

# Departure of New Commercial Code of Ethiopia on Formation of Share Companies

## Description

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### Introduction

The new Commercial Code Proclamation 1243/2021 comes with some changes in the formation area of share companies. The new Commercial Code uses the same definition of the old Commercial Code(1960) on share companies: 'A 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.' Hence we discuss here some of the departures of the new Commercial Code from its predecessor only in the formation stage of a share company.

### Nominal value of Shares

The minimum capital of ETB 50,000(Fifty Thousand) for formation of a share company remains the same between the old and new Commercial Code. However the par value of each share, says the new Commercial Code, should not be less than ETB 100(hundred). In the old Commercial Code, the par value of shares used to be not less than 10(ten) Ethiopian dollars.

### Distinction between Founders and Promoters

The old Commercial Code gives the name and status of a founder to any person, even though outside the company, who has initiated plans or facilitated the formation of the company. Now in the new Commercial Code a person( both artificial or natural) who initiates the formation of a company by public subscription, invites persons to join the company by preparing prospectus or in general acts with the view to realizing the formation of the company is called promoter. The new Commercial Code provides in detail what the liability of promoters are and special benefits allocated to promoters. Under the new Commercial Code, the name 'founder' is narrowed down to those individuals who establish a share company as between themselves without offering shares for public subscription. Article 252(2) of the new Commercial Code obliges the number of founders of a share company not to be less than five.

### Redacting Article of Association

The old Commercial Code provides both memorandum of association and articles of association as formation documents of a share company. Whereas in the new Commercial Code, only memorandum of association is accepted as the formation document of the share company. Article of association is left out.

### Valuation and Verification of Contribution in Kind

The old Commercial Code used to put a report of valuation of the in-kind contribution by a subscriber to be made by experts appointed by the Ministry of Commerce and Industry. Such valuation shall be verified within six month from the date of the formation of the company by directors and auditors. Now in the new Commercial Code, it is stated that the person who made the contribution in kind will provide an expert valuation report. The requirement of an appointed expert from the Ministry is left out. The verification process became a two step process. The promoters and formation auditor shall verify the valuation of contribution in kind first. This happens before the meeting of subscribers takes place. And then the board of directors and auditors shall verify the valuation in kind within six months from the date of registration of the company. Where the company under formation is not established by public

subscription, the founders of the company shall verify the report of the expert. Similarly the second step of verification happens within six month from the date of registration of the company by the board of directors and auditors.

### **Signatories and Contents of Prospectus**

Prospectus is a document prepared for serving the purpose of an offer for subscribers. The prospectus used to be signed by founders in the old Commercial Code. In the new Commercial Code, the prospectus is signed by all the promoters. The prospectus added few contents to the previous code. The prospectus will contain the anticipated time within which the formation of the company is to be completed and the company acquires legal personality. The law on Article 259(1)(g) second sentence of the new Commercial Code stipulates that under any circumstance, the time set for the compilation of the formation of the company shall not exceed five years. The prospectus should include bank details opened in the name of the company under formation in which payments are required to be deposited.

### **Auditing Requirement before Calling of Meeting of Subscribers**

The old Commercial Code did not have the requirement of auditing before the meeting of subscribers. The meeting of subscribers will be called when the time for making an application for shares has expired. Now in the new Commercial Code, before the meeting of subscribers is called, the promoters are obliged to verify by an external auditor as to the fulfillment of the requirements of the formation of the company. The audit shall look into the fact that the promoters meet the requirement set by the law, full subscription of the capital of the company is made, contribution in kind is valued by experts and it is correct, deposit of cash collected from subscribers in the bank account opened in the name of the company is made and any other requirement set out by law or the memorandum of association of the company. Such an audit report shall be presented by the auditor to the meeting of subscribers for their approval.

### **Powers and Duties of Meeting of Subscribers**

The new Commercial Code included as powers and duties of the meeting of subscribers the right to approve the reports of the promoters and formation auditors. The meeting will also determine the shares in the profits allocated to the promoters. In the old Commercial Code, the resolution of subscribers' meetings was required to be signed by the founders. Now in the new Commercial Code, resolutions of subscribers' meetings shall be drawn up and signed by all the promoters or founders and members of the board of directors that were elected at the meeting.

### **Who Registers the Company in the Commercial Register?**

The old Commercial code was silent as to who goes to register the company at the commercial register. Now under Article 265(2) of the new Commercial Code, the registration of the company shall be effected by the promoters or as appropriate, the founders or any other person having a power of attorney from the promoters or founders.

### **Accompanying Documents for Registration in the Commercial Register**

The new Commercial Code avoided the articles of association as an accompanying document for registration and included an audit report regarding valuation of contribution in kind and company formation. The rest of accompanying documents namely authenticated memorandum of association, prospectus where the company is formed by public subscription and resolution of meeting of subscribers will be submitted.

### **Action Period for Non-Compliance**

The entry into the commercial register without complying fully, results in the endangerment of the interests of creditors or shareholders, the latter may request for dissolution of the company or any other appropriate measure from the court. Such a request has to be taken within three months from the date of registration in the commercial register, as per the old Commercial Code. Such a period of action for non-compliance is extended to one year by the new Commercial Code.

### **Conclusion**

The departures in tasks and responsibilities, documents requirements and period of actions of the new Commercial Code from the old Commercial Code in the formation process of a share company contribute to clarity and easier implementation procedure. Many of the old Commercial Code concepts and ideas are still maintained, which shows that the old Commercial Code has proven effective in the formation stage of share companies throughout the test of time.

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