

Defining Business Organizations

BUSINESS ORGANIZATIONS

- ❑ A person may carry on his business as sole proprietor (trader).
 - He will take profits and bear losses alone;
 - Most simple form of conducting business;
- ❑ Persons may also do business by means of business organizations. i.e.,
 - Association of people having the common goal of operating business;
 - Issues of members personal liability for the entities' obligation;
 - Laws of various nations provide for various alternatives of these business associations with their own advantages and disadvantages;

BUSINESS ORGANIZATIONS

- ❑ These business organizations based on their characteristics may be classified into partnerships and companies.

Defining Business Organizations

- ❑ The Commercial Code provides a common definition for all forms of business organizations.

Defining Business Organizations

Old

- Article 210 of the **OLD** Commercial Code defines a business organization as “any association arising out of a partnership agreement.”
 - Pursuant to Article 211 of the Code, a partnership agreement is “a contract where by *two or more persons* who *intend* to join together and to cooperate undertake to *bring together contribution* for *the purpose of carrying out activities of an economic nature* and of *participating in the profits and losses* arising out thereof ,if any.”
- The old Code defines BO and partnership agreement separately under art. 210 & 211.
- In the new Code, what used to be the definition of partnership agreement has become part of the definition of BO.
- Also, the fact that the Code used “**association arising out of a partnership agreement**” sounds as if the definition is applicable only to partnership business form. Now MoA.

BO

- The new Code defines BO under Art. 172
 - *A business organization is an association established through a memorandum of association by persons who bring together contributions for the purpose of undertaking **an economic activity in cooperation** and of **participating in the profit** made.*

Art. 173. --- Memorandum of association

- *A memorandum of association is an **instrument drawn up to establish a business organization.***

...continued

- A look at the provisions of both the old and new Codes reveals two important aspects of business organizations,
 1. The contractual aspect
 2. Institutional (organizational) aspect

1. Contractual

- The fact that a business organization **is an association stemming from a contract** known as “a memorandum of association.”

See **Art. 172 & 173**

➤ **Most importantly, art. 177 explicitly stipulates:**

➤ *The formation of a business organization shall be of no effect unless it is **established through a memorandum of association.***

...continued

2. Institutional (organizational) aspect:

- Even if a business organization emanates from a partnership agreement, the mere fact of concluding a valid partnership agreement by itself is not enough to create a business organization.
- **There is more to the formation of a business organization *de jure* than the conclusion of a partnership agreement.**
- ***Pursuant to art. 223 old Code,*** a business organization shall have no legal existence nor personality until all the provisions of this Code relating to ***publicity have been complied with and registration is published*** in accordance with Art. 87 of the Code.
- *Art. 175 of the New Code: All business organizations other than a joint venture shall acquire legal*

EXCEPTION: JV

❖ **172 (2): PUBLICITY**

- **177: No MOA Required**
- **175, 234: No Registration Requirement**

... registration

- *Federal Commercial Register*
 - *MoTI Shall establish and administer Fed. Com. Register (art. 70)*
 - *MoTI Shall undertake Registration of Traders and BO*
 - *Mo*
 - *TI may partially delegate its power to other federal institution*
- *Regional Commercial Register*
 - *Regional State and City Administration may establish their own commercial register and undertake commercial registration (art. 71)*
 - *The applicability of Regional laws (art. 71 (2))*
 - *Administration of register;*
 - *designation of authority;*
 - *Duties and responsibilities of the authority;*
 - *Applicability of Com. Code on regional registers*
 - *The registration shall be undertaken in strict compliance with the provisions of Title IV the Code*
- *Central Data Base (art. 72)*
 - *MoTI shall establish and administer database with national application;*
 - *Shall use modern technology;*
 - *Shall be open to public;*
 - *Shall be accessible on MoTI website*
 - *Shall include persons registered in regional registers*

... **registration....mandatory**

- Any BO carrying commercial activities within the territory of Ethiopia shall be registered (Art. 82 (1))
- A Though a trader shall make his application and get registered before he begins to carry on trade he person shall not be registered as a trader unless an application to this effect is made by the said person or his agent. (Art. 83)

... **registration**

➤ **Where should the application for registration be made?**

- To registry in a jurisdiction where the trader or BO has its head office (art. 85 (1))
- Where the head office is abroad, to registry in jurisdiction where principal branch or agency situate (art. 85 (2))
- Jurisdiction refers to regional state and sub-regional administrations, if any.

Principal and summary registration (art. 86)

- No trader or business organization shall be principally registered in more than one local register even if he carries on different trade in different Regions;
- Nor shall he be registered under more than one registration number in one register;
- *Where a trader carries on a trade or operates a branch or has a representative office in Regions other than the place where he is principally registered, he shall make an application to be summarily registered in those Regions and a reference shall be made to the principal registration.*

Publicity

- A further formality requirement imposed on the parties to a valid partnership agreement is publicity.
 - Art. 73 for traders; Art. 265 for companies, 175
- According to [old Code Article 219(1)] of the Commercial Code “any business organization other than a joint venture shall be made known to third parties.”
 - **Cumulative reading of Arts. 175 cum 172, 173 (1) and 73**
- The policy consideration behind the publicity requirement is to protect third parties.
 - *Entries shall have effect as of the business day following the day of entry. (art. 73)*

Key elements in the definition BO

- The new Code defines BO under Art. 172
 - A business organization is an association established through a memorandum of association by persons who bring together contributions for the purpose of undertaking an economic activity in cooperation and of participating in the profit made.
- There are some key elements in this definition:

Key elements in the definition BO

1. Contract (Partnership agreement or MoA)

- BO is created by an agreement among the persons who have agreed to join hands.
- Persons who associate themselves should enter into a contract of association.
- The word person includes not only physical persons but also legal persons as well. Hence, ***Business organizations and other legal persons as well can be partners.***
- Even bodies corporate under public law, religious institutions, civil society organizations or cooperative societies may happen to be shareholders or partners in a business organization Art. 4 (2)

Key elements in the definition BO

- The contract has to be a valid contract pursuant to Art 1678 of the civil code.
- **That, is, the parties must be persons, physical or juristic, having capacity to enter into contracts.**
- Thus, minors, lunatics persons are not eligible to establish BO. **Article 11(1), 12, 13**
 - **They must also give their free consent.**

Key elements in the definition BO

- The object of a partnership agreement as any other contract should be **sufficiently defined, lawful, moral, and possible..**
- By object of a partnership agreement we are referring to the obligation of the partners they owe each other and the activity to be carried out by the business organization.

Form

- **If required**, the contract should be made in the form prescribed by law:

- **See art. 214 of the Com. Code (Old)**

Art. 214. - *Formation to be in writing.*

- The formation of any business organisation other than a joint venture shall be of no effect unless it is made in writing.

- **Though there is no explicit requirement in the new Code, the fact that BO must be established by MOA (177) renders the requirement of writing clear.**

- **Art. 175** A memorandum of association is an instrument drawn up to establish a business organization. See also 175 cum 172

Two members requirement..

- As business organizations are groupings we need at least two persons.
- This requirement of minimum of two persons is true for all business originations except Share Company where at least five persons are required.
- **A minimum of two persons** requirement ousts the possibility of one man business organization.
- The new Code recognizes **one person private limited company** as a business organization. (sub-3 of art. 172)
- Thus, an entity established by one person save the case of art. 172 (3) is not a BO within the meaning of the Commercial Code.

Two members requirement

- **The minimum requirement of two persons is true for all business organizations except the share company, for which there must be at least five and one man private limited company.**
- There is no general limit on the maximum membership size of business organizations, except in the private limited company where it is fixed at **fifty**. Art. 495 (4)

Contributions

- To be valid, parties to agreement to establish BO must undertake to bring in contributions.
- In all business organizations, except in a share company or private limited company, contributions can be made in cash, kind, or services (skill)
- In PLC and Sh. Co. contributions should be made in cash or kind. (art. 256 Sh. Co., art. 501 PLC)
- Limited partners in limited partnership may not make contribution in the form of skill.

Contributions

Nature and extent of contributions (GP Art. 186, LP art. 215, LLP Art. 226, JV 236, Sh. Co. art. 256)

➤ Unless agreed otherwise, contributions **shall be equal** and **of the nature and extent required for carrying out the business purpose** 186 (3)

➤ Equality of contribution is, thus, a presumption in GP.

➤ For GP, unless otherwise agreed, every partner shall have an equal share in the profits and losses, **irrespective of the nature and amount of contribution** he made to the partnership. (Art. 192 (1)) cum 211 (3)

– *If the agreement specifies only either the share in the profits or losses, such agreement shall apply*

Contributions

Nature and extent of contributions

- Business can be also contributed to BO (art. 168)
- Capital contribution includes intangible property (186).
- Contribution can be made in the form of money, movable or immovable property, skill, trademark, good will, patent, lease right, usufruct or other contributions., or even debts owed to the contributor. (186 (1))
- Contributions may be made to enable the partnership to **own** or **use property**. (art. 186 (2))

Contributions in kind

- In the case of in-kind contributions, their value and method of valuation shall be indicated in MoA art. 185 (5)
 - For partnerships, valuation of contribution in kind shall be as agreed by the partners. 186 (4)
 - But, the difference between the overvaluation and the actual value of the contribution shall be paid by the contributor in case of overvaluation or his share shall be reduced accordingly art. 186 (5)
 - **For Sh. Co.** valuation of contributions made in kind follow stricter procedure. It shall be in

Contributions in kind

- A partner who has **made contributions in kind** shall carry out the duties of a seller under the sale provisions of the Civil Code (art. 187 (1))
 - A partner who contributed the ownership of property may not claim it back upon dissolution but its value. (art. 192 (2))
 - The risk shall be transferred to the BO (Art. 188)

Contributions in kind

➤ ***In JV, every partner owns his contribution.
(art. 236 (2))***

- ተቃራኒ ስምምነት ከላ በቀር እያንዳንዱ ማህበራዊ ገቢ ሊደረገው መዋጮ ባለሀብትነቱን እንደያዘ ነው የሚቆየው። ከሰር ጀምሮ ከተደረገው ክርክር እንደሚታየው ውሉ ከተደረገ በኋላ በጋራ የተገዛ ንብረት ወይም የተደረገ መዋጮ የለም። ይሉቁንም የጋራዥ ንግድ በተጠሪ ስም ብቻ እንደተመዘገበ ነው የቀጠለው።
- የንግድ ፍቃድም በተጠሪ ስም ነው። በመሆኑም የአመልካች ባለቤት የጋራዥም የጋራ ባለሀብት ነው የሚባልበት የህግ ምክንያት የለም። ሲጠቃለል አመልካች በጋራዥ ላይ የጋራ ባለሀብትነት መብት እንዳለው በመቁጠር ያቀረበው ክርክር በሰር ፍ/ቤቶች ውድቅ መደረጉ በአግባቡ ነው።

Contributions: service

- Where there is a partner contributing skill, **the services required from him** must be indicated in the MoA art. 185 (6)

Contributions: Use of property and debt

- A partner who has contributed only the use of property shall carry out the obligations of a lessor under the provisions of the Civil Code dealing with the contract of lease (art. 187 (2)).
 - The risks shall remain with the contributing partner (Art. 188)
 - A partner who contributed only the use of property is entitled to take it back upon dissolution. (art. 192 (1))
- A partner who has contributed a debt shall have the same obligation as a debtor under the contract of loan provisions of the Civil

Contributions

- A partner who fails to make a contribution in due time shall be liable to pay interest or penalty to the partnership from the date he should have made the contribution. (art. 189)
- Effect of failure to contribute Cassation in Partnership vs. Share company
 - **Vol. 7 No. 19258**

Intent to Join Together and Cooperate

- **For a partnership agreement to be valid, the parties to it must have had the intention “to join together and to cooperate.”**
 - **See art. 172 (1) bring together contributions for the purpose of undertaking an economic activity in cooperation.**
- For one thing, this is to mean that the parties to the partnership agreement acted in the way they did with a view to forming a business organization.
- In other way, this is to say partners (particularly in partnership business form) must undertake the economic activity in **cooperation**.
 - **See also art. 192 (b) work diligently and with due care to achieve the purpose of the partnership;**
- **Even more, inability to act together may result in dissolution.**
 - a disagreement occurs among the partners precluding them from acting together art. 205 (1)(c) GP

Intent to Join Together and Cooperate

- Cassation Vol. 18 94481:
- የሽርክና ማህበር በህግ አግባብ ተቋቁሞ እየሠራነው ለማለት በጽሁፍ ውል መደረጉ እንደተጠበቀ ሆኖ በተግባራዊ እንቅስቃሴ ተዋዋይ ወገኖች በጋራና በተናጥል በመተባበር በመስራት ከጥቅሙም ይሁን ከእዳው በጋራ ሲጋሩ እንደነበር መረጋገጥ ያለበት ሥሆን መሆኑ፤
- አንድ የሽርክና ማህበር በህግ አግባብ ተቋቁመ ለማለት የሚቻለው ተዋዋይ ወገኖች ተነጻጻሪ ሳይሆን ተደጋጋፊ የሆነ ግብ ይዘው መዋጮ በማውጣት አብረው በመስራትና በመተባበር ትርፍና ኪሳራም በህግ አግባብ እየተጋሩ ኢኮኖሚያዊ ተግባር ማከናወናቸው ሲረጋገጥ ብቻ ስለመሆኑ

Carrying out an economic activity, with profit motive

- An essential character of a business organization that it **should have a profit motive**, this being the feature which distinguishes it from an association.
- If profit is considered to be the **underlying motive** for the formation of a certain organization, then it is said to be a business organization vice versa.

Carrying out an economic activity, with profit motive

- The old code's commercial-non-commercial BO dichotomy
 - Exception: ordinary partnership:
 - *Art 213. 1) Any business organisation other than ordinary partnership may be a commercial business organisation within the meaning of Art. 10 (1).*
- *(2) **Where a commercial business organisation** is created in the form of an ordinary partnership or where the form of the organisation is not specified, the commercial business organisation shall be deemed to be a general partnership.*

...Carrying out an economic activity, with profit motive

- It has to be pointed out that economic activities include, **but not limited to**, all of the commercial activities mentioned under Article 5.
- However, we should bear in mind that **all non-economic activities are excluded outright** by virtue of the above-mentioned requirement.
- **In short, the purpose or object of BO must be to carry on one of the activities listed under art. 5 or similar activities.**

Participation in the profits and losses arising out thereof

- There must be an agreement among the partners to share the profits and losses of the business.
- If two or more persons **share the income of jointly owned property**, it is not regarded as partnership.
 - ***No matter how much the extent is, participation both in profit and loss is mandatory.***
- **Every party to the partnership agreement must have the intention to share in the profits and losses.**
- **Profits and losses will be distributed between the members in the proportion stipulated in the partnership agreement.**

Profit and Loss

- **New: Art. 185. --- Memorandum of association**
- The memorandum of association of the partnership shall contain among others:
 - 7) *the share of each partner in **the profits and losses**, and mode of allocation of profits;*

Share in Profit and Loss

- The share of the parties in profits and losses need not be equal. If so, they must agree.
- **Old Code** 252 & 192 of the New. - *Manner of distributing profits and losses.*
- *(1) Unless otherwise agreed, every partner shall have an equal share in the profits and losses, irrespective of his contribution.*
- *(2) If the agreement specifies either the share in the profits or the share in the losses, this provision shall apply equally to the share of profits and losses.*

Profit and Loss

- Similarly, the partnership agreement may never award all profits to some of the partners alone.
- Also, no partner may be exempted from losses that may accrue.

Art. 215:-Void provisions (old).

- *(1) Any provision giving all the profits to one partner shall be of no effect.*
- *(2) Any provision relieving one more of the partners of his share in the losses shall be of no effect.*

Draft Art. 178. --- Void agreement

- *Any agreement giving all the profits to only one or some of the members of a business*

Profit and Loss

New Code Art. 178

- ***Any provision giving all the profits to only one or some of the members of a business organization shall be of no effect.***
- ***Read also Art. 172....participating in the profit. (loss is omitted)***
- ***For some reason, the legislator seem to allow exemption of one or some of the members in the share of loss.***
- ***IF so, exemption shall be explicitly agreed as there are counter presumptions. See Art. 192 cum 211 for GP***

Profit and Loss: exception

Art. 254. - Contribution of skill.

- *Notwithstanding the provisions of Art. 215, provisions may be made to the effect that a partner who contributes skill **only shall share in the profits and not in the losses.***

A BO is formed:

- A BO is perfectly formed and acquire legal personality:

1.If the parties draw up a valid MOA which includes:

- *The MOA fulfils the requirements of a valid contract as per the provisions of the general contract;*
- *If all the parties agreed to make contribution;*
- *If the parties have intention to join together and cooperate;*
- *If the purpose or object of the business is to carry on economic activities and has principally a profit making motive*