Commercial Code provisions. Thus, according to this sub-article, any foreign investor who brings investment capital to Ethiopia intending to invest in Ethiopia must register and obtain a certificate from the National Bank of Ethiopia (NBE). Registration here means obtaining a certificate from the National Bank for the capital that investors have entered. Apart from this, the Investment Proclamation by this sub-article has referred to the issue of recognition of foreign companies to be implemented in accordance with the provisions of the Commercial Code. On the other hand, as discussed in the previous sections, the Commercial Code provisions that govern the issue of recognition do not grant recognition to companies incorporated abroad. Rather, existing rule obliged foreign companies to be reincorporated and acquire new legal personality by the Commercial Code and should govern their internal affairs by the Commercial Code provisions accordingly. Thus, the cumulative reading of Art. 8 (1-b) and (3) refers to the issue of recognition of foreign companies to Art. 584 of the Commercial Code. As already discussed earlier, under Art. 584, Ethiopia adopts the real

---

191 *Id.*

seat theory which is a theory that denies recognition for both the legal personality and the law applicable for the internal affairs of the foreign company.

To conclude, though Art. 2 (6-c) and Art. 8 (1-b) seem that they grant recognition for companies incorporated abroad, foreign companies are not recognized under Investment Proclamation. The EIC also grants recognition by applying these two inappropriate provisions. But the Investment Proclamation still refers to the recognition to be taken place by rules governing recognition of foreign companies under the Commercial Code provisions. The Commercial Code, on the other hand, adopts the real seat doctrine which denies recognition for foreign companies. In a conclusion, companies incorporated abroad are not recognized in Ethiopia[192].

## 4.6. Real Seat Theory as a Regulatory Obstacle for the Attraction of FDI in Ethiopian Foreign Companies' Recognition Rule

As discussed above, under the Commercial Code the real seat theory recognition rule which is a regulatory obstacle for immigrating companies has been adopted[193]. In other words, it is certain that the real seat theory which Ethiopia adheres statutorily becomes an obstacle for the attraction of FDI in Ethiopia and makes Ethiopia unable to harvest its benefit to facilitate its economic development. Denying recognition for the legal personality and the law applicable for the internal affairs of the foreign companies in all circumstances is not just. However, this does not mean that the Commercial Code should grant recognition to foreign companies always. Rather it is proper to grant recognition for the legal personality of foreign companies in the following circumstances: First when the foreign companies can disclose their status for Ethiopian citizens who deal with them. Second, as the companies cannot be considered insolvent at the beginning of their business operation, their legal personality should be recognized without imposing the minimum capital requirement. Furthermore, concerning the law applicable for the internal affairs of the foreign companies, the Code should grant recognition for the law applicable for the internal affairs of the foreign company in three circumstances: (a) if no shares of foreign companies are acquired by Ethiopian nationals. (b) Though Ethiopian nationals have acquired shares in the foreign company, it is minimal that recognition overweight than denying the foreign

[192] Anthony Giustini, Nadezhda V., Tadesse K., Habtamu H., Ethiopia's New Investment Law-What Does It Mean for Foreign Investors?, Paris: Clifford Chance & Ethiopia: Tadesse Kiros Law Office, 2020, 4 Available at https://www.cliffordchance.com/briefings/2020/04/ethiopia-s-new-investment-law--what-does-it-mean-for-foreign-inv.html (November 21, 2021)

[193] See the discussion on Section 4.3.1.and Section 4.3.2. above.

law and applying Ethiopian law (the Commercial Code provisions). Third, by applying laws enacted to protect the public interest separately from laws applicable for the internal affairs of the foreign companies.

## 4.7. Incorporation Theory Subject to Exception for Recognition of Foreign Companies under the New Commercial Code of Ethiopia

### 4.7.1. Is It Necessary to Adopt Incorporation Theory Subject to Exception Currently?

FDI is, without doubt, one of the primary engines of economic growth in all economies[194]. The preponderance of studies shows that FDI triggers technology spillovers, assists human capital formations, contributes to international trade integration; helps to create a more competitive business environment, and enhances local enterprises. Ethiopia is today among the fastest-growing economies in the world[195]. Thus, like other countries, FDI also plays a great role in Ethiopia. This is why the investment law and policy of Ethiopia have the mission of enhancing investment and promoting opportunities[196]. In affirming the role of FDI to the economic development of the country the P.M. of Ethiopia Dr. Abiy Ahmmad says:

> "…Currently, Ethiopia is on the development path. Considering the current overall economic growth, FDI grew by 20% in 2020. In addition to those registered to invest, currently, 2.7 billion dollars has entered the NBE. We must continue to expand the capacity of FDI for the economic development of our country. It is the one which is solving most of our problems now."[197]

This belief of the P.M. is also reflected in the 2019 world economic forum held in Davos, Switzerland. In his speech at the forum, he highlighted the potential contribution of foreign investment to Ethiopia's economic growth as follows:

---

[194] UNCTAD, Investment and Innovation Policy Review: Ethiopia, 1 (2002) Available at https://unctad.org/system/files/official-document/poiteipcm4.en.pdf (November 23, 2021)

[195] Guide to Do Business in Ethiopia and Investing in Ethiopia, 10 Available at https://www.unido.org/sites/default/files/files/2018-08/Guide-to-doing-business-and-investing-in-Ethiopia-2016.pdf (Accessed on November 22, 2021)

[196] ELIAS, N. The investment promotion and environmental protection balance in Ethiopia's floriculture: the legal regime and global value chain (Doctoral dissertation), War wick School of Law, (2012) at p. 9-10

[197] Watch the Speech of Dr. Abiy Ahmed on 6th Annual Session of the House of Peoples' Representatives held on July 5, 2021, broadcasted by EBC available at https://www.youtube.com/watch?v=N5QEnJySBGE (Accessed on November 22, 2021).

"… We are committed to opening up the economy to international investors. We are confident that international capital and expertise will deliver significant value for Ethiopians and contribute to our development agenda."[198]

In supporting the idea of the head of state, Deputy Prime Minister of Ethiopia, Ato Demeke Mekonnen said "Our priorities are to strengthen the role of private sectors in the economy, achieved sustained growth through export-led industrialization and make Ethiopia an African beaker of prosperity by 2030. This to be achieved, the contribution of FDI is significant."[199]

It is affirmed that FDI has contributed a great role to the economic development of Ethiopia. Countries are recommended to ease mainstream regulations needed to start a business in their jurisdictions to have a better policy environment to attract FDI[200]. As a response to having a business-friendly environment, Ethiopia is undergoing significant institutional reforms and reviewing its Investment Code, Commercial Code, and other business regulations to enhance the easing of doing business in Ethiopia. The P.M also supported the reforms and called for further reforms to be continued and strengthen as follows:

"…We have also revised our investment and Commercial Code to ensure that the domestic law is business-friendly. But the revisions are not enough and deep-rooted revisions are still needed. We must continue in reviewing the mainstream regulations needed to start a business and provide a better policy environment. We should make it easier to do business for everyone who wishes to invest in our country."[201]

As repeatedly stated throughout the thesis, the incorporation theory subject to exception could facilitate the inflow of FDI to countries that adopt it by protecting the competing interests of foreign companies, creditors, and shareholders of the host state nationals and the host state public interest. Thus, the current level of economic growth of Ethiopia and her desire to attract FDI will no doubt compel her to follow this version of incorporation theory.

[198] Watch the Speech of Dr. Abiy Ahmed on the 2019 World Economic Forum held in Davos, Switzerland, Available at https://www.youtube.com/watch?v=0AwXkhFWeqM (Accessed on November 22, 2021).

[199] Watch the Speech of Deputy P.M. on the 2020 UK-Africa Investment Summit held in London, Available at https://www.youtube.com/watch?v=Rv33zdG_MGA (November 18, 2021)

[200] World Bank Group, Doing Business: Comparing Business Regulations in 190 Economies, (2020), at p. 9-10

[201] Abiy Ahmed, *Supra Note 198*

#### 4.7.2. Insight of Partakers as to the Adoption of Incorporation Theory Subject to Exception

The assessment made by the author of this work in EIC, Jimma Industrial Park Development Corporation (IPDC), and with some legal experts reveals favoring the adoption of incorporation theory subject to exception under the New Commercial Code provisions.

A legal expert at EIC explains the advantage of incorporation theory subject to exception by supporting its adoption as follows:

> *"When companies incorporated abroad apply to establish a branch (principal place of business in Ethiopia, the Commission grant recognition both for their legal personality and the law applicable to the internal affairs. The companies do not lose the legal personality they have acquired abroad. However, if the Commission denies the companies legal personality and obliged to reincorporate according to Ethiopian Commercial Code provisions, this would expose them to incur dissolution cost in the home state and reorganization cost in Ethiopia and discourage them not to come and invest in Ethiopia"*[202]

EIC-Jimma Industrial Park Branch Manager also supports the adoption of incorporation theory subject to exception. In criticizing the real seat theory he expresses his view as follows:

> *"In our park, there are three foreign companies now in operation. The machinery planted for the production process is heavy and costs billions of dollars. Unexpectedly, Ethiopian nationals can acquire shares in these foreign companies. So, obliging foreign companies to regulate their internal affairs by Commercial Code provision has no usage apart from discouraging foreign companies to come and invest in Ethiopia. Not only have these, but the foreign companies have also created job opportunities, transfer technology, and skills. They also earn foreign currency by producing export-oriented products. Not only this, huge companies in Ethiopia are very few. So, I believe the incorporation theory subject to exception play a great role foreign companies to be established in Ethiopia by avoiding the regulatory obstacles in the real seat theory.*"[203]

Some legal experts also do not support the adherence to the stricter and dogmatic form of real seat theory under art 584 and 586 of the Commercial Code. As to them, the theory focuses only on creditors' and shareholders' protection. It does not take into consideration that the application of this theory in its stricter form will expose foreign companies to incur costs at the home state

[202] Ahmmed Yusuf, *Supra Note* 155

[203] Interview with Ato Mulugeta Tsegaye, EIC-Jimma Industrial Park Branch Manager, on November 19, 2021

and host state (Ethiopia) due to dissolution and reorganization respectively and this will affect their economic competitiveness at the international level, and finally discourage not to come and invest in Ethiopia.[204] In addition to this, they have also said that it is not recommended for Ethiopia to adhere to this doctrine at this level of economic development[205].

### 4.7.3. The Adoption of Incorporation Theory Subject to Exception for Recognition of Foreign Companies under the New Commercial Code of Ethiopia

As discussed in the preceding sections, justifying improper ways of creditors, shareholders, and the protection of the public interest, the real seat theory recognition rule creates a lot of obstacles for foreign companies coming to invest in Ethiopia. On the other hand, the incorporation theory subject to exception has enshrined rules that would not expose foreign companies to incur costs and snatch the founders' right to party autonomy when they transfer their real seat to Ethiopia while the interest of creditors, shareholders, and the general public is still protected. Because of this, experts from industrial parks and some legal experts favor the avoidance of real seat theory and replacing it with the recognition rule of incorporation theory subject to exception under the New Commercial Code of Ethiopia. Reaching this conclusion raises a valid question that how this foreign companies' recognition rule should be crafted?

As the experiences of other countries shows, the degree of measures imposed on foreign companies to protect the interest of host state's nationals who engage in business dealing with the foreign companies, the way by which circumvention to minimum capital rule was categorized under public or private law issues, the law applicable for creditors protection and the pre-condition for recognition of legal personality is crafted in a way that able to protect the interests of the host state's nationals who engage in business dealing with the foreign companies and in a manner that does not expose foreign companies to incur costs when they transfer their real seat to their jurisdiction. Furthermore, situations when the founders' right to party autonomy has limited to protect the interest of the host state's nationals who acquire shares in the foreign company and the way host states protect the violation of public laws by letterbox companies are crafted for companies that transfer the real seat to their jurisdiction.

---

[204] The argument summarized from the opinions forwarded by (1) Ato Ermias Melese, *Supra Note* 151 (2) Ato Mulugeta Tsegaye, *Supra Note* 203

[205] *Id.*

# CHAPTER FIVE

# 5. FINDINGS, CONCLUSION, AND RECOMMENDATIONS

## 5.1. Findings

In the existing legal framework, Ethiopia statutorily adheres to the real seat theory recognition rule. Accordingly, under the Commercial Code, it has used real seat (head office or principal place of business) as a connecting factor to determine the nationality of companies and the law applicable to their internal affairs. Therefore, the legal personality and the law applicable to the internal affairs of companies incorporated and duly formed abroad who seek to operate a business in Ethiopia by transferring their head office or principal place of business are not recognized in Ethiopia. As a result, they lack legal personality and consequently could not sue and be sued in their capacity as a foreign company in Ethiopian courts. They are also banned from performing any juridical acts including business operations.

However, if they prefer to operate a business in Ethiopia, they should reincorporate following the Commercial Code provisions and Investment Proclamation. The reincorporation requires the transfer of registered office together with head office or principal place of business. Transferring a registered office presupposes dissolution and winding up in the home state. Hence, the winding-up makes the companies pay huge taxes for the home state. The reincorporation also incurs organizational costs in Ethiopia. Furthermore, obliging the companies to regulate their internal affairs by the Commercial Code provisions restrict the founders' right to party autonomy, right to choose the best company law regime that favors their business. While the theory by its nature is a regulatory obstacle and embodied preconditions that expose foreign companies to incur a lot of costs, Ethiopia adopts it justifying creditors, shareholders, and the general public interest protections. This results in discouraging foreign companies not to come and investing in Ethiopia. If this is so, it makes Ethiopia unable to harvest the benefits of FDI to facilitate its economic development. In practice, EIC grants recognition to foreign companies without any established rule justifying only provisions of Investment Proclamations which seem to grant recognition despite the provisions referring the issue of recognition to the real seat theory adopted under the Commercial Code. Therefore, finding out a legal solution that could able Ethiopia to harvest the benefits of FDI by allowing foreign companies to be established businesses in a cost-effective way and exercising their right to party autonomy while the interests

of creditors, shareholders, and the general public are protected is necessary. In this regard, replacing the real seat theory with incorporation theory subject to exception under the New Commercial Code of Ethiopia is indispensable and would expect to provide the following benefits.

First, replacing the real seat theory by incorporation theory subject to exception can able to avoid the legal obstacles enshrined within the real seat theory and save foreign companies not to incurring costs due to dissolution and reorganization in the home state and host state (Ethiopia) and eases doing business in Ethiopia. It also respects the founders' right to party autonomy. Due to this, a recognition rule which does not expose foreign companies incorporated abroad to incur costs when they establish a business by transferring their head office or principal place of business is applied by countries especially developing ones who seek to attract FDI and boost their economies such as India, Philippines. The incorporation theory subject to exception recognition rule prohibits the host state from imposing disproportional measures on immigrating companies. It also prohibits the host state from violating the founders' right to party autonomy and imposes unjustified measures in the case when the form of incorporation abroad is different from the form that is recognized under the host state. The application of real seat theory in its stricter form exposes foreign companies to incur costs by imposing disproportional measures. Furthermore, it snatches the founders' right to party autonomy under the cover of shareholders protection without having concrete facts to what extent the host state's citizens acquire shares in the foreign companies. It also imposes unjustified measures. The costs that foreign companies incur highly affect their economic interest and accordingly make them not competitive at the international level and finally discourage them from investing in countries that adopt the real seat theory which contains draconian requirements. As a legal framework that governs the inflow of FDI, if the recognition rule contains measures beyond necessary to provide information for nationals of host state who will engage in business dealing with the foreign company, take into consideration violation of minimum capital requirement as issues under public law, obliging the foreign companies to regulate their internal affairs by its Company law without taking into consideration to what extent its nationals are acquired shares in the foreign company and justify the violation of public laws to deny the Company law of the home state as a law applicable to the internal affairs, it is unquestionable that the recognition rule crafted in this way would be an obstacle for the attraction of FDI. Thus, adopting the incorporation theory subject to exception

makes a country have a recognition rule which does not expose immigrating companies to incur a cost. Otherwise, the adherence to a stricter form of real seat theory would be a legal obstacle for foreign companies who seek to invest in countries that adhere to this draconian form of recognition rule.

Second, it makes Ethiopian citizens have enough information about the status of foreign companies and able to make the right choice before entering into a business dealing with them to protect their interest. It also protects the interest of Ethiopian nationals by subjecting the foreign companies to the Commercial Code provisions in the case when a substantial amount of shares of the foreign companies are acquired by Ethiopian nationals.

Third, the adoption of incorporation theory subject to exception helps Ethiopia to attract FDI, harvest its benefits to boost its economy, and able to achieve its plan of being a lower-middle-income country by 2030.

Fourth, it enables the Ethiopian government to control foreign companies incorporated abroad in circumstances when the companies arrange themselves in a manner that violates laws enacted to protect the public interests such as tax law, labor law, etc. by applying the doctrine of abuse without affecting the interest of foreign companies to govern their internal affairs by the Company law of the place of incorporation.

## 5.2. Conclusion

Seeking to harvest the benefits of FDI, to facilitate their economic development, countries of the world allow/grant recognition to companies incorporated abroad to operate business activities by transferring head office or principal place of business to their jurisdictions. To grant recognition to companies incorporated abroad, countries might adhere to either a pure version of incorporation theory, the real seat theory, or incorporation theory subject to exception. However, while the pure version of incorporation theory could be a cause for abuse of host state's public laws by letterbox companies and a cause to regulatory competition race to the bottom, the real seat theory becomes a regulatory obstacle for immigrating companies.

The pure version of incorporation theory uses registered office/place of incorporation as a connecting factor. Accordingly, it grants recognition for the legal personality and the law applicable to the internal affairs of companies incorporated abroad without putting any exception. While adopting this doctrine lays a favorable ground for the companies, it exposes the interests of creditors and shareholders of the host state nationals, and the interest of the general

public to be at stake. The real seat theory, on the other hand, uses head office/principal place of business as a connecting factor to determine the nationality of companies and the law applicable to the internal affairs. Accordingly, it denies recognition for the legal personality and the law applicable for the internal affairs of companies incorporated abroad. Rather, it requires the companies to be reincorporated in the host state jurisdiction. In addition to reincorporation, it also enshrines some draconian requirements within it. For example, it imposes the minimum capital requirement, tries to protect creditors by Company law rather than Bankruptcy law and hence fail to have a cross-cut between the two laws regarding creditors protection, takes circumvention of minimum capital requirement as a ground to deny the legal personality by considering it as an interest fall under the category of public interests. Furthermore, it requires the companies to be reincorporated and regulate their internal affairs by the host state's company law. Worst, it imposes the duty to fulfill rules on share companies which oblige recording the decision of the general meeting of shareholders into the Commercial register and liability of directors if the forms of incorporation abroad are different from the forms of business organizations recognized under the host state's Company law.

The study reveals that the Ethiopian Commercial Code adopts the stricter form of real seat theory. The legal personality and the law applicable to their internal affairs are not recognized. As a result, they lack their limited liability status, are unable to sue and be sued in Ethiopian courts, and cannot operate business activities at all. If they seek to operate a business in Ethiopia, they should be reincorporated following the Commercial Code provisions and acquire new legal personality, fulfill minimum capitalization rule, there is also the tendency to protect the interest of creditors by Company law rather than Bankruptcy law and accordingly fail to have a demarcation line between the two laws regarding creditors protection. In addition to acquiring a new legal personality, they are under a duty to regulate their internal affairs by the Commercial Code provisions. Worst, they are under a duty to fulfill rules on share companies which oblige recording the decision of the general meeting of shareholders into the Commercial register and liability of directors if the forms of incorporation abroad are different from the forms of business organizations recognized under Art. 174 of the Code. However, in practice, the EIC grants recognition for companies incorporated abroad though it authorizes inappropriate legal grounds. But the Commission does not bother about the protection of creditors and shareholders who are Ethiopian nationals.

Thus, the study focused, to have a recognition rule which encourages the inflow of foreign companies and enable Ethiopia to harvest its benefit while the interest of its nationals who engage in business dealing with the foreign companies and who acquires shares in the foreign company, and the interest of the general public are still protected i.e. replacing the real seat theory with incorporation theory subject to exception. As the experience of India, Philippines, and Belgium, and the international and regional legal instruments shows, this doctrine allows the investment regulatory organs to grant recognition in a manner that the interest of the above stakeholders are protected and could make their country to be attractive to foreign investors.

But, when we come to the Ethiopian experience, the existing legal framework of Ethiopia adopts the stricter form of real seat theory recognition rule under the New Commercial Code. However, while many countries which adhere to this theory had stopped and began to adhere to the incorporation theory subject to exception, Ethiopia still statutorily adheres to the real seat doctrine. However, practically, the EIC grant recognition though the law prohibits so.

Currently, Ethiopia is among the fastest-growing economies in the world. FDI is needed to catalyze its economic development. In addition to its Investment Proclamation and other developmental plans, some legal experts argue that the current developmental level of the country is not the right time to adhere to the real seat theory recognition rule. Therefore, it is necessary to replace the real seat theory with carefully crafted incorporation theory subject to exception recognition rule which can encourage the immigration of foreign companies to Ethiopia while the interest of Ethiopian nationals who are creditors and shareholders of the foreign companies and the interests of the general public is protected.

Thus, based on the previous discussion and findings, the author would like to recommend the following points:

## 5.3. Recommendations

(1) To encourage foreign companies to invest in Ethiopia and makes Ethiopia harvest their benefits and boost its economy while the interests of creditors, shareholders, and the general public are protected, lawmakers should take into consideration the dogmatic and being regulatory obstacle nature of the real seat theory adopted under the New Commercial Code of Ethiopia and should remove it and replace by a well-crafted recognition rule of incorporation theory subject to exception.

(2) The recognition rule of incorporation theory subject to exception should be formulated in a manner that able to grant recognition for the legal personality and the law applicable for the internal affairs by taking lessons from the notable jurisdictions, international and regional legal instruments, and the case laws as follows:

(a) First, the connecting factors, head office or principal place of business, adopted under Art. 584 of the Commercial Code should be removed and replaced by a connecting factor called the place of incorporation/registered office. As using this connecting factor results in granting recognition for companies incorporated abroad, it could veil them from incurring costs due to dissolution in the home state and reincorporation/reorganization in Ethiopia. As such, it is advisable to obliged the company to mention the full address of the registered or principal office of the company in the home state on documents it submits for registration As Section 380 (1-b) of the Indian Company Act does.

(b) Once the registered office is used as a connecting factor, the rules on recognition of legal personality, applicable laws, and laws to protect public interest could be framed as follows.

**A) Rules on Legal Personality**

In formulating the rules on recognition of legal personality,

(a) It is better to impose only disclosure requirements on the foreign companies so that Ethiopian nationals who would engage in business dealing with them could have enough information about the status of the companies and be able to make the right choice before entering into a business dealing with them. If protection of creditors' interest is made in this way, the measure imposed becomes proportional and keeps foreign companies out of unnecessary expenses. In doing so, it encourages foreign companies to immigrate to Ethiopia. This is the only proportional measure that should be imposed for creditors' protection.

(b) It is recommended if minimum capital requirement is eliminated because (1) imposing minimum capital requirement makes the measure for the protection of Ethiopian nationals who engage in business dealing with foreign companies disproportional (2) Minimum capital requirements would not provide real protection to creditors. This is because minimum capital requirements are not of a size appropriate to ensure creditors' protection. It is hard to see how small sums of money that companies maintain initially are enough to protect creditors, especially when a company can incur liabilities that

amount to millions. (3) While recognition is a matter of Company law, creditors' protection is a matter of Bankruptcy law. So, it is illogical to justify creditors' protection to deny the legal personality.

(c) Circumvention to minimum capital should not be considered as rules of private law that amount to abuse and could be a ground to deny legal personality. Considering minimum capital requirement as such as is an obstacle for immigrating companies as decided by the ECJ on Inspire Art case of 2003.

**B) Rules on applicable law**

In formulating the rules on recognition of applicable law,

(a) It is advisable to grant recognition for the law applicable to the internal affairs of companies incorporated abroad unless a substantial amount of shares of the foreign companies are acquired by Ethiopian nationals. This is because, when Ethiopian nationals acquire no shares or a minimal amount of shares, the advantage of granting recognition overweight than the interests of shareholders. The substantial amount possibly will be 50% as adopted under Section 379 of the 2013 Indian Company Act or another amount based on the Ethiopian context.

(b) To avoid unjustified restrictions imposed to ignore the Company law of the country where the companies or firms are incorporated based on the difference in forms of incorporation abroad under Art. 586 of the Commercial Code, it would be advisable to expand the meaning of companies or firms incorporated abroad. This would encourage foreign companies to arrive in Ethiopia with different forms of establishments. The scope of the meaning of companies or firms will be expanded as the meaning of companies or firms mentioned under Art. 54 Paragraph- 2 of the TFEU.

**C) Rules on Laws Enacted to Protect the Public Interest**

The measures which has taken for violation of public laws such as tax law, employment law, etc. by foreign companies should be formulated in a manner that does not result in denial of recognition for the legal personality and the law applicable to the internal affairs. Rather, it is advisable to oblige the companies to respect the respective violated laws by applying the doctrine of abuse. In other words, the connecting factor for public laws should be the principal place of business while the registered office is for the laws applicable to internal

affairs. A better formulation of such laws could be shown under Section 146 of the 2019 Revised Corporation Code of the Philippines.

(3) The EIC then should grant recognition based on the newly formulated recognition rule i.e. incorporation theory subject to exception.

# BIBLIOGRAPHY


## Books

- THOMAS BACHNER, CREDITOR PROTECTION THROUGH INSOLVENCY LAW IN ENGLAND, (2006)
- PASCHALADIS PASCHALIDIS, FREEDOM OF ESTABLISHMENT AND PRIVATE INTERNATIONAL LAW FOR CORPORATIONS (Oxford University Press in Private International Law Series) (2012)
- GOWER-DAVIES, PRINCIPLES OF MODERN COMPANY LAW (6th edition, 1997)
- GIJS FIBBE, EC LAW ASPECTS OF HYBRID ENTITIES (Doctoral Series, 2009)
- STEPHAN RAMMELOO, CORPORATIONS IN PRIVATE INTERNATIONAL LAW: A EUROPEAN PERSPECTIVE (Oxford University Press in Private International Law Series) (2001)

**Journals**

- Nabil Md. Dabour, The Role of Foreign Direct Investment (FDI) in Development and Growth in OIC Member Countries, 21 (3) Journal of Economic Cooperation, 27 (2000)
- Massimo Benedettelli, Five Lay Commandments for the EU Private International Law of Companies', 17 Yearbook of Private International Law 209 (2015/16)
- Sinisa Petrovic Jr. & Tomislav Jaksik, Right of Establishment and Corporate Mobility-An outline of Issues, 636 (2011)
- Marc V. De Looverbosch, Real Seat Theory v. Incorporation Theory: The Belgian Case for Reform, Int'l Company & Common L Rev, (2016)
- Eric Stein, Conflict of Laws Rules by Treaty: Recognition of Companies in a Regional Market, 68(7) MICH. L. REV. 1327 (1970)
- Werner F. Ebke, The "Real Seat" Doctrine in the Conflict of Corporate Laws, 36 (3) INT'L LAW 1015 (2002)
- Robert R. Drury, The Regulation and Recognition of Foreign Corporations: Responses to the "Delaware Syndrome", Cambridge Law Journal 1 (1998)
- Anatoli van der Krans, The Virtual Shareholders Meeting: How to make it Work?, 2(1) Journal of International Commercial Law and Technology 32, (2007)

**Online Journal**

- Anthony Giustini, Nadezhda V., Tadesse K., Habtamu H., Ethiopia's New Investment Law-What Does It Mean for Foreign Investors?, Paris: Clifford Chance & Ethiopia: Tadesse Kiros Law Office, 2020, 4 Available at https://www.cliffordchance.com/briefings/2020/04/ethiopia-s-new-investment-law--what-does-it-mean-for-foreign-inv.html
- The Role of FDI in Economic Growth Available at https://www.articlelibrary.com/economics/role-of-foreign-direct-investment-in-economic-growth/40257
- ISS, Policy Brief Key to on the Horn Ethiopia's Prospects to 2030 (2017), Available at https://media.africaportal.org/documents/policybrief102.pdf
- Why are Minimum Capital Requirements a Concern for Entrepreneurs? Available at https://www.doingbusiness.org/en/reports/case-studies/2013/why-are-minimum-capital-requirements-a-concern-for-entrepreneurs

**Reports**

- World Bank Group, Doing Business: Comparing Business Regulations in 190 Economies, (2020)
- UNCTAD, Investment, and Innovation Policy Review: Ethiopia, (2002)
- World Bank Group, Comparing Business Regulations for Domestic Firms in 189 Economies 41 (11th Edn) (Doing Business, 2014)
- Carsten G. Buehrle, Federico M, Edmund S., and Mathias S., Final Report of the European Commission: Study on the Law Applicable to the Company, (Luxembourg: Publication Office of the European Union, 2016)
- Carsten Gerner-Beuerle, JR., ET AL., Making the Case for a Rome V Regulation on the Law Applicable to Companies, (ECGI Working Paper Series in Law, 549/2020, Oct. 2020)
- Christiana HJI Panayi, Corporate Mobility in Private International Law: Debunking Some Myths (Legal Studies Research Paper No. 26.09. Queen Marry University of London, 2009)

- Gerner-Beuerle, ET AL., The Illusion of Motion: Corporate (IM) Mobility and the Failed Promise of Centros, (2019)
- Eddy Wymeersch, the Transfer of the Company's Seat in European Company Law, European Corporate Governance Institute Working Paper Series in Law No. 08 (2003).

**International Legal Instrument**

- The Convention of 1 June 1956 of the Hague Conference on Private International Law

**Regional Legal Frameworks**

- The Treaty on the Functioning of the European Union (TFEU)
- The EEC Convention on the Mutual Recognition of Companies of 1968

**Case**

- C-55/94 Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procurator di Milano [1995] ECRI- 04165
- Case C-23/93 TV10 [1994] ECR I-4796
- Centros Ltd. v Erhvervs-og Selskabsstyrelsen [1999] ERC I-1459
- Uberseering BV v Nordic Construction Company Baumamagement GmbH (NCC) [2002] ERC 1999 I-9919
- Inspire Art Ltd. v Kamer Van Koophandel en Fabrieken voor Amsterdam [2003] ERC 20003 I-10155

**Foreign Legislations**

- The 2013 Revised Company Act of India
- The 2019 Revised Corporation Code of the Philippines
- The 2019New Belgian Company and Association Code

**Domestic Legislation**

- The New Commercial Code of Ethiopia, Proclamation No. 1243/2020
- Ethiopian Investment Proclamation No. 1180/2020

**Interviews**

- Interview with Ato Ermias Melese, senior legal advisor at Ethiopian Investment Commission, on November 8, 2021
- Interview with Ato Ahmmed Yusuf, Director License and Registration Directorate, at Ethiopian Investment Commission, on November 8, 2021
- Interview with Ato Antenne Wolde, Regulation Team Leader at EIC, Interview Conducted on November 8, 2021
- Interview with Ato Mulugeta Tsegaye, EIC-Jimma Industrial Park Branch Manager, on November 19, 2021

**Websites**

- The Belgian New Code of Companies and Associations: From Real Set Theory to Incorporation Theory. Available at https://www.eubelius.com/sites/default/files/09_corporate_mobility.pdf
- The OECD, Policy Brief on the Social Impact of FDI, (2008), Available at https://www.oecd.org/els/emp/The-Social-Impact-of-foreign-direct-investment.pdf
- https://europa.eu/epso/doc/en_lawyling.pdf
- https://corporatefinancelab.org/2017/02/21/real-seat-theory-vs-incorporation-theory-the-belgian-case-for-reform/
- https://jeanmonnetprogram.org/archive/papers/01/012701-03.html
- https://www.worldbank.org/en/news/feature/2019/11/18/ethiopias-industrial-parks-are-making-jobs-a-reality