

CHAPTER FIVE

LAW OF TRADERS AND BUSINESS ORGANIZATION

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Introduction

In this era almost everything that we produce and consume comes out from a business. To produce and distribute products, traders establish either sole business or business organizations. As a business student it will inevitably be important to know the legal framework behind business, traders, business organization establishment, registration, licensing and responsibilities. This will make the business students aware of the legal environment in which they are going to engage after graduation.

The law has lots to say in connection with the way you carry out your commercial activities. The way people do business is regulated by the law. The elements of business are identified, defined and protected by the law. At present day it is becoming very difficult to imagine

doing business without the artificial persons that we call business organizations. This chapter is about business and business organizations.

Learning Objectives:

After completing this study, you will be able to:

- Define traders and business organization
- Explain partnership agreement
- Identify different types of business organization
- Identify different types of company from partnership

4 INTRODUCTION

5.1. Traders

Who are traders under Ethiopian Law?

The legislative framework governing trade and traders in Ethiopia offers a number of opportunities for organizing and conducting business activities. A business may be carried out by an individual operating as a sole proprietorship, by two or more persons in a partnership agreement or by a foreign company registered or incorporated abroad. A trader as defined under Art. 2 (10) of the Trade Practice Proclamation No.329/2003, means any person who carries on any of those activities specified under Article 5 of the Commercial Code professionally and for gain or who dispenses services, or who carries on those commercial activities designated as such by regulations issued by the Government. So, a sole trade is a business carried on by an individual acting in an independent way and the person who conducts such business is sole proprietor. The business operation will be treated as personal assets and liabilities of the owner. The owner is the ultimate employer and manager, regardless of whether he or she lives in the country. In terms of the legislation in force, before starting any commercial or investment activity, such a person must apply for a registration.

5.2. Business Organization and its Formation

What is business organization?

Pursuant to article 210 (1) of the Commercial Code of Ethiopia, any association arising out of a partnership agreement is called a business organization. Generally, any business organization must be formed by a contract known as partnership agreement. Article 211 of the Commercial Code defines the partnership agreement. The Key elements in the definition of the partnership agreement are:

a. A Partnership agreement is a contract

Accordingly, in order for a contract to be a valid partnership agreement, the parties to it must fulfill the substantive and formal conditions set down by Article 1678 et seq. of the Civil Code.

Persons Incapable Under the Civil Code: art 11 of the Comm. Code,
Spouses: Art 16 of the comm. Code

b. Two or more persons, physical or juristic, can be parties

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

c. Intent to Join Together and Cooperate

d. Contributions

e. For the purpose of carrying out economic activities

f. Participating in the profits and losses arising out thereof

A business organization established in such a way is a legal entity, except for the Joint Venture, operating in its own right and obligation and has its own name, capital, principal office, management and etc.

The laws that are applicable to business organizations are the Commercial Code of Ethiopia; the Commercial Registration and Business Licensing Proclamation No 67/1997, Trade Practice

Proclamation No.329/2003 and the Federal Government Commercial Registration and Licensing Council of Ministers Regulation No 13/1997. Before a business organization starts operation, it should be registered in the commercial register kept by the Ministry of Trade and Industry or Regional Trade Bureau. But as a one-stop shop, the Ethiopian Investment Authority serves as a trade register to foreign investment pursuant to the power vested upon it by Proclamation No 67/1997 article 43.

The Commercial Code of Ethiopia defines six forms of business organizations under the category of Partnership and Company. These are:

- a) General Partnership
- b) Limited Partnership
- c) Joint Venture
- d) Ordinary Partnership
- e) Share Company
- f) Private Limited Company.

5.3. Partnership in General

What is General Partnership? What makes it different from other partnership types?

Partnership is a contract between two or more persons to cooperate and join together by contribution for the purpose of carrying out activities of an economic nature and to participate in the profit and lose arising thereof, if any. All forms of partnership except for the joint venture shall be in writing. Publication and registration is also a requirement for establishing partnership except for the joint venture. The base for establishing partnership is the contribution of the parties. Contribution may be in money, debts, property or skill. Property or use of property may be contributed. When the property itself is contributed, the contributor will be considered as a seller and ownership will be transferred to the partnership whereas, if use of the property is contributed, the contributing partner shall be deemed as a lessor and the risk shall remain with him. Partnership may be managed by one or more managers who are to be appointed by the partnership agreement or by the decision of the partners either from the members or out of the

members and managers appointed in the partnership agreement (statutory manager) may not be revoked, save for good cause. In the absence of appointed managers, all partners will have a right to act as a manager. When there are several managers and their duties have not been specified or if there is no indication to act jointly, each may carry out acts of management. The word 'acts of management' is not defined in the commercial code and the definition given in the civil code may not go in line with the duties of a manager in commercial activities. But this lacuna may be filled in the partnership agreement.

1. General partnership

General partnership is an agreement between two or more persons who are eligible for entering into binding contract. The partners are personally, jointly, severally and fully liable as between themselves and to the partnership for the partnership firm's undertaking. General partnership has no minimum capital requirements. It is left to the partners to decide on the amount of the capital to be contributed. The partnership shall have a firm name consists of the names of at least two of the partners followed by the words "General Partnership".

The memorandum of association drawn up by the parties has to be approved by public notary, published in the news paper and finally be registered by commercial register. When these requirements are fulfilled, it will get legal personality.

The management and administration of the company is determined by the agreement concluded by the partners in the memorandum of association. The memorandum of association can also provide voting procedures in which the partners make their decision as to the assignment of 'shares'. However the word 'share' used in partnership is confusing with Share Company. There is no 'share' in case of partnership but contribution. So if parties want to assign or transfer their contribution, all the parties shall agree on the same subject to contrary agreement.

2. Limited Partnership

A limited partnership is a partnership with two types of partners namely, general partners who are personally, jointly, and severally liable and limited partners who are only liable to the extent of their contribution. A limited partnership shall have a firm name.

The name of a limited partnership must consist of the names of the general partners followed by the words "Limited Partnership". Where a limited partner allows his name to be included in the firm's name, he shall be jointly and severally liable to third parties in good-faith as though he were a general partner.

A limited partnership is managed by the general partners. Limited partners are not allowed to participate in management. Otherwise they are to be held jointly and severally liable for all the debts and obligations of the partnership arising from their activities. However, they can require to be presented with a copy of the balance sheet and are entitled to inspect the books of the firm.

3. Joint Venture

- Unlike other business organization, joint ventures are not required to be formed in writing, is not registered and publicized. Nor does it have a legal personality.
- A joint venture is not disclosed to third parties and its main advantages constitute in this.
- The unlimited liability will come only when the existence of a partnership is disclosed and the partner is known as a member.
- Otherwise, if the partnership remains undisclosed, then its liability will be borne by the acting partner or the manager.

4. Ordinary Partnership

Although an ordinary partnership is defined as a business organization, it is not known as commercial business organization and is not authorized to undertake trade activities. If it carries out a trade activity, it will automatically be considered as a general partnership.

- An ordinary partnership is a business organization that is established to perform activities which are not commercial in their nature. It is a non-commercial business organization. That is to say ordinary partnership cannot be used to carry out any of the activities listed under article 5 of the commercial code. Thus ordinary partnerships are only meant to run business activities other than ones listed under Article 5.
- The formation of an ordinary partnership has to be writing, registered in the commercial registry and it has to be publicized.

- The contracting parties are partners.
- The partners' obligation includes the obligation to be loyal. Diligent and hardworking as well as use the skill they use in conducting their private affairs.

5.4 Company in General

A company is an aggregate or collection of shares or capital. As a result, what is important is legal personality of the company. Thus, the company may own property, make contracts, and sue and be sued under its name. It is entirely distinct from its members. The company has perpetual succession. As a result, death or insolvency of a shareholder does not affect its existence unlike partnership. In a partnership firm, of paramount importance is personality of the individual partner. This is so, because incapacity, death, or serious disagreement between partners may result in dissolution of the partnership firm. Insofar as intimate personal collaboration is expected of each partner, only persons who know each other very closely may enter into a partnership agreement giving rise to a partnership firm. Here under is the discussion on two types of companies.

1. Share Company

Share Company is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company.

The establishment of Share Company requires at least five persons and there is no maximum provided in the law as to the number of shareholders. Subject to the laws provided for the establishment of banks and insurance, the capital of the company shall not be less than birr 50,000. The name of the share company shall not offend public policy nor the rights of third parties and it shall include the words "Share Company".

The shares are either registered in the name of the shareholder or it may be to the bearer. When Share Company is established between the founders, all the shares have to be allocated among them and one-quarter of the par-value of the shares has to be paid up and deposited in a bank in the name and to the account of the company. Public subscription is another possibility for establishing a share company. In this case a notarized prospectus must be drawn up and filed with the trade register in the appropriate authority. The trade register certifies compliance with

the Ethiopian legislation and authorizes the issuance of the prospectus. One quarter of the capital raised by subscription shall be deposited in a bank account opened for the company to be established.

The article and memorandum of association which governs the operation of the company shall be drawn up by the founders in accordance with the law.

The shareholders' general meeting is the supreme managing body of the company. Shareholders' meeting may be general or special. General meeting may be of ordinary or extraordinary. The company is generally managed by the board of directors. The day to day operation of the company is governed by the general manager elected by board of directors. The directors shall deposit as security such number of their registered shares in the company as is fixed in the memorandum of association.

A) Board of Directors

Share Company being legal person cannot act by itself. It must act through some human agency. The persons by whom the business of the company is carried on are, termed as directors and group of directors as an institution is termed board of directors. The board of directors is the managerial body on general issues. It is established by general assembly from among the shareholders. The number of directors is set in the statutes, but must be not less than three and not more than twelve; all directors must be shareholders of the company. They must have the real ownership and deposit of certain number of share as may be fixed in the statutes. Such share should be deposited in the company until directorship is ceased and liability is discharged, if any /Art 349/. Individuals or legal entities can become directors. If a legal entity is appointed as a director of Share Company, it must appoint an individual person /Art 347/4/.

The first directors may be appointed in the statute. Their appointment shall be submitted to the first meeting of subscribers for conformation. If the meeting does not approve the appointment, other directors may be appointed. Subsequent directors are appointed by ordinary general meeting of shareholders. The term of office of the director cannot exceed three years provided that he can be eligible for re-election. The board of directors possess the power to act in all circumstances on behalf of the company subject to the limit of the company business purpose and to the powers which are expressly reserved by law to meetings of shareholders (i.e. mainly

approval of the annual accounts amendments of statute) In practice, however, the business of the company is taken care of by the chairman and general manager and the board of directors merely defines the general policies to be followed by the company; takes or approves strategic decisions and controls the chairman of the board.

The following are some of the duties of the board

- Organizing management and meeting records
- Keeping of accounts and books
- Calling shareholder's meeting each year after closing of the fiscal year in order to approve management report, account and allocation of profits also meeting should be called where three quarters of the capital are last.
- Establishing reserve fund required by the law and statutes
- Applying to the court where the company is unable to pay debt with the view of composition, bankruptcy or winding - up.

B) Auditors

Auditors are appointed by shareholders and are entrusted with the external control of the company. Their main functions are to audit the accounts of the company, certify certain information provided to the shareholders, and prepare reports which must be submitted to the shareholders.

Company may elect one or more auditors and one more assistant auditor. The first auditors of the company shall be appointed by the subscribers of the company and subsequently be appointed by the general meeting of the company (Art 369/1/). The auditors appointed by subscriber shall hold the office until the first annual general meeting. Auditors elected at annual general meeting may hold office for three years (Art 369/2/).

The following person are prohibited to be elected as an auditor (Art 370)

- (a) the founders, contributors in kind, beneficiaries enjoying special benefits /preferred rights/ directors of a company or one of its subsidiaries or its holding company,

- (b) the blood relatives or in-laws of any person mentioned in (a)
- (c) persons who receive from persons mentioned in (a) a salary or periodical remuneration in connection with duties other than those of an auditor,

In addition, the law prohibits auditors not to be appointed as a directors or managers of the company which they audit, nor of one of its subsidiaries of its holding company within three years from the date of the termination of their function. Art 371 of commercial code states that auditors may be removed by general meeting at any time subject to demand compensation, if they are removed not for good cause.

C) Dissolution and winding up

There are many causes of dissolution of a company /or partnership/. Causes common to all kinds of business organization /Art 217-218/ are the application of rules of law, provisions in the statutes of the company/ partnership, the common agreement of the members to dissolve or a judicial decision dissolving the companies for just cause.

2. Private Limited Company (PLC)

A private limited company is a company whose partners are liable only to the extent of their contributions. The maximum number of the partners is fifty while the minimum is two. The company shall not issue transferable securities.

The company has a minimum capital of Birr 15,000 which must be paid up on registration. The capital contributed by the partners may include in kind contribution which is subject to valuation. The registered capital is divided into shares. Shares may be transferred among shareholders as provided in the memorandum of association, but they can be traded with third parties only after seeking the approval of shareholders owning at least three quarter of the capital. This characteristic of PLC makes it a hybrid of Share Company and Partnership. On one hand, its member's liability is limited to the extent of their contribution; on the other hand shares are not freely transferred to the outsiders, which is chief characteristics of partnership. Thus, this company is middle way between Share Company and partnership.

The company may have one or more managers. They must be individuals appointed by the shareholders, but they need not be shareholders. Although the memorandum of association may provide limitations on a manager's power, these limitations are not binding on third parties. The appointment of auditors is compulsory if the number of shareholders exceeds twenty. In such cases the company should have at least three auditors.

The name of the private limited company may contain a disclosure of the nature of its activity and must include the words "private limited company". The firm-name and the amount of capital of the company shall appear on all of the company documents, invoices, publications and other papers.

Nowadays, most of the companies established in Ethiopia by foreign or domestic investors are private limited companies.

Summery

Ordinarily the word business is used to connote every activity of a person. But legally speaking business is any activity that seeks profit by production and supply of goods or services to satisfy the needs of consumers.

Normally business can be carried out by an individual as a sole proprietor and/or business organization. Business by an individual, usually called sole proprietorship, is an easy way of doing business. To do business in this form, registration is a legal requirement. Sole proprietorship does not have legal personality and as a result there is no distinction between the business's and the owner's liabilities.

The second form of doing business is in the form of business organization. Business organization, by definition is an association of two or more persons for the performance of business activities with the ultimate objective of sharing profits. There are six forms of business organization: ordinary partnership, joint venture, general partnership, limited partnership, Share Company, and private limited company. The Commercial Code provides common provisions to business organizations and special provisions for each. Under the common provisions, with the exception of joint venture, business organizations must be formed in writing must be registered, and they have legal personality. All business organizations carry out their legal activities through agent. With few exceptions, the profits and losses coming out of the business must be shared

among all partners. Generally business organizations may come to an end by agreement of the partners, or in accordance with the provisions of the law, or by court decision to be made for good cause.

As to the special provisions, an ordinary partnership is formed for professional services. The partners assume unlimited liability and ownership interest is not easily transferable. As to joint venture, it does not have legal personality; it must not be divulged to third parties; and it must not be registered. As to general partnership, it is the common form of partnership business organization. The partners assume unlimited liability and, like other partnerships, ownership cannot be easily transferred. As to the limited partnership, it is almost the same with general partnership. But there is one big difference. In limited partnership, there are two categories of partners: general partners with unlimited liability and limited partners with limited liability. It is only the general partners that can manage the affairs of the partnership.

Share Company is different from the other forms of business organization in many aspects. The liability of the owners is limited. The government control of the business is strict. The minimum capital and the number of members required are birr 50,000 and 5 respectively. As to the private limited company, it is a compromise between company and partnership. Like a company the owners' liability is limited. And like partnership it is established by few members (maximum being 50) and ownership interest is not freely transferable. The minimum amount of capital required to open up private limited company is 15,000 birr.

Activity 1

1. Discuss trade and traders under Ethiopian context.

2. Discuss the different types of business organizations in Ethiopia

3. What are the differences between company and partnership?

4. Which type of business organization is allowed to involve in banking and insurance?

5. Explain the main difference and similarities between Share Company and Private Limited Company, if any.

Case Type Questions

Case 1

A, B & C agreed to form a partnership to carry out dairy farming. They entered in to a partnership and they fulfilled all the legal requirements of the law. The agreements among others reveal that partners are not jointly and severally liable among themselves as well as to third parties.

Qⁿ. What kind of partnership is established by the partners? 10%

Case 2

‘X’ & ‘Y’ General Partnership empowered ‘A’ and ‘B’ to administer partnership jointly through its memorandum of association. However, ‘A’ has purchased a property in the name of the partnership without consulting ‘B’.

Qⁿ.

- a. Would A’s act binds the partnership? 5%
- b. Mention at least two members to this partnership. 5%

3. Marvin Private Limited Company is established by three members in order to bread fish and shells. Is this PLC a trader? Why or why not? 10%