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THE NATURE AND SCOPE OF PRIVATE
LIMITED COMPANY IN ETHIOPIA
THE LAW AND PRACTICE
FOCUS ON BANKRUPTCY

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ADDIS ABABA, ETHIOPIA

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LIMITED COMPANY IN ETHIOPIA
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FOCUS ON BANKRUPTCY**

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INTRODUCTION

Private limited company, like other forms of business organizations was introduced in Ethiopia in 1960 when the empire of Ethiopia adopted for the first time a comprehensive commercial code.

It is the most popular form of business organization in Ethiopia. According to Article 510/2 of the Commercial Code of Ethiopia, private limited company is a company whose members are liable only to the extent of their contribution. The writer was initiated to show not only the problems of bankruptcy under the private limited company but also the solutions.

The first chapter deals with concepts of the definition of business organizations and the types of the business companies in Ethiopia in general.

The second chapter deals with the concept and historical development of private limited company in Ethiopia. This chapter briefly indicates the basic characteristics of private limited companies in comparative analysis with the characteristics of share companies. In addition to this concept the writer compares the formation and dissolution of private limited company with similar companies of other countries.

The third chapter explains the bankruptcy proceeding of private limited company in Ethiopia. This chapter shows that, why bankruptcy is occurring in private limited company? And what should be the founder's responsibilities before establishing or forming private limited company legally?

Finally, the fourth chapter deals with conclusion and recommendations.

CHAPTER ONE

AN OVERVIEW OF BUSINESS ORGANIZATIONS

Business organization maybe concluded under various forms of business organization, the principle for a business organizations are:- Individual or sole proprietorship, partnership and corporations.

The section of the form of business organization is often determined by tax considerations with extent of liability for business debts and the extent of control of the management of the business being other important factors¹.

The Ethiopian commercial code of 1960 created a new comprehensive law of business organization for Ethiopia. The purpose of the code is to describe the general provisions principles concerning business organization their relation to the other laws and some of the problems they create².

1. **Definition:-** Article 210 of the Ethiopian Commercial Code defines a Business Organization as "any association arising out of a partnership agreement." A partnership agreement is "a contract where by two or more persons who intend to join together and to corporate undertake (to agree to be responsible for a job or to do it) to bring together contributions for the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising out there of it any."³

Whenever a valid partnership agreement is made and other required formalities, if any, are performed, a business organization exists.

¹ Business Law, Principle, cases, Environment
Anderson/Fox/ Twomey Chapter 42 P. 696

² An Introduction to the Law of Business Organizations
By Everett F. golber P. 495

³ Commercial Cole Art. 210

The Law contains numerous provisions which regulate business organizations, many of which may not be modified by the agreement. Also, except for joint ventures; all business organizations have legal personality. Business organization enables people to do things which would be difficult or impossible for them to do alone. The object of the business organization is making of profits.

When partners agree to establish a business organization the members should fulfill to satisfy the attributes of a valid contract as set forth under Article 1678 of the civil code, which consists of capacity, consent, object and form. Parties to a partnership agreement must be capable to contract which is the parties must have the requisite legal capacity to give a Juridical producing the effect that the partner intended consent to the agreement. Then minor and interdicted persons may not be parties to a partnership agreement.

The consent must be free from defectors. The object of the business organization must be clearly defined, possible to perform, lawful and morally acceptable. According to the Article 1711 of the Civil Code the partnership agreement must clearly determine the rights and obligations of parties to the agreement. The agreement forming any form of business organization other than joint venture shall be made in writing.

Contribution is one of the most important of any business organization. It is a kind of input made by the parties to the association to be created. There are four kinds of contributions under the Ethiopian Law of Partnership:

1. Contribution in kind
2. Contribution of debts (claims)
3. Contribution in cash
4. Skill (knowledge) contribution

2. Types of Special Business Organizations

In the Commercial Code of Ethiopia under Article 212 from six types of formation of business organizations ordinary partnership and joint venture are especial business organizations:

Ordinary **Partnership**:- A partnership is an ordinary partnership within the meaning of this title where it does not have characteristics, which makes it a business organization caused by another title of this code (Article 227 of Commercial Code of Ethiopia).

Joint Venture:- A joint venture is an agreement between partners on terms mutually agreed and is subject to the general principle of law relating to partnership (Article 271 of Commercial Code).

The elements of joint ventures are the following:-

1. An express or implied agreement to carry on an enterprise.
2. A manifestation of intention by the parties to be associated as a joint ventures.
3. A joint interest as reflected in the contribution of property, finance effort, skill or knowledge by each party to the joint venture.
4. A measure of proprietorship of joint control of the enterprise and
5. A provision for the sharing of profits or losses.

The major distinction between joint venture and partnership is that “a joint venture relates to a single enterprise or transaction and a partnership relates to continuing business. Both requires a meeting of minds and contract formation⁴.

A joint venture agreement as that of ordinary engagements may not necessarily be in written form, as contracts may be entered in to

⁴ Law for Business
Seventh Edition, Barnes Dworkin Richards
Chapter 25 P. 438

orally, be conduct Article 214, 272 (2). It is, however suggested that writing would ease proof of existence of this joint venture. The joint venture need not be registered Article 272(3) of Commercial Code. In this condition if any dispute arises it appears difficult to have witness to prove the very existence of the venture. Therefore, if an agreement is written and signed by the members accordingly, one can easily prove the fact that he had worked with other through joint venture.

Almost all of causes of dissolution of partnerships also dissolve a joint venture. If maybe dissolved by act of parties, either by the request of one of the ventures or by agreement all of the members. The dissolution of joint venture can be treated by Article 278 of the Commercial Code.

Therefore, joint venture is one of the six forms of business organizations. The main difference from other business is:

1. Secrecy
2. Absence of legal personality
3. Its information need not be made in writing
4. Not be registered
5. It is existence need not be disclosed to third parties⁵.

General Partnership:- According to the Commercial Code Article 280 (1), a general partnership consists of partners who are personally, jointly, severally and fully liable as between themselves and to the partnership for the partnership firm's undertakings, any provision to the contrary in the partnership agreement shall be no effect with regard to third parties. Partnership is a voluntary association designed to carry on a business for profit purpose⁶. In other words

⁵ St. Mary's University College
Module 1 Page 125

⁶ Law for Business
Seventh Edition
Barnes Dworkin, P. 413

partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

Limited Partnership:- Under Article 296 of Commercial Code “A limited partnership comprises two types of partners.”

- a) General partner in full liable personally, jointly and severally.
- b) Limited partners who are only liable to extent of their contributions.

The Types of Companies in Ethiopia

1. Share company
2. Private Company

Share Company:- A share company is a company whose capital is fixed in advance and divided in to shares and whose liabilities are met only by assets of the company (Article 304 of Commercial Code). The share company is established not less than five members. The primarily important documents for the establishing share companies are the memorandum of association and article of association. The founders shall be fully, jointly and severally liable to the third partners in respect of commitments entered into for the formation of the company. The share company shall not have less than three nor more than twelve directors who shall form a board of director those directors are selected by members of the company. The company is managed by the board of directors. The general manager is an employee of the company and may not be elected from directors of the company.

Some areas of business require huge capital that can not be financed individually or with capital of few business persons. Greater unity is needs when an area of investment in very capital incentive.

In this situation, the most appropriate form of business organization is a share company. Share Company is very

important instrument to carry out large enterprises. The basic purpose of the share company is accumulation of large amount of capital. Share Companies can offer their shares to the public in order to raise sufficient capital to run large business, such as mining, production of Electricity power. Through a share company that can sell share to the members of public, it is possible to collect capital until it comes sufficient to maneuver a projected venture.

I. **Dissolution of Share Company:-** Dissolution is a process of terminating the legal existence of business organization.

The ground of dissolution are three:

- a. **Voluntary Dissolution:-** Members of the share company may decide to avoid their company where the life span of a company was not limited by a formative document, members of the company, at any time can make themselves free from a business bond dissolving the company. According Article 495(d) to dissolve the share company free should be resolution of an extra ordinary general meeting.
- b. **Dissolution by Operation Law:-** In one case the share company was set up comprising a minimum of five members, up on death or by any case who is not capable to be the member of the company , the others requested dissolution of the share company claiming reduction of number of members below the legal minimum five.

II. **Judicial Dissolution (Dissolution by Court Order):-** A company may be dissolved by court order whenever a ground justifying dissolution by court happens. According to Article 218(1) of the Commercial Code, a business organization may be dissolved for good cause by the court on the application of a partner. In addition to this article 218(2) of the Commercial

Code the court is entitled to order dissolution. This Article states that "There shall be good cause in particular where a partner seriously fail in his duties or become through infirmity or permanent illness or for any other reason incapable of carrying out his duties or serious disagreement exists between partners."

Therefore, when the share company dissolves. Its legal personality. It should be announced through the National New Paper of the Country in order to declare to the third parties that if the third parties has debts on the share company.

Private Limited Company:- Private limited company is a company whose members are liable only for to the extent of their contributions. It is established by the memorandum of association and article of association. The members are minimum of two and maximum of fifty. The private limited company is managed by the manager(s). It can be established for a limited period of time to accomplish a plan of the company or it could be establish for unlimited period of time. The members of the company are fully, jointly and severally liable to the third parties in respect of commitment intended into the formation of the company⁷.

Therefore, all the six forms of business organizations have got some common features under the Ethiopian Law of business Organizations. The following are brief out line of common features attributer able to any business organizations.

1. According to Commercial Code of Article 210(1). All business organization arise from partnership agreement.
2. They all have a legal personality except a joint venture Commercial Code Article 210(2).

⁷ Commercial Code 510

3. According to the Commercial Code of Article 214 the format in of all business organizations other than joint venture shall be in writing.
4. Article 215 of Commercial Code states that "Any provision filling all profit to one partner or relieving him from share in loss shall be of no effect.
5. All business organization transact with third parties or act in legal proceedings through their agent (Commercial Code Article 216).
6. All business organizations other than a joint venture must be made known to third parties (publicity requirement).

CHAPTER TWO

PRIVATE LIMITED COMPANY IN ETHIOPIA

- 2.1. **Definition:-** According to Ethiopian Commercial Code Article 510 it is define as that "Private Limited company is a company whose members are liable only to the extent of their contribution, and whose members are not less than two or more

than fifty. It is always commercial form or activities. The capital is fixed in advance and divided into shares and it shall not issue transferable securities in any form." This definition does not show that if the members take a wrong action on their activities of business and leads the company to the bankruptcy, the members are responsible for factual bankruptcy of the company.

2.2. Historical Development Private Limited Company under Ethiopia

Private limited company, like other forms of business organizations, was introduced in Ethiopia in 1960 when the Empire of Ethiopia adopted for first time a comprehensive commercial code. But this does not mean that there were no business organizations in Ethiopia prior to the enactment of the commercial code. Even though there were not distinctive types of business organization like the ones recognized under the commercial code with uniform and comprehensive law to regulate them there had been business organizations before the code was adopted. "Arrangements under which a business is carried on by two or more persons jointly have long existed in Ethiopia....As early as the 15th century the Fetha Negast or "Law of the Kings' devoted an entire chapter [chapter 34] to the regulation of partnership." Furthermore although, owing to the out break of the war with Italy, the attempt was not successful, in 1933 an attempt was made to bring different organizations under a single set of rules. As a result, the law of companies was adopted. However, although the war became an obstacle for the implementation of the law of companies, after the Italian occupation business organizations were established by Ethiopians jointly with foreigners particularly Italians.

A significant and prominent work not only with regard to business organizations but also with regard to traders and business, carriage and insurance, negotiable instruments and banking transactions was

made in 1960 when the 1960 Commercial Code of Ethiopia shaped in modern legal regulations was adopted⁸.

Following the enactment of the Commercial Code, business organizations particularly general partnerships, share companies and Private Limited companies have flourished in Ethiopia. In 1965 there were about 389 business organizations registered at the then Ministry of Commerce and Industry. Of this number, about 108 were general partnerships, with a total declared capital of Birr 7,324,000; about 106 were share companies, with a total declared capital of Birr 218,781,000; about were private limited companies, with a total declared capital of Birr 34,775,000⁹.

The development and growth of business organizations, however, has been discouraged during the Derg regime. Ownership of banks and insurance businesses which only share companies can possibly undertake, were transferred to the Government by a decision made on January 1, 1975 by the Provisional Military Government. By another decision passed on February 3, 1975, the ownership or majority share holding of business organizations were transferred to the Government.

From the paragraph we can understand that the Government was either a sole owner or a shareholder of business organizations. Consequently, participation of private individuals in the business activities was greatly restricted. Moreover, proclamation number 76 of 1975 prohibited the formation of Private Limited companies in particular. For those reasons the commercial code dealing with business organizations especially those provisions of private limited company have been dormant since 1975 up to the overthrowing of the Derg¹⁰.

⁸ Powers and liabilities of managers under the commercial code pp. 6,7
Author. Debas Yeshaw Dessie
Published May 1999 AAU Faculty of Law

⁹ Powers and liabilities of managers under the commercial code pp. 6,7
Author. Debas Yeshaw Dessie
Published May 1999 AAU Faculty of Law

¹⁰ Powers and liabilities of managers under the commercial code pp. 8

Even though the present writer requested the Addis Ababa Trade Industry and Tourism Office for statistical information about the number and corresponding capital of all forms of business organization, the Record and Data Processing Department of the office responded that it is only the four forms i.e. general partnership, share company, ordinary partnership and private limited company that are registered at the Addis Ababa Trade Industry and Tourism office. The other forms such as joint venture and limited partnership are not registered.

One has to imagine that, since the present governmental structure of Ethiopia is federalism, the number of business organizations discussed above represents business organizations formed only within Addis Ababa Trade Industry and Tourism Development Office. Addis Ababa as a centre of commerce and trade might constitute a significant percentage, there might be many business organizations in other regional states commerce and trade are actively practiced, such as Dire Dawa, Harar, Nazaret, Awasa, Bahr Dar and Mekele there might be many business organizations.

When we compare the number of business organizations registered in 1965, which represents those formed through out the country, including Eritrea with a number registered 2005- Jun 2008 respectively only those registered in Addis Ababa Trade, Industry and Tourism office are shown below in table.

"B"

The following table shows that the comparative analysis development of business organization in Ethiopia¹¹.

Business organizations	1965		2005		2006		2007		2008 (June)	
	No	Capital	No	Capital	No	Capital	No	Capital	No	Capital
P.L. Company	175	34,775,000	1057	2,355,755,314	951	2,412,694,976	1101	2,337,335,550	234	526,847,800
S. Company	106	218,781,000	39	121,051,115.29	31	61,880,600	23	456,396,375	13	23,698,00
G. Partnership	108	7,324,000	12	357,940	11	22,084,000	7	7,447,500	-	-
Ordinary partnership	-	-	1	1,500,000	-	-	-	-	-	-
Total	389	260,880,00	1109	2,477,314,369	993	2,496,659,576	1131	2,801,179,425	247	550,545,800

¹¹ Addis Ababa Trade and Industry Office Data Processing Department
Under the Commercial, code of Ethiopia
Debas Yeshanew Dessie
Faculty of Law AAU May, 1999 (1965)
P: 7

From the above table information we can observe that Private Limited Company is increasing yearly. What is the reason behind it? because.

1. It does not require rigorous (strict) procedures and sophisticated organization management.
2. They are not subject to double taxation, unlike Share Company.
3. There is generally no need of publicizing the prospectus of the company to solicit potential shareholders.
4. It is a family or friendly company.

2.3. Formation and Management of Private Limited Company under Ethiopian Law

The formation and the management of Private Limited Companies are rightly different from country to country, its characteristics such as limitation of membership, minimum share capital, are not identical through out the world.

In India, the formation of Private Limited Companies can be established minimum of two and maximum of fifty members. The management is contracted by directors. In the formation of Share Company the minimum requirement members are seven and the maximum is unlimited¹².

In India, the stages of formation of a company is classified in to three stages (phases) they are:-

1. Promotion of the company
2. Registration and incorporation of a company
3. Commencement of business

1. Promotion of a company:- it is the first stage in the formation of a company. Before a company is actually formed, certain persons

¹² The text book of company law p.p.s GOGNA pp. 30,23

plan about the starting of same business and after arriving at the decision about the formation of a company, they take necessary stages in this regard. The promotion of a company refers to all those stages which are taken from the time of having an idea of starting a company to the line of the actual starting of the company business.

2. Registration and incorporation of a company:- It is the second stage in the formation of a company. We know that a company comes into existence when it is registered under the companies Act. If the company is to be formed in a public company, any seven or more persons associated for any lawful purpose and if the company is to be formed as Private Company, any two or not more than fifty members may get registration by authorized organization office¹³.

A certificate of incorporation is one which certifies that the company is formed. It contains the name of the company, the date of its issue, and the signature of the registrar with his seal. This certificate states.

1. The company comes into existence and to it become a legal entity independent from its members¹⁴.
2. The company's life starts from the date of the certificate of incorporation¹⁵.
3. The company requires a perpetual succession i.e. it remains in existence forever unless wound up according to the provisions of the companies. In other words the death, requirement, admission etc. of the members of the company does not affect its existence¹⁶.

¹³ A text book of company law p.p.s GOGNA pp. 59

¹⁴ A text book of company law p.p.s GOGNA pp. 61

¹⁵ A text book of company law p.p.s GOGNA pp. 61

¹⁶ A text book of company law p.p.s GOGNA pp. 62

4. The memorandum and article of association become binding upon the company and all its members.
5. The liability of the members of the limited company become limited¹⁷.

The memorandum and article of associations are the most important documents to the formation of private limited company.

Memorandum of Association:- It is the first step in the formation of companies. It contains the fundamental conditions on which the company is to be incorporated. In fact, this document is of great important in relation to the affairs of the proposed company. It may rightly be called a "charter" or the "construction" of the company as it regulates the relationship of the company with the outside world. It also lays down the powers and objects of a company, and the scope of the operations of the company beyond which its actions cannot go. The company is bound to act according to the objects and powers as contained in its memorandum of association. If the company's acts go beyond the provisions of the memorandum, its act will be ultra-vires¹⁸.

Article of association:- It is the document contains the rules, regulations and bye-laws for the internal management of the company. These rules and regulations are framed for the purpose of carrying out the objects of the company as stated in the memorandum of association. "The articles define the duties, the rights, and the powers of governing body as between themselves and the company at large, and the mode and the form in which the business of the company is to be carried on, and the mode, the form, in which changes is internal regulations of the company, from the time to time, be mode¹⁹"

¹⁷ A text book of company law p.p.s GOGNA pp. 62

¹⁸ A text book of company law p.p.s GOGNA pp. 73

¹⁹ A text book of company law p.p.s GOGNA pp. 102

Commencement of Business

A company comes into existence, when the company is registered and a certificate of incorporation is issued by the registration of companies. There after, the company becomes entitled to commence its business. On the commencement of business, there is some difference between the private company and a public company. A private company can start its business immediately after obtaining the certificate of incorporation²⁰.

According to the Ethiopian commercial code Articles 312-324 and article 516-520 are the provisions of governing the procedures of company formation, i.e. formation of Share Company and Private Limited Company respectively, under the Ethiopia law of business organization.

In Ethiopia, the procedure of company formation may be broadly classified into the five (phases) of procedures.

1. The initiation (planning) stage,
2. The negotiation and drafting stage
3. The solicitation stage
4. The signing and authentication stage
5. The registration and publication²¹

1. In Initiation stage (planning stage):-When we come to the world of business, the first thing in the life of the business is the conception of the idea of operating a particular sort of business among the many alternative areas of venture.

Various people with diverse degree and different capacity may participate in the formation of company. Initiation may stem from certain limited number of people and he/she may convince some other people to join him for purpose of carrying out business activity.

²⁰ A text book of company law p.p.s GOGNA p. 63

²¹ Module 2 law of business organization St. Mary's University College p. 37

A founder can only be a member of company in Ethiopia only if he/she subscribes a share or shares either making contribution in kind or paying cash. He/she cannot have free share without any further payment for sole reason of founding a company²².

Article 315 of the commercial code provides the valuation of contribution in kind.

2. Negotiation and drafting stages:-The first practical step or procedure in the formation of a company is the negotiation and drafting of the deed of company formation, namely the memorandum and articles of associations²³.

3. The solicitation stage the prospects:- This is stages of preparing the necessary documents for the establishments of the company by the lawyer(s)²⁴.

4. The signing and authentication:-It is the last stage of the final approval and legal entity of the company²⁵.

Private limited companies are companies whose capital is fixed in advance and divided into shares and whose members are liable only to the extent of their contributions in the assets of the company, just like share companies. Private Limited Company resembles a share company in many respects and it also appears to have some similarity with partnership in general and what is called limited partnership is particular especially in respect of owners rights in the management of the company and restriction of freedom of transfer of shares to newcomers.

²² Module 2 Law of Business Organization St. Mary's University College pp. 38

²³ Module 2 Law of Business Organization St. Mary's University College pp. 56

²⁴ Module 2 Law of Business Organization St. Mary's University College pp. 74

²⁵ Module 2 Law of Business Organization St. Mary's University College pp. 85

Private Limited Companies do not require strict (rigorous) formation of procedures, and sophisticated organization management. There is no necessary to publicizing the prospects of the company to request people for the membership of the company (solicit) to be potential shareholders. It does not have the obligation to be double of taxation unlike share companies, Private Limited Companies are generally preferred by those persons who wish to operate a business with relatively smaller amount of capitals compared to share companies²⁶.

Private Limited Companies are usually formed by persons who have a relationship of some kind between themselves or between persons who know each other. Such a relationship gives them mutual trust and confidence in one another.

Example:- it may be observed that in most cases, it is a husband and wife, or members of a family, or close friends who bring their capital together and form Private Limited Companies. These, in these forms of companies, the identify of an individual shareholder is of material significance to other members, and this is why there is prohibition to transfer shares to outsiders without the consent of other members of the company.

Therefore Private Limited Companies are different from share companies in that there is restriction or limitation to the right to transfer or assign shares to outsiders, and even if a shareholder wishes to transfer or assign his shares to a third party, a majority of other shareholders representing at least three quarters of the capital must approve of the transfer or assign, this is according to the commercial code article 523(2).

²⁶ Module 2 Law of Business Organization St. Mary's University College pp. 14

According to the commercial code of Ethiopia article 525 the Private Limited Companies shall be managed by one or more managers. Where there are more than twenty members and auditors shall be appointed. If there are twenty or less members the members shall not be bound by the decision passed by the meeting. This is two decisions passed by the meeting. This is stated under article 525(1,2,3) respectively.

Advantages and disadvantages of Private Limited Company under Ethiopian Law

2.5.1. Advantages

1. The formation of the company is based on close relationship.
2. There is no requirement of deposit of cash during the formation (establishment) of the company.
3. There is no need of requirement of board management and appointment of auditors. If the members are less than 20 (article)
4. No need of reporting publicizing the accounts balance sheet of the company.
5. The liability is limited to the extent of contribution.
6. The close relationship could translate to strict and perfect management.
7. No inspection by the government organs.
8. The most important determining factor for P.L.C is not the capital, but the personality of members. That the question is not what is amount of the capital but who are the members.

2.5.2. Disadvantage

1. Number of members are limited (maximum 50)
2. Huge capital can not be raised
3. Not having a strict requirement for board members and auditing to abuse of power.

4. The members cannot engage in huge financial business like insurance and banking.

Registration of Private Limited Company

The final stage in company formation is the registration stage. This is the stage at which the company is said to be legally formed, and acquires legal personality and existence distinct and separate or independent of its members. Our law lays down a requirement that companies must go in to the procedure of registration they are to be considered "born" in the eyes of law and be capable securing a license and transacting with third parties.

The status of independent legal existence and personality of companies, separate from their owners in turn is manifested by and gives rise to the following legal consequences.

1. The company would have capacity at law, hence it holds attributes of personality with legal capacity it requires, the company is just like human person, transact with third parties, enter in to obligations and perform some sue or be sued under its own name and in its behalf²⁷.
2. It would have a proper legitimacy to require operating or trade license with in the limits of the business purposed it has in its deeds of formation²⁸.

Different countries have adopted different rules in respect to limitation imposed on a maximum number of members of private limited company and share companies. For instance according to the India commercial law, the minimum number of the share companies are seven where as

²⁷ Module 2 Law of Business Organization St. Mary's University College pp. 90

²⁸ Module 2 Law of Business Organization St. Mary's University College pp. 90

the Ethiopian Commercial Code Article 307(1). A company not be established by less than five members.

In both countries the Private Limited Companies are the minimum number are two and maximum fifty.

According to the German commercial law once the company is formed, it is recognized that one member may acquire the other member's share, such acquisition does not destroyed the legal personality of the company which remains in existence even if there is only one member²⁹. When look to the Ethiopian Commercial Code Article 511 "where the number of members is reduced below two, or where the organs of the company cease to exist, the court may, on the application of a member or a creditor, or the dissolution of the company and make such provisional orders as are necessary unless the company makes arrangements to comply with the law within a reasonable time."

In India the Private Limited Companies are managed by the board of directors, where as in Ethiopia According to Commercial Code Article 525(1) "A Private Limited Company shall be managed by one or more managers.

Dissolution of Private Limited Company

Dissolution:- is the process of terminating the legal existence of business organization or it is end of the legal existence of artificial persons.

The grounds for dissolution of the Private Limited Companies are the following³⁰.

²⁹ Module 2 Law of Business Organization St. Mary's University College pp. 90

³⁰ Module 3 Law of Business Organization St. Mary's University College pp. 62

1. **Dissolution by Act of parties:-** (members). Members of companies may decide to avoid their company. Where the life of span of a company was not limited by a formative document, member of the company, at any time, can make themselves free from a business bond by dissolving the company. To dissolve a company, there should be a resolution of an extraordinary general meeting (Article 495(d). the Private Limited Company voluntary dissolution of the company is possible where shareholders holding $\frac{3}{4}$ of the total of the company have attended the meeting or sign on the resolution to dissolve (Articles 536 of commercial code) and voted for the dissolution thus for any reason, where all of the necessary procedure are met member of a company pass a resolution³¹.

2. **Dissolution by operation of law:-** According to article 542(2) of commercial code "A judicial interdiction, bankruptcy or insolvency of a member, shall not cause dissolution of a company nor shall death of a member unless otherwise expressly provided is the articles of association." Thus, where a member dies, unless article or other documents of a company envisages (possible) otherwise, heirs may be assumed as members of the company (article 524(1) of the commercial code. In one case, a company was set up comprising two members. Up on death of one of the members below the legal minimum...two. Can be dissolve the company, because there is no one man company is our law³².

But according to the German Law, in order to form GMBH (Private Limited Company) the Ethiopian equivalent plc, at least two founders (shareholders) who may be natural or legal person, are necessary. But once the company is formed, it is recognized that one member acquire the other member's share, such acquisition

³¹ Module 3 Law of Business Organization St. Mary's University College pp. 63

³² Module 3 Law of Business Organization St. Mary's University College pp. 64

does not destroy the legal personality of the company, which remains in existence even if there is only one member³³.

3. **Bankruptcy:-** Bankruptcy is loss of capital and inability to meet demands of creditors because of such loss when the court is satisfied, the failing entity or a businessperson may be declared bankrupt. Under Commercial Law Article 969,970(1) shows the grounds of declaration of bankruptcy.
4. **Failure or accomplishment of business purpose:-** according to article 217 of commercial code. "Any business organization shall be dissolved where its purpose has been achieved or cannot be achieved³⁴.
5. **Judicial dissolution (by court):-**According to article 218 of the commercial code the court is entitled to order dissolution.

Article 218(2) "There shall be good cause in particular where a particular seriously fails in his duties or becomes through infirmity or payment illness or for any other reason incapable of carrying out his duties or where serious disagreement exists between the parties.³⁵"

³³ Powers and liabilities of managers under the commercial code pp.
Author. Debas Yeshaw Dessie
Published May 1999 AAU Faculty of Law

³⁴ Module 3 Law of Business Organization St. Mary's University College pp. 65,66

³⁵ Module 3 Law of Business Organization St. Mary's University College pp. 66

CHAPTER THREE

BANKRUPTCY PROCEEDING OF PRIVATE LIMITED COMPANY IN ETHIOPIA: THE LAW AND PRACTICE

The Bankruptcy Proceeding of Private Limited Company in Ethiopian Law

Bankruptcy proceeding is a statutory system under an insolvent debtor is adjudicated bankruptcy in order that its assets are to be distributed among creditors in an equitable (fair and reasonable) expeditious (quick and effective) manner³⁶.

Article 975 of commercial code provides that bankruptcy proceeding shall be instituted by way of petition made by debtor(s) creditor(s) public prosecutor and the court itself³⁷.

When the companies became bankrupt the debtor can institute a bankruptcy proceeding voluntary. Voluntary bankruptcy is the one in which a debtor who is unable to meet its obligations on its own motion, applies to the court to be declared bankrupt.

According to Article 969 and 971 of the commercial code of Ethiopia a company may be declared bankrupt only if it is judicially established to have suspended payments i.e. where there are any facts, acts or documents showing that the company is no longer able to meet the commitments related to its commercial activities. Which means where the company petitions to be declared bankrupt the court should see to it that the alleged insolvency really exists³⁸.

³⁶ Module 4 law of Business Organizational and Bankruptcy
St. Mary's University College P. 58

³⁷ Commercial Code of Ethiopia Published 5th may 1960

³⁸ Module 4 law of Business Organization and bankruptcy
St. Mary's University Collage pp. 59, 64
Published September 2004

On the other hand when the company become bankrupt the shareholders or manger(s) may not report to the court in order to declare that the company is bankrupt. It shows that the debtors are involuntary to declare the bankruptcy of the company.

Involuntary bankruptcy is the situation where the debtor(s) is (are) forced in to bankruptcy upon the motion of its creditors. Article 975(b) of the commercial code provides that one or more creditors may institute bankruptcy proceeding against the debtor, with a view forcing the debtor into bankruptcy³⁹.

After receiving the petition for bankruptcy according to article 975 the court would investigate the affairs of the debtor to find out if the conditions of insolvency, which is inability to pay (suspensions of payment) are there when the court determine that the debtor is in fact unable to pay its debts, it will declare the debtor bankrupt⁴⁰.

Declaration of bankruptcy would have the legal effect of depriving the bankrupt of its right to exercise act of management regarding its business. It will also prohibit the debtor to dispose of its assets and appoint a commissioner and trustees to take care of management of the affairs of the bankrupt and to effect settlement of claims of creditors⁴¹.

On settlement of creditors it must be noted that there are three major categories of creditors to be considered.

1. Preferential creditors
2. Secured creditors
3. Unsecured creditors.

³⁹ Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College pp 59, 64

⁴⁰ Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College pp 112

⁴¹ Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College pp 112
September 2004

Taxes and wages of employments are preferential claims against the bankrupt's assets while mortgage, pledge and lien holders are secured creditors.

Regarding priority and subordination of claims in settlement of creditors' claims, preferential claims are settled in first priority to all to all other claims. Secured creditors have a second priority interest in the security they hold (i.e. second to preferential creditors) while ordinary, unsecured creditors are to be paid last from the residual amount after the claim of preferential and secured creditors have been settled.

Remedies Against Bankruptcy

The remedies against bankruptcy can be divided into ways.

1. Composition and schemes of arrangement
2. Schemes of arrangement

1. Composition:- is a proposal seeking compromise with the unsecured or ordinary creditors of the bankruptcy who are going to be paid out of the sale of the assets of the bankrupt which are not held in security by creditors. The procedure of assessing marketable assets of the bankrupt and realizing them in settlement of unsecured claims of the bankrupt is called winding up the bankruptcy⁴².

Article 1081 of the commercial code provides that any time after the expiry of the period of time provided article 1046, the bankrupt may be propose a composition with the creditors and submit the proposed compensation to the commission.

⁴² Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College p. 117
Published September 2004

Article (1081) shows it is the debtor who is declared bankrupt, and not his creditors, who may initiate compositions. Since composition is a remedy against the harsh consequences of bankruptcy procedures, i.e. since composition is sought to prevent from being wound up bankruptcy and since it is no sense to think a debtor who initiated a bankruptcy proceeding against himself would later on decide not to go into winding up, we may conclude that compositions is a remedy available to the debtor declared bankrupt under involuntary bankruptcy, i.e. bankruptcy proceeding brought against him by his creditors⁴³.

2. Schemes of arrangement:- it is a remedy available to a debtor who is insolvent but is not declared bankrupt and who wishes to avoid bankruptcy proceeding from being brought against him by his creditors. Article 1119 of the commercial code provides that any trader who has or is about to suspend payments and has not been declared bankrupt may apply to the court for the opening of a scheme of arrangement.

Application for scheme of arrangement made:- Article 1119 of commercial code provides that when a company who is insolvent fear that its creditors are about to institute a bankruptcy proceeding against it, it may apply to the court for the opening of a scheme of arrangement. Such an application should be follow article 1120(1) of commercial code⁴⁴.

Compositions and scheme of arrangement are similar in that both are the remedies available to debtor against the harsh consequences of bankruptcy. The basic difference between the two is that while

⁴³ Module 4 Law of Business Organization of Bankruptcy
St. Mary's University College p. 117
Published September 2004

⁴⁴ Module 4 Law of Business Organization of Bankruptcy
St. Mary's University College p. 122
Published September 2004

composition is resorted to after the debtor has been declared bankrupt, scheme of arrangement is sought before bankruptcy proceeding is brought against the debtor.

Bankruptcy under the Ethiopian Law and the Practice

Historical Background

The term bankruptcy come from two Latin words, meaning "bench" and "break". Thus its literal meaning is "broken bench". Under Roman law, after gathering together and dividing up the assets of a delinquent (behaving in a way that is criminal) debtor, the creditors would break the debtors work bench as a punishment and a warning to other in-debted trades men. Bankrupt individual were regarded as thieves who deserved sever penalty. Roman deprived such persons of their civil rights, and many other societies stigmatized them by requiring them to dress in a particular identifying garb (clothing that shows your situation in life or the work you do)⁴⁵.

Our society has provided a system by which the honest but financially over burdened debtor can pay into court whatever property the debtor possess, be relieved of most obligations, and start economic life again. This is achieved through a proceeding called bankruptcy.

Historically the bankruptcy law was not concerned with benefiting the debtor as much as it was with benefiting the debtors creditors. In its origin, the law was designed to compel fraudulent debtors to bring their property into court and pay it to their creditors, thus preventing them from concealing their property or from paying it to only some of their creditors. Today, a bankruptcy proceeding has both features as can be

⁴⁵ Internet Visit Crown Finance Ministries on Line at www.crown.org.

seen from the fact that a case in bankruptcy maybe started by the debtor (a voluntary) or by creditors (an involuntary case).⁴⁶

Definition:-

- A. Bankruptcy is a situation a person or a business organization became bankrupt⁴⁷.
- B. Bankruptcy may be defined to be the case where the debtor is incapable of fully setting his debts.

The term bankruptcy has been defined in the various ways according to the purpose of the definitions. For the purpose of the business organization activities. For the purpose of the business organization activities it could be define as follows.

- C. Bankruptcy is a situation where one who, by his acts and conducts affords evidence of his in ability to pay or his intention to avoid payment of his debts⁴⁸.
- D. Bankruptcy is the states of a person who has been made the subject of the application of bankruptcy law and who has been declared bankruptcy by a court of law⁴⁹.

The Types of Bankruptcy

There are two kinds of bankruptcies

- 1. The factual bankruptcy
- 2. The legal bankruptcy

⁴⁶ Business Law Principles. Cases. Environment

- Anderso /Fox/ Twomey
- P. 567
- South-Western Publishing co. 8th Edition.

⁴⁷ Mocmillan Dictionary

⁴⁸ Module 4 Law of Business Organization and Bankruptcy P. 16
Published September 2004

⁴⁹ Module 4 Law of Business Organization and Bankruptcy P. 16
Published September 2004

Factual Bankruptcy:- Factual bankruptcy- may simply to understand to refer to the case where the debtor has in fact, apparently, no sufficient means to pay his debts, making him unable to pay his debts. It is sometimes called insolvency. In order to know a debtor is a bankrupt in law (legal bankruptcy) his factual bankruptcy must be proved by the court through the procedure of adjudications. The qualifying phrase "unable to pay its debts" as used in the definition of insolvency or bankruptcy does not include a mere excess of liabilities over assets and the liabilities of a company between the assets and the liabilities of a company as shown in the balance sheet must be so wide that there is no prospect for the company and recover from such a financial crisis in a short period.

The legal Bankruptcy:- Under Articles 969, 970(1) and article 971 is what may be termed a factual bankruptcy, which is contemplated under 970(2). Factual bankruptcy may result from a judgment passed against a debtor by a criminal court in respect of bankruptcy or any offence connected with it before his suspension of payment has been judicially established⁵⁰.

According to article 10(2) of the commercial code share companies and private limited companies are always commercial organizations, then they are always proper subjects of our bankruptcy law within the meaning of article 968(1) of the commercial code.

The private limited company and share companies prepared a balance sheet and income statement at the end of each fiscal year, showing that the year end balance of the company assets, liabilities and capital on the day the document is prepared. These documents show that if the assets

⁵⁰ Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College
pp. 19, 20
Published September 2004

of the companies are greater than the liabilities, there would be a capital enable to settle the liabilities, and if the liabilities of the company are greater than assets. It indicates that the company is in the position of unable to pay its debts to the creditors. The unable to pay must be proved by the court in order to conclude that the company is bankrupt (legal bankruptcy).

According to article 969 of the commercial code any trader who has suspended payments and has been declared bankrupt shall be deemed to bankrupt.

- Generally under the Ethiopian bankruptcy laws the proper subject of bankruptcy are governed by the article 968(1) commercial code which provides.

The provisions of...shall apply to any traders within the meaning of Article 5 or the commercial code and to any commercial organizations within the meaning of Art 10 or commercial code except joint ventures⁵¹.

The provision states that only traders and commercial business organizations are proper subject of bankruptcy laws under the Ethiopian bankruptcy law. It may be of a help to see categories of traders which are the proper subject of bankruptcy within the meaning of article 968(1) of the commercial code and also if there are any traders which are excluded from the coverage of this provision⁵².

According to article 510(1) private limited companies are liable whose members is limited to their contribution in the capital of the company.

⁵¹ Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College September 2004 p.22,46

⁵² Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College September 2004 p.22,46

This, limited liability is the item making distraction between the companies and partnership⁵³.

From this article of statement we can understand that a general rule that shareholder are not personally liable for the debts of the company. The company is an entity distinct from its members; hence the assets it owns and the liabilities it owes (debt) do not affect the members, and creditors of the company may not as a rule resort to the members for the company's debts even when the later is insolvent.⁵⁴

Therefore, under the Ethiopian Law, individuals and ordinary partnership are not subject of bankruptcy law, unless they are not traders with in the meaning of article 5 of the commercial code of Ethiopia. While private limited and share companies are the subject of bankruptcy law as they are always commercial business organizations. Ordinary partnership and joint ventures are excluded from the coverage of bankruptcy law for the reasons that ordinary partnership are not traders where as joint ventures have no legal personality⁵⁵.

On the other hand the private limited and share companies member are not liable for obligations (debts) of the company beyond their contribution. Once the company entered in the commercial register and thereby has acquired legal personality, it is directly liable to its creditors; creditors have no direct claim against the members (share holders). The members are only liable to the company not to the creditors to pay their debts in respect of their subscribed shares. If the members do not full

⁵³ Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College September 2004 p.22,46
Published September 2004

⁵⁴ Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College September 2004 p.46,53

⁵⁵ Module 4 Law of Business Organization and Bankruptcy
St. Mary's University College September 2004 p.46,53
Published September 2004

paid their contribution (subscription) they are liable to the company; but not the creditors.

According to article 517(g) of the commercial code. It states "a statement that the capital is fully paid". This statement indicates that the capital is already paid, payment is installment seems not be allowed, registered. There is no any mechanism of law that to prove the members of the company has already paid to the company their contribution before the company is established or registered.

Why Bankruptcy Occur in Private Limited Company?

Companies do not emerge by themselves. Before coming into existence, the basis for valid formation has to be leveled by other persons. "Sketch" to form a company may be set by any member of the idea of forming a company may be communicated to like person, who may agree to involve in the company founding. These people conduct feasibility, study and do whatever venture that would make the proposed company a reality. The plan has to be tested with an objected reality prevailing at a given targeted environment. If the feasibility study is taken positive, the next step is bringing additional person, if important, and collecting necessary capital and property to the proposed company. These processes may be leveled in three heading discovery, investigation and assembly⁵⁶.

When look to the English law of bankruptcy act of 1986, all individuals-Traders and non-traders alike-with some exception, are proper subjects of bankruptcy law, and as far as bodies corporate or partnerships are concerned, partnerships formed under limited partnership act of 1907 are subject of bankruptcy laws, while companies or partnerships

⁵⁶ Jima University Journal of Law Volume 1 Number 1 October 2007 P.2

governed by the companies act of 1948 are not subject to go in to the bankruptcy, instead, they are wound-up⁵⁷.

When we come to American bankruptcy law, it be asserted (to state firmly that something is true) with plausibility (argument, explanation, lesson) that it generally takes the same position as the British Bankruptcy laws in that the amenability to bankruptcy in American law extends to all individuals-traders and non-traders alike, with some exceptions. As opposed to English law, however, the American law extends amenability to bankruptcy laws also to bodies corporate (private corporations) and partnership although some are excepted for policy reasons.⁵⁸

Under the Ethiopian bankruptcy laws, the proper subjects of bankruptcy are governed by article 968(1) of the commercial code which provides.

"The provisions of ... shall apply to any traders within the meaning of Article 5 of the commercial code and to any commercial business organizations within the meaning of article 10 of the commercial code, exception of joint venture".⁵⁹

The private limited companies are formed usually by persons who have relationship of some kind between themselves or between persons who know each other. Such a relationship gives them mutual trust and confidence is one another. It is observed that in most case husband and

⁵⁷ Module 4 law of business organization and bankruptcy
St. Mary's University College
pp. 21,22
September 2004

⁵⁸ Module 4 law of business organization and bankruptcy
St. Mary's University College
pp. 21,22

⁵⁹ Module 4 law of business organization and bankruptcy
St. Mary's University College
pp. 21,22
September 2004

wife or membership of family or close friends, who bring their capital together to form private limited companies.

The doctrine of piercing /lifting/ the corporate veil

The term lifting /piercing) of corporeal veil means ignoring the separate legal entity of the company, and looking in to the realities. It is an important doctrine in the company law according to which in a certain circumstances, the separate legal entity of the company is not taken in to account. The company and the members are treated as one person.

We know that the chief characteristics of a company is that it is a separate legal entity independent and different from its members. And due to this characteristic, many other advantages are enjoyed by the company. The fact is not denied that, by fiction of law, a company is a separate legal entity, independent and different from its members. But in reality, it is an association of persons who are in fact the beneficial owners of all the corperty (i.e. company's property). As a matter of fact, the business of a company is carried on by some human beings who are the ultimate beneficiaries of corporate advantages. Due to the report legal entity of the company, these real beneficiaries of corporate advantages. Due to separate legal entity of the company, these real beneficiaries behind the company are disregarded once they have formed a company and given to their association the status of legal entity.

The separate legal entity of the company is to be respected. As a matter of fact, the whole law of corporation is based on this principle of corporate personality (i.e. separate legal entity) of a company. However, the statutory (controlled by law) privilege of separate personality of the company must be used for legitimate business purpose only. Sometimes, it becomes necessary to find out the real persons who control the company. When the corporate personality (legal entity) of the company is

misused for fraudulent or improper conduct or for doing things against public policy. In such cases, the court ignore the separate entity. In other words the corporate veil of the company is probed (to find out the truth about an issue made by an official) in to and lifted up. This, however, is the discretionary power of the court, and will depend up on the underlying social, economic and moral factors as they operate in and through the company. When the corporate personality of a company is used as a shield to cover its wrong doings, such as for evasion of tax, the courts may life the corporate veil⁶⁰.

According to the Back's law dictionary piercing the corporate veil is a judicial process where by court will disregard usual immunity of corporate officers or entities from liability for wrongful acts or activities... The doctrine which holds that the corporate structure with its attendant limited liability of stockholders may be, disregarded and personal liability of stockholders, officers and directors in the case of fraud or other wrongful acts done the name corporations⁶¹.

According to the definition stated in the Black's Law dictionary above, lifting corporate veil is a judicial action or a decision of the courts not only to disregard the corporate entity but also to override the principles of limited liability and impose personal liability in those who are behind the corporate veil. The general observation of cases that involve the disregarding of the corporate personality shows that lifting of the corporate veil is a judicial action or a decision of the court not only to disregard the corporate entity but also to over ride the principle of limited liability and impose personal liability on those who are behind the corporate veil. All issues concerning lifting the veil involve around liability of the company being imposed on the personal properties of he

⁶⁰ A text book of company law
P.P.S GOGAN
Revised 5th edition. p.16

⁶¹ Black's Law Dictionary

shareholders. But more often issues of lifting the veil are raised in relation to corporate groups in parent and subsidiary relations which might mislead the definition to seem to be only applicable in such cases.

Lifting of corporate veil under the judicial interpretation

1. **Protection of revenue:-** Sometimes, the lifting of corporate veil is necessary for the benefit of revenue; where the separate of the company which is corporate entity is used for evasion of tax. In such cases, the court may lift the corporate veil (i.e. ignore the separate entity of the company) and the income of the company and its members may be taxed as that of one person⁶².

Eg. "A" was a shareholder of a tea company. Under the income tax act then in force, the income of a tea company was exempted from tax up to 60% as agriculture income, and 40% was taxed as an income from manufacture and sale of tea. "A" received certain amount as dividend in respect of he shares held by him in the company. He claimed that this dividend income should be regarded as agricultural income up to 60% and should be exempted from tax. It was held that although the income in the lands of the company was partly agricultural, but the same when received by the shareholders could not be regarded as agricultural income.

2. **Prevention of fraud or improper conduct:-** It appears to the court that the company is formed for same fraudulent or improper purpose; which like to defraud creditors, to avoid legal obligations or to defeat the provision of law. In such cases, the court may lift the corporate veil i.e. ignore the separate entity of the company. Thus, where the company is a mere sham i.e. formed to deceive or

⁶² Text Book, Company Law

defraud, the court will lift the corporate veil and look into the ownership of the company⁶³.

Eg. Abebe borrowed a huge amount of money in his own name from commercial bank of Ethiopia. He formed four companies and invested the entire money borrowed from the bank in these companies. The members of these companies were Abebe and his son only. When the loan was not repaid to the bank filed a suit for the recovery of the loan amount, also sought it be recovered out of the assets of the companies. It was held that the amount can be recovered out of the assets of the companies as these were created only to deceive the creditor, that the lending commercial bank.

3. ***Prevention of fraud upon public***:- A company commits a fraud upon the public and the people suffer financial loss due to company's such fraudulent act. In such cases, the court can lift the corporate veil so as to expose any person to liability who have committed a fraud upon the public from their suffered position⁶⁴.

Lifting of corporate veil under the express statutory provisions (liability of directors and members)

- The company is Act, itself, also provides certain cases in which the directors or members of the company are held personally liable i.e. a part from the liability of the company, the person behind it are also held liable.

It may however, be noted that in these cases the separate entity of the company is not ignored which is independent existence of the company is maintained. The only point is that the directors or members are also held

⁶³ Text Book of Company Law
P.P.S. GOGNA
p. 17,18,21
Revised 5th Edition 2004

⁶⁴ Text Book of Company Law
P.P.S. GOGNA
p. 17,18,21

personally liable along with the company. Thus, the distinction between the lifting of corporate veil under judicial interpretation and under "expects statutory provision's is that, in the former the separate entity of the company is ignored. But in the latter the separate entity of the company is maintained with the exception that the persons behind it are also held personally liable. The following are the main provisions, where the members are personal liable⁶⁵.

1. Reduction of membership below statutory limit

The company must have the minimum number of members as provided in the company act. If at any time the number of members of a company is reduced below their statutory limit and the company carries on business for more than six months with the reduced members, then every member who is aware of this fact, shall be jointly and severally liable for all the debts of the company which were contracted during that period. It may noted that the personal liability of the members starts after six months of carrying on business which reduced members⁶⁶.

In Ethiopia context law of commercial code article 511, where the number of the members is reduced below two, in any case on the application of a member or a creditor order the dissolution of the company and make such provisional orders as all necessary unless the company makes arrangements to comply with the law within reasonable time.

When we come to the German law private limited company limitation imposed in order to form a private limited company. It is equivalent to the Ethiopian private limited company at least two founders. Once the

⁶⁵ Text Book of Company Law
P.P.S. GOGNA p. 17,18,21
Revised 5th Edition 2004

⁶⁶ A Textbook of Company Law
P.P.S GOGNA pp 23-24

company is formed, it is recognized that one member's share such acquisition does not destroy the legal personality of the company, which remains in existence even if there is one member⁶⁷.

Eg. Mesert Trading Private Limited Company was established by Melakgenet Yohannes and W/ro Fatie on Meskerm 21/1991 E.C. Melakgenet Yohannes applies to the court for the dissolution of the company by different reason which is stated in the application of the court. After observing the case the court gave the decision by saying that according to the commercial code of Ethiopia Art. 510(2) "a private limited company shall not have less than two or more than fifty members and is always commercial form."

Therefore the decision of the court to dissolve the Mesert Trading Private Limited Company according to the commercial code 510 is correct. But in understanding of the writer once the company is established and or formed and start its objectives business activity it should not be dissolve because many workers are employed in the company they are leading their life by getting salary from this company, and also it pays a huge amount of taxation in each budget year to the government, hence instead of dissolving the well organized private limited company business, it is better to follow the Germany law of dissolution of private limited company that is once the private limited company is established, if the members are below the minimum requirement the company will not dissolve by the law, it continues its activities by one member. This is a very good system of law because it is useful for the country as mentioned above.

⁶⁷ Powers and Liabilities of Managers of PLC
Under the Commercial code of Ethiopia
Debas Yesaw Dessie
Faculty of Law AAU May 1999
P. 14

2. Mis-description of Companies Name

The name of the company should be properly described (i.e. in legible character) in all business communication. Moreover, the name should also indicate company. If the name of the company is not properly used, and there is no indication that the acts are done on behalf of the company, then the person, who have actually done the act, will be personally liable⁶⁸.

Eg. "A" was a director of a company named AB agencies limited. He signed a cheque on behalf of the company mentioning company's name as "A" and "B" agencies. In this case, the name of the company is not properly described, and thus "A" will be personally liable to pay the amount of the cheque.

3. Fraudulent conduct of business

The members of the company are also personally liable for fraudulent conduct of company's. Sometimes, in the course of winding up, it may appear that the business of the company has been carried on with the intention defraud creditors of the company or any other person, or any fraudulent purpose⁶⁹.

Hence, the above 4 are examples of the lifting corporal veil under the express statutory provisions (lifting of directors and members.)

Let us observe the practical lifting the corporal veil decision given by the high court in Ethiopia.

No. 3471

December 18/1998 E.C

⁶⁸ A Textbook of Company Law
P.P.S GOGNA pp 23-24
Revised 5th edition 2004

⁶⁹ A Textbook of Company Law
P.P.S GOGNA pp 23-24

Plaintiff – W/ro Genet Mamo

Defendants 1. Ato mulugeta Kelkaye

2. Beza International P.L.C

The defendants borrowed birr 1,000,000 from Awash International bank on December 18/1990 E.C by securing the plaintiffs residence house which is found in Worda 17 Kebele 20 house No. 406.

Ato Mulugeta Kelkaye is the shareholder of the Beza International Private Limited Company and also he is a manager, while the contract of loan was concluded with bank he signed on behalf of the company. According to the contract agreement the defendants become unable to pay their debts to the bank. Because this is reason that the plaintiff paid birr 709,000 to the bank for the time being until the due date of the total free.

The plaintiff suit the defendants in federal high court by listing the property of the Ato Mulgeta Kelkay who is the manager of the private limited company to be sold by auction and return the bank loan.

According to the suit of the plaintiff the defendants brought the documents which shows the property of the Beza International Private Limited Company with worth 2,310,370 dollar was taken by the government of Eriteria from Asseb port. Because of this reason the second defendant became bankrupt. Then he can not pay his debts to the bank.

According to the view of the manager the company was established in accordance to the commercial code of Ethiopia. Then when the private limited company become bankrupt the shareholders are not liable except their contribution.

Therefore, the manager is not responsible to pay the loan of the second defendant, while the contract was concluded with the bank and signed

on behalf of the second defendant the money was not for the use of personal to the manager.

The court observed the documents of the case seriously and finally gave the decision saying that the manager has the responsibility to pay the loan to the bank and return the amount of money the plaintiff has already paid to the bank in the case the court lift the corporate veil of the company.

In the understanding of the writer the decision of the court was a reasonable because, there is no a tangible document of the general assembly of meeting, the membership which shows that the company needs a loan from the bank. It was the only interest of the manager to get loan from the bank on behalf of the company for his personal use. Then the courts ignore the separate entity of the company and lift the corporate veil and order the manager to pay from his personal property.

CHAPTER FOUR

CONCLUSION AND RECOMMENDATIONS

A private limited company is an artificial fictitious legal person with a separate and distinct existence apart from its members. As approved under article 212(1)(f) and article 210(2) of Commercial Code of Ethiopia the company has a separate and independent legal personality distinct from its members.

Private limited company, like other forms of business organization, was introduced in Ethiopia in 1960 when the empire of Ethiopia adopted for the first time a comprehensive commercial code. From the six business organizations provided in the Commercial Code, general partnership, share companies and private limited companies have flourished in Ethiopia.

From the six business organizations private limited company is the most popular in Ethiopia particularly in Addis Ababa. For example from 1997–1999 general partnership, share company, and private limited companies were registered and issued the license in each business sector 25,74 and 2901, respectively in Addis Ababa Trade and Industry Bureau⁷⁰. This figure shows the development and the most selected business in Addis Ababa. It constitutes 96.7% of all the business organizations registered there. And the corresponding capital of private limited companies constitutes of 96.28% of the whole capital of all business organizations⁷¹.

Private Limited Companies are formed usually by persons who have relationship of some kind between themselves or between persons who knows each other very closely. In practice, the establishment of Private Limited Company in Ethiopia mostly is formed by husband and wife or

⁷⁰ Addis Ababa Trade and Industry Bureau

⁷¹ Addis Ababa Trade and Industry Bureau

membership of families or close friends who bring their capital together to form private limited companies.

According to the Commercial Code of Ethiopia there is no any requirement of members that they should show capacity or the knowledge to fulfill, how to manage the proposed company by plan and make it successful in its purpose of the commercial activities of the company. Most of the founders of private limited companies in Ethiopia don't know clearly the duties, obligations and the rights of the proposed private limited companies according to the law of the country.

In most cases they focus on the reduction of the taxation by way of employing themselves in the company, and pay monthly from its initial capital and different kinds of miscellaneous expenses, like telephone, electricity, transport expenses are all covered or paid from the company income or from the initial contribution of members. During this time if the company is not managed properly by skilled or knowledgeable person by plan, the company may bankrupt. Under the Ethiopian bankruptcy law individuals and partnership is not the subject of bankruptcy law, unless they are traders within the meaning of article 5 of the commercial code while private limited and share companies is the subject of bankruptcy law as they are always commercial business organizations.

The bankruptcy proceeding may be instituted either by the debtor himself or by his creditor or by the public prosecutor or by court of law⁷². After collecting or receiving the petition for bankruptcy the court would investigate the affairs of the debtor to find out whether the conditions of insolvency which is inability to pay (suspension of payment) are there. When the court determines that the debtor i.e. the company to be declared is in fact unable to pay its bankruptcy debts, it will declare that the debtor is bankrupt. This shows that the company follows the process

⁷² Module 4 Law of Business Organization St. Mary's University College
P: 58 Published in September 2004.

of the legal bankruptcy, because it is proved by court that for different reasons the company dose not have the capacity to pay its debt to its creditor, whereas some times mostly in Ethiopia there are founders of the private limited company who has the aim to borrow money from the financial institution on behalf of the Private Limited Company it could be by the manager himself and the lead to the factual bankruptcy system, which is planed from the bingeing of the establishing of the company. The case between Awash International Bank versos Beza International Private Limited Company is attached with this paper for more elaboration of factual bankruptcy.

If the business organization becomes bankrupt the bankruptcy law protects the following objectives of bankruptcy of business organizations⁷³.

1. To keep and facilitate the debtors property in order to distribute to its creditors fairly according to their ratio of property.
2. If the creditors sue the debtors in different courts or benches the case should be consolidated together under one court to give decision of the bankruptcy within a short period of time.
3. To help the bankrupt business organization how to avid its debts and re-establish a new business activities.
4. If the debtor did any frudent out of good faith, it must be penalized and lift his right from his business organization or from any legal rights concerning his business organization⁷⁴.

⁷³ The Discussion Concerning the Law of Bankruptcy with Federal and High Court Judges
Prepared by Seyum Yohannes
On Meskerem 8, 1996 E.C
Nazret

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The result of the above four main objectives of bankruptcy are reflected under the commercial code of Ethiopia from article 1019- 1040.

When the company become bankrupt in the sense of factual bankruptcy, the manager(s) and shareholders are responsible to the creditors according to Article 530, 531 of the Commercial Code of Ethiopia. Even if, article 510(2) of the Code gives the right that whose members are liable only to the extent of their contribution. The managers are responsible, this article does not force to collect the contribution before the company is established; the law assumed that the members have already paid to the company. The amount of each member's commitment or contribution before establishing the proposed company.

Article 530 and 531 indicates that if the company becomes bankrupt by fraudulent act of the manager(s) and the shareholders, the separate company as legal entity will be ignored and looking into the realities will be started. That means the company and the members are treated like one person, and no more limited liability.

In principle, the separate legal entity of the company is respected. As a matter of facts, the whole law of corporation is based on this principle of corporate personality (i.e. separate legal entity) of the company. However, the statutory privilege of a separate personality of the company must be used for legitimate business purpose only. Sometimes, it becomes necessary to find out the real persons who control the company. When the corporate personality (legal entity) of the company is misused for fraudulent or improper conduct or for doing things against public policy, in such cases, the court ignore the separate entity and give the decision in the sense of the realities, the company and the share holders are treated as a person i.e. lifting corporate veil is to be employed as a mechanism.

Lifting corporate veil is divided into two parts. They are judicial interpretation and express statutory provision. Judicial interpretation is the method of lifting of corporate veil where the separate legal entity of the company is ignored by the court for different reasons like the following:

1. **Protection of revenue:-** Sometimes the lifting of corporate veil is necessary for the benefit of revenue. Example:- Where the separate entity of the company (i.e. corporate entity) is used for evasion of tax. In such cases, the court may lift the corporate veil (ignore the separate entity of the company), and the income of the company and its members may be taxed as that of one person⁷⁵.
2. **Avoidance of contractual obligation:-** sometimes, a company is formed simply to avoid the obligations arising out of contracts. In such cases, the court may lift the corporate veil i.e. ignore the separate entity and decide the case assuming that no company is in existence⁷⁶.

Lifting of corporate veil under express statutory provisions which liability of managers and members. It is a form of lifting corporate veil which maybe provided by the acts of the company itself where certain cases in which the manager(s) or members of the company are held personally liable. The only point is that the manager(s) or members are also held personally liable along with the company, like circumstance:

1. **Reduction of membership below the statutory limit:-** If at any time the number of members of a company is reduced below this

⁷⁵ The Text Book of Company Law
Author P.P.S GOGNA 5th edition
P. 17

⁷⁶ The Text Book of Company Law
Author P.P.S GOGNA 5th edition
P. 19

statutory limit and the company carries on business for more than six months with the reduced member is the existing member is liable for all debts of the company which were contracted during that period⁷⁷.

- 2. *Misdescription of company's name:-*** The name of the company should be properly described (i.e. ineligible character) in all communication. Moreover, the name should be also indicated that the acts are done on behalf of the company. If the name of the company is not properly used, and there is no indication that the acts are done on behalf of the company the person who have actually done the act will be personally liable⁷⁸.

By why of Recommendation the Following Could be Proposed

1. Before establishing or forming the company the founders should have to think that the responsibilities, duties and the rights of the proposed company as well as the shareholders according to the commercial code of Ethiopia. In addition to this, before the company is established legally, there should be a basic research of the proposed company by asking themselves the following questions.

1. Will it be productive?
2. Can we get available raw materials?
3. Can we get skilled manpower?
4. Is there transport facility?

⁷⁷ The Text Book of Company Law
Author P.P.S GOGNA 5th edition
P.

⁷⁸ The Text Book of Company Law
Author P.P.S GOGNA 5th edition
P. 23

5. Do we know the law and regulation of taxation for private limited company in Ethiopia?
6. Do we have sufficient money to manage the proposed Private Limited Company? Etc. should be studied before the company is established legally.

When we look the practical establishment of private limited company in Ethiopia most of the founders do not know the duties, obligations and the rights of the proposed company. In most cases the founders focus on the reduction of the government taxation by means of salary, rent of the business house, telephone expenses, transport expenses and other miscellaneous expenses will be reduced at the end of the each fiscal year when the company prepares the statement of accounts and submit to the land revenue authority.

2. Under the Commercial Code Article 510/1 Ethiopia gives the right that the members of the private limited company are liable only to the extent of their contribution. It should be improved by saying that, the members are responsible for any fraudulent cases concerning the bankruptcy of private limited company.
3. Before establishing or forming the private limited company legally the founders has to know the duties, obligation and the right of the proposed company. The mechanism is the government has to formulate the Proclamation and Regulations of the capacity of the members of Private Limited Company.
4. The founders should have to know the law of taxations and regulations of the private limited companies before they start to establish the company.
5. When the Private Limited Company becomes legally bankrupt the government should take the responsibility and support in financial

activities by giving loans until it becomes strong and manage itself properly.

6. Once the private limited company is established legally, what ever the minimum number of members is below the requirement, the company should not be dissolved. It is better to continue its commercial purpose or activities like the German law of private limited company that is according to the law of private limited company of the German. The law of the Private Limited Compnay in German Law is once the private limited company is established what ever the number of shareholders it should continue its business activities, this is a good principle of private limited company. This means the company becomes a one man company.
7. A specialized bench court should be established for the commercial activities purpose.
8. The deposit of like a quarter of capital at bank like Share Company to protect the tired parties from farudent bankruptcy.
9. One-man company or family company. The term one-man company may be defined as a company in which one person holds the substantial number of shares, and has the controlling power over the company. It may be noted that this does not mean that there is only one member in the company, because there must be at least two members for a Private Limited Company. In a one-man company practically whole of the shares of the company are held by a single member. The other members are included only to comply with the statutory requirement of minimum number of members. Generally, the other members are his friends or near relatives who hold one or two shares. Such a company is also called a "family company." It will be interesting to know that one-man company is perfectly valid. The reason for the same is that there is nothing in the companies act which suggests that the members should be independent or unconnected, or that they

should hold substantial number of shares. One share is sufficient to make a person the member in the company. Thus, a single person can hold practically all the shares and give each to his relatives or family members. And in this way he can enjoy the control over the company, and also enjoy the profits of the company with the benefit of limited personal liability.⁷⁹

The above principle of one-man company or family company is actively applied in India. This principle shows that it ignores the separate entity of the company from its members.

It protects the fraudulent of the members on the company because if there is a bankruptcy the person who holds 90-99% is liable to pay any debt; from his personal property. I recommend this principle to apply especially who are establishing the family private limited company in Ethiopia.

⁷⁹ The Text Book of Company Law
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I here by declare that this paper is my original work and I take full responsibility for any failure to observe the conventional rules of citation.

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Signed _____