Law of Traders and Business Organizations

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2021

Chapter Five

Share Companies

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Introduction

The disadvantages of one form of BO are the driving forces behind that led to the innovation of other forms of BO.

- ✓ With the expansion of commerce, discovery and the need for large scale business operation, **it was understood that SP&PP are unsuitable for pooling up capital to conduct a larger business.**
- ✓ Thus, companies **AKA** corporation begun to emerge in the 16th C in the Dutch and England.

Why companies? What are the advantages that companies offer better than PP?

Why Company?

Companies are the preferred modes of doing business among investors at least for the following **main** reasons. These are:

1. Pooling Capital: Companies are in a better position to mobilize resources.

- ✓ B/c it is possible to (esp. in SC/Public Company) divide a share in to small shareholding threshold that enable small income group to buy shares.

2. **Limited Liability**: LL is the **major merit** of companies that influence investors.

- ✓ Only the assets of the company meet its liabilities →*in the worst case situations shareholders forgo only the amount they subscribed (invested into the company)*.

Thus, owing to a small risk (b/c of LL) and high return, small investors tend to prefer companies to sp & pp.

- ✓ LL provides '**owner shielding**' (restricts creditors claims only to the assets of the firm).

Why Company?

3. Legal Personality

It is the capacity to:

- ✓ *enter into contracts and*
- ✓ *owning its own property (a 'separate patrimony');*
- ✓ *capable of* ***delegating*** *authority to agents; and*
- ✓ *capable of* ***suing*** *and being* ***sued*** ***in its own name***

Legal Personality results in:

1. Priority rule: a firms asset serves as a security for firms' creditors (prior to personal creditors of firms' owners)

2. Entity shielding: protects the assets of the firm from the creditors of the firm's owners.

4. Better Growth Rate: Companies have huge capital that can make them capable to **quickly expand their investment**.

- ✓ Companies will be able to provide more w/t increasing unit production cost…

Why Company?

5. **Professional & Delegated Management**: In Companies o/ship is separated from management and thus Cs are managed by professionals who are **skilled** to bring the expected outcome, profit.

6. **Continuity and Stability**: perpetual succession

7. **Positive Social Benefits**:

- ✓ Companies create **more employment** due to magnitude of their investment
- ✓ The public at large will be able to get goods & services at a competitive price…b/c of mass production by the companies

8. **Risk is shared among members**…

Different Forms of Companies

A. Chartered Vs. Incorporated

- ✓ **Chartered C:** were companies formed by government charter (concession) not through the formal process of registration.

Only those who are government or close to gov't have the chance to establish chartered company.

- ✓ **Incorporated C**: are the present day form of companies which are formed through the stringent process of registration and are open to public.

B. Public/Open Vs. Private/Closed

- ✓ **Open or public-** companies with freely tradable shares …as SC in Ethiopia
- ✓ **Closed or private-** companies with restriction on the tradability of shares…as PLC in Ethiopia

Form of Companies in Ethiopia

- What are the forms of companies recognized in Ethiopia?
- Is there a difference between the Old and the New Commercial Code of Ethiopia in relation to the forms of companies?
- What are the major differences between the forms of companies recognized under the New Commercial code?

COMPANY

- **SHARE COMPANY (Sh. Co.)**
- **Private Limited Company(PLC)**
- **One Person Private Limited Company (OPPLC)**

Share Company

1. **Membership (248/3+252/2):**

- Min: 5 – Max: unlimited members.

2. **Directors:**

- Managed by directors whose minimum number shall be three.

3. **Public Subscription:**

- Can invite public to subscribe to its shares and debentures.

4. **Prospectus (259):**

- Is required to file a prospectus in order to go to the public to raise its capital

5. **Minimum subscription:-**

- all capital must be subscribed and 25% of the capital must be paid-up before registration (254/1).

PLC

1. Min: 2 –Max: 50 members.
2. Managed by one or more managers.
3. Can not go to public to raise its capital.
4. No prospectus requirement.
5. It can be registered by fully paid-up capital.

Share Company

Articles 245-494

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Natures of Share Companies

- **Limited Liability** (**245/1/2**)
- **Perpetual Succession**
- Ability to **Issue Securities** (Shares and debentures)-peculiar to SC only (267&ff).
- **Free transferability of shares** (276)…can however be restricted by the MoA.

Formation of Share Company (254-266+245-253)

Share companies can be formed in two ways:

i. By **public subscription of shares** or

ii. Only by founders contributions

Accordingly, depending on the above two choices of the investors who wants to form a SC, requirements and procedures in the formation of SC may **differ**.

Who are founders? Are they different from promoters? Any difference b/n the two code in relation to these group of persons?

- ✓ The Old Com C refers person who are responsible for the formation of companies, in general as **founders**.
- ✓ The New Com C addresses person who form company through public subscription of shares as a **promoters** and those who form company only between themselves through their own contribution as a **founders**.

Promoters

- ✓ Promoters are person who initiate the formation of a company by **issuance of shares to the public** (248).
- ✓ They in**vite a person to join the company through a preparation of a prospectus**

Are professionals who support formation of the company professionally by a contract with the founders a promoter? –ve 248

Promoters are responsible to:

- ✓ Prepare relevant documents
- ✓ Set object and purpose of the company
- ✓ Advertise and circulate a prospectus

Incompetency to be a promoter (249): a person convicted of **breach of trust, theft/robbery** or other similar criminal offenses **in r/n to** his function as promoters, director, manager, auditor or any other managerial position in BO is incompetent to be a promoter of a SC.

- ✓ A promoter can be **one or more natural or artificial person** (248/2.

Promoters contd.

- A promoter **need neither be a member** of the company **nor required to purchase a share** in the company (248/2).

Liability of Promoters (250) and Founders (252/3)

Ps are jointly and severally liable to sh/holders, persons with whom the deal and 3rd party for:

- ✓ **Commitments entered in to the formation of the Company (**f**)**
- ✓ **Failure to deposit the paid up capital in the name and to the account of the company & any other related matter (founders)**
- ✓ **Error in valuation of in kind contribution (**founders**)**
- ✓ Inaccuracy of statements made to the public during formation of the company
- ✓ **Illegality of the procedure of formation (f)**
- ✓ Where the company is not formed, for payment of paid-up contributions with interests to subscribers

Promoters contd.

- A claim for damages against promoters **shall be barred within 5 years** from the date **the victim knew of the damage & of the person liable (250/2).**
- Such claim shall absolutely be **barred after ten years** from the date when the act complained of took place (250/2).

Rights of Promoters (253)and Founders (as the case may be)

✓ Are entitled to 20% of the net profit **for three years**.

The issue here is are these three years consecutive or the promoters can just select best years?

The code says for a period not exceeding three years **beginning from the date on which the company starts making profits (253/1). T**he code also states that **amount and years** of payment may be determined by the MoA.

✓ Being entitled to 20% net profit does not affect their right to be entitled to a benefit as a shareholder in the company (253/3).

✓ This 20% of net profit benefit share shall be paid in cash and cannot be paid by issuing shares (253/4).

Promoters contd.

1. Are promoters agents of a company under formation?
2. Who is a principal at this stage? (the firm under formation has not yet acquired a legal personality)
3. Does the minimum requirement of five members for SCs mean 5 promoters?

Yet, founders act in the name of a company under formation→ **a company will take over founders' commitments necessary for its formation or** were **approved by the general meeting of the subscribers** after its formation **(**Art. 251/1**)**

Subscription and Payment of Capital

A share company **may not be formed until** (254/1):

- ✓ the capital has been **fully subscribed** &
- ✓ at 1/4th of the **par value of shares sold in cash has been paid up** and deposited in a block bank account opened in the name of the company under formation.

Once the paid up capital is deposited if the company has **not been registered within one year**, **subscribers** who do not seek to continue as members of the company **may request the return with bank interest of their paid-up sums** (254/3).

- ✓ In such cases, formation of the company may continue as between the remaining subscribers.

Formative Documents

- ✓ In the old commercial code, **there were two** formative documents required for the formation of SC, MoA and AoA.

However, the new code with a view to ease formation, require promoter or founders only to come up with MoA.

- ✓ The new code seems to **abolish** AoA since founders just submit two but similar documents under a different name.
- ✓ **A question for practitioner is that what will be the status of the articles of associations of companies from now on?**

The Code doesn't answer this question. But going forward, companies have to **re-register a unified MOA incorporating provisions of the articles of association** up until the new code will remain valid indefinitely.

MoA: What is it?

- ✓ MoA is a a **constitutional** document of SC without which it cannot be formed.
- ✓ It **sets out the structure of the company, delimit its object and define the r/n of the company** to 3rd party.
- ✓ It serves as a supreme document of the company but also required to comply with commercial code.

MoA serves two major purposes:

1. Enables investors to know the field in which they are investing
2. Enables creditors, shareholders & others to know the scope of object of the company before dealing with it.

AoA on the hand governs internal affairs of the company.

What are the contents of MoA?

MoA: Contents-255

- The following are the **main contents of MoA** forming a SC:

1. **Name Clause** (251/1+246)
2. **Head office**, and the branches, if any
3. **Liability Clause:**
4. The **names, nationality, and address** of the shareholders, the number of shares which they have subscribed and paid-up;
5. **Object/purpose/sector clause**
6. **Capital clause**: Amount of **share** subscribed & paid
7. Par value, number and classes of shares
8. **Name of sh/holder who contribute** in kind& its valuation
9. **Manner of distributing profit**
10. Amount of benefit to promoter/founders
11. No of directors& managers of the company and their powers
12. No of BoD and auditors
13. **Duration…if** any ‘’fixed”

Doctrine of Constructive Notice Vs. Indoor Management

1. Doctrine of Constructive Notice

According to the doctrine of **CN** MOA & AOA must be **registered** and **become public document** – accessible & open for public inspection upon payment.

- ✓ Thus, **every one dealing with the company is presumed to have read & understood MOA & AOA.**
- ✓ This **deemed knowledge** of the two documents and their contents is known as **Constructive Notice of MoA & AoA.**

It is **negative** towards (operates against) **outsiders**, **positive** towards the **company**.

- ✓ Protects the company against 3rd party.

Doctrine of Constructive Notice Vs. Indoor Management

2. Doctrine of Indoor management

- ✓ Is an **exception** to the rule of constructive notice.
- ✓ It **protects outsiders against the company**.
- ✓ It presumes that outsiders are not under notice to know the internal management of a company.
- ✓ **Indoor/internal management** rules, other than registered in the office of registration, conducted by the company **do not bind outsiders** – they are **presumed not known by the outsiders**.

Contributions in SC

- ✓ With the **exception** of **skill**, Art. 186 of this Code regarding cash and other contributions in kind shall apply *mutatis mutandis* to a share company (256).

Contribution in kind **requires extra care** as it can jeopardize other stakeholders interests (eg. Creditors)

Hence in kind contributions should be proved to be:

- ❖ **Useful**: helps in the attainment of the business purpose of the share company (**of the nature** and **extent required for carrying out the business** purpose of the partnership-186/3).
- ❖ **Valid**: in many jurisdictions only **cash and in-kind** contributions are allowed. Contributions of know-how, work and services are prohibited. Why?
- ✓ A member who makes a contribution in kind shall **file an expert valuation** report (257/10 which **shall be verified by** the **founders** or **promoters** and formation auditor before the meeting of subscribers takes place (257/3) and also by **BoD** within **six months** after registration of the company (257/5)

Prospectus-259

- **Is prospectus an offer or acceptance? What about subscription? Read art. 259/1.**

When the promoter wants to raise the capital for the formation of the company, they need to prepare a **prospectus** as an offer to the subscriber, containing (259):

- ✓ the text of the MoA;
- ✓ a **summary of the expert valuation report**, if any;
- ✓ the date until when the subscribers may be required to discharge their obligations;
- ✓ the **price at which shares are to be issued**;
- ✓ the **amount to be paid up on the shares until** the general meeting of the subscribers;
- ✓ the **anticipated time within which the formation of the company is completed** and the company obtains legal personality;
- ✓ the time within which the formation of the company is completed may, under no circumstance, extend beyond five years

Auditing of the Formation Procedure-261

The promoter shall have the formation of the company verified by external auditors, among other in relation to:

- ✓ Whether requirements of the law regarding promoters are meet
- ✓ Full subscription of the capital of the company
- ✓ Payment of contribution in kind & their expert evaluation
- ✓ Deposit of cash received from subscribers
- ✓ Fulfillment of formation of SC as required by law

Finally, the audit report has to be submitted to and **approved** by the meeting of subscribers through the auditor.

Meeting of Subscribers:262-264

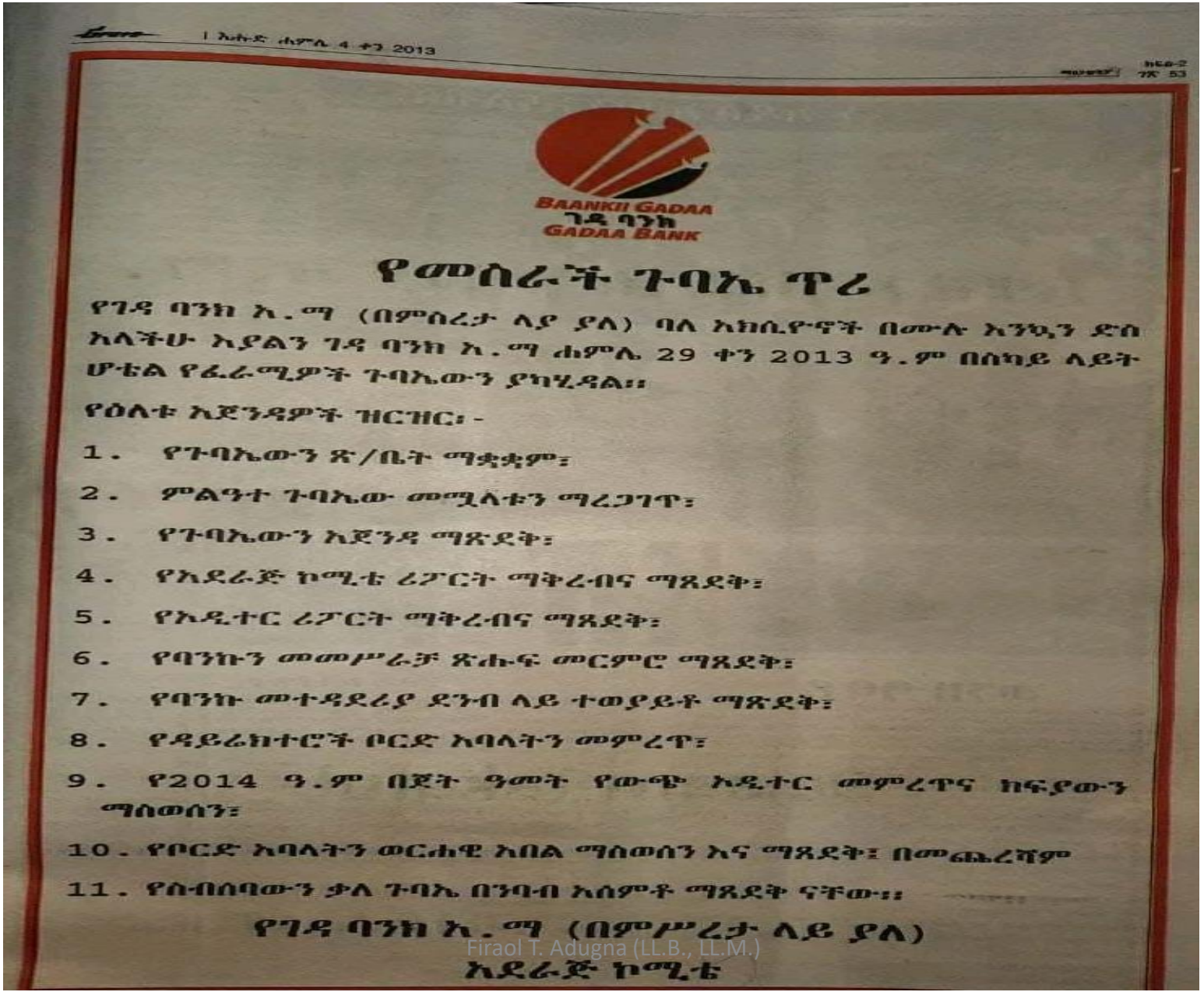
Upon completion of audit of the company formation, the promoters shall **forthwith** (?) call a meeting of subscribers.

Powers and duties of meeting of subscribers

1. Verify the requirements relating to formation
2. Deliberate& approve final text of MoA
3. Approve report of the promoters and formation auditors
4. Approve contributions in kind if any
5. Decide on the share in the profits allocated to promoters
6. **Make appointments** of organs of the company to be made by the meeting of subscriber under the law and MoA.

What does the practice looks like?

Subscribers Meeting Agenda



ሐሙስ 4 ቀን 2013

BAANKII GADAA
ገዳ ባንክ
GADAA BANK

የመሰረች ጉባኤ ጥሪ

የገዳ ባንክ አ.ማ (በምሰረታ ላይ ያለ) ባለ አክሲዮኖች በሙሉ እንኳን ድሰ አላችሁ አያልን ገዳ ባንክ አ.ማ ሐምሌ 29 ቀን 2013 ዓ.ም በሰካይ ላይት ሆቴል የፈራሚዎች ጉባኤውን ያካሂዳል።

የዕለቱ አጀንዳዎች ዝርዝር፡-

1. የጉባኤውን ጽ/ቤት ማቋቋም፣
2. ምልዓተ ጉባኤው መሟላቱን ማረጋገጥ፣
3. የጉባኤውን አጀንዳ ማጽደቅ፣
4. የአደራጅ ኮሚቴ ሪፖርት ማቅረብና ማጸደቅ፣
5. የአዲተር ሪፖርት ማቅረብና ማጸደቅ፣
6. የባንኩን መመሥረቻ ጽሑፍ መርምሮ ማጸደቅ፣
7. የባንኩ መተዳደሪያ ደንብ ላይ ተወያይቶ ማጽደቅ፣
8. የዳይሬክተሮች ቦርድ አባላትን መምረጥ፣
9. የ2014 ዓ.ም በጀት ዓመት የውጭ አዲተር መምረጥና ክፍያውን ማስወሰን፣
10. የቦርድ አባላትን ወርሐዊ አበል ማስወሰን እና ማጸደቅ፤ በመጨረሻም
11. የስብሰባውን ቃለ ጉባኤ በንባብ አሰምቶ ማጸደቅ ናቸው።

የገዳ ባንክ አ.ማ (በምሥረታ ላይ ያለ)
አደራጅ ኮሚቴ

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Rules of Resolutions at Subscribers Meeting-264

- ✓ **Resolutions at SM** shall be **drawn and signed by all promoters** and all documents submitted to the meeting shall be annexed to the resolutions (264/1).
- ✓ Any subscriber can take part in the discussions and exercise his voting right
- ✓ **Contributor** in kind and promoters **may not vote** concerning valuation and approving share in the profits allocated to them respectively
- ✓ The draft MoA can only be amended with **approval of all the subscribe**r, however, majority is enough if the amendment relates with approval of contributions in kind or approval of special share in the profits allocated to the promoters (264/4).

Registration of the Company in the Commercial Register

All BO are public and registered, so is SC.

- ✓ Thus, SC shall be registered in the commercial register **regardless of the manner in which it was formed.**
- ✓ The company shall obtain legal personality by registration (**265+175** of CC+ **7/1** of 980/2016).
- ✓ The registration shall be effected by promoters/founders or any other person having a power of attorney from the promoters or founders.

The registration application shall be **accompanied by: an authenticated MoA,** a **prospectus** where the company is formed by public subscription, **audit report on valuation of contributions in kind** and **formation** and **minutes of the subscribers` meeting** (265/3).

- ✓ **These** documents shall publicized on a news paper and be open to public (**Art. 7/2-3 of 980/16**) and can be accessed by 3rd parties.

Effects of Registration

- Once the company is registered **it will acquire a legal personality** that will enable it to enter in to various juridical acts.

What if a company is registered without fulfilling the legal requirements?

- In such cases, the company shall have legal personality notwithstanding that all the legal requirements relating to the formation of the company have not been complied with (266/1).
- If in such cases, interest of creditors or sh/holders are endangered, the court may decide for dissolution of the company and take provisional measures as may be required if there is an application to this effect within one year of registration (266//2).

Art. **7/2 of 980/2016** require that BOs shall be published on a newspaper having nationwide circulation at the time of their establishment.

- **What is it purpose? What if they fail publication? Will BO loose its legal personality? Can that be a ground for dissolution?**

Summary on Formation of SC

Ethiopian Company law requires fulfillment of **seven particulars** for the formation of a share company. These are:

1. Min of **five (5) members** (**248/3+252/2)**
2. Minimum **initial capital (247/1)**(of 50,000 ETB for non financial share companies)…**why? Is it better to fix?**

It is aimed at the **protection of creditors** (prevents undercapitalization + limited liability of shareholders)

3. Full subscription of the capital (254)
4. Payment of ¼ of the par value of cash shares (254)
5. Submission and valuation of contributions in kind (257)
6. Adoption of memorandum (172, 173+255) and
7. Registration and publicity requirements (**265+175** of CC+ **7/1** of 980/2016)

Summary on Formation of SC

- ✓ As understood from the steps above, **the formation of a company is a lengthy process.**
- ✓ It passes through the steps of promotion, capital subscription and registration before it commences its business.
- ✓ **Promotion** is the first stage in the process of formation and it refers to activities that are required to be undertaken to establish a firm.

It starts with founders work of;

- ❑ **Discovery** (finding a business idea to be exploited)→
- ❑ **Investigation** (determining the economic viability of the business idea)→
- ❑ **Assembly** (the process of bringing together money, property and personnel and set the business in motion

Financing Share Companies

Shares and the Rights & Duties of Shareholders in SC

Book II, Title VI

Chapter 3 Art. 267-295

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Financing Companies

Any business has to **decide three things**:

1. What goods and services will it provide?
2. What **assets are needed to do so**?(tangibles + intangibles+ service of employees + money needed for daily operation(*working capital*)
3. **How** will **the needed assets be paid for? (**sources of money).

Companies may have the following possible sources of money:

- ✓ Borrowing from lenders
- ✓ Selling o/ship interests- issuing equity security (shares) to the public
- ✓ Issuing debt securities (bonds or debentures)
- ✓ Retained earnings (re-invested profits)

Financing Companies

Companies finance their venture from different sources of money.

- ✓ **One** of the prominent sources of finance is obtained by issuing **securities** to investors in the market.
- ✓ **Securities** are devices used by companies for the purpose of raising fund.
- ✓ Share company can issue two kinds of securities: **equity** security and **debt** security.

What are equity security and debt security? What is the difference between the two? Which one should a company is advised to issue? Why?

1. Equity Securities/Shares

Equity security is contribution of shareholders to the company after its formation to raise its capital.

- ✓ Equity Share are nothing but shares of a company.
- ✓ Share is a small unit of legal capital of a company.
- ✓ Equity Share **bestows** up on the shareholder d/t pecuniary and personal rights.

Some of these entitlements (pecuniary) may depend on financial situation of the company while some are independent of it (personal).

What are these rights which arise from equity?

Pecuniary entitlements/rights of equity/shareholder

- Entitlements to **dividends** (when a company is a profitable one)
- **Liquidation Asset**, if any (up on liquidation and winding up)
- **Preemptive right** in the context of capital increase

Rights of equity/share/holders which are independent of the financial worthiness of the company

- Right to be informed on the management of the company
- Opportunity to inspect corporate books and records
- Participation in shareholders meeting and voting power on major issues

Natures of Shares

- ✓ Share is **incorporeal movable** property
- ✓ Shares are **freely transferable**, unless such is restricted by law or MoA (276)
- ✓ Shares are **indivisible (270/1):** two or more persons may jointly own a single share in a company but cannot separately claim it.
- ✓ Shares **cannot be sold below par (268/1)**. **But** can be sold above par value, at **premium (268/2)**.

Premium is the difference when share is sold above its par value.

- ✓ Shares can be given as a **collateral (271)**:- can be pledged.

Can be issued in an instrument (on paper) or in an incorporeal (electronically) form (272).

Shares shall be sold to the public through a **prospectus**, a document inviting the public to make an offer to subscribe.

SO, is a prospectus an offer by itself? Vs. Art. 259

Forms of Share

There are two forms of shares which can be issued by a share company. These are:

1. **Registered** shares and
2. **To bearer** shares

- ✓ What is registered share? How it differ from to bearer shares? On **transferability**?
- ✓ Does the two entitle their holders to different rights?
- ✓ How does the new code deals with forms of shares?
- ✓ Is there any change from the old code, if any why?

Forms of Shares Contd.

1. Bearer Shares

- ✓ Is a share in which name of the owner is not indicated.

It is thus, easily transferable. …284/1

- ✓ The company does not know who its shareholders are and communicates them through **announcement**.
- ✓ Cannot be issued when the law or MoA prohibits.

The New Com C has prohibited that new bearer shares shall not be issued after its enforcement commences (267/1) and the issued bearers shall be converted in to registered shares within 3 years (267/2) a/r w/c it may not confer membership rights (267/4). Why?

- ✓ **It may be because** considering the practice that a prospective shareholders wants to have their name indicated on the share certificate to avoid –ve effects incase of loss of certificates of shares.

Forms of Shares Contd.

2. Registered Shares

- ✓ It is a share that indicates the name of its owner.
- ✓ Its transfer is effected by delivery and registration of the share in the name of the transferee in the register of shareholders (285/2)…if it is an **instrument share**
- ✓ **If the registered share is incorporeal**, its transfer is effected by indicating the name of a transferee and the amount of shares through crediting the account in the share account in banks (288/1)
- ✓ It is transferable but notice has to be given to the company…b/c it is must to change a name.
- ✓ The company communicates with the shareholder through its address.

Both **bearer and registered** shares confers up on their owners similar rights.

Classes of Shares-278 & ff

The MoA may provide for issuance of classes of shares with different rights (278/1).

- ✓ If any, shares of the same class have the same par value and confer the same rights.

Accordingly, shares can be **preference or equity(common)** shares.

1. Preferential Shares (279): are shares which confer special benefits including:

- ✓ Preference over other **shares subscription in the event of future issue**s,
- ✓ Rights of priority over **profits**
- ✓ Priority right over **repayment of contributions** in the case of liquidation of the assets of the company
- ✓ Priority in **distribution of a share of the surplus in the winding-up**

Classes of Shares-278 & ff

Preference shares contd.

- Preference shareholders may only vote in matters which concern extra ordinary general meeting if the same is provided by MoA(279/3)
- Companies cannot issue preference share as to voting rights (279/2).

Practice of Preference shares in Ethiopia

✓ **Can any company issue preference shares…?**

The Banking Bss Proc-592/08 art 10/1 and the Insurance Bss Proc-764/12 art 11/1 **prohibits** banks and insurance companies not to issue preference shares respectively.

Classes of Shares Contd.

2. Equity/Ordinary/Common Shares-291

Are shares which are not preferential and its holders are entitled to get devidend only when the company makes a profit.

Holders of ordinary shares have the following rights:

- ✓ participate in the annual net profits and to a share in the net proceeds on a winding-up…in proportion of his paid up capital (291/1/2)
- ✓ Voting rights in proportion to the amount of capital represented by his shares (293/3)
- ✓ Preferred right, in proportion to his holding, to purchase of cash shares issued on an increase of capital-next to preference shareholders.

Redemption of Shares

- Shares once subscribed can be redeemed at the request of the **minority shareholder** (minority)/292/ or at the request of a **majority shareholder (294).**
- Accordingly, where a shareholder holds more than nine-tenths (90%) of the shares in a company, each minority shareholder of the company may demand redemption by that shareholder (291/1+294/1)
- When a redemption for shares become successful, the majority shareholder has to make sure that shareholders of a company is **reduced below five due** the redemption (294/7).
- If the number of shareholders I reduced below five (5), the majority shareholder is responsible to **increase the number of shareholders** or **change the form of the company** within **three (3)** months.

Liability of Shareholders

Notwithstanding the provisions of 245/2 (Limited liability) share holders with **decisive vote??** are liable if they are found to commit one of the following (295):

1. Intentionally commit unlawful act and jeopardizes interest of the company
2. Merge ppty of the company to the ppty of shareholder
3. Fail to separate legal personality/identity of the company form that of shareholders
4. Deliberately mislead creditors by releasing financial information's
5. Using asset of the company w/t permission or pmt
6. Payment of dividends that exceed the limit set by the law

Liability to Meet Calls-289

- ✓ Holders, previous transferees, and subscribers shall be jointly and severally liable to the company for calls on shares.
- ✓ Such liability will cease **within two years** from the date of transfer, when the holder/subscriber transfer it.
- ✓ When a subscriber fail to pay the remaining amount within a written notice of fifteen days his share would be sold by auction (289/4)
- ✓ Where the sale cannot be effected the BoD may decide to forfeit the share and retain the amounts paid without and can also claim extra if any (289/5).
- ✓ Then, the unsold shares will be cancelled and the capital will also be reduced accordingly. (289/6)

Debt Securities: Debentures (407-424)

A **debenture** is a **transferrable debt instrument** whereby the issuing c**ompany undertakes to guarantee the debenture holder to pay a fixed interest** to the latter **for (definite) a specified period of time** and to repay him the loan **upon maturity date** (407/1)

- ✓ It is a document **representing the debt of a company owed to a debenture holder**.
- As opposed to holders of shares who are owners of the company, holders of debt securities are creditors of the company.
- Holders of debentures rank prior to shareholders and are entitled to be remunerated b/r the shareholders.
- They are paid at a fixed agreed rate while the income of shareholders depend on the profit of the company.

Debt Securities

A company can only issue debentures after its capital is fully paid and is in business for at least one year (408).

- ✓ The amount of debenture to be issued should not exceed the paid up capital of the company (409/1)…but exceptionally possible…409/2
- ✓ Debentures can be issued at par, above and exceptionally below par value-412

The provisions of the code concerning indivisibility, form of issue, transfer and defenses relating to shares shall apply *mutatis mutandis* to debentures -414

Meeting of debenture holders: 415-424

- ✓ Debenture holders can held their own meeting at the expense of the company and pass resolutions concerning their interest.

The meeting may consider **proposals by the company to change business objective or it structure, amalgamation or division of the company, variation in the terms of loan?** and etc.

Corporate Management

Management of Share Company

295-406

Firaol T. Adugna (LL.B., LL.M.)

Corporate Management

Corporate Management refers to actions taken by a company to lead the business in a positive direction.

- ✓ The management of a company is carried out by the **shareholders general meeting, the BoD and general managers**.

In relation to the powers bestowed up on the shareholders general meeting and the BoD there are two approaches:

Liberal Approach: special powers, such as altering of statutes, appointment & removal of directors are specifically given to GShM.

- ✓ What is not specifically given to GM of shareholders will fall within the ambit of powers of BoD.

Restrictive Approach: it **limits the power of BoD** by requiring that the powers of both organs should be specifically stated in the MoA.

Shareholders Meeting

362-406

Firaol T. Adugna (LL.B., LL.M.)

Shareholders Meeting: General (363-391)

A shareholders GM is the highest decision making organ of the company (362/1).

- ✓ Every shareholders has the right to participate in ShGM.

Shareholders meeting can be (365):

1. **General ShM**: comprise shareholders of all classes
   - ✓ General Sh M can be either **Ordinary** or **Extra-Ordinary**
2. **Special Meeting**: comprise only shareholders of a special class

Rules Common to all Shareholders Meetings

A. Procedural Rules

- ✓ A **call** for a GM made by directors, supervisory board,if any, auditors, liquidators , by (when requested by 1/5th of the shareholders) **court** -366/1 or by Ministry of Trade and Industry(366/2)
- ✓ Notice for a meeting has to be made 24 b/r the intended date (370).
- ✓ The organ who call the meeting shall also prepare the **agenda** and send them in advance to the shareholders-372
- ✓ Shareholders can **participate** in and **vote** by **proxy** on a meeting (373)
- ✓ Attendance shall be taken
- ✓ The chairperson of the BoD shall preside at all meetings (379/1)

Rules Common to all Shareholders Meetings

B. Substantive Rules

- ✓ **Right to inspect documents**: Each share holder shall be given right to inspect or take documents before the meetings (381) so that they could make informed decision.
- ✓ **Every share carries equal voting right** (383/2) and any provision restricting or is likely to restrict a voting right shall be of no effect (386)
- ✓ **Conflict of interest**: A shareholder or a director whose interest is a subject of resolution may not vote (385)

1. Ordinary General Meetings (392-398)

OGM shall be **held annually within 4-6 months** from the end of each financial year (393/1/2).

When necessary, another OGM can be called and held (393/1).

Powers of OGM-394

- ✓ Amend or approve or reject the balance sheet, profit& loss account, BoD, auditors and supervisory boards report
- ✓ Appoint or remove directors, members of supervisory board or auditors and decide their remuneration
- ✓ Approves issues of debentures and guarantees there to
- ✓ Approve transfer of 51%/more of the asset of the company within the year
- ✓ Decide on any other issues other than specifically reserved for Extra OGM

OGM: Participants, Majority and Quorum

Any shareholder has the right to take part in ordinary meetings without regard to the number of shares held- contrary agreement can't serve as a defense (397/1)

Unless the MoA provides otherwise, shareholders may be represented by another person, whether a shareholder or not (397/2).

Majority and Quorum in OGM-398

- ✓ At least **1/4th of the voting shares** during 1st call
- ✓ The quorum shall be reckoned **based on the amount of capital represented,** not by number of shares or sh/holders
- ✓ When called for 2nd time, the meeting may be held **w/t regard to number of voting shares** representing the capital
- ✓ **Decisions** at OGM shall be taken by **simple majority** of shares representing the capital.

2. Extra-Ordinary General Meetings (398-403)

Extra OGM can be called at any time when the company wants to (400):

1. Amend MoA
2. Increase or reduce its capital
3. Change nationality
4. Decide on dissolution, conversion, division or amalgamation
5. Decide all other matters specifically assigned to the Extra-OGM by MoA

Notwithstanding contrary agreement, any shareholder has the right to take part in Extra-OGM-401

Majority and Quorum at Extra-OGM-402

- ✓ 2/3rd majority of voting shares represented is required for resolutions to be adopted at Extra-OGM
- ✓ Resolution to **change nationality** of the company shall only be adopted where the shareholders with voting right are present and the vote is **unanimous** (402/2)
- ✓ Extra-OGM **may not compel shareholders to increase his investment** except that it is decided **unanimously**, to increase par value of shares from the legal reserve or profits which may be distributed (402/3)
- ✓ A quorum at extra-OGM is met only when shareholders represent: **½ (50%), 1/3 (33.33%),** and **¼ (25%)** in the first, second and the third calls are present, respectively(402/4).

Leaving the Company-403

Shareholders dissenting from resolutions relating to change of business purposes or conversion or amalgamation or division of the company may leave the company up on notice to the general manager and then be paid the average market value of their shares within six months. No contrary agreement or resolution is welcomed

3. Special Meetings (404-406)

Special Meeting is held only by particular classes of shareholders on matters concerning their interest in the company.

It can be held to approve or disprove decisions of the Gm of the company.

- ✓ For instance a GM resolution to modify the rights of a class of shareholders becomes effective after approved by a special meeting of shareholders in the class (404)

Quorum and Majority in SM

A quorum at SM is met only when shareholders represent: **½ (50%), 1/3 (33.33%),** and **¼ (25%)** in the first, second and the third calls are present, respectively (406/1.

Board of Directors

Articles 296-336

Board of Directors: General

BoD is the **highest** ranking organ next to Sh GM.

Accordingly, a share company will have 3-13 directors-296/1 among w/c 1/3rd of them will engage in daily business of the company.

- ✓ As a **new dev't** in the new code, non-members can be selected as a director but should not exceed 1/3rd of the total (296/2) and cannot be elected as a chairperson (300/1).

A legal person can be appointed as a director and thus will act through a permanent representative (296/4).

Qualification requirements: 297

In order to qualify as a director, a person may be required to fulfill **minimum age, if any is fixed, possess good moral character and not convicted of breach of trust**, theft or robbery in relation to his previous job as a manager, director etc.

- ➢ **Appointment(298)**: the 1st director may be appointed by the MoA and approved by subscribers meeting or the subscriber meeting it self may appoint.
- ➢ Subsequent directors shall be appointed by general meeting for not more than **three** years.

Board of Directors: General

- ✓ The MoA may require directors to furnish **security to guarantee** the discharge of their duties (302/1) which will be **released** when they cease to be director.
- ✓ Directors shall receive a fixed annual remuneration (304/1)
- ✓ OGM ay also decide that directors be entitled to net profits of a financial year not exceeding 10% of the dividend to be distributed (304/2/3)
- ✓ **Removal(305):** directors can be removed at any time by the GM notwithstanding contrary provision in the MoA (305/1).
- ✓ If a director is removed without good cause, he cannot claim reinstatement but claim for his wrongful dismissal (305/2).
- ✓ Directors may not contract loan with the company unless it is approved by GM resolutions (307/1).
- ✓ Directors can be represented at a board meeting by another director through a proxy to be given by leter, fax, or electronic mail -310

Powers and Responsibilities of the Board-315

In general directors shall be responsible for exercising duties imposed on them by law, memorandum of association, and resolutions of general meetings of shareholders.

- ✓ Manage the company's financial situation
- ✓ Ensure the company's governance is going well
- ✓ Take necessary measure to manage risk
- ✓ Take necessary steps to prevent or mitigate acts w/c are prejudicial to the company

Directors are also responsible to **keep regular records** of the meeting of the BoD, **submit** accounts& books to auditors, submit annual report to the GM, **convene** meetings as provided in the code or the MoA and etc(315/6)

Duties of Directors

Duty of Loyalty (316)-shall act in good faith to promote success of the company.

Duty to **exercise independent judgmen**t(317)

Duty to Care (318)- shall discharge his responsibility with care, skill and diligence and will be liable for damage due to lack of care and diligence.

Restriction on private trade/Non compete duty (319): w/t approval of the GM a directors may not be partners with joint and several liability in rival business entities nor compete against the company either on their own behalf or on behalf of third parties.

Duty to **avoid conflict of interests** (320) and disclose if any (321)

Duty not accept a benefit from 3rd party, even after he ceases to be a director-322

Limitation on Voting right-323- to prevent conflict of interest

Liability of the Member of the BoD-324-330

- ✓ Directors shall be **jointly and severally** liable to the company for damages caused by **failure to carry out their duties.**
- ✓ Directors shall be responsible for showing that they have exercised due care and diligence **-burden of proof.**
- ✓ **A provision that purports to exempt a director of a company, to any extent, from any liability is void-325.**
- ✓ **Directors are liable to creditors for failing to preserve asset of the company intact and when they knew or ought have that there was no reasonable prospect of the company being able to pay its creditors (329/1/2).**

Supervisory Board- 331-336

A company may decide to have or not, a supervisory board.

- ✓ Supervisory board as an optional structure in the management of SC **is a new development** of the new commercial code.
- ✓ The supervisory board constitutes only shareholder and has to be three to five (3-5) and elected by the ShGM (331/1-5).
- ✓ They are accountable to the ShGM (331/5)
- ✓ Members of the supervisory board may neither be members of the board of directors nor take part in the general management of the company (331/6).

Then, what is their role?

Powers and duties of the supervisory board-332

- Call and lead a general meeting, where the board of directors are unable or not willing to convene such a meeting
- Present and take part in the meeting of board of directors without voting
- Examine or cause to be examined an act which may injure the company, if need be, take necessary measures with the view to instituting proceedings
- Supervise that directors and other members of the management are discharging their responsibilities properly
- Supervise and examine financial affairs of the company
- Submit report to the GM

Liability of the Supervisory Board

- ✓ Members of the SB are J and severally liable for damages that may be caused to the company, shareholders or third parties as a result of failure to discharge their responsibility (334)

Period of Limitation-336

- ✓ Claims by company, shareholders or creditors against directors, and members of the supervisory board where applicable, for damages under the foregoing articles **shall be barred after two years from the date when the aggrieved party knew or ought to have known** of the damage.
- ✓ There shall be an **absolute limitation after ten years** from the date when the act complained of took place.

General Manager 337-342

A **general manager** is a person who is appointed by the BD to be responsible for the general management of the company (335&338).

General manager **is employee of the company** and can be a member of the BD but can't be a chair person.

A general manager is responsible, among others for (338/4):

- ✓ **Implementation** of decisions passed by the board of directors;
- ✓ **Preparation of annual work plan and budget** of the company and implementing the same upon approval by the board of directors; and
- ✓ **Hiring, managing and firing the employees** of the company, as necessary.

The company shall have a **secretary** to be appointed by the BD up on recommendation of the general manager (341-343).

Auditors:343-354

Every share company shall have one or more independent and impartial external auditors and assistant auditors.

- ✓ **Appointment**: The 1st auditors by subscribers meeting and then by **ShGM** of the company for 3 years (342+344)
- ✓ Can also be appointed by shareholder(s) representing not less than 20% of the capital of the company.
- ✓ A body corporate may act as auditor.

Competency(345+306/6):

- ✓ **Not** members of the **BD** and **SB**, **Manager**, **Secretary** of the Company and a person related to them by affinity or consanguinity…
- ✓ Not a member or employee of the company
- ✓ Not a **holding** company or **subsidiary** to the company and etc.
- ✓ Issued with **professional license**
- ✓ Possession of **good moral character/standing**

Auditors Contd.

Auditors in general have a **duty to:**

- ✓ exercise their duties on the basis of acceptable accounting principles;
- ✓ provide accurate information;
- ✓ give equal treatment to shareholders;
- ✓ keep professional secrets;
- ✓ verify the correctness and accuracy of the inventories, balance sheets, and profit and loss accounts, books and other financial documents…
- ❖ Auditors **can call shareholders** GM (351)
- ❖ Auditors shall be **present at annual GM** and any other shareholders` meetings (352/2)
- ❖ Auditor of the holding company may also audit accounts of the subsidiary.
- ❖ Auditors shall be **civilly liable** to the company, shareholders and third parties…and are also **criminally liable** (354)

Profits and Reserve Funds 432-441

Profit of the company is the **net receipts for the financial year after deduction of general costs and other charges, and of amortization and allowances (432/1)**

- ✓ Distribution of profits shall be effected after transfer to the legal reserve(236/1).
- ✓ Dividends may only be paid to shareholders from net profits shown in the approved balance sheet (438/1).
- ✓ If dividend is paid out of the net profit, it will amounts to a **fictitious dividend** may entail liability (438/2)
- ✓ A shareholder shall become a creditor of the company for the amount of the dividend from the date fixed for payment (438/5)

Reserve Funds-433

- ✓ It is an **accumulation of profits** that supports the company's integrity or indicate the relative economic strength of the company.

It is **made out of the net profits** (433/1).RF can **includes(433/2**):

1. **Legal** RF (434): 5% of the net profit until it reaches 5% of the company's capital
2. **Supplementary** RF (433/2/b): when created by OGM as per MoA
3. **Optional** RF (433/2/C): when created by OGM as per MoA
4. **Free** RF (433/2/d): by OGM without the law or MoA requiring it.

Companies may also have a **reserve created by issue of premiums** (issuing and selling of shares above par value and depositing the premium to a reserve fund from which only former share holders benefited) (435)

Increase and Reduction of (Legal) Capital

1.Capital Increase (442-461)

A Share Company may increase its legal capital by **issuing new shares** or by **adding par value of already existing** shares (242).

2.Reduction of Legal Capital (462-472)

- ✓ Companies may based on **proposal of the BD** and approval of the Extra-OGM (462) or **due to loss** (465-468) **be reduced below the legal minimum**.

Manner of Reduction: by (1) **reducing par value of share**s or (2) **exchanging old shares for a lesser number of share**s (465/1).

- ✓ In such cases a resolution may be taken by the Extra-OGM that shareholders would be compensated before profit is distributed, for the reduced amount (466).

Reduction of Legal Capital Contd.

Rights of Creditors

- ✓ Creditors may **oppose a resolution** to reduce the minimum legal capital when they are not paid or given an adequate guarantees for pmt (467).

For how long should the capital remain below the legal minimum?

When the reduction is successful, the capital shall be increased to the minimum legal capital within a period of **one year** since publication of the reduction (468/1).

- ✓ **If not**, the company has to be reorganized or be dissolved by court order (468/3)

Dissolution and Winding Up: 473-491

Grounds of Dissolution (473+181)

1. **Law**

- ✓ No of Sh/h **reduced below 5** for more than 6 months
- ✓ Legal capital **reduced below legal minimum** & not increased for one year
- ✓ **Loss** of ¾ (75%) of its capital and decided by Extra-OGM

2. Statutes/Formative Documents

- ✓ If formed for a specified time & such period lapse
- ✓ If the company achieved it objective

3. Decision of the Extra-OGM

4. Judicial Dissolution-up on application of interested parties

- ✓ Whatever the cause of such dissolution is, decision to dissolve a company has to be published (474).

Winding-Up

It is the process of **shutting down the company** by **paying off its liability** (creditors) from its asset, **turning assets of the company to cash** and **dividing the cash** among shareholders.

- ✓ During the liquidation process, the company will **retain its legal personality and name** (479/1).The word "**in liquidation**" will be added to its name.

During winding-up, **the organs of the company shall restrict their activities to acts necessary to facilitate the winding-up** and which are not acts within the scope of the liquidators (479/2).

The liquidators shall have the same duties and liabilities as directors (481/1).

Winding-up Contd.

Powers and liabilities of Liquidators

- ✓ **When asset is insufficient** to cover the debts of the company, the liquidators shall call upon the shareholders to pay according to their share holding such installments as may be due on their shares (481/4).
- ✓ Sell the assets of the company as whole, compromise and arbitrate and shall represent the company in legal proceedings, collects credits and pay debts of the company (482/1).
- ✓ May **not undertake a new business**, **unless** required for the execution of contracts still running or when required for the winding-up (482/2).
- ✓ Liquidators are subject to joint and several liability in respect of business undertaken outside the power given to them by law or MoA (482/3)
- ✓ Until creditors are paid, the liquidators may not distribute any part of the assets among the shareholders (483).

Winding-Up Contd.

Creditors shall be informed of dissolution of the company by letter or through notice (284/1) three times, once in a month.

- ✓ The **surplus asset** may not be distributed until one year from the 3rd publication (487).
- ✓ Where known creditors have failed to file their claims, the amounts owing to them shall be paid into court (485).

Where a shareholder failed to collect his share in the surplus within 3 months it shall be deposited to bank with the name of the shareholders (488)

- ✓ After paying the company`s liabilities, the liquidators shall prepare a final balance sheet, showing what percentage of the surplus asset is available for distribution on each share.
- ✓ Such balance sheet shall be deposited in the Ministry of Trade and industry or any other relevant government authority after it is signed by liquidators and BDs (486).

Winding-up Contd.

When the final balance sheet has been approved, the liquidators shall see to it that the registration of the company is cancelled (489/1)

If there is a damage to sh/holders due to failure of cancelling registration of the company, liquidators shall be liable, j&s (489/2).

What if a creditor shows up after cancellation of the company?

- ✓ Such creditors can claim pmt **from shareholders** in person **to the extent of their shares in the surplus asset,** or
- ✓ **From** the **liquidators** if they have not been paid due to negligence of the liquidators (490/1/2)

The books of the liquidated company shall be deposited fro a period of 10 years and be open to public inspection (491).

Website 492-494

- ✓ Every share company shall have a website which is accessible to any person (492_494/2). **Why?**

Contents of the website

a) the memorandum of association, and amendments thereto, if any;

b) notices regarding general meetings and related information;

c) approved audit reports;

d) report on transactions involving conflict of interest prepared pursuant to Article 395(5);

e) any other information required to be made public by this Code or the memorandum of association;

The website shall, to the extent possible, **include features to conduct electronic meeting and enable voting through electronic means.**