Law of Traders and Business Organizations

Chapter Three

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Business Organizations

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Introduction

Business organizations, from a legal viewpoint, are **undertakings with more than one member**, having assets distinct from the private assets of the members and a **formal system of management**, which may or may not include members of the organization.

Business may ,however, not always conducted by BO. Individuals alone can engage in bss for various reasons.

Sole Proprietorship

- ✓ A person may engage in the business as an individual (sole proprietor).
- ✓ Currently, it is the most common way of conducting business in Ethiopia. m/n 50%.
- ✓ It has huge room of **flexibility** in decision making. As a result decision making is quick.
- ✓ It is **easier to start and dissolve**
- ✓ **No startup capital requirement**. But there may be no chance of capital intensive investment.
- ✓ It is suitable for **small scale** businesses.
- ✓ It is **risky** in that you may shoulder the risk all alone, as you do for the profit.

Business Organizations

Art. 172/1 defines BO as

"an **association** established through a **memorandum of association** by **persons** **who intend to cooperate and to bring together contributions** **for the purpose of undertaking an economic activity** **and of participating in the profit arising out thereo**f."

Compared to the definition given to BO by the old code, arts. 210/1+211/1 which one is comprehensive?

- ✓ Memorandum of Association (MoA) is defined as an instrument **drawn up to establish a business organization** (173).
- ✓ In case of JV, a **secret agreement** made b/n the partners is enough to establish a BO (172/2).
- ✓ **In case of One Man PLC, it is possible to establish a BO with a single member (172/3)**

Business Organizations

Elements in the definition

- ✓ **Association**: grouping/coming together as opposed to doing a business individually
- ✓ **Persons**: natural or legal persons
- ✓ **Intention to cooperate**: Consent…doing business is consensual
- ✓ **Contributions**: members who forms a BO must contribute what is necessary for the establishment and operation of the business in the form of:

Money Cash, in kind, Skill and money debt.

- ✓ **Engaging in economic activity** (Objective)…vs **Art 5?**
- ✓ **To gain and share** the profits thereof

What about the loss, if any?

Why BO?

- Despite the advantages of doing business as a sole proprietor, person may choose to invest in the forms of BO for the following reasons:

1. **Lack of resource**: u hv the skill but not the resource
2. **Lack of skill**: U hv the resource but not the skill
3. **Goodwill**: since it is important in a success of certain business, want of goodwill will make an investor join another…
4. **Limited Liability**: BOs have a legal personality which keeps the asset of the business and that of owners separate. Thus at the time of liability, they will only be liable to the extent of the BO's asset.

Common Attributes of BOs

1. They all are established through a Mo A (Written), except JV (172+177)
2. All BO have **legal Personality** except JV (175)
3. All BO must be **registered** and be licensed except JV (175)
4. All BO must have a **trade name** and this name should not affect interest of another BO and should not be contrary to law and public morality (176)
5. All BO are **public** in nature, except JV
6. All **can be commercial** (except OPP in the old code)
7. All of them has a distinct asset from that of their owners…

Common Attributes of BO Contd.

The fact that asset of the BO is separate from that of its owners is important to:

- ✓ Identify the assets to which a creditor of the organization can resort….
- ✓ Make clear the assets the manager could use to carry on the business for the owners benefit.

Commercial Vs. Non-Commercial BOs

Depending on **forms** and **objectives** of BO, BO can be classified as commercial and Non-commercial Bos.

- In relation to form, a BO is commercial if it takes the forms of SC and PLCs, irrespective of their purpose.
- In relation to objectives, a BO is commercial if it engages in acts listed under art 5.

Why the classification? What are its effects:

- ✓ Only commercial BO are required to keep books and accounts
- ✓ Both C and Non C BO are required to be registered except that of JV
- ✓ Non-Commercial BO cannot engage in acts under art. 5 but can engage on economic activities.

Partnership Vs. Company

- The d/c b/n the two may be explained in terms of the **legal & procedural requirements to their formation**, **management**, **decision making**, **nature of liability to 3rd party**, **mode of transfer of one's interest in the business**, **taxation** & etc.

1.Partnership (PP) is a **collection of individual** members while company is **an aggregate of share/capitals.**

- ✓ As a result, while **personality of the partner matters in pp**, capital is more important than personality of the co-owners in company.

Thus, a trader who decides to form a PP must choose the right co-partner.

- ✓ That is why pp firm is mostly established among family members…high level of mutual trust is required.

Partnership Vs. Company

2. In pp liability of partners is not limited while shareholders in company are entitled to a **limited liability** (**as matter of principle**).

- ✓ **This means**, pp are **jointly and severally liable to the liability of the firm** i.e. **Creditors** can directly resort to the asset of any of the partners to satisfy his claim.

Limited Liability: what is it? What is its basis?

Presence of LL means, partners (sh/holders)will only be liable to the extent of their contribution.

Basis of LL is the (**1**) **legal personality**. The fact that personality of the firm and its owners are separate.

- ✓ What is more, **LL is justified** based on the fact that (**2**) those who don't participate in the management shouldn't be punished for a wrong made by others…shareholders in share company and **Limited partner in LPP.**

Partnership Vs. Company

3. **Duration** of pp in the absence of a contract to the contrary is **contingent**.

- ✓ This is because, it comes to end when the partner dies or becomes insolvent.

Companies on the other hand has **perpetual succession** and thus, death & insolvency of a shareholder doesn't affect its existence.

4. **Shares** are **freely transferable in Companies**, while they are **not in partnerships**.

- ✓ In pp, since personality of the partner matters, every decision needs a consent of partners.

Partnership Vs. Company

5. **Partners in pp are considered agents of each other**. One is jointly and severally liable for the acts of each others.

6. Companies are **managed** by **Board of Directors and General Managers**…while partners themselves are the managers in pp.

7. Companies are subject to **double tax**…

- ✓ corporate income tax and
- ✓ dividend tax

8. **Minimum Start up Capital**: required for companies but not for partnerships firms.

BO vs. Associations & Cooperative Societies

Association (404 Civil C): is a grouping formed between 2/more persons **with a view to obtain results other than securing profit**.

- Associations are always formed for non-profit motives. ..charity, NGOs
- Associations may not carry on trade and if does, it will be dissolved.
- Governed by the Civil Code (408-482) while BO are governed by Book II of the Com Code.
- Associations can't engage in trade, while BO do.

Cooperative Society: are groupings that are formed to provide an economic service to members, but not with a view to make profit.

✓ Governed by civil societies proclamation No.1113/19

Chapter Four

PARTNERSHIPS

Articles: 183-244

Historical Genesis of PP

- Human being started to engage in business to satisfy his need. In order to satisfy this need,exchange was inevitable.
- No man was/is able to fulfill all his need using his own means alone. Hence, this way business was started by individuals.
- **However**, after starting exchange (individual business) some times they were unable to do business alone may be due to physical or economical limitation.
- Consequently, they begun to cooperate with their family members, which latter paves a way for partnership to develop.
- **Partnership predated companies** in their formation which was only established in the 16th C.

Types of Partnerships

The new commercial code removes one type of pp (OPP) and come up with a new form of partnership (LLPP).

Thus, under the New Com C there are four (4) types of pp recognized (**Art 174**). These are;

1. General PP (Arts. 183-211)
2. Limited PP(Arts 212-220)
3. Limited Liability PP (Arts 221-233) and
4. Joint Venture (Arts. 234-244)

GENERAL PARTNERSHIP

Articles 183-210

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GENERAL PARTNERSHIP

GP is a **BO established through a MoA** and in which each partner is **jointly and severally liable with the partnership for the obligations of the partnership (183+172/1)**.

- ✓ Any **agreement to the contrary** may not be raised against third parties (183).

Thus, even if the partners choose to make one of the partner free from J&S liability, it would not bind 3rd party.

- ✓ This makes GPP a pp with the highest level of liability.

Name of General PP-184

- Name of GPP consist of **all or at least 2 partners** and is followed by the words "General Partnership" (184/1).
- A non partner who fails to object when his name is used in the PP name, **shall be liable for the obligations of the partnership as a full partner** (184/3).

Formation of GPP

✓ **GPP is formed through MoA (173+185).**

The MoA forming a GPP will have the following contents (**185**):

1. **Firm Name**: sue/sued under firm name
2. **Head office and branches**, if any- **jurisdiction**
3. **Name, Address & Nationality of partners**
4. **Business Purpose:** you can't do what is not on the list
5. **Amount of contribution**… if in-kind, then its value and method of valuation
6. **Service required from a skill contributor**
7. **Profit clause:** how to share profit & losses?
8. **Manager & Agent of the firm…** need to be optional
9. **Duration:** It Is uncommon & can be a ground of dissolution

Contribution: Nature and Extent

Partners can make a contribution in the form of **money**, movable or immovable **property**, **skill**, **trademark, good will, patent, lease right, usufruct** or other contributions (186/1)

- ✓ When property is contributed, it can be its use or its o/ship (186/2).
- ✓ Contributions **shall be equal** and of the nature and extent required for carrying out the business purpose of the partnership (186/3). **Can be agreed otherwise?**
- ✓ When in-kind contribution has been **overvalued**, the contributor shall pay the difference in cash…if he can't, then, the value of his share in the PP shall be adjusted (186/5).
- ❖ A partner who has contributed the **ownership** and **use** of property shall bear the obligations of a seller and a lessor, **respectively**, under Civil Code (187/1/2).
- ❖ A partner who contributed **debt** shall have the same obligations as a debtor under the contract of **loan** provisions of the Civil Code (187/3).

Contribution: Contd.

- ✓ When a partner contributes o/ship of a ppty, **risks against the ppty shall pass to the pp firm** (188/1).
- ✓ **But**, where only the **use** of property is contributed, the risks shall remain with the contributing partner unless the risk is caused by the fault of the partnership (188/2).

What if a partner fail to make a contribution in due time?

- ✓ In such cases, the partner shall be liable to pay interest to the partnership from the date he should have made the contribution (189)

Rights and Duties of Partners in GPP (190-197)

Rights of partners-Art. 190

Each partner shall have the right to:

1) **participate and vote** in meetings of the partnership;

2) **share the profits** of the partnership (equally… **irrespective of the nature and amount of contribution when there is no contrary agreement (192/1 also read 192/2).**

3) inquire about the state of the partnership`s business, consult the books and papers of the partnership, and take note therefrom;

4) where the partnership continues for more than one year, **require a report on the management** to be prepared at the end of each year;

5) **obtain his share in the assets of the partnership where it has been dissolved.**

Rights and Duties of Partners in GPP (190-197)

Obligations of the partners-191

- ✓ Pay contribution in due time
- ✓ Work diligently & with due care
- ✓ Non-compete duty: refrain from handling a business w/c would affect the pp
- ✓ Jointly and severally liable for the debt of the pp
- ✓ Discharge obligations arising out of MoA

Can creditors directly take action against partners for the debt of the pp firm?

- ❖ **In such cases, creditors has to, first, demand payment from the pp firm (191/2).**
- ❖ **However, when the action is for a repayment of factious dividend, it is possible that creditors directly claim from the partners (191/2 2nd sentence).**

Partner in GPP

- A new partner can only be admitted to the pp with the consent of all the partners. Contrary agreement it possible if made in the MoA (193)
- Partner is entitled to transfer his share to another, unless the contrary is agreed in the MoA (194)
- If a partner leaves a pp w/t transferring his share, he has the right to be paid an amount fixed by agreement of the partners (195)
- A leaving partner is responsible for the liability incurred before his departure. Or it may transfer to his substitute with consent of the creditors (196).
- A partner may transfer beneficial interests and rights in his share to a third party without the consent of the other partners but it may not bind the pp firma and may not entail membership right (197).

Management of General PP 198-204

The partnership shall be managed by **one or more managers** who may or may not be partners (198/1).

- ✓ The manager shall **have the power to carry out**, **in the name of the partnership**, **any lawful act with the view to achieving its purpose** (199/1)

A person appointed as a manager cannot for himself or for 3rd party, w/t approval of other partners, **engage in similar or related business carried by his partnership** (**202-Non Compete D**).

- ✓ A manager **may not have dealings with the partnership** on his own behalf or for the benefit of 3rd parties unless there is a consent from partners (201).

A manager can be **dismissed** as per the MoA rules, by **majority vote** of partners (203/1/2) or by the **court for good cause** at request of a partner (203/3)

Management of General PP 198-204 Contd.

Where **a manager acted in the name of the partnership for his own benefit** the PP shall be liable to 3rd party in good faith. In other cases, the manager alone shall be liable (200/1).

- Where a manager deals with 3rd party w/t using the pp name, he shall be **deemed to have acted on is own behalf** (200/2).
- A manager who acts outside the scope of his powers shall alone be liable.

Decision Making (204): **Unanimous vote** to amend MoA, appoint attorney or carry out **acts beyond normal** pp practice (204/1)

- Partners may however, agree to take decisions by **majority vote** of all partners…if no agreement then, Unanimous V (204/2)…**majority of shares or number of pp?**
- In the absence of a contrary agreement, each partner shall have **equal vote** (204/3)

Dissolution and Winding-up of General Partnership (181+ 205-211)

- **Dissolution** refers to a decision to bring an end to the operation of a business organization.
- **Winding up** refers to liquidation of a business organization which will bring the disappearance of the business organization.

GPP may be dissolved under 181, where:

1. It **achieved** or cannot achieve **its purpose**
2. **Expiration** of a fixed time
3. **Agreement** of the partners
4. **Decision** of the court up on request of members for good cause
5. A court declares the pp bankrupt

Dissolution and Winding up Contd.

GPP may be dissolved under 205 :

- ✓ Up on **demand** of partners (6 month notice) (Read 205/2/a…others may agree to continue, **though**)
- ✓ **Incapacity** of one of the partner (infirmity, illness and etc)
- ✓ **Disagreement** w/c preclude partners from working together
- ✓ **Death**, bankruptcy or loses of legal capacity to be a partner of the partner (**unless** agreed to continue by paying the **heir of the deceased**, **tutor** of the incapable or **trustee** of the bankrupt partner-205/2

What if number of partners is reduced to one?

Dissolution and Winding up Contd.

Appointment of Liquidator

- The winding-up of the partnership shall be **carried out by one or more liquidators** appointed in the **MoA** or by the **agreement** of all the partners or by **court** (207/1/2).
- Until liquidator is appointed to dissolve the pp, the **manager shall retain his power** but has to **refrain from commencing new business** after decision of dissolution (206/1).
- The managers shall **hand over** to the liquidator the **property of and all necessary documents relating to the partnership** and render an account of their management up to hand over date.
- The appointment of liquidators may **be revoked** by the agreement of all the partners, or by the court at the request of one partner (209).

Powers and Duties of Liquidators

The liquidators shall take all steps necessary to complete the winding-up of the partnership.

Among others, liquidators may be required to (208/1):

i. Complete business already started
ii. Draw up inventories of the assets and liabilities
iii. Collect assets of the pp, sell its property, pay creditors of the pp
iv. Represent the pp in proceedings (arbitral, judicial or administrative)
v. Distribute assets to the partners

As far as their liability is concerned, liquidators will have the same liability to that of managers (208/2)

Effects of Dissolution

Dissolution will have the following consequences:

- ✓ The **cancellation** of the business organizations from the **commercial register** (182/1). The cancellation has to be published.
- ✓ Then, the BO shall **cease to have legal personality** starting from the day following the date of the cancellation-182/1.
- ✓ **Entitlement to restitution** of the contribution made to the partnership (210/1).
- ✓ Partners who contribute **o/ship of property** and **skills** shall receive the monetary value of their contribution at the time of contribution (210/2&4)
- ✓ Where there is a **surplus** after all claims have been settled and contributions returned, **the surplus shall be distributed among the partners** (211/1) **equally**, where no other proportion has been specified in the MoA (211/3)

Limited Partnership

Articles 211-220

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Limited Partnership

Limited PP is a pp that formed through a MoA and comprises two types of partners: **general p and limited p**, the former with joint & several liability while the later is only liable to the extent of his contribution (212+172).

General Partners: are like partners in GPP

- ✓ Are jointly and severally liable to the firm.
- ✓ Can act as a manager.

Limited Partner: is like a shareholder in SC.

- ✓ Make contributions but **denied the right to participate in mgt (216/2)** and thus entitled to Limited Liability unless he **allows his name to be used in the PP name** (213/3).
- ✓ **In the absence of contrary agreement**, **death, incapacity and bankruptcy** of a limited partner may not lead to dissolution of the pp (218/7).

LPP: Name, Formation and Contributions

- ✓ **LPP** shall have a firm name consisting names of **general partners** followed by the words "Limited Partnership" (213/1/2)
- ✓ The contents of MoA establishing LPP shall contain in addition to the requirements of Art. 185, names of both general & limited partners (214).

Contribution: Except that **a limited partner may not make skill contribution**, the rules under 186 shall be applicable (215).

Rights and Obligations of Partners in LPP

General partners:

- ✓ The provisions on **right of partners in GPP** shall apply to rights of General Partner in LPP (**216/1+190**)

Only general partners may be appointed as a manager, unless MoA allows appointment of 3rd party (216/2).

- ❖ General partner has a **non compete duty** (**read 217**)- the general partner **may not:**
- ✓ Carry out transactions, on behalf of a third party or on his own behalf, **which relate to business carried on by his firm**,
- ✓ Be a **partner with joint and several liability in another firm carrying on similar business**.

Rights and Obligations of Partners in LPP

Limited Partner:

- ✓ Have an obligation to pay when sued by creditors to pay unpaid contributions(217/1)
- ✓ May not be required to repay a dividend received in good faith(217/2)
- ✓ **May not act as a manager even under a power of attorney**… if become a manager, then, he shall be jointly and severally liable together with the general partners (217/3).
- ✓ A limited partner may be employed for non-managerial acts

Limited PP Contd.

- ✓ Transfer of share is possible with **consent of all general partners** and **majority of limited partners**(219/1).

Partners may follow different voting arrangement in the MoA.

- ✓ Provisions on GPP (Art. 187-211) dealing with **contributions**, **Rights and Duties** of Partners, **Management** and **Dissolution** and W**inding-up** shall be applicable, without prejudice to (articles 211-220)

Limited Liability Partnership

Articles 221-233

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Limited Liability PP

LLPP is defined as "**a BO formed by two or more persons to render professional services and services complementary thereto** and **whose liability is limited to the extent of their contributions**."-221/1

What is professional service?

What kind service are considered to be complementary?

- ✓ **Professional service**: a service provided in line with a professional license granted by an appropriate organ
- ✓ **Complementary service**: service that falls under one or more professions and is related and necessary to provide the professional service . 221/2

LLPP: Name, Nature & Formation

- LLPP shall have a name agreed by partners but indicating purpose of the pp (223).

LLPP shall **have legal personality** distinct from its partners.

- The **death**, **bankruptcy**, departure from the partnership or any other change in the status of the partners **may not affect the existence, right or obligation of the partnership**.

✓ Only **licensed professionals** or **LLPP engaged in similar professional service** become a partner in LLPP (224/1)

The **general manager** of the pp shall be a natural person licensed to practice in the profession in which the partnership renders a service -224/2

- **Contents of MoA** are similar to that of GPP (185) except that type of profession of each partners and license number has to be included.
- In relation to **contribution** 186 shall ***mutatis mutandis*** be applicable (226) to LLPP.

LLPP: Conflict of Interest and Liability

- **With consent of other partners**, a partner in LLPP **may** on his own behalf or on behalf of a third party, **engage in a similar undertaking** or **be a partner** in another firm pursuing similar business purpose (227).

Liability in LLPP (228)

- ✓ LLPP shall be liable **J&S and without limit with a partner who commits a fault** intentionally or negligently (228/1)… **Unless** the victim knows the partner or employee who caused damage did not have the power to carry out the undertaking (228/2)
- ✓ LLPP **shall have insurance coverage to make good damage emanating from professional fault** committed by the partners or employees. ..**unique to LLPP…Why**?

Losing membership to LLPP-229

A partner may lose his membership or leave LLPP:

- ✓ Willingly a/r giving 3 months **written** advance notice
- ✓ Dies or dissolved if a an entity
- ✓ His entire share is taken by personal creditors or is disposed or declared bankrupt
- ✓ Cancellation/suspension for longer period/ of his professional license
- ✓ Become incapable of carrying out his duties due to permanent illness or infirmity
- ✓ Court decision to expel the partner for good cause

The **departing** partner may be liable to 3rd party for a dealing before he leave (229/3).

Departure of a partner has to be registered (229/4) in the commercial register

LLPP Contd.

- ✓ When a partner leaves the pp w/t transferring his share, a person who is entitled to claim such share shall receive **the value of the share in cash.**

He is **not entitled to become a partner in lieu of the partner who died or left the partnership** (230/1).

Decision Making (231):

- ✓ 2/3rd majority to amend MoA
- ✓ Other decisions majority vote
- ✓ 3/4th majority to change nationality of the pp or its business purpose

Dissolution of LLPP

- A LLPP shall be **dissolved** and **wound-up** where the **number of its partners is reduced to one** and it is not possible to substitute another partner within **six/nine/** month (232/1).
- Provisions on GPP (Art. 187-211) dealing with **contributions**, **Rights and Duties** of Partners, **Management** and **Dissolution** and W**inding-up** shall be applicable, without prejudice to (articles 221-232)

Joint Venture

Articles 234-244

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Joint Venture: Meaning & Nature

- ✓ JV is a BO **without legal personality** established by two or more persons through a **secret agreement** be made b/n the partners & **not known to 3rd parties** (**172/2+234)**.

Registration formalities required of other business organizations are not applicable to a joint venture.

- ✓ JV is a **secret** BO…. **Why?**
- ✓ Where a JV is made known to 3rd parties, it shall, as of such date, be regarded, insofar as such parties are concerned, as a GPP (235).
- ❖ **Contribution**: 186 shall be applicable. **But in JV every partner owns his contribution (236/2).**
- ❖ JV is **managed** by 1/more manager who need not be a partner.

JV: Relations with 3rd parties

- ✓ Only the manager of a joint venture is known to third parties (241/1).
- ✓ Every partner of a joint venture shall deal with third parties **in his own name** (241/4)
- ✓ Without prejudice to the preceding provisions of this Title, the provisions relating to general partnership shall apply ***mutatis mutandis*** to a joint venture (244).

Share Companies