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BY

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MAJOR PROBLEMS ASSOCIATED WITH PRIVATE LIMITED COMPANIES IN ETHIOPIA: THE LAW AND THE PRACTICE

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DECLARATION

I, the undersigned, declare that the thesis is my original work and has not been presented for a degree in any other university and that all sources of materials used in the thesis have been duly acknowledged.

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ABSTRACT

Business organizations are important to operate business activities that demand the involvement of many persons. In these days, therefore, business organizations are getting momentum in every sector of the economy. In most jurisdictions, business organizations are classified as companies (corporations) and partnerships. The 1960 commercial code of Ethiopia provides six forms of business organizations, among which two of them are companies, namely share companies and private limited companies.

In Ethiopia, private limited companies are dramatically increasing in all corners of the country and its role in the economy of the country is also considerable. Private limited company in Ethiopia, however, is surrounded by problems irrespective of its tremendous rising up. The problems are related with the provisions of the commercial code governing private limited company in Ethiopia. The sketchy nature of the provisions in the commercial Code in turn brought about practical problems which are prevailing in every company. In this regard, the study tries to point out the legal and practical problems related with: fully paid up capital, the mandatory legal requirement of the two members in the formation of such company, restrictions of share transfer out side the company, and the limited liability of members who manage a private limited company. Accordingly, the thesis tries to recommend that the commercial code should be amended so as to rectify the existing problems.

Introduction

Business Organization is an important scheme that enables people to do business which would be difficult, if not impossible, for them to do alone. Thus in these days business people tie themselves under certain form of business organization's chain and tackle commercial hurdles through collective efforts.

In Ethiopia, present day witnessed proliferation of tremendous business organizations in all corner of the country. The structure of business organization chosen may, however, have an impact on how simple it is to obtain finances, how taxes are paid, how accounting records are kept, whether liability of members is limited or unlimited, the ways of management have to be taken in to account before commencing the business operation.

The 1960 Commercial Code of Ethiopia has recognized six forms of business organizations. Thus, the study tries to shade some lights on these forms of business organizations. The prime concern of this paper is, however, about the major problems associated with private limited companies in Ethiopia. In effect, the discussion of this paper does not apply to sole proprietorships, civil associations under the Civil Code and the public enterprises.

The law of the US, UK, German and French were also chosen and discussed in the paper. These countries have been chosen because they are considered as key legal innovators and economically successful. To this end, the German and French Civil and Commercial Codes formed the basis of business law in many countries; the UK is widely recognized as a birth place of the common law and the US as democratizing the corporations.

As a result, by studying the ways in which firms operating under those jurisdictions and institutions have successfully solved the organizational problems they faced, Ethiopia may learn much about how to make its institutional heritages work to support its economic growth.

Terminologies and words used in Ethiopian law have been employed instead of those in the references of foreign jurisdictions where it is believed that will not affect the ideas in the references being used. Consequently, corporation, publicly held corporation and closely held corporation are some of the terms comparably used in Ethiopian law as Company, Share

Company and Private Limited Company respectively. As a matter of fact these words may also be used interchangeably in this paper.

The paper is organized in five chapters. Accordingly, the first chapter is about the proposal of the study, which is concerned with background, the problems that need to be addressed, and the objective of the study, the significance, the scope and methodology employed in the study

The second chapter deals with partnerships. In this chapter an overview on business organizations, types and nature of partnerships, formations, management and dissolution of partnerships are the main concern.

Chapter three is devoted to companies in general and in Ethiopia. Hence, an attempt has been made to discuss: an overview on companies, nature of companies in Ethiopia with respect to formation, shares, company governance and management, legal personality and its consequences, piercing corporate veil and dissolution of companies. Further, similarities and distinctions of a share company and a private limited company are assessed for the purpose of comparison.

Chapter four is concerned with the theme of the paper, which is about major problems associated with private limited companies in Ethiopia. Thus, the problems related with fully paid up capital, the two man requirement, restrictions of free transfer of shares, management and limited liability of members will be dealt in the chapter. In this regard, the law and the practice will be analyzed on the basis of court cases and data found from Ministry of Trade Industry.

The fifth chapter deals with conclusion and recommendations on basis of the findings of the study. In the chapter an attempt has been made to demonstrate the legal and practical problems related to private limited companies in Ethiopia, and to recommend possible solutions.

CHAPTER ONE

Proposal of the Study

1.1. Background

Business organizations have existed for a long period of time though they were not more refined and structured as they exist today. Scholars agree that partnerships were in use for carrying on trade before Companies came in to being.[1] Further, as commerce had grown, more business men's speculation had further increased and limited partnership type of business organization were invented.[2] At the close of middle ages, however, limited partnerships were not in a position to accommodate the extensive and intensive commercial activities developed in Europe.[3] This in turn required more people who could be willing to contribute money to merchants or to partnerships of merchants in order to raise huge capital.

Nevertheless, there were problems in those days that the large number of partners was difficult to participate in the management of a partnership and, some of them had no idea about business.[4] Consequently, forming corporate body was to be one of the solutions to the problems of the then. This is because corporations (companies) allow persons to invest their money, and become owners without imposing unlimited or management responsibility on themselves.[5] This is in the sense that many people were anxious and willing to invest their savings in large, risky business if they have limited liability and limited management responsibility.[6] Indeed, Corporations were found to be convenient because of their legal personality, limited liability, and unlimited number of contributors.

Despite the ancestors of the modern corporation existed in the time of Hammurabi, ancient Greece, and Roman Empire,[7] a great increase in number and activities of the Chartered Companies took place during the second half of the 16th Century, when the English, French and

[1] Selamu Bekele, Private Commercial Companies under Ethiopian law : Legal and Practical Significance, Faculty of Law A.A.U. (unpublished) 1966, p.1.
[2] Ibid
[3] Ibid
[4] Ibid, p. 2
[5] Michael B. Metzger and et al, Business Law and Regulatory Environment Concepts and Cases, (8th ed) Irwin Inc. Boston, 1992, p. 897.
[6] Ibid

Dutch governments were ready to assist trade and encourage overseas exploration.[7]In England, two of the earliest and most important of over seas trading Companies were the Muscovy Company (1555) and the Turky Company (1583)' and Company for African trade was also founded in 1585.[8]

Further more, in France, from 1599 to 1789, more than 70 companies came in to existence and the French East India Company was founded in 1664, and the colonial and Indian trade was placed in the hands of Chartered Companies in which the king himself had large financial interests.[9] The financial crush of 1720s, however, destroyed public confidence of chartered companies, and the later development of modern limited liability company under successive companies acts led to a decline in the importance of Chartered Companies.[10]

To this end, as the advantage of incorporation soon became obvious, business men wanted more and more to incorporate their business venture, and began to organize in a corporate form without waiting for a royal charter.[11] Consequently, the state had established regular procedures that enabled it to regulate such de facto corporations. A corporation is a legal entity separate from its shareholders; it erects an imaginary wall, between a corporation and its share holders, that protects share holders from liability for a corporation.

From the above discussion, one can comprehend that the development of a business organization was from individual trader to a group of individuals, in the form of partnership and from limited partnership to a corporate form of business organization.

In Ethiopia, an organized form of business had its inception during the region of Emperor Menelik II, however, the then small and a few firms were in the hand of foreigners, whose residence was in the Empire.[12] Moreover, in 1894 Emperor Menelik granted a concession to his Swiss advisor, Ilg, authorizing him to establish a company for the purpose of building a railway

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[7] The New Encyclopedia Britannica (15th ed.) vol.3, USA 2005, p.132
[8] Ibid
[9] Ibid
[10] Ibid
[11] Selamu supra note 1, p.2
[12] Richard Pankhurst,The Reign of Menelik:An Era of Innovation" Tarik ,Addis Ababa 1963, No.2, p. 2

from Djibouti to the White Nile, Via Harar and Entoto.[13] This Company was formed in France and in return for the concession, the company had to grant shares of the company and in addition half the profits when ever these exceeded 3,000,000 Francs to Emperor Menelik.[14] Further, in 1905, the Bank of Abyssinia was established at Addis Ababa as a branch of the National Bank of Egypt, an English company.[15]

The first Private Share Company in Ethiopia was, nevertheless, established in the name of Agricultural and Commercial Development Company of Ethiopia in 1909.[16] The Company was incorporated by Imperial proclamation and the founders who signed the memorandum of association were the Emperor, the empress and other five officials of the emperor.[17] According to the company's articles of association, the duration of the company was 51 years subject to the extension by the decision of the meeting of share holders. Further, the company was established with the capital of 3,200,000 Maria Theresa Dollars, a quarter of which had to be paid up when the memorandum of association was signed and it was divided in to 40,000 shares with the par value of 80 Maria Theresa Dollars.[18] Decisions were passed by majority vote and it was binding on all share holders including those who could not vote and could dissent.

Some of the principles provided in such Company's articles of association were enshrined in the Company law of 1933 and later in the Commercial Code of 1960.[19] From the aforementioned discussion one can observe that the 1909 Ethiopian private company was the beginning of Ethiopian company law prior to the promulgation of the consolidated company law of 1933. Towards the end of the reign of Menelik II, there were several business firms managed and owned by individuals but no evidence of national company.[20]Accordingly, no suggestions were given by travelers or historians with respect to the advancement of business organizations from the reign of Menelik to the Company law of 1933.[21]

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[13] Ibid
[14] Selamu supra note 1,p .4
[15] Pankhrust supra note12, p.23
[16] Selamu supra note 1,p.4
[17] Ibid
[18] Ibid
[19] Ibid
[20] Pankhurst supra note 12
[21] Ibid

The Company law of 1933 was enacted to govern, inter alia, the formation, acquisition of legal personality and administration of the then companies.[22] The law was written in Amharic and French, and it deemed to have been modeled on the French Company law.[23] The law was, nevertheless, not as such tested in practice as it was interrupted by the Italian invasion and occupation of Ethiopia in 1936. When Emperor Haile Sellassie returned home in 1941, the matter started again and the number of business organizations greatly increased and the participation of Ethiopians were also considerable though not as supposed to be.[24]This is to mean that foreigners still played a great role in holding business organizations with all its problems. Indeed, foreigners actually invested in small sums and expected quick returns rather than investing on large scale businesses. As a result, they preferred partnerships to share companies and in effect the development of the later lagged behind.[25]

Twenty four years later, the current Commercial Code of Ethiopia was promulgated in 1960. The Code created a new and comprehensive law of business organizations. As its predecessors, the Company law provisions of the Commercial Code were also suspended during the Derg regime (from 1975-1991) where formation and owning private companies were prohibited by the socialist government. Nonetheless, the company law has become effective and a number of companies have been established since 1991, as the current government is pursuing the free market economic system.

The Ethiopian Commercial Code of 1960(the Commercial Code herein after) provides six forms of business organizations, namely:[26] Ordinary Partnership (Arts 227-270), Joint Venture (Arts. 271-279), General Partnership (Arts. 280-295), Limited Partnership (Art. 296-303), Share Company (Arts. 304-509) and Private Limited Company (Arts. 510-543). Although the main concern of the paper is the private limited company, some lights will be shaded on all forms of these business organizations. For the purpose of this paper, the writer will classify the six business organizations into two: partnerships and companies, and deal in different chapters.

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[22] Selamu supra note 1, p. 5
[23] Ibid
[24] Ibid
[25] Ibid
[26] Commercial Code of the Empire of Ethiopia ,Negaret Gazeta, extra ordinary Issue, No. 3 of 1960, Art. 212 (1).

Under Ethiopian law both forms of companies provide limited liability for their shareholders. That is to mean that the share holders are not personally liable for companies debts rather the company's liability should be meet by the asset of the company. But there are a number of distinctions between these companies. Among the two companies recognized in the law of Ethiopia, private limited company has been the prominent one. For instance, out of 9897 companies registered the number of private limited companies is 9504(about 96%), whereas the number of the share companies is only 393(about 4%).[27]

To sum up, though private limited company is prevalent in the country, there are a number of problems associated with its legal regime and practice as well. Hence, the study tries to show those problems and recommend gap-closing solutions.

1.2. Statement of the Problem

A Private limited company is more suitable for small and medium size businesses composed of a few members, who were not only acquainted with one another but also who supplied all of the capital themselves. Further, it is also a hybrid form of business organization as it shares the characteristics of a partnership and that of a share company.[28] A private limited company is, however, criticized for various problems surrounding the same, *inter alia,* the following are some of the major ones:

- Members may not pay the capital fully as required by the law though shown in the memorandum of association.
- As a result, the concept of fully paid up capital has been the source of conflicts and litigations in Ethiopia. What is more, creditors of a company may not be adequately protected as the law does not provide sufficient safeguarding mechanisms with respect to the fully paid up capital;
- The mandatory requirement of the 'two man' in the formation of a private limited company is the other problem. In actual sense, the legal minimum requirement in Ethiopia is nominal or fake.

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[27] Data obtained from Ministry of Trade and Industry, Data Base Department, November, 2008
[28] Everett F. Goldberg, an Introduction to the law of Business Organizations, J.Eth.L. vol 8 No.21972, p.502

- The above requirement may also lead a company to the dissolution if disagreement arises between the two members or when one of them decides to withdraw or dies ;
- Restrictions of share transfer and minority oppression is also prevalent in private limited companies,
- As far as organizations of a company is concerned, lack of explicit prohibition or permission with regard to appointment of board of directors, and auditors for a company with twenty or less than twenty members, and
- Whether a member manager of a private limited company should be liable for company debts or not.

Based on the above problems, the study tries to address:

- Whether the capital shown in the memorandum of association of a private limited company has really been contributed fully or not in practice?
- Whether the provisions governing a private limited company are sufficient to protect third party creditors of the company?
- Whether the requirements of two members in the formation of a private limited company attain the purpose as supposed to be?
- Whether restrictions of shares transfer in those companies is prejudicial to the members particularly the minority share holders?
- Should private limited companies appoint auditors or not if their number is less than twenty?
- To what extent should the Ethiopian law shield members who manage a private limited company for liability of the company?
- In sum, the study attempts to address the legal and practical problems related with the:
    - Formation,
    - Share transfer restrictions,
    - Organization of the Company,
    - Limited Liability of members of a private limited companies.

1.3. Objectives of the Study

There has been a paradox as regards to the private limited companies of Ethiopia. On the one hand, it is a prevalent business organization compared to a share company; on the other hand, it is criticized for its legal and practical problems. Thus, it has paramount importance to identify the problems or the gaps that equate it a problem fraught business organization, and recommend the solutions. Besides, as the number of private limited companies being established in Ethiopia is highly increasing, it is prudent to rectify the existing problems surrounding this company, so as to accommodate foreign and domestic investors that would contribute much for the economic prosperity of the country. Having this in mind, the objective of the study will be:

- To detect out the gaps of legal provisions governing private limited companies and recommend solutions,
- To provide information how the third party creditors of the company would be protected.
- To recommend one man private limited company so as to avoid the unnecessary coalition of nominal members, and to minimize the dissolution of companies due to the requirement of two members.
- To show how lack of free share transfer affects the minority share holders and shareholders having equal shares in private limited companies.
- To recommend members liability who manage a private limited companies in Ethiopia.

1.4. Significance of the Study

The study will focus on the problems of the Ethiopian private limited companies and the recommended solutions. Hence, it may hopefully contribute much for the forthcoming amendment of the Commercial Code of the country with respect to private limited companies.

It will also have certain contributions for the legislative body, the judges, and the lawyers in creating awareness, and for those who are interested to invest in the area of private limited companies. The study will also serve as a basis and may call the attention of those who want to conduct further research in the field. Finally, it may serve as a reference material in the academic sphere.

1.5. Scope of the Study

The whole study is concerned with the major problems of the Ethiopian private limited companies. However, though not in detail, the study will also include partnerships and companies. Further, for the purpose of clarification, similarities and distinctions of private limited company and Share Company will be made part of the study.

In addition, the nature and characteristics of foreign companies, from some selected countries, will be dealt for the purpose of comparisons. Consequently, the law of US, UK, Germany and France were made part of the study. As far as geographical limit of the study is concerned, the information will be collected from the Federal Ministry of Trade and Industry and Federal Court, as well.

1.6. Methodology

The method emphasized in the investigation of the characteristics of the private limited company based on the Commercial Code of 1960 and sample study of the company registered in the Ministry of Trade and Industry. In the study, both the qualitative and quantitative methods will be employed. The study is qualitative in that it will devote on the reasons, justifications or logical arguments on legal provisions and decided court cases. Cases would be analyzed so as to show the practical problems of the company at hand. It is quantitative because the study depends on certain data and information collected from Ministry of Trade and Industry.

Data will be collected from primary and secondary sources. Primary data were gathered mainly through interviews, and survey. The secondary sources are legislations, domestic and foreign literatures related with the study. Finally, comparative and analytical approaches will be employed in the study.

1.7. Literature Review

Companies are legal entities created and recognized by law.[29] In nexus to this, John Marshall, the chief justice of US supreme count indicated that "a corporation is an artificial being, invisible,

[29] Thomas L. Miller and Jentz, Business Law Today, (6th ed.) Thomson West, 2003, P. 502.

intangible, and existing only in contemplation of law".[30] It is an artificial person or artificial entity independent of the incorporators, owners or investors, which conduct business in its own name, acquired assets, contract entered in to and liabilities incurred in the same way that a physical person can.[31] Thus, one of the advantages of companies is that the liability of its owners is limited to their investments.

To this end, limited liability has been developed as an incentive to business men. Companies have facilitated the rapid economic development of the modern day.[32] Thus, companies are emphasized as they are perhaps the most important business organization in the history of human being, it is also said that with out the modern companies, the tremendous economic growth of the western world in the past several centuries would have been impossible.[33] This is in the sense that investors would not be willing to risk their wealth by forming uncertain business venture.

As business companies exist primarily to make profit, it is beneficial to the share holders in that their risk of loss from business is limited to the amount of capital the share holders invested in the business.[34] Further, free transferability of corporate shares makes the company an acceptable mechanism for many investors to contribute the capital assets needs to finance modern business enterprises.[35]

In the absence of companies, the option to invite a large number of persons to be involved in business may have considerable drawbacks. For instance, they may disagree with each other as regards decision making of a business. Thus, it is believed that companies partially solved the problems in that there is a necessity of a formal constitution[36] (i.e. memorandum of association and article of association), which sets out the voting system and other rights of all members of the company.

In some jurisdiction, "companies" are known as "corporations" and therefore, companies and corporations could be used interchangeably in this paper. In US, corporations are usually classified in

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[30] Ibid
[31] Robert W-Hamilton, the Law of Corporations in Nut Shell (5th ed) West's Law, 2000, pp. 46-47.
[32] Metzger supra note5
[33] Reger Leroy Miller and Jentz, Fundamentals of Business Law, West Pub. Company, St. Paul, 1990, p. 388.
[34] Ronald A. Andrson, Business Law, Southwest Publishing Company, Ohio, 1983 p. 697.
[35] Ibid
[36] Janet Dine, Company Law, Palgrave Macmillan (5th ed), East Bourne, 2005 p. 1.

to publicly held and closely held corporations.[37] Publicly held corporations are those whose shares are widely owned, publicly traded, and managed by professional managers.[38]

Closely held corporations are those with relatively a few shareholders, there is no public market for their shares and are managed by the shareholders themselves or by persons associated with shareholders.[39] The typical closely held corporation has less than ten shareholders, but most of them are owned by one person.[40] In many of them, shareholders will have entered in to agreements restricting the transferability of shares to outsiders without the consent of the existing shareholders. Closely held corporation is one whose shares are held by members of family and referred to as family or privately held corporations.[41]

In France private and public companies are the common forms companies.[42] Public company (the *societe anonyme*-SA) is a form of capitalized company whose shares are represented by transferable security.[43] Private company (*societe a responsibilite limitee*-SARL) is a mixed type of company that resembles a partnership as personal element in its member ship is very important and its share are not freely transferable.[44] On the other hand, it shares the features of public company in that all its members are liable to contribute towards its debts and obligations only to the extent of the agreed contributions.[45] To this end, outsiders who deal with the company often require personal guarantee of the company's obligation from its members[46] and members are personally liable for its debts the same way as partner.[47] Where as private companies are prohibited from issuing or causing to be issued, any advertisement offering securities to be issued by the company.[48]

The Ethiopian Commercial Code of 1960 provides two forms of companies, namely: share companies and private limited companies.[49] A Share Company is a form of company, which may offer shares

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[37] Hamilton Supra note 31, p. 2.
[38] Ibid
[39] Ibid
[40] Ibid
[41] Miller and Jantz Supra note 33, pp. 440-441.
[42] J-Le Gall, French Company Law, Oyez Publishing Ltd, London, 1974 ,p. 41.
[43] Ibid
[44] Ibid, p. 43.
[45] Ibid
[46] Ibid, p. 185.
[47] Dine Supra note 36, p. 12.
[48] Ibid
[49] Commercial code Supra note 18, Art. 212 (1) (d & e)

publicly and has no upper limit on the number of shareholders, which is also relatively, corresponds to the French public company (SA), to US publicly held corporation and to England public company.

On the other hand, private limited company is a company which has a fewer formalities compared to the share companies, may not offer shares to public and may not have less than two and more than fifty members.[50] The Ethiopian company law of 1933 recognized this form of companies but regulated it with flagrant lack of method.[51] The Ethiopian private limited company, roughly, resembles to the French private company (SARL), to English private company and to US closely held corporation. As pointed out above Private limited company is the prime concern of this paper with respect to major problems associated with it.

By way of conclusion, private limited companies are known in most legal systems though designated by different names. Likewise, the forms and characteristics of such companies may also differ in different countries. For instance, there is difference in limitation of memberships, the requirements of share capital and the capital to be contributed to establish the company, and the organizations of the company. Indeed, the study will emphasize on the problems related to private limited companies in Ethiopia.

[50] Ibid, Art. 510 (2) and 512.
[51] Peter Winship, Background Documents of the Ethiopian Commercial Code of 1960, Faculty of Law AAU. 1974, p. 69.

CHAPTER TWO

Partnerships

2.1. General Overview on Business Organization

Business organizations enable people to do business which would be difficult, if not impossible, for them to do alone. In the modern era, the move towards market economy brought about a tremendous increase in numbers and types of business organizations, and each of them may also involve a number of legal consequences. Thus, it has paramount importance to be aware of these consequences in choosing and structuring a business organization. In connection to this, one of the questions faced by any entrepreneur who wishes to set up a business is what form of business organization he or she has to choose.[52]As a result, every entrepreneur should understand the basic features of each business organization and needs to decide what would be the best form of business organization for his or her business endeavor.[53]

Business organizations may take various forms in different countries. In this regard, the major forms of business organization in US are: the sole proprietorship, Partnerships, Limited Partnerships, Corporations, Limited liability Companies and Limited Partnerships.[54] In UK, the two major categories of companies are public and private companies. German law provides for two principal categories of business organizations: the Aktiengesellschaft/AG/which is equivalent to the US Corporation and the Gesellschaft mit beschrankter Hafttung/GmbH/or limited liability company.[55] The French Commercial Code also provides four forms of Commercial companies: General Partnerships, limited Partnerships, Limited Liability Companies and Public Limited Companies.[56]

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[52] R.L.Miller and G.A.Jentz, Business Law Today: the Essentials (6th ed) Thomson, USA 2003 p. 479.
[53] Ibid
[54] Ibid
[55] Henry P. Devries and F.K. Juenger, Limited Liability Contract: the GmbH, Columbia Law Review vol.64,1994 p.867
[56] Book II of the French Commercial Code updated 03/20/2006,Art.L 210-1

The Ethiopian Commercial Code of 1960 (hereinafter the Commercial Code) recognizes six forms of business organizations, namely: Ordinary Partnership, Joint Venture, General Partnership, Limited Partnership, Share Company and Private Limited Company.[57] Further, the commercial Code also classifies business organizations into commercial and non-commercial pursuant to Art.210 of the Code. Accordingly, ordinary partnership may not be a commercial business organization[58] as result of which it cannot carry on any of the activities listed under Art.5 of the Commercial Code. Share Companies and private limited companies are always commercial nature of business organizations.[59]

On the other hand, General partnership, Limited Partnership and Joint Venture may or may not be commercial depending on whether or not one of their objects according to the memorandum of association or in fact is to carry on any of the activities specified in Art.5 of the Code.[60] Thus, it could be said that in contrast to the aforementioned legal systems, the Ethiopian Commercial law most likely adopted that of the French one with respect to classification of business organization.

Business organization is defined as any association arising out of partnership agreement as per Art.210(1) of the Commercial Code. As it is appeared in the same article of the Code, business organization is an association; and such association arises from a partnership agreement. From the above provision one can perceive that a partnership agreement is a prerequisite for the existence of a business association/organization in Ethiopia.

Further, Art.211 of the Code provides a partnership agreement as:

"A partnership agreement is a contract where by two or more persons who intend to join together and to cooperate undertake to bring together contributions for the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising out there of, if any."

By virtue of this provision, business organization is grouping of persons having the common purpose of sharing of profits and losses.[61] It could also be argued that having the characteristics of profit making objectives is one of distinguishing features of business organization apart from

[57] Commercial Code of the Empire of Ethiopia of 1960, Negaret Gazeta, Extraordinary Issue 19th year No.3 Art.212(1)
[58] Ibid, Art.
[59] Ibid, Art. 10(2)
[60] Ibid, Art. 10(1)
[61] Commercial Code, Art.211

other civil associations. Nonetheless, the word *association* in Art.210 of the commercial Code seems rather misleading, and distinction should be made between *association* and business organization.

In the Civil Code, association is defined as "… a grouping formed between two or more persons with a view to obtaining a result other than securing or sharing of profits."[62] As per this definition, associations are formed for attaining non-profit making purposes. Thus, in view of the Ethiopian Civil Code, association is a grouping formed to achieve a certain result other than profit. In this regard, Churches, NGOs, Civil Societies are some of the examples of association within the meaning of the Civil Code.

Conversely, the term '*association'* in Art.210 of the Commercial Code denotes a 'business organization'. In this sense, association is the grouping formed for the pursuit of profit and is not used in the sense mentioned under Art. 404 of the Civil Code. It is worth to note that association in the Commercial Code is used to indicate grouping of business people for mutual economic benefits.

Thus, the writer is of the opinion that, in order to avoid such confusion the Commercial Code should be amended to that effect and employ the term "business organization" uniformly through out the Code rather than "association" for those who organized with the view to make profit.

Though the Ethiopian Commercial Code provides six types of business organizations, for the purpose of this paper, the writer would like to classify them into two major categories: the partnerships and the companies. In this chapter, the writer deals with Partnerships, whereas Companies will be discussed in chapter three of this paper.

2.2. The Concept of Partnerships

A partnership is a common form of business organization that is of an ancient vintage, and tracing its roots back to the Roman law.[63] A partnership was widely used by the merchants of the

[62] Civil Code of the Empire of Ethiopia, Negarit Gazeta, Proclamation No. 165 of 1960,19th year No.2 Art. 404.
[63] Neil Story and Lynn M.Ward, American Business Law and Regulatory Environment, South western

middle ages, particularly those of the Italian city-states.[64] In England, it is said that the law of partnership came in to the common law from the law of merchant.[65] Originally, partnership was a common law form of business organization, but was largely codified by the Uniform Partnership Act of 1914.[66]

2.2.1. Meaning of a Partnership

Black's law dictionary defines partnership as:[67]

> *"A business owned by two or more persons that is not organized as corporation. A voluntary contract between two or more competent persons to place their money, labor and skill or some or all of them, in lawful commerce or business, with the understanding that there shall be a proportional sharing of the profits and losses between them."*

From the above definition one can observe that a partnership is a business organization that may be formed by two or more persons who desire to combine their money, labors or skills to share business profits or losses. The Uniform partnership Act of 1914 defines partnership as "an association of two or more persons to carry on as co-owners a business for profit" pursuant to section 6(1) of the Act. Hence, the essence of a partnership is, partners have common ownership interest in a partnership property, each has an equal right to manage the business of a partnership, each partner owes a fiduciary duty to the other partners, the acts of any one partner bind other partners, and each partner is personally and unlimitedly liable for the debts of a partnership.[68]

Partnership is also defined as "the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all."[69] In the aforementioned definition, a partnership is a voluntary association of individuals that is based on the agreement among parties, who reflect their intention to create a partnership, contribute capital, share profits and losses and participate in management. In South Africa, the term partnership "may refer either to the contract between the parties or to the relation ship brought about by that contract."[70] Here,

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Pub.Co. ohio, 1989, p. 945

[64] Encyclopedia Americana International Edition,vol.21,Scholastic Library Pub.Inc.USA,2006,P.498

[65] Ibid

[66] Robert W. Hamilton, the Law of Corporations in a Nutshell (5th ed) West Pub.Co, ST. Paul 2000, p.7

[67] Henry Campbell Black, Blacks Law Dictionary (6th ed) West Publishing Co. St. Paul,1991, P. 1120.

[68] Story Supra note 12, p. 946.

[69] S.S. Gulshan and G.K. Kapoor, Business and Corporate Laws, International Ltd. Pub., 2002, p. 1.

[70]J.T.R.Gibson, South African Mercantile and Company Law (2nd ed) Juta& company Ltd,1966, p.206

the essential feature, however, is the contract for the rights and obligations of the partners flow from the terms express or implied of their agreement.[71]

The Ethiopian law provides a partnership agreement as:

"A partnership agreement is a contract where by two or more persons who intend to join together and to cooperate undertake to bring together contributions for the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising out there of, if any."[72]

This provision lays down that each of the partners brings contributions together, the business should be carried on for the joint benefit of the parties, and the object should be to make profit. From the foregoing definitions of a partnership, the following key elements can be drawn.

- A partnership is ***a contract between two or more persons***

There must be at least two persons who should join together so as to constitute a partnership, as one person can not become a partner with himself. Hence the intention to associate is the essence of a partnership and one can not join a partnership unless others consented to that effect.[73] It could also be said that a true partnership relationship involves a high degree of trust and reliance, where each partner is an agent for the other partners.

- A partnership must be ***the result of an agreement***

A partnership is not a product of statutes, which means that it does not arise by operation of law as in the case of joint ownership. Likewise, partnership can not arise by mere joint acquisition of property, but it can arise from contract.[74] In connection to this, like any other contract, an agreement to constitute partnership must fulfill all essential elements of a valid contract under the Civil Code.

- ***Bringing contributions together***

The phrase …to bring together contributions …' implies that persons, who are intending to be parties to a partnership, have to be willing to make contributions to the partnership within the meaning of Art 211 of the Commercial Code. Contributions to the partnership may broadly be

[71] Ibid
[72] Commercial Code Art. 211
[73] Miller Supra note 1, p. 414.
[74] Gulshan Supra note 19.

categorized in to three, namely: contribution in cash, in kind/where property is contributed/ and in skill[75]/where a partner agrees to work for a partnership/.

- ***Carrying out activities of economic nature***

The expression 'activities of economic nature' connotes that persons may organize themselves to strengthen their economic power or to collect profits. A Partnership, therefore, cannot be established for the purpose other than profit making in view of Art.211 of the Commercial Code. Thus, a partnership does not exist between members of charitable society or religious association.

- ***Sharing of profits and losses***

A partnership is an agreement to participate in the profits and losses arising out of the business organization. Members of limited partnership, however, cannot be compelled to share losses more than their initial contributions.[76] As a general rule, the Ethiopian law clearly provides that "any provision giving all the profits to one of the partners shall be of no effect."[77] Meaning, a partnership agreement giving all the profits to one or to group of partners can not be enforced. Indeed, every partner to a partnership agreement has to have a share in the profit.

Contrary to Art.211 of the Code, there is also a possibility that a person may become a partner under a distinct understanding that he/she is not to share the losses, but only to share the profits.[78] Accordingly, Art. 254 of the Code states that "…, provisions may be made to the effect that a partner who contributes skill only shall share in the profits and not in the losses." Thus, though very unlikely, partners who contribute in the form of skill may be relieved from sharing of losses if there is an agreement to that effect.

Even though sharing of profits is an essential feature of a partnership, the mere fact that a person is given a share in the profits of the business does not necessarily make him a partner.[79] Likewise, Art.283 of the Code provides that granting of beneficial interest in share to a third party shall not bind the partnership and such third party has none of the rights of a partner. For instance, a

[75] Commercial Code,Art.229
[76] Ibid, Art.296
[77] Ibid, Art. 215 (1)
[78] Gulshan supra note 18, P. 3
[79] Ibid

person who is a partner of a certain partnership owed money to several creditors. Then, the person agreed to pay his creditors out of the profits of his business what he owed to them. In effect, such kind of arrangement does not make the creditors, who share in the profits, partners with the persons in the business.

To sum up, a partnership arises from an agreement between two or more persons to carry on a business for profit. Partners are co-owners of a business and have joint control over its operation and the right to share in its profits.[80] Partners in a partnership are subject to personal liability for partnership obligations if the partnership unable to pay its debts.[81] That means, if the assets of a partnership are insufficient to pay the claims of its creditors, the personal assets of the partners are subject to creditors claim. To this end, partners may pay more than their shares of partnership liabilities.

A Partnership is a legal person with in the meaning of Art.210(2) of the Commercial Code but does not exist distinct and separate from its partners. Unlike companies, therefore, the right and obligations of the firm are in fact the rights and obligations, of the partners composing the partnership. As a result, partnership is said to be a riskier form of business organization compared to companies and its members are subject to internal and external liability.

2.2.2. Types and Nature of Partnerships

Different forms of partnerships could be identified with different characteristics. Thus, types and distinctive features of partnerships will be discussed here under.

2.2.2.1. General Partnership

"A general partnership consists of partners who are personally, jointly, and severally and fully liable as between themselves and in the partnership for the partnership firm's undertaking. Any provision to the contrary in the partnership agreement shall be of no effect with regard to third party"[82].

[80] Miller supra note 1, p.480
[81] Ibid, p.481
[82] Commercial Code, Art.280(1)

Per the above provision, General partnership is a partnership in which all the partners hold the same position. This implies that there is no category of partners in a general partnership, and where a partnership fails to discharge its obligation; all of the partners of a general partnership will be jointly and severally liable.

Apart from the joint and several liability of the partners in a general partnership, any agreement to exclude joint and several liability of partners will not affect third parties but if any it will have effect only as between the partners them selves.[83] This implies that partners in the general partnership may avoid internal liability or they may limit liability as between themselves. On the contrary, agreement that avoids the joint and several liabilities of the members shall not have any effect on the third party or they could not avoid their external liability.

To this end, where a partnership fails to respond to its creditors' claim, the creditors can demand payment from any one of the partners. What is more, the term *personally* indicates that a partner may be compelled to pay from his personal property, the word *severally* on the other hand, shows the partner may be individually liable to the full claim, and *jointly* shows that the partners are together liable to the full claim of the creditors.

In France, a general partnership is designated by its business name which may incorporate the name of one or more partners and followed by the words "*societe en nom collectif*"[84].Similar to its Ethiopian counter part, in French law, partners in a partnership shall have unlimited joint liability for the debts of the partnership, and all the partners are deemed to be merchants.[85] In effect, the debts and obligations of a partnership are also deemed to be of the partners own, however, a partnership's creditors may not demand payment from a partner before demanding the same from the partnership it self by extra judicial means.[86]

Likewise, Art 294 of the Commercial Code of Ethiopia provides that "no action may be taken against individual partners for the debts due by a partnership until after payment has been

[83] Commercial Code,Art.280(1)
[84] Book II of the French Commercial Code,Art.L221-2
[85] Ibid,Art.221-1
[86] Ibid

demanded from the partnership." In view of this provision individual partners cannot be sued personally unless the creditors demand payment from the partnership first and fail to succeed.

From the foregoing discussion, it is tenable to argue that partners in a general partnership may be individually liable without limit for the whole of the debts and obligations of the partnership. As a result, creditors may sue any one or more partners for the payment of their debts, and they cannot require the creditor to add the other partners as co-defendants.[87] What is more, the joint and several liabilities of partners in the general partnership enables the creditors of the partnership to sue any one of the wealthy partner that can able to discharge the debt or can sue all the partners jointly.

2.2.2.2. Limited Partnership

A Limited partnership is a special type of partnership, which consists of at least one general partner and one or more limited partners.[88]The *general partners* assume responsibility for the management of a partnership, and are equally liable for its debts; other individuals called *limited partners* may invest without directly involving in the management, and are liable only to the extent of their contributions.[89] Thus, a limited partner has no right to participate in a general management of the partnerships and assumes no liability for the partnership debts beyond the amount of capital that he has contributed.[90]

A limited partnership is defined in Art.296 of the code as: *"A limited partnership comprises of two types of partners: general partners in full liable personally, jointly and severally and limited partners who are only liable to the extent of their contributions."*

The aforementioned provisions reveal that a limited partnership comprises of two types of partners, namely the general partners who are jointly, severally and personally liable with out limit for the debts and obligations of the partnership. The other types of partners in a limited partnership are limited partners, whose liability for the debts of the partnership is limited to the

[87] Hamilton supra note 15, p.8
[88] Miller supra note 1, p.481
[89] http:// investor words.com/3609/partnership html, accessed on July 27, 2008.
[90] Miller supra note 1, p.481

amount of their contributions.[91] Hence, the very provision defined limited partnership in terms of the partners it comprises.

In view of that, a limited partner may be insulated from personal liability for the liability and losses of a partnership unless he plays an active role in managing a partnership.[92] If the limited partner infringes the prohibition and enters in to transactions with third parties on behalf of a partnership, he may lose his shield of limited liability and is liable jointly with the general partners for the debts and obligations of partnership.[93]

On the other hand, general partners in a limited partnership are jointly and severally liable for all debts and commitments of the partnership in case a partnership fails to discharge its obligations.[94] Thus, if a partnership fails to pay its debts the creditor can demand payment from personal properties of any one or all of the general partners.

By way of conclusion, in many respects, a limited partnership is governed by the same rules that are applicable to general partnership. What is unique to the limited partnership is the presence of limited partners who are passive investors with very limited power to participate in the management of the firm.

2.2.2.3. Joint Venture

Pursuant to Art.271 of the Commercial Code, joint venture is one of the business organizations, which is subject to the general principles of law relating to partnerships. Though joint venture is governed by the general provisions of the partnership, there are some peculiar features that make it distinct from partnerships. Among other things, the existence of joint venture should not be disclosed to third parties, the formation agreement need not be in writing or be registered and at the end of the day it does not have legal personality.[95] Indeed, joint venture is the only business organization that is deprived of legal personality. As a result, joint venture could not enjoy the

[91] Commercial code Art.296
[92] Story Supra note 12, p.884
[93] Commercial Code,Art. 301(3)
[94] Commercial Code Art.296
[95] Ibid Art.272(1-3)

legal consequences of personality. Thus it cannot sue or be sued, cannot own property, or cannot enter into contractual dealings.

A joint venture may be managed by one or more managers, a member or third party, acting for the joint venture in his own name as the latter does not have legal existence or name.[96] In effect, it is the manager who is kwon to the third parties, and shall be fully responsible for the liabilities arise from the joint venture pursuant to Art.276(1) of the Code. Nonetheless, partners who are not managers shall be liable to the extent fixed in the memorandum of association as per sub-2 of the same article.

2.2.2.4. Ordinary Partnership

Ordinary partnership is recognized under Art.227 of the Ethiopian Commercial Code of 1960, and defined as:

> *"A partnership is an ordinary partnership with in the meaning of Title II of book II which provides about ordinarily partnership, where it does not have characteristics which make it a business organization covered by another title of the commercial code".*[97]

From the out set the definition given herein above lacks clarity and one could not understand what an ordinary partnership is by plain reading of this provision. To this end, in order to understand the nature of an ordinary partnership, one should be familiar with the nature of other business organizations. A business organization is, therefore, an ordinary partnership if such business organization does not posses the characteristics of other business organizations (general partnership, limited partnership, joint venture, Share Company or private limited company).

In sum, knowing the distinctive features of ordinary partnership vis-à-vis all business organizations in the Code is considerable to comprehend an ordinary partnership.[98] In this regard, one of the distinctions is that ordinary partnership is always non-commercial form of business organization regardless of its nature or the activity it carries out.[99]

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[96] Ibid,Art.275(1)
[97] Ibid, Art.227
[98] Ibid, Art.227
[99] Ibid, Art.213(1)

2.2.3. Formation of Partnerships

The first step in forming a partnership is to conclude agreement with respect to rights and duties of partners and partnership. Here one should note that a partnership is a business organization, and a business organization is any association arising out of a partnership agreement pursuant to Art.210(1)of the Commercial Code. This means that in order to form a partnership, partners have to enter into partnership agreement through memorandum of association[100] with the intention of Art 211 of the same code.

The above mentioned discussion revealed that formation of a partnership is not by the imposition of law; however, it comes into existence by the voluntary assent of the partners. A partnership is the result of a specific contractual agreement among the partners. In US, the agreement need not be in writing to be effective at law, but prudence and good practice recommend a written partnership agreement to avoid misunderstanding and disagreements.[101]

In Ethiopia, since a partnership agreement is a contract, it has to satisfy the essential elements of a valid contract stated under Art.1678 of the Civil Code, namely: Capacity, Consent, object and form of the contract. Thus, one of the elements for the existence of a valid contract is capacity of the partners. In this sense all of the members to the partnership agreement have to be capable under the law. In other words, minors, insane persons, persons with notorious infirmities affecting their ability to give free consent, judicially interdicted persons, and persons legally interdicted are incapable and could not enter in to a partnership agreement pursuant to the Ethiopian Civil Code.

Consequently, a contract entered by the aforementioned persons is void able contract that may be invalidated by the request of the incapable persons, his representative or his heirs.[102] Further, the commercial Code provides that provisions dealing with the incapacity to become a trader shall also apply to a member of the business organization.[103] Thus, Art.12 of the Commercial Code prohibits the tutor of a minor or of the interdicted person from carrying on a trade in the name

[100] Ibid, Art.
[101] Supra note 12, p.497
[102] Everett F.Goldberg, An Introduction to the Law of Business Organizations, J.Eth L, vol.8no.2 1972,p.
[103] Ibid

and on behalf of the minor or interdicted person. Similarly, pursuant to Art.13 of the same Code, emancipated minors is made incapable by the law though emancipated minor is deemed to have attained majority under the general rule as per Art.313 of the Revised Family Code.

The second element required to have a valid contract is consent. This is to mean parties to a partnership agreement should give their consent voluntarily, which is free of any vices of contract. Vices of a contract exist when the consent of parties tainted by the factors like, mistake, fraud, or duress that affect the validity and enforceability of the contract and leads the same to invalidation.[104]

Object of the contract is the third required element of valid contract and partnership agreement. In the first place object of a contract connotes the obligation of the parties in the contract pursuant to Art.1715 of the Civil Code. To this end, obligations of the contracting parties in the partnership agreement shall clearly be defined, humanely possible to perform and lawful.[105] In other words, the law requires the obligations of the parties or of one of them to ascertain with sufficient precision for the contract to have effect as per Art.1714(1) of the Civil Code. Further, with in the meaning of articles 1715 and 1716 of the Civil Code, the obligation of the parties shall be possible, lawful and should not be immoral.

The last but not the least requirement to have valid partnership agreement is the formality requirement. The Ethiopian Commercial Code explicitly provides that the formation of any business organization other than joint venture shall be made in writing.[106] Thus, as a partnership is one of the business organizations provided in the Commercial Code,[107] partnership agreement has to be made in writing so as to have valid effect.

In US a general partnership is formed simply by an oral or written agreement of the partners, who share the right to manage and the right to participate in the profits and losses.[108] Thus, the US law does not prescribe formality requirement to establish a partnership. Indeed, in contrast to the US

[104] Civil Code, Art.1696-1710
[105] Ibid,Art.1711-1718
[106] Commercial Code,Art.214
[107] Ibid Art.212(1)
[108] Hamilton supra note 15, p.8

formality requirement of partnerships, it is mandatory in Ethiopian law to follow written from in the formation of partnership agreement (memorandum of association).

In addition, registration and publicity with the view to make the partnership known to third parties is the other pre-requisite in order to have valid partnership and to acquire legal personality.[109] In view of this, third parties who have business dealings with the partnership must have certain knowledge about the partnership, and in effect their interest will be protected and develop confidence.

2.2.4. Management of Partnerships

In a large partnership, partners may agree to delegate daily management responsibilities to management committee made up of one or more of the partners.[110] The majority controls decisions in ordinary matters connected with partnership business unless unanimous consent of the partners is required, however, to bind the firm in some cases.[111]

In this regards, Art. 236 of the Ethiopian Commercial Code states: "All partners shall have a right to act as managers, unless the partnership agreement or decision of the partnership has appointed one or more of the partners or a third party as a manager." From the aforementioned provision, one can view that an ordinary partnership may be managed by one or more managers. The managers may also be partners or outsiders, who may be named in the partnership agreement or appointed by subsequent meetings. It is also worth to note that if a partnership agreement is silent as to the persons managing the partnership, and if there is no subsequent appointment, all the partners are considered as managers.[112] Further, though different provisions govern management of general and limited partnerships, there is no conceptual difference between the two provisions.[113]

In a limited partnership, however, only the general partners or persons who are not partners may be appointed as managers. In this regard, Art.300 of the Code states that:

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[109] Commercial code Arts.219-222
[110] Ibid
[111] Ibid
[112] Commercial Code, Art. 287(2)
[113] Ibid,Arts.236&287

"The general partners in a limited partnership shall have the same rights and obligations as partners in a general partnership and only they may be appointed as managers".

The above paragraph envisages that as a rule only general partners of a limited partnership may be appointed as managers. Put other wise, limited partners of a limited partnership cannot be appointed as managers of the same. If limited partners, by what ever reason, represent such partnership, they may be jointly and severally held liable as general partners for all effects of the representation they have executed.[114] In this sense if a limited partner participates in the management process, the law holds him liable with the latter.

In other jurisdictions like US, each partner in a general partnership is an agent of the partnership for purposes of its business and has a right to participate in the management.[115] Further, if there is no specific agreement, all partners share equally in the management decisions, however, they may agree among themselves as to how the partnership is to be managed.[116] From the discussion herein above, there is no as such considerable distinction between the US and Ethiopia with respect to partnership management.

2.2.5. Rights and Duties of Partners

The rights and duties of partners refer to the rights that partners may enjoy and the duties that they have to discharge. Rights and duties may be provided by law or spelled out in the memorandum of association or by some other contractual engagements entered into by the partners. In spite of their source, some of the rights and duties of partners are shown here under.

2.2.5.1. Rights of Partners

Subject to the agreement between the partners, every partner has unlimited rights over the affairs of a partnership, among others, a partner has a right to take part in the conduct of business.[117] A partner has also the right to express his opinion on any matter, but in case of difference of opinion

[114] Ibid ,Art.301(3)
[115] Hamilton supra note15 p.10
[116] Ibid
[117] Gulshan Supra note 18, p.13

regarding ordinary matters of the business he is bound by the majority decision.[118] No change, however, can be made in the nature of the business without the consent of all the partners.[119]

Per the Ethiopian law, a partner can manage the partnership or may appoint outsider manager and can at any time revoke a non statutory manager, a right to have access to inspect and a copy of the books of the firm.[120] On top of that, every partner shall have the right to check the state of firm's business, to consult the books and paper of the partnership and to draw up a statement of the financial positions.[121] A partner is also entitled to share in the profits as the most important motive for the formation of a partnership is acquiring the profits as per Art.251 of the Code. The method of sharing profits and losses may be provided in the memorandum of association. In the ordinary partnership, if the memorandum of association is silent as to the method of distribution of profits or losses, every partner shall have an equal share in the profits and losses, irrespective of his contribution.[122] A partner has a right to do all such acts as are reasonably necessary to protect the firm from loss, and is entitled to indemnification by the firm in respect of liabilities incurred to him.[123]

2.2.5.2. Duties of Partners

For the matter of fact, in partnership agreement partners promises to discharge certain duties to the partnership. Thus, a partner is bound to carry on the business of the firm to the greatest common advantage, to be just and faithful to each other and bound to render true accounts and full information of all things affecting the firm.[124] A partner is required to attend diligently to his duties, and shall indemnify the firm for the loss caused to the partnership by his fraud in the conduct of the business of the firm.[125]

Likewise, Art.243(1) of the Code provides that every partner of an ordinary partnership shall use the diligence and skill he uses in conducting his private affairs while conducting partnership's

[118] Ibid
[119] Ibid
[120] Commercial Code,Arts.236,240,346,248&287
[121] Commercial Code, Art. 24
[122] Ibid, Art. 252.
[123] Gulshan Supra note 18, p. 1
[124] Ibid
[125] Ibid

business. Sub-2 of the same article also strengthens the duty of a partner by stating that every partner shall be liable to the other partners in respect of any damage which he caused by his default. This implies that there is fiduciary duty of partners and thereby the law tried to avoid conflict of interest. What is more, a partner shall not handle, either for his own benefit or for any other party, a business which would be detrimental to the partnership.[126]

In view of this, the Ethiopian Commercial Code has the purpose of avoiding conflict of interest, and safeguarding the interest of a partnership and the partners as well. The law also explicitly prohibits a partner in a general partnership from engaging in an activity that relates to the one carried out by the partnership on his own behalf or on behalf of a third party unless the other partners permit him.[127]

A partner in an ordinary partnership has a duty not to introduce a third party as a partner without securing the consent of other partners.[128] This is because; a partnership is a business relationship that is based on the close relationship of partners, whose personality, experience, skill, talent and honesty of a partner are important to other partners. Further, in a general partnership, a partner may assign or transfer his share when all the partners agree unless; the memorandum of association provides that approval shall be made by majority of the partners pursuant to Art.282 of the Code.

The other duty of a partner is the duty to satisfy the claims of partnership's creditors. One of the most important duties of a partner is the duty to contribute to the partnership. As discussed in the pervious section other *than limited partners in a limited partnership*, partners are personally, jointly and severally liable for the debts of a partnership. The above assertion demonstrates that a partnership's creditor can demand payment or performance of an obligation from any one of the partners. Of course; partners of an ordinary partnership can avoid the joint and several liability obligations if they agreed to that effect.[129] This, however, does not hold true for general partners in a limited partnership and partners in a general partnership.

[126] Commercial Code, Art. 244
[127] Ibid, Art.292(1)
[128] Ibid, Art. 250
[129]Ibid Art. 255(2)

2.2.6. Dissolution of Partnerships

Dissolution of a partnership means discontinuance of the juridical relations, or the breakup of the relations between all the partners of the firm.[130] Dissolution is not defined in the Ethiopian Commercial Code; nevertheless, there are three major grounds that lead to the dissolution of partnerships.

2.2.6.1. Dissolution by Operation of Law

Dissolution of a partnership by operation of law has the connotation of dissolution of the firm without the consent of the partners, or dissolution other than a judicial decree.[131] Accordingly, a partnership shall be dissolved where the purpose for which it was formed is achieved or can not be achieved.[132] In this sense if the purpose for which a partnership was formed was achieved, the organization is no more useful and its life should be brought to an end. A partnership may also does not serve any purpose, rather than dissolution if the purpose for which it was formed is of a nature that cannot be achieved.

Expiry of time limit for which a partnership was formed is the other cause of dissolution by virtue of law. Actually, a partnership may be formed for a definite period of time or otherwise based on the respective instrument that establishing the firm. In effect, if a partnership was formed for a definite period of time, it will be dissolved by operation of law where the time for which it was formed lapses, unless the partners agree to continue the partnership pursuant to Art.217(c) of the Code.

The other causes that may lead to the dissolution of a partnership are the death, incapacity or bankruptcy of a partner.[133] This is to mean that a partnership may be dissolved as regards all partners by the death, incapacity or bankruptcy of any partner. From the aforementioned discussion, one could understand that a partnership is apparently a fragile form of business organization, which may be dissolved when a partner dies or leaves the partnership or when a

[130] Gulshan Supra note 18,P.18
[131] Francis M.Burdick, Law of Partnership including Limited Partnerships, Fred B.Rothman and Supra note Colorado, p. 326
[132] Commercial Code, Art.217(a)
[133] Ibid Art.260

partner expressly states that no longer to be a partner.[134] Subject to a saving agreement between the partners, however, the partnership may continue as between the remaining partners, with the heirs or representatives of the deceased, incapable or bankrupt partner as per Art.260(3) of the Code.

2.2.6.2. Dissolution by Court Order

On application of a partner or a creditor, the court may order dissolution of a partnership for good cause[135].Further, Art. 218(2) of the Code provide instances of good cause that may bring about the dissolution of a partnership by court order. Accordingly, good cause exists where a partner fails in his duties, become incapable of carrying out his duties or where there is serious disagreement between the partners. Consequently, if one of the grounds exists, a partner may file to the court demanding order for dissolution of a partnership.

Further, if a partner is guilty of conduct which is likely to affect the carrying on of the business of the firm, and persistently commits breach of the partnership agreement regarding management, or otherwise, the court may order dissolution of a partnership.[136]What is more, continuous refusal by a partner to attend his duties in the partnership business or the fact of hostility between the partners may be good grounds or sufficient reasons for the court to order dissolution of a partnership.[137]

2.2.6.3. Dissolution by the agreement

As partners are usually free to form a partnership, they do the same at any time to dissolve the partnership, in fact with the consent of all the partners pursuant to their contract. In this sense where there is unanimous consent; nothing would hinder the partners to cause the dissolution even before the lapse of the time fixed in the memorandum of association.[138] Indeed, dissolution of a partnership is possible where its life is for unlimited period of time or before the lapse of the time fixed if the partners unanimously agree.

[134] Hamilton supra note 15, p.13
[135] Commercial Code,Art.218(1)
[136] Gulshan Supra note 18,p.20
[137] Ibid
[138] Commercial Code,Art.217(b)

However, the problem may arise if some of the partners initiate for dissolution and other members do not agree to that effect. In such case, every partner is allowed to bring about the dissolution of the partnership by giving six months notice as per Art.258 of the Code. The law also requires notice to dissolve shall be given in good faith and must not be unreasonable.[139] This implies that notice should not be given in bad faith and be appropriate. The other point that one has to note is that every notice need not necessarily cause dissolution of the partnership. In this regard, the partners may prevent dissolution by paying out the shares of the partner who has given the notice, and the partnership could continue as between the other partners within the meaning of Art.259 of the Code. Pursuant to Art 261 of the Code, the court may order the expulsion of a partner for good cause and the partnership shall continue between the remaining partners.

[139] Ibid,Art.258(2)

CHAPTER THREE

Companies in General

In a preceding chapter the writer discussed the types and nature of partnerships. In this chapter, the attributes of companies in general and in Ethiopia will be dealt. The chapter is concerned with an overview of companies in general and the nature of companies in Ethiopia with the view to through some lights on the major problems of the Ethiopian private limited companies.

3.1. An Overview on Companies

The word company includes ‘corporations’,[140] For the purpose of this paper, therefore, the writer uses the word “Company” to denote “Corporation” and they may be used interchangeably in this paper. According to black’s law dictionary, Corporation means “an entity usually a business having authority under law to act as a single person distinct from the shareholders who own it and having rights to issue stock and exist indefinitely…”[141] The word “corporation” derives from corpus, the Latin term for body, or “a body of people”, entities which carried on business and were the subject of legal rights were found in ancient Rome.[142]

In the US, New Jersey was the first to adopt an enabling corporate law with the aim of attracting more business to the state.[143] Further, Delaware followed, and soon become known in the US after New Jersey raised taxes on the Corporations, even today, most major public corporations are established under Delaware law.[144] By the beginning of 19th Century government policy began to change as corporations were found to be riding the economic wave of the future, and they were also granted rights which they had not previously enjoyed or recognized.[145]

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[140] American Jurisprudence (2nd ed) jurisprudence Publishing, Inc, vol.18,1965, p.551
[141] Bryan A. Garner (ed) Black’s Law Dictionary (7th ed.) West Group, St.Paul,1999, p.341
[142] http:// en-wikipedia.org/wiki/corporation, as accessed on Nov. 5, 2008.
[143] Ibid, p.4
[144] Ibid
[145] Ibid

Likewise, British legislation passed joint stock companies Act in 1844, and latter enshrined into the law of the preeminent hallmark of modern corporate law-*the concept* of *limited liability*.[146]

> *"… a corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of some-body who is really the directing mind and will of the corporation, the very ego and center of the personality of the corporation."*[147]

According to the above quotation, a corporation is an artificial fictitious and intangible entity that exists only for contemplation of law. Corporation requires, however, human beings who may act as its agent and bring the corporation into existence. The implication here is that the immediate result of a company formation is the creation of two independent bodies: the company and its shareholders. As a result, corporate status typically gives corporations the ability to own property, sign binding contracts, pay taxes in a capacity that is separate from its shareholders.[148]

Further, a company substitutes itself for its share holders in conducting corporate business and incurring liability, yet its authority to act and the liability for its actions are separate and apart from individuals who own it.[149] A company may consist of two or more natural persons identified under common name; it can also be owned by a single person, or it can have hundreds, or thousands, of owners or shareholders.[150] In most legal systems, a company is incorporated with limited liability and a separate legal entity, whilst it holds its assets for the ultimate benefit of the associated rights of its membership.[151]

Limited liability has the benefit that member's liability to contribute to the debts of the company has a fixed limit.[152] In England, companies are limited by share or limited by guarantee.[153] Company limited by share is the most common type in practice whereby the members will never pay more into the company than the full purchase price of their shares.[154] In other words, members transfer risk of business failure from members to creditors, and a share holder's

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[146]Ibid
[147] Ibid
[148] Ibid
[149]Roger L Miller and G.A. Jentz, Business Law Today: the Essentials(6th ed)Thomson USA ,2003 p. 503
[150] Ibid
[151] Ibid
[152] Janet Dine, Company Law (5th ed) Pal grave Macmillan,2005 p.11
[153] Ibid
[154] Ibid

personal assets are thereby protected in the case of company's insolvency, but money invested in the company will be lost.[155]

In the case of company limited by guarantee, the company's constitution states for liability on the part of the members to contribute a fixed amount of money towards the debts of the company to the extent they guaranteed upon dissolution of the company.[156] The implication is that members of such companies are contingently liable for the amount which they have agreed to contribute in the event of dissolution due to insolvency.[157]

3.2. Nature of Companies in Ethiopia

In Ethiopia, the origin of companies could be traced back to the 1909, where the first Ethiopian private company was formed in the name of Agricultural and Commercial Development Company.[158] Nevertheless, the first consolidated company law was enacted in 1933, which derived some of its provisions from its predecessor.[159] As old age trends of conducting business on one's own gradually gave way to organized business form, the Imperial government wanted to have a comprehensive and complete law of business organization as a result of which, the 1960 Commercial Code of Ethiopia was brought in to existence.

The Ethiopian Commercial Code provides two forms of companies: Share Company and private limited company.[160] There are also other businesses organizations incorporated out side Ethiopia in other legal systems and carried out their business, and are regulated with the rules that apply to share company.[161] The two companies in Ethiopia have distinct features as regards formation, ways of raising capital, share transfer, company management, and the like. Among companies registered in Ethiopia, private limited companies are more prevalent ones, which account about

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155 http://en-wikipedia.org/wiki/private limited company, accessed on 3 July 2008.
156 Stephen Griffin, Economy and Law: Fundamental Principles (3rd ed) Pearson Edu. Limited, 2000, p. 50
157 Ibid
158 Selamu Bekele, Private Commercial Companies in Ethiopian law; there Legal and Practical Significance AAU unpublished 1966 p. 4.
159 Ibid
160 Commercial Code of the Empire of Ethiopia of 1960, Negaret Gazeta, Extraordinary Issue 19th year No.3 Art.212(e)&(f)
161 Commercial Code, Art.555-557

9504(96%) of the total [9897] companies, whereas share companies cover about 393(4%) of the companies registered in the country[162] as shown in *table I* here under.

Table I*: Data showing Companies registered in Ethiopia*

Forms of Company	Year				
	Pre-2000	2000- 2002	2003-2005	2006-2008	Total
Pvt.Ltd Co.	2968	1227	2187	3122	9504
Share Company	177	79	56	81	393
G/total	3145	1306	2243	3203	9897

Source: Ministry of Trade and Industry, Data base Department (December 11, 2008)

Share Company

According to the 1960 Ethiopian Commercial Code, Share Company is a company whose capital is fixed in advance and divided into shares, and liabilities are only met by assets of the company.[163] The aforementioned provisions envisage that company's capital is fixed and divided into shares before the coming into existence of the company. Further, the liability of the company is borne by the company itself, and shareholders are only liable to the extent of their shareholdings in the company as per Art.304 (2) of the Commercial Code.

The Ethiopian share company roughly corresponds to the English public limited company, the publicly held corporation of the US, the German Aktiengesellschaft (AG) and the societe anonyme (SA) of French.[164]

According to English Company Act section 1(3) of 1985, public company is a company limited by share or limited by guarantee and having a share capital.[165] Further, a public company is one whose memorandum of association proposes to operate as a public company and must have been registered as "public limited" company and is to be identified as "PLC".[166] It is also a company

[162] Data Obtained from Data Base Department, Ministry of Trade and Industry(December11,2008)
[163] Commercial Code, Art. 304 (1).
[164] Booz A. Hamilton, Ethiopia Commercial Law and Institutional Reform and Trade Diagnostic, USAID, Jan 2007, p. 18.
[165] Dine supra note 13, p. 11
[166] Griffin supra note 17, p. 49

whose shares are traded on the stock exchange and invitation can be made to the public for subscription of shares or debentures, transfer of shares and acceptance of public deposits.[167]

In the US, publicly held corporation is a corporation whose shares are generally available to public investors.[168] Nearly all the shareholders of publicly held corporation are simply investors who are not concerned in the management activities of the corporation.[169] To this end, although the directors of publicly held corporation may own shares of the corporation, the corporation tends to be managed by professional managers.[170] In effect, it offers investors to enter or exit merely by buying and selling their respective shares.

The other beneficial quality of publicly held corporation is that share holders who are dissatisfied with management's performance may follow the "*wall street rule*" and sell their shares.[171] The 'wall street rule' connotes that the share holders may enter or exit by buying and selling their respective shares, or may obtain a return of invested capital without securing the consent of board of directors or other shareholders.[172]

The French *societe anonyme* (SA) is adopted as "public limited company' under Book II of the French Commercial Code as updated 03/20/2006. In this Code public limited company is a company whose capital is divided into shares and which is formed among members who shall bear liability only to the extent of their contributions, and the number of members may not be less than seven.[173] The members of an SA hold transferable shares that may take different forms including preference shares and shares with double voting rights for those loyal members remaining for at least 24 years in the company.[174] Free transfer of shares to third parties may be restricted by the statute and made subject to approval of the members.

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[167] http://answer yahoo. Com/question/index?
[168] M.B.Metzger and etal, Business Law and the Regulatory Environment: concepts and cases (8th ed.) Irwin Inc,USA,1992 P. 899
[169] Ibid
[170] Ibid
[171] Robert A. Ragazzo and Moll ,Closely held Business Organizations: Cases, Materials and Problems, American Case Book Serious Thomson 2006, p. 275.
[172] Ibid
[173] Article L225-1of Book II of the French Commercial Code as updated on 03/20/2006
[174] Larry C.Backer, Comparative Corporate Law: US, UK, China and Japan, Carolina Academic Press USA,2002, P.207

Private Limited Company (Pvt. Ltd. Co)

A Private limited company (hereinafter Pvt Ltd. Co) is defined as "a company whose members are liable only to the extent of their contributions."[175] The above provision envisages that members of a Pvt. Ltd. Co are not liable for the company's debts beyond their initial contributions. A Pvt. Ltd. Co is a hybrid type of company.[176] It resembles a partnership in that the personal element in its membership is crucial and the shares held by its members can not be freely transferable out side the company unless it is approved by majority vote.[177]

On the other hand, it resembles a share company as all its members are not liable to contribute towards company's debts but obliged only to the extent of their agreed contributions, except members who acted in managing the company and breached their duties as per Art.531 of the Commercial code. A private limited company could be named by different names in different jurisdictions, like private company in English, closely held corporation in the US, the Gesellschaft mit bescharankter Haftung (GmbH) in Germany and societe a responsabilite limitee (SARL) in France.[178]

The English private limited company is a company whose shares may not be offered to the general public.[179] That means unlike a public company, shares in private limited company can not be traded on public stock exchange. A private limited company is particularly suitable for running a business in which a small number of people are involved, and is required to have the suffix "Limited" often written "Ltd."[180] Further, the regulations governing private limited companies are less extensive than those governing public companies.[181]

In the US Closely held corporations, one cannot find a single and accepted definition of closely held corporation, thus, some commentators emphasize an integration of ownership and management.[182] Others focus on the number of shareholders and the nature of the market for the

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175 Commercial Code Art.510(1)
176 Le Gall, French Company Law, Oyez publishing Ltd. London p. 43
177 Commercial Code Art.523(2)
178 Booz A. Hamilton Supra note 25 , p.19
179 http://www.en.wikipedia.org.wiki/limited company, accessed on 27 July, 2008.
180 Dine supra note 13, p. 12
181 Ibid
182 Ragazzo and Moll supra note 32, P 568.

stock.[183] From this perspective, closely held corporations could be characterized by: small number of shareholders, no ready market for the corporate stock, and substantial majority stock holder participation in the management, direction and operation of the corporation.[184]

Most closely held corporations never have a registered public distribution of securities, and most of them are small but this is not universally true since there are some very large closely held corporations.[185] Indeed, compared to the publicly held corporations, shareholders in closely held corporations are static as there is no dynamic change in ownership of shares.[186] Most states of the US do not provide any special treatment for such corporations and they must comply with the various provisions of the state corporation statute the same way as another corporation.[187] Several states, however, have enacted special statutes dealing with such corporations as they have special problems and needs.[188]

The French SARL or a limited liability company is a company which may be formed by one or more persons who shall be liable only in respect of their contributions.[189] In the French limited liability Company (SARL), shares may only be transferred to outsiders with the consent of the majority members representing at least one half of the shares, unless a greater majority is stipulated in the articles of association.[190] The implication here is that shares are not freely transferable to third parties outside the company with out the consent of the other partners like in the case of Ethiopian Pvt.Ltd.Co but with different requirements.

3.2.1. Formation of Companies

Companies come into existence by certain arrangements performed by founders. In this regards, there are three essential categories of promotional activities of founders in the formation of companies.[191] These are: (a) discovery, which includes the stage of searching the business idea to

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[183] Ibid
[184] Ibid, p.569
[185]Robert W. Hamilton, the Law of Corporations in Nutshell (3rd ed.)West publishing Co. St Paul 1991, p.14
[186] Ibid
[187] Ibid, p.250.
[188] Ibid
[189] Backer supra note 35, p. 207
[190] Supra note 34, Article L 223-14
[191] Seyoum yohannes,On Formation of a Share Company in Ethiopia J.Eth.L vol.22 ,No.1 July,2008 p.102

be conducted, (b) investigation, which involves determination of the economic feasibility of the proposed business idea, and (c) assembly, which consists of the process of bringing together the human and material resources which are required to begin the respective business.[192]

In Ethiopia, a Share Company may be formed either among the founders or by public subscription. In the former case, the capital fixed in advance has been fully subscribed by the founders themselves as per Art.312(1)(a) of the Commercial Code. Where the formation of a share company is as between the founders, the law in Ethiopia requires them to show in the memorandum of association that all the shares have been allocated and the sums have been deposited in a bank in the name of the would be company.[193] The founders are also expected to show in the memorandum of association that the valuation of contributions in kind shall be performed as per Art.315 of the Commercial Code and to have provided for the administrative organ of the respective share company.[194]

The other method of forming a Share Company is by public subscription whereby the public is invited with the view to raise money for the pre-fixed capital of the company as per Art.317 of the Commercial Code. An offer to the subscribers should be made by a document called prospectus singed by all the founders and must show the indications under Art.318(1) of the Commercial Code. Formation of a share company by public subscription also requires other formalities to be complied with.

For instance, application for shares shall be made in the form provided; founders shall call meetings of subscribers after the expiry of the time for application.[195] The meeting has the purpose of verifying that the requirements for the formation of the company are met and to draw up the final text of memorandum and article of association; to approve contribution in kind (if any) and the share in the profits allocated to the founders and to make appointments required in the memorandum of association.[196]

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[192] Ibid
[193] Commercial Code, Art.316(1)&(2)
[194] Ibid, Art. 316 (3) &(4)
[195] Ibid, Arts. 319 & 320
[196] Ibid Art. 321

Like the Ethiopian Commercial Code, The French law also states that the French public limited company (SA) can be formed with a public offering or without public offering.[197] In this regard, it could be said that formation of a share company in the Commercial Code of Ethiopia resembles its French counter part (SA).

Irrespective of the methods of formation, the minimum persons required in establishing a Share Company is five, but no maximum number is fixed as per Art.307(1) of the Commercial Code. The capital shall not be less than 50,000 Ethiopian dollars, and the amount of the par value shall not be less than ten Ethiopian dollars.[198] Besides, the capital has to be fully subscribed and one quarter at least of the par value of the cash contribution has to be paid up and deposited in a bank in the name of the would be company.[199] Shares subscribed in kind, however, shall normally be paid at the time of formation of the company pursuant to Art.339(1) of the Commercial Code.

The concept of capital is very important in companies, and the legal minimum capital is provided with the view to safeguard the creditors' interest since shareholders are not personally liable to the company's debts.[200] The legal minimum capital requirement is provided with the view to safeguard the interest of the creditors of the company as shareholders are not personally liable to the company creditors. The official in charge of the commercial register also requires proof to that effect pursuant to Art.323 of the Commercial Code.

The French public limited company (SA), the counter part of the Ethiopian Share Company requires at least seven members who may be natural or legal persons, but no minimum capital is fixed by the law.[201] However, capital fixed in the memorandum of association and subscribed in cash must be paid in respect of at least fifty percent of their face value.[202]

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[197] Supra note 34,Arts. L225-2 to L225- 16.

[198] Commercial Code, Art. 306(1)& (2)

[199] Ibid, Arts 306 (1) &312 (1) (a and b)

[200] Seyoum supra note 52, p.109

[201] Book II of French Commercial Code, ArticleL225-1

[202] Ibid, Article L225-3

Unlike Share Company, formation of Pvt.Ltd.Co in Ethiopia requires at least two persons and a maximum of fifty members.[203] What is more, persons who decide to form a Pvt. Ltd. Co must raise at least 15,000 Ethiopian dollars as a minimum capital, which shall have to be fully paid up, and be shown in the memorandum of association.[204] As opposed to the share company, the law does not impose any obligation on the members of a Pvt.Ltd.Co to deposit the capital contributed.

This in turn brings about financial problems in Pvt.Ltd.Cos as the majority of these companies are formed without contributing the required capital.[205] Indeed, the fully paid up capital is one of the sources of conflict in Ethiopia and will be discussed in detail in chapter four of this paper.

In France *societe a responsabilite limitee* (SARL), which corresponds to the Ethiopian Pvt Ltd. Co may be formed by one or more persons and the amount of capital is determined by the memorandum and articles of association.[206] The number of members of the SARL shall not exceed one hundred as per Article L223-3 of the current French Commercial Code. Accordingly, unlike the Ethiopian Pvt.Ltd.Co, the French SARL does not require two persons to form a limited liability company and there is no fixed minimum capital required by the law. Thus, one can observe that the French law is more liberal in this regard compared to the Ethiopian law. Thus, the two man requirement in the formation of a Pvt Ltd Co is one of the problems in the Ethiopian Pvt.Ltd.Co, which will be dealt in the next chapter of this paper.

Memorandum and articles of association are also the two essential documents required in the formation of companies and used to present the company to the outside world.[207] A memorandum of association is a superior document which constitutes different clauses that demand decisions of founders/promoters.[208] Thus, every memorandum of a Pvt.Ltd.Co mainly states the name of the company, the registered office, the company objectives, the amount of capital, the statement that the capital is fully paid, the number of managers and their powers.[209] Articles of association shall

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[203] Commercial Code, Art 510 (1) (2)
[204] Ibid, Arts 512 (1) &517 (g).
[205] See those court cases annexed to this paper
[206] Supra note 34, Arts. L223-1 & L223-2
[207] Denis Keenan, Law for Business (12th ed.) Pearson Education Limited, England 2003, P. 49.
[208] Ibid
[209] Commercial Code, Art. 517

be deemed to form part of the memorandum of association and govern the operation of the company.[210]

In most jurisdictions, companies have distinct names which include the term 'company' or an abbreviation that denotes its status that does not need to make reference to their membership.[211] Art.514 of the Commercial Code provide that Pvt.Ltd.Co may have a firm name that indicates the nature of the business carried on by the company and shall be followed by a designation "*private limited company*". In Canada, however, many smaller Canadian corporations have no names at all, but merely numbers based on their provincial sales tax registration number.[212]

Registration and publicity is the other prerequisite in the formation of companies, and commercial register is a widely recognized institution in different jurisdictions including Ethiopia.[213] The Ethiopian Commercial Code requires both the memorandum and articles of association have to be deposited in the Commercial register and a notice to be published in a newspapers with a country wide circulations.[214] The requirement of publication in a newspaper has now been abolished and a company shall acquire legal personality by registering in the commercial register without being publicized in a newspaper.[215]

A private limited company could be formed when the memorandum of association setting up the company shall be signed by all the members or by persons acting on their behalf and authenticated as per Art.516 of the Commercial Code.

3.2.2. Shares

According to the Ethiopian Commercial Code, shares in a share company can either be issued in the name of the shareholder or to bearer as required by a shareholder.[216] The two forms of shares have distinct characteristics with respect to transfer of shares. To this end, bearer shares can be

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210 Ibid, Arts.314 &518
211 Supra note 3, p.8
212 Ibid
213 Seyoum supra note 52, 2008 p.120
214 Commercial Registration and Business Licensing Proclamation No.67/1997 Federal Negarit Gazeta and Commercial Code Art.87,219,220,223&224
215 Commercial Registration and Business Licensing (amendment)Proclamation No.376/2003,Art.2(2)
216 Commercial Code, Art 325 (1)

assigned or transferred by mere delivery without any stringent requirement as shown under Art 340 of the Code. Further, instruments to bearer could be transferred by handing over the instruments to bearer, and the holder of the same establishes his right to the entitlement in the instrument by the mere fact of presentment of the said instrument.[217] As a result, the holder of a bearer share is deemed to be the owner of such share unless it is proved to the contrary.

On the other hand, in the case of registered shares, ownership must be established by the relevant entry in the register at the head office, which means such shares may not be assigned by mere delivery.[218] In this regard, Art.723(1) of the Commercial Code provides that instruments in specified name could be transferred by the entry of the name of the transferee in the instrument and in the register held by the one issuing the respective instrument. A holder of such share, therefore, establishes his right to the entitlement as expressed in the instrument by the fact of designation as a beneficiary therein.[219]

Art. 335 of the Commercial Code provides for different classes of shares with different entitlement as to dividends, capitalization of dividends, return of capital in case of dissolution and winding up. Further, shares of the same class shall have the same par value and similar rights as per Art.335(2) of the same Code. Preference shares enjoy a preference over other ordinary shares, like preferred right of subscription in the event of future issues, of priority over profits or assets or both.[220] However, preference shares may not entitle its holders preference right to vote as opposed to that of a French law pursuant to Art.336(2 of) of the Code.

In contrast to a share company, all shares in a Pvt.Ltd Co have to be entered in a register consisting of those indications under Art.521(1) of the Commercial Code. In this sense, shares in a Pvt.Ltd.Co are only issued in a specified name and hence, the discussion above in a share company with regard to registered share may also apply to a private limited company. By and large, shares in such company may not be freely transferable outside the company without approval by a majority of members representing at least three-quarters of capital.[221]

[217] Ibid, Art.721(1)&(2)
[218] Ibid Art 341.
[219] Ibid, Art. 722
[220] Ibid, Art. 336(1)
[221] Ibid, Art.523(2)

Nevertheless, there is no as such a restriction on the transfer of shares as between members of the same unless provided in the articles of association pursuant to Art.523 of the Commercial Code. Assignment of shares in a Pvt. Ltd. Co shall also be of no effect unless they have been entered in the share register in relation to the company and the third parties.[222] Unlike a Share Company, a Pvt. Ltd. Co can not issue various classes of shares, and it could be said that shares in such company are always ordinary.

The reason may be, shares in private limited company are not publicly traded and no reason for the company to issue preference shares that could encourage outsiders in buying its shares. It is also worth to note that restrictions of share transfer in pvt.ltd.co is one of the problems that will be dealt in the forthcoming chapter of this paper.

3.2.3. Company Governance and Management

According to Black's law dictionary ' governance' means a group of persons or officers having ultimate control over a company(e.g. board of directors), whereas 'management' is the people in a company who are responsible for a company's day to day activities.[223]

In contrast to the direct democracy scheme of governance followed in partnership, companies follow the so called representative way of governance whereby the shareholders appoint a group of individuals, called board of directors.[224] Despite shareholders own corporations, they do not participate in management, nor do they have any authority to act for the corporation, but their vote may be required to approve certain fundamental transactions carried on by directors.[225] All corporate powers and authorities may flow from the board, but the board does not run the day to day activities of the company rather delegates its functions to the officers and typically meets regular basis and monitors performance.[226]

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[222] Ibid,Art.522

[223] Gamer Supra Note 2, p 971

[224] Joseph Shade, Business Associations in *a* nutshell (2nd ed) Thomson/West USA 2006, p. 100

[225] Ibid, p. 102

[226] Ibid, p. 103

To this end, the formal structure for control and operation of a company can be described by reference to three basic groups, namely the shareholders, directors and officers.[227] By the same token, different categories of people may be involved in the governance of a share company in Ethiopia (e.g. shareholders, a board of directors, and managers) as provided in Art. 347 of the Commercial Code.

Shareholders

The shareholders are one of the most important governance organs of a share company in which the ultimate decision making power are vested in. The share holders have the power to appoint and remove directors, managers or auditors of the company,[228] and have the power to dissolve the company at any time. Share holders can exercise their power through a resolution that has to be made by meetings, and meetings can be classified into ordinary general meetings, extra-ordinary general meetings and special meetings pursuant to Art. 390 of the Commercial Code.

Ordinary general meetings are meetings that have to be conducted regularly four months from the end of each financial year, unless the period of time is extended by the articles of association as per Art.418 of the Commercial Code. As far as the business conducted at this meeting is concerned: the balance sheet, the profit and loss account and the directors' and auditors' report shall be read out with the notion to approve or reject the accounts for the last financial year.[229]

Further, the allocation and distribution of profits, where necessary, may be decided in the meetings. The meetings may also appoint or remove directors and auditors, decide the amount of their remuneration, amend the accounts after considering the report under Art.375 of the commercial Code, and decide all matters other than those reserved to extraordinary general meetings.[230]

Extraordinary general meetings are meetings, which may be held exceptionally and any shareholders, including preference shareholders may take part in such meetings regardless of the

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[227] William A. Klein and Coffee, Business Organization and Finance: legal and Principles (10th ed.) Thomson West 2000, p. 122

[228] Commercial Code, Arts 354 & 419 (2).

[229] Ibid, Art. 419(1)

[230] Ibid Art. 419.

number of shares held.[231] It is only by these meetings that the memorandum and articles of association could be amended, unless the law provides otherwise as per Art. 423 of the Commercial Code.

Special meetings are meetings, which comprise only shareholders of specific class, such as preference shareholders or debenture holders, which have to be called in order to confirm a resolution of general meetings that modified the rights of a class of shareholders concerned pursuant to Art. 426 of the same Code. The law in Ethiopia requires meetings to be properly established and conducted in accordance with the law, and decisions of the meetings bind all shareholders whether absent, dissenting, incapable or having no right to vote.[232]

In sum, it could be said that shareholders can control the operation of the company by electing directors, who form board of directors and collectively exercise general supervisory control over the company through meetings.

In Private limited companies, procedures of general meetings need not be identical to that of Share Companies. In the first place, decisions may be made at meetings where the number of members of the Pvt.Ltd.Co is more than twenty.[233] Art. 532 (1) of the Commercial Code also provides that a company consisting of more than twenty members shall hold a general meeting each year as fixed by the articles of association.

The provisions of Arts.525 & 532 (1) of the Commercial Code envisage that members of a Pvt.Ltd.Co may not necessarily conduct formal general meetings unless the number of members is more than twenty. This implies that where the members are twenty or less, the members shall not be bound to take decisions at meetings. In connection to this, where the holding of a meeting is not required by the law or by the articles of association, the managers may draft and send to each member the text of resolutions or decisions to be taken in writing.[234]

[231] Ibid, Art. 424
[232] Ibid, Art. 388 (1)& (2).
[233] Ibid, Art. 525(2)
[234] Ibid, Art 533.

The writer, however, believes that members of a Pvt.Ltd.Co whose numbers are less than twenty may hold general meetings as shown in Art. 525(3) of the Code, which states where there are twenty or less members, they shall not be bound to take decisions at meetings. Actually, sub article (3) does not impose an obligation on members of a Pvt.Ltd.Co to take decisions at meetings if their number is twenty or less. Conversely, the law does not explicitly prohibit such members from making decisions at meetings if they wish to do so. From the foregoing discussion, therefore, one may conclude that members of a Pvt.Ltd.Co may hold general meetings irrespective of their number of members.

Board of directors

Per Art. 347(2) of the Commercial Code, Share Companies are required to appoint from three to twelve directors, who shall form 'board of directors'. The same provision also stipulates that company's affairs shall be managed only by members. Further, both legal and physical persons can be members of the board, nonetheless, legal persons can not be appointed as chairmen of the board.[235] In case where directors resign from office during the financial year, the surviving directors may appoint other persons to complete the period for which the resigned directors were appointed.[236]

The appointment of directors should also be submitted to the next general meeting for confirmation, and the general meeting may confirm or appoint other directors in their place as per Art.351 (2) of the Commercial Code. Where there is no surviving directors, auditors may convene a general meeting for the election of directors pursuant to Art. 351 (4) of the same Code.

Directors also owe duties and responsibilities while discharging their directorship activities, among others, they should not enter into dealings that compete against the company they direct as provided in Art.355 of the Code. It is also prohibited for a director to contract with the company unless such transaction is approved by the board of directors and notice shall be given to the auditors.[237]

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[235] Ibid, Art.347 (4)
[236] Ibid Art 351(1).
[237] Ibid Art. 356 (1).

In contrast to a Share Company, Pvt.Ltd.Co lacks the centralized organ of governance called a 'board of directors'. According to the Commercial Code, a Pvt.Ltd.Co shall be managed by one or more managers who are named in the memorandum or articles of association, or appointed by the members.[238] It is also provided that managers can be appointed from members or non members and conferred with full powers with in the limits of the objects of the company as per Art.528 of the Commercial Code.

Strictly speaking, it is difficult to rule out the possibility of the existence of board of directors in Pvt. Ltd. Cos. This is to mean that even if such companies are not expressly authorized by the law to be managed by a board, there is no clear legal provision that prohibits appointment of board of directors in such company. In practice, some memorandum and articles of association of Pvt. Ltd. Cos in Ethiopia constitute board of directors like that of Share Companies. In this regard, among the files (100 files) investigated by the writer two of them appointed board of directors as a managing organ.[239]

The significance of directors, however, in closely held corporations, the equivalent of a Pvt.Ltd.Co in Ethiopia, could be debatable. In connection to this, Story stated that in many closely held corporations, directors are really unnecessary, since the shareholders so closely participate and control the direction of such corporations.[240] Thus, under some modern statutes no board of directors are required and share holders may directly manage closely held corporations.[241]

Likewise, the number of members of the majority of the Pvt. Ltd. Cos in Ethiopia is also small and they may directly take part in the management of such companies. Participating directly in managing Pvt.Ltd.Cos may be detrimental to the members in case where the company is bankrupt and the assets of the company are found to be inadequate.[242] Of course, members or managers may not be held liable in such case if they show that they have acted with due care and diligence as per Art.531(2) of the Commercial Code.

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[238] Ibid Arts. 525 &526

[239] Memorandum of associations of the ABB-MIDROC Industrial Service plc and the KADISCO Chemical Industry plc, See Annexes –I and II

[240] Neil Story and Lynn M.W, American Business Law *and* the Regulatory Environment, South West Pub. Co., Ohio 1989, p. 980.

[241] Klein and Coffee supra note 88, p. 133

[242] Commercial Code, Art. 531(1)

Auditors

Actually, auditors are not managing organs rather they are regarded as "watch-dogs" for the members' interests in the company. However, in exceptional circumstances auditors deemed to have managed a share company in case where there are no surviving directors. In this regard, Art. 351(5) the Commercial Code provides that auditors may carry on the management of the company during the period prior to the calling of the general meeting. However this should not be taken for granted as it only serves the purpose of gap filling situation to that effect.

One or more auditors and one or more assistant auditors have to be appointed at the general meetings of every share company, that means one main auditor and one assistant auditor should necessarily be appointed in a share company.[243] Auditors may be appointed by the general meetings of subscribers until the first ordinary general meeting is held and thereafter by the annual general meeting[244]. Per Art.368(2) of the Commercial Code, share holders representing 20% and above of the capital may also appoint an auditor selected by them.

The law in Ethiopia also emphasizes that auditors should be neutral and impartial. To this end, there are persons who are not competent to act as auditors, among others, founders, contributors in kind, those holding special benefits, directors, of the company, spouses or relatives of the aforementioned persons to the fourth degree inclusive are not eligible to be appointed as auditors.[245] The prohibition deems to have the purpose of avoiding the conflict of interest in the company's affairs and it is fair.

Auditors are expected to discharge their responsibilities and official duties, and should maintain professional secrecy. If they breach their duties under the law, they may be held criminally and civilly liable to the company and third parties depending on the circumstances as provided in Art. 380 of the Commercial Code. The general meetings can dismiss an auditor from office at any time, but he can claim damage for any wrongful dismissal as per Art.378 of the same Code.

[243] Ibid, Art. 368 (1)
[244] Ibid, Art. 369 (1)
[245] Ibid, Art. 370.

As opposed to a share company, a Pvt. Ltd. Co. need not necessarily appoint auditors unless the number of members of the company is more than twenty.[246] From the provisions of Art.538(1)of the Code, one can understand that a Pvt.Ltd.Co which has more than twenty members must appoint at least three auditors. The implication is that the law may not bind such companies to appoint even a single auditor unless their members are more than twenty.

Nevertheless, the forgoing provisions, however, do not explicitly prohibit the appointment of auditors even where the number of members of the company is less than twenty. Thus, the members of a Pvt. Ltd. Co. can appoint auditors so as to safeguard their interest irrespective of their number. What is to be noted here is that the members are not obliged to comply with the number of auditors to be appointed. Hence, where the members are less than twenty, the company may appoint one or more auditors as there is no legal obligation on the company to appoint three auditors. The practice in Ethiopia reveals that almost all memorandum and articles of associations, which the writer investigated, have appointed at least one auditor.

3.2.4. Legal Personality- *the concept of separate entity*

The 1960 Commercial Code of Ethiopia provides that any business organization other than a joint venture has legal personality.[247] Thus, a share company and a Pvt.Ltd.Co in Ethiopia acquire legal personality upon registration and publicity as per Art.210(1), 212(1), 324(1) and 520(3) of the same Code. According to the proclamation No.376/2003, business organizations shall acquire legal personality by registering in the commercial register with out being publicized in a newspaper.[248]

Legal personality of companies, however, is different from other forms of business organizations (i.e. partnerships) in that companies are complete legal person with full liability to undertakings made in its name, and with limited liability of members and have separate legal existence, in law, distinct from their members.[249] Thus, companies are conferred with the power to sue, to enter in to contracts, the right to acquire properties, the right to appoint agents and to compromise

[246] Ibid, Arts. 525 (2) & 538 (1)
[247] Ibid, Art. 210 (1)
[248] Supra note 76,Proclamation No.376/2003, Art.2 (2)
[249] Supra note 3, p.12

disputes.[250] The above paragraph envisages that companies are the subject of rights and duties, similar to physical persons, distinct from its shareholders, directors or managers.[251]

In Ethiopia, the principle of separate legal existence was applied by the *High Court in Addis Ababa in the case of Delbourgo* ***Vs*** *the Inland Revenue Department,*

> *"The Inland Revenue Department in assessing the income tax of the company had ordered the three members to produce the pass books and statements of their private bank accounts from the petitioners. The petitioners were a share company and three members of the company. The court held that the department had no power to make such an order as the tax being assessed was only that of the company and the principle remains that a company has completely different existence from individual shareholders."*[252]

Further, the separate legal personality of a company could be exemplified by the classic case of' *Salomon* **Vs** *Salomon and Co. Ltd (1897) Acc 22'*,

> *"Mr. Salomon had a business trading as leather merchant and boot manufacturer. He decided to form a registered company and sell the business to the company for £39,000. Salomon and his wife and children became members of the company. The family members took one share of £1 each. He took 20,000 £1 share and £ 9,000 from the cash held by the former sole trader business. More importantly he was prepared to regard the outstanding sum of £10,000 as a loan from him to the company that it was required to repay in the future. He also made himself a secured creditor by taking a mortgage debenture. This gave him a right to take the company's assets and sell them to recoup his loan if the company failed to repay it. Due mainly to strike by workers in the boot trade the company fell on hard times and went into liquidation. Since it could not pay its debts in full, the question arose as to how the liquidator should pay them. Salomon claimed all that was left (£ 6000).Since this would leave the trade creditors with nothing, they asked the court to set aside Solomon's debenture on the ground that he could not own money to himself. They challenged the concept of separate entity or juristic personality. The matter came before the House of Lords and their lordships ruled that Salomon could take all the funds. He had made a valid contract of loan with the company and, since it was already the law that secured creditors ranked above unsecured creditors, Salomon took the first place."*[253]

[250] Seyoum supra note 52,p.104
[251] Ibid
[252] Everett F. Goldberg, An Introduction to the Law of Business Organizations, J.Eth.L,vol8 No.2,1972, p.503
[253] Keenan Supra note 68, p. 481

A close look at the above case may reveal that a company is a separate legal entity whose liability does not extend to the members who established it so long as there is no fraud on the part of the members.[254] It is also worthy to note that the court would not have ruled as it did in the above case had there been fraud. As a matter of fact, the concept of separate legal personality of a company prevents third parties from taking action against members of the company.

3.2.4.1. Consequences of Corporate personality

Limited Liability

Limited liability is beneficial in that investors would be unwilling to invest in large and risky firms without the protection afforded by the concept of limited liability.[255] As pointed out above, a company is separate legal entity from its shareholders and the later are entitled to enjoy limited liability.[256] In this sense, once the members of a company paid for their shares in full they may not be required to contribute towards the payment of the company's debts. In other words, members are liable to contribute if called up on to do so the full nominal value of their shares so far as this has not already been paid.[257] Unlike in a partnership, therefore, shareholders of a modern business corporation have limited liability for the corporation’s debts and obligations.[258]

The law in Ethiopia provides that a share company is a company whose liabilities are met only by the assets of the company, and its members shall be liable only to the extent of their share holding pursuant to Art.304 (1) & (2) of the Commercial Code. This implies that liability of the shareholders of a share company is limited to the amount of shares held by the respective share holders and company’s liability is met only by the assets of the company itself. Hence, in principle share holders are not liable for debts of a share company other than the amounts originally invested to the company in return for their shares.

The Commercial Code of Ethiopia also provides that “a Pvt.Ltd.Co is a company whose members are liable only to the extent of their contributions.”[259] From the aforementioned provisions, it

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[254] Ibid
[255] Seyoum supra note 52, p.105
[256] Ibid
[257] Ibid
[258] Supra note 3, p.12
[259] Commercial Code, Art. 510(1)

could be said that the members may be held liable only to the extent of their contributions if they did not effect such payment. Nevertheless, it is not as such clear from the provisions as to the liability of the private limited company. In any measurements, members' liabilities are limited to their contributions and creditors of the company have no claim against the personal assets of the members except in cases provided under Art.531 of the Commercial Code.

Perpetual succession

Perpetual Succession refers to the continuity of life of a company beyond the life time of its share holders.[260] Hence, corporate personality gives a company perpetual succession that death or bankruptcy of a member does not affect the continued existence of a respective company.[261] In a partnership, the above events (death or bankruptcy) may bring about dissolution of a partnership, unless the partnership agreement provides for the business to be continued among the rest partners.[262]

Similarly, the Commercial Code provides that death, judicial interdiction or bankruptcy of a member does not cause dissolution of a company unless expressly provided in the articles of association.[263] This implies that the life of companies in Ethiopia does not depend on the fate of their investors. From the above discussions, it could be said that despite the explicit provision in the commercial Code, the concept of perpetual succession is incorporated in the Ethiopian law. But, it is worth to note that the notion of perpetual succession (unlimited life) only serves useful purpose in contrasting companies with partnerships.

Free Transfer of Shares

Being a personal property of shareholders, a Share may be transferred in the same way as other personal property.[264] Shares should be freely assigned or other wise disposed of by the owner of a company unless there is a restriction in the articles of association.[265] In the law of Ethiopia, Shares can freely be transferred in a Share Company unless provisions restricting free transfer of

[260] Supra note 3
[261] Keenan supra note 68, p. 482
[262] Ibid
[263] Commercial Code, Art 542 (3)
[264] Hamilton supra note 46, p. 19
[265] Ibid

shares are made pursuant to Art. 333 of the Commercial Code. The notion of the above provisions is that a Share Company is an association of capital rather than association of persons, where personality of the members is not as such crucial.

In a Pvt.Ltd.Co, however, shares may not be freely transferable outside a company unless approved by majority of its members representing at least three-quarters of the capital.[266] The articles of association may also provide larger majority or unanimity vote in transferring shares outside the company as per Art.523(2) of the Commercial Code. Nonetheless, there shall be no restrictions on the transfer of shares between the members unless free transfer of shares is restricted by the articles of association pursuant to Art.523(1) of the same Code.

3.2.5. Piercing Corporate Veil

As a general rule, companies are recognized as legal entities separate from the shareholders, as a result of which corporate obligations remain a liability of the companies.[267] The basic concept that a corporation is a separate legal entity seems to dictate the answer that separate existence of such a duly formed corporation should never be ignored. However, the law has not taken this position and courts often refuse to recognize such separate existence in certain compelling circumstances.[268] Piercing a corporate veil refers to the judicially imposed exception to this general rule by which courts may disregard the separateness of a company, and hold shareholders responsible for the company's debts as if it were the share holders' own.[269] When the separate existence of a corporation is ignored, courts often use a colorful metaphor, commonly called 'piercing corporate veil'.

The Ethiopian Commercial Code provides that, those who have managed the affairs of a company as directors may be held liable to the company's creditors where they failed to preserve intact the company's assets as per Art. 366(1) of the Commercial Code. This implies that the law disregards the "veil" that shields directors from company's liability in some instances. Where the assets of a company is found to be inadequate to satisfy creditor's claim, proceedings may be

[266] Ibid Art 523 (1) (2)
[267] Ragazzo supra note 32, p. 405.
[268] Robert W.Hamilton and J.R.Macy, Cases and Materials on Corporation Including Partnership (9th ed) West pub. Co. Thomson, 2005 p. 134
[269] Ibid.

instituted against the directors of a company if a resolution is passed by general meeting to that effect as per Art.365(1) of the same Code.

In like manner, managers of a Pvt. Ltd. Co. are liable to the company and third parties in case where they breach their duties under the law and the articles of association.[270] They are liable individually, or jointly and severally, as the case may be. Hence, the liability of a company may extend to managers only in case where the law or the court disregards the separate existence of a company by piercing the "corporate veil". What is more, where a Pvt. Ltd. Co is declared bankrupt and its assets are shown in adequate, the court may order that the company's debts shall be paid by the managers or by the members or by both of them with or without joint liability.[271]

The aspiration of the law is that where separate legal personality is found to be detrimental to the company and third parties, such privilege may be ignored and the corporate veil will be pierced to look in to the share holders. As a consequence, the concept that liability of shareholders is limited to the extent of their share holdings/contributions may be overridden and a company's creditors may demand payment from personal properties of managers or members who do not perform their activities diligently.[272] Indeed, managers who unwisely and carelessly administered the properties of a company and jeopardized third parties' interest could be held liable regardless of the distinct existence of a company from its members.

In this regard, continental countries have come to recognize that there is nothing absolute about a corporate personality, and in Germany, '*lifting of a veil'* is known as that of the breach of the wall of the corporation.[273] One of the recognized principle in German law is that courts apply to make shareholders liable for company's debts when a sole or controlling shareholder who has failed to distinguish between his assets and affairs, and the assets and affairs of the corporation and who has derived advantage from such acts.[274]

[270] Commercial Code, Art. 530.
[271] Ibid Art. 531.
[272] Ibid
[273] Backer Supra note 35, p. 1064
[274] Ibid

3.2.6. Dissolution and Winding-up of Companies

3.2.6.1. Dissolution

As there are requirements that must be met in order to form a company, there are also conditions to be fulfilled in order to dissolve the same. Dissolution is the end of the legal existence of a company but it does not terminate the life of the company.[275] The implication is that dissolution requires a company to cease its business, to windup its affairs and to liquidate its assets.[276] Further, dissolution does not destroy the legal personality of a company until all its assets have been disposed of and all claims against it have been discharged, and the liquidation has been formally concluded.[277] The Ethiopian Commercial Code provides three grounds for the Dissolution of companies.

Dissolution by law

Per Art. 495 of the commercial Code, a share company may be dissolved where the life of the company expires unless the members agree to extend its life by modifying the memorandum of association. Further, a share company may also be dissolved when the purpose for which it was established is achieved or not achieved. This implies that the success or failure to achieve the purpose for which the company was created may bring about its dissolution by operation of law. By the same token, those grounds for dissolution of Share Company by operation of law are applicable to the dissolution of a Pvt.Ltd.Co.[278]

Dissolution by court order

Dissolution by court order may be made when petition is lodged to the court, and there must be good cause for the court to order dissolution as shown in Art. 218 (1) & 495(e) of the Commercial Code. For instance, inability of carrying out member's duty like failure to pay debt may hold good cause for dissolution of the company. In addition, loss of three-quarters of capital and institution of bankruptcy may cause dissolution of a company by court order.[279]

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[275] Metzger Supra note 29 p. 941
[276] Ibid
[277] Ibid
[278] Commercial Code, Art.542
[279] Commercial Code, Arts. 495 (e, g and h) &543 (1) (2)

Dissolution by agreement

Dissolution by members implies that members who can bring a company into being can also extinguish its existence. Thus, members of a company are free to dissolve their company at any time by an extra ordinary general meeting. In this regard, Art. 495 (d) of the Code provide that voluntary dissolution is one of the grounds for dissolution of Share Company. In Pvt. Ltd. Co no clear provision as to voluntary dissolution of a company but no reason to prohibit members of Pvt. Ltd. Co if they wish to dissolve their company by agreement. The practice also shows that Pvt.Ltd.Co could be dissolved by the agreement of its members. In this regard, the writer came across minutes of general meeting that held to dissolve a Pvt.Ltd.Co by agreement.[280]

3.2.6.2. Winding-up

A dissolved company continues to enjoy its corporate existence,[281] but may not carry on any business except those ones appropriate to wind up its affairs.[282] Winding-up refers to the orderly collection and disposal of the company's assets and the distribution of the proceeds of the sale of assets.[283] From these proceeds, the claims of creditors will be paid first, preferred share holders will be paid second and finally shareholders receive any proceeds that remain.[284]

According to the Ethiopian Commercial Code winding up is a process of completing the business at hand, collecting and auditing of company's assets, calling and paying of creditors and distributing the residual assets to the members. These processes have to be carried out by liquidators, who may be named in the articles of association or by the general meeting that decided dissolution of the company as per Art.496 of the same Code. During winding-up, liquidators have to perform activities that facilitate the winding-up of the company and can not begin new projects.[285]

After the distribution of the company's assets, the liquidators have to apply for the cancellation of the company from the registrar, as a result of which the company is said to be dissolved pursuant to Art. 507 of the Commercial Code. There is no clear provision in the code that deals with the liquidation process of a Pvt.Ltd.Co or no cross-reference to the provisions governing Share

[280] Files investigated in the Ministry of Trade and Industry,
[281] Ibid Art. 497(1)
[282] Ibid, Art. 500(2)
[283] Metzger Supra note 29, p. 942
[284] Ibid
[285] Commercial Code, Art. 495 (2)

Company. Nonetheless, one might argue that it is likely possible to apply by analogy the share company's provisions to Pvt.ltd.co as for as liquidation is concerned.

3.3. Comparison between Share Company and Pvt. Ltd. Co.

3.3.1. Similarities

Being classified as companies share companies and private limited companies have a number of similarities, among others, both Share Companies and Pvt.Ltd.Cos offer their members the benefits of limited liabilities.[286] In both companies members shall be liable only to the extent of their initial investment in the companies. According to the Commercial Code members of the share companies are only liable to the extent of their share holding and members in the pvt.ltd.cos are liable only to the extent of contributions as per Arts.304 & 510(1) of the Code respectively. Thus, members in both companies enjoy the benefits of limited liability and they are not compelled to pay to the company's debts if the company fails to do so.

There is also a similarity between Share Company and Pvt.Ltd.Co. in issuing shares to their members. In fact, the types of shares that can be issued by the companies may not be identical. In both companies, contributions may be made in cash or kind as enshrined.[287] What is more, there is legal minimum of capital to be contributed and the minimum numbers of members are also fixed alike by the law but with distinct minimum requirement. By and large, both companies require memorandum and articles of association to be drafted in the formation of the companies.[288] A Share Company and a Pvt.Ltd.Co are always commercial business organizations irrespective of the activities they are engaged in as per Art. 10(2) of the Commercial Code.

3.3.2. Distinctions

Some of the distinctions between share companies and Pvt.Ltd.Cos are discussed here under. The minimum number of members is not the same. In case of Share Company the minimum number of persons required to form a company is five while it is two in a Pvt. Ltd. Co.[289] There is no maximum number of members for share company where as the maximum number of members must not exceed fifty in case of Pvt. Ltd. Co. The minimum initial capital required to form a

[286] Ibid, Art. 304(2)&510(1)
[287] Commercial Code, Arts. 338,339 and 519
[288] Ibid, Arts 313, 314, 517 and 518.
[289] Ibid, Arts 307 (1) &. Art 510 (2)

Share Company is 50,000 birr while 15,000 birr is required to form Pvt. Ltd. Co pursuant to Arts 306(1) & 512(1) of the Code respectively.

As discussed above a board of directors is the mind of a share company which is responsible for the operation of the company, whereas directors are not provided as organ of governance in Pvt.Ltd.Co. Similarly decisions of policy matters demand the meeting of shareholders in a Share Company whereas meeting is not as such mandatory in Pvt.Ltd.Co unless the number of members is more than twenty.[290]

In a share company, the capital fixed in advance shall be fully subscribed and at least one quarters of the cash capital has to be paid up and deposited in a bank in the name of the company, whereas in the case of Pvt. Ltd. Co, the capital has to be fully paid as per Arts.312(1)(b) & 517 (g) but no legal provision that binds the members of Pvt.Ltd.Co to deposit the capital paid up in the bank. Shares in a share Company are freely transferable unless other wise agreed, while in Pvt.Ltd.Co the right to transfer share is restricted. What is more, Share Company can issue different forms and classes of shares, whereas shares are not freely transferable out side the company and no classes of shares in private limited company.

A Share Company can offer shares to the public whereas no public subscription in case of a Pvt.Ltd.Co, rather all the shares have to be distributed among the persons who form the company. Besides, Share Company may issue debentures or bonds, but Pvt.Ltd.Co can not issue transferable security in any form as per Art.510(3) of the Commercial Code. Despite both companies are commercial in form, Pvt.Ltd.Co can not carry on banking, insurance and any business of similar nature,[291] but there is no such restriction to share companies.

[290] Ibid, Arts. 525(2) &532(1)
[291] Ibid, Art. 513.

CHAPTER FOUR

Major Problems Related to Private Limited Companies in Ethiopia

Despite its various features and nomenclatures across countries, Private Limited Company is a limited liability enterprise whose capital cannot be raised from the public nor did its shares trade in organized markets.[292] Further, it is characterized by integration of ownership and management as discussed in chapter three of this paper.

In Germany, the tightening of formal and substantive requirements rendered the *Aktiengesellschaft* (AG) impractical for other than large business organizations.[293] To this effect, movements with in the German business community for a less cumbersome and expensive entity brought about the *Gesellschaft mit besschrankter Haftung* (GmbH) that serve the need of smaller enterprises.[294] In effect, the German-GmbH, equivalent of a Pvt. Ltd. Co in Ethiopia, was developed for small and medium firms that were easily regulated than public/share companies.[295] However, today such companies control a wealth which rivaled that of the more stringently regulated corporations/share companies.[296]

Consequently, the passage of enabling legislation for the GmbH in Germany in 1892, the PLLC in Great Britain in 1908, the SARL in France in 1925, the close corporation in the US after world war II,[297] and the private limited company in Ethiopia in 1960,[298] gave business people additional flexibility to mix and match attributes of both partnerships and corporations.

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[292] www.Law.Yale-edu/document/pdf/intellectual life, accessed on Dec. 7/2008.
[293] L.C.Backer, Comparative Corporate Law: Us, Eu, China and Japan, cases and Materials Carolina Academic Press, USA, 2002, p. 213
[294] Ibid
[295] Ibid, p. 198
[296] Ibid, p.213
[297] Supra note 1, p. 3.
[298] Commercial Code of the Empire of Ethiopia of 1960,Negaret Gazeta Extra ordinary Issue 19th year No.3 Art 212 (f).

4.1. Characteristics of Private Limited Companies in Ethiopia

Before embarking on to the problems of private limited companies in Ethiopia, it is worthy to mention some of their peculiar features as shown here under.

In the first place, one of the characteristics of Pvt. Ltd. Cos is that shares are not freely transferable,[299] and this is one of the factors that make the companies private. Private limited Company does not attract huge amount of capital as there is no public subscription in its formation, and it does not issue transferable securities in any form.[300] It also combines the advantages of partnerships and Share Companies with a very flexible internal structure in that like partnership, the relationship among members must be one of trust, confidence and absolute loyalty if the enterprise is to succeed.[301] In view of this though Pvt.Ltd.Cos are association of capital it resembles that of partnerships where personality is crucial.

On the other hand, like a share company, a Pvt.Ltd.Co enjoys the benefit of limited liability and allows business people to avoid the threat of untimely dissolution inherent in partnerships.[302] This implies that Pvt. Ltd. Co. is a distinct legal person that may enjoy the benefit of perpetual life of companies or continuity of life.[303] The corporate nature of Pvt. Ltd. Co entitles the same a limited liability by separating assets of the company from that of its members.[304] This means investors in the Pvt. Ltd. Cos are not liable for the debts of the company more than the amount they contribute pursuant to Art. 510(1) of the Commercial Code

The Ethiopian Commercial Code provides that private limited company shall be managed by one or more managers who may be members or non-members.[305] Unlike Share Company, the law does not expressly require to have a board of directors as a governance organ in Pvt. Ltd. Co. Thus, Pvt. Ltd. Co avoids the need to provide for certain corporate formalities, among others, it

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[299] Ibid, Art. 523(2),(3)(4) and (5)
[300] Ibid, Art. 510(3)
[301] Supra note 1.
[302] Melvin A. Eisenberg, Corporations and Other Business Organizations (8th ed) New York 2000 p. 342.
[303] Ibid
[304] Robert Romano, Foundations of Corporate Law (ed) Oxford University Press, Inc. USA, 1993, p. 65.
[305] Commercial Code, Arts.525 and 526

could be managed by the share holders of the company rather than the board of directors.[306] Pvt.Ltd.Co is prohibited to undertake some profitable commercial business like banking and insurance as per Art. 513 of the Commercial Code.

4.2. Legal and Practical Problems in Private Limited Company

From the out set, the Ethiopian Commercial Code provisions governing Private Limited Companies (Pvt.Ltd.Cos) are said to be sketchy, and are not sufficiently provided in a fashion to address issues of the company in question. What is more, the Commercial Code does not make any cross reference to the provisions applicable to Share Companies that may be applicable by analogy to Pvt. Ltd. Cos. Hence, one could understand that the provisions governing Pvt Ltd. Cos in the Commercial Code are incomplete.

As pointed out above, the general assumption for the development of closely held corporation, the counter part of Pvt. Ltd. Co in Ethiopia, in one's legal system would be to provide alternative company that suit the small and medium size business.[307] As opposed to this assumption, currently, Pvt. Ltd. Co is one of the most popular and dominant form of business organizations in Ethiopia as indicated in table I of this paper. Indeed, it can be utilized to serve not only small companies, as intended before, but also enterprises with multimillion dollar capital.

For instance, "MIDROC Gold mining PLC" was established in 1991 with 353, 615, 000 birr.[308] This reveals that Pvt. Ltd. Cos in Ethiopia control a wealth which rivaled the stringently regulated share companies. This implies that attention should be paid to the provisions governing Pvt.Ltd.Cos, and the legal and practical problems attached there to should also be identified and addressed. As regards this, there are a number of problems that are surrounding the Ethiopian Pvt.Ltd.Cos. The writer, nevertheless, discussed some of the problems related with the formation, share transfer restrictions, organization of the Company and limited liability of members respectively, in this chapter.

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[306] L.D. Solomon and et al, Corporations Law and Agency: Materials and Problems (4th ed.) West Group, St. Paul, 1998, p. 421.
[307] Backer supra note 2
[308] Memorandum of Association Establishing MIDROC Gold Mine PLC.

4.2.1. Problems Related to Formation

In spite of various problems of the private limited company, this section, however, devoted to the problems of the fully paid up capital and the two man requirements in the formation of a Pvt.Ltd.Co.

4.2.1.1. Fully Paid up Capital

The concept of capital is crucial in the formation of companies with limited liability, and is deemed to be a general security for the payment of debts of the company.[309] As consequence contributions of capital either in cash or in kinds is beyond doubt. Hence, Countries consider contribution of initial capital necessary to provide safeguards to ensure that fraudulent or care less practice in the formation of a company does not affect the financial solidity, credit worthiness and profitability of the new company.[310]

In Ethiopian law, members of Pvt.Ltd.Cos are expected to pay their contributions in lump sum or fully pursuant to Art. 517(g) of the Commercial Code. The notion of the provision is that there should be no 'installment payment in Pvt. Ltd. Co and that means if the capital is not fully paid up no Pvt. Ltd. Co. would be formed. As a consequence, the capital collected by contribution of members is very important for both shareholders and creditors, particularly for creditors such capital is the guarantee they have for any debts due to them from the company.

Accordingly, the legal requirement that obliges founders/members of a Pvt.Ltd.Co to contribute the whole capital could be one of the safeguards devised to achieve this purpose. In sum, the reason behind capital contribution is, inter alia, to protect stake holders, typically creditors of such companies. Thus, the Ethiopian law requires that capital has to be paid up in full before the formation of a Pvt Ltd.Co, and a statement to that effect shall be shown in the memorandum of association.[311] Unlike that of a Share Company, however, no provision of the Commercial Code pertaining to a Pvt.Ltd.Co deals with the manner of administering the paid up capital.

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[309] Everett F. Goldberg, An Introduction to the Law of Business Organizations J. Eth .L. vol.8 No.2 1972, p. 512

[310] Seyoum Yohans, On Formation of a Share Company in Ethiopia, J. Eth L. Vol. 22 No.1, July, 2008 p.109.

[311] Commercial Code Art. 517 (g).

What is more, there are no ways of confirming as to whether really such capital is fully paid up, by external mechanisms, like depositing in Bank or Producing bank statement or any evidence to that effect. In other words, there is no clear provision that requires the member of a Pvt.Ltd.Co to produce any evidence as to the money contributed to the company. As a result, members of the company might be tempted to provide false statements in the memorandum of association, and many of them do not have paid up capital.[312] Consequently, the issue of fully paid up capital before the formation of a Pvt.Ltd.Co has been one of the sources of conflict and litigation among members and creditors of such companies in Ethiopia. Indeed because of the legal loopholes in the Commercial Code, various practical problems have been arising after the concerned authorities authenticate the formation of private limited companies.

In Ethiopia, the practice, therefore, has revealed that members of a Pvt. Ltd. Co simply put a statement that the capital is fully paid up in the memorandum of association but with out effecting the actual sum of their respective contributions.[313] Thus, in most cases what have been stated in the memorandum of associations are just for the sake of formalities that have to be fulfilled to get the company registered.

Besides, the organ that is responsible to authenticate the truthfulness of the legal requirements shown in the memorandum of association has not been making any effort in that regard. For instance, to a question posed by the writer, to one of the officials in the Ministry of Trade and Industry, the official replied that there is no law that empowers him to check the truthfulness of the statement made in the memorandum of association.[314] According to my interviewee, the fully paid up capital could not be checked due to two reasons: first such attempt is out of his power; second, the law does not impose any duty upon the members to produce any evidence showing that they have fully paid the capital to have their company registered.

From the aforementioned discussion, one might argue that the provisions of the Commercial Code governing Pvt. Ltd. Cos do not offer sufficient protection to third party creditors, who

[312] See different court Cases annexed to this paper
[313] GET-YAN plc V. Mr.Zang de Kuan and Ms.Ni Chun Yan, Federal High Court (1997) Annex-III.
[314] Interview with Ato Tekletsadiq Somenno, Head of the Commercial Registration and Licensing Department Ministry of Trade and Industry, January 29, 2009.

transact with the company. As a result, the law in Ethiopian could not meet one of the purposes for which capital is to be contributed before the formation of the private limited company. Finally, Art 517 (g) of the Commercial Code had remained a dead letter.

In connection to this, there was a court case between the *GET-YAN International Plc and two Chinese.* In such case, GET-YAN plc was established by two Chinese and three Ethiopians with 20, 000, 000 Birr capital in 1994 here in Ethiopia. The memorandum of association establishing the Company showed that the whole capital is fully paid up. In 1997, however, the *GET-YAN Plc* brought an action against the two Chinese before the Federal High Court alleging that the defendants did not pay their contributions the amount of which is 9, 800, 000 Birr.[315]

The Court, however, decided against the plaintiff, GET-YAN plc stating that members of a Pvt.Ltd.Co are not bound to contribute their shares unless there is any damage due to such unpaid share capital. The court added that being a membership is voluntary and consensual; the claim of the plaintiff is not sustainable.

Although, the law requires that the capital be fully paid up before the formation of a Pvt. Ltd. Co, and the statement to that effect be shown in the memorandum of association, the case at hand discloses that the practice is to the contrary. From the aforementioned case, it is obvious that the company demanded payment two years after its establishment, which is a direct contravention with the legal provision.[316] Thus, it is tenable to argue that what is stated in the memorandum of associations of most Pvt.Ltd.Cos are fictitious and false statement.

There was also another case between Mr.*Zang* de *Kuan* (the plaintiff here in after) and the *GET - YAN plc* (the defendant).[317] The plaintiff brought an action before the Federal First Instance Court for the dissolution of the *GET-YAN Plc*, in which he was a member. The plaintiff argued that there was serious disagreement between members and the company should be dissolved as per Art. 218(1) and 542 of the Commercial Code. The defendant on its part contended that the

[315] See Annex No. -III
[316] Commercial Code, Art. 517 (9).
[317] Federal Supreme Court, Civil Case Appeal No.28921 Mr.Zang de kuan **V**. Get Yan Plc and its members (2000) Annex No. IV

plaintiff had not made any contribution to the company either in cash or in kind, so he had no right to request for the dissolution of the company without discharging his obligation of a membership.

Then, the Court, after examining the case held that the company's memorandum of association showed that the plaintiff had contributed his share in full. In this sense, he has a right to claim as a member of the company. Finally, the Federal First Instance Court ordered the dissolution of the GET-YAN plc and for the appointment of liquidators as there is a serious disagreement among the members.

The *GET- YAN Plc* objected to the decision of the First Instance Court and lodged its appeal to the Federal High Court stating that the present respondent had not made any contribution. What is shown in the memorandum of association is not actual payment but simply stated to fulfill the legal requirements under Art. 517 (g) of the Commercial Code. According to the appellant, what is provided in the memorandum of association could not serve as an evidence for one's contribution of his share capital.

The Federal High Court reversed the decision of the lower court on the ground that there is disparity between the argument of the respondent (Mr.Zang de Kuan) and what is provided in the memorandum of association. According to the Court, the memorandum of association showed that all members effected their contributions in cash, whereas the respondent alleged that he had made contribution in kind. Finally, the Federal High Court reversed the decision of the First Instance Court and decided against the respondent, Mr.Zang de Kuan,[318]and rejected the contention of the respondent.

Later on, Mr.Zang de Kuan (herein after the appellant) lodged an appeal to the Federal Supreme Court against the decision of the Federal High Court on the grounds that were produced in lower Courts. The Federal Supreme Court, after examining the decisions of the lower Courts and the evidence submitted, reversed the decision of the Federal High Court and affirmed that of the

[318] Ibid.

Federal First Instance Court.[319] The Supreme Court rejected the contention of the *GET-YAN* plc that no contribution was made by the appellant and what is shown in the memorandum of association is not actually paid but simply showed for the sake of mere registration requirements. The Court also held that a memorandum of association is not a mere document rather a legal document in which the rights and obligations of members could be created.

According to the Federal Supreme Court, the evidentiary value of the memorandum of association is also substantial as far as the rights and duties of the members of a company are concerned. As regards the method of contribution, the Court also took note from the evidences presented before it and pronounces that the appellant had made contribution in kind to the extent of 6,014,000 Birr.[320] As a consequence, the Supreme Court reversed the decision of the High Court and ordered for the dissolution of the *GET-YAN Plc* due to a serious disagreement among the members.[321] The *GET-YAN plc*, lodged the case to the Federal Supreme Court for cassation bench claiming that the Federal Supreme Court committed fundamental error of law, although not decided to this date.

From the above mentioned case, one could perceive how the issue of fully paid up capital is distorted by the members and becomes a source of conflict and litigation between members of a Pvt.Ltd.Co. It is also interesting to note how a legal requirement overlooked by those who establish private limited companies in Ethiopia.

Likewise, in the case between *Habib Kebir **V**. Daniel Egu*,[322] the Latter brought an action before the High Court for the dissolution of the "Black Pearl" Private Limited Company pursuant to Art. 542 and 218 of the Commercial Code. a plaintiff alleged that there is a serious disagreement between the members and requested the Court for the dissolution of the company and the appointment of liquidators. The defendant on his part contended that the plaintiff did not make any contribution. He added that the whole amount of capital is contributed for the formation of the company by the defendant and, the plaintiff has no right to request the dissolution of the

[319] Ibid
[320] Ibid
[321] Ibid.
[322] Supreme Imperial Court, Civil case Appeal No 533-60 Habib Kedir V. Daniel Egu, J.Eth.L. Vol.7 No 2, 1970, p. 325.

company. In his argument, the defendant established the company at his own expenses and the plaintiff agreed to render services at a fixed salary for a period of five years, and at the expiration of which it was provided that they would share in the profits as per the separate agreement made between them in Rome.

After examining the fact, the then High Court did not accept contention of the defendant, and decided that there is serious disagreement between the members and ordered for the dissolution of the *Black* pearl *plc.*

The defendant however, objected to the decision of the Court and appealed to the then Imperial Supreme Court. The Imperial Supreme Court affirmed the decision of the High Court and dismissed the appeal. The justification for the decisions of both courts were, that the memorandum and articles of association establishing the "Black Pearl" Private Limited Company showed that the amount of contributions were made by each members. The capital of the company is 80,000 birr and is fully paid up. In view of this, the contention that the plaintiff did not pay his contribution and may not have right to request the dissolution of the company was not acceptable to both Courts.

The writer agrees with the decision of the courts in that the law clearly provides that when a Pvt.Ltd.Co is formed the amount of contribution made by each member shall be fully paid up and be shown in the memorandum of association as per Art 517 (g) of the Commercial Code. Further, this fact, at least in theory, was verified by the official in charge of registration of the company. Hence it would be paradoxical to challenge the full payment of capital after the company was duly established and acquire legal personality.

In the above case, for instance, the defendant argued that the capital was contributed fully by him, and the plaintiff was employed to give service in the company. This implies that the plaintiff is not a member, if so the company was established by a single person, which is contrary to the two man requirement of the law to establish a Pvt.Ltd.Co as per Art. 510(2). However, the memorandum and articles of associations show that each member contributed his share as per the Commercial Code and the company acquire legal personality.

In the case between Birehanu Muleta **vs.** Mega Consultant Trading Company and its members, Birehanu brought an action against the company and four of its members before the Federal First Instance Court claiming the dissolution of the Company at hand.[323] The plaintiff alleged that there is a serious disagreement among the members of the company and one of the members, Seyoum Bekele, had registered in the company with out contributing the shares required of him. For our case the latter issue is relevant in that a person became a member of a Pvt.Ltd.Co with out effecting payment.

The lawyer of the defendants surprisingly argued that Seyoum Bekele did not make his contribution based on the agreement reached among the members. According to such agreement his contribution would be deducted from profits he would earn in the company. Such agreement was made by members taking in to account his professional contribution to the company in question. Thus, in the case at hand, it is clear that Mega Consultant Trading Company was established though its capital is not fully paid up. What is more, professional or skill contribution which is not explicitly permitted to be contributed to a company is considered by the members. In general, the members of the company made agreements in contravention to the law and should not be acceptable.

The foregoing cases revealed that, Ethiopian Pvt. Ltd Cos have been established and got license without satisfying the legal requirements as far as paid up capital is concerned. What is more, the indications in the memorandum of association are also fictitious. As a result, it could be said that the notion of the law that requires fully paid up capital in the formation of Pvt.Ltd.Cos is defeated by the prevalent practices in the country.

For the writer, the responsible person who is assigned to verify the fulfillment of legal requirements is also assisting such malpractices pertaining to fully paid up capital. As far as the writer's knowledge is concerned, authentication means ascertaining the truthfulness and trustworthiness of the statements indicated in the legal document, i.e. a memorandum of association. Thus, the officer in charge has to ascertain the reliability of the information stated by

[323] Federal First Instance Court, Civil case No. 69/88, Birehanu Muleta Vs. Mega Consultant Trading Company and its members (2000), See annex- V

the applicants for registration in any mechanism that may help. If this had not been the case, the law would not have required the authentication of the documents for the formation of the company.

Moreover, the writer would also disagree against the view that there is no legal provision that empowers the official to compel the production of evidence as to the full payment of the capital. Despite explicit provisions to that effect, from the cumulative reading of Art 97 and 222 (2) of the Commercial Code, one might argue that the official can request any evidence in order to verify the document which is presented before him for registration.

Art.97 Accuracy of statements:

1. *The official in charge of the register shall verify the accuracy of the statement made by the person applying for registration…*
2. *The official shall check all documentary evidences supporting the statement and conformity of the statement to such evidence.*
3. *The official may require the applicant to produce such further documents or in formation as may be necessary.*

Art. 222: Registration

(2) The provisions of Art 95-99 of this Code shall apply. The official in charge of the register shall examine whether the legal conditions relating to the formation of business organization have been ful filled.

The above provisions envisages that an official who is responsible to register the company is duty bound to ascertain the conformity of the statement shown in the memorandum of association and the evidence submitted there to. In effect, the officials are empowered to require the company requesting to be registered to produce evidence that the capital being contributed is fully paid (emphasis is mine). In general, legal requirements with respect to the fully paid up capital in the formation of Pvt.Ltd.Co is hardly considered by members of the company and an official in charge of the register, as well. As a result, it is safe to conclude that the practice is dominating and going in contravention of the legal provisions.

Effects of Unpaid up Capital

As it was pointed out above, most of the Pvt. Ltd. Cos were formed with out sufficient capital that they could not pay their debts due to shortage of finance/ capital. Thus, the gaps between the law and the practice would have prejudicial effects on the creditors of Pvt. Ltd. Cos. For instance, in the case between *Dashen Bank **V**. Martrade Ethiopia PLC,* Dashen Bank brought an action before the Federal High Court against Martrade Ethiopia PLC in 1991 E.C. The plaintiff alleged that the company borrowed 5,000,000 Birr from the Bank but did not pay as per their agreement and prayed the Court for the order of repayment of the said money. The defendant on its part admitted the debt but said that it failed to pay due to '*force majeure'* and requested the court to dismiss the case.

Finally, the Federal High Court held that the defendant should pay back the money it borrowed and other related expenses incurred by the plaintiff. However, the judgment creditor (Dashen Bank) could not execute its judgment as per the judgment, because there was no asset registered in the name of the Martrade Ethiopia plc.[324]

Similarly, in the case between *Research Periodicals & book service inc. (the plaintiff)* ***V****. Reliance International PLC*[325] (the defendant), the plaintiff brought an action against the defendant before the Federal High Court claiming that the defendant issued different cheques to the plaintiff for payment of its debts the amount of which is 2,100,000 Birr, from the Dashen Bank Main Branch. The Bank, however, rejected the cheques stating that the defendant has no sufficient money in its account. The plaintiff, therefore, requested the Federal High Court in summary procedure to pass a decision against the defendant so as to pay the debt including interest and related expenses incurred by the plaintiff.

Consequently, the court held that the defendant is liable for the amount of money shown on the cheques and ordered the defendant to pay the plaintiff as per the request of the later. Finally, the judgment creditor tried to execute the judgment but the company could not discover any assets of the judgment debtor to effect payment. The judgment creditor applied to the court stating that the

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[324] Interview with Ato Yosef Kebede, attorney at Dashen Bank main branch, December 15, 2008.

[325] Federal High Court, Civil Case No. 13889,(1995) Research Periodicals and Book Service,Inc **V**.Reliance International plc, Annex- VI

latter should make an order to all banks in the country if there is any fund deposited in the name of the defendant, and if any, not to be retransferred to third parties. The court did as per the request of the judgment creditor; however, banks replied that no money was deposited with them in the name of the defendant, Reliance International PLC.[326]

Like wise, in one case Lema Wedajo brought an action against Elun plc and its manager before the Federal First Instance Court claiming a sum of debts which the plc at hand failed to discharge.[327] The defendant admitted the allegation of a plaintiff but failed to discharge its obligation as per the contract due to *force majeure* and requested the Court to dismiss the case. The Court, however, rejected the contention of the defendant and made the plc liable for the said debt. While the judgment creditor tried to execute the judgment, he could not discover any assets registered in the name of Elun plc.

In the case of Bekelcha Transport Share Company Vs.Tana Transport plc, the former brought an action against the latter before the Federal First Instance Court claiming that Tana Transport plc failed to discharge its contractual obligation, which the plc indebted to the plaintiff. The Court decided that Tana Transport plc is liable to the plaintiff. The plaintiff, however, could not discover any assets of the defendant and its address to execute the judgment.[328]

From the aforementioned cases one could observe that Pvt. Ltd. Cos in Ethiopia are established without contributing the required capital, and this has left creditors at risk. This in turn brings about negative repercussion on the investment of the country and her economic development as a whole.

In this regard, some jurisdictions, for instance, France does not fix the minimum initial capital by law but left for the capital to be fixed in the memorandum of association.[329] The capital fixed in the memorandum of association, however, has to be deposited before the formation of the

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[326] The Response Made by the Dashan and Abysinia Banks for the Order made by the Federal High Couret, See Annexes- VII and VIII

[327] Federal First Instance Court, Civil Case Execution File No. 285/92, Lema Wedajo Vs. Elun plc (2001) Annex-IX

[328] An application lodged to the Ministry of Trade and Industry by the Bekelcha transport Share Company, see annex-X

[329] Book II of the French Commercial Code, as updated 03/20/2006, Art. L 223-7

company/SARL/. Hence, in the formation of the SARL, the equivalent of a Pvt. Ltd. Co in Ethiopia, "The total shares subscribed must be fully paid if they represent contributions in kind and at least one fifth of the face value of shares representing contributions in cash must be paid and deposited with in the conditions and deadlines specified by conseil d' etat decree."[330] The French Law also prohibits the company's authorized representative not to withdraw the fund resulting from payment of shares before the company is entered in the registrar of the companies.

In contrast to the French societe *a responsibilite limitee* (SARL), the Ethiopian Pvt.Ltd.Co is not sufficiently elaborated, open to interpretation and very reluctant in protecting the interest of creditors. The law does not explicitly provide that the fully paid up capital has to be deposited but to be shown in the Memorandum of association as per Art. 517(g) of the Commercial Code. In practice, nonetheless, persons have established Pvt. Ltd. Cos with out satisfying the legal requirements. In effect, failure to observe such legal prerequisite has led to conflicts among business people, as it was appeared herein above. There fore, the law has to be amended and should include provisions that compel members to deposit the capital contributed and warrant its truthfulness in the formation of private limited companies in Ethiopia.

4.2.1.2. Problems Related to Two Man Requirements

As it was pointed out above, shareholders in closely held corporations, the equivalent of Ethiopian Pvt.Ltd.Cos, are likely to be linked by family ties or close personal relationship.[331] The same hold true in Ethiopia, where the number of members of such companies is obviously small, and the law requires minimum of two persons pursuant to Art. 510 (2) of the Commercial Code. The stand of the law is also rigorous in that reduction below the legal minimum may entail dissolution of the company unless the company makes necessary arrangements to comply with the legal requirements with in reasonable time.[332]

The law, however, does not give meaning to the term "reasonable time" and this could lead to different interpretation by individual judges, which in turn may be prejudicial to member's interests. In any case, reasonable time may not amount to long period of time and one should note

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[330] Ibid
[331] J. Shade, Business Associations in a nut shell (2nd ed) Thomson West, USA 2006 p. 134
[332] Commercial Code, Art. 511

that it may refer to short period of time, subject to individual cases. As far as the ‘two man’ requirement in the formation and continuity of a Pvt.Ltd.Co is concerned, the writer would like to give emphasis on two problems:

First, such mandatory requirements in the formation of Pvt. Ltd. Cos in Ethiopia, has brought about unnecessary coalition, where most of such companies consist of fictitious members. That means a person who want to establish a Pvt.Ltd.Co requires another partner, commonly called a sleeping partner, just to fulfill the minimum legal requirement and get license of incorporation. As a result, majority of Pvt.Ltd.Cos in Ethiopia have been established with two members as shown in *table II* below.

Table II: A Sample Showing Number of members and number of Pvt.Ltd.Cos in Ethiopia

Number of members	2	3	4	5-6	7-10	11 and above	**Total**
Number of companies	44	26	19	7	3	1	**100**

Source*: Memorandum and Articles of Association in the Ministry of Trade and Industry*

According to the table herein above, out of 100 files investigated by the writer, 44(44%) of them are companies established by two members. Further, most of them are also formed between spouses or parent and their children, even who have not attained the age of majority (eighteen years)[333]. The implication here is that capital is raised by a single person and the management is also held by the same fellow. Thus, one might argue that the two members of a Pvt. Ltd. Co may not come together or associate to contribute capital in cash or in kind and participate in the profits and losses as supposed to be, but simply to fulfill the legal requirements of incorporation.

In effect, it could be said that Pvt.Ltd.Cos in Ethiopia are one man companies and the members are pseudo. The reason is that there are nominal members who hold insignificant shares in the company, the so called sleeping members. Hence, the minimum legal requirements in the formation of private limited companies in Ethiopia do not serve any purpose other than a criterion to get a license. Some of the distributions of shares among two member companies are provided in *table III* here under.

[333] Memorandum and articles of Associations in the Ministry of Trade and Industry

Table III: a Sample Showing Distribution of Shares between two Members of Pvt. Ltd. Cos in Ethiopia

No	Name of Pvt.Ltd.Cos.	No of members	No of Shares	Distribution of Shares	
1	NIZAR International PLC	2	50	45	5
2	International Business Group PLC	2	250	235	15
3	Vision Ethiopia Business Group	2	2000	1975	25
4	Idyll General Business Group	2	100	99	1
5	SEKA Business Group PLC	2	10,000	9990	10
6	T.S Group PLC	2	500	400	100
7	ALMEHA Farming PLC	2	10,000	7000	3000

***Source**: Memorandum and Articles of Association of these respective Pvt.Ltd.Cos in the Ministry of Trade and Industry.*

In table III shown above, one can observe that distributions of shares between the two members are inflated. Thus, it is sound to argue that a partner with insignificant shares is there only for the purpose of two member requirements and to supply assistance to the other partner to do business. For instance, in the table III above, one of the members of the Idyll General Business Group held only 1% while the other partner controls 99% of the total shares. Thus, one shareholder in a Pvt.Ltd.Co is obviously nominal, who simply submitted his name to be included in a memorandum of association to fulfill the minimum requirements of two persons. Put differently, a majority shareholder requires another partner only for the satisfaction of the conditions required by law.

From aforementioned discussion, one can conclude that if one man company is allowed business persons may not need such nominal share holder and artificial coalition. In connection to this, there was a practical problem that encountered a Pvt. Ltd. Co called "SEKA Business Group PLC". The Company at hand was established between spouses (Ato Seid and W/ro Fatuma) with 20,000,000 Birr.[334] The marriage between the spouses, however, was dissolved and their common properties were also partitioned between the spouses. Then, one of their common properties 'SEKA Business Group PLC' was granted to the husband (Ato Seid) and the Shares held by the

[334] Minute of the General Meeting of SEKA Business Group PLC, See Annex-XI

wife (Fatuma) were made to be transferred to Ato Seid, who became the sole owner of the shares in the company.

Nevertheless, it is impossible for a single person to own a Pvt. Ltd. Co in Ethiopia unless certain arrangements have been made. Indeed, Seid was compelled to transfer some of his shares to another person in order for the company to continue. Then, out of his 10,000 shares, he transferred 10 (0.1%) of the total shares to another person (Shashe), which is in fact nominal.[335] From the case herein above, it could be said that the minimum legal requirement of members for the formation and existence of a Pvt. Ltd. Co is merely a procedure that invites a nominal member to the company.

In effect, one may be forced to assign his shares so as to avoid the dissolution of a company. In the above case, for instance, if Seid did not transfer some of his share to Shashe, the fate of SEKA business group would be dissolution as a single person could not own a company pursuant to Art. 511 of the Commercial Code. In addition, the two man requirement in Pvt.Ltd.Cos may also be a problem in that it is a potential for the dissolution of the company when ever the two members enter in to disagreement, when one of the members dies, or want to withdraw from the company[336]

There is also a case between Ethiopian Insurance Company Vs. Radia International plc and Yasin Mehammed.[337] In the case at hand, Radia International plc was established by two members. Nevertheless, the major share holder and manager of the plc in question died in 1990 E.C, and hence the plc left with a single member. The Ethiopian Insurance Company applied to the Court for the dissolution of a Company pursuant to Art.511 and 544(4) of the Commercial Code. The court held that Radia International plc should be dissolved as a Pvt.Ltd Co shall not continue with less than two members as per Art. 510(2) and 511 of the same Code. This implies how far the minimum legal requirement of members in Pvt.Ltd.Cos is prejudicial to the interests of business people.

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[335] Ibid
[336] Commercial Code, Arts. 218 and 542
[337] Federal First Instance Court, Civil Case No. 70/89, Ethiopian Insurance Company Vs.Radia International plc and Yasin Mehammed (2000), Annex-XII

Unlike the law in Ethiopia, in most foreign jurisdictions, the 'two man' requirements are lifted and private limited company could be formed by a single member.[338] As discussed in the previous chapter no legal minimum of members and of capital is required for instance in French law, in effect a single person can establish a private limited liability company (i.e. one Man Company).[339]

Second, the other problem associated with the requirements of two members in Pvt.Ltd.Cos is the problem of deadlock. The term deadlock refers to "the fundamental disagreement among equal shareholders that can virtually paralyze the company's ability to operate by destroying the ability to agree".[340] If a Pvt.Ltd.Co has two shareholders each owning fifty percent (50%) of the share, the two shareholders would normally elect themselves as managers and would run the company. If these two shareholders have disagreement and can no longer agree on certain issues, there is a potential of deadlock, which brings about dissolution of the company in question.

As a matter of fact, in Ethiopia, where two persons is a mandatory requirement and where the majority of the Pvt.Ltd.Cos are established by two members, potential for deadlock may be one of the problems. In Connection to this, for instance, among the 44 Pvt.Ltd.Cos established by two members as indicated in table II above, 13 (about 30%) of them have equal shares.[341] This implies that about 30% of the two man companies in Ethiopia have been under a threat of deadlock. Indeed, such companies are susceptible to deadlocks as decisions should be made by the two members unanimously. In other words, disagreement of one of the members may automatically end in a deadlock, which in turn may result in dissolution of the company-the harsh and last remedy.

4.2.2. Problems Related to Restrictions of Share Transfer

Four forms of share transfers have been recognized in the Ethiopian Commercial Code of 1960.[342] These are transfer of shares between members, transfer of shares outside the company, transfer of shares to heir of a deceased member and transfer of shares upon execution where order

[338] Backer supra note 2
[339] Supra note 38, Book II of French Commercial Code Art. L223-1.
[340] Shade Supra note 40, p. 135
[341] Memorandum and Articles of Associations in the Ministry of Trade and Industry
[342] Commercial Code Arts. 523 and 524

is levied on member's share.[343] For the purpose of this section, however, the writer is concerned with share transfer out side the company.

In principle, shares of all companies are freely transferable; but, this is the concept that reflects in publicly held corporations,[344] the equivalent of the Ethiopian Share Companies. The reality is, however, different for shareholders of closely held corporations, the counter part of Pvt.Ltd.Cos in Ethiopia, as shares are not freely transferable due to the private nature of the same. As a result, finding a buyer is the practical problem in such companies, particularly for minority shareholders.[345] The only likely buyer is the majority share holder who is usually willing to buy at a favorable price and may restrict his fellow shareholders from selling their shares to outsiders.[346]

In this regard, the law in Ethiopia provides that "a transfer of shares outside the company shall be approved by a majority of members representing at least by three fourth of the capital."[347] Further, a large majority or unanimity may be fixed in the articles of association to transfer a share to outsiders pursuant to Art. 523(2) of the Commercial Code. Thus, in Pvt.Ltd.Cos, transfer of shares to non-members requires the approval of majority members representing three quarters of the capital.

In other words, one who failed to secure the majority approval of other members, bound to sell to the members possibly on low price, or to apply to a court for dissolution of the company. In both cases the remedy provided by the law is detrimental to the minority shareholders and to others if dissolution is to be ordered. That means selling shares with low price is against the financial (economic) interest of a shareholder and jeopardizes his interest. On the other hand, dissolution is also a harsh remedy, which is prejudicial not only to the members but also the employees of the company. In view of this, one may observe the problems of share transfer restriction in the Pvt. Ltd. Co.

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[343] Ibid
[344] Shade Supra note 40, p. 131
[345] Ibid, p. 132
[346] Ibid
[347] Commercial Code, Art. 523(2)

In view of this, though free transferability of shares is said to be a fundamental attribute of companies, it is not open to shareholders in Pvt. Ltd.Cos. Indeed, compared to Share Companies, where investors can easily sell their shares, investors in Pvt.Ltd.Cos could not sell their shares freely.[348] Thus, the need for protection against unwanted intrusion Pvt.Ltd.Co is analogous to the desire of each member of a partnership to select its own partners. The objective of selectivity, however, runs against generally accepted rule that unlimited restrictions on the transferability of shares are contrary to the public interest,[349] and has negative repercussion on the members. In this regard, if members are unable to freely transfer their shares, they are vulnerable in the event of a dispute with other shareholders. Particularly; the minority shareholders are at risk where there is misconduct by the majority shareholder.[350]

As far as minority shareholders are concerned, section 459 of the UK Company Act of 1985 provides that:

> *"A member of a company may apply to the court by petition for an order on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial"*[351]

The Act in UK intended to provide a more comprehensive remedy to minority shareholders and to broaden the circumstances under which relief would be granted to the aggrieved party. Thus, if the court is satisfied that a petition is justified the court may award a remedy in different ways, among others, issuing an order regulating the conduct of company's affairs in the future, requiring the company to refrain from certain conduct, and ordering one or more members to purchase the shares of other members.[352]

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[348] Solomon Supra Note 15, p. 422.
[349] W.P.Scott, The Close Corporation in Contemporary Business, Business Lawyer, vol 13 NewYork,1958, p.744
[350] Backer Supra note 2, p. 1346
[351] Ibid
[352] Ibid

In the law of Ethiopia, dissolution is the sole judicial remedy available to members of a Pvt.Ltd.Co, who have irreconcilable grievance with one another.[353] Art 542 (1) of the Code provides that a Pvt.Ltd.Co may be dissolved by the court for good cause. Good cause is not defined in this provision; however, one may resort to the general provisions of business organization and derive the meaning of good cause. Accordingly, good cause may refer to the event of non performance of obligation by one of the members or of serious disagreement between the partners pursuant to Art.218(2) of the Commercial Code.

In France, the Company law of January, 1978 provides for anticipatory dissolution of a company by tribunal up on demand of one of the members where there are valid reasons to that effect.[354] The German law provides highly discretionary judicial remedies when the shareholder has a dispute with other shareholders. Thus, as the dissolution remedy is so severe, Courts have developed two additional remedies: the withdrawal and expulsion in Germany.[355]

The concept of withdrawal is that the aggrieved member seeks to withdraw from the company and is entitled to obtain the fair market value of his/her interest in the company.[356] In the case of expulsion, the aggrieved ones seek to expel the other member/s, provided that the right to obtain either of these remedies is premised on showing that there is substantial basis for the remedy.[357] In establishing substantial basis for a withdrawal there are possible grounds like: objectionable personal characteristics of the shareholder, the arbitrary exercise of management of the shareholder and the existence of special factors unique to the facts and circumstances.[358] Hence, the German minority shareholders are given several remedies, such as dissolution, withdrawal and expulsion.

In contrast to the laws of the aforementioned countries, the law in Ethiopia resembles the French one, which provides for dissolution as a remedy where there is serious disagreement among the members of a Pvt.Ltd.Co. Thus, the remedy provided in Ethiopian law is more severe than that of

[353] Commercial code Art. 218 and 542(1)
[354] Backer Supra note 2, p. 1348
[355] Ibid, p. 1344
[356] Ibid
[357] Ibid
[358] Ibid

the UK or Germany. This is because, decision on dissolution is the harsh remedy that leads to loss of businesses and jobs.

To sum up, the restriction of free transfer of shares could be one of the problems in Ethiopian Pvt.Ltd.Co. This is because, protection of the law for minority shareholders is minimal and the last option is dissolution which is the other evil in business world. Thus, the Ethiopian law should adopt additional remedies from foreign jurisdictions like, Germany.

4.2.3. Problems Related to Organization of the Company

4.2.3.1. Company Governance and management

In spite of the fact that companies are deemed to be persons distinct from their creators, they never have physical and mental capacities that enable them to perform any juridical acts. In this sense companies need physical persons to act as their agents and shall acquire rights and incur liabilities through these agents, commonly called company governance and management.[359]

As it is to be recalled, in a previous discussion we have noted that a Pvt. Ltd. Co is managed differently from that of a Share Company. As a rule, shareholders of a share company normally elect a Board of Directors to set a policy for the company, which in turn appoints managers to carryout the day to day activities of the same.[360]

In Ethiopia, however, the Commercial Code does not provide for a board of directors as an organ of governance for Pvt.Ltd.Cos as opposed to Share Companies.[361] Per Art. 525(1) of the Code a Pvt. Ltd. Co is managed by one or more managers rather than Board of Directors. The reason may be a company is owned by few share holders, who are usually active in management of the business. On top of that, they view themselves much the same way as partners in a general partnership and run the business they own.

For instance, from files investigated in the Ministry of Trade and Industry, "*the E and D Associates PLC*" was established by Ezana and Daniel with the capital of 1,000,000 Birr and each

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[359] Commercial Code, Art. 216(1)
[360] Shade Supra note 40, p. 38
[361] Commercial Code Art. 347 and 525

held 50% of the shares.[362] The two shareholders were also appointed as managers of the company in the memorandum of association establishing the company. Like wise, in the case of "Mamit Trade and Industry PLC," the members of the company, Ato Desie and W/ro Yeshiwork were appointed as the manager and Deputy Manager of the Company respectively.[363] The foregoing practical instances reveal that members of Pvt. Ltd.Cos also appoint themselves as officers of the company by disregarding the hierarchical structure of company governance.

On the other hand, though all the share holders actively participate in the management of the business, minority share holders have no right to share the fruits of management.[364] Thus, it might be argued that in Pvt.Ltd.Co the seat of power is in the hand of the controlling share holders. The implication is that in most cases Pvt. Ltd.Cos lacks corporate democracy.

In some instances, however, there is Pvt. Ltd.Cos that could be managed by a Board of Directors, like share companies, and consist of the three tiers of managing organs. From the files examined in the Ministry of Trade and Industry, the writer of this paper came across memorandum of associations establishing Pvt.Ltd.Cos, which provide for board of directors. For instance, ABB-MIDROC Industrial Services PLC provides for a Board of Directors composed of five members appointed to govern the company.[365] Likewise, KADISCO Chemical Industry plc was established by three members who also appointed as board members.[366] What is more, they appointed themselves as a chairman of the Board, a manager and Deputy Manager of the company at hand, respectively.[367]

From the preceding paragraph, one may understands that shareholders appointed themselves as directors of the companies and officers of the same. In effect, the same persons usually occupy all the three tiers of the corporate governance hierarchy.[368] They often ignore corporate formalities associated with the three tiers of hierarchy in share companies/publicly held corporations.[369] As

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[362] Memorandum and Articles of Associations in the Ministry of Trade and Industry,
[363] Ibid,
[364] R.W. Hamilton, <u>the Law of Corporations in a Nut Shell</u>(3rd ed) West Pub.Co.St Paul 1992, p. 258
[365] Memorandum of Association Establishing ABB-MIDROC Industrial Services PLC, see Annex -I
[366] Memorandum of association Establishing KADISCO Chemical Industry plc, See annex _II
[367] Ibid
[368] See Annexes –I and II
[369] Shade Supra note 40, p. 38

previously discussed, Pvt. Ltd. Cos. are not explicitly prohibited to appoint a board of directors. But the problem is that it may lack uniformity among the companies established in the country as there is no clear law to that effect.

4.2.3.2. Auditors

Appointment of auditors is also optional for Pvt. Ltd. Cos consisting of twenty or less than twenty members. Art. 538(1) of the Commercial Code provides that not less than three auditors shall be appointed in the memorandum of association where the company consists of more than twenty members. With in the meaning of this provision a Pvt.Ltd.Co consisting of twenty or less than twenty members need not be required to appoint auditors. Thus, under Ethiopian law, the number of members of a Pvt.Ltd.Co seems a yardstick to be bound for the appointment of auditors.

The stand of the law in this regard does not seem to be justifiable to the writer of this paper. This is because the number of members may not reveal how far the business purpose is complicated for management nor the amount of capital injected to the company. In effect, the number of members in a Pvt.Ltd.Co should not be a benchmark for the appointment of auditors. Indeed, the writer is of the opinion that the appointment of auditors in Pvt. Ltd. Co should be either on the basis of the amount of capital or of complication of the respective company in management. As a matter of fact, auditors are watch-dogs of the members' interests and hence, in order to safeguard their interests, the appointment of auditors should be beyond dispute at any level.

In practice, however, the Majority of memorandum and articles of associations examined by the writer have appointed or provided for the appointment of at least one auditor irrespective of the number of members of a company.[370] In this regard, though there is no clear prohibition of the law as to the appointment of auditors in a Pvt.Ltd.Co with twenty or less than twenty members, the appointment of auditors should not be optional. As a result, appointment of auditors lacked uniformity among Pvt.Ltd.Cos in Ethiopia.

[370] Memorandum and Articles of Association in the Ministry of Trade and Industry

4.2.4. Problems Related to Limited Liability of Members

As it is to be recalled, in our discussion of previous chapter, the concept of limited liability is an essential rule in companies as investors are not liable for more than the amount they invest.[371] Thus, limited liability has developed as an incentive to industrial growth, without it, investors would be reluctant to risk their personal wealth in an uncertain business venture.[372] The same holds true in Ethiopia and the law provides that liability of members of a Pvt. Ltd. Co is limited to the extent of their contributions pursuant to Art. 510(1) of the Commercial Code. This envisages that in principle, the liability of members of a Pvt.Ltd.Co may not be beyond their respective contributions. In other words, once the members effected payment, they are not liable for the debts of a company from their personal assets.

Art. 510(1) of the Commercial Code of Ethiopia, however, does not explicitly provide liability of the Company and lacks clarity. As a result one lawyer argue that the concept of limited liability in a share company, Art.304(2) should be seen differently from that of a private limited company, Art.510(1).[373] In the case between Lema Wedajo ***Vs*** Elun plc and Gosa zewdie, the member and manager of Elun plc, the lawyer of the plaintiff, Ato Million Assefa, argued that members of a private limited company are liable to the extent of their contributions with in the meaning of Art.510(1) of the Commercial Code.[374] According to this lawyer, the above provisions do not state that the liability of a Pvt.Ltd.Co shall be met by assets of the company and this is one of the distinctions of the company at hand to that of a share company.

Based on this ground, he lodged an action against Gosa Zewdie, who was a member and a manager of Elun plc before the Federal Courts but decided against him. He also applied to the Federal Supreme Court of cassation Bench stating that the lower Courts committed fundamental error of law. The Federal Supreme Court, however, quashed the application on the reasoning that there is no fundamental error of law.

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[371] Romano Supra note 10
[372] L.E.Mitchell,Closed Corporations Reconsidered, Tulane Law Review vol 63,1989 p.1157
[373] Interview with Ato Million Assefa, an Attorney and consultant at Law, On November, 25,2008
[374] Ibid

As far as the above issue is concerned, the writer posed a question to one of Law instructors,[375] at Addis Ababa University whether there is a basic difference between the provisions of Arts.304(2) and 510(1) of the Ethiopian Commercial Code. My interviewee replied that there is no as such basic difference between the two provisions herein above other than the way they stipulated the liabilities of shareholders and members in a share company and a private limited company, respectively.

The writer also agrees with the opinion of the Courts and the latter interviewee in that the liability of members in a Pvt.Ltd.Co should be limited to the extent of their initial contributions, and of course, with certain exceptions to members who manages a private limited company.

Nevertheless, there is an exception where liability may be imposed up on the members of a Pvt.Ltd.Co for the debts of the company if it is declared bankrupt and its assets found to be inadequate to pay its debts.[376] Further, managers of the company may be liable to the company and third parties for any breach of their duties under the Commercial Code and articles of association.[377] Once a Pvt.Ltd.Co is formed, controlling shareholders may cause bankruptcy of the company by their failure to keep company assets separate from their own personal assets and thereby expending company funds as if they were their own. Hence, that is why, the doctrine of piercing corporate veil has been devised and discouraged the use of legal personality as an insulator against liability.

Thus, corporate veil should be pierced where it has been used to defraud creditors so as to evade existing obligations. That means, had piercing of corporate veil not been devised, companies would have been dissolved by themselves and put their creditors at risk. Further, as an agent of the company, a manager should be liable for the debts of the company provided that he did not perform his functions diligently and properly.[378]

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[375] Interview with Ato Seyoum Yohannes, a Lecturer at Faculty of Law, Addis Ababa University, January21,2009
[376] Commercial code Art. 531 (1) (2)
[377] Ibid,Art.530
[378] Ibid, Art. 530

In US close corporations, for instance, there is much less separation between management and ownership.[379] As a result, the benefit of limited liability may not exist in such company unlike public corporations.[380] This implies that, the concept of limited liability in Pvt.Ltd.Cos should be different from that extended to public companies. As a consequence, formation of small corporations may have been encouraged by the development of limited liability, but limited liability had very little effect on the small, closely held corporations.[381] According to Dodd, therefore, blind adherence to limited liability for the closely held corporations, the counter part of the Ethiopian Pvt.Ltd.Cos, is unjustified.[382] Put differently, the principle limited liability should not equally apply to Pvt.Ltd.Cos and share companies. In other words, limited liability of members in private limited companies should be restricted as opposed to that of share companies.

The writer agrees with the assertion of the above discussion in that liability of members in a Pvt. Ltd. Co should be treated differently from that of a Share Company. In Ethiopia, in most cases members hold the same position to managers in a private limited Company. Ltd. Co, and managers are granted full power with in the limits of the objects of the company as enshrined in Art. 528(1) of the Commercial Code. On the other hand, as discussed in a previous section, most of these companies have been established by two or three members who directly participate in managing the company.[383] To this effect, members of a Pvt. Ltd. Co, who participate in management activities, should be liable for company's debts whenever there is fault on their part.[384]

It is also logical that when a member manages a company, it brings a private limited company much nearer to the partnership in form and the same should apply to a member managing a company. In this respect, the policy reasons that support unlimited liability of a general partnership go directly to the protection of creditors,[385] and the same policy concern should govern the members who manage a Pvt.Ltd.Co. It is worthy of being mentioning that a

[379] Romano supra note 13
[380] Ibid
[381] Mitchell supra note 81, p.1167
[382] Ibid, p.1168
[383] Memorandum and Articles of Associations in the Ministry of Trade and Industry.
[384] Commercial Code, Art. 531(1)
[385] Mitchell supra note 81, p.1181

Pvt.Ltd.Co may also be managed by a non member,[386] and the above rule should not apply to a manager who is not a member. The reason is, non member manager does not participate in decision making powers, but mainly participates in implementing of the decision of the members.

In relation to this issue, the writer did not come across court cases whereby a member manager of a Pvt.Ltd.Co, who was held liable for company's debts. In most court cases creditors brought actions against companies, where companies fail to pay, managers who are members were not held liable due to the principle of limited liability.

For instance, in the court cases seen above, *Dashen Bank* **V**. *Martrade Ethiopia PLC,* or Research periodicals & book service Inc **V.** Reliance International plc; the judgment creditors did not bring actions against members or managers of respective companies though the companies were unable to pay their debts. In general, my search revealed that there were no cases that were decided against managers of Pvt.Ltd.Cos, and cases in which managing members are held liable to third parties are likely to be quite few.

In one case, a creditor brought an action against a manager of a private limited company, but did not succeed. In the case between Lema Wedajo Vs.Elun plc and its manager (Gosa Zewude), Lema brought an action against the plc and its manager, who is a member of the same before the Federal First Instance Court claiming a debt due to him in 1989 E.C. In its statement of defense, the Company admitted the said debt but was unable to discharge its obligation due to unforeseen events. The Court, however, decided against the company on the ground that the evidence produced did not amount to *force majeure.*

The manager and a member of the Company at hand on his part objected to the allegation of the plaintiff on the ground that he acted only on behalf of the Company and did not enter into any transaction with the plaintiff for his personal benefits hence, prayed the court to dismiss the Case. Even though the plaintiff argued that a member of a Pvt.Ltd.Co is liable to the extent of his contribution as per Art.510(1) of the Commercial Code, the Court held that a Pvt.Ltd.Co is an

[386] Commercial Code, Art. 526

independent legal entity and distinct from its members, who can be sued in its own name. Hence, the Court rejected the suit which was brought against the manager and a member of the Elun plc.

As it was discussed in previous sections, Elun plc could not pay its debt to a judgment creditor, Lema Wedajo, as no assets could be discovered in the name of the company. Thus, the writer is of the opinion that the issue of a manager, who is a member, should be treated differently in case where a private limited company fails to effect payments. Thus, the Court should not generalize that liability of members are limited only to the extent of their contributions.

Actually, a manager is the agent of the company who is entrusted with the duty to keep records of the transactions, and follow up the day to day activities of the same pursuant to the law and the articles of association of the respective company. What is more, managers are responsible to perform all activities that are necessary for the achievement of company's business purpose. Hence, if a company is found with out any registered assets, it is likely that managers did not perform their duties properly and diligently as supposed to be.

From this perspective, it would be tenable to argue that managers have breached their duties and should be liable towards third parties, since managers are there to manage company's affairs. By and large, distinct personality of the company should not be prejudicial to the innocent third party creditors. To this end, managers who could not discharge their duties must not benefit from the fruits of limited liability.

In sum, the writer would like to disclose that managers, who are members of a Pvt.Ltd.Co, have breached their duties on two bases:

First, in my research, I tried to show that most private limited companies in Ethiopia have been established without contributing the required capital fully. This implies that a manager has breached his legal duties from the inception as the law requires capital to be fully paid up before the formation of the company.[387] Knowing the fact that capital is not fully paid up, a manager who is a member, may enter into transactions with innocent third parties on behalf of the same

[387] Commercial Code, Art. 517(g)

company. In due course, a company can not discharge its obligation as adequate capital was not contributed by members including a manager.

Second, managers in Pvt.Ltd.Cos have breached their duties because they failed to deposit a legal reserve. The law clearly provides that not less than one-twentieth of the profits shall be deposited as a legal reserve each year pursuant to Art. 539 of the Commercial Code. According to the law, it is mandatory for the Pvt.Ltd.Cos to transfer the legal reserve fund each year whenever they make profit.[388] The implication here is that legal reserve is an additional protection to third party creditors. Thus, it should not be distributed among the members and any payment out of the legal reserve fund of the companies is considered as fictitious dividend. That means, if it is to be distributed to members, it amounts to breach of duties and jeopardizes creditors' interests.

In practice the majority of the Pvt.Ltd.Cos in Ethiopia, however, do not deposit the legal reserve required to be deposited. Had it been deposited, companies would have not been found without any asset registered in their name as pointed out herein above. Obviously, the intention of the law as regards the legal reserve is with the view to safeguard creditors' interests. Thus, if managers fail to deposit the legal reserve, it could amount to breach of duties entrusted by the law and the managers should be held liable within the meaning of Art. 530 of the Commercial Code.

By way of conclusion, the concept of limited liability should be interpreted narrowly in Pvt. Ltd. Cos. and should not relieve the members who closely administer the company where the company fails to pay its debts without sufficient reasons.

[388] Commercial Code, Art.539

CHAPTER FIVE

Conclusion and Recommendations

5.1. Conclusion

Although business organizations have existed since time immemorial, they have been more refined with the advancement of industrial and technological changes. In majority of the countries, if not all, business organizations may be typified into partnerships and companies. Unlike, partnerships, companies have a number of characteristics, such as limited liability, transferability of shares, centralized management, and continuity of life (perpetual succession).

In the 1960 Commercial Code of Ethiopia, six business organizations are recognized, among which two of them are companies, namely share companies and private limited companies. Both forms of companies offer their members limited liability where members are not personally liable for company's debts beyond their initial investment in the company. In current days, therefore, people would like to undertake business with out risking their personal liability. As a result, a large number of companies, in particular, private limited companies are flourishing more than ever in Ethiopia. Private limited companies are said to be vehicles to carry on small and medium size business.

In Ethiopia, among the two companies, the Overwhelming majority (about 96%) goes to private limited companies. Nevertheless, private limited companies are criticized for being problem fraught business organizations in the country. The writer of this paper, therefore, tries to summarize the legal and practical problems related to private limited companies in Ethiopia.

In Ethiopia, memorandum of associations of majority of Pvt. Ltd. Cos reveal that the formation of such companies is dependant on familial or other personal relationships. Thus, most of them are established among husbands and wives, their children or among brothers . In effect, loan granting institutions may not have confidence in doing business with Pvt. Ltd. Cos. Being a family company; it lacks adequate protection for creditors as there is no mechanism of checking paid up contributions.

From the inception, provisions of the Commercial Code dealing with the private limited company have no clear stipulation as to the full payment of capital before the formation of a Pvt. Ltd. Co. In other words, as opposed to a share company, there is no provision that clearly requires the members of Pvt. Ltd. Co to pay their respective contributions before the formation of the company and deposit the capital in the name of the would be a Pvt. Ltd. Co. The law merely requires a statement that the capital is fully paid up, and this has to be shown in the memorandum of association. This is one of the legal gaps in Commercial Code of Ethiopia.

In practice however, the members of Pvt.Ltd.Co put a statement that the capital is fully paid up in the memorandum of association, but not actually paid. What is interesting here is that such false declaration of members is verified by the officials in charge of registration and licensing department as if it were true. Thus, despite the presumption of the law that capital is fully paid up prior to the formation of a Pvt. Ltd. Co, there is no fully paid up capital rather than mere declaration shown in the memorandum of association establishing such company.

Therefore, the practice of this country shows that, the majority of private limited companies are registered and formed with out or with little paid up capital. As a result, this is one of the sources of conflict and litigation among the members and third party creditors of private limited companies. For instance, in the case between *GET-YAN plc* and *Mr.Zang* De *kuan*, the lawyer of the GET-YAN plc argued that the statement shown in the memorandum of association as to the fully paid up capital does not have any legal effect other than a requirement to be registered. The implication here is that the legal requirement of fully paid up capital has been undermined not only by laymen members of a Pvt.Ltd.Co but also by legal professionals.

Besides, non payment of required capital may have negative repercussion on the third party creditors, who transact with the respective private limited companies. This is because such companies do not have paid up capital, and hence could not discharge their obligations. Eventually, company's creditors will not get their money back due to lack of assets deposited in the name of a Pvt. Ltd. Co. Indeed, judgment creditors of a Pvt. Ltd. Co. can not execute their judgments against these companies due to absence of any assets registered in the name of the respective company. Put other wise, the Commercial Code provisions dealing with the Private

Limited Companies do not offer sufficient protection for third party creditors who transact with the same.

The mandatory requirement of "two man" in the formation and life of the Pvt. Ltd. Co is also the other problems reflected in the Ethiopian Private Limited Companies. The law in Ethiopia provides that a Pvt. Ltd. Co. shall not have less than two members, and if the number reduced below two, such company may be dissolved unless necessary arrangements made with in a reasonable time. In practice, this does not serve any purpose because many of the Pvt.Ltd.Cos (about 44%) among the files investigated by the writer are established by two members in which one of them is nominal as it was is reflected in the share distribution of the members as indicated in table III of this paper.

As a matter of fact, a majority share holder requires another partner simply to fulfill the minimum legal requirements (two persons) and get license of incorporation. In effect, Private Limited Companies in Ethiopia are one man companies and membership, by and large are pseudo. This may be one of the reasons that made the drafter of the would be amended Commercial Code to include the one man private limited company.

In addition, companies with only two members are also susceptible to deadlock where two members own equal (50%) shares in the company. In this sense, decisions may not be made if one of them disagrees and this leads to the dissolution of a company. What is more, if one of the members dies or withdraws from the company, the inevitable fate of a Pvt.Ltd.Co is dissolution as it could not continue with a single member unless certain arrangement is made with in a reasonable period of time.

Despite free transfer of shares in companies, the concept may not hold true in private limited companies. As a result, shares in Pvt.Ltd.Cos shall not be freely transferable out side the company unless approved by majority members representing at least three-quarters of the capital. The articles of association may also fix the larger majority or unanimity to approve the transfer of shares to a person other than the member of such companies. This becomes a problem when one of the members, typically, a minority share holder wants to assign or transfer his share. That means one may not find easily a buyer other than the majority shareholders in the Pvt.Ltd.Co. In other words, the majority shareholders may buy the share at a low price by restricting the minority shareholders from selling their shares out side the company. The minority share holders are, therefore, bound to sell their entitlements with low price to the other member or may demand the dissolution of the company, which is the harsh remedy rather. There is also a problem where two members own equal shares, each having fifty percent, it is impossible to attain the requirement that stipulates members representing tree quarters of the capital.

One of the basic characteristics of a company is centralized management. To put it differently, in companies there is significant separation of ownership and management. Nonetheless, this does not hold true in Pvt.Ltd.Cos, where the shareholders are likely to be active in the management of the business in such companies. This implies that there is a fusion between the ownership and management of Pvt.Ltd.Cos. As a result, the members may withdraw money from such companies as if their own and endanger the financial solidity of the company. Further, as one may not get financial information of the firm, the lenders' interest will be jeopardized.

In the Commercial Code of Ethiopia, provisions dealing with Pvt.Ltd.Cos offer members of a company with a limited liability. The provisions under Art.510(1) of the Code does not explicitly provide about the liability of members and their companies compared to that of share companies. Further, the law does not explicitly deal with the distinctions of the two companies as far as limited liability is concerned. As a result, the very provision leads to different interpretations and becomes the source of litigation as it is to be recalled herein above.

The concept of limited liability in Pvt.Ltd.Cos should be treated differently from that of share companies. The reason is that, no separation of ownership and management in Pvt. Ltd. Cos as opposed to Share Companies; hence, there must be a distinction between these companies. What is more, as pointed out above, Pvt. Ltd. Cos share some features of partnerships, and a member who manages a company like that of a partnership.

5.2. Recommendations

As pointed out herein above, private limited companies are the most popular forms of companies in Ethiopia. By and large, it is hardly possible to underestimate the significant role to be plied by such companies in Ethiopian economy. Nevertheless, no amendments have been made since its birth in 1960 and the gap in Pvt. Ltd. Cos provisions is huge. In effect, they are always subject to abuse for their incomplete legal provisions compared to that of share companies. Private limited companies are not, however, all gloomy and should be abolished, but the writer would like to recommend the following:

In the first place, the provisions of the Commercial Code governing Pvt. Ltd. Cos are incomplete and sketchy. What is interesting is that such provisions do not make any cross-reference to the provisions of share companies that are applicable to Pvt.Ltd.cos by analogy.

In connection to this, for instance, private limited companies may not step in to legal existence without certain arrangement. Thus, it is beyond dispute that Pvt.Ltd.Cos come in to being through certain promotional activities of founders. On the contrary, provisions dealing with Pvt.Ltd.Cos do not stipulates about the issue of founders as opposed to that of share companies. Nonetheless, it is mandatory to consult provisions of share companies governing pre-incorporation activities of founders and apply the same to Pvt.Ltd.Cos in Ethiopia. What is more, the Commercial Code does not provide for provisions that govern liquidation of Pvt.Ltd.Cos though liquidation is an inevitable fact in Pvt. Ltd. Cos. Hence, such provisions should be included in the forthcoming amended Commercial Code of Ethiopia.

The concept of capital in Pvt. Ltd. Cos is crucial and indisputable to achieve the purpose for which the company is formed. Obviously, the capital paid could be considered as part of the companies' assets and trust funds for creditors of companies. In Share Companies the law explicitly provides that capital of a company shall be fully subscribed and one quarter of such capital at least be paid up and deposited in a bank in the name of the company. However, provisions dealing with Pvt. Ltd. Cos fail to provide such requirements plainly. In this regard, the law in Ethiopia simply requires a statement that the capital is fully paid up to be shown in the memorandum of association. The practice, however, shows that the majority of the Pvt. Ltd. Cos are established with out fulfilling the legal requirement and formed with out paid up capital.

In consequence, such mal-practices become the source of conflicts among the members and prejudicial to the third party creditors who enter in to contract with such companies. What is more, the Ministry of Trade and Industry who is in charge of registration of companies fail to verify the trustworthiness of the statements shown in the memorandum of association establishing the very company. Thus, since capital is the essential element in the formation of any company, the law should include provisions that bind the members of Pvt.ltd.Cos to deposit certain amount of capital before the formation of companies. Further, there must be mechanisms by which the capital required to be paid is ascertained. Put differently, there must be clear provisions that empower the officials in charge of registration, in the Ministry of Trade and Industry, or others such regional bureaus of Trade and Industry to verify the truthfulness of statements in the memorandum of association.

Despite lack of explicit provisions in the Commercial Code as to ascertainment of the truthfulness of the paid up capital shown in the memorandum of association, the writer is of the opinion that the officials could likely demand a Pvt.Ltd.Co to produce reliable evidence with respect to information provided in the memorandum of association on the basis of Arts. 97 and 222 of the Commercial Code.

Hence, the writer would believe that concerned officials should employ the above legal provisions rather than authenticating false information as seen in practice. Otherwise, the writer recommends that concerned officials should devise mechanisms by which the reliability of the statements made in a document brought before them for registration of a company should be proved.

The mandatory requirement of ‘two man’ in the formation of Pvt. Ltd. Cos is also a problem in such companies, since most of the two members company is a fake and subject to different constraint. Thus, it could be said that the importance of a person who has insignificant share is just to satisfy the minimum legal requirement of two members and to assist a majority shareholder to do business. Now therefore, the introduction of one Man Company in the existing Commercial Code would likely avoid such unnecessary requirements of coalition with another person in order to comply with the legal minimum number of members.

The introduction of one man company in the Commercial Code may reduce, if not avoid, potentials of the dissolution of Pvt.Ltd.Cos due to the death or withdrawal of one of the members in private limited companies having ‘two members’. By and large, laws of those countries selected and discussed in this paper also show that the minimum requirements of two members in the formation companies, equivalent of private limited companies in Ethiopia, has been abolished.

Restriction of freely transferable shares is one of the distinguishing characteristics of a private limited company. This, however, jeopardizes mainly the minority shareholders. As increasing protection of minority shareholders may help to attract investment, the Ethiopian Pvt.Ltd.cos’ provisions should be reframed so as to achieve such purposes. In this regard, the Ethiopian law seems severe as the minority share holders may be compelled to sell their share with the price that is favorable to a majority shareholder, in case where they want to withdraw from the company. To this end, Ethiopia should adopt the law of other jurisdictions where the member who wants to transfer his share may get fair price.

Besides, the law in Ethiopia seems aggressive where disagreement arises between members of Pvt. Ltd. Cos. In this case, the remedy provided is dissolution of the company, which is the harsh remedy. Thus, the law should incorporate the mechanisms of expulsion and withdrawal so as to save the life of a company from dissolution like that of the German law.

As far as company governance is concerned, provisions dealing with Pvt.Ltd.Cos neither prohibit nor expressly authorize such companies to appoint Board of Directors. In practice, there are some private limited companies which have appointed Board of Directors. Thus, the law should provide clear provisions that establish grounds for appointment of directors in private limited companies where several members and huge capital is involved.

The law in Ethiopia provides that Pvt.Ltd.Cos whose members are twenty and less may not be bound to appoint auditors. The stand of the law seems erroneous because it takes in to account the number of members for the appointment of auditors. Auditors are required to safeguard the interests of the members, and hence the law should explicitly provide the appointment of auditors by taking into account either the amount of capital or the complexity of finance to be administered in respective private limited companies.

Although limited liability is the concept of companies, the writer believes that in private limited companies, where members participate actively in management may be treated differently from the share companies, in which shareholders are passive. This is to indicate that when a member manages a company it associates the Pvt. Ltd. Co much nearer to the partnership in form. In other words, the policy reasons supporting the unlimited liability of a general partnership go directly to the protection of creditors and the same policy concern should govern the members who manage the Pvt. Ltd. Cos in Ethiopia.

What is more, in the management of Pvt. Ltd. Cos financial statements may not be audited even appointment of auditors is not mandatory if the number of members are twenty and less. As a result, members of private limited companies may receive fictitious dividends, draw cash in a form of other than dividends, and make the company difficult to be profitable, and this is what has been practiced in Ethiopia. Based on the above grounds, therefore, there must be a restriction of limited liability in Pvt. Ltd. Cos as opposed to that of share companies.

This, however, does not mean that all Pvt. Ltd. Cos are treated alike as far as limited liability is concerned. The writer would like to suggest that unity of ownership and management should be taken in to account in the restriction of the limited liability of members of a Pvt. Ltd. Co. in question. Put differently, the determining factor, however, should be how far the management and ownership in a particular Pvt. Ltd. Co. are separated.

Thus, members of a Pvt. Ltd. Co, who are much closer to management and do not sufficiently separate their private funds from company capital should be liable and the law should incorporate provisions that govern such matters. The rule, however, shall not apply to non member manager who is not a member because he did not participate in voting rights in the decisions of a private limited company. The reason is, the major functions of a non-member manager are only to implement those decisions made by members of the companies.

As far as creditors are concerned, the writer would like to recommend that lenders should not provide credits to private limited companies unless mortgage, other collaterals or their principal shareholders added their personal guarantees to the obligation of the respective private limited company.

By way of conclusion, the writer would suggest that the provisions governing Pvt. Ltd. Co. should be amended in a way that could address the existing practical problems associated with such companies so as to make the Ethiopian law compatible with the current global affairs.

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