

FOUNDERS OF SHARE COMPANIES UNDER THE ETHIOPIAN SHARE COMPANY LAW: LEGAL ANALYSIS

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Abstract

This article explores the Commercial Code and other laws of Ethiopia regarding founders – who they are, liabilities and benefits - who are also called ‘promoters’ by many other company laws. To some extent, it also looks into the business practice based on documents like memorandum of associations, articles of association and prospectuses. By so doing, it discloses many of the flaws in the existing laws. It argues that the Ethiopian share company law recognizes large number of persons as founders which is against the general convention in the area. Accordingly, it tries to indicate that not all founders in the law shall be held responsible for the liabilities that may emanate from the activities pertaining to forming a share company. In addition, it shows that the law does not adequately regulate the matters connected with the liabilities and benefits of founders. Apart from imposing liabilities on a person who should not be responsible at all, it is found that there are several challenges for both the injured parties to claim against the founders and the founders to get their benefits. Accordingly, the article suggests that the law on founders should be revisited to avoid the pitfalls arising out of the process of establishing share companies.

Keywords: *founder, joint and several liability, pre-incorporation commitments, promoter, Share Company*

I. INTRODUCTION

A share company does not exist spontaneously as its formation requires planning and other preliminary arrangements.¹ These preliminary tasks are to be carried out by persons called ‘promoters’.² Promoters have decisive roles in a share company formation. As a result, company laws give due attention for matters related to promoters.³ They impose various duties and liabilities to safeguard the interests of the share company that will be formed, subscribers and other third parties who have interests relating to the formation. Additionally, the laws recognize certain rights to the persons involved in share company formation.

Likewise, Ethiopia, mainly through the provisions of its Commercial Code, attempts to regulate the issues that would arise in relation to promoters. There are, however, a number of flaws in the laws that regulate the same. The problems generally relate with the definition of promoters (which the law names as ‘founders’), their liabilities and their relationships with the

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¹ See Seyoum Yohannes, *On the Formation of a Share Company in Ethiopia*, XXII: 1 J. ETH. L. 102, 100-127 (2008).

² See JANET DINE, *COMPANY LAW* 86 (4thed.) (2001).

³ See FIKADU PETROS፣ የኢትዮጵያ ኩባንያ ሕግ፣ አንደኛ እትም፣ 2004 ዓ.ም፣ at 68.

share company, third parties and the subscribers. What is more, the draft Commercial Code has maintained almost the whole provisions on founders as they exist in the current Commercial Code. It is, thus, desirable to examine the existing laws to rectify the challenges that arise during the formation of share company.

To meet its purpose, the article analyzes the relevant provisions of the Ethiopian Commercial Code and other laws dealing with founders as primary sources. It also analyzes these laws with the practice in the business community by referring to prospectuses, memorandum of associations and articles of associations. Different books, journals and laws of other countries were also consulted to examine the Ethiopian law on founders of share company.

The remaining parts of this article are organized as follows. Section II provides brief overview of promoters. It tries to define the term promoter and indicates the various tasks the promoter would do to establish share companies. Section III provides some of the rationale to identify founders from other parties involved in the formation process in different capacities. Section IV is destined to investigate the Ethiopian law on what it calls ‘founders’. In particular, it dwells on dealing with the aptness of the lists of persons whom the law considers as founders. Section V is reserved to discuss the diverse duties and liabilities of founders and related issues in Ethiopia. To this end, the section gives attention to the nature and grounds of liabilities. More importantly, it also examines if all founders are equally liable for all injuries arising from the process of share company formation. Section VI is about the benefits and protections given to founders in the law. It points out the conditions for the enjoyment by founders of the benefits and protections. Finally, section VII provides conclusion and remarks on the subject.

II. PROMOTERS OF SHARE COMPANY: GENERAL

In Ethiopia, there is sometimes a claim that the term “founder” in the Ethiopian Commercial Code is the same as the term promoter.⁴ On the flip side, there are others who claim that the two terms are different.⁵ Despite this, the clearest thing in the Commercial Code is the fact that the term promoter is used nowhere in the Commercial Code. Terms like ‘founder’ and ‘organizer’ are said to be synonyms of ‘promoter’ in the general jurisprudence.⁶ ‘Incorporator’ is also used instead of ‘promoter’ in some jurisdictions.⁷ In addition, projector was used to refer to persons engaged in the formation of a corporation.⁸

The complete judicial acceptance of the word promoter is, however, of recent date.⁹ Promoter, as a term, was not being used until after it had been used in the Joint Stock Companies Act of 1844 of UK.¹⁰ According to this Act, promoter is every person acting by whatever name in the formation of a company at any period prior to the company obtaining a certificate of

⁴ Seyoum, *supra* note 1.

⁵ See, for instance, Liku Worku *et al*, የንግድ ሕግ ማሻሻያ የፖሊሲ ሰነድ፡-የንግድ ሕጉን ለማሻሻል የተረገቡ የፖሊሲ ነጥቦች አጭር ማጠቃለያ፣ at 15.

⁶ ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW 23 (2nded.) (2004).

⁷ David C. Donald, *Approaching Comparative Company Law*, 14:1 FORDHAM JOURNAL OF CORPORATE & FINANCIAL LAW, 121, 82-178 (2008).

⁸ BLACK’S LAW DICTIONARY 3835 (8th ed. 2004).

⁹ *Id.*

¹⁰ *Id.*

complete registration.¹¹ This definition is only for the purposes of the act so that it is inadequate for general purposes.¹² Though it can be agreed that promoters are indispensable for the formation of a company, defining them seems to be a difficult exercise. Black's Law Dictionary defines promoter as "a founder or organizer of a corporation or business venture; one who takes the entrepreneurial initiatives in founding or organizing a business or enterprise".¹³ In UK, there is no satisfactory statutory definition of a promoter.¹⁴ The statutory attempt to define promoter has been made under section 67(3) of 1985 UK Companies Act which defines promoter as "a person who is 'a party to preparation of prospectus or a portion of it'". Clearly, this definition cannot be sufficient since it confines the status of promoter only to the preparation of prospectus.

In the common law, the usual dictum is that of Cockburn CJ in *Twycross v Grant* (1877).¹⁵ In that case, the term promoter is defined as "one who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose".¹⁶ This definition is broader than the one given above under the 1985 UK Companies Act. The definition incorporates two necessary elements that need to be satisfied for a person to become a promoter. One is the intention element which can be expressed when the person accepts to form a company. The second is the activity element which can be expressed by taking the necessary steps during the formation process. However, judicial practices provide us with certain exceptions to which the above definition would not apply for persons who were engaged in certain activities during the formation. It does not, for instance, apply to persons acting in a purely professional capacity if they are not involved in the business side of the formation.¹⁷ In particular, the status of founder should not be given to employees acting in their capacity as employees as per their employment contract.¹⁸ Interestingly, however, it may be possible for a person not to have been overtly engaged in the formation process. In this case, it has been said that the person shall be held as a promoter if he/she is the real 'power behind the throne'.¹⁹

Though identifying promoters is approached variously in different legal jurisdictions, there is a common element in the attempts to define or explain the term. It stands for persons who are involved to carry out the necessary steps to form a company. They framed the company, prepared the prospectus, found the directors and paid for printing, advertising and the expenses incidental to establishing the company.²⁰ Generally, the promotional activities of promoters may

¹¹ MANFRED W. EHRICH, *THE LAW OF PROMOTERS* 4 (1916).

¹² *Id.*

¹³ BLACK'S LAW DICTIONARY, *supra note* 8.

¹⁴ See NICHOLAS BOURNE, *ESSENTIAL COMPANY LAW* 44 (3rd ed.) (2000).

¹⁵ See NICHOLAS BOURNE, *PRINCIPLES OF COMPANY LAW* 25 (3rd ed.) (1998).

¹⁶ See BEN PETTET, *COMPANY LAW* 44 (2nd ed.) (2005). See also *Id.*

¹⁷ *Id.* See also the Malaysian Companies Act of 1965, Section 4(1)

¹⁸ Lantera Nadew, *Pre-Incorporation Management under the Ethiopian Company Law: The Need to Redefine the Provisions Defining Founders*, 1:1 JIMMA UNIVERSITY J.L., 12, 1-14 (2007).

¹⁹ See DINE, *supra note* 2.

²⁰ *Id.*

be classified as discovery (finding business idea), investigation (studying economic feasibility of the idea) and assembly (bringing together the necessary personnel, property and money).²¹

III. THE NEED TO KNOW FOUNDERS

Naturally, the process of forming share company causes various legal transactions in which the founders and subscribers are the primary actors. The subscribers are required to make a specified amount of contribution up on subscription for shares. According to Article 338(1) of the Commercial Code of Ethiopia, the specific amount is determined by the law or company documents. More importantly, Article 339(1) of the Commercial Code obliges in kind contributors to fully pay their contribution before the company is registered. For those who subscribe shares, the main reasons are the founders as they could invite them to invest in the share company under formation. The founders may invite even small income groups by lowering the minimum shareholding threshold.²² The subscribers will benefit when the company is established and make profit. On the other hand, they may suffer loss when the company goes nonpaying or is not established at all. In this instance, the investors need remedies against unwarranted actions of the founders that may affect their interest. In addition, other outsiders (prospective creditors) would develop interests in the success of the company formation process. Their interest may be due to the contracts they have concluded with the founders. The founders may rent offices, hire and train relevant workers, use professional expertise and may conclude other contracts. In practice, they also make use of institutions like banks to facilitate sale of shares. Moreover, third parties may conclude contracts with the share company after its formation. These parties may be urged to do so due to the statements made to the public about the company. All these persons need the assurance that they will be paid back or get the promises of the founders.

It should not also be forgotten that the company under formation may come up with its own interests against the founders. The failure of the founders to take all the due cares during the pre-incorporation period may affect the company after it becomes a legal person. The founders themselves may sell their assets to the company under formation and the company can be badly cheated.²³ Besides, the founders may be tempted to overvalue the property and fail to make disclosure of overvaluation to an independent person which, in turn, violates their fiduciary duty.²⁴ Therefore, it is imperative to have a way for the company to be remedied against the problems it may suffer due to the founders' pre-incorporation acts. Lastly, the need to identify the founders is not only to impose liabilities. Rather, rewarding the efforts made for the formation of the company is also something appealing which the law should recognize.²⁵ This can be made by allowing certain protections and privileges to founders.

²¹ See Seyoum, *supra* note 1.

²² Fikadu Petros, *Emerging Separation of Ownership and Control in Ethiopian Share Companies: Legal and Policy Implications*, 4:1 MIZAN L. REV. 14, 1-30 (2010).

²³ See DINE, *supra* note 2.

²⁴ *Id.*

²⁵ See FIKADU, *supra* note 3, at 70.

The above discussions justifying the need to identify founder can be further reinforced by the fact that the company under formation and the founders have no principal and agent relationship. In almost all jurisdictions, a company has no legal existence before it is formed.²⁶ It is incapable of entering into a contract itself and equally incapable of acting through an agent.²⁷

Understandably, the transactions during the formation process call for legal regulations. As a result, rules are necessary to protect the subscribers, the creditors and the company under formation. To this effect, company law should device a special mechanism. Accordingly, the Ethiopian share company law tries to regulate the legal relation of the parties during and after the formation of the company. As we shall see later, the share company law devices mechanism to establish legally recognized relationships between the founders and the share company which they finally establish. The company law imposes liabilities on the share company and founders toward each other. Similarly, the company law regulates the relationship of the founders with the subscribers and third parties. What is more, in the event the share company is established, third parties may have claim against the company based on their relation with the founders. For all these, identifying founders is, thus, of paramount significance.

IV. FOUNDERS IN THE ETHIOPIAN SHARE COMPANY LAW

Terminologically, the Ethiopian Commercial Code consistently adopts the term ‘founder’ though it does not specifically define the term. Despite this, there is a practice of using the term promoter both in the academic and business community. Beyond this, the business community sometimes classifies promoters as Main and Associate Promoters.²⁸ However, the practice within the business community regarding the two terms is not yet consistent. In some cases, the terms are interchangeably employed.²⁹ It can be, however, noted that promoter (main and associate promoters) is used to refer to the persons who are called promoter in other jurisdictions. There is also an increasing trend of using the term ‘promoter’ for persons who principally lead the formation process and ‘founder’ for subscribers who pay their whole contribution within a stated time.³⁰ In the academics too, there is no consistent understanding regarding the difference between ‘founder’ and ‘promoter’. In some cases, all of the persons whom the Commercial Code considers founders are called promoters.³¹ Importantly, the confusion is not still clear even for some persons involved in the amendment of the Commercial Code. In the views of these persons, the existing provisions on founders have no problems, so they can be kept as they are.³²

With regard to definition, all the Commercial Code does is listing persons that can be taken as founders of share company. Accordingly, several persons are considered as founders. As

²⁶ ANDREAS CAHN & DAVID C. DONALD, *COMPARATIVE COMPANY: LAW TEXT AND CASES ON THE LAWS GOVERNING CORPORATIONS IN GERMANY, THE UK AND USA*, 139 (2010).

²⁷ *Id.*

²⁸ See Prospectus of Hibir Sugar Factory, available at <www.hibersugarethiopia.com>, [last accessed Dec, 12, 2015]; See also Prospectus of Dalol Oil Share Company

²⁹ See for instance, Memorandum of Association of Dalol Oil Share Company, Art. 9 and its prospectus in English version.

³⁰ See FIKADU, *supra note 3*, at 70.

³¹ *Id.* at 68.

³² See Liku, *et al.*, at 16.

alluded to above, there is an agreement that founders are persons engaged in the pre-formation steps of a company. Moreover, the status should only be given to persons who took the necessary preliminary steps of company formation.³³ Contrary to this, the Ethiopian Commercial Code goes far to have broader lists of founders.

Article 307(1) of the Commercial Code makes it clear that the formation of share company is not possible by less than five persons. This minimum requirement applies to both share company established among founders and through public offering of shares. With less than five members, the company, according to Article 311(1) of the Commercial Code, will exceptionally be validly alive for a maximum of six months. When we think of the above minimum number, it is not clear if the five members are required to be founders. In this regard, there is a claim that the ‘five members’ requirement is about the need to have five founders to get the permission and to engage in establishing a share company.³⁴ Though the title of Article 307 reads as ‘founders’, it does not use the same term under Article 307(1). It rather says a company may not be established by less than five “members”. Members do not necessarily refer to the founders only. Thus, it may be understood that it simply requires that there should be five members (they may be founders and other subscribers) for the share company to get registered.

Article 307 of the Commercial Code provides the lists of persons who should be founders. However, the list is not exhaustive. Article 547(2) of the Code mentions another set of founders. Pursuant to Article 547(2), members of a Private Limited Company (PLC) who decide to convert the PLC in to share company will occupy the status of founder of the new share company. Cumulative reading of Articles 547(1) and 536 can tell us that conversion of a PLC in to share company does not require unanimous decision of the members. As such, some members may oppose the decision to convert it to a share company. In this case, the law does not make them founders. During such a conversion, it is plausible to assert that certain groups of founders under Article 307 of the Commercial Code can be founders. This is so because Article 544(5) of the Commercial Code states that rules related to formation of relevant business organization shall apply during conversion. As a result, the rules on founders are applicable in connection with conversion of a PLC to a share company.

A. Persons who Signed Memorandum of Association and Subscribe the Whole Capital

This group of founders exists only in connection with share companies established among founders. Article 307(2) envisages two requirements to bestow a legal status of founder. First, the person should sign the memorandum of association of the share company. In a share company established among founders, the founders have no duty to present prospectus. Rather, they have to sign memorandum of association of the share company that they are to establish

³³ Tilahun Teshome *et al*, *Position of the Business Community on the Revision of the Commercial Code of Ethiopia*, July 2008, at 20.

³⁴ See Liku Worku, *et al*, *supra* note 5 at 11. See also Booz Allen Hamilton, *Ethiopia Commercial Law & Institutional Reform and Trade Diagnostic*, January 2007, at 83.

among themselves.³⁵ Second, the subscription of the whole capital of the share company under formation shall be made only among those who signed the memorandum of association.³⁶

The requirements to establish share companies among founders are less stringent than those required for public share companies. Article 316 of the Commercial Code enumerates the elements that should appear in the Memorandum of Association. In closely held share companies, there are different categories of founders recognized in the Commercial Code. These founders may be the legal minimum of five persons or more. Irrespective of their numbers, initial subscribers of closely held share company are thus always founders. This is also true regardless of the nature and amount of their contribution to the share company. In fact, the subscribers should not be ‘straw persons’ as regards contribution.³⁷ They are expected to make relevant contributions that enable the prospective company be established and function well.

B. Persons Who Signed the Prospectus

Since prospectus is not offered by share companies among founders, such type of founders is known only in connection with share companies through public subscription.³⁸ As per Article 318 of the Commercial Code, prospectus is the document which should be prepared and presented for the public for selling shares. In capital goods finance share companies, prospectus is defined as “a printed statement that describes and forecasts the course or nature of the company along with expected risks to be distributed to prospective investors.”³⁹ According to Article 318 the Commercial Code, the founders by signing this document have many tasks that have to be part of the prospectus. They directly influence the subscribers more than any other group of founders since they provide the very important information for subscriptions.

At this junction, it may be imperative to highlight the nature of prospectus in our law. Generally speaking, there are different positions regarding the nature of prospectus. Since the earlier time, some suggest that it is an offer and others argue that it is not an offer.⁴⁰ It has been said that an agreement to subscribe for shares would be construed as a contract by the promoter upon the stipulated basis and to sell certain shares to the subscribers.⁴¹ On the other hand, company laws like Indian considers prospectus as documents inviting offers from the public for subscription.⁴² In Ethiopia, whether a prospectus is an offer or an invitation to offer is not clear. In the Commercial Code (Art. 318(1)), prospectus seems an offer. From contractual point of

³⁵ It can be said that these persons shall also sign the Articles of Association of the share company they are to form.

³⁶ See Commercial Code of the Empire of Ethiopia, Proc. No. 166/1960, NEGARIT GAZETA, *Gazzet Extraordinary*, 19th Year No. 3, Addis Ababa, 5th May, 1960, Art. 316 [herein after, The Commercial Code].

³⁷ See Seyoum, *supra note* 1, at 107.

³⁸ These types of share companies are formed through offering shares for the public at large. More than the closely held share companies, many interests would come in to play in this type of share companies. Consequently, the law puts some stringent and detailed requirements for their formation. The law governing the relations among the parties coming together for the events connected to the formation process is also more detailed.

³⁹ See Requirements for Licensing of Capital Goods Finance Business Directives No. CGFB /02/ 2013, Art 5.2.3

⁴⁰ See EHRICH, *supra note* 11, at 84-85.

⁴¹ *Id.* at 88.

⁴² See The Companies Act of India 2013, Section 2(70).

view, it is said that prospectus is an invitation to offer.⁴³ If so, the contents of Article 318(1) of the Commercial Code shows that the prospectus is meant to simply assist investors to make offers to subscribe shares. This, in turn, means that the founders may reject offers by this or that of the subscribers.⁴⁴

A critical look at Article 318 of the Commercial Code may indicate the possibility to take the prospectus as an offer.⁴⁵ Of course, this article contains more information beyond what a typical offer should contain. As said above, this information is to let investors make informed decisions to make an acceptance.⁴⁶ The prospectus should allow the subscribers to make informed assessment of the activities, assets, liabilities, management and prospects as to profits and losses and rights attaching to the shares being offered.⁴⁷ This can be possible, *inter alia*, through the additional information contained in the prospectus. However, the remaining elements under Article 318 of the Commercial Code are purely the terms of the offer that must be accepted by the offerees. Indeed, the prospectus as defined in the capital goods finance directive does not contain any term as an offer. Where a subscriber introduces any modification to the terms of the prospectus, it is a defective acceptance and shall be deemed to be a rejection as per Article 1694 of the Ethiopian Civil Code. This means the subscriber is making a counter offer which the founders do not have obligation to accept. Similarly, Article 469 of the Commercial Code indicates that, during capital increment, prospectus provides offers to subscribers of new shares. This provision also mentions the information that should be provided in the prospectus and the necessary terms that should be accepted by the subscribers.

More importantly, Article 318(2) defines the offerees. This would fulfill the Civil Code requirement that the offerees shall be specifically defined.⁴⁸ According to Article 318(2), all persons who may wish to apply to subscribe shares can do so. In fact, this provision does not work for certain categories of persons, as, for instance, non-Ethiopians, influential shareholders and regional states are prohibited from acquiring shares in the financial sector.⁴⁹ Moreover, the express use of the term “offer” in Article 318 and 469 of the Commercial Code intends to consider the prospectus as an offer. It is, therefore, possible to say that subscription is an ‘acceptance’ by an investor to purchase shares.⁵⁰ Article 319 of the Commercial Code further

⁴³ FIKADU, *supra note 3*, at 66.

⁴⁴ *Id.*

⁴⁵ The prospectus seems to be different from the declaration of intention under article 1687(a) of the Ethiopian Civil Code. As per this provision, declaring intention to give, to do or not to do something without making this intention known to the beneficiary of the declaration cannot be an offer. With the prospectus, the founders declare their intention to sell share and the beneficiary is anyone who comes to know the prospectus.

⁴⁶ The elements in Article 318(1(a) to (1c)) are purely to provide information to base decisions by the investors.

⁴⁷ Tikikile Kumulachew, *Regulation of Initial Public Offering of Shares in Ethiopia: Critical Issues and Challenges*, 4 ETHIOPIAN BUSINESS LAW SERIES, 13, 1-52 (2011).

⁴⁸ See Civil Code of the Empire of Ethiopia, Proc. No. 165/1960, NEGARIT GAZETA, *Gazzet Extraordinary*, 19th Year No. 3, Addis Ababa, 5th May, 1960, art. 1687(a) [herein after The Civil Code].

⁴⁹ *Commercial Registration and Business Licensing Proclamation* No. 686/2010, FED. NEGARIT GAZZETA 16th Year No. 42, Addis Ababa, 12 July 2010. Arts. 2(18), 2(16) and 2(26), *Insurance Business Proclamation* No. 746/2012, FED. NEGARIT GAZZETA 18th Year No. 746, Addis Ababa, 22 August 2012. Arts 9-10; and *Banking Business Proclamation* No. 592/2008, FED. NEGARIT GAZZETA 14th Year No. 57, Addis Ababa, 25 August 2008. Arts. 9-10.

⁵⁰ See Seyoum, *supra note 1*, at 110.

requires the founders to provide the application form with the prospectus. Besides, Article 319(2) of the Commercial Code requires the subscribers to declare that they read the prospectus.

Leaving the issues about nature of prospectus aside, persons who signed it are founders according to Article 307(3) of the Commercial Code. Staring at Article 318(1) may create confusion on who should sign the prospectus. Unlike Article 307(3), the reading of Article 318(1) does not suggest that the persons who signed the prospectus are founders. Rather, it requires the prospectus to be signed by the founders.⁵¹ This pushes one to know these founders, which in turn leads to Article 307 and other provisions of the Commercial Code. Pursuant to Article 307(3) and (4) of the Commercial Code, there are different group of founders. The conclusion that can be drawn from the cumulative reading of Article 307(3) and 318(1) of the Commercial Code is that all the founders should sign the prospectus.

However, close reading of them may make this conclusion unacceptable. Or else, at least for some of the founders, the conclusion may not work as they become founders after the prospectus is presented for the public. For instance, this applies to founders under Article 307(4) of the Commercial Code and for founders who make in-kind contributions. Understandably, thus, the founders stated under Article 318(1) of the Commercial Code are those implied by the phrase “*persons who sign the prospectus*” under Article 307(3) of the Commercial Code. This means that the founders who are expected to sign the prospectus are those persons who signed it under Article 307(3). Some of the founders under Article 307(3) and 307(4) are not expected to sign the prospectus. Sometimes, this may not, however, be true for those under article 307(4) of the Code. Those who merely initiated the formation of the share company may put their signature on the prospectus. Related with this, it has been argued that persons who sign on the prospectus are founders though they do not involve in any other action in connection with the formation process.⁵²

C. Persons who bring in-kind Contributions

The other group of founders is those subscribers who contribute in-kind.⁵³ Here, the mere contribution in-kind alone suffices to acquire the status as no regard is given to the type and amount of contribution. However, such status of founder is maintained only to in-kind contributors who make their contribution before the registration of the share company. This can be inferred from the reading of Article 370(1a) of the Commercial Code which excludes ‘*founders and in kind contributors*’ from being elected as auditors of the company. In this Article, it is clear that the term ‘*founders*’ includes contributors in-kind under Article 307(3).

The perplexing issue with this category of founders is the justification why these subscribers are founders while their counterparts via cash contribution are not. The distinction may be of no problem if it is considered in its face value. The problem would be vivid when we examine these

⁵¹ Such understanding has been reflected. See Nigussie Taddese, *Major Problems Associated with Private Limited Companies in Ethiopia: the Law and the Practice* (LL.M Thesis), (AA University, School of Law, 2013), at 98.

⁵² See Lantera Nadew, *supra note* 18, at 8.

⁵³ See The Commercial Code, Art 307(3).

founders in light of the benefits and liabilities attached to founders. Does the law have enough justification when it gives benefits to and impose liabilities on in-kind contributors, but not to those who contributed in cash? In the extreme case, one may question the basis to make in kind contributors founders even without comparing them with the cash contributors.

As stated before, the benefits for the founders are made as reward. Also, founders are required to bear liabilities. In the Commercial Code, the base for the liabilities seems to rest on the roles the founders played in making the members of the public or the would-be- company incur losses. Besides, the law does not seem to consider the magnitude and the relevance of the roles played by the founders. On the other hand, it may be contended that the Commercial Code considers the magnitude of roles played in the formation of the company and in putting the interests of other persons at risk. The distinction made between the subscribers (in cash or in kind) can support this contention. It also seems that the law tends to identify founders primarily to impose liabilities. The one who poses more potential threat on the interest of stakeholders should be required to take more of the risks. Herein below, a discussion is made based on this consideration to look if the distinction between the subscribers is tenable.

Unlike contribution in cash, contribution in-kind is subject to different requirements. In-kind contribution should be mentioned in the memorandum of association with its values, object, price, and shares allotted to the shareholder in exchange.⁵⁴ It does not mean that the value of the contributions in-kind is always equal to the value of shares given to the contributor. This may be understood from the reading of Art. 313(7) of the Commercial Code which does not require shares of equal value to be given to the shareholder. As shares cannot be issued at discount (Art. 326(1) and 306 of the Commercial Code), the value of in-kind contribution must not be lower than the sum of par values of the shares. Where shares are issued at premium as per Art 326(2), the value of the contribution should at least pay the amount including the premium.

Article 318 of the Commercial Code requires that the contribution in-kind with the above element should appear in the prospectus. On top of this, the Commercial Code under Art. 315(1) needs the valuation of the contribution to be made by experts. In the report, the experts have to show detailed description of the properties, the value and the method of valuation they employed. This requirement is to help investors make an informed decision. The valuation by the experts was designed to attach values that the in-kind contributions really deserve. These disinterested experts are much trusted than the founders or the contributors to give fair evaluation of the contributions. However, this requirement is no more applicable as it is repealed.⁵⁵ The agreement of the founders or the members of the business organization would be enough to make the valuation.⁵⁶ During the valuation process, whoever is to value, the contributors may be

⁵⁴ *Id.*, Art. 313(7). The law lacks clarity as to how valuation of in kind contribution can initially be presented in the prospectus. It may be possible when founders who signed the prospectus are also contributors in kind. Additionally, the law does not put the necessity of revising the prospectus once offered. If amendment is possible, every contribution in kind may be valued and the prospectus is amended accordingly.

⁵⁵ See *Commercial Registration and Business Licensing Proclamation* No. 980/2016, FED. NEGARIT GAZZETA 22th Year No. 101, Addis Ababa, July 2016. Art 5(9).

⁵⁶ *Id.*

expected to take the necessary steps like bringing the in-kind contributions to a certain place which have cost implication.

In addition, the time when the subscribers should perform their obligation may be important to examine the appropriateness of the distinction among the subscribers. The subscribers, if they are late, shall wholly contribute before the date of registration of the company.⁵⁷ Moreover, Article 339(2) states that shares representing contribution in-kind may not be separated from the counterfoil of the company and be negotiated before two years from registration. This bars the rights of the subscribers from simply transferring or pledging their shares before two years from the formation of the company. This is also another burden on the in-kind contributors. In this regard, there is a proposal that the length of the year should come down to one year.⁵⁸ Despite this, the Draft Commercial Code simply maintains the position of the Commercial Code. Nonetheless, the proposed one year time would not totally avoid the discrimination.

At times, the in-kind contributors may be forced to leave the company at all. To show this, we can find two situations where the in-kind contributors may face danger of leaving the company. The first instance comes when the subscribers sit to conduct the tasks of the subscribers' meeting as provided under Articles 320 through 322 of the Commercial Code. Among the purposes of this meeting is to approve contribution in-kind.⁵⁹ The subscriber shall leave the company where the subscribers' meeting reduces the number of shares allocated to contributors in-kind.⁶⁰ He may remain in the company if he can make the balance good.⁶¹ Being successful at this stage cannot totally avoid the possibility of withdrawal of or extra contribution by the contributor. Rather, the verification of the value of in-kind contributions by the auditors and directors would remain to be another source of worry. This is, as it is provided under Article 315(4) of the Commercial Code, when the verification of the valuation results in the value of the contribution being lowered by one fifth. Indeed, it does not seem that they are forced to leave the company for every minor reduction. A reduction by an amount below one fifth of the value appears tolerable. The directors and auditors shall make the verification within six months from the date of formation of the company. The law unequivocally states that the contributor shall withdraw unless he makes the difference good. Also, Article 315(3) stipulates that the shares representing the in-kind contribution shall not be given to the shareholder until the verification is made. This means the in-kind contributors can take their shares after the verification so that they can enjoy them in a way they like. This does not yet seem true since Article 339(2) prevents the in-kind contributors from assigning their shares before two years from the time of formation of the company.

Apart from the above, the law is not clear as to the effect of the verification of the auditors and directors or the approval of the subscribers which increases the value of the contribution by even a meaningful amount. The law is also mute as to the remedies to the contributor up on

⁵⁷ See The Commercial Code, Art. 339(2).

⁵⁸ See LikuWorku, *et al*, *supra* note 5, at 14.

⁵⁹ See The Commercial Code, Arts. 321(3), 322 (5) and 315(4).

⁶⁰ *Id.*, Arts. 315(4), 322(5)

⁶¹ *Id.*

leaving the company. In the former case, it may be possible to argue that the contributor may benefit from the increase if there is any. In support of this, Article 315(3) of the Commercial Code may be invoked. The provision generally authorizes the auditors and directors to review the valuation. Such review may increase the value of the contribution. In itself, such decision would also lead to a very important question. If the contributors are to be issued with additional new shares, it will increase the capital of the company. As can be observed under Article 464 and subsequent provisions, the Commercial Code imposes fairly stringent regulation in relation to increasing capital by share companies. In the first place, increasing capital amounts to amendment of the memorandum of association of the company.⁶² If so, Article 423 of the Commercial Code gives the power to amend the memorandum of association and articles of association to extraordinary meeting of the company. Hence, the directors and auditors cannot issue new shares to the in-kind contributors in the above situation. Secondly, the Commercial Code does not seem to allow new shares to be subscribed in return for in-kind contribution. This can be inferred from Art 464(2) of the Commercial Code which in a seemingly exhaustive manner lists out the means to pay for new shares. Apparently, contribution in-kind is not in the list. Indeed, one may argue that, as far as it does not affect the subscribed capital, the amount beyond the initial value can be returned to the in-kind contributors.

In case where the subscribers' meeting examines the in-kind contribution for approval, the above issue may not be serious. In this case too, one may raise certain concerns. The law envisions that the in-kind contributor may make additional contribution or shall leave the company where the meeting reduces the number of shares allocated to contributors in-kind.⁶³ However, the law remains unspeaking about the consequence if the subscribers' meeting finds that the value of the contribution was erroneously reduced. Of course, it may be possible for the meeting to issue new shares for the subscriber and amend the draft memorandum of association accordingly.

Obviously, the problems related to contribution in-kind are not only the concern of the contributors. As said, the subscribers meeting may reduce the capital of the share company when it reduces the number of shares in return to in-kind contribution. Even well after six months from the date of formation, the capital of the company may be reduced when the value of the contribution is found to be lowered by one fifth of its originally assigned value. Noticeably, the six months time would cause the share company to have several creditors that would be at risk.

Apart from the above, it is imperative to consider the roles of and burdens on cash subscribers to understand the said distinction. In fact, this category of shareholders does not include persons who are to be allocated a special share in the profits and those cash subscribers who become founder under Art 307(4) of the Commercial Code. The law requires subscribers through cash to pay one-fourth of the shares they subscribed upon subscription.⁶⁴ Indeed, the

⁶² *Id.*, generally Chapter 7 Amendments to the memorandum or articles of association and the articles starting from 469.

⁶³ *Id.*, Arts. 322(5) & 315(4).

⁶⁴ *Id.* Art. 338(1).

memorandum of association may demand more than this amount.⁶⁵ Unlike in-kind contributors, they may have five years from registration to perform the balance of their obligations.⁶⁶ In addition, there is no legal restriction on the transfer of the share of this kind of contributors. The only restriction is that the shares shall stay registered shares until full payment of the subscription.⁶⁷ Actually, it does not mean the transfer is absolutely free as it may be subjected to requirements imposed by the articles of association, resolution of an extra ordinary meeting or by law for another reason.⁶⁸ Compared to in-kind contribution, it should also be noticed that cash shares may not pose unclear danger on the company and its creditors. Because the amount cannot affect the capital of the company as they are already liquid, they are not exposed to problems like exaggeration of value.

It is said that identifying person as founder is also to bestow benefits for what they did towards the formation of the company. As discussed below, the benefits out of being founder are not attractive due to the various encumbrances. The mere success of the formation process alone cannot guarantee the founders realize the benefit provided for in the law. In the first place, the rule is ‘no profit no benefit’. As discussed under section VI (B) of this work, there are also other strains to the benefit. On the other hand, in the eyes of the law, founders could hardly escape liabilities if there is any damage to persons due to the formation process of the company. Thus, it may be argued that the main aim of the law is to primarily regulate the liability aspects. From benefit perspective, Article 322(3) of the Commercial Code further allows the cash contributors to challenge rights of their counterparts contributing in-kind. At times, they may totally deny the benefits to all or some of the founders.

D. Persons to be allocated with Special Share in the Profit

Pursuant to article 307(3), persons that are to be allocated with a special share in the profits of the share company under formation are given legal status of founders. It can be said that this group of founders exist only in case of publicly held companies. To this effect, the phrase “*where a company is to be formed by the issue of shares to the public*” in article 307(3) can be cited. Yet, the law does not indicate the grounds that entitle these persons with special benefits in the profits. In practice, they are persons who pay all or certain percentage of their contribution before or on a certain date.⁶⁹ In fact, it is possible to get instances in the practice that certain outsiders are allocated with special benefits. For instance, advisors of promoters constitute this category. Since these outsiders are given certain benefits for their contribution in the formation process, the grounds discussed below would encompass them.

Like the in-kind contributors, persons to be allocated with special share can be founders if they subscribe before the share company is registered. Article 370(1a) of the Commercial Code

⁶⁵ *Id.*

⁶⁶ *Id.*, Art. 338(2).

⁶⁷ *Id.*, Art. 338(1).

⁶⁸ See Articles 333 and 349 of the Commercial Code for further readings on the possible restrictions on shares.

⁶⁹ For instance, in case of Hibir Sugar Factory Share Company, it is mentioned that subscribers who may pay 50% of their subscription before Dec 11, 2009 are considered as founders. See Prospectus of Hibir Sugar Factory, *supra* note 28.

can support this assertion as it makes ‘*founders and beneficiaries holding special benefits*’ ineligible to be share company auditors. Legally speaking, the word ‘*founders*’ here includes persons that are to be allocated with a special share in the profits of the company under formation.

E. Persons who Initiated Plans or Facilitated the Formation of Share Company

This group of founders is known to both forms of share company. Any person who has initiated the plans for the formation of the company or has facilitated the formation of the company is a founder.⁷⁰ Sometimes, these persons are named as ‘organizers’ of the share company under formation.⁷¹ In reality, the ‘organizers’ play very crucial roles during the formation of capital goods finance companies. Among others, they appoint project manager who is responsible to take care of the whole process of getting license for the capital goods finance company.⁷²

The above group of founders may or may not constitute the legal minimum required for the formation of share company. The phrase “*even though outside of the company*” under Article 307(4) of the Commercial Code indicates this fact. Coming to judicial practice, there was the tendency of the judiciary to take outsiders like advisors of promoters as founders.⁷³ In some cases, those who initiate plans or facilitate the formation of the share company may be shareholders. For instance, a cash contributor who is not founder based on the other grounds may possibly become founder under this category. In case of public companies, the number of this kind of founders can be higher due to the existence of public offering of shares. The offering of shares to the public involves various intermediaries like banks, postal offices and other brokers.⁷⁴ On the other hand, the number of the outsiders in case of closely held companies may be limited for the absence of share offering. This fact reduces the relevance of employing brokers in trading the shares of closely held share companies. Additionally, there is no need to prepare prospectus which then limits participation of outsiders in the closely held share companies.

The reason in taking persons who initiate or facilitate company formation as founders seems that some persons may push investors to invest or deal with persons for the formation of the company. Those who convinced the third parties either directly or indirectly should bear liabilities. They may also cause damage to the company and other third parties. Though this argument seems logical, there is a problem as to the scope of persons under this category. It could be difficult to exactly fix what ‘initiating plans’ or ‘facilitating formation’ means.⁷⁵ This provision permits one to consider many persons, even with so insignificant contribution in the formation process, as founders. This is because the terms ‘initiation’ and ‘facilitation’ are not defined with clear boundaries. Persons appointed as agents by the founders, employees, accountants, and lawyers may thus come under the purview of this provision since, in most

⁷⁰ See The Commercial Code, Art. 307(4).

⁷¹ Requirements for Licensing of Capital Goods Finance Business Directives No. CGFB /02/ 2013, Art 2.8.

⁷² *Id.*, Art. 4.1.1.

⁷³ Mesfin Shiferaw and others v. Zemen Bank, FED. FIRST INSTANCE CT., LIDETA DIV., FILE NO. 190351 (Decision of 25 June 2004 E.C).

⁷⁴ Taddese Lencho, *To Tax or Not to Tax: Is that really the question? VAT, Bank Foreclosure Sales, and the Scope of Exemption for Financial Services in Ethiopia*, 5 MIZAN LAW REV. No. 2, 280, 264-310 (2011).

⁷⁵ See Tikikile, *supra note* 47, at 38.

instances, persons who facilitate the formation of the company are paid workers and professionals.

In this regard, it is maintained that persons who act merely in a professional capacity will not be founders unless they become involved in the business side of formation.⁷⁶ Also, employees acting within their employment contract should not be taken as founders.⁷⁷ Similarly, Section 269(c) of the 2013 Companies Act of India excludes a person who is acting merely in a professional capacity from being a promoter. In Ethiopia, Article 307(4) of the Commercial Code has provided no exception like this. However, the need to clearly introduce exceptions has been felt.⁷⁸ In fact, there is still a belief that there is no problem within the law.⁷⁹ Interestingly, the Draft Commercial Code does not at all consider persons who facilitated the formation of the company as founders.⁸⁰ This outright exclusion may create its own problem as it does not permit outsiders who become involved in the business side of the formation process to be considered.

On this category of founders, it seems to appear that there is a difference between the Amharic and English versions of article 307(4) of the Commercial Code. The English version clearly deals with two types of founders. Firstly, those who have initiated plans for the formation of the company are founders. Regarding these founders, the Draft Commercial Code downsizes the scope of the provision of the Commercial Code. Art 307(4) of the Draft considers founders as those who have initiated plans in respect of commitments entered into for formation of the company. It seems to deal with person who initiates plans for entering into commitments for formation of the company which are only part of the pre-formation activities. Initiating founders to enter in to commitments may itself amount to an involvement to the business side of the formation. Therefore, maintaining founder status to these persons seems justified.

In the second place, article 307(4) of the Commercial Code stipulates that persons who have facilitated the formation of the company shall have the status of founders. As said above, these are not recognized as founders under the Draft Commercial Code. This exclusion can be appropriate as far as the persons who facilitate the formation are doing it in their professional capacity or as employees. However, this total exclusion may prevent the possibility of taking those acting beyond their professional duties as founders.

Unlike the English version, the Amharic version of Article 307(4) of the Commercial Code does not clearly put the two types of founders. It seems to recognize only one group of persons who are outside of the company. Whether it recognizes those who initiate the formation of the company or those who facilitate its formation is not clear. Actually, this may come as no surprise since the meaning of these terms and the difference between them is not vivid. Article 307(4) of the Amharic version reads as “በማህበሩ ያልገቡ ማንኛዎቹም ሰዎች የማህበሩ መቋቋም እንዲጠና ሲሉ ማንኛውንም እርምጃ ለማህበሩ ስራ ያደረጉ ሁሉ እንደ መስራች ይቆጠራሉ።” This provision seems to provide cumulative conditions for an outsider to be a founder. Anyway, it clearly indicates that a person

⁷⁶ See PETTET, *supra note*, 16.

⁷⁷ See Lantera, *supra note*, 18.

⁷⁸ Liku Worku, *et al*, *supra note* 5, at 15.

⁷⁹ *Id.* at 16.

⁸⁰ The Draft Commercial Code of the Federal Democratic Republic of Ethiopia, Art 307.

would be a founder for any activity done with a view to form a company. The phrase “የማህበሩ መቋቋም እንዲጠና ሲሉ” implies the persons engage in the activities with an intention of helping the formation process. This would amount to an involvement in the business of forming a company. As a result, it can be contended that persons providing only professional services and employees are excluded from the ambit of being founders.

V. DUTIES AND LIABILITIES OF FOUNDERS UNDER ETHIOPIAN SHARE COMPANY LAW

A. Duties of Founders

The Commercial Code does not oblige any person to act as a founder. That is rather to be taken by volunteers whom the law then takes as founders. The law then imposes certain duties on the founders. In many jurisdictions, promoters have a fiduciary duty in relation to the company to be formed. By this, they owe duties of care and loyalty to their co-promoters, the company that is going to be formed and to others who have financial interests in the company.⁸¹

Similarly, the Commercial Code imposes certain duties on founders of companies. Among others, the founders shall sign memorandum and articles of association before applying for commercial registration.⁸² However, before that, founders or members of a business organization shall get the verification of the registering office on whether the proposed name of the business organization has already been occupied.⁸³ The previous law on commercial registration required advance written permission, which was to be secured by the founders, by the registering office of companies to start formation through public subscription.⁸⁴ This condition was not required where the company to be established is among the founders. It is so because the founders of closely held companies do not offer shares for the public. In some share companies, disclosure of the formation process to the public is obligatory. As part of formation duties, founders of a bank are required to publish a notice of intention to engage in banking business in widely circulating newspapers.⁸⁵ The same duty is also expected from founders of insurance companies.⁸⁶

As regards the specific founders to secure the written permission, it is, as a matter of fact, the founders who should sign the prospectus to obtain the permission. After obtaining the permission, the founders shall prepare the prospectus with the required details provided under Article 318 of the Commercial Code. Perhaps, the prospectus may be prepared even before securing the permission. It should be remembered that not all founders can sign the prospectus and make it available for the public. The founders should also allow the prospectus and the expert report on in-kind contribution (which is part of the prospectus as per Art. 318(1)) of the Commercial Code) to be available to all persons who may wish to subscribe. In addition, the

⁸¹ See PINTO & BRANSON, *supra* note 4, at 29.

⁸² See *Commercial Registration and Business Licensing Proclamation* No. 980/2016, FED. NEGARIT GAZZETA 22th Year No. 101, Addis Ababa, July 2016, Art 5(6).

⁸³ *Id.*, Art. 5(7).

⁸⁴ See *Commercial Registration and Business Licensing Proclamation* No. 686/2010, FED. NEGARIT GAZZETA 16th Year No. 42, Addis Ababa, 12 July 2010, Art. 12(5).

⁸⁵ *Banking Business Proclamation*, *supra* note 63, Art. 4(1c)).

⁸⁶ *Insurance Business Proclamation*, *supra* note 63, Art. 4(1c)).

offer through the prospectus should be accompanied by an ‘application form’ to be filled by any subscriber.

Pursuant to Article 309(1(c)) of the Commercial Code, the founders have also the duty to make accurate statements to the public in respect to the formation of the company. This provision envisages a means other than the prospectus of providing information to the public. Article 318 of the Commercial Code does not require that all the information shall be made through the prospectus. Actually, the contents of the prospectus are mentioned under Article 318 of the Commercial Code in a manner which seems exhaustive. In practice, founders use diverse media to provide information regarding the company under formation. In these instances, they are duty bound to keep the information accurate. It is also a duty whose violation is punishable under Article 718 of the Ethiopian Criminal Code. This provision makes it clear that a founder, who is in a position to know the state of affairs of an undertaking, intentionally gives or causes to be given essential and untrue information to the public is punishable by imprisonment or fine. Indeed, the provision puts private complaint as a prerequisite to prosecute the founder. Practically speaking, it may be difficult to effectively prosecute founders on the basis of the above provision since, for instance, it requires proving intention of the founders.

As per Article 319(1) of the Commercial Code, when the time for making applications for share has expired, the founders are duty bound to call a meeting of the subscribers. The purposes of this meeting and the manner of conducting it are stated in the law.⁸⁷ In addition, founders have the duty to draw and sign the resolutions of this meeting according to Article 322(1). The Commercial Code also imposes duties on the founders even after they successfully form the share company. It seems that the Commercial Code expects them to closely follow matters in connection with, inter alia, forms, classes and prices of shares, transfer of shares, indication on shares, register of shareholders, purchase by the company of its own shares, paying up on shares, etc.⁸⁸ What is more, not all persons whom the law considers founders are responsible to carry out the above duties. As indicated somewhere above, all of them cannot, for instance, prepare and sign the prospectus. All of them cannot practically involve in calling subscribers’ meeting.

B. Liabilities of Founders

During carrying out the duties imposed by the law and initiations of the founders, it is inevitable that founders may incur liability. The liabilities may be either contractual or extra contractual. In addition, the founders may incur criminal liabilities as per Articles 718, 675 and 676 of the FDRE Criminal Code. For the purpose of convenience, the grounds of the liabilities are classified based on “commitments for formation of the company” and “other grounds”.

1. Liabilities of Founders Due to Commitments for Formation of the Share Company

For long time, most common law countries follow the rule in *Kelner v. Baxter* (1886) which established that founders are personally responsible for liabilities arising from pre-incorporation

⁸⁷ See The Commercial Code, Art. 321

⁸⁸ See The Commercial Code, Art. 346. This article does not make such a distinction, though.

contracts and that the company cannot adopt them.⁸⁹ The principle is still maintained though there exist certain exceptions (for example, by way of ratification) under which the company up on its formation will overtake the commitments.⁹⁰ Likewise, it is accepted that there could be no contract between a promoter and his unformed company to claim reimbursement of expenses incurred in setting up the company.⁹¹ As alluded to in this work, the primary justification for the positions is evident, i.e. the company has no personality during its process of formation.

In Ethiopia, too, the principle is that founders are jointly and severally liable for the pre-incorporation commitments.⁹² Exceptionally, however, the law requires the company, up on establishment, to take the commitments of the founders and refund the expenses they have incurred.⁹³ The conditions under which the company may take the commitments and refund expenses are discussed in the part dealing with protection of founders. Article 308(1) of the Commercial Code states that the founders are ‘fully, jointly and severally’ liable to third parties for the pre-incorporation commitments. Here, the expression used to indicate the nature of the liability calls for correction. The phrase “*fully, jointly and severally*” is not different from the notion of “joint and several liabilities”, so it is recommended to change it accordingly.⁹⁴

Article 308(1) of the Commercial Code specifies two categories of parties who are liable for the pre-incorporation commitments. The first is the founders which are implicated in its first statement. The second is ‘*all persons who acted in the name of the company before its registration*’. With this statement, one may question as to who would be this second category of persons. Whether these persons are the founders or other persons is far from being clear. Reading this with other provisions on founders implicate that this category of persons seems to be different from the persons whom the law regards as founders. There is, however, an assertion that these persons are also founders under Article 307(4) of the Commercial Code.⁹⁵ Of course, it can be said that these persons would fall under the widest scope of Article 307(4). We may say that a person has at least facilitated company formation if he acted in the name of the company under formation.

In a different way, a more acceptable view has been offered regarding the identity of this group of persons (‘*all persons who acted in the name of the company before its registration*’). Accordingly, the second statement refers to persons who prematurely act on behalf of a share company because they erroneously but in good faith believe the company has been formed.⁹⁶ There are jurisdictions that do not impose liabilities on such persons.⁹⁷ However, the Ethiopian Commercial Code does not relieve them from liabilities out of pre-incorporation contracts. In

⁸⁹ Joseph H. Gross, *Liability on Pre-Incorporation Contracts: A Comparative Review*, 18 MC GILL L.J, 513.

⁹⁰ See BOURNE, *supra* note 15, at 46.

⁹¹ See BOURNE, *supra* note 16, at 28 & CAHN & DONALD, *supra* note 26, at 139.

⁹² See The Commercial Code, Art. 308(1)

⁹³ *Ibid*, Art 308(2), As far as expenses are concerned during the establishment of public enterprises, the Expenses of the Supervisory Authority are deemed to be part of the capital of the Public Enterprise. See Public Enterprises Proclamation No. 25/1992, Art. 5(4).

⁹⁴ See Tilahun Teshome *et al*, *supra* note 33, at 19.

⁹⁵ See FIKADU, *supra* note 3, at 74.

⁹⁶ See Seyoum, *supra* note 1, at 123.

⁹⁷ *Id*.

any event, it is difficult to argue that the second statement of Article 308(1) of the Code is to consider what other jurisdictions say ‘active shareholders’ who influenced founders to enter into certain commitments.⁹⁸ This is because the persons envisaged in the statement are those who acted in the name of the company under formation which can fall within the ambit of Article 307(4) of the Commercial Code. If this is so, the statement remains to be redundant.

2. Liabilities of Founders Based on Other Grounds

In addition to pre-incorporation commitments, the Commercial Code recognizes other circumstances to impose liabilities on founders. Accordingly, the liabilities of the founders are generally of three types: for the company, subscribers and other third parties. The nature of the liabilities may slightly differ based on whether the intended share company is established. Article 309(1) of the Commercial Code stipulates some grounds to hold the founders jointly and severally liable to the company they have established or third parties. Once the founders take the initiation to establish a share company, they are expected to take all the necessary cares to establish a strong share company. The founders owe the share company fiduciary duty as it is entirely in their hands during its formation.⁹⁹ If this duty is violated, they will be liable for the share company they have established. Likewise, Article 309(1) of the Commercial Code does not allow the founders to cause damage on third parties that may transact with the company. It stipulates three common grounds to hold the founders jointly and severally liable to the company or third parties. It should be noticed that these liabilities of the founders to third parties are in addition to their liabilities arising from the pre-incorporation contracts under Article 308 of the Commercial Code. In joint and several liabilities, a judgment in favor of one promoter does not bar to bring a subsequent action against the other promoters.¹⁰⁰

2.1. Liability for Damage Related to Subscription of Capital and Payments required for the Formation of the Share Company

Coming to the bases of the liabilities, the first source is mentioned under Article 309(1a) of the Commercial Code. As such, the founders shall be jointly and severally liable to the share company or third parties for any damage related to “subscription of capital and payments required for formation of the share company.” As is known, the law requires full subscription and payment of certain amount of the capital before registration.¹⁰¹ The share company may encounter difficulties if it is formed with a capital less than the law requires. Thus, the law holds the founders liable to the company for any damage in connection with this. Apparently, the capital of the share company as it appears in the memorandum of association may entice third parties to enter into various transactions with the share company. Due to the concept of limited liability, the capital of the share company is the main guarantee for third parties. Thus, third parties may incur damage if the share company has not been properly financed during formation and is not able to perform its liabilities towards its creditors.

⁹⁸ See CAHN & DONALD, *supra* note 26, at 138.

⁹⁹ See PETTET, *supra* note 16, at 44; & BOURNE, *supra* note 15, at 26.

¹⁰⁰ See EHRICH, *supra* note 11, at 298. See The Civil Code, Art. 1898.

¹⁰¹ See The Commercial Code, Arts 312(1), 338 and 339.

When one talks about the liability of the founders based on the above ground, there would arise certain mind-boggling questions. The first is about the exact liability of the founders to the share company which is defectively formed at least due to the defect in relation to capital subscription and payment. In our law, a share company has a legal personality up on registration and publication notwithstanding that all the legal requirements of formation have not been complied with.¹⁰² Exceptionally, the existence of the share company would be contested if the interests of creditors or shareholders are endangered due to the non-fulfillment of the legal requirement.¹⁰³ In such cases, the court may even order dissolution of the defectively formed share company. The Commercial Code does not, however, specify the grounds that may lead to dissolution. Despite this, Article 324(3) of the Code sets three months as period of limitation for the creditors or shareholders to submit application for dissolution based on the defects of formation.

Apart from the above, Article 324 of the Commercial Code does not entitle the share company, creditors or shareholders to proceed against the founders due to the defective incorporation. In this regard, it is argued that the founders shall be held liable to the creditors by piercing the corporate veil.¹⁰⁴ As dissolution may not necessarily be the measure, one may argue that the court may decide that the founders should make the defect in relation to capital subscription and payment good. To this end, Article 309(1a) of the Commercial Code may be invoked. With respect to third parties, the dissolution would actually give certain benefits for the creditors. For instance, Article 501 of the Commercial Code requires that the asset of the share company may not be distributed among the shareholders before the creditors are paid. As said above, this right is also available when there is non-compliance with the formation requirements which endangered the interests of the creditors. However, whether non-compliance of any requirement which endangered the interest of the creditors permits them to claim against the founders is not clear. It can, however, be argued that when the defect is connected with subscription of the capital and payment for the formation, the creditors can claim against the founders.

In other jurisdictions, the company would claim against the promoters if they acted in violation of their fiduciary duty. For instance, the promoters may be required to surrender to the company profits or commissions they have got at the expense of the company.¹⁰⁵ The promoters may acquire undeserved profit by selling their property or by enabling a third party to sell his property to the company. In Ethiopia, similar liability is not clearly imposed on founders. It is also very difficult to stretch the liability in relation to capital subscription and payment to cover liability of this sort.

¹⁰² See The Commercial Code, Art 324(2). Publication is not currently a requirement to acquire legal personality. See *Commercial Registration and Business Licensing Proclamation* No. 980/2016, FED. NEGARIT GAZZETA 22th Year No. 101, Addis Ababa, July 2016. Arts. 5(1) & 5(2).

¹⁰³ *Id.* Art 324(2).

¹⁰⁴ See Endalew Lijalem, *The Doctrine of Piercing the Corporate Veil: Its Legal Significance and Practical Application in Ethiopia*, (LL.M Thesis) (A.A University, School of Law, 2011, Unpublished), at 93.

¹⁰⁵ See EHRICH, *supra* note 11, at 302.

2.2. Liability for Damage Related to Contribution in-kind

The second ground to hold founders liable is when, pursuant to Articles 309(1b) and 315 of the Commercial Code, the share company or third parties incur damage due to problems arising from contribution in-kind. Here too, it is not easy to exactly ascertain the liability of founders to the share company. Article 315 of the Commercial Code contains the remedies when there is a problem connected with valuation of in-kind contributions. In the first place, Article 315(4) of the Commercial Code permits the contributor to make the difference good when the value of the contribution is lowered by one fifth of its previous value. Should the contributor be unwilling, Article 315(4) obliges him to withdraw from the company. Upon withdrawal, the same article orders the reduction of the capital of the share company. It does not require the other founders to make the difference good. This leaves the liability of the founders unclear. Despite this, one may argue that the founders should be liable for the difference though that will not constitute part of the capital. This means the amount will be the asset of the share company so that its total asset remains unaffected by the reduction of its capital. Promoters may convey property to the company at a cost beyond its price.¹⁰⁶ In this case, they shall be required to make the difference good or return the shares they acquired from the company.¹⁰⁷ In this regard, our law needs the in-kind contributors either to pay the difference or leave the share company.

Based on Articles 309(1b) of the Code, third parties may also have claims if they incur damage from the problem in relation to valuation of in-kind contribution. More than the cash contribution, in-kind contribution has great repercussion on the capital of the share company as it could be source of undercapitalization. This would in turn affect third parties who enter into transactions with the share company based on what is presented regarding the capital.

2.3. Liability for Damage Related to Inaccuracy of Statements about the Formation of the Share Company

This ground of liability to the share company is mentioned under Article 309(1(c)) of the Commercial Code. It makes the founders liable when the company or third parties incur damage owing to accuracy of statements made to the public about the formation of the share company. These statements may be available through the prospectus or through other various means. Founders are required to make sure that such statements are accurate. If not, the law holds them responsible for causing damage. Third parties may suffer damage due to false or misleading information made by the founders. Therefore, the law in such cases entitles them to proceed against the founders. As far as it is helpful, Article 2059 of the Ethiopian Civil Code can also be used to establish liability against founders based on their false information. However, the requirement could be very difficult to be satisfied to invoke this provision of the Civil Code.¹⁰⁸

While discussing liabilities of founders under the Commercial Code, it should not be forgotten to appreciate the grounds of liabilities stipulated under its Article 346. This provision imposes liability on founders owing to problems out of the implementation of Articles 325

¹⁰⁶ See PINTO & BRANSON, *supra note*, 6, at 30.

¹⁰⁷ See EHRICH, *supra note* 11, at 311 & 328.

¹⁰⁸ At least the claimant needs to prove that the founders acted either intentionally or negligently.

through 345 of the Commercial Code which deal with shares, rights and duties of shareholders. Several of these provisions regulate matters which have no connection with the activities of the founders at all. Actually, it does not make sense to hold founders responsible for misdeeds unrelated to the formation of the share company.¹⁰⁹ Regarding Article 346 of the Commercial Code, there has been an understanding that the provision imposes liabilities in connection with implementation of all the above cited provisions.¹¹⁰ In effect, it has been argued that the last part of Article 346 of the Commercial Code should read as “the observance of the *relevant provisions* of this Chapter”.¹¹¹ In spite of this, a look at the phrase “*Subject to the provisions of Art 309*” in the provision would make the said amendment irrelevant. This phrase is meant to indicate that the founders’ joint and several liabilities with the directors is not for every problem connected to implementation of the chapter. The Amharic version of the provision which says “በቁጥር 309 በተነገረው ቃል መሰረት” is clearer in limiting the founders’ liabilities. Hence, Article 346 of the Commercial Code should be read with Article 309. This does not yet seem helpful to perfectly fix the liabilities of the founders that would arise in relation to the chapter.

Be the above as it may, it would be proper to impose liability if the founders have issued shares before the share company is registered. Pursuant to Article 327 of the Commercial Code, such shares are null and void though the liabilities thereof shall not be affected. Still, it is credible to hold founders liable for problems related to capital, par value, number, form, class of shares and premium therewith and the required payment that should be made before company registration of the share company. This can be inferred from Articles 313(6) and 330 of the Commercial Code. In addition, the founders may be liable for problems that may arise in relation to classes of shares such as if they fail to assign the same par value for the same class of shares as it can be inferred from Article 335(2) of the Commercial Code. This is so because the founders have a very important role in specifying these matters within the memorandum of association and prospectus. It would also be justified to impose liability on the founders for problems in connection with the payment of capital as provided under Articles 338 and 339 of the Commercial Code. In short, it is not the intention of Article 346 of the Commercial Code to hold the founders liable for every liability arising from non-observance of Articles 325 of the Commercial Code and the following.

Common to all the above grounds, whether all the persons whom the law considers as founders are liable remains to be another question. Actually, this question is equally significant for the liabilities of founders towards subscribers. Thus, this discussion is essential in identifying the responsible persons for the damage that may be incurred by the third parties or subscribers.

Legally speaking, Article 309 of the Commercial Code holds all the persons whom the law considers as founders jointly and severally liable to the share company and third parties. This, in turn, invites some crucial concerns to arise. One of such concerns is whether it is justified to hold all types of founders including those who initiated or facilitated the formation of the share company liable. The justification of imposing liability on in-kind contributors or persons to

¹⁰⁹ See Tilahun Teshome *et al*, *supra* note 33, at 23.

¹¹⁰ *Id.*

¹¹¹ *Id.*

whom special share in profit are allotted that did nothing than subscribing remains to be another concern. In addition, the justification to hold all those founders liable for the faults committed by certain founders alone may still be a concern. Generally, it is hardly possible to establish that the law intends to make no distinction at all when it comes to liability of founders. This idea may be buttressed by the fact that founders who are subscribers are not liable for the pre-incorporation commitments. This is implied in Article 308(3) of the Commercial Code. Further, Article 309(2) of the Commercial Code can also be invoked to ossify this argument since it implies that the claimants should identify the liable person even among the founders.

In any way, the founders who signed the prospectus as per Article 318 of the Commercial Code should be held liable for damages in relation to the capital subscription. Taking persons who signed the Prospectus as founder may not be arguable since they trigger the formation process.¹¹² It may be expected that these founders should always be there where there is a matter in relation to the formation process. They should supervise the activities of those founders or other intermediaries acting in the interest of the formation process. In the eyes of the law, the intermediaries can indeed be founders since they facilitated the formation of the share company. They can be commission or sales agents who are engaged in offering the shares to the public. In practice, banks, postal offices, commercial nominees and other business organizations serve as commission agents.¹¹³ The mere fact that they serve as sales agents should not make them equally liable with other founders. Sales agents are expected to provide the prospectus and other basic information. As a result, it will be fine to hold them liable if they commit faults in discharging their duties like not disclosing the prospectus or providing false information. Similarly, it is justified to make them liable in cases where they use their position to further their interests at the expense of the share company, subscribers or third parties. Likewise, persons engaged in providing inaccurate information should not escape liabilities for the ensuing damage.

In relation to contribution in-kind, the law attempts to state the liability of this kind of founders. In fact, it is also made clear that performing this liability is left to the will of the in-kind contributors, i.e. they may opt to make the damage good or leave the company. Apart from this, the liability of the other founders arising from the in-kind contribution is not vividly shown in the law. In any case, it would not be justifiable to hold those persons (founders) who have no connection with the in-kind contribution as stated under article 309 liable.

C. Liability Related to Damage to Subscribers

Founders have also liabilities towards subscribers who have invested in the company to be formed. Subscribers as persons who give their asset to the founders need their interests to be safeguarded. To this end, the Commercial Code imposes certain duties on the founders. As we know, Article 312 of the Code mandatorily requires full subscription of the capital. More importantly, it requires at least one-quarter of the par value of shares to be deposited in a bank. Where registration has not been effected within one year from this deposit, the founders shall

¹¹² FIKADU, *supra* note 3, at 69.

¹¹³ See Tikikile, *supra* note 47, at 29.

have the duty to repay the deposit to the subscribers.¹¹⁴ For any damage related to repayment, they shall be jointly and severally liable. Very importantly, if they fail to effect the payment, the sums shall bear interest at the legal rate which is 9% according to Article 1751 of the Civil Code.

On the liability of founders to subscribers, one can raise certain concerns. First, the Commercial Code is mute as to the return to their owners of in-kind contributions. In addition, it is silent as to the fate of in-kind contributors whose contribution has already been consumed or assigned during the formation process. Secondly, the law keeps quiet as to the interest of the subscribers on premium/service charges they might have paid upon subscription. Added to this, whether the founders need to hand over the interests that may accrue to the deposited amount during one year time is not clear. In this regard, it is argued that they have to distribute such interest.¹¹⁵ Thirdly, there is also a problem in determining the date the one year period begins to run. This concern practically emanates from the fact that cash subscribers do not pay the required 25% of the par-value of their shares on the same day.¹¹⁶ To solve such problem, it is suggested that “*the closing date for bank deposit*” should be the point of reckoning.¹¹⁷

VI. Protections and Benefits to Founders under Ethiopian Share Company Law

Apart from the liabilities, to encourage establishment of companies, there should be mechanisms to relieve founders from their pre-incorporation liabilities and to grant certain benefits. As a result, our law recognizes certain protections and benefits to founders. The term ‘protection’ is employed to show the ways the founders can be relieved from liabilities due to pre-incorporation commitments and other liabilities.

A. Protections of Founders

Before the establishment of a company, promoters may conclude contracts expecting the company to enjoy the rights and perform the liabilities thereof.¹¹⁸ However, their expectations may not come true as they will be responsible for pre-formation commitments. Since there is no principal, there can be no ratification by the company upon formation.¹¹⁹ Despite this general principle, company laws provide cases whereby the founders can be free from liabilities they have incurred in their way to establish a company. Concerning the matter in Ethiopia, this section presents two different ways contemplated in the Commercial Code to relieve the founders from the said liabilities.

1. *Taking over Commitments and Refunding Expenses*

In many cases, after being formed, the share company is required to take over the commitments entered by the founders and to refund their expenses. This is one way of protecting the founders. In the interest of the formation process, the founders may enter into diverse commitments. Furthermore, they may incur expenses from their own pocket. Possibly, they may

¹¹⁴ See The Commercial Code, Art. 312(3).

¹¹⁵ See FIKADU, *supra* note 3, at 75.

¹¹⁶ See Tilahun, et al, *supra* note 33, at 21.

¹¹⁷ *Id.*

¹¹⁸ See DINE, *supra* note 2, at 90.

¹¹⁹ See BOURNE, *supra* note 15, at 46.

also incur tort liabilities. Hence, they need the share company to take their liabilities after its formation. Additionally, they need to get refund of the expenses they have incurred. On their side, the subscribers and the company may not be so cheerful to take the commitments and expenses. Indeed, the subscribers are bound to know that a corporation cannot be organized without expense and other commitments.¹²⁰ The law should strike an appropriate balance between the above conflicting interests. While so doing, the law should not also discourage persons from being involved in company formation. Seen from this vantage point, it is fair to oblige the share company to take pre-formation commitments and refund expenses incurred by its founders.

Article 308(2) of the Commercial Code is meant to govern the situations where the share company shall take over the commitments and refund expenses made by the founders. The law is clear that the share company shall take the commitments and expenses in two cases: when they are necessary or approved by the subscribers' meeting as necessary.

1.1. Commitments and Expenses Necessary for the Formation of the Share Company

For commitments and expenses of this nature, the company has a legal duty to take over the commitments and refund the expenses. However, there is no indication as to what commitments and expenses are deemed to be necessary for the formation of the company.¹²¹ Nor is the law clear as to who is going to decide that they were necessary. In Ethiopia, it is suggested that the board of directors is the final organ to decide on this issue.¹²² Generally speaking, it is alleged that the initial board of directors should review and take action with respect to each pre-incorporation contract.¹²³ At this juncture, it is reasonable to question the fairness of the decision given by the board of directors on whether the commitments and expenses were necessary. The board may decide against the interest of the founders. Conversely, the board may decide every commitment or expense as necessary particularly when it is constituted of the founders.

In addition, the Commercial Code is not clear as to how the third parties can claim against the founders in case of necessary commitments. Whether the third parties can directly claim from the share company is not vivid. No doubt, there could be no agent-principal relationship between the share company and the founders when they made the commitments and expenses. Due to this, it may be purported that the third parties can have no direct claim against the share company. This means that the founders will be the only persons to be liable for the third parties. After carrying out the commitments, it can be said that the founders can require the share company to indemnify them based on Article 308(2) of the Commercial Code. At this time, the share company would have no obligation of indemnification if the founders did not pay the third parties. In fact, the third parties may proceed to attach the shares where the founders are shareholders.

¹²⁰ See EHRICH, *supra note* 11, at 153.

¹²¹ Nowadays, a commitment due to employing experts for valuation of in kind contributions may itself arguably be a necessary commitment as there is no legal duty to employ such experts.

¹²² See FIKADU, *supra note* 3, at 73.

¹²³ See PINTO & BRANSON, *supra note* 6, at 28.

On the other hand, it can be argued that the third parties can directly proceed against the share company since the law says that the share company ‘*shall take the commitments*’ from the founders.¹²⁴ At this moment, one may ask about the effect of this action on the founders where the share company is not able to carry out the commitments. Actually, the third parties may not effectively recover from the share company in two cases: when the share company rejects their claim since the commitments were unnecessary or when the share company is not able to perform the liabilities even if they were necessary. In this circumstance, the assumption of the commitments by the company cannot, totally release them.¹²⁵ In Germany, it is necessary for creditors to act first against the company and then against the promoters.¹²⁶

In Ethiopia, the law does not take a clear position regarding the liabilities of the founders in cases where the law requires the company to take over the commitments. In spite of this, it can still be argued that the third parties need to have the right to seek remedies from the founders if they are unable to recover from the share company. First, it is not fair to prevent them from suing the founders since their attempt against the company fails. From the inception, they shall not be forced to claim from the company which did not exist during their dealings with the founders. Secondly, the law, which even fails to require third parties to claim against the company, does not expressly relieve the founders because the share company assumes the commitments.

1.2. Approval of Commitments and Expenses as Necessary for Formation of Share Company

The second ground to oblige the share company handle the commitments and expenses, mentioned under Article 308(2) of the Commercial Code, is when subscribers’ meeting approves the commitments and expenses as necessary. Compared to the first ground, this may be simple for enforcement. It is yet unclear if the founders can participate in the meeting during the approval process. As mentioned, the founders have no say in any capacity on the resolution approving their special share in the net profits of the share company. Nonetheless, the law does not thwart them from attending the subscribers meeting. Obviously, this permits them to get their voices heard during this meeting regarding the special benefit. From fairness point of view, there should be a mechanism to permit the founders to get their voice heard on the meeting sitting to decide if the commitments and expenses incurred were necessary. In fact, it is essential to limit the influence of the founders on the meeting like by blocking their voting rights. Anyway, the subscribers’ meeting may decide the commitments and expenses were unnecessary. In this case, the only option for the founders may be showing that the commitments or the expenses were necessary for the formation of the share company. This is to be made after the share company acquires personality.

Understandably, the above mentioned commitments and expenses will be taken only if the share company is established. This means that the founders would remain helpless where the formation of the share company is aborted. The law prevents them from claiming anything from the subscribers. Article 308(3) of the Commercial Code states that where the share company is

¹²⁴ See The Commercial Code, Art. 308(2).

¹²⁵ See EHRICH, *supra note* 11, at 145.

¹²⁶ See CAHN & DONALD, *supra note* 26, at 139.

not established for whatsoever reason, the subscribers shall not be liable for the commitments or expenses made by the founders. Based on this stipulation, it may be argued that founders who are at the same time subscribers are not liable to the commitments and expenses. This particularly refers to in-kind contributors and subscribers to whom special share in the profit are allocated.

Besides, it is essential to generally ask if all persons whom the law considers as founders are liable when the share company is not formed or refuses to take the commitments. The Commercial Code does not stipulate how the founders should act in taking the necessary steps in the formation process. Unlike this, the organizers of capital goods finance companies are expected to have a committee who are then jointly and severally liable for pre-incorporation commitments.¹²⁷ The Commercial Code does not require founders to act jointly. It does not clearly state effect of dealings of individual founder on other co-founders either. However, Article 308(1) of the Code implies that commitments by one founder impose joint and several liability on the co-founders. Moreover, the acts of the real founders¹²⁸ create joint and several liabilities on founders who are not even member to the share company or who have no relation with the commitments at all.

Though not adequate, our law tries to regulate the relations of the founders with the company, subscribers and third parties regarding pre-formation commitments and expenses. Admittedly, it also attempts to regulate the relation between third parties and the share company. However, it is not as such concerned about the relationship among the founders due to the commitments and expenses. In the jurisprudence, it was once claimed that promoters are not partners and have no power to act for and bind each other in the absence of express or implied authorization.¹²⁹ As a result, only those promoters who made or authorized a contract can be liable.¹³⁰ Seen from third parties perspective, shielding some of the founders would be unacceptable, however.

In Ethiopia, it can be argued that the relevant general contract law provisions can regulate the internal relation of the founders. So the Commercial Code should not necessarily be worried about the relations among the founders. In any case, it could not be justified to hold those persons who have no involvement in the business side of the formation process jointly and severally liable with the real founders. As this work indicates, employees who acted accordingly and persons providing professional services should not be liable. On the other hand, subscribers who have been actively involved in the business side of the company formation should not escape liabilities. Actually, it seems difficult to adduce stronger reason to hold subscribers liable after the share company is formed if we say they are not liable in case the process does not result in formation of a share company.

Aside the above pre-incorporation liabilities, the liabilities of the founders towards other persons may also be extra-contractual in nature which they might have incurred while carrying

¹²⁷ See Attachment I to Requirements for Licensing of Capital Goods Finance Directives No. CGFB /02/ 2013.

¹²⁸ The term real founder here particularly stands for persons who signed the prospectus as founders and other founders who played meaningful roles during the time of incorporating the share company.

¹²⁹ See EHRICH, *supra note* 11, at 46.

¹³⁰ *Id.*

out the necessary steps to form the share company. However, they may not get this liability taken by the share company after formation. First, there could be no agent and principal relationship. Thus, the founders may not invoke Article 2222(1) of the Ethiopian Civil Code which obliges the principal to release the agent from any liabilities he incurred in the interest of the principal.¹³¹ Secondly, unlike the other pre-incorporation commitments, the Commercial Code does not envisage situations for the share company to take such liabilities. What is more, any founder cannot claim against the share company for damage he sustained in the course of undertaking the necessary activities though he committed no fault. Had there been an agent-principal relationship, the founders would have invoked Article 2222(2) of the Civil Code to hold the company liable for the damage they sustained. It is also very difficult to characterize such damage as necessary expenses to form the share company in the eyes of Article 308(2) of the Commercial Code.

2. Protection through Period of Limitation

In Ethiopia, period of limitation is the other mechanism to avoid liabilities of founders that might arise because of their involvement in the formation of share company. To this effect, we have Articles 1845 and 2143 of the Ethiopian Civil Code, Articles 309 and 324 of the Commercial Code and Articles 216 and subsequent provisions of Ethiopian Criminal Code. With regard to the various liabilities of founders, the period of limitation is not the same. For liabilities stated under Article 309 of the Commercial Code, actions against the founders shall be barred after five years from the date when the aggrieved party ‘knew of the damage and of the person liable’. Except when the liability of the founders arises from criminal offenses, as per Article 309(2) and 309(3) of the Commercial Code, there shall be absolute limitation after ten years from the ‘date when the act complained of took place’.

To establish liability against the founders, there may be possibility to invoke Article 2059 of the Civil Code. If so, the period of limitation in the Commercial Code does not apply. Rather, Article 2143 of the Civil Code requires the victim to claim his rights within two years from the time at which he suffered the damage. Obviously, this gives better chance for the founders to escape liabilities. In addition, the Commercial Code does not put specific periods of limitation to bar the liabilities of founders in tandem with the pre-incorporation commitments. As a result, there must be resort to the Civil Code. In this regard, the general period of limitation in the Civil Code puts ten years period of limitation.¹³² For all periods of limitation, it must be remembered that the Civil Code provisions dealing with interruption of the periods are applicable.¹³³

B. Benefits of Founders of Share Company

After share company is established, it is fair to compensate promoters for their services in addition to taking their commitments and refunding expenses.¹³⁴ Benefits for promoters may

¹³¹ Art. 2222 of the Civil Code states that the principal shall release the agent from any liabilities which he incurred in the interest of the principal. The principal shall also be liable to the agent for any damage he sustained in the course of the carrying out of the agency and which was not due to his own default.

¹³² See The Civil Code, Arts. 1845 & 1677.

¹³³ *Id.* Arts. 1851 through 1856 and 1677.

¹³⁴ See EHRICH, *supra note* 11, at 154.

come in various forms. They may be in the form of remuneration.¹³⁵ However, particular problems may arise as there is no contractual obligation between the promoter and the company.¹³⁶ In some cases, the benefits for the promoters may appear in the form of commission.¹³⁷ The promoters may also be allowed to have founder's shares in the company, which of course is clearly prohibited in Ethiopia.

In Ethiopian, the benefit for the founders is recognized via allocation of special share in the net profits.¹³⁸ Pursuant to Article 452 of the Commercial Code, the net profits comprise the net receipts for the financial year after deduction of general costs, amortization, allowances and other charges of the company. This benefit is personal to the founders and they cannot be issued with founder's shares.¹³⁹ One may tempt to argue that founder's shares can be allocated when he/she reads that one of the tasks of the subscribers' meeting is '*approval of shares allocated to the founders*' under Article 322(4) of the Commercial Code. But, the phrase "*approval of shares allocated to the founders*" should not be taken to refer to founder's share. It is to mean the "*special share in the profit*" or "*a share which shall not exceed one-fifth of the net profits*" stated in Articles 322(3) and 310(1) of the Commercial Code respectively. Like other jurisdictions, this benefit of special share in the net profit is not automatic as it is subject to certain conditions.

Article 310(1) of the Commercial Code talks about the benefit that may be stipulated in the memorandum of association. More vividly, Article 310(2) states that no other advantage than the special share in the net profit to founders may be provided in the memorandum of association. Due to this, one may contend that other benefits for the founders can be stated in another documents like articles of association or other resolutions.¹⁴⁰ This, albeit, does not seem the intention of the law. The law rather tries to limit the benefits to founders. This can be deduced from the conditions encumbered on this single benefit. There is no other provision in the Commercial Code dealing directly or indirectly about any other benefit to founders than this special benefit. However, one may practically observe that additional benefit is permitted for the founders within the memorandum of association.¹⁴¹ Alternatively, it may be argued that the articles of association is part of the memorandum,¹⁴² so no other benefit can be stated in it. Yet, this argument can be challenged as the law usually takes the articles of association as a separate and distinct document from the memorandum. Some have, however, suggested that the separate document called articles of association need to be avoided by incorporating its elements in to the Memorandum of Association.¹⁴³

¹³⁵ See, for example, the German Stock Corporation Act, Section 26.

¹³⁶ See BOURNE, *supra note* 15, at 45.

¹³⁷ See UK Companies Act of 2006, Section 553. The UK's Act states that the amount or rate of the commission shall be authorized in the articles of associations. The same condition also applies for the remuneration of founders in German. See the German Stock Corporation Act, Section 26(2)).

¹³⁸ See The Commercial Code, Art. 310 (1).

¹³⁹ *Id.* Art. 310(3).

¹⁴⁰ See FIKADU, *supra note* 3, at 70-71.

¹⁴¹ For example, Article 9.2 of the Memorandum of Association of Dalol Oil Share Company gives the founders an additional benefit to buy shares at their par value for four years.

¹⁴² See The Commercial Code, Art. 314(4).

¹⁴³ See Liku Worku, *et al*, *supra note* 5, at 12.

Be the above as it may, the whole reading of the relevant provisions can inform us that the conditions attached to the benefit are fairly stringent. The conditions are to put hurdle against the founders not to abuse their positions. By that, it would be possible to safeguard the interests of the share company, subscribers and other third parties. As said before, the law allows the founders to agree the special share in profit in the memorandum of association. It also seems that the founders will not claim benefit unless it is indicated in the memorandum of association.¹⁴⁴ They are also required, under Article 313(9) of the Commercial Code, to state in the memorandum of association the reason for such share in the net profit. This requirement is to assist the subscribers' meeting to approve the special benefit that the founders allocated for themselves.

Furthermore, the law puts conditions with respect to the amount of the benefit that can be allocated to the founders. The maximum amount of the special share in the net profit that may be agreed is, as per Article 310(1), one-fifth of the net profit in the balance sheet. Regarding the lifespan of the benefit, it should be for a maximum period of three years. The law does not, however, state the time the period of three years starts to run. In this respect, it may be argued that the subscribers while approving the benefit can decide on the time. The practice reveals that the time begins at the time the company starts making profit or starts operation.¹⁴⁵ The law is but clear that the three years are in period, i.e. they are not randomly selected. Once a year is selected for the founders to take their share, they will be taking it for the coming two successive years.

It may be a fact that one or two of the years in the period may be of no profit. The law leaves unanswered as to what will happen to the founders when this occurs. This problem may not happen for the first year if it is determined to be the year the company starts making profit. The problem would exist if the year the company begins operation is selected. It does not yet seem that the law intends to deny the benefit. Still, it may be the power of the subscribers' meeting to decide on this issue. Failure of this meeting to decide this matter may result in conflicts in the share company as it may lure the shareholders to deny this benefit. By its nature, the subscribers' meeting is a temporary organ. It is not also clear if the subscribers' meeting can authorize the other relevant permanent organ of the future share company to take care of matters related to benefits of the founders. Practically, it has been confirmed that it is only the subscribers' meeting which is empowered to decide regarding the benefits to be allocated for the founders.¹⁴⁶ It is not, however, uncommon that share companies decide on this matter via their general meetings.

Apart from the above, one may also worry whether declaration of dividend is mandatory for the founders to get their special share in the net profit. As is well known, there is a possibility that shareholders may not take the net profit for themselves if they decide that dividend should not be declared. The effect of such decision on the benefits of the founders is not clearly regulated in the law. In fact, the law does not make declaration of dividend a condition to enjoy the benefit by the founders. As a result, the founders may simply claim their share in the net profit.

¹⁴⁴ See The Commercial Code, Art. 313 (9) & 310.

¹⁴⁵ See FIKADU, *supra* note 3, at 71. See also Memorandum of Association of Dalol Oil Share Company, Art. 9.

¹⁴⁶ See Mesfin Shiferaw and others v. Zemen Bank, *supra* note, 73.

The conditions under Article 310 of the Commercial Code are not the only conditions. Though the founders stick to the requirements under Articles 310 and 313 of the Commercial Code, they can be entitled to the benefits only if their proposal receives the blessing of the subscribers pursuant to Article 321(3). As can be noted from Article 320 of the Commercial Code, the founders shall call meeting of the subscribers after the time for making application for share has expired. One of the purposes of the subscribers' meeting is, as per Article 321(3), to approve the special shares in the net profits allocated to the founders. At this time, the founders may not vote as shareholders or proxies on the resolution approving their special share in the profits which is the rule under Article 322(3) of the Commercial Code. This prohibition is meant to curtail the influence of the founders and block them from deciding on their own cases. Obviously, the subscribers' meeting may go to the extent of limiting or even denying the special share the founders proposed. It may discriminate among the founders and this can be made based on the involvement of the founders during the pre-incorporation period. The difference may be made as regards either to the amount of the percentage or the number of the years. To do so, the reasons that shall appear in the memorandum of association would be of great help. The practice witnessed existence of such kind of discrimination even based on whether a person is main or associate promoter.¹⁴⁷

In respect of the special share in the net profit, another crucial matter is whether the special share in the net profit is for all persons whom the law takes as founders. The Commercial Code does not provide for separate liabilities or benefits for some categories of founders alone. The law simply imposes joint and several liabilities on the founders. By the same token, the law does not specifically permit the benefit for only some of the founders. However, it cannot be justified to permit all the founders to share the special benefits. Some of the persons whom the law bestow a legal status of founders can be paid workers. This is particularly true in relation to persons who have served by facilitating the formation process. If there is anything to be given for these persons, it should be as a compensation for their services. This may, in turn, be entertained as pre-incorporation commitments of the founders.

Additionally, a critical look at the law may enable one to contend that the benefits are only to some of the founders. It also seems that the benefit goes only to persons who are the shareholders. Article 310(1) of the Commercial Code clearly indicates that the special benefit to be stated in the memorandum of association is in addition to the rights of the founders as shareholders. Besides, it is the founder shareholders who are prohibited from voting in the subscribers' meeting approving the special benefit under Article 321 of the Commercial Code. Had the law intended to extend this special benefit to other outsiders, it would have incorporated provisions to deal with all the founders in relation to this benefit. Therefore, it can be concluded that those who are outside of the company are not entitled to the benefit. Practically, this is not always true. In practice, the benefits are given to those persons who were involved in the business side of the formation process, persons with special contribution and persons whom the

¹⁴⁷ See Prospectus of Hibir Sugar Factory, *supra* note 28.

subscribers' meeting considered as founders. Seen in light of the burdens and risks the in-kind contributors are expected to assume, assigning special benefits to them may be acceptable.

VII. CONCLUSION

As this work reveals, the allegation that company laws give special consideration to matters related to promoters is subject to several limitations when it comes to the Ethiopian Commercial Code. It is also pointed out that clear identification of the persons involved during the formation of a company is essential to safeguard the interests of subscribers, third parties and would be company. Identifying founders is also helpful to reward those who establish the company.

Though there is no single definition to the term 'founder', the Ethiopian Commercial Code provides lists of circumstances that give a person the status of founder. This paper, however, uncovers that the Commercial Code goes too far to take a person, even with any minimal contact with the process of company formation, as founder. Furthermore, the ways the law imposes liabilities on founders and gives protections and benefits to them is subject to flaws. With regard to liabilities, the law imposes joint and several liabilities, for any ground of liability stated in the law, on all persons whom it calls 'founders'. But, there are many founders who have nothing to do with many of the liabilities. Similarly, the law does not make discrimination when it assigns benefits to founders while it is obvious that such benefits cannot go to all persons involved in the company formation. Additionally, the law does not adequately show how third parties can claim against founders or the established companies when their claims arise from pre-formation commitments.

The existing practice with regard to identifying founders, their liabilities and benefits is better than the stipulations in the law. It makes distinction between the terms 'founder' and 'promoter' by reserving the latter for persons who are involved in the business side of company formation. It usually recognizes certain specified persons as founders and it actually does so for the purpose of benefit. Nonetheless, it is difficult to say that the position of the existing practice is perfect regarding who the founders are. It does not help us include all the persons who are actively involved in the process of share company formation. As it is discussed, the Draft Commercial Code also tries to downsize the scope of founders by amending certain provisions of the existing Commercial Code. This move is not still a perfect one as it prohibits considering some persons as founders at least from the vantage points of liabilities.

Thus, the law should be revisited to give status of founders to persons that other jurisdictions say promoters. With this, it has to also reconsider the existing defects on the relation between founders, the company and third parties due to pre-formation commitments. The law should also be revisited to clarify the confusions and problems that exist in implementing the liabilities, benefits and protections to founders. By so doing, it would be possible to safeguard the interests of all parties having interests in the process of share company formation. This, in turn, would facilitate the formation of share company which is much needed in the country.