Private Limited Company

Definition

- To start from simple understanding of the nomenclature, “Private Limited Company”.
  - The term “Limited Company” indicates that: the members liability is limited to the extent of their contribution.
  - On the other hand the term **“Private”,** which principally differentiates it from (public) share companies indicates the fact that **the shares are privately held between the members only**, as opposed to share companies which its share are listed on a recognized stock exchange and the **shares are traded publicly.**

Private Limited Company

- Thus, private Limited company is a type of company that **offers limited liability**, or legal protection for its shareholders but that **places certain restrictions on its ownership.**
- So, private **limited** companies are similar to **Public limited** companies (PLCs) , in the sense that they are **legally distinct entities with their own assets, profits and liabilities.**

Characteristics of a Private Limited Company

- Most private limited companies **are family businesses**, the **shareholders of private limited companies** are therefore usually **closely connected with the running of the business**.
- A private limited company shares shall not be open for subscription by the public / over a stock exchange [Art. 495 (2)]
- *Disadvantage:*
  - Shares of a private company are not listed in the stock market exchange. Therefore regular dealings in these shares cannot occur. Because of this a shareholder cannot know the real value of his investment in a private limited company.
- The owners of private limited companies are called shareholders, because they own a part, or a share.
  - "…a business organization whose capital is **fully paid-up in advance**, **divided up into shares**…"
  - "የተወሰነ ኃላፊነት ያለው የግል ማህበር መዋጮ መከፈል ያለበት ማህበሩ ሲቋቋም እንጂ ተቋቁሞ ሥራው ከተጀመረ በኋላ ስላለመሆኑ" 19258 Vol. 7

Characteristics of a Private Limited Company

- Shares in private limited companies can only be bought and sold with the agreement of other shareholders. [Art. 523. (2) Old] [Art. 509. (1) the New. Similarly reads:
  - *A transfer of shares outside the company shall be approved by a majority of the members representing at least three-quarters of the capital, unless a larger majority or unanimity is fixed in the articles of association.*
  - *Shall be in writing and entered in the share register (art. 508.1)*
  - *Thus,* shareholder cannot leave a private company easily and quickly.
- In addition, shareholders cannot sell or transfer their shares without offering them first to other shareholders for purchase [Art. 508. (3)**] [No such provision exist in the old Code] [right of first refusal]**
  - *A member shall, prior to disposing of his share to a person outside the company, give an opportunity to other members to purchase such share by revealing to them the price offered to him for the same price and under the same condition.*
  - *4) The offeror-member may accept the offer made to him by a person outside the company where the offeree-member has failed to accept the offer within fifteen days from the receipt by the manager of the company of the notice under sub-art. 3 of this Article.*

Characteristics of a Private Limited Company

- The number of shareholders cannot exceed a fixed figure (commonly 50). [510 (2) Old] [495 (4)]
  - ***Disadvantage:***
    - Growth of a private limited company can be limited because maximum shareholders allowed are 50.
- Less government intervention
  - Public/Society has a little confidence in a private company because its affairs are unknown and it is not subject to strict control under the law unlike Share Co..
  - Example: See Art. 525. (2)(3) [Old] vs. 518 new

    1)Where there are more than twenty members, auditors shall be appointed and hold annual meetings.

    2)Where there are twenty or less members ,the members shall not be bound by the provisions of sub-art. (2).

New: more than 9 members or 1o million ASSET.

Why “**private**” limited company

- It allows closely related individuals or families to establish limited liability companies without going through stringent requirements that should be complied to **establish and operate** share companies.

Formation: requirements

Members

- A minimum of two and maximum of 50 members. Art. 495.4
  - Obviously, it is impossible to establish a PLC with out two members.
  - But, what if the number of members reduced below two after establishment?
    - See art. 511 old Code vs. **498 of the New Code**
    - *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,** order 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.*
  - *Thus, two possibilities for PLCs to continue functioning regardless of the reduction of members below two.*
    1. *A company may continue operating for reasonable period of time while making arrangements to comply with law [raising the number of members] [that is if application is made to a court to dissolve the company]*
    2. *A PLC may continue to operate as long as application is not made to dissolve it by a member or creditor*

- *Thus, it is possible to say that a PLC may not be **formed** with less than two persons but there are possibilities to exist with one member **after establishment in the old code.***

Formation: requirements

Members

- The new Code?
  - **Art. 498. --- Reduction of the number of members below the legal minimum**
    1) Where the number of members of a private limited company is reduced below two and another person does not join such company as a member within six months, ***the company shall be dissolved.***
  - **Pretty clear that a PLC neither formed nor continues to exist with one member.**
- **But, as per art 498 (2):**
  - *the company whose members are reduced below two may be registered as a-one-person company within six months*
- **Most jurisdictions require at least two persons to form PLC but they provide a possibility to be transformed to one man company. It is possible under the new Code.**

Formation: requirements

Members: why is it important to allow PLC to exist even if their members reduced below 2?

- **Firstly, in practice most PLCs shares are controlled by 1 person (99% share) and the other person is simply there to fulfil the criterion of two persons. *So, ineffective requirement from the very beginning.***
- ***Secondly, it is not feasible to dissolve a company where the livelihood of many individuals rely on the mere ground that its members are reduced below two. Employees, tax, economic contribution…***

Formation: requirements

Members: what if the number of members increase above maximum limit [i.e. 50]?

- Globally, two main approaches exist in this regard:
  - Any transfer or sell of share is void, if same will increase members above 50
  - A PLC's members can be raised above 50. But, a company must reduce such number to 50 or register as share [public] company within certain period.
- Ethiopia?
  - See Art. 495 (4) A private limited company may not have less than two or more than fifty members.
- But, no provision is laid down regarding the violation of such prohibition, unlike the effect for reduction of members below two or loss of ¾ capital, in which case the company should be dissolved (See arts 511 & 543).
- *So, is it possible to say that the PLC may exist even where its members are increase above the legal limit???*
- *One could argue there is no express legal effect, on the another hand Art. 510 (2) employed the term 'shall not' have, which is a*

Capital [Art. 496]

- The minimum capital of a private limited company may not be less than 15,000 Ethiopian Birr.
- The capital is divided into shares with the same nominal value, which may not be less than birr 100 Art. 496(2).
- The whole capital of private limited company **must be paid-up** when the company is formed 495 (1), 499.1 & 2.
- Contribution can be: Art. 501
  - In cash:
  - In kind: the value of contributions in kind shall be counted towards the capital. Art. *502*

Preservation of Capital

- Companies operates with budget way greater than their capital. The surplus is obtained from creditors.
- But, creditors guarantee is the capital of the company
- So, the capital must be preserved.
- The main purpose of preservation of capital is to prevent members from redistributing the capital of a company among themselves:
  - In the form of loans on favourable terms
  - Pledging company property for personal credit
  - Dividend of fictitious profits

Preservation of Capital

- Different mechanisms are used to preserve the capital of the company.

Legal reserve. Art. 528

- Not less than one-twentieth (5%) of the profits shall be transferred each year to the legal reserve fund until such fund amounts to one-tenth of the capital.
- The reserve is 10 % in share companies, too.
- The reserve cannot be paid out for members and serve to fill any difference in the capital.
- Fictitious **profit**
- This is where the members share profits while the company is not actually profitable.
  - *Members may be required to repay dividends which have been paid out of sums which are not actual profits within five years from the date the dividends were paid. [Art. 529]*
- In share companies [see art. 439] duly approved fictitious profits may not be claimed back from the

Preservation of Capital

- Though there are numerous possibilities in which members may compromise the capital of the company through favourable loan terms and sale price, no provision is provided to prevent such risk in Ethiopia.

Preservation of Capital

- Despite efforts to preserve the capital. The capital may still be lost.
  - In such case, (1) Where three-quarters of the capital are lost, the managers shall consult with the members and decide whether the company should be dissolved. [Art. 532.]
  - (2) If the members decide not to dissolve the company; they shall make additional contributions to restore the capital.
  - (3) Where the managers fail to consult the members or no valid decision is taken, any interested person may apply to the court for dissolution.
- This is special ground of dissolution of PLC, in addition to the provisions of

Liabilities of members for the company’s obligation

- The liability of the members is limited to the amount if any, unpaid on the shares respectively held by them. Art. 495.

Members' meetings in PLCs

- Where less than ten, **members are not required to take decisions at meetings. [Art. 523] The old Code stipulated** twenty or less members [Art. 525 (3)]
  - In such case, the managers shall send to each member the text of resolutions or decisions to be taken and ask for the members` written or electronic vote thereon. Art. 523 . [See of the old for comparison Art, 533]
  - ***So, members are only exempted from calling general meeting but not from participating in the decision making.***
- Where a company has more than ten members, it shall hold a general meeting **each year at the date fixed by the MOA**.

Members' meetings in PLCs

Meetings of the company may be:Art.519

- **Ordinary**:
  - Shall be conducted annually; Art. 521.1
  - Shall be called by the: 521.1
    - Board of directors,
    - Manager
    - members representing more than one-half of the capital of the company.
  - If persons listed above are unable or unwilling, the court may for good cause appoint a person to call a meeting (5)
  - Minutes Art. 522

Members' meetings in PLCs

- **Quorum and Majority in ordinary meetings [525]**
  - more than one-half of the capital of the company shall be present; (1)
  - At a second meeting, decisions shall be taken by a simple majority of shares represented without regard to the amount of capital represented. (4)
  - Decisions of an ordinary general meeting are taken by a simple majority of shares represented at the meeting. (3) Capital represented or share represented. ***Read cum with sub 1 and the last sentence of sub 4***

Members' meetings in PLCs

Extraordinary

- Changes in the nationality of the company or
- Increase in the capital of the company by raising the par value requires the unanimous decision of members. Art. 526
- Amendment to the memorandum of association requires the consent of members representing ¾ of capital

- Other meetings may be called: art. 521.4
  - By the manager or,
  - In his absence, by the auditors, **if any,**
  - And in their absence by members representing more than 10% of the capital.
- Under article 392-403 concerning general meetings
  - Regarding period and power of ordinary meeting

Board of Directors

Old code

- **No requirement, no prohibition, members of PLCs may decide to appoint directors.**
- If PLCs decide to have board of directors, they should regulate the appointment, the number, duties of directors etc. in the article of association.

New Code 513 ff

- May be provided in the MOA
- If provided shall be 3 to 7 members
- Sub-Article (4) and (5) of Article 296, Article 297, 298, 300-312 and Article 314-330 shall apply as appropriate to the board of directors of a private limited company.

General Manager

- A PLC shall be managed by one or more directors. [514] [525 (1) old]
  - May be member or outsider;
  - Shall be appointed by general meeting 514.2
  - Shall be appointed by board, if any 514.2
    - But, in practice managers are members

Scope of power

- where the company is managed by a board of directors,
  the provisions of Article 337-339 of this Code shall apply;
- where the company does not have a board of directors, the manager **shall have full powers to act in the name of the company;**
- Provisions in the MOA restricting the powers of the manager shall be of no effect except as between the company and members on the one hand and the

General Manager

- So, as between the manger and the company, the statute may limit the authority of the manager even within the scope of business objects of a company. Hence, a manager can be held liable to the company for ultra virus act.
- But, **as regards third parties in GOOD FAITH,** the scope of power of manager is determined by business object of the company.
- Thus, every act which are necessary to achieve the objects of a company are valid in relation to third parties.
- Also, a manager shall be liable, as the case may be, to the company, shareholders and third parties for any damage caused by a breach of their duties under this Code or the articles of association.
- The liability of managers may emanate from agency law [as agents of the company], employment law [as employee of the company], tort or criminal law.
  - They are agents and employees, as well.

General Manager

- **Dismissal of a Manager Article 517.**
  - manager may be dismissed by the organ appointing him
  - manager is not entitled to be reinstated to his position even where the dismissal is without good cause (3)

Auditor

Old code

- Auditors are not mandatory requirement for PLCs. Art. 525 (2)
- Auditors are required only where the members exceed 20.
- But, where a company consists of more than twenty members, not less than three **auditors shall be appointed in the memorandum of association.** [Art. 538]
  - This requires the amendment of MoA to dismiss the auditors.

New Code Art. 518

- Not mandatory unless
  - company consists of ten and more members or
  - its total assets exceed Ten Million Ethiopian Birr
  - shall be elected by a general meeting

Shares in PLC

- This is where we can notice big difference between share companies and PLCs.
  - Unlike the shares of Share Company, the shares of private limited company are not transferable by the normal commercial forms of transfer.
- Why? The very nature of PLCs.
  - Parties are small in number and their personality matters in case of PLCs whereas the **identity of a shareholder is irrelevant** in the case of share companies.
- However, shareholders may, in the AoA, provide for easy transfer of shares in PLCs or make stringent criteria for share companies.

Forms of Shares

- The company may issue only shares **registered** in the name of the members. [507,]
- Accordingly, Any transfer of shares shall be made in writing; Transfer of shares shall be of no effect in relation to third parties unless it has been entered in the share register. [Article 508]
- Also, the company may not issue transferable securities. Art. 495.5 5/

Transfer

1. **Transfer of shares where the member is alive:**
   - Shares in private limited company, are freely transferred among the company members (Art 508(2)).
   - Transfer of share for outsiders require the consent of members representing ¾ capital. Or larger majority or unanimity if required in the MOA. Art. 509.1
   - Even in such case, prior to disposing of his share to a person outside the company, the member should give the right of first refusal to the other members [508.3]
   - The other member may exercise purchase:
     - at the price offered to the member by outsider;
     - Under the same condition;
     - Shall notify the acceptance of the offer made by the member within 15 days.

Transfer

2. Transfer mortis cause [devolution by way of succession]

- Two questions need to be answered here:
  - Can the membership transferred to the heirs?
  - Are the remaining members forced to work with the heirs?
- When the shareholder dies his shares transmit to his heir (Art 511).
- But, the heirs may become members, [511. 1 & 2]
  - If the MOA does not prevent such transfer;
  - If the heirs are willing to be shareholders;
- Pursuant to Art. 511.1, members may restrict transfer of shares to the heirs in the MOA.
  - Thus, the MOA may provide that the heirs of a deceased member may, **join the company** or **be paid the deceased member's shares**. [511 (1)]
- But, such restriction may only prevent the heir from becoming a member and does not prevent him from

Transfer

2. Transfer mortis cause [devolution by way of succession]

- However, even where the MOA does not prevent the transfer, the hears may refuse to be a member.
  - In such case, they shall be paid from reserve funds.
  - But, this right cannot be exercised if the company does not have sufficient reserve that is distributable to shareholders.
- **What is the remedy for heirs unwilling to become shareholders and also want the money immediately? Are we going to force them stay in the company till it accumulates such reserve funds?**
  - Compare 511 with 510 (4) [execution]

Transfer

3. Transfer for satisfaction of debt or execution of judgment

- Share is property. As such, one may use as a guarantee for debt or any interested person may attach share for satisfaction of debts. See Art. 505
- Where execution is levied on a member's share, person shall need the approval of the other members in accordance with Sub-Article (1) of Article 509 of this Code to become a member. ¾ majority.
- If the members are not willing to admit the person, [Art. 510.2]
  - such share shall be transferred to any member of the company interested in buying it;
  - where no interested, the company shall pay the price of the shares to the judgment creditor.
- The payment shall be effected using distributable reserve funds; or from the capital which shall be reduced accordingly; [510.4]
  - The shareholders shall be jointly and severally liable, to the extent of the reduction in capital, to persons who concluded

PLC vs. Share Companies

- To sum up, as compared to share companies private limited companies are
  - **formed and operated with less capital;**
  - ***need not to be run by a board of directors;***
  - ***are not required to be subject to audit unless the numbers of members is over certain limit***; and
  - are **regulated less rigorously** than share companies.
- Easy to form and run but provide less protection for third parties and minority shareholders.
- PLCs borrow the characteristics of both partnership [particularly in relation the

Dissolution

- **See art. 531**
  - A private limited company may be dissolved on the grounds applicable to all business organizations including art. 181
    - Dissolution by the court for good cause
    - Dissolution upon expiry of term
    - Dissolution at the request of any member where the term of the company has not been fixed
- But, a death, judicial interdiction, bankruptcy or insolvency of a member shall not cause dissolution of a company, unless otherwise expressly provided in the articles of association.
- Additional grounds for dissolution are:
  - Where a PLC does not have a required management organ **upon request of members or creditors**; art. 531
  - Where three-quarters of the capital is lost and members are not willing to restore the capital; art. 532 with within ninety **upon request of any interested person**
- The dissolution and winding-up process shall be undertaken in accordance with art. 473-491.