Chapter III: Business Organizations

- Generally there are **two** modes of doing business or kinds of Business Entities
  - **1. Sole proprietorship**:-
  - **2. Business organizations**
- Q? what is the difference b/n the two?

1. Sole proprietorship

- **A single Person (natural person = traders) c**arrying on business **on his or her own name** or **a business name**
  - The **business and the person are one and the same**,

❖ This brings **three key implications**:-

- **The sole proprietor is legally responsible:**
  - 1. To **complete all contracts** entered into by the business.
  - **2.** For T**orts committed >Vicariously liable** for the torts of employees.
  - **3.** For I**ncome/losses of the business** for **tax** purposes.

i.e. **Unlimited personal liability**

Definition of BO

- **Old Code** Art **210 +211** Vs New code Art. **172**
- Any difference?
- ***Old Code Art 210+211***=A business organization is any **association** arising out of a **partnership agreement**
- ***Art 211***-A partnership agreement is a **contract** whereby 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** arising out thereof

Definition of BO under the New Code Art. 172-

- BO is **"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"**

- **Q? What are the essential elements**

Essential elements in the definitional articles

- **For the Old Code** Essential elements in partnership agreement
  - **Contract** - “partnership agreement.”
  - **Two** ore more persons
  - **intend** to join together and to cooperate
  - Bring together **contribution -** in cash, kind, or services.
  - Carrying out activities of an **economic** nature
  - **Participating** in the **profits** or losses

Essential elements in the definition…

- For the **New Code**:-
- 1. **Memorandum** of association **Art. 177**
- **2. One** person can form a business organization by himself.
- **3. Contribution-** in **cash**, **kind**, or **services**.
- **4. Participate in an activity of economic nature**
  - **Exclude activities done by civil association** with a **humanitarian** nature.
- **5. Cooperation**
- **6.**P***articipating in the profits or losses arising out thereof***
- Profits or losses will be distributed , giving all the profits to only one or some shall be of no effect (Art. **178**).

Publicity of BO

- Besides **validity requirement** we have seen so far as essential element, **Publicity** is further formality requirement **under the old code**.
- As per Art. 219(1) "any business organization other than a joint venture shall be **made known to third parties**."
- This has been ***Getting Rid*** of by the New code from being

BO Vs Business owned by one man

- **Features distinguishing** BO from the business owned by one man **includes**:-
- 1. **Plurality of membership**- more than one member
- 2. **Possession of distinct assets**- having assets distinct from the private assets of the members
- 3. **System of management**

Business Organizations Vs Associations

- **Art. 404** of the Civ - association is formed a view to obtaining a result **other than the securing or sharing of profits**.
- **Associations** are always formed for **non-profit purposes** as charitable organizations, religious groups, NGOS ....
- BUT the underlying motive for the formation BO is **profit**
- Associations and business organizations are **governed** by **two different legal regimes**.
- Associations are regulated by Articles 408-482 of the **Civil Code** whereas BO are governed by Book II of the **Commercial Code**

BO Vs Cooperative Societies

- Cooperative Societies are groupings that are **organized to provide an *economic service without profit* to their members**
- **Cooperative societies are governed by the Cooperative Societies Proclamation**
- Cooperative Societies shall have one or more of the following objectives:-
  - to ***solve problems*** collectively which members cannot individually achieve;
  - to achieve a better result by coordinating their knowledge, wealth and labor;
  - to promote self-reliance among members;
  - to collectively, withstand and solve economic problems;
  - to improve the living standards of members

Classification of BO

- **BO** may be **classified into two** according to the **general characteristics** they **share** in common:-
  - 1. Partnerships and
  - 2. Companies on the other.

1. **Partnerships**

- An **aggregate** or **collection of individual members**.
- **Personality** of the individual partner has importance.
- **Intimate** personal collaboration is expected of each partner and **only persons who know each** other very **closely** with a relationship of **mutual trust and confidence** may form a partnership firm.
- This is because **incapacity**, **death**, or serious **disagreement** between partners may result in **dissolution** of the partnership firm.
- **The partners are** agents **for each other.**
- A partner **cannot transfer or assign his interest** in the firm to an **outsider or third party** and make the transferee or assignee a **partner without the consent of all the other partners.**
- They are **jointly and severally** liable with **unlimited liability to third parties**

(2) **Companies**

- An aggregate or **collection of shares or capital**.
- **Legal personality** of the company has importance.
- It is **entirely distinct** from its members.
- The company may own property, make contracts, and sue and be sued **under its name**.
- The company has **perpetual succession**- **Death** or **insolvency** of a shareholder does **not affect** its existence.
- Shares in a company are **freely transferable unless otherwise provides**.
- **Members** of a company are **not entitled** to take part directly in the **management** of the company unless they become directors.
- Managed by a BOD, general manager, shareholders' meetings, and auditors

Forms of Business Organizations

- ***Under the Old Code***, there are **six legal forms of business** organizations provided under **Art. 212** of the Comm. Code:

1. **Ordinary** partnership
2. **Joint** venture
3. **General** partnership
4. **Limited** partnership
5. **Share** company
6. **Private** limited company

Forms of Business Organizations…..

- Under the New Code, there are **Seven legal forms of business** organizations provided under **Art. 174** of the Comm. Code:

1. **General** partnership
2. **Limited** Partnership
3. **Limited Liability** partnership
4. **Joint** Venture
5. **Share** Company
6. **Private Limited** Company
7. **One person** Company

The common Features of all the 7 types of BO

- The **7**types of business organizations are **different** and are one of their own kinds, but they **share in common the following points**

- **1**. **Formation** of each type of business organization shall be by **memorandum of association** & in **writing** save for Joint Venture.
- **2**. All of them shall be granted **legal personality up on registration in a commercial register excluding Joint Venture.**
- **3**. All of them exist **artificially** and run their trading activity through agent (Biological Person) only.
- **4**. **Assignment of profit** or loss to a single partner is totally prohibited in all kinds of business organization.
- **5**. All of them shall **dissolve** as a business organization when **partners agreed** to the effect, or by **Law**.

Memorandum of Association

- **Content**
- firm-name;
- head office and branches,
- name, address and nationality of Share holders
- business purpose
- Details of contribution,
- mode of allocation of profits
- manager and agent etc ....
- See Art. 185 eg for Partnership

Common Grounds of **Dissolution** of BO

- **1**) **Purpose** **achieved** or **cannot** be achieved;
- **2**) **Term** of business organization was formed **expires**,
- **3**) Members **agree** **to dissolve**
- **4**) **Court** **decides to dissolve** the business organization for **good cause**
- **5**) **Court** declares the business organization **bankrupt**.
  - See Art. 181 New Com. Code

Winding up and Liquidation procedure

- **Dissolution** of a business organization should **follow** winding up and liquidation **procedure** which **includes**;-
  - **Completing** **unfinished** business,
  - **Collecting** debts,
  - Taking **inventory**,
  - Reducing assets to **cash**,
  - **Auditing**,
  - Paying **creditor** and
  - Finally **distributing** the remaining assets to members.

Cancellation of registration

- Where a business organization is **dissolved and wound-up**, the **liquidators** shall apply for the **cancellation** of the business organizations from the commercial register.
- The business organization shall **cease to have legal personality** starting from the **day following** the date of the cancellation.
- The cancellation shall be **published in a newspaper** with wide circulation in the area where the business organization had its head office.
- See Art. 182

chapter 4- 10 ----

- The ***basic legal structure of each form of business organizations will be outlined by our discussion under chapter 4- 10 focusing on the factors that distinguish one form from another.***
- In addition the legal implications of conducting business under certain organizational form will be discussed.
- Before that let you to have glance look at new introductions made by the new Commercial Code briefly as follow

New introductions made by the new Commercial Code

New introduction by the new Commercial Code

- The former Code recognizes six Business Organizations
- the new Code recognizes seven Business Organizations; three Companies by introducing one Company,
- The new has also removed the controversial Ordinary Partnership while it introduced Limited Liability Partnership(LLP) and One Man Company .
- Under the former Commercial Code for a Business Organization to exist there must be at least two members
- but under the new Commercial Code it is possible to have a Company with only one member with limited liability.

Getting Rid of the Articles of Association Requirement

- The formation of a company is made through a public memorandum which contains the details of the company such as name, address, membership, capital contributed, etc., which is referred to as the ‘memorandum of association’.
- In addition to the memorandum of association, the Repealed Code required articles of association, which govern the operation of the company.
- However, the New Code got rid of the requirement to have articles of association as part of the formation of the company.
- Under the New Code, the mere adoption of the memorandum of association by the founders is sufficient to establish a company.

New introduction On share company

- Adoption of a two tier Board of Directors structure of a Share Company by introducing ’Management Board’ and Supervisory Board.
- The former code, has recognized only the Management Board of Directors of Share Company in which only shareholders of the Company can be a member while the new law recognized two levels of Board of Directors by recognizing both Management Board of Directors and Supervisory Board of Directors. In doing so, the new law has adopted both ‘stockholders’ approach in which case only shareholders of a Company can be a member of the Board of Directors and ‘Stakeholder approach’ in which case a non-shareholder stakeholder can be a member of Board of Directors.

Introduction of supervisory Board of Directors

- The introduction of supervisory Board of Directors in Share Company is an important new development for it enables stakeholders to have a say on what Companies do without the need to be a shareholder of the Company.
- , “good Corporate governance is a key in the success of a Company and the introduction of a robust Corporate Governance scheme under the new Commercial Code is a positive step forward in advancing the Corporate Governance of the Companies”.
- In addition to introducing two tier Board of Directors, the new law has also introduced non- shareholder members of the Board of Directors as opposed to the former Code that requires being a share- holder to be a member of a Board of Director

Holding Company

- Holding Company and its relationship with affiliate companies and subsidiary Companies as opposed to the former one.

The LLP Form:

- The LLP is an improvisation on the Limited Partnership already contained in the ECC and different in sense that all of the partners, whether participating in management or not, have limited liability. The LLP is intended for providing an opportunity for professional service firms (e.g. lawyers, accountants, auditors, architects, etc.) to organize in a corporate form at the same time enjoying limited liability to the extent of only their contribution to the capital of the LLP. It is not clear how the tax law will treat the LLP form and whether it will enjoy the tax treatment accorded in the jurisdictions where it is prevalent

changes to the provisions relating to Private Limited Companies (PLCs)

- The right of members of a PLC to form a Board as a management body is clearly recognized;
- The minimum par value of a share has been increased from ETB 10 to ETB 100 (this is the same for share companies);
- Meetings via video conference or other means of communications have been recognized as legitimate;
- Recognition of pre-emption rights for shareholders when an offer is made by a non-shareholder; and
- A company is permitted to buy back its shares.

The OPC Form:

- The OPC is formed just by one person making a declaration in a form prescribed by the law.
- It enjoys a legal personality autonomous or separate from the person forming it and its liability is limited to the extent of the contribution that the person makes into the company. Liability does not extend to any other property and this feature makes this form very suitable to sole proprietors. It seems the intention of the law is to offer an opportunity to natural persons who are sole proprietors to set up an OPC if they wish to and may not extend to apply to a corporate entity (an artificial person). The person forming the OPC may himself be the manager or he/she may appoint another person as manger. It is important to note here the prohibition that one person cannot establish more than on OPC although it is not clear why this is the case.
- One-person Company can be formed by one person, something that was not previously allowed under the Repealed Code.

Forms of Shares

- The Repealed Code recognized two forms of shares: registered and bearer shares. Bearer shares are owned by a person who has the share certificate and can be transferred by mere delivery of the certificate to another person. On the other hand, registered shares need to be registered in the name of a specific shareholder under the company's registry, hence, any transfer needs to be registered.

- The New Code, compatible with other share transfer rules of the country, got rid of bearer shares. Also, the New Code came up with an incorporeal form of shares, which is a share created electronically by a financial institution licensed by the National Bank of Ethiopia, which is a reference to shares traded in stock markets.

New Rules Concerning Share Transfers

- A. Mandatory Redemption by Request of Minority Shareholder
- The New Code introduced a minority shareholder protection clause in which a minority shareholder holding less than 10% of the shares in a company may request a majority shareholder, holding more than 90% of the shares in a company, to redeem its shares. With the request, the minority shareholder needs to provide the basis used for determining the redemption price. If the price proposed by the minority shareholder is not acceptable to the majority shareholder, they can refer the case to court, and the court will appoint an expert to determine the price.

- B. Redemption by a Majority Shareholder
- A shareholder holding more than 90% of a company can request that the minority shareholders have their shares redeemed by that shareholder, and the request shall take effect in 5 weeks. The same rules apply, discussed above, for determining the redemption price.
- C. Mandatory Bid
- If any person wants to buy shares representing 50% or more of the total capital of a company, that person will be required to make a tender offer to all the shareholders of the company. Despite having this provision, the New Code is not clear about the circumstances and conditions in which this mandatory bidding process will occur.

7. Board Related Changes

- In the ladder of corporate governance, the role of the Board of Directors is immense. Under the Repealed Code, the establishment of a Board of Directors is only recognized for share companies. Under the New Code, the following major changes are adopted concerning a Board of Directors.

- A. Non-Shareholder Board Members
- In the Repealed Code, only shareholders of the company were allowed to be represented in the Board of Directors. This requirement has been eliminated by the New Code, which allows companies to appoint non-shareholders as directors. This change enables independent directors to sit on the Board, bringing an outside perspective and more objective viewpoint to the company.

- B. Board of Directors in Private Limited Companies
- The New Code introduces a Board for private limited companies. As discussed above, only share companies used to be required to establish a Board of Directors. However, members of a PLC have been given the option to establish a Board of Directors under the New Code.

- C. Introduction of a Supervisory Board
- Companies have been given an option to establish a supervisory board, in addition to a Board of Directors. The number of supervisory board members may not be less than three or more than five. Only shareholders of the company who are not already members of the Board of Directors can be appointed as members of the supervisory board.

- This change introduces a tiered board system to the Ethiopian company law. A supervisory board is empowered to oversee the Board of Directors and the management to ensure that directors and managers are discharging their responsibilities properly. The supervisory board also oversees the financial affairs of the company and can recommend corrective measures when they see acts that jeopardize the interest of the company. Finally, the supervisory board is empowered to undertake the role of a board of directors in the absence of directors in terms of calling general meetings of shareholders, and the supervisory board will have a non-voting seat on the Board of Directors.

9. Detailed Rules about Merger and Division of a Business Organization

- The New Code includes detailed rules about mergers and division of business organizations. These rules align with the current legal and institutional framework of doing business.
- The New Code provides details about the merger and division decision-making process, rights of different stakeholders and the practical procedures for completing these functions