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Module Introduction

Dear student! Welcome to the second Module of your course on Law of Business Organizations. In this module, you will study about the laws of share and private limited companies in Ethiopia as embodied in the Commercial Code of 1960. Moreover, you will be acquainted with the relevant provisions of the Code dealing with the conversion and amalgamation of business organizations.

To this end, the Module has been divided into three chapters each chapter having its own sections and sub-sections. Accordingly, the first chapter, relatively the broader one, is extensively devoted to the laws of share companies. The chapter focuses largely on the formation, operation and dissolution of share companies.

The second chapter, on the other hand, is dedicated to the laws dealing with private limited companies. Like in the case of share companies, the relevant provisions of the law dealing with the formation, operation and dissolution of private limited companies have been thoroughly scrutinized.

Eventually, the last chapter of the Module comprehensively addresses important issues relating to the conversion and amalgamation of business organizations.

Furthermore, it should be noted that each section is immediately followed by a set of self-assessment questions. Similarly, at the end of each chapter there come a brief chapter summary & sets of review questions for which key answers on some of the selected questions are provided at the back of the Module.

Note: Dear student, while you study this Module, you are strongly advised to keep, *inter alia*, the Commercial Code at your reach so as to make a quick reference to the relevant provisions of the Code.
CHAPTER ONE
COMPANIES LIMITED BY SHARES

🌟 Introduction

As you might recall from your previous study in the first Module, share company is one of the six forms of business organizations recognized by the Ethiopian Commercial Code of 1960. It is one form of an association of business people set up for mutual benefit and for common goal. It has been said that companies limited by shares are the suitable organizations, with the primary object of carrying on a business for profit and to divide that profit among the members.

A share company is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company. Thus, a company limited by shares is one of commercial business organizations with a fixed capital in advance which consists of shares subscribed by the members (shareholders). Furthermore, the liabilities of the members of a share company are limited to the assets of the company in which the members cannot be compelled to pay liabilities of the company outside their initial investment. This is also true of private limited companies which will be treated in the next chapter. Therefore, the aforementioned features of share companies are the main reasons for the increased importance of share companies to draw huge capital and make much profit.

In general this chapter deals with the requirements for the formation of share companies, their shares & debentures. In addition, the various organs, management and control mechanism of share companies and their accounts will be discussed in this chapter. Lastly, a brief discussion of memorandum and articles of association, their amendments as well as the dissolution and winding up of share companies will be made. Towards this end, the chapter is divided into five sections each section being followed by some self-assessment questions. Besides, at the end of the chapter there come a brief summary and review questions on the chapter as a whole.
Objectives:
After you have completed studying this chapter, you will be able to:

- state the basic features of share companies.
- enumerate the requirements for the formation of share companies.
- explain the concept of shares and debentures as enshrined under our commercial code;
- know the various organs, management and control mechanism, accounts, etc. of share companies;
- prepare (draft) memorandum and articles of association for share companies: and
- list causes for the dissolution and winding up of share companies under Ethiopian commercial code.

Section: 1.1. Formation of Share Companies

Overview:
In order to set up any business organization, there are certain requirements to be complied with. Since share companies are one of the six forms of business organizations that are recognized under Ethiopian commercial code (Art.212), for their formation, the requirements like the existence of a valid partnership agreement, full subscription of the minimum capital required, deposit of at least one quarter of the par value of the shares, registration, publicity etc must be fulfilled in accordance with the relevant provisions of the law. Furthermore, as companies do not emerge by themselves, before they come into existence, basis for a valid formation should be leveled by physical persons i.e., the founders. It is also possible that share companies may be formed by public subscription in which an offer to subscribers would be made by a prospectus signed by all the founders.
Objectives:
At the end of this section, you will be able to:

- list the various requirements for the formation of share companies.
- identify the formation of share companies among founders.
- distinguish between formation of share companies among founders and formation by public subscription.
- point out whether the formation of share companies currently operating in Ethiopia companies with the provisions of the Ethiopian commercial code or not.

1.1.1. General Requirements for the Formation of Share Companies.
In principle, there are certain general requirements for the formation of share companies in the absence of which a valid share company having legal personality is inconceivable.

a) Partnership agreement
To begin with, a valid partnership agreement, inter alia, is one of the essential requirements for the formation of a share company. That is, in order to establish a valid share company, there should be a valid partnership agreement out of which the business organization arises. This is evident from the following provision of the Ethiopian commercial code.

Art. 210(1) - “A business organization is any association arising out of a partnership agreement.”

Thus, the existence of a valid partnership agreement to be made in writing is one of the essential requirements for the formation of share companies.

b) Formation to be in writing.
Further, it is an essential requirement that the formation of a share company shall be made in writing. Accordingly, Art.214 of the Comm. Code states that the
formation of any business organization other than a joint venture shall be of no effect unless it is made in writing (emphasis added). There is no possibility of a share company to be formed in any other form other than in writing.

c) Registration and Publicity

Registration and publicity are also other essential requirements for the formation of a share company in the absence of which the company would be devoid of legal personality. Art.100(1) of the comm. code provides that any business organization carrying out commercial activities in Ethiopian shall be registered. Upon filing the application for registration, the official in charge of the register shall examine whether or not the legal conditions relating to the formation of the share company have been fulfilled.

Similarly, as regards the requirement of publicity, it is understandable from Art.219 of the Comm. Code that a share company as a form of business organization shall be made known to third parties. Such publicity shall be made by a notice published in a newspaper empowered to publish legal notices, by the deposit of two copies of the memorandum of association and all complementary documents, if any, with the official in charge of the commercial register.

What is the effect of publicity on a share company?

Art. 223 - Effect of publicity

“A business organization shall have no legal existence nor personality until all the provisions of this code relating to publicity have been complied with and registration is published in accordance with Art. 87 of this Code.”

Therefore, it is crystal clear from the reading of the afforecited provision that failing publicity, a share company shall have neither legal existence nor personality in the eyes of the law.
Does the non-compliance with the other legal requirements relating to the formation of the company deprive the company of a legal existence and personality?

Even though it is necessary that all the legal requirements for the formation of a share company should be complied with, as per Art. 324 of the comm. Code where publication and registration have been made, the company shall have a legal existence and personality notwithstanding that all the legal requirements relating to the formation of the company have not been complied with.

d) Full subscription of a capital and payment of the par value of the shares.

There are also other general requirements provided under Art. 312 of the Comm. Code that a share company shall not be formed until the capital has been fully subscribed and one quarter at least of the par value of the shares has been paid up and deposited in a bank, in the name and to the account of the company.

e) The required legal minimum of value of the capital.

Any business organization has its own initial capital to be established whether the amount has been fixed by law or not. Unlike other forms of business organizations, the law expressly fixes the legal minimum capital for both share and private limited companies. Accordingly, as per Art. 306 (1) the required minimum value of the capital that must be raised initially for the formation of a share company shall not be less than 50,000 Ethiopian Birr.

f) Memorandum of association

Furthermore, the law requires as per Art. 313 of Comm. Code that the formation of a company shall be by a public memorandum of association- the founding instrument- in which contained are, inter alia, the business purpose of the company, the amount of capital subscribed and paid up, the par value, number, form and classes of shares etc. of the company.
of members is reduced to less than five.

1.1.2. Formation Among Founders

Basically, companies do not emerge by themselves

g) The legal minimum number of members.

What is the legal minimum number of members required for the formation of a share company?

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Art. 307(1). “A company may not be established by less than five members.”

Thus, unlike partnerships, the legal minimum number of members required for the formation of a share company is five. Even after it is formed, no company shall remain in business for more than six months after the number. Before coming into existence, basis for valid formation should be laid down by certain persons. These people conduct feasibility study of the proposed venture and test the plan with objective reality prevailing at certain targeted environment.

Who are the founders?

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Those persons laying down the foundations and carrying out the pre-formation management of the company are called founders (promoters). The classes of persons having the status of founders and their minimum number have been provided in the Commercial Code.

Art. 307 – Founders

1) A company may not be established by less than five members.

2) Persons who sign the memorandum of association and subscribe the whole of the capital shall have the legal status of founders.
3) Where a company is to be formed by the issue of shares to the public, persons who sign the prospectus, bring in contributions in kind or are to be allocated a special share in the profits shall have the status of founders.

4) Any person even though outside the company, who has initiated plans or facilitated the formation of the company, shall have the status of a founder.

It follows from the above provisions that the expression “founder” covers a wider range of persons and is a question of fact. It may range from village grocer to a professional promoter to the full extent each undertaking to form a company with reference to a given project.

More precisely, all persons who are directly or indirectly involved in the establishment of a share company are given the status of founders. Formation of share company exclusively among the founders is sometimes called closed company, for the founders alone subscribe the whole approved and issued capital of the company. This makes such a share company similar to a private limited company.

Thus, in the case of a share company formed among the founders, where shares are not offered by public subscription, the founders shall, as per Art 316, show in the memorandum of association that all the shares have been allocated; that one-quarter at least of the par value of the share has been paid up and deposited in a bank in the name and to the account of the company and that the valuation of contribution in kind has been made in accordance with Art. 315 of Comm. Code. Moreover, the founders shall show in the memorandum that they have provided for the administrative organs of the company. It is also worth noting that where a share company is formed among the founders, all the general rules and procedures of the formation applicable to all forms of commercial business organizations other than joint venture are also applicable to the company so formed.
1.1.2. Formation by Public Subscription.

Apart from the formation of a share company among the founders discussed so far, the other way of forming a share company is through public subscription. A share company of this kind may be formed through public contribution in accordance with Arts. 318- 322 of the Comm. Code in which the founders invite the public offering shares and the contribution of subscribers (persons purchasing shares or agreed to purchase shares) will be financial basis to the company. This is the only way in which shares will be accessible to the public at promotional stage of the company.

Compared to the first formation of share company among founders, formation of share company by public subscription is rare in Ethiopia. Almost all of share companies in Ethiopia are formed between the founders. This may be due to lack of stock exchange market and trust between businesspersons in Ethiopia. Thus, only very few share companies such as Wegagen Bank s.c., Abyssinia Bank s.c, United Bank s.c, and ALFA University college s.c are examples of share companies formed by public subscription that advertise the sale of shares through mass media in Ethiopia.

In order to form a share company through public subscription, certain procedures should be followed. These are primarily after the founders complete their ideal company into tangible venture, for instance, after drafting the memorandum and articles of association and valuation of contributions in kind, they should issue a prospectus signed by all of them.

The prospectus is a legal document that usually contains information about the company to be formed and that includes the text of the draft memorandum of association, a summary of the principal provisions of the articles of association, the expert report of the valuation of contributions in kind and etc as provided under Art. 318 of the com. Code.
Following the issuance of the prospectus, application for shares shall be made by any member of the public on the form provided and deposited in the place of application.

Finally, after applications for shares are made and all formalities of such application are fulfilled and the time for application has expired, the founders shall call a meeting of the subscribers as per (Art 320). The purpose of the meeting shall be to verify that the requirements relating to the formation of the company have been complied with, to draw up the final text of the memorandum and articles of association; to approve contributions in kind, if any and the share in the profits allocated to the founders, and to make all appointments required under the memorandum of association. All the resolutions of the meeting must then be signed by the founders and all other documents be submitted to the meeting annexed thereto.

**Self-assessment Questions**

1. Define a share company.
2. What are the essential legal requirements for the formation of a valid share company?
3. What is the source of a share company as a form of business organization?
4. What is the purpose of the law to require a share company to have a fixed capital in advance?
5. Can a contribution in a share company be made in skill? Why?
6. Explain the concept and purpose of a prospectus, its forms and contents.
7. Enumerate the categories of persons that can have the status of founders in the formation of a share company. Are they shareholders?
Section: 1.2. Shares and Debentures of Share Companies

Read: Arts. 325-345, 400, 407(2)& 429-444 of the comm. code.

**Overview**

Dear student! Welcome to the second section of this chapter under which thoroughly treated are the securities of share companies. One of the advantages of share companies is the possibility of raising money from the general public. When there is shortage of money to carry out the intended venture the most efficient way to overcome financial constraints is issuing company securities (shares) and selling them to any one who wishes to invest money in the company or lend money through purchase of securities (debentures). The two main types of company securities are, therefore, equity securities (shares) and debt securities (debentures) both of which may be issued to collect money.

In general, this section will deal with the concept, bar value and price of shares. An attempt will also be made to discuss the forms and classes of shares as well as their assignment. Finally, the various forms and classes of debentures will be explained in-depth.

**Objectives:**

At the end of this section, you will be able to:

- explain the concept, forms and classes of shares.
- list the forms and classes of debentures.
- distinguish between par value and price of shares.
- state the requirements for the issuance of debentures.
1.2.1. Shares of Share Companies

1.2.1.1. Concept of a Share

How do you understand the concept of a share? Or what really a share is?

Actually, there is no fixed concept of a share and its nature is not yet determined for the notion of “share” may be understood in different senses.

Firstly, a share may be grasped as a chose-in-action. Chose-in-action is a property that one does not actually perceive, as it has no physical existence but a right that can be enforced by legal action. However, defining the term, "share" as a chose-in-action does not always help us draw a clear picture of the concept for the expression “chose-in-action” itself is a vague concept consisting of bundles of rights evidenced by documents.

Secondly, a share may be understood as part of the share capital of the company. This may be evident from Art.304 of the Comm. Code which defines share company on the basis of concept of share stating that share company is a company "whose capital is fixed in advance and divided into shares…." This concept of a share is defective in that a share is not merely a sum of money but an interest measured in sum of money and made up of bundles of rights. It represents an equity or ownership interest in the company. By their nature, shares are indivisible.

1.2.1.2. Par value and Price of Shares

What is the difference between par value and price of shares?

Par value of a share is the nominal value of the share as shown on its face. It is the momentary amount of a share once fixed and contained in the memorandum of association. As is provided under Art 306(2) of the Comm. Code, the amount of the par value of each share shall not be less than 10 (ten) Ethiopian birr. Where as the price of share, as could be inferred from Art.318(1)(e) of the Comm.Code, is the
actual price at which shares are to be issued and that must be mentioned in the prospectus. It is the price that the company is willing to accept and the subscriber is willing to pay on the open market during public subscription.

**Can shares be issued at a price lower than their par value?**

Shares may not be issued at a price lower than their par value. But as per Art. 326(2) of the Comm.Code, they may be issued at a greater price than their par value where such issue is provided by the memorandum or articles of association or decided by an extraordinary general meeting. The difference in amount between the par value and the price at which shares are issued shall be known as a *premium*.

**1.2.1.3. Forms and classes of shares.**

i) **Forms of shares**

**What are the forms of shares under Ethiopian law?**

Art. 325- *Forms of shares*

(1). *Shares are either registered in the name of the shareholder or to bearer, as required by the shareholder.*

Therefore, there are two forms of shares in Ethiopia: registered and bearer. The distinction between the two lies in the rights that may be enjoyed and obligations that may be discharged by holder of the share. In the case of registered shares, the name of the person is required to appear in the company’s register while the owner of a bearer shares, for most purposes, is the possessor.

It must be noted that all shares shall be registered in the name of the shareholder where bearer shares are prohibited by law, the memorandum or articles of association (Art.325(2)). Moreover, it has been provided under. Art. 325(3) of the
Comm. Code that where bearer shares are not prohibited, any shareholder may notwithstanding any provision to the contrary convert his bearer shares into registered shares and vice versa.

ii) Classes of shares

What are the various classes of shares and how could they be set-up?

In principle, the law under Art.335(1) of the Comm. Code provides that the memorandum of association or an amendment thereto by a general meeting may provide for the setting up of several classes of shares with different rights. Thus, a share company is free to design various classes of shares with different rights depending on its financial necessity.

In general, the company’s share may be divided into ordinary, preference and dividend shares. If the memorandum or articles of association is silent as to classes of shares, the company can issue only ordinary shares. Ordinary shares are shares which entitle their holder to exercise identical rights, or shares carrying identical obligations.

The other class of shares is preference shares. According to Art. 336(1) of Comm. Code, a share company may create preference shares either in the memorandum of association or by resolution of an extraordinary general meeting.

What is the advantage of preference shares?

Such shares enjoy a preference over other shares, such as a preferred right of subscription in the event of future issues or rights of priority over profits or assets or both (Art.336(1)). However, the shareholders with preference shares may be deprived of voting rights. But as pet Art 336(3) of the Comm.Code, the memorandum of association may provide that shareholders who have been given rights of priority over profits and distribution of capital up on dissolution of the company may vote only on matters which concern extraordinary meetings.
Dividend shares, being one class of shares, may be issued to shareholders up on redemption of the ordinary shares. Art. 337(2) provides that shareholders whose shares are thus redeemed shall receive dividend shares. These shares do not confer any right to the part of the dividend representing the statutory interest, nor to repayment of contributions up on the dissolution of company.

Do the shareholders of dividend shares lose a right of vote like the case of preference shares?

It has been stated under Art. 337(2) of the comm.code that the shareholders however retain a right of vote, unless otherwise provided in the memorandum of association. They also retain a right to that part of the dividend exceeding the statutory interest and a right to distribution of a share of the surplus in the winding-up.

Moreover, it is worth nothing that all share of the same class shall have the same par value and the same rights (Art.335(2)). Every share shall confer a right to participation in the annual net profits and to a share in the net proceeds on a winding-up.

1.2.1.4. Assignment of Shares.

A share, being a movable property, may be freely assigned or transferred from one person to the other. This, however, does not necessarily mean that no restriction may be made on the free transfer of shares where provided in the company’s constitution. Exceptionally, the law or agreement of the company may hinder free assignment of shares. To this end, Art.333(1)&(2) of comm. code states that restrictive provisions may be made in the articles of association or by general resolution of an extraordinary meeting on the free transfer of shares or making assignment of shares subject to the consent of the board of directors.
Nevertheless, these restrictive provisions may not result in preventing assignment of shares nor in causing serious damage to a shareholder who may wish to assign his shares.

**In what manner could the assignment of either form of shares be effected?**

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Art. 340(1) - “Bearer shares are assigned by delivery, without any other requirement.”

Therefore, when a company issues bearer shares, the shares can freely be assigned in the manner similar to other ordinary movable properties for which delivery alone is sufficient without any further formality requirement.

On the other hand, the assignment of registered shares shall be effected only when they are registered in the name of the assignee after the name of the assignor is struck out. Art 341 of the comm. code provides that ownership of registered shares shall be established by the relevant entry in the register kept at the head office and no transfer is complete until recorded in this register. Thus, it will be a defective transfer and shall be of no effect in the absence of registration for a valid assignment of registered shares necessarily requires registration.

**1.2.2. Debentures**

**What are debentures and when are they issued?**

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It is possible that a company's financial need may not be met by the fund raised from investors only; the money collected through sale of shares may still be insufficient to run the business of the company. In this case, the company may opt for borrowing money from the public by issuing debt securities (debentures). Accordingly, money may be borrowed from individuals, banks and other lending financial sources who will be creditors of the company holding the debentures as securities.
Can all forms of business organizations in Ethiopia issue debentures to pull-up sufficient fund?

Not all forms of business organizations have the power to issue debentures. Only a share company has the power to issue debentures to meet its financial need. Other forms of business organizations, for example a private limited company (Art.510(3)) and partnerships have no power to issue debentures nor do have individuals any such power.

Is there any requirement for a share company to issue debentures?

A share company can issue debentures only when the shareholders have cleared their obligations on the shares. According to Art. 429(2)&(3), no negotiable (transferable) debentures shall be issued by companies whose capital is not fully paid and which have not issued a balance sheet in respect of their first financial year. The reason behind such requirements seems to safeguard the interest of the creditors--debenture holders. A company should not be allowed to issue debentures so as to saddle all the chance of risks on the creditors when its capital has not fully been paid up.

i) Forms of debentures

As that of shares, debentures may be registered or bearer. The difference lies only in the mode of their transfer. Thus, registered debentures can be transferred from one person to the other where the necessary registration is completed and when the debenture bond is conveyed to the transferee. Transfer of bearer debenture is completed where the bond is delivered to the transferee. The holder of the bearer debentures is assumed to be the owner thereof and is entitled to exercise rights deriving from the debentures. These rights may include the right to collect interest,
participate in debenture holders meeting, the right to have his debenture redeemed, etc.

ii) Classes of debentures

Like that of shares, a company may design different classes of debentures with varying privileges. Thus, debentures may be redeemable or irredeemable. The difference between those classes of debentures is that redeemable debentures are debentures that may be redeemed by the company pursuant to the terms stipulated in the debenture certificate (bond) while the holders of irredeemable debentures will retain them for the life time of the company unless the debentures are transferred to third parties.

It is also possible that debentures may be convertible or non-convertible in which the former may be converted into shares. Non-convertible debentures may however be changed into convertible subject to the agreement of the shareholders in their general meeting to that effect and the resolution of debenture holders in their special meeting.

In general, holders of debentures of a given issue may combine as a legal personality to protect their common interest participating in general meetings of their own (Art. 435(1)).

At whose expense shall debenture holders’ meetings be held?

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As per Art. 436(7) of the comm. Code, the calling and holding of general meeting of debentures holders shall be at the expense of the debtor company. Similarly, the remuneration of the agent of debentures holder shall be borne by the debtor company (Art. 442(2)).
Self-assessment Questions

1. Can a shareholder convert his share into either form under all circumstances?

2. Explain the concept of a share.

3. In what manner can you establish the ownership of the two forms of shares?

4. Distinguish between par value and price of shares?

5. What are the various classes of shares and which one is most advantageous to shareholders?

6. What are the forms of debentures and the difference between them?

7. How can the debenture holders protect their common interests?

Section: 1.3 Organs, Management and Control Mechanism of Share Companies


Overview

Dear learner! Welcome to the third section of this chapter. As you know companies being artificial persons, they need the assistance of natural persons who, as organs of management, conduct the administration of the affairs of their business on their behalf. These persons include shareholders acting collectively, directors, auditors or managers and other officers who act on behalf of the company. Therefore, this section will deal with the main organs of management and control mechanism of share companies.
Objectives:
At the end of this section, you will be able to:

- enumerate the various organs of management of a share company
- identify the rights and duties of shareholders, director, general managers and auditors.
- explain well the control mechanism of share companies.

1.3.1. Shareholders

Shareholders are one of the main organs of Share Company. Not all persons connected with the activities of a share company are shareholders. Rather, shareholders are usually members of a share company who have subscribed to the capital of the company either at time of its establishment or later and who have been issued shares of the company.

Are all founders necessarily shareholders?

Since any person even outside the company, who has initiated plans or facilitated the formation of the company shall have the status of a founder as per Art.307(4) of the comm.code, it follows that not all founders are necessarily shareholders. But those founders who have subscribed the whole of the capital or brought in contributions in kind may be shareholders.

Regarding the role of the shareholders in the management of a share company, the ultimate power of the management affairs of the company rests on the general body of shareholders. The general body of shareholders has an immense power to pass any resolution in respect of the company or its business where it thinks appropriate. Although members of the company may not claim to manage the affairs of the company merely by virtue of being shareholders, there is a possibility for a shareholder to be a pointed as a member of board of directors or as a manager in the company.
In case of control mechanism of a share company, shareholders can exercise power of control over the other organs of the company and their activities in various situations. Thus, shareholders’ power of control may be exercised, for instance, over the directors during their appointment and later at the time of their removal. The ultimate control and destiny of the company is in the hands of shareholders in that the latter exercise this power of control over the company through meetings. Through the meetings, the general body of shareholders may take any action it thinks fit to the extent of changing and modifying the nature and purpose of the company.

Meetings of a share company are broadly divided into general and special meetings as per Art.390 of the comm.code. The agenda of a general meeting which should be held at least once a year may be provided in the articles of association. General meetings may be divided into ordinary and extraordinary general meeting the latter being held to discuss extraordinary matters.

The special meeting on the other hand is a meeting in which only special class of shareholders discuss issues pertaining to that class alone.

1.3.1.1 The Rights, Duties and Liabilities of shareholders.
Shareholders are entitled to various rights in the share company. Likewise, they have duties and liabilities towards the company and third parties as the case may be.

i) The Rights of shareholders

What are the various rights of shareholders?

Generally, shareholders are entitled to several rights. These bundles of rights may include: voting rights, the right to a share certificate, pre-emptive rights and rights to share warrants, the right to obtain a dividend, inspect the corporate records and the right to transfer their shares. Furthermore, as per Art 345(1), they enjoy rights arising out of shares such as a right to participation in the annual net profits and to a share in the net proceeds on a winding-up. Besides every shareholder has a preferred right, in
proportion to his holding, to allotment of cash shares issued on an increase of capital (Art. 345 (4)).

ii) The Duties of shareholders

As they enjoy several rights, the shareholders have certain corresponding duties. The primary duty of a shareholder is to pay up all the subscribed shares fully and to meet calls on shares to that effect. It has been stated under Art.338(1) of the Comm. Code that shares subscribed in cash shall be paid up on subscription as to one fourth of their par value or a greater amount if so provided in the memorandum of association and, where appropriate, as to the whole of the premium. They may only be registered shares devoid of rights until they are fully paid.

What the effects of failing to make payments on shares when they become due?

As per Art.342(4)& (7) of the comm.code, the company may fifteen days after the receipt by the shareholder of a registered letter demanding payment offer the unpaid shares for sale by auction. These shares shall be cancelled and new shares delivered to purchaser. A member who fails to make payments on shares when they become due shall lose his voting rights.

iii) The liabilities of shareholders

It is the advantage of a share and private limited company that the liabilities of a shareholder are limited to the extent of his initial investment in the company. The liabilities of a shareholder may be either towards the company or a third party or both. Hence, where a shareholder fails to pay the call at the due date, he shall be liable to pay interest at the legal rate where no rate has been provided in the articles of association (Art 342(3)). The shareholder is liable to the company for calls on shares which have been pledged in which the pledgee may sell out the shares if the calls are not met by the shareholders (Art. 329(3)). In case shares are held jointly by several
persons, the joint owners of the shares shall be jointly and severally liable as shareholder.

As regards the liability of a shareholder towards third party, the shareholder may be liable to a usufructuary for repayment up on the expiry of the usufruct of the share where the latter who is liable for the calls as per Art 329(4) has met the calls on shares.

Who else besides a shareholder is/are liable to meet calls on shares? What is the nature of their liability?

Holders, previous assignees and subscribers shall be jointly and severally liable for calls on shares as per Art.342(1) of the comm. code. Any subscriber or shareholder who has assigned his share shall cease to be liable for calls only after two years from the date of the assignment (Art.342(2)).

1.3.2 Directors

Who are directors and what are their roles in the management of a company?

A share company which is a legal person has another organ called directors to manage its daily business activities. They are the governing organ of the company appointed by the shareholders. Art.347(1)(2) of the comm..code provides that only members of a company may manage the company as directors whose total member shall not be less than three nor be more than twelve to form a board of directors.

Where the memorandum of association does not specify the number of directors but fixes only a maximum and a minimum, the meeting of subscribers shall decide the number of directors to be appointed. Bodies corporate may be directors, but the chairman of the board of directors shall be a natural person (Art. 347(4)) .
i) **Appointment of directors** (Art.350)

The first director may be appointed under the memorandum or articles of association. This appointment shall be submitted to a meeting of subscribers for confirmation. If such confirmation is not given, the meeting shall appoint other directors. The subsequent directors to be appointed by a general meeting as well as the first director may not be appointed for more than three years.

ii) **Replacement of Directors** (Art.351)

Where, during a financial year, one or more of the directors have left the board, the serving directors may appoint other persons to complete the period for which the directors who have left the board were appointed. The appointment of such directors shall be submitted to the next general meeting for confirmation in which the general meeting may confirm their appointments or appoint other directors in their place. But where the surviving directors are less than half of the board of directors they may not appoint directors but shall convene a general meeting to appoint other directors. In the absence of all directors, the auditors shall convene a general meeting with out delay for directors to be elected.

*What is the legal effect of acts done by persons appointed by the surviving directors if the appointment of such persons is not confirmed by the general meeting?*

Art. 351(2) states that acts done by persons so appointed shall be valid notwithstanding that the appointment of such persons is not confirmed by the general meeting.

iii) **Removal of Directors** (Art.354)

Notwithstanding any provision to the contrary, directors may be removed at any time by a general meeting. That is, no good ground is required to remove directors. However, a director who was removed with out good cause may claim compensation from the company.
iv) **Powers of Directors** (Art.363)

Practically, directors have almost all powers on the affairs of the company. In terms of authority, however, directors are under the control of shareholders. The powers of directors may emanate from the law, the memorandum or articles of association and resolutions passed at meetings of shareholders. The articles of association shall specify whether the directors are jointly responsible as managers or agents of the company or whether one only of the directors is responsible when the directors are authorized to act as agents for the company in its name, any restriction on their powers shall not affect third parties acting in good faith.

v) **Rights of Directors**

Directors of a share company have certain rights to exercise against the company. Accordingly, as per Art.353(1) of the comm.code, directors are entitled to a fixed remuneration the amount of which shall be determined by a general meeting and charged against general expenses. Furthermore, the articles of association may provide that the directors may receive a specified share not exceeding 10% in the net profits of a financial year. The fixed remuneration and share in the profits to be allocated to the board of directors shall be allocated in one sum. The director’s share in the net profits shall, however, not be paid where no dividend has been distributed to the shareholders.

vi) **Duties and Liabilities of Directors** (Arts. 357,362,364, &366)

Generally, directors shall be responsible for exercising the duties imposed up on them by law, the memorandum or articles of association and resolutions of meetings, with the care due from an agent(Art.364(1)). Directors who are jointly and severally liable have a general duty to act with due care in relation to the general management.

In addition, directors shall be responsible for keeping regular records of the management and of meetings keeping accounts and books, convening meetings as provided in the articles of association, etc as per Art.362 of the comm. code. They shall also be responsible for showing that they have exercised due care and diligence.
As regards the liability of directors to the company, they shall be jointly and severally liable to the company for damage caused by failure to carry out their duties. Moreover, directors shall be jointly and severally liable when they fail to take all steps within their power to prevent or to mitigate acts prejudicial to the company which are with in their knowledge.

Are the directors liable to the company’s creditors?

Directors shall be liable to the company’s creditors where they fail to preserve intact the company’s assets. To this end, it is provided under Art.366(2) of the Comm. Code that proceedings may be instituted by the creditors against the directors where the company’s assets are insufficient to meet its liabilities. Even a resolution of the general meeting not to institute proceedings against the directors shall not affect the creditor’s rights. The directors may also be liable to the shareholders or third parties who have been injured by the fault or fraud of the directors.

1.3.3. General Managers (Art.348)

A general manager is an employee of the company and may not be a director. It is a person who is authorized to carry out acts of management and to sign in the name of the company. A general manager shall be appointed by the board. In their relations with third parties, the general manager shall be deemed to have full power to carry out all acts of management connected with the business activities of the company, including the power to sing a negotiable instrument (Art.348(3) cum. Art.35(1)).

1.3.4. Auditors (Arts.368-380)

The other organ of management of a share company are auditors. The law requires that the general meeting of every company limited by shares shall elect one or more auditors and one or more assistant auditors. Auditors shall be elected by the meeting of subscribers and thereafter by the annual general meeting.
Is there any difference between the auditors elected by the meeting of subscribers and those elected by the annual general meeting?

Normally, there is no substantial difference between such auditors. The only difference is that auditors elected by the meeting of subscribers shall hold office until the first annual meeting, whereas those elected by the annual general meeting may hold office for three years (Art.369(2)).

Are all persons competent to be elected as auditors?

Certain persons are legally excluded from being elected as auditors. Accordingly, persons enumerated under Art.370 (1) such as founders, contributors in kind, to mention few, are considered incompetent to be elected as auditors. But a body corporate may act as an auditor.

Once an auditor is appointed, a general meeting may at any time revoke the appointment without prejudice to any claim he may have for wrongful dismissal. The remuneration of auditors shall be fixed by the general meeting on their appointment. Where the general meeting fails to fix the remuneration, the Ministry of Commerce and Industry may on the application of any interested party fix the remuneration.

The auditors have, at any time, the powers to make on the spot such audits and checks as they think necessary and may call for any information, agreements, books, accounts, minute books, and such other documents as may be required for the proper execution of their duties.

As regards the duties of auditors, the duties have been enumerated under Arts.374-377 of the comm.code some of which are the duty to audit the books and securities of the company, to submit to the annual general meeting a written report on the manner in which they have carried out their duties, to inform directors irregularities or breaches of legal or statutory requirements, etc.
What is the liability of auditors?

Auditors shall be civilly liable to the company and third parties for any fault in the exercise of their duties which occasioned loss. In addition to civil liability, an auditor may criminally be liable where he knowingly gives or confirms an untrue report concerning the position of a company or when fails to inform the public prosecutor of an offence which he knows to have been committed and shall be punished under Art.443 or Art. 703 of the Federal Criminal Code of Ethiopia.

Self –assessment questions

1. Is there any instance where a third party is liable to meet a call on shares? If yes, what right is available to such a party against the shareholder?
2. Explain the rights, duties and liabilities of shareholders, directors and auditors.
3. Who can be a member of board of directors in governance of a share company?
4. What are the sources of the powers of board of directors?
5. Identify the difference between the liability of directors and auditors.

Section: 1.4. The Company’s Constitutions, their Amendment and the Accounts of the Company

Overview

Dear student! Welcome to the fourth section of chapter one. In the previous section we have thoroughly seen the main organs of share company, their roles in the management of the business affairs of the company as well as their rights, duties and liabilities.

In this section, a brief explanation on the company’s governing constitution will be made. Analogous to a modern government having its own constitution, a share company has its own constitution, a two fold documents, viz, memorandum and articles of association. An effort will also be made to discuss some points regarding their amendment. Finally, this section will deal with the accounts of a share company.
Objectives:
After a thorough study of this section, you will be able to:

➢ identify the two governing documents of a company.
➢ list the major contents of memorandum and articles of association
➢ draft the documents.
➢ enumerate factors necessitating amendment of the constitutional documents.
➢ explain about the accounts of a share company

1.4.1. The Company’s Constitution
1.4.1.1 Memorandum of Association (Art.313)

Memorandum of association is one of the important documents required both for the formation and operation of a company. The preparation of memorandum of association is one of the important steps for the formation of a company without which no company can be registered and acquire legal personality. Sometimes it is called a founding or life giving document. It lays down the basic constitution of the company.

What are the major contents of memorandum of association?

Memorandum of association contains, inter alia, major clauses about the name, head office and branches, object/purpose, liability, and capital of the company. It also defines the limitations and power of the company, beyond which the company can not conduct its activities. It also defines the relationship of the company with outsiders.
1.4.1.2. Articles of Association (Art.314, 363, 364(1), …)

Articles of association are a document that governs the operation of the company and is drawn up by the founders in accordance with the law. The drawing up of articles of association may follow the model supplied by the Ministry of Commerce and Industry with the necessary modifications.

The articles of association are the regulations or bye-laws which govern the internal management of the company. For instance, as per Art.363 (2) of the Comm. Code, articles of association shall specify whether the directors are jointly responsible as managers or agents of the company or whether one only of the directors is responsible. The articles of association may also specify the power and duties of directors.

1.4.2 Amendment of Memorandum and Articles of Association

Read: Arts.423, 462-494 of the comm. code

Amendments to memorandum or articles of association once drawn up during the formation of the company may be made at a later time where the need arises. That is, amendments to the particulars of the documents of the company such as change in the objects or nature of the company or the transfer of its head office may be made depending on the circumstances of the activities of the company.

Who may amend the memorandum or articles of association?

Unlike the case of their preparation by founders, unless otherwise provided by law, only extraordinary meetings may amend the memorandum or articles of association (Art.423). The extraordinary meetings called to vote on amendments to the memorandum or articles of association shall conduct their business in accordance with the provisions of Art.388-416 and 422-425 and resolutions thereon shall be published in accordance with the provisions of Art. 224 of the Comm. Code.
Some of the factors necessitating amendments to the constitutional documents may be the need to increase, amortization or reduction of the capital of the company, change in the nationality or transfer of the head office of the company etc.

During the passage of resolutions for the amendments, any shareholder including preference shareholders, may take part in an extraordinary meeting without regard to the number of shares held (Art.424).

What is the quorum (the minimum number of shareholders to be present in a meeting) required in extraordinary meetings to a resolution in respect of the amendment?

In principle, not less than a two-thirds majority is required for a resolution to be adopted in an extraordinary meeting to pass a resolution, abstentions and blank ballots being disregarded. However, in exceptional cases of the resolutions of the meeting to change the nationality of the company or to require the shareholders to increase their investments in the company shall only be adopted where the holders of all shares having voting rights are present or represented and the vote is unanimous (Art.425(2).

What right is available to the shareholders objecting to the resolution of the extraordinary general meeting regarding the amendment?

Up on the amendment of the memorandum or articles of association, some of the shareholders who are not satisfied with the resolutions of the meeting to this effect may withdraw from the company. Art. 463 of the comm.code states that shareholders who dissent from resolutions concerning any change in the objects or nature of the company or the transfer of the head office abroad may withdraw from the company and have their shares redeemed after they have notified the company of this fact by a registered letter.
1.4.3. Accounts of a Share Company


As is dictated by Art.63 of the comm. code, it is mandatory that a business organization carrying on trade shall keep books and accounts in accordance with business practices and regulations. Thus, when a share company keeps accounts of its own as per Art.445 of the comm. code, the accounts may contain the inventory, balance sheet, loss and profits of the company.

At the end of each financial year, the directors shall prepare a detailed inventory and valuation of assets and liabilities. They shall draw up a balance sheet and a profit and loss account and prepare a report on the states of the company’s activities and affairs during the last financial year. The report shall give detailed information on the profit and loss account, an exact statement of the total amount of remuneration of the directors and auditors, and proposals for the distribution of dividends, if any.

Furthermore, it is required that the inventory, balance sheet, profit and loss account and the directors report shall be submitted to the auditors and the Ministry of Commerce and Industry. Where a company is a holding company, the accounts of its subsidiaries shall be submitted to the annual general meeting at the same time and in the same manner as its own accounts.

At what time interval shall financial accounts of a company be prepared?

The balance sheet and profit and loss account shall be prepared each year in the same form as in proceeding years and the methods of valuation shall remain the same, unless the general meeting adopts variations in the mode of presentation of the accounts or the methods of valuation on the reasoned advice of the auditors (Art.448(1)). The profit and loss account shall show under separate heads losses or profits arising out of the company’s various activities.
What do constitute the net profits in the profit and loss account of the company?

The net profits comprise the net receipts for the financial year after deduction of general costs and other charges, and of amortization and allowances (Art. 452(1)). Whereas the profit for distribution is the profit for the financial year less previous losses and plus additional revenue and any distribution from the reserve funds specially approved by the general meeting.

When shall the distribution of profits be effected?

Distribution of the profits shall be effected after transfer to the legal reserve as provided in Art. 454 of the comm. code. According to the provision, legal reserve is an amount not less than 1/20th of the net profits that shall be transferred each year to the reserve fund until it amounts to 1/5th of the capital. It is from the net profit shown in the approved balance sheet that dividends may be paid to shareholders. Dividends distributed contrary to this shall be treated as fictitious dividends and the persons making the distribution shall be criminally and civilly liable (458(2)).

Self-assessment Questions

1. Explain the importance of memorandum and articles of association and the difference between them.

2. Is it mandatory for a certain share company to draw-up its own articles of association?

3. Which meeting of shareholders has the power of amending the constitution documents of a share company? Why?
4. Enumerate the major contents of memorandum of association.

5. Try to draft a sample memorandum of association in accordance with the relevant provisions of the law for any share company you are familiar with for your own exercise.

6. When should accounts of a share company be prepared? Which meeting of share holders does approve the balance sheet and profit and lose account drawn up?

7. Distinguish between profits and net profits, dividends and fictitious dividends.

8. Can dividends once distributed illegally to shareholders be claimed back from the shareholders?

Section: 1.5. Dissolution and Winding-up of Share Companies.

Read: Arts. 495-509 of the Commercial Code

Overview
Dear student! Well come to the last section of chapter one of this Module. This section will concisely deal with dissolution and winding-up of a share company. By now, you have understood from the previous sections that a share company comes into existence by law which confers up on it a legal personality. After its formation, it may be dissolve due to various reasons and may consequently lose its legal personality. Thus the process of terminating the legal existence of a share company is called dissolution. Dissolution is preceded by the process of liquidation facilitating the total termination of the rights, duties and liabilities of the company called winding-up. Each of these crucial concepts would be elucidated further hereunder.

Objectives:
After a thorough study of this section, you will be able to:

- explain the concepts and the legal effects of dissolution and winding-up of share companies
- list the various grounds for dissolution of a share company
enumerate the major steps taken in winding up of a share company.

1.5.1. Dissolution of Share Companies

Dissolution of a share company means termination of the legal existence a share company created by law in consequence of which the entity shall no longer carry on legally binding acts under its former name. It renders the legal entity lifeless. The company which was conferred a legal personality through registration would be deprived of its legal existence following the cancellation of the registration.

Grounds rendering business organizations devoid of legal personality may slightly vary from one form of business organization to the other. That is, even though there are some similar grounds, they may not necessarily be identical to all business organizations. Accordingly, a share company may be dissolved for the following reasons:

(a) expiry of the life of the Company as fixed in the memorandum of association, unless extended by a decision of an extraordinary general meeting;
(b) completion of the venture for which the company was formed;
(c) failure of the purpose or impossibility of performance;
(d) voluntary dissolution resolved by an extraordinary general meeting;
(e) dissolution by order of the court for good cause on the application of a member;
(f) subject to the provisions of Art. 311, acquisition of all sharers by a member;
(g) institution of bankruptcy proceedings;
(h) loss of three quarter of the capital.

Therefore, the dissolution of a share company may generally be made by the act of the parties, order of the court and by operation of the law.

1.5.2. Liquidation or Winding-up of Share Companies

As has been pointed out above, the life of the business entity cannot be ended automatically. Certain procedures need to be met before the entity totally loses its life. For instance, the property of the company, if cannot be given back to the contributors, should be sold; business at hand at the time of the dissolution should be completed; debts if any, should be paid etc. Thus all these procedures, inter alia, that need to be carried out before the company totally dissolves are called winding up process.

Who have the power to liquidate or wind-up a share company?

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The business of liquidation is to be carried out neither by the directors nor by shareholders of the company but by the persons who are appointed for the purpose of winding-up. Those persons so appointed are usually called liquidators. Similar to the appointment of directors, liquidators may be appointed by the memorandum or articles of association. Where their appointment is not provided for in the memorandum or articles of association, they shall be appointed by the general meeting which resolved dissolution or failing such appointment, by the court on the application of the directors, the members or auditors (Art. 496).

**Does the company lose its legal personality during winding-up?**

The law provides that the company does not lose its legal personality on the spot during winding-up. Art. 497 of the comm. code states that until winding-up is completed, the company shall retain its legal personality and name, to which the words "in liquidation" shall be added. During winding-up the organs of the company shall restrict their activities to acts necessary to facilitate the winding-up and which are not acts within the scope of the liquidators.

**Do the organs of the company fully carry out their activities during such time?**

The liquidators and directors shall jointly prepare and sign an inventory of assets and liabilities. Where the assets appear to be insufficient to cover the debts of the company, the liquidators shall call upon the members to pay according to their shareholding such installments is may be due on their shares (Art. 499(4)).

**What are the duties and liabilities of liquidators?**

Unless otherwise provided by law or the articles of association, the liquidators shall have the same duties and liabilities as directors (Art. 499(11). They shall take possession of the property and books of the company.

**What are the powers of liquidators?**

As per Art.500 of the Comm. Code, subject to any limitations imposed by the articles of association or by the meeting appointing them, liquidators shall have full powers. They may sell the property of the company as whole, compromise and arbitrate and shall represent the company in the legal proceedings. However, they may not undertake new business, unless required for the execution of contracts still running or where the interests of the winding-up so require. They shall be personally, jointly and severally liable in respect of any business undertaken outside the limits provided.
Self-assessment Questions
1. Explain the difference between dissolution and winding-up of a share company.
2. Enumerate the various grounds for dissolution of a share company.
3. Who has / have the power to appoint and remove the liquidators of a share company?
4. Can the liquidators distribute any part of the asset among the members before the creditors of the company have been paid? Why?

CHAPTER SUMMARY
A share company is one of the six forms of business organization recognized under Ethiopian law. It is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company. The members of a share company shall be liable only to the extent of their share holding.

There are various requirements for the formation of a share company to acquire a legal personality and operate as a valid business entity in the eyes of the law. Some of the requirements are the existence of partnership agreement, publicity, registration, formation to be made in writing, the legal minimum number of the members and minimum amount of capital, drawing up of memorandum of association etc.

A share company may be formed only among the founders in which the founders have fully subscribed to the whole capital of the company. Such a company is called a closed company. On the other hand, a share company may be formed by public subscription where the public is invited to purchase the shares of the company to become shareholders. As its name implies a share company is constituted of various forms and classes of shares. Although there is no fixed concept of a share, which is indivisible in its nature, it is not a mere sum of money but an interest made up of after certain prerequisites are fulfilled. Only a share company has the power to issue debentures: bearer and registered and various classes such as redeemable, bundles of rights.

The two forms of shares are bearer and registered shares. The company may design different classes of shares such as ordinary, dividend and preference shares. These shares may be assigned by the share holders to third parties who will become shareholders.

A share company in order to borrow money may issue debt securities (debentures) irredeemable, convertible debentures etc.

The company also consists of several organs such as share holders, directors, general managers and auditors each having certain specific roles in the management of the company. They have their own respective rights, duties, powers and liabilities in the company.
Shareholders are usually members of the company who have subscribed to the capital of the company while directors are those members of the company appointed to manage the business activities of the company. Their powers may emanate from the law, the memorandum or articles of association and resolutions passed by the meetings of shareholders. They shall be responsible for exercising their duties with the care due from an agent. The directors are jointly and severally liable to act with due care in relation to the general management.

General Manager of a share company is an employee of the company and may not be a director. He is a person authorized to carry out acts of management and to sign in the name of the company. Whereas, the auditors among organs of management of the company and elected by the general meeting of the company. Not all persons are legally competent to be elected as auditors, for certain persons like founders, contributors in kind, etc enumerated under Art 370(1) of comm. Code are excluded from being elected as auditors.

Auditors shall be civilly liable to the company and third parties for any fault in the exercise of their duties which occasioned loss. Moreover, they may criminally be liable where there they commit the offences provided under Arts. 443 and 703 of the Criminal Code.

A share company has twofold constitutional documents that regulate both the formation and the operation of the company. The first document, memorandum of association, is the founding document which lays down the basic constitution of the company. The second constitutional document, articles of association, governs the operation of the company. The latter is a set of regulation that governs the internal management of the company. Both documents are drawn up by the founders.

Amendments to the documents may also be made where the need arises. They may be amended, for instance, where there is change in the nature or purpose of the company or where the transfer of its head office or increase of its capital or change in its nationality etc is made. The documents so amended shall be deposited as required by law to have legal effect on third parties. Only extraordinary meetings of the shareholders may amend the documents (memorandum or articles of association) by its resolution.

It is also with noting that a share company is required to keep books and accounts in accordance with its business practices and regulations. Thus, at the end of each financial year, the directors shall prepare a detailed inventory and valuation of assets and liabilities. The directors shall also draw up a balance sheet and a profit and loss account and prepare a report on the states of the company's activities and affairs during the last financial year. The account shall show under separate heads profits or losses arising out of the company's activities.

A share company once established acquiring legal personality may be dissolved and consequently be deprived of its legal existence on various grounds. Thus dissolution means a process that spells out the termination of the legal existence of the share company. Dissolution of a share company may be made generally by the act of the parties, order of the court and by operation of law.
Before the dissolution is completed, there comes the process of winding up or liquidating the company. This involves the sale of the property of the company, if any, payment of debts to the creditors of the company, distribution of the remaining assets among the members etc. The persons entrusted with these functions are called liquidators who maybe appointed by the memorandum or articles of association, the general meeting or the court as the case may be. Liquidators have the same duties and liabilities as directors.

**Review Questions**

1. What is /are the most decisive and essential requirement (s) for the formation of a share company and its acquisition of legal personality in the eyes of the law even if the other legal requirements are not complied with?
2. Who are allocated with a special share of profit in a share company?
3. Can a non-member who merely facilitate the formation of a share company acquire the status of a founder?
4. "A share company formed by public subscription is the most suitable form of business organizations for developing countries than developed ones." Test the tenability of this statement.
5. Suppose that the instructors in the Law Faculty of Haramaya University in collaboration with some legal practitioners in Dire Dawa city have established a legal entity called "Public Pro Bono Share Company" for the purpose of rendering free legal aid to the needy people of Ethiopia. The entity has been registered in commercial register of the Ministry of Commerce and Industry.

Then, answer the following questions:

a) Is the entity a valid share company? Why?

b) Are the provisions of the commercial code applicable to such an entity? Why or Why not?

c) Are the nomenclature of the entity and its registration valid?

6. What rights does every share confer up on a shareholder? Does every class of shares carry a voting right? Why?
7. Two of the directors of a share company have concluded a contract of loans with the company. Is the contract valid? Why?
8. Discuss the similarities and distinctions between shares and debentures of a share company.
9. Suppose that a certain share company becomes bankrupt due to lack of proper preservation of its assets. The company has got three creditors whose debts have not been paid. Can the creditors proceed against either the directors or shareholders or both? Why?
10. Explain the way the shareholders, the ultimate decision making bodies, exercise their authority in a share company.

CHAPTER TWO

PRIVATE LIMITED COMPANIES

Introduction

Dear learner, so far we have been dealing with share companies. As was mentioned in the proceeding chapter, the other form of business organization to which this chapter is devoted is a private limited company. In its nature, private limited company is a hybrid form of company sharing some of the characteristics of partnership and share company.

A private limited company is a company whose members are liable only to the extent of their contributions. It is usually formed between or among people who know each other that no share is offered for public subscription or transferred to an outsider without the consent of the members.

In general this chapter is divided into four major sections each of which will be discussed thoroughly. At the end of each section, there follows, as usual, a set of self-assessment questions.

Objectives:

After a thorough study of this chapter, you will be able to:

- enumerate the major legal requirements for the formation of a private limited company.
- Identify the special features of a private limited company under Ethiopian law.
- state the various organs of management of private limited companies.
- list the grounds for the dissolution of a private limited company.
Section: 2.1. Formation of Private Limited Companies

Read: Arts. 510-520 of Comm.Code

🌟 Overview

Dear learner! Welcome to the first section of chapter two of this Module. This section deals with the legal requirements for the formation of private limited companies. Unfortunately, unlike that of the formation of a share company, the law does not provide for separate and detailed requirements for the formation of private limited companies. This may be due to the fact that the requirements for both types of the companies are, without prejudice to certain differences, almost similar. In this section, some of the special features of a private limited company will also be highlighted.

Objectives:

At the end of your study of this section, you will be able to:

- list the main legal requirements for the formation of a private limited company.
- figure out some of the special features of a private limited company.
- identify some of the transactions a private limited company is prohibited to undertake.

2.1.1 General Requirements

As is stated earlier, the general requirements to be complied with for the formation of a share company except in certain cases are equally applicable for the formation of private limited company. Accordingly, the existence of a valid partnership agreement, formation to be in writing, registration, publicity, drawing up of memorandum or articles of association, their deposit, etc are the general
requirements to be complied with for the formation of a valid private limited company.

2.1.2. Special Features of Private Limited Company.

Though a private limited company is considered to be the hybrid form of partnerships and a share company, there exist certain special features of a private limited company particularly as compared to a share company.

To begin with, the minimum member of members required for the formation of a private limited company is two unlike that of a share company which can not be formed by members less than five in numbers. Besides, a private limited company shall not have more than fifty members unlike other forms of business organizations whose maximum number of members is not fixed by law.

As regards, the legal minimum capital of a private limited company, Art.512(1) of the Comm.Code provides that the capital of a private limited liability company shall not be less than 15,000 Ethiopian birr.

Can a private limited company undertake any form of business activities?

It is one of the special features of a private limited company that it shall not undertake banking, insurance or any business of a similar nature (Art. 513).

Does a private limited company have the power to issue any form of transferable securities?

The other features of a private limited company as compared to a share company is that the former, as per Art.510 (3) of Comm. Code, shall not issue
transferable securities in any form. Thus, a private limited company can not issue negotiable debentures to meet their financial need.

**Self-assessment Questions**

1. What are the special features of a private limited company?
2. “In a private limited company all the members have the status of founders.” Verify the validity of this statement.
3. Could there be a non-commercial private limited company under Ethiopian law?
4. What do you think is the reason behind prohibiting a private limited company from undertaking banking, insurance or any business of a similar nature?

**Section: 2.2. Shares and Assignment of Shares in a Private Limited Company.**

Read: Arts. 521-524 of the Comm.Code

**Overview**

This section deals with the forms, assignment and devolution of shares by way of succession and the restriction on the transfer of shares of a private limited company.

**Objectives:**

At the end of this section, you will be able to:

- indicate the form of the assignment of shares.
- identify the requirements for the transfer of shares outside the company.

**2.2.1. Shares of Private Limited Company**

As private limited company does not offer shares to the public, the shares of private limited company are fully subscribed by the founding members. Thus, there is no prospectus to be issued for the subscription of shares.
What is/are the form(s) of shares in a private limited company?

Unlike the two forms of a share company, there is only a single form, viz, a registered share, in a private limited company. All the shares shall be entered in a register which shall show the names of the members, the value of all contributions made by the members, all transfers of shares and all amendments to these particulars (Art. 521). Thus, there is no bearer share in a private limited company. Similarly, the law does not provide for different classes of shares as it does in case of a share company.

In general, all shares shall be of equal value and a member may hold more than one share. The amount of each share shall not be less than 10(ten) Ethiopian birr.

2.2.2. Assignment of Shares

As compared to that of a share company, the shares of a private limited company may not freely be assigned to the outsiders. There is a requirement that a transfer of shares outside the company shall be approved by a majority of members representing at least ¾ of the capital, unless a larger majority or unanimity is fixed in the articles of association (Art. 523(2). It is further required that the approval shall be entered in the commercial register.

Is there any requirement as to the form of assignment of shares in a private limited company?

It has been stated that there is only a registered form of shares in the company. Hence, the assignment of such shares should be in writing and shall be of no effect in relation to the company or third parties unless they have been entered in the share register (Art. 522). The share register or lists shall be kept by the manners who shall jointly and severally be liable for any loss occasioned by in accuracy in the register.
Moreover, where execution is levied on a member’s share, the purchaser shall obtain the consent of the other members.

Are the restrictions on the transfer of shares outside the company subject to the requirements mentioned above equally applicable to assignment between the members?

Unlike the assignment of shares to the outsiders, there shall be no restriction on the transfer of shares between members unless otherwise provided in the articles of association.

Another point to be noted at this juncture is that the shares of a deceased member devolve up on his heirs unless otherwise provided in the articles of association. It may provide that the member has the right to leave his shares to the heir he wishes (Art. 524). This is another typical feature of a private limited company.

**Self-assessment Questions**

1. What are the requirements for the assignment of shares of a private limited company to outsiders?
2. Do the requirements under Q.No 1 above apply where the company is in liquidation?
3. Identify the form(s) of the shares of a private limited company.

**Section: 2.3. Organs, Management and Accounts of Private Limited Companies**

Read: Arts. 525-538 of the Comm.Code

**Overview**

Dear student, welcome to the third section of chapter two. In the proceeding sections, we have seen the formation, shares and assignment of the shares of private limited companies. In this section, we will consider the organs, management and accounts of private limited companies.
Objectives:
At the end of this section, you will be able to:

➢ identify the organs of a private limited company.
➢ explain the management system of the company.
➢ understand the manner of regulating the accounts of the company.

2.3.1. Organs and Management of a Private Limited Company.

The organs of a private limited company may include the members (shareholders), the managers and auditors. The members, as explained earlier, are the founders of the company, persons to whom the shares may be assigned, and heirs of the deceased members(s) upon whom the shares of the latter have been devolved. Like the members of a share company, the members of a limited company may exercise their power of control over the other organs in various ways such as through their meetings, appointment or dismissal of the organs.

As regards the management of a private limited company, it shall be managed by one or more managers (Art.525). In this regard, private limited companies share characteristics of partnerships. The managers whose power, duties and liabilities are closely analogous to that of directors of a share company may however be from the members or outsiders.

Who can appoint the managers?
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It is provided under Art. 526 of the comm. code that managers, other than members, may be appointed by the members or by the memorandum or articles of association for such period as is considered desirable. Once they are appointed,
manager shall have full powers within the limits of the objects of the company. Thus, their powers will be limited by the objects of the company.

**Shall a provision in the articles of association restricting the powers of the managers be binding on third parties on the ground of its publication?**

Such a restricting provision shall not bind third parties notwithstanding the fact that it has been properly published. Art. 528(2) of the code provides that the restrictive provisions on the powers of the managers shall be binding only as between members and managers.

Managers are entitled to remuneration for their functions. The remuneration consisting either of a fixed salary, or of a share in the profits, or both shall be fixed by the members.

A manager of a private limited company shall only be dismissed for good cause acceptable to a court. Following his dismissal, the manager shall forthwith and forever cease to function. Where the court is of opinion that a dismissal was without good cause, it may grant damages to the manager who has been dismissed (Art. 527(3)).

**What is the nature of the liability of the managers?**

In accordance with civil law, managers shall be liable individually or jointly and severally, as the case may be, to the company and third parties for any breach of their duties under the comm. code or articles of association.

It is the duty of a manager to act with due care and diligence while exercising his functions. One of his functions is to call meetings other than the general meeting. Regarding the latter, a company consisting of more than 20 members shall hold a
general meeting each year at the date fixed by the articles of association. Every member may take part in the meetings.

The other organ of management of a private limited company is auditors who shall be appointed by the meeting of the members or by memorandum or articles of association. In real sense auditors do not manage the affairs of the company if management is meant execution of the company's business. Auditors rather control and inspect the process of management. They usually certify the financial documents of the company before they are displayed to the share holders or any authorized interested party.

Auditors may be dismissed as provided in the articles of association and shall be liable individually or jointly and severally, to the company and third parties for any fault or negligence in the execution of their duties (Art. 538).

2.3.2. Accounts of Private Limited Companies.


As regards the accounts of a private limited company, transfer to legal reserve fund shall be made from the profits shown in the profit and loss account. Not less than 1/5th of the profits shall be transferred each year to legal reserve fund until such fund amount to one-tenth of the capital.

Can members of private limited company be required to repay fictitious dividends? Are the persons making the distribution of such dividends liable like in the case of a share company?

In case of a private limited company, as opposed to a share company, members may be required to repay dividends which have been paid out of sums which are not actual profits. Nonetheless, the claims of such repayment shall be barred after five years from the date the dividends were paid (Art. 540). The law does not, however, provide for liability of the persons making the distribution of the dividends.
The memorandum of association may provide that a fixed interest shall be paid to members, even where there are no profits, during the period when works are being constructed prior to business operations. Such interest shall be carried to the debit of the installation account and spread over the years where profits are made, in accordance with the articles of association.

**Self-assessment questions**

1. Enumerate the organs of a private limited company.
2. Compare and contrast the directors of a share company with the managers of a private limited company.
3. What are the rights, duties and liabilities of the managers of a private limited company?

**Section: 2.4. Dissolution and Winding-up of Private Limited Companies**

**Overview**

Dear student! Welcome to the last section of chapter three. This section deals with the various grounds for the dissolution of a private limited company and the process of winding up the company. It will also deal with certain circumstances that may not be considered as grounds for the dissolution of a private limited company.

**Objectives:**
At the end of this section, you will be able to:

- enumerate the various ground for the dissolution of a private limited company.
- list some of the circumstance that could not be grounds for dissolution of the company.
- explain the legal effects of dissolution of a private limited company.

**2.4.1. Dissolution of Private Limited Companies.**

A private limited company may be dissolved on the grounds applicable to all business organizations. This may include dissolution of the company by the order of
the court for good cause and dissolution at the request of any member where the term of the company has not been fixed. It should be noted here that the dissolution may not be made at the request of a member where the duration of the company has been fixed to be a definite period of time.

Can a member of the company redeem the shares of other members during dissolution?

It is possible that provision may be included in the articles of association permitting redemption of the members’ shares for a fixed sum as per Art. 524(2) of the comm. code. Thus, where no provision has been included in the articles of association, there would be no possibility of redeeming the shares.

Do the judicial interdiction, bankruptcy or insolvency of a member or his death cause dissolution of private limited company?

Art. 542(3) states that a judicial interdiction, bankruptcy or insolvency of a member shall not cause dissolution of a company, nor shall the death of a member, unless otherwise expressly provided in the articles of association. Instead, the articles of association may provide that the heirs of a deceased member may, at their option, join the company or be repaid the deceased member’s shares at a rate based on the last inventory.

2.4.2. Winding-up of Private Limited Companies.

As regards winding-up of private limited companies, the commercial code of Ethiopia has not expressly governed the steps to be taken to wind-up the companies. Surprisingly, the code has not made even the cross-reference of certain relevant provisions that may be applied for a private limited company. However, even though the law is silent on this point, based on the nature of a private limited company as a hybrid of other forms of business organizations, the relevant provisions applicable for
the liquidation of particularly a share company may, by analogy, be applied for a private limited company mutatis mutandis.

Self-assessment Questions
1. What are the grounds for the dissolution of private limited company?
2. Discuss the powers and liabilities of liquidators during the winding-up of a private limited company.
3. Can the dissolution of a private limited company be made at the request of any person in all cases? Why or why not?
4. “The death of a member of a private limited company shall never cause the dissolution of the company in all circumstances even if the deceased has no heir”. Verify the tenability of the statement.

CHAPTER SUMMARY
A private limited company is a hybrid form of company sharing the characteristics of partnerships and share company. It is a form of business organization with limited liability. As regards the formation of a private limited company, the general requirements provided for the formation of a share company, with certain exceptions, are equally applicable for the formation of a private limited company.

Though a private limited company is usually considered as the hybrid of other forms of business organization, it has certain special features that distinguish the company from other. One of the special features of a private limited company is that it shall not undertake banking, insurance or any business of a similar nature. Moreover, unlike a share company, a private limited company cannot issue transferable securities in any form.

Another point with regard to a private limited company is that a private limited company does not offer shares to the public for the shares of the company are fully subscribed by the founding members. There is only one form of shares, i.e.,
registered shares in such a company. Furthermore, such shares may not freely be assigned to the outsiders. There is a requirement that a transfer of shares outside the company shall be approved by a majority of the members unless a larger majority or unanimity is fixed in the articles of association.

There are various organs of a private limited company namely, the members, the managers and the auditors. These organs have their own respective rights, duties and liabilities in connection with the management of the company. Once the member or non-member managers are appointed, their powers shall be within the limits of the objects of the company.

The other organs of management of a private limited company are auditors who shall be appointed by the meeting of the members or by memorandum or articles of association. The auditors inspect the process of management and certify the financial documents of the company.

Finally, a private limited company may be dissolved on the grounds applicable to all business organizations, including dissolution by the court for good cause and dissolution at the request of any member where the term of the company is indefinite.

**Review Questions**

1. A certain General Garment and Trade Private Limited Company has been validly formed as per the relevant provisions of the Comm. Code and Mr. Daniel has been subsequently appointed as a manager by the articles of association. In the articles of association duly published, a provision has been inserted that defines the power of the manager to perform all managerial activities except signing a negotiable instrument in the name of the company. However, the manager has signed and issued a bill of exchange containing a fixed sum of Birr 1000 in the name of the company and has given it to Ato Abebe who is fully aware of the provision so included in the articles of association.
a) Can Ato Abebe ask the company for the payment of the sum fixed in the bill? Could the company raise the defense that a restriction on the power of the manager to sign the instrument had been made and was dully published? Why?

b) Assuming that the company has paid Ato Abebe the sum fixed in the bill, can it then make recourse against the manager? Why or Why not?

2. Ato Ayele was the creditor of a certain private limited company for a total debt of 20,000 Ethiopian Birr. Later he went broad and stayed there for few years. In the meantime, the company was formally dissolved and the surplus assets remaining after paying the debts of other creditors have been distributed among the members. Ato Ayele has come back to Ethiopia just recently only to find the company already dissolved.

Answer the following questions based up on the above hypothetical case.

a) What is the right available to the creditor? Can he claim repayment of the money after dissolution of the company?

b) Assuming that the creditor was not notified of the dissolution of the company, who else would be liable to him? Why?

3. Suppose that Mr. X as a member of “Y” private limited company has assigned his hares to Mr. Z in writing for the shares of the company are all registered shares in their form. Later, Mr. Z, the assignee, has asked the company for the payment of dividends due on the assigned shares which the latter has flatly refused. Is the refusal of the company lawful or not?

4. Discuss the major distinctions between a share company and a private limited company.

5. “Under no case shall a judicial interdiction or insolvency of a member nor shall his death cause the dissolution of a private limited company”.

Test the veracity of this statement.

6. Compare and contrast the powers, rights, duties and liabilities of the managers of a private limited company with those of a share company.
CHAPTER THREE
CONVERSION AND AMALGAMATION OF BUSINESS ORGANIZATIONS

Read: Arts.544 -554 of the Commercial Code

Introduction
Dear student, welcome to the last chapter of this Module. It is possible that one form of business organization may be converted to or intermingled with another form of business organization due to various reasons and such a process is known as conversion and amalgamation of business organization respectively. Thus, this chapter under its different sections will deal with conversion and amalgamation of business organizations in connection with the rights of the respective creditors. Further, the chapter will highlight some of the legal effects of the process of conversion and amalgamation on the former and the new business entities.

Objectives:
At the end of this chapter, you will be able to:
➢ distinguish between conversion and amalgamation of business organizations.
➢ analyze the legal effects of conversion and amalgamation.
➢ explain the manner and requirements of conversion and amalgamation of business organizations.
➢ identify the rights of the creditors of the converting as well as the amalgamating firms.

Section: 3.1. Conversion of Business Organizations
Read: Arts.544 -548 of the Commercial Code

Overview
Dear student, you are welcome to the first section of chapter three. In the previous chapters, we have thoroughly dealt with the formation, operation and dissolution of share and private limited companies under Ethiopian law. In this section, we will further deal with the conversion of one form of business organization into another form when the circumstances imperatively so demands. Besides, the section will highlight the effects of conversion on the members and creditors of the business organization.
Objectives:
At the end of this section, you will be able to:

- state the manner in which a business organization will be converted into another.
- explain the legal effects of the conversion on the members and creditors of the business entity.
- enumerate the remedies available to the members objecting to the conversion.


As is stated above, the change of one form of business organization into another one as permitted by the relevant provisions of the commercial code is known as conversion. For instance, the law provides that any general or limited partnership and company limited by shares may be converted into private limited companies.

Does the conversion of one form of business organization into another form necessarily cause the creation of a new legal person?

According to Art. 544(1) of the Comm. Code, the conversion of one form of business organization into another does not necessarily cause the creation of a new legal person. That is, to mean, the separate legal existence initially acquired will remain intact irrespective of the conversion. Because a mere change in the form of the business organization does not deprive it of its legal personality nor does it confer a new legal personality on the new form of business entity.

What are the general requirements for the conversion of a business organization into another form?

One of the general requirements is that the decision of conversion of a business organization into another should be made either by the members unanimously or by the majority required by law, or the articles of association. For instance, in the case of a company limited by shares, the decision shall be taken by an extraordinary general meeting held under the provisions of Art. 425 of the Comm. Code. Whereas, a private limited company may be converted into share companies as per the provisions of Art. 536 of the Code. It is also required that the names of the members taking the decision shall be written in the minutes and such members shall be become founders of the new share company.

In the case of partnerships, other than ordinary partnership, the conversion can take place only where unanimous consent for the modification of partnership agreement is secured as per Art 233(1) of the Comm. Code. As regards ordinary
partnership, the partnership agreement may, however, provide to pass a decision of conversion by simple majority.

The other requirement is that the decisions of conversion shall be duly authenticated and be published in accordance with Art. 224 of the Comm. Code. Furthermore, the rules relating to the formation of the relevant business organization shall apply without prejudice to the rights of third parties.

As regards the rights and liabilities of the members in connection with conversion, a member may not be deprived, in whole or in part, of the rights of membership without his consent in cases of conversion. Moreover, in no case shall the decision increase the liabilities of a member without his consent.

**What right is available to the dissenting member where the decision of conversion is made by majority vote?**

For example, in a decision of converting a share company into a private limited company made by a majority vote, the members who dissent have the right to withdraw in which their shares will be redeemed as per Art. 463 of the Comm. Code.

**Shall the conversion of a firm discharge members with unlimited liability of their liability for undertakings made prior to conversion?**

It has been stated under Art. 548 of the Comm. Code that the conversion of a firm shall not discharge members with unlimited liability of their liability for undertakings made prior to the registration of the decision of conversion in the commercial register. But the members may be discharged of their liability where the registration indicates that the creditors have approved the conversion. Such approval shall be presumed where creditors have been informed of the decision of conversion by registered letter and have not expressly dissented therefrom within thirty days from the date of such notification.

### 3.1.2. Conversion and Rights of Creditors

Up on conversion, the assets of the former firm shall pass automatically to the new business organization as from the date of registration in the commercial register. In other words, all rights and obligations of the former organization shall be transferred to the new organization as of the date of registration. Thus, the creditors of the former firm can establish their claims against the new firm. To this effect, Art. 546(2) of the Comm. Code provides that on registration, creditors of the former firm shall be required to establish their claims within a reasonable time and shall be informed that, unless they object thereto, they shall be deemed to be creditors of the new firm.
What is the right of the creditors who do not accept the new firm?

In principle, creditors have the right to be called as to whether they accept the new firm or not. Accordingly, where they do not accept the new firm, they have the right to be paid off or guaranteed. In order to protect the rights of the creditors, the law provides that no payment out of the assets shall be made to shareholders until all creditors have been paid or guaranteed.

Self-assessment Questions
1. Enumerate some of the requirements for conversion of a business organization
2. Can a joint venture be converted to other form of business organization? Why?
3. What are the rights and liabilities of the members in connection with conversion of a business organization?
4. What rights are available to the creditors of a converting firm?

Section: 3.2. Amalgamation of Business Organizations

Overview
Dear students! Welcome to the last section of the last chapter of the Module. In the preceding section, we have dealt with the conversion of one form of business organization into another form and its legal effects both on the members and creditors thereof.

In this section, we will deal with the amalgamation of business organizations in Ethiopia. Amalgamation is the combination of business entities. Similar to the preceding section, in this section the concepts of amalgamation, its effects on the members and the creditors thereof will be discussed briefly.

Objectives:
At the end of this section, you will be able to:
➢ understand the concept of amalgamation of a business organization.
➢ list the requirements for amalgamation
➢ identify the legal effects of amalgamation on the members and creditors of the amalgamating business entities.

3.2.1. Amalgamation

Amalgamation, as its name indicates, is the combination of two or more forms of business organizations into a single firm. Amalgamation of business organizations takes place where two or more firms amalgamate either by taking over or by the formation of a new firm.
Thus two or more business organizations may merge their financial or managerial power into one and form a third entity or an independent entity may be taken over by the other. The very purpose of amalgamation is to increase an economic power by tackling constraint of capital and to engage in very capital-intensive projects without looking at the hands of lending institutions.

What are the legal requirements for amalgamation?

The first legal requirement for the amalgamation of business organizations is that a decision to amalgamate shall be taken by each of the firms concerned. In connection with this, Art. 550 of the Comm. Code states that special meetings of shareholders of different classes or meetings of debenture holders shall approve the taking over or being taken over. Decision for amalgamation shall be passed in the same manner as that of conversion.

The other requirement is that the terms of the amalgamation shall be drawn up by a deed which shall be published in accordance with the provisions of Art. 224 of the Comm. Code. Notices of the amalgamation shall be published at the head office of the firm taking over or of the new firm resulting from the amalgamation, as well as at the head offices of firms ceasing to exist on amalgamation.

3.2.2. Rights of Creditors

In principle, following the amalgamation, the claims and liabilities of the firm ceasing to exist shall pass to the firm taking over or to the new firm. In this regard, amalgamation is not different from conversion. Thus, the claims of the creditors of the former firms, unless other arrangement is made, will be transferred to the succeeding entity.

Can the creditors of the former firms object to the amalgamation of the firms?

Like the case of conversion, creditors of the firm or firms taken over or the firms constituting a new firm, whose claims came into existence before the publication of the deed of amalgamation may object to the amalgamation within three months from the date of such publication. However, as per Art. 552(2) of the Comm. Code, the court shall reject such objection where it is satisfied that all the creditors have agreed to amalgamation. Similarly, the court shall reject such objection where it is satisfied that those who dissented have been paid or that sums corresponding to their debts have been paid into a special account in the National Bank of Ethiopia.
Where the court rejects the objection of the creditors, which firm(s) shall pay the debts or provide adequate guarantees to the creditors?

In case the court rejects the objection and orders that the deed of amalgamation to be confirmed, the court may order that the firm taking over or the new firm resulting from the amalgamation shall pay the debts or provide adequate guaranties.

It should be also noted that where the amalgamating entity is a share company, amalgamation obviously affects rights of debenture holding creditors. Thus, the resolution to bind debenture holders should be approved by a special meeting of this category of creditors. But where the debenture holding creditors object to the merger, the amalgamation can only be effective where the debentures are redeemed within 3 months of the publication of the deed of amalgamation.

**Self-assessment Questions**

1. What are the similarities and difference between conversion and amalgamation of business organizations?
2. What is the purpose of amalgamation?
3. Do you think that amalgamation is advantageous to the creditors of the former firms? Why or Why not?

**CHAPTER SUMMARY**

It is possible that one form of business organization may be changed into another where the circumstances imperatively so demands. Such a change in the form of a business organization is called conversion. For instance, the law provides that any general or limited partnership and company limited by shares may be converted into private limited company. The later may also be converted back into a share company.

The conversion of one form of business organization into another may not necessarily cause the creation of a new legal person for the initially acquired separate legal existence shall remain intact irrespective of the conversion. One of the requirements for the conversion of a firm is that the decision of conversion should be taken either by the members unanimously or by the majority required by law or the articles of association, as the case may be. The other requirement is that such decision shall be duly authenticated and be published.
As regards the rights and liabilities of the members of the converting entity, a member may not be deprived, in whole or in part, of the rights of membership nor shall he be burdened with increased liabilities without his consent.

Another point to be noted with regard to conversion is that all rights and obligations of the former firm shall be transferred to the newly converted one as of the date of its registration. Thus, the creditor of the former firm can establish their claims against the new firm where they have not objected to the conversion.

The second important point treated under this chapter is amalgamation of business organizations. Amalgamation, as its name indicates, is the combination or merger of two or more forms of business organizations into a single firm. Accordingly, it takes place where two or more firms amalgamate either by taking over or by the formation of a new firm.

Like conversion, amalgamation, too, has certain legal requirements to be complied with. Hence, it is legally required that a decision to amalgamate shall be taken by each of the firms concerned. Furthermore, the terms of the amalgamation shall be drawn up by a deed which shall be published as required by law.

Following the amalgamation, the claims and liabilities of the firm ceasing to exist shall pass to the firm taking over or to the new firm. Consequently, the claims of the creditors of the former firms, unless otherwise agreed, shall be transferred to the succeeding firm. It is also worth mentioning that where the creditors, for instance, the debenture holding creditors object to the merger, the amalgamation shall be effective only where the debentures are redeemed within 3 months of the publication of the deed of amalgamation.

**Review Questions**

1. A, B & C were formerly the members of a private limited company currently converted into a company limited by shares. The members were in favor of the conversion and their names were accordingly written in the minutes. Later, D, E & F were added as members of the new share company. Recently, the new share company’s profits have been distributed between the shareholders. The members of the former company, A, B & C, have been claiming that they are entitled to a share not exceeding $\frac{1}{5}$th of the net profits in the balance sheet.

   a) Is their claim valid?
b) Can they claim such a benefit for indefinite period assuming that their claim is valid?

2. “Any form of business organization may be converted into a joint venture and vice versa.” Is the statement tenable?

3. Can two or more firms in liquidation amalgamate to form a new firm?

4. “Unlike conversion, during amalgamation, the concerned firms shall lose their legal personality and the new firm emerging therefrom shall acquire a new legal personality.” Test the validity of this statement in light of the relevant provisions of the law.

5. What is the right available to the members who object to the conversion of a private limited company into a share company?

**Key Answers to Selected Review Questions.**

**Chapter One**

1. The two most decisive and essential legal requirements for a share company to have a legal existence are publication and registration. As per Art 324 of the Comm. Code, where publication and registration have been made, the company shall have a legal existence and personality notwithstanding that all the legal requirements relating to the formation of the company have not been complied with.

3. Yes, Art. 307(4) of the comm. code, inter alia, declares that persons who without being member of a proposed company facilitate the formation of a share company acquire the status of founders.

5. a) No. Because a valid share company as a form of business organizations arising from a valid partnership agreement must have the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising thereof as per Art. 210 & 211 of the comm. code. In the question at hand, the entity has totally the purpose of
rendering free legal service to the needy people which is purely social in nature and non-profit making.

b) No. The provisions of commercial code are applicable to persons (legal or physical) carrying out business activates. The entity at issue is rather a civil association for which relevant provisions of the civil code are applicable.

c) No. Its registration as a share company is not valid for it is not a true share company in the eye of the law, rather a civil association for which the nomenclature must be corrected accordingly. The name of the entity should be corrected and the words “share company” must be dropped off.

7. No. Because as per Art. 357(1) of the comm. code, directors of a company other than bodies corporate may not borrow money from the company, obtain an overdraft in current account or have any obligation guaranteed in respect of business in respect of business transacted with third parties.

9. Since the directors shall be liable to the company’s creditors where they fail to preserve intact the company’s assets as per Art. 366 of the code, the creditors may proceed against the directors where the company’s assets are insufficient to meet its liabilities. (Art. 366(2)). But the shareholders are not liable to the creditors unless they haven’t fully subscribed when they are called to do so. A part from this instance, they are not liable to the creditors for their liability is only to the extent of their share holding as per Art 304(2) of the comm. code.

**Chapter Two**

1. a) Yes. For such an act of signing a negotiable instrument is within the general power of a manager to carry out acts of management as per Art. 35(1) of the commercial code. The company may not raise the defense of the fact that the restriction was dully published since such a restriction shall not bind third parties though properly published. (Art. 528(2)).
b) Yes, because the manager has acted outside the power fixed in the articles of association for the restriction made therein on his power is binding up on him as per Art. 528(2).

3. Yes, Because as per Art. 522 of the code, the assignment of the shares shall be of no effect in relation to the company unless they have been entered in the share register. That is, assignment in writing alone shall not have any effect unless registered.

5. The statement is partly not tenable. Because where it is expressly provided otherwise in the articles of association, it may be dissolved accordingly (Art.542(3). Furthermore, even if it is not provided, the death of a member may necessarily cause its dissolution where the total number of the members is reduced to less than two as a result.

Chapter Three

1. a) A, B & C are the founders of the new share company as per Art. 547(2). So, as founders they are entitled to a share not exceeding 1/5th of the net profits in the balance sheet in addition to their rights as shareholders, provided that such a benefit has been reserved to them in the memorandum of association (Art. 319(1)).

b) No. As per Art. 310(1) of the Comm. Code, the founders may claim such a benefit for a period not exceeding three years since the formation of the new company.

3. Yes, Art. 549(2) provides that amalgamation shall apply to firms in liquidation.

5. The numbers objecting to the conversion of a private limited company into a share company have the right, as per Art. 547(3), to withdraw under the provisions of Art. 463 of the commercial code.