Addis Ababa University

College of Law and Governance Studies

School of Graduate Studies

Problems Associated With Contribution In-Kind in the Formations of Companies in Ethiopia

By

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Addis Ababa

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Approval Sheet

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By

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Declaration

I, the undersigned, declare that the thesis is my original work and that all sources of materials used in the thesis have been duly acknowledged.

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Acknowledgment

"Our Father in heaven, may your name be kept holy!"

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Abstract

Companies in Ethiopia can be formed by contributions of cash or in kind. There are different problems that would arise by the mere fact that there is contributions in-kind. Thus, if there is contribution in kind, regulation of the same is important in order to ensure that the value placed on it is not overstated, that is, there is a need to ensure that the consideration is not overvalued. If not, actual risk would exist that the MoA would mislead creditors as to the capital value of the company.

To avoid the effects, Ethiopian commercial code adopted revaluation scheme by directors and auditors in Share Company. Revaluation by directors and auditors is not blamable by itself it is rather making the contributor liable for the valuation which invites several problems. Further, the time in which revaluation would be conducted appears long. Under PLC, all members are jointly and severally liable for overvaluation indiscriminately which is painful.

Therefore, it is recommended that initial valuation should be conducted by an independent expert(s) with all responsibility at least to reduce some of the issues without affecting the scheme of revaluation by directors and auditors.

Chapter One

1. Proposal of the Study

1.1. Background of the Study

Doing business is an aged practice of human being all over the world setting aside the differences exhibited in the size(volume), development or otherwise of the same. A person may conduct business either individually or together with other person/s based on their free and consensual needs. In order to carry out business, there should be safe environment through proper legal frame works and institutions established accordingly. Collective working of business may range from Joint Venture to share company in the context of Ethiopian commercial code (here after the code) which may not necessarily be true for other countries of the world. When they do business jointly, each member is expected to contribute resources based on the law of country where the business is established. Accordingly, the form of contribution may be in cash, kind or services. It is obvious fact that two types of companies are recognized in our legal system[1] and these are Private Limited Company (here after PLC) and Share Company (SC). The code has accepted contribution in-kind in the formation of these companies with different regulations provided therein. Thus, this paper is intended to see issues connected with contribution in-kind in the establishment of companies.

1.2. Statement of the problem

Conducting business jointly in an organized form has numerable advantages especially when compared with sole proprietorship[2]. Business organization enable people to do things which would be difficult or impossible for them to do of business organization, for the most part in the form of companies, raising resources in different form is a must. The members of company under formation should contribute resources which could be in cash and kind. The Code has

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[1] Commercial Code of the Empire of Ethiopia Proclamation, 1960, Arts 304 & 510, Proc. No. 166, Neg. Gaz. Year 19, no. 3. alone.[1] Limited liability is a great advantage to a businessman. He may operate his business without the fear of losing all his personal property if the business fails.[1] In order to engage in business in the form

[2] Comparing an LLC to a Sole Proprietorship and a Partnership available at https://www.legalzoom.com/knowledge/limited-liability-company/topic/llc-sole-proprietor-partnership comparison(accessed on May 11, 2016); it may be also good in terms of limited liability

recognized both cash and non-cash contribution as valid contribution[3] to form either of the companies with the latter being qualified as contribution in-kind i.e. property contribution is eligible whereas service/skill contribution is not clearly provided as an acceptable contribution in both form of companies. Here, there may be arguments that could be raised due to the gaps of the code or other relevant legislations which does not neither clearly accepts service contribution nor rejects the same in the formation of companies in Ethiopia. However, the writer agrees with the invalidity of service contribution in companies as discussed under 2.2. Apart from this, regarding contribution in-kind, there are various problems that would occur and among these;

One of such problems is two stage verification/approval of the contribution made in-kind. The first approval is conducted at the meeting of the subscribers as stipulated under article 321(3) of the code[4]. Under this stage of approval, once the contribution in-kind is contributed then it means that the capital of the company under formation is known and can be registered accordingly. Nevertheless, this provision of the code is amended in that the proclamation leaves valuation of contribution in-kind to shareholders themselves abandoning valuation by an expert envisaged under the code.[5]

The second stage is the verification that would be made by the directors and auditors of Share Company[6]. In the process of revaluation, the value of property contributed may be increased, decreased or it may be same with initial valuation. The critical problem here is that, the value of property is not constant/stagnant through the passage of time and due to different factors the value of the property could appreciate or depreciate. Therefore, the second valuation might have the possibility of change in the value of the property contributed which would led accordingly, the change of memorandum and articles of association and it may also causes dissolution of the same if the required capital cannot be satisfied by any other means. In relation to this, the company may continue its operation irrespective of the fact that it has found that the value of

[3] Comm. C., arts. 307(3) and 313(7), and 517(f) for Share Company and private limited company respectively that indicates the recognition of contribution in kind in our legal system in the formation of companies.

[4] Id, art. 321(3)

[5] Commercial Registration and Licensing Proclamation, 2016, Art. 5(9), Proclamation No. 980, **Federal. Neg. Gaz**.. year 22, no.101

[6] Comm. C., art. 315(3)

the property contributed did not match with the previous valuation which could finally affect the interests of the potential creditors of the company even if directors are liable for the act.

The other problem attached to contribution in-kind is that, once the agreement of the subscribers/ founders on the valuation the property is made, the title (ownership) on the thing will be transferred and the name would be changed into the company's name. The entire document related to the property contributed would be given to the company and name change is not free of charge. The payment that might be paid in this transaction would not be easy particularly if the property contributed is immovable, special movable and intellectual property rights. The question here is, who would pay registration and other related expenses if the latter valuation resulted in the value of contribution being lowered and the property is returned, and the contributor is unwilling/unable to make the difference good? Once again there might be overvaluation of the property contributed that could potentially affect the interests of the company, the shareholder, and third party creditors.

Regarding contributions in-kind in PLC, the major problem that could be raised at this point is the liability of the all members regardless of their knowledge as to the existence of overvaluation and lifting of limited liability principle due to the contribution of property. These are some of the problems that the research attempted to discuss.

1.3. Research Questions

Based on the statement of problems, some of the major questions that the study attempted to answer are;

i. Is conducting revaluation logical? If the answer is to the positive, how it should be seen in light of the fact that the value of property is not constant due to different factors?
ii. What are the parameters/market reference to value property contributed?
iii. Does the code addressed issues of claim contribution?
iv. Does the Code and other laws addressed the problems of revaluation, particularly expenses that would come in relation to cancellation and registration of the property (either immovable or special movable) contributed to its previous owner i.e. the contributor in case the value is lowered; who will cover these expenses (ownership transfer related expenses), the company or the contributor?

1.4. Significances of the study

One of the importance of this study is to clarify certain problems in relation to contribution in-kind in the formation of companies. The other implication of the work could be that it may serve as starting point for further research for those who will have interests on the issue at hand.

1.5. Objective of the Research

1.5.1. General objective

General objective of the study is to identify the issues linked with contribution in-kind in the formation of companies in Ethiopia

1.5.2. Specific objectives

The specific objectives of the study are;

- To appreciate difficulties encountered in the valuation of property contributed
- To identify the specific issues surrounding contribution in-kind in the formation of companies in Ethiopian context

1.6. The Scope of the Research

The study is confined to discuss the problems related with contribution in-kind in the formation of companies in Ethiopia.

1.7. Research Methodology

In undertaking the study, relevant provisions of the code, Commercial Registration and Business Licensing Proclamation No. 980/2016(here after the proclamation), and others were examined. In addition to that, an interview with individuals, reference of documents and literature were carried out. To conduct an interview, the subjects of an interview are selected based on purposive approach; this is designed to get appropriate persons in the area of study. The interviewees are four from Ministry of Trade and one from NBE. The basis of the choice is relevancy and seniority.

To analyze the data the qualitative approach is employed in that it devoted on the reasons, justifications or logical arguments on legal provisions.

1.8. Limitation of the study

In conducting this research, limitations like in ability to access the draft commercial code and lack of materials either book or article directly relevant to the topic are mentionable.

1.9. Organization of the paper

One of the essential requirements for formation of companies according to the law is contribution of resources (as it is called association of capital). Each member is expected to invest something of value. The contribution could be in cash or in-kind. Consequently, this paper concerns with contributions made in-kind and effects associated with the same. Accordingly, it comprises four chapters.

The first chapter is all about the proposal part. The second chapter is concerned with formation of companies and basic requirements for its formation, kinds of contributions and usefulness, and invalidity of service contribution.

Third chapter deals with valuation of contributions in-kind; under this, roles of founders, members and directors, and valuation in PLC is also discussed. The last chapter, which is the central part of the thesis, discussed effects of contribution in-kind. As a final point, Conclusion and recommendations are provided.

Chapter Two

2. Formation of Companies in Ethiopia

In this chapter, the formation of companies in Ethiopia will be highlighted. In addition to that, contributions that could be made to form companies and thereby invalidity of service contribution, and usefulness of the contribution in-kind are also discussed.

According to the general characteristics they share in common, "business organizations may be classified into two basic categories and these are partnerships on the one hand and companies on the other"[7]. But, since the scope of this paper is limited to companies it does not deal with the formation and other aspects of partnerships save the references rarely made for comparison as the case may be.

Companies must be formed by a contract called partnership agreement. Article 211 of the Code defines the partnership agreement as:

> "a contract whereby two or more persons intend to joint together and to cooperate undertake to bring together contributions for the purpose of carrying out activities of an economic nature and of participating in the profits and losses arising out thereof."[8]

One of the essential elements of partnership agreement, from the definition, is bringing together contributions.

> "The parties must undertake to bring in contributions in order that a contract survives as a valid partnership agreement. Contributions can be made in cash, kind, or services. In a SC or PLC, it should be made in-cash or kind".[9]

Contribution is a must to establish companies because life of a company is dependent on the capital which is collected from the members in the form of cash or in-kind and described in the MoA. Capital is important not only for the company itself but also for creditors that may transact with the same. In company, capital is more important than the personality of the members.

[7] Alemayehu Fentaw & Kefene Gurmu, Law of Traders and Business Organizations (2009). p. 46

[8] Comm. C., art. 211

[9] Alemayehu Fentaw and Kefene Gurmu cited above at note 9, p.52

"Capital is a figure that is stated in the charter of the company and equals the sum of the face value of its shares; it represents the minimum start-up financing (initial capital)".[10] Capital is a money or assets invested in a company by members.[11]

> The total amount of promised contribution must at least equal the amount of capital set forth in the charter. That is, the total face value of the shares must equal the amount of capital the company is required to have as established in its charter and the minimum contributions of all members.[12]

The commercial code also described the concepts of capital. Accordingly, "the capital is the original value of the elements put at the disposal of the undertaking by the partners by way of contributions in cash or in-kind".[13] Hence, capital refers not to the money or property contributed as such, rather to its original value of the contributions to the exclusion of service contributions.

The calculation of capital is made based on the value of the property on the day of contribution. Accordingly, company capital, being the original value of the total money and property that the members contribute and is a fixed amount that may change only through amendment to the MoA.[14]

> "…in most of the cases, creditors transact with a SC looking at the declared capital of the company. Contributions in-kind is one form of contributions that makes up the capital of the company. If it is overvalued, the capital will be inflated and attracts creditors to transact with the company. Hence, in having transactions on the basis of the company's capital, the disparity between the declared and real (actual) value of the contribution in-kind may not be tolerated by the creditors".[15]

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[10] Marcus Lutter "Limited Liability Companies And Private Companies" International Encyclopedia of Comparative Law, Vol. XIII(1998) p. 33

[11] Bryan A. garner, Black's Law Dictionary (1999, 7th ed.) P. 200

[12] Marcus Lutter cited above at note 12, p.33

[13] Comm. C., art. 80(1)

[14] Alemayehu Fentaw & Kefene Gurmu cited above at note 9 p. 58

[15] Paul Mc. Carthy, material for the study of Agency and Business Organizations, faculty of law,(unpublished Haleselassie I University, 1972)p.88

Therefore, as contribution in-kind is one form of contributions that makes up the capital of the company, it should be seriously and carefully evaluated to reduce, if possible to eliminate, the effects of overvaluation. The face value of shares should be effectively paid. Hence, it is essential to maintain the confidence of the creditors on the company's capital, esp. if there is in-kind contribution.

Now, let us discuss the formations of SC and PLC.

2.1. Share Companies

Formation of SC and validity requirement for its formation are provided in different parts, for the most part, of Book II of the code. The collective analyses of certain pertinent provisions of Title I and VI of the book mentioned, and proc.No.686/2010 as amended by proc. No. 980/2016 , one can amassed the fact that there are essential requirements to be fulfilled to have legally formed SC.

Accordingly, to have lawful and protected company there are certain basic requirements that needs to be fulfilled but the paper is interested only to raise the following requirements, not all.

i. Subscription of the Capital of the Company and Minimum Capital

> *"*Limited liability contains obvious dangers for creditors of business organizations and the law contains a variety of provisions to protect them. Organizations in which the members enjoy limited liability either must have, a specified minimum capital (share companies and PLCs) or must have at least one member without limited liability (limited partnership)."[16]

The shareholders of a SC should contribute something either in cash or in-kind that would be the capital of the company. Like any business organization, SC needs to have capital that enables the same to operate its commercial activity, to protect the interest of creditors that would transact believing there is asset of the company, and to the extent possible to protect the interests of some shareholders that might be injured due to non-contribution by other members. Therefore, in order to avoid such kinds of undesirable consequences, the law designed the full

[16] Everret F. Goldberg cited above at note 3, p. 510

subscription of the capital of the company before its establishment having legal personality.[17] The chapter of the code that deals with formation of company started by stating the necessity of subscription of full capital of the company under formation and in this regard the article clearly indicated the concept as "a SC shall not be formed until the capital has been fully subscribed."[18] Full subscription of capital means the promise of the subscribers to pay their respective shares. To strengthen the obligatory nature of stating capital subscription of the would be SC, the code makes clear that the contents of MoA should indicate the same.[19] And, what is subscribed is the capital fixed in advance as stated under article 304(1) of the code.

However, what should be understood here is that subscription of capital does not indicate full payment of the total capital of the company under formation it rather means a binding promise to raise the entire predetermined capital of the company under formation by the investors (buyers of the share/s) and what the law obliged is the payment of one quarter (25%) of the stated total subscribed cash capital to commence its operation.

Regarding minimum initial capital, it is not arguable that any business organization including sole traders (though not stated by the law) should have initial capital to commence its commercial activity which is also absolutely true for SC. It also enable to protect the interests of creditors. The question is whether this capital should be fixed by the law or left for the discretion of the business person. It is the writers view that in our law, save PLC and SC, minimum initial capital of partnerships and that of traders is not fixed by the law this could be due to the fact that each partners except limited partners of Limited Partnership are personally liable for the debt of their partnership. Secondly, the types of business they may engage in also be a factor for not to legally set the minimum capital requirement, for instance, they cannot engage in banking and insurances (this is of course true for PLC too) that needs great care and may bring high risks unless properly regulated. Once again the investors should know the amount of their capital and weigh whether the desired objective of the business could be achieved with the capital at hand, hence, it invites for reconsideration of their initial capital and may increase the same after a thorough understandings of the case. Furthermore, limited

[17] Comm. C., art. 312(1(a))

[18] ibid

[19] Comm. C., art. 313(5)

liability of shareholders of SC and PLC may be one cause that necessitated in fixing minimum initial capital by the law and thereby it enables to protect creditors of the company. Article 306(1) stated that the minimum amount of capital for SC is 50,000 Ethiopian dollars. But this is provided as general rule for any SC and does not mean that there is no exception to the rule. And in this regard, different legislations enacted for the establishment of financial companies provided a minimum initial capital which is of course much greater than what is stated in the commercial code.[20]

However, fifteen thousand birr is the capital needed to commence a business in the form of PLC.[21] Here, the amount provided is may be to protect creditor(s) and to enable the company to run its business but neither of the purposes might be maintained with this capital and even it may not cover the cost of establishment. Hence, the writer has an opinion that it should be either increased to protect the said persons or eliminate the minimum requirement to encourage creativity and entrepreneurship. However, now the draft of council of ministers regulation on commercial registration and licensing leaves the issue of minimum capital and the requirement of blocked bank statement.[22]

ii. Payment of at least 25% of the par value of cash shares and valuation of contribution in-kind

After the capital of the company under formation is fixed in advance, what the law required is payment of which could never be less than one fourth (1/4)/25%[23] of the par value of cash shares.[24] The language of the law is clear in that it stated the bottom line which is 25% and members of the would be company can increase the payment of the par value of cash shares up

[20] Licensing and supervision of banking business minimum capital requirements for banks,2011, directives no. 50; Licensing and supervision of insurance business minimum paid up capital for insurers,2013, directives no. 34. See article 4 of the respective directives.

[21] Comm. C., art. 512(1). In this point, the capital required is not that much difficult in contemporary situation due to market inflation and the other is that the possible justification that can be raised for the different approach adopted for companies and partnerships regarding initial capital seems that it relates with strict legal personality of the former in which the creditors cannot claim from the personal property of the members which is possible in the latter case.

[22] Draft Commercial Registration and Licensing Council of Ministers Regulation, drafted as per proc. No. 980/2016

[23] Comm. C., art. 312(1(b))

[24] Ibid. And art. 338(1)

to the total amount of shares subscribed in cash. One of the rationale behind of requiring having paid up capital might be to protect creditors and to enable the company itself to commence its operation having something at hand because "every enterprise requires financing."[25]

Relating to valuation of contribution in-kind, the code requires the detail description of the method of valuation, the price of the thing contributed during acceptance, numbers of shares, etc. are needed to be mentioned in the MoA.[26] This is approach is employed may be to give awareness to creditors and shareholders regarding the nature and values of the contributions made in-kind. And, what the proclamation required is that 'the agreements of the founders or members of the company regarding valuation of contribution in-kind must be indicated in the MoA.'[27] But this does not mean that details of the contributions stated in the code is amended. Generally, taking into account the detail insights that would be made in the next chapters, payments of 25% of the par value of the subscribed cash shares should be there and agreements concerning valuation of property contributed should be mentioned in the MoA for establishment of SC. Consequently, during an application for registration documents like MoA, AoA, a bank statement showing that at least one fourth of the par value of the subscribed cash shares is deposited in a blocked account … shall be submitted together with signed application.[28]

2.2. Private Limited Company (PLC)

Similar to SC, there are certain formalities that should be fulfilled for the establishment of PLC. However, for the purpose of this paper it is preferred to see the one stated here under.

Full Payment of the Capital

Unlike SC, except when the total contribution is in-kind, that requires 25% of paid up cash share capital and full payment of contribution in-kind, the law of PLC obliges the full payment of the subscribed capital of company under formation irrespective of the natures of the contribution. The articles of the code plainly stipulated this requirement. [29] But there is a draft

[25] Marcus Lutter cited above at note 12

[26] Comm. C., art. 313(7) and art. 315(1-2)

[27] Commercial Registration and Business Licensing Proclamation cited above at note 7

[28] Commercial Registration and Business Licensing Proclamation, cited above at note 7, Art.6 (1), and together with article 11 of draft regulation which is under preparation for the new proclamation.

[29] Comm. C., Art 517(q)

Commercial Registration and Licensing Council of Ministers Regulations which is under preparation based on the proclamation and in this regulation it seems that the full payment of the capital of a PLC is amended in case there is contribution in-kind. It stipulates that "title on property should be transferred within a year after registration is made".[30] Though not binding and finally adopted, the inclusion of the same even at the final draft level of the regulation may reflect the presence of idea to change the requirement mentioned above.

2.3. Contributions Made To Form Companies

Contributions are those things put at the disposal of the organization for its use in carrying out its activities, in return for which the contributor receives a membership interest in the organization."[31] "Contributions (investments) are assets that members contribute the company to obtain their membership interests. Unless the state law imposes restriction, contribution may include almost any types of asset (cash, property, service rendered). Members generally contribute assets to the company in their capacity as members".[32]

To form any business organization, contributions by the subscribers (potential shareholders) and/or founders is a requirement. "Every business organization is formed with contributions. Each member must transfer to the organization something of value, be it money, land, other corporeal or incorporeal property, or service."[33] In order to have a valid partnership agreement, each member must undertake to make a contribution to a company.

The nature and the extent of contribution made may not be necessarily equal. There are various types of contribution that could be made based on the legal system of the country concerned. With regard to the types of contribution, for example, OHADA[34] identifies almost three types of contributions and these are; contribution in cash, contribution in-kind and supply of labor /services (not necessarily applies to companies).[35] When we see our relevant laws i.e. the code

[30] Art. 10(8) of Draft Commercial Registration and Licensing Council of Ministers Regulation

[31] Everret F. Goldberg cited above at note 3, p. 515

[32] Martin M. Shenkman, Samuel Weiner, and Ivan Taback, Starting a Limited Liability Company(2003, 2nd ed.) p. 15,

[33] Id, p. 510, though this explanation is useful, it does not work in partnerships in that service cannot be transferred.

[34] The Organization for the Harmonization of Business Law in Africa

[35] Article 40 of OHADA

and the Proclamation the two types of contributions, cash and in-kind contribution, are clearly understandable as an acceptable contribution in the formation of companies. The difference between the two types of contribution is that in case of cash contribution, a contributor is not expected to discharge its obligation at once whereas the contributors of in-kind contribution should fully discharge (full provision of the property contributed) of its duty. It should be noticed that the contribution could be exclusively contribution in cash but it cannot be wholly in-kind according to directives enacted by NBE for the establishment of banks and insurance companies.[36]

… If a man contracts to take shares he must pay for them, to use a homely phrase, 'in meal or in malt'; he must either pay in money or in money's worth. If he pays in one or the other, that will be a satisfaction.[37]

So, contribution in-kind may consist of any kind of assets that have economic values. A question arises regarding whether claims (debt[38]) may be contributed or acquired in the form of contribution in the formation of companies? Though different literature defined contribution in-kind by incorporating claim as one element the Ethiopian commercial code impliedly rejected its validity as it can be gathered from the cumulative reading of articles 339 and 517(g) regardless of whether it is secured by a charge. But in other jurisdictions claims is allowed provided that they have the value and if a claim is secured by pledge or mortgage. "A member who transfers a claim warrants both validity of the claim and solvency of the debtor."[39]

Regarding service contribution, Everret F. Goldberg argued that in the case of any business organization other than a SC and PLC, the contribution may consist of cash, kind or services.

[36] Minimum paid up capital for insurers Directive no. SIB/34/2013, art. 2.6(b)- insurer under formation should collect in a cash from its founding shareholders a minimum capital required, again art. 4 of the same directive "minimum paid up capital required to obtain insurance license ought to be fully paid up in cash…"Also, contributions in kind for banks directive no. SBB/3/95 art. 2.3 stated that capital contributions in kind shall not be considered for the purpose of fulfilling minimum required capital…

[37] Stephen Mayson, Derek French, And Christopher Ryan Company Law (21st ed.2004-5) p. 198

[38] Comm. C., art. 230(3); the law of partnership required only the existence of a debt not whether it is secured or not. Regarding validity of claim contribution in company there is no explicit article that permits the same rather certain provision can be inferred that shows its non-acceptance to constitute contribution.

[39] Marcus Lutter, cited above at note 12 p. 51; "In a few countries, e.g. Brazil, a members who transfers to the company a claim against a 3rd person warrants not only that the claim is legally valid (CC art. 1074) but also that the debtor is solvent and can satisfy the claim."

Contributions to a SC or PLC may only be in cash or kind.[40] And he added that only contributions in cash or kind (property, debt, etc) are taken into account in calculating capital of companies. In partnerships, contributions may be made in the form of services to be rendered to the organization (articles, 229(1), 295,303)[41]

It is valid contribution in case of partnership[42] but nothing has been said in the company part of the code. This may lead to arguments one supporting and the other arguing against validity of service contribution in company formation and this would happen because of the fact that the law neither prohibits nor allows in clear terms. In this issue, the whole reading of the code regarding contributions, a lot has been provided, for example, on contribution in-kind; its valuation, times of assessment, and evaluators are also enshrined in the code (even in the proclamation save the amendment) that is, the law has provided the rules how contribution in-kind can be accepted but nothing is there for service contribution. Though it may be persuasive to accept skill as contribution that could promote a company's objective (although it may be risky for creditors if a company is at default), there is no any clue and rules of administering the same in the law. In addition, "it may be argued, the law impliedly prohibits an undertaking to render service in the future. This can be gathered from Art 339(1), which provides shares representing contributions in-kind are fully paid for, not later than the day of the registration of the Company".[43] Where shares are issued for in-kind contribution, the consideration must be transferred in full, that is, must be fully paid and it can be problematic to postpone its payment and if not, problems like a change of value of the thing and the destruction of object of the contribution would occur. Moreover, the same article is carefully designed to reduce the risk that the value of in-kind contribution may substantially decreases between the times of a subscription and the time performance and hence immediate and full performance of the same is provided. Further, article 517(g) states that one of the contents of the MoA of a PLC should indicate statement that the capital is fully paid. Thus, it appears that service is excluded.

[40] Everret F. Goldberg cited above at note 3, p. 515

[41] Id, p. 511

[42] Comm. C., Arts. 229,271,295.303

[43] Seyoum Yohannes, "On Formation Of Share Company In Ethiopia"22 **J.Eth.L**.No.1(2008)P.114

Even in other jurisdictions, "a public company may not accept, as part or all of the contribution in exchange for issuing shares, a promise to do work or perform services for the company."[44]

Past services may be paid for in shares, provided the amount to be paid for the service is a liquidated debt of the company (and so counts as a cash contribution) or an independent valuation report can be made on the service.[45] This means that services that would otherwise be paid for by the company.

Shares may not represent contributions in the form of services in Public Limited Companies[46] and in LLC, if applicable, the MoA and AoA shall specify the terms and conditions under which shares may be subscribed in the form of services.[47]

Moreover, the following rationales are raised to challenge validity of service contribution in a business organization where there is member's limited liability.[48] and these reasons are; 1) difficulty of assessing service that would be given in the future time, 2) though it may be possible to value, it would be very difficult if the person who contributed skill/labor refuses to perform as per the agreement. In this particular situation our civil code forbids forced performance[49], and 3) Limited liability of the members. There is no room for creditors to sue service contributor in case the assets of the company fails to satisfy their claim due to the presence of corporate veil. Again as service is not transferable, the creditors and the company itself cannot turned the same into money.

Therefore, it seems that the legislature does not accepted service as valid contribution and thus, the argument that service is not valid contribution may outweighs the other side of arguments except the argument that past service contribution may be valid. However, to avoid confusion the law should be clear enough regarding what contribution is qualified including the conditions for its acceptance.

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[44] Stephen Mayson, Derek French, And Christopher Ryan cited above at note 39, p. 200

[45] Id, p. 201

[46] France commercial code, art. L225-3

[47] Id, art. L223-7 of Limited Liability Company

[48] Commentary on Book II of the draft commercial code page 26

[49] Civil Code of the Empire of Ethiopia Proclamation, 1960, Arts 1776, Proc. No. 165, Neg. Gaz. Year 19, no. 2.

2.4. Usefulness of the Property Contributed

As explained above, to commence any commercial activity, a business organization should have capital that enables it to do the same. If the contribution made is money there is no question as to its significance. The worry comes in case the contribution is in-kind. Above all, the nature and usefulness of property contributed may affect the interests of creditors and shareholders, in addition to the problems of overvaluation which also absolutely affects the interests of the said stakeholders. The creditors may be affected since they enter into a transaction with the company by considering its assets as their security and the interests of shareholders may be endangered due to less profits that their company would generate and aggravated by being portioned by members that contributed less useful property. "Each contribution made must be something of value."[50]

Under Ethiopian company law provisions, the usefulness of the contribution in-kind is not mentioned in any single provision, though it is obvious that the liability of members of a company, be it SC or PLC, is limited and therefore, it requires a critical looking of the nature and usefulness of the contribution in order to protect various interests. In our code that deals with partnership part has concerned with usefulness of what is contributed to form the same. In this regard, a provision of the code states that "unless otherwise agreed, contributions shall be equal and of *the nature* and extent required *for carrying out the purposes* of the partnership."[51] From this, it can be understood that the thing contributed for the formation of partnership should have a quality of helping to attain the objectives of the organization. In other words, the usefulness and even the nature of the property contributed should be seen at the time of making the contribution and if it fails to satisfy the criteria of usefulness, then the contribution should not be accepted as valid contribution.

In practice, what the registration officers consider is not the merit of the contribution rather the capital of the company.[52] And an officer explained that even packed papers may be valid

[50] Everret F. Goldberg cited above at note 3, p. 515

[51] Comm. C., Art. 229(3). In addition see art. 295 and 303 of the code that referred to the criteria of usefulness of the contribution made by a partner.

[52] Interview with Nuredin Mohammed, በንግድ ሚኒስቴር የአክሲዮን የንግድ ና ዘርፍ መሀበራት ጉዳዮች ዳሬክቶሬት ዳይሬክተር, October 13/02/09E.C

contribution as far as the members of a company agrees.[53] There were also a circumstance where "unripe/immature one month wheat plant presented in the form of contribution in-kind and in this particular case the officers under Ministry of Trade ordered them to bring valuation made by agricultural experts of the area but latter on they brought other kinds of contribution maybe due to the fear of ups and downs".[54] In this particular matter, it is very difficult even to value because such types of things are not usually subjected for sale in open market. However, according to article 80(1) of the code what is considered is the original value of the contributions, not future value. In our case at hand, the costs incurred to cultivate the wheat may be taken as the value of the contributions. But, the cost incurred (if cost approach is employed) and the final result may not be equal for different factors.

However, albeit there is no provision that governs usefulness of contributions in company part of the code except in area of financial sector, unlike some jurisdictions "explicitly require that the contribution in-kind be of such a nature that they facilitate the attainment of the business purpose of the company. A case in point is the Belgian law that requires incorporators to draft a report indicating the importance to the company of each contribution in-kind"[55]. The writer contends the necessity of assessing usefulness in companies because of the following reasons; a) Limited liability of the members in which the creditor cannot sue them(especially if they fully paid the subscribed shares); b) to protect the interests of the company and c) Using analogy we can strongly argues that testing the usefulness of contribution in-kind is more logical in company than partnerships due to the fact that there is no personal liability in the former while possible in the latter case. For that reasons, issue of usefulness should be enshrined in the code and even in the absence of that, the founders/subscribers and also officers of Ministry of Trade should critically examine the quality of what is offered as contribution in-kind. Because, unless the thing contributed have economic value the objective of the company cannot be achieved.

[53] Interview with Jirata Nemera, በንግድ ምዝገባና ፍቃድ ዳሬክተሬት የምክርና መረጃ ቡድን መሪ, October 13/02/09 E.C

[54] Interview with Nuredin Mohammed cited above at note 54

[55] Seyoum cited above at note 45, p.112-113

Chapter Three

3. Valuation of Contribution In-Kind Under Ethiopian Law

In a SC, the law requires different stages of valuation of contribution in-kind mostly to protect the creditors' i.e. third parties. One of the objectives of valuation could be to make the public confident of the capital of the registered company. This is because "the disparity between par value and the actual value of the contribution, be it because of lack of competence or corruption, has a very adverse effect on third parties."[56] Regarding this issue, article 326 addressed the price at which shares should be issued. Accordingly, "shares may not be issued at a price lower than their par value".[57] This is maybe designed to protect creditors. Nevertheless, one of inevitable difficulties that would arise in applying the prohibition against below-par issue (issuance of share at a price lower than their par value) is in case there is contribution in-kind. Article 315(4) on the other hand, tolerates certain margin of overvaluation. Thus, there is a contradiction between articles 315(4) and 326(1). Accordingly, the prohibition of below-par value issues would pragmatically irrelevant though the revaluation of contribution in-kind is made by directors and auditors.

As stated under article 229(2) of the code property may be contributed in the formation of partnerships which is also true in case of companies. Contribution of property is one category of contribution in-kind. According to article 1126 of the CC[58], goods are classified as movable and immovable. Goods can also be classified as corporeal and incorporeal based on the physical existence or character of a thing and accordingly, business which is incorporeal movable[59] and intellectual property fall under the latter category of goods. This means that as far as they are property they can be validly contributed. Regarding a business, the law stipulated in clear expression that the possibility of contribution of a business to a business organization.[60] But

[56] Simegneh Belay, contribution in kind to share companies and its valuation: the law and practice in Ethiopia, faculty of law, A.A.U (senior essay, unpublished) 2000, p. 33

[57] Comm. C., art. 326(1)

[58] Civil Code , Arts 1126- 1127

[59] Comm. C., art. 124; see also art.127 elements of a business

[60] Id, art. 206-209

the valuation of each category of property is problematic. The difficulty becomes more complicated in case incorporeal goods are contributed which requires well-informed and experienced person(s) to conduct an appraisal. In Germany, to establish the appropriateness of the payment for contributions of a business, the result of the last two fiscal years must be known.[61] This is a clue the way a business is valued.

Besides the Civil and Commercial Codes, Proc. No. 980 defines what constitutes property as "it means that movable and immovable property and includes intellectual property rights."[62] Hence, when we say contribution in-kind it may include contribution of immovable property, trade mark, goodwill, lease right, patent and other intellectual property rights. Among these properties valuation of immovable and lease right comparatively easier than valuation of intellectual property rights. Concerning contribution of lease right in the formation of companies, the urban land law proc. No. 721/2011 explained that a lessee may transfer his leasehold right or use it as collateral or capital contribution to the extent of the lease amount already paid.[63] Therefore, contribution of lease holding right is clearly provided with its circumstances and amounts. To summarize what constitutes contribution in-kind, Everret F. Goldberg states:

> "contributions in-kind are contributions of corporeal or incorporeal property, including debts owed to the contributor, or the use of property. Examples are immovable property, movable property, rights of literary or artistic ownership, industrial property (trademarks, patents, designs or models), a business, lease of movable or immovable property, etc".[64]

Officer who work in the commercial registration explained that officers may sometimes order that the evaluation of contribution in-kind be made by the respective bureau or office for

[61] Martin Schulz, The Law of Business Organizations: A Concise Overview of German Corporate Law, (2012) p. 167

[62] Commercial Registration and Business Licensing Proclamation cited above at note 7, art. 2(5)

[63] Urban Land Lease Holding Proclamation, 2011, art. 24(1), proclamation No. 721, **Federal Neg.Gaz**. year 18 no.4

[64] Everret F. Goldberg cited above at note 3, p.515

instance, if vehicle is contributed transport bureau may carry out the task of evaluation.[65] And currently the members by their own initiation rarely brought evaluations made by experts.[66]

Valuation of contribution in-kind in Ethiopian company law is not well treated in a manner that could protect the interests of the third party. Valuation is not simple task rather it needs profession in some instances like IP rights evaluation. In Australia it has been found that even professional valuers are being at high risk due to difficulty of approximate assessment of some properties. "Insurance companies are no longer prepared to guarantee valuers' professional indemnity (PI) cover. Without PI cover valuers cannot afford to take the risk of practicing at all. This puts the future of the valuation profession in doubt."[67]

The other issue in assessment of contribution in-kind is approaches that could be employed during evaluation. There is no clear approaches to be followed to value a contribution. Usually there are about three methods of valuation of property and these are cost approach, income approach and market approach.[68] Adopting only one approach is not good because each of them may be found relevant based on the natures of property being under evaluation. For instance, the cost method (also called depreciated replacement cost) in valuation practice "it is usually adopted where there is a lack of data for income method or where the property is new and there is no sufficient evidence of recent property transactions in the open market."[69] Therefore, we can understand from this statement that methods of valuation can be used alternatively based on the evidence the valuers has regarding the property being valued. In addition, certain property may not have transactions in the open market due to their newness in the business (where there is no market value for a property). Acquiring data on production cost may be also difficult that would literally challenges the performance of the valuers. So, this all may be

[65] Interview with Jirata Nemera cited above at note 55; this was done especially before the enactment of proc. No. 686/2010 because the burdens of evaluation was on the Ministry.

[66] Interview with Hunde Belay, Senior Trade Registration and Licensing Supervisor, December 14/04/09 E.C

[67] Challenges Confronting Property Valuation Practitioners in Australasia**,** Ninth Pacific-Rim Real Estate Society Conference, Brisbane, Australia 19-22 January, 2003, available at http://www.prres.net/papers/Bond-challenges-confronting -property-valuation.pdf

[68] "Challenges of Using the Cost Method of Valuation In Valuation Practice: A Case Study of Selected Residential And Commercial Properties In Awka And Onitsha, Anambra State, Nigeria,"

International Journal of Civil Engineering, Construction and Estate Management Vol.3, No.2,(2015) pp.16-35

[69] Id, p. 1

challenges to assess a contribution in-kind in a proper manner. That is why it seems that our laws has underestimated the problems of contribution in-kind in establishing a company as we can see from the subsequent discussion.

In one way or in another valuation of contribution in-kind is made by groups that are presumed by the law to have an interest in a company. Accordingly, this section mainly focuses on valuation system of contribution in-kind in our legal system both in SC and PLC in reference to the roles expected from the founders, subscribers and directors of SC, and that of the PLC by study of relevant provisions of the Code and the proclamation.

3.1. Share Company

Estimation of contribution in-kind made in formation of a SC could not be seen differently from the roles played by founders, subscribers and directors because they may take part in estimating the value of contributions. In the commercial code, the initial estimation was assigned to the experts from Ministry of Trade and Industry[70] but currently there is an amendment to that and it replaced experts by shareholders/founders.[71]And, one of the rationale for avoidance of experts at ministry to value contribution in-kind is that "it was found to be difficult to have diverse experts for different kinds of property and in the future there may be possibility of an independent expert with full responsibility that would take the roles which were played by envisaged experts at the ministry."[72]

Furthermore, our law has adopted double standards on evaluation of contribution in-kind based on the nature of commercial activity carried out by the companies. In this regard, Licensing and Supervision of the Business of Micro-Financing Institutions Directive No. MFI/02/96 and Licensing and Supervision of Banking Business Directive No. Sbb/3/95 on contribution in-kind with their common provisions can be referred as to the acceptability of contribution in-kind and the person who can make the assessment of the contribution.

[70] Comm. C., art. 315(1)

[71] Commercial Registration and Business Licensing Proclamation, cited above at note 7, Art. 5(9)

[72] interview with Yosef Alemu, በንግድ ሚኒስቴር የአክሲዮን የንግድ መሀበራት ዘርፍ ክትትልና ድጋፍ ዳሬክተሬት, October 13/02/09 E.C

In the case of valid contributions that can be made in-kind in those sectors, "items like building, essential vehicles, built in vault and others that are accepted to the National Bank of Ethiopia (NBE) may be considered as capital contribution,"[73] and concerning valuation "contribution in-kind should be valued by professional and certified valuers acceptable to the NBE."[74]

There is a better and strict regulation on companies engaged in financial sector than the one involved in other businesses regarding contribution in-kind.

The law attempts to indicate the kinds of property that could be contributed to form share companies that would like to engage in financial sector. The agreement of the members on the validity of the contribution in-kind is not sufficient rather the blessing of NBE on the same must be there. Further, the law cleared the issue on qualification of valuers of the contribution. In this case, professional and certified valuers that are recognized by the bank are the only person that can involve in the estimation of the contribution made in-kind in the companies engaged in the said sector. "To my knowledge only there is one valuer in Ethiopia and though practically rare we brought actuaries from Kenya".[75] The mere fact that a person is professional does not permit him to assess the contribution made in-kind in the financial sector. This all indicate the degree of care given to the said sector and its creditor(s) regarding contribution in-kind in general and its valuation in particular is very clear.

3.1.1. The Role of Founders

Before discussing role of founders, it is necessary to answer the question who are founders? In this regard, the code lists persons that could be designated as founders and these are; "persons who sign on MoA, who sign on a prospectus, persons making contribution in-kind, persons allocating with special shares of profit, or persons who initiate plans for the formation of company or making possible the formation".[76] These five categories of persons are recognized as founders under the code. One of the problem in categorizing founders is that persons who

[73] Licensing and Supervision of the Business of Micro-Financing Institutions Directive No. MFI/02/96 and Licensing and Supervision of Banking Business Directive No. Sbb/3/95, the Common article 2(1),

[74] Id, art. 2(2)

[75] interview with ato wubishet Tola, Bank Supervisory officer at National Bank of Ethiopia, December18, 2009 E.C

[76] Comm. C., art. 307; see also Federal Justice Organs Professionals Training Center on Commercial Law, page. 56

contributed in-kind, not in cash, are considered as founders.[77] Why do articles 307(3) of the Code and the Draft consider a person who makes contribution in-kind as a founder as a result of the type of contribution alone? In what respects is such person materially different from a person who contributes in cash that he should be regarded as a founder while the latter is not?[78] And the other interrelated issue is persons who initiated plans or facilitated the formation of the company are also called founders. But "it is unclear whether or not people, such as auditors, lawyers, investment advisors fall within the ambit of founders. This is because of lack of judicial interpretation and statutory definition of what 'who has initiated plan' and 'facilitated' mean."[79]

Difference should not be made among shareholders on the mere fact and basis of the kind of contribution. Members that contributed in cash should rationally be considered as founders when seen in light of others who contributed in-kind that may invite several activities to make the estimation. As a result, those who have paid fully in cash should also be considered as founders so long as they fall under one of the categories of the definition under article 307. In addition to this, the law should clearly state regarding the status of the members who fully paid in cash the same as who contributed in-kind.

Coming back to the role founders can play in estimation of contribution in-kind, the proclamation states that "the agreement of founders of a business organization on the valuation of contribution in-kind shall be stipulated in the MoA.[80] This typically happens in case the company is formed as between founders.[81] But the issue that can be raised here is that whether the 'agreement' stated in article 5(9) requires unanimous consensus or majority vote is not clear from the language of the law. At any rate, an agreement of the founder is important on valuation of contribution in-kind. In order to estimate reasonable value of the thing contributed, founders

[77] Id, art. 307(3) paragraph two

[78] Position of the Business Community on the Revision of the Commercial Code of Ethiopia, prepared by a teams of fourteen national experts, July 2008, p. 20. Also available at http://www.businessenvironment.org/dyn/be/docs/207/8-PSDHub-Commercial%20Code-web.pdf,(accessed on oct.13,2016)

[79] Tikikile Kumulachew, "Regulation of Initial Public Offering of Shares in Ethiopia: Critical Issues and Challenges" Ethiopian Business Law Series Vol. IV(2011)P.38

[80] Commercial Registration and Business Licensing Proclamation, cited above at note 7, Art. 5(9)

[81] Comm. C., art. 316

are expected to conduct various activities in assessing the values of the contributions. Beyond and above the labor, time and other costs incurred by founders, they may employ third party that could support them in estimation process of the thing contributed in order to avoid or reduce an arbitrary valuation that would affect the interests of the creditors and other members of the company. On top of this, the proclamation is silent in making the founders liable for overvaluation and the code on the other hand stipulated "the joint and several liability of the founders to the company and third parties for any damage in connection with contribution in-kind."[82] The code is convincing due to the fact that they are expected to follow every activity more than any person. This is true irrespective of revaluation by the directors and auditors. As the result, a role played by the founders in the course of valuation of contribution in-kind should not be undervalued both in company formed by public subscription and formed among themselves.

3.1.2. The Roles of Subscribers

It is obvious that a SC can also be formed by the public subscription.[83] To start the establishment of such kind of company, proc. No. 686/2010 requires the founders to obtain written permission beforehand from the registering office[84] which is not a prerequisite in the Code. However, the proclamation has avoided the condition of obtaining permission to establish company by public subscription maintaining the positions of the code.[85] In the Code, one of the roles of the members regarding valuation of contribution in-kind was to approve contribution in-kind, if any.[86] And, more burden in relation to contribution in-kind was put on the contributor, directors and founders. The Code provision was intended to prevent overvaluation and the resultant exaggeration of capital. Of course, this is very important, as capital is the only security for

[82] Id, art. 309(1(b))

[83] Comm. C., art. 317

[84]Commercial Registration and Licensing Proclamation, 2010, Art. 12(5), Proclamation No. 686, **Federal. Neg.Gaz**. year 16, no.42 but currently it is avoided by art. 51(1) of proc. No. 980/2016.

[85] Art. 51(1) of the proc. No. 980/2016 stated that the business registration and licensing proc. No. 686/2010 is amended.

[86] Comm. C., art. 321(3); the law was not clear as the subscribers could reject the estimations made by experts of ministry of trade and industry and rather it stated in positive manner which can be said that subscribers can approve the estimation.

creditors of a SC [87] which in deed requires knowledge and experience to conduct valuation of contribution in-kind.

In this regard, the problems could be that in case the members are hundreds and thousands, can they properly estimate the contribution? Once again, does valuation of contribution not require skills/knowledge particularly valuation of incorporeal property that requires high degree of experience? If so, what if the majority of members are unskilled? In view of that, it is very difficult to escape the fear of overvaluation that could affect the interests of stakeholders on the reason that where the majorities are unskilled or large in number, then they would assign persons (either from members or outsiders) that may jeopardize the interests of the creditors, members and a company by exaggerating the value. When members are assigned to conduct the estimation they may involve in malpractices in addition to their inexperience to do their valuation task as it should be.

In relation to liability of the members that agreed on the value of contribution in-kind, it is not stated in the proclamation and that means they are not liable. Therefore, what should be noticed is that authorization of members/founders to value a contribution does not mean that revaluation by directors and auditors is amended. Rather evaluation of contributions by members is not final and subjected for further evaluation by directors and auditors. That is because the law should safeguard, above all, the interest of creditors.

Additional related matter is that when the law says "agreement" of the members, it is not clear on the number of votes required on the evaluation made i.e. does the law required simple majority, absolute majority or unanimity is not understandable. However, one may infer some clue from a provision of the code which reads "… provided that a majority vote shall be sufficient where the amendment relate to approval of contributions in-kind …"[88] and so, by analogy we can argue that a simple majority vote is also sufficient to reach an agreement as to the values of the contribution in-kind. This approach seems persuasive in that what is improved is the roles of members from approval to taking active part from the start in the determination of the value. So, the vote required at approval stage may be used at evaluation phase by analogy.

[87] ibid

[88] Comm. C., Art. 322(4)

In other jurisdictions too, "decisions related to the valuation of the share in-kind shall be made by majority votes of the subscribers of cash shares provided that such majority owns, at least, 2/3 of the said shares. The kind shareholders shall have no right to vote even if they hold cash shares."[89]

In our case, however, whether the majority is majority of person or shareholding and whether other contributors in-kind can vote (to avoid collaboration) is not identified except that contributor in-kind can't qualify for vote. It is better that independent expert(s) shall appraise, subject to their own responsibility, the value of the contribution in-kind instead of the members.

3.1.3. The Roles of Directors and Auditors

A corporation is an artificial entity, it must act through others (corporate actors).[90] Corporate actors are divided into two types: corporate agents and corporate organs. Corporate agents—like all agents— act on behalf of the corporation and subject to its control. Yet being an artificial entity, the corporation itself cannot control anyone; it needs another type of actor—the corporate organ, who acts on the corporation's behalf.[91] Corporate organs—in particular the board—assert the corporation's control over the agents. A board of directors is a body of elected or appointed members who jointly oversee the activities of a company , in which its activities are determined by the powers, duties, and responsibilities delegated to it or conferred on it by an authority outside itself. These matters are typically detailed in the organization's constitution and bylaws.[92] In the structure of companies the place of the directors should be acknowledged.[93]

Our company law too requires the establishment of organs of a company before the company acquires its personality.[94] It is raised not essentially to discuss the organs of a company rather

[89] Oman Commercial Companies Law No. 4/1974**,** Amended by Royal Decrees Nos. 53/1982, 13/1989, 83/1994 & 16/1996, May 1997, art. 66

[90] Amitai Aviram, Officers' Fiduciary Duties And The Nature of Corporate Organs, available at https://illinoislawreview.org/wp-content/ilr-content/articles/2013/3/Aviram.pdf(accessed on Oct. 15,2016)

[91] ibid

[92] https://en.wikipedia.org/wiki/Board_of_directors(accessed on Oct. 15,2016)

[93] Watson, Susan. Conceptual confusion: Organs, agents and identity in the English courts [online]. Singapore Academy of Law Journal, Vol. 23, Special ed., 2011: 762-794. Availability: <http://search.informit.com.au/documentSummary;dn=983145390425890;res=IELHSS> ISSN: 0218-2009. [Cited 15 Oct 16].

[94] Comm. C., arts. 313((10-11) and see also art. 311(2) of the code that called directors and auditors of a company as 'organ' of the same

used as an introduction to the central issue of the roles of directors and auditors of a SC in valuation of contribution in-kind. As repeatedly stated, currently valuation by experts have been avoided and substituted by members or founders as the case may be. But the main question is that whether the roles of directors and auditors provided under article 315(3-5) of the code is altogether amended or not. At this point, it is important to raise stages of valuation of contribution in-kind that are enshrined in the code and these are; a) valuation by experts,[95] b) approval by the meetings of subscribers,[96] and c) revaluation by directors and auditors of a company.[97] What the proclamation did is, though not clearly provided therein, that the first and the second stages involved in the valuation process are brought to an end by merging them together. In case of the first stages of estimation tasks, the law eliminated experts and replaced it with founders/ members and for the second steps which is approval by subscribers, it is also brought to an end due to the fact that it is the members themselves that are authorized to evaluate from the start and therefore, it is non-sense to sit for revaluation (approval) of their own task (redundancy of valuation by the same body should be avoided).

About the third stages of appraisal of contribution made in-kind, where auditors and directors are expected to play roles, the proclamation did not stipulate a provision that has the spirit of amending the roles of these organs that are assigned by the code to revise valuation of contribution in-kind.[98] However, the writer contends that revaluation provided in the code is still relevant because of the following rationales; firstly, the proclamation is mute to make founders or members liable for their, particularly, overvaluation that would affect the interests of the creditors and others too, that may perhaps imply that revaluation is there to correct wrongs done by members. Secondly, it may also be contended that revaluation by directors and auditors is preserved purposefully to rectify the problems that may occur because of valuation being done by members large in number which is in effect difficult to properly provide an approximate value of the property. Thirdly, the proclamation is silent on the roles of directors and auditors on the subject matter which could be understood as it is not amended even in

[95] Id, art. 315(1-2)

[96] Id, art. 321(3) and art. 315(5)

[97] Id, art. 315(3)

[98] ibid

implied style of amendment and moreover it may be to avoid redundancy of stating their role in the proclamation. Additionally, other writer also explained that:

> "…one should not thinking that the current law has no mechanism at all aimed at averting overvaluation. It does require directors and auditors to verify and, where necessary, review the valuation made, within six months from the formation of the company."[99]

Accordingly, based on the abovementioned reasons the role of directors and auditors is there as mentioned in the code.

After the issue that whether directors has role in valuation of contribution is established, the next point is how and when the revaluation activity would be conducted. Revaluation must be conducted within six months of registration of the company. However, six month is too long in that many things may happen up on the property contributed including wears and tears of the same and not only that it is difficult to estimate the original value of the thing, e.g., after four months. It should be noticed that the law is silent on providing approaches to be followed in the revaluation process i.e. the law in any stages of valuation fails to indicate as to what kinds of techniques of valuation, like cost approach, income or fair market price, be used. Anyway, directors and auditors even with the assistance of experts should make sure that the contribution in-kind has not been overvalued.

Above all, directors and auditors in addition to revising the contribution in-kind have the duty to carefully assess whether the contribution in-kind have positive effect on the activities of the organization since they are potential risk bearer.[100] Both of them are expected to show that they have exercised due care and diligence in order to escape from future liability.

Moreover, revaluation by directors and auditors may not free from personal interests. In this regard, in addition to lack of knowledge and experience of valuation, a member who contributed in-kind may be a director and in that status s/he may influence the appropriate valuation of contribution in-kind, though latter s/he is liable jointly with other board members. In other

[99] Seyoum cited above at note 45, p.116

[100] Comm. c., articles 364 and 380; in this regard the law is carefully designed in that the last power and responsibility is given to these organs to verify the value of contribution in kind and even impliedly the usefulness of the property contributed because for any damage that arises due to their negligence attracts liable to third party and shareholders

jurisdictions too, "directors are obliged to be honest and to use prudent business judgment in the conduct of corporate affairs."[101] The cumulative reading of the Commercial and Civil Code, directors must exercise the same degree of care in assessment of contributions made in-kind that reasonably careful agent use in conducting the affairs of their principal and if not they can be held answerable to the shareholders and creditors of a company.[102] That is, the director's needs to show a reasonable care to the affairs of the company like a good father would show toward his family.

To conclude the case of contribution in-kind in SC where all members have limited liability, creditors of the organization need additional protection to assure that the value of the contribution in-kind is reasonably accurate. This protection is also needed by shareholders in a SC formed by public subscription, since they may not have easy personal access to the property or its contributor. Nevertheless, practically there is no monitoring mechanism and directions on revaluation made by directors and auditors.[103]

3.2. Private Limited Company

PLC is a popular incorporated business form in Ethiopia that can be established by a minimum of 2 and a maximum of 50 persons.[104] One reason is that it is particularly well adapted to small and medium–sized business and currently, the Ethiopian business is at these stages.[105] The other rationales for the rapid expansion of such kinds of business organization could be that the limited liability of the members and the minimum member requirement (compared with SC) that enables persons at family level to establish the same.

It is similar with a close corporation in that whose shares are held by members of a family or by relatively few persons. Usually, the members of the small group constituting a close corporation are personally known to one another. In practice, a close corporation is often

[101] Gaylord A. Jentz , Roger Leroy Miller And Frank B. 'West's Business Law' (6th ed.1995) p. 797

[102] Comm. C., art. 364(1) and C. C. art.2211 (1), that the former imposed duty of diligence expected from agent and the latter stipulated the diligence required of agents as "the agent shall exercise the same diligence as a bonus pater familias in carrying out the agency". Therefore, the standards of care expected from directors is this.

[103] Interview with ato Yosef cited above at note 75

[104] http://www.2merkato.com/articles/starting-a-business/82-how-to-start-a-plc-private-limited-company-in-ethiopia-particularly-in-addis-ababa(accessed on Oct. 17,2016)

[105] Alemayehu Fentaw & Kefene Gurmu , cited above at note 9, p.134

operated like a partnership.[106] This resemble to our PLC where there is limited number of shareholders, the transfer of share subject to certain restrictions and the company must not make any public offering of its shares.[107]

Similar to other business organizations, formation of PLC requires capital that would be collected from the members either in the form of cash or in-kind and the issue arises in case a member contributes the later. Whenever there is contribution in-kind, the MoA is expected to show "the nature and the value of the contribution, the price accepted by the other members and the share in the capital allocated to the member."[108] Furthermore, it is the right of the members to formulate methods of valuation that they think appropriate.[109] In this regard, apart from empowering the members to set the methods of valuation, the law is mute as to what number qualifies to set the method and accordingly conduct evaluation. But, it can be understood by interpretation that unanimous consensus is not required as it can be inferred from "…members shall be jointly and severally liable for such payment, *notwithstanding that they were not aware of the overvaluation.*"[110] It may be possible to suppose that unawareness could happen either the member might not take part in setting the methods because of his/her nonappearance or though s/he attend the process, unawareness may happen because of business inexperience.

The point at which PLC and SC are similar in contribution in-kind is that, in both cases the task of valuation at first place is made by members of the respective company and it should be fully paid. Valuations conducted in PLC may be reconsidered in case where there is a suspicion of an overvaluation. This can be concluded from the first sentence of article 519(4) that states as "where it is shown that a contribution has been overvalued, the contributing member shall make good the overvaluation in cash" but there is no hint as to who is authorized to reconsider the valuation. On top of this, we need to recall the general features and actors of PLC. In SC revaluation is made by directors and auditors but in PLC we don't have such organ and for that

[106] Gaylord A. Jentz , Roger Leroy Miller And Frank B, Cited above at note 104,p.776(under USA Law)

[107] Comm. C., arts. 510(2) and 523(2). See also art. 543

[108] Comm. C., art. 519(1)

[109] Id,art.519(2)

[110] Id, art. 519(4)

reasons it is logical to conclude that members themselves that would reconsider valuation of contribution in-kind where there is a suspicion of an overvaluation. This is left for them because of the joint and several liability enshrined to protect the interest of creditors and others.

Members who contributed in-kind are liable for overvaluation of the property. Other members are also jointly and severally liable to such overvalued amount.[111]

> Thus, "the rule concerning contribution in-kind are unusually severe. Contrary to the provisions of certain laws, the joint and several liability of the members extends even to members who do not know of the overvaluation of the contributions. In this form of company, all the members should be sufficiently interested in the running of the company's business not to be able to hide behind ignorance, which would be a culpable form of negligence".[112]

In order to escape from such harsh liability each member should actively follow the evaluation process. Of course, the liability of the non-contributing member comes to the picture if the contributing member failed to discharge the liability for any reason. A public company may not allot shares for a consideration other than cash unless the non- cash asset has been independently valued by a person qualified to be the auditors of a company (valuation of non-cash consideration in public companies).[113] And, in case a private company issues shares in return for a non-cash consideration the court will not usually inquire into the adequacy of consideration (valuation of non-cash consideration in private companies).[114] This mean that even in other jurisdictions, the degree of attention given to valuation of contribution in-kind is different in case of public and private companies that shares more or less similar features with our SC and PLC respectively.

By and large, in a PLC, all the members of the organization are guarantors to third persons of the valuation fixed in the MoA which is painful and contrary to the notion of corporate veil.

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[111] Alemayehu Fentaw & Kefene Gurmu , cited above at note 9, p.136

[112] Background Document of the Ethiopian Commercial Code of the 1960, available at http://www.abyssinialaw.com

[113] Keith Abbot, Norman Pendlebury and Kevin Wardman, Business Law (7th ed., 2002), P. 391

[114] ibid

Chapter Four

4. Effects of Contribution In-Kind in Company Formation

4.1. Share Company

Ethiopia's law of business organization allows contribution in-kind as valid contribution and the only difference lays on the approach of their valuation and responsible body assigned to the same. Based on this facts, this part of the paper tries to examine some of the problems directly or indirectly associated with contribution in-kind in the formation of SC.

4.1.1. The Prohibition of Handing over of the Share Certificate

It is not a contending fact that a person can be a shareholder in any business organization through contributing properties that validly and clearly acceptable as per the commercial law. "Companies issue share certificate so as to provide their members with convenient evidence of ownership of shares to facilitate selling the shares." [115] On a sale and purchase of shares, it is obviously fundamental to make sure that those who are purporting to sell the shares are indeed the owners of such shares and that they have good title to them.[116] The same author explained that,

> "in addition to making sure that the seller is the registered holder of the shares in question, the buyer should ideally investigate the seller's title to them by following the trail of entries in the register of members in order to satisfy that there are entries in those registers which show how the shares devolved upon those purporting to sell them".[117]

Shares issued in return for contribution in-kind in SC is not given to the shareholder/s at the time when other members who contributed in cash receive the delivery. In fact the code under article 339(1) stipulated that "shares representing contributions in-kind shall normally be fully paid at the time of formation of the company and not later than the day of registration of the company."[118] This is a time when the ownership over the contributed property should be transferred to the company. The issue is after the ownership is transferred to the company, the

[115] Stephen Mayson, Derek French, And Christopher Ryan cited above at note, 39, p. 237

[116] Andrew stilton, Sales of shares and business(2nd ed. 2008)p. 72

[117] Id, p. 73

[118] Comm. C., art. 339(1)

contributor is obliged to wait for two years from the registration of the company to acquire the share and transact with it. Sub article two of the same reads that "shares may not be separated from the counterfoil and be negotiated before two years from registration"[119] This mean that the shareholder cannot sale or transfer his/her share until two years have been completed which is calculated from the registration of the company. This particular method is employed may be to safeguard the interests of the company and third parties that may transact with same where other person claims that they have ownership or other property rights over the thing contributed.[120] It should not be forgotten that if a member's contribution consists of property, such member shall be deemed to have given the Company his guaranty against hidden defects and defects in title.[121]

The supplementary but related rationales could be that the directors and auditors of a company may revise the evaluation made by members and if this reconsideration shows that there is reduction in value more than tolerable by the law then the contributor in-kind may want to adjust the difference and s/he can do the correction activity within the two years. However, it seems there is bittersweet paradox concerning contribution in-kind, that is, on the one hand the law considered contributor in-kind as founder with some benefit (however they are liable under article 308 and 309) and on the other, it denies the same to access the share certificate.

Whatever the case may be, the members that contributed in-kind and transferred the same to the company cannot sell, pledge, or transfer his share via another way and benefit from his property(share) which restricts his/her right as per the existing law. It appears excessive because all properties may not need this much time to assure they are free from the claim of third persons. That is, all of the contributions made in-kind may not necessarily require such lengthy time to minimize risk thought i.e. a claim may not be there at all. Article 2343(3) of Italian civil code provides that "until the evaluations have been verified, the shares corresponding to the contributions in kind are not transferable and shall remain deposited with the company" which could be better experience.

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[119] Id, art.339(2)

[120] Commentary on the draft commercial code on book II, page 27

[121] Comm. C., art. 231(1), the code imposed liability for breach of warranty in accordance with general principles of the law of sale. The warrant is a) the contribution is free from defects; b) and is not subject to the rights of third persons.

Therefore, it is understandable here that there are two conflict of interests and these are the interest of the contributor, and the interests of the company and other person(s) that have business relation with the company and the rest of the shareholders. So, this is one problem that could occur due to contribution in-kind and it is writers' suggestion for reconsideration of the two years requirement to balance and reconcile the two contending interests.

4.1.2. Problem of Undervaluation

In addition to overvaluation, there may be a situation where a contribution made be undervalued by the members because of different factors among which business inexperience of a contributing member could be mentioned. If this is found during revaluation and whenever a finding is greater than the first estimation, is there an issuance of share for the extra money found latter for the contributing member? Should the capital of a company be increased accordingly? For instance, in the first evaluation the value was estimated to be 400,000.00 birr and increased to 500,000.00 birr result of review. This shows that there is 100,000.00 birr difference which significantly affects the interests of a contributing member. In addition the contributor, the interests of government may be affected since stamp duty is based on the value of the property being transferred.[122]

On the issue at hand, the code stated in clear expressions that if the review of the directors and auditors resulted in the reduction of one fifth or more than one five of the evaluation made before, then there should be reductions of shares allocated to the contributor in-kind.[123] This is sound because the person should not benefit from what s/he has not contributed. The question is what if the revaluation resulted with values greater than before compared with the first evaluation i.e. what if the valuation is increased by 20%? The law is mute on this issue and the fate of the contributing member is not legally backed.

Moreover, a company is expected to adjust its capital grounded on reductions[124] or rise of the value of contribution in-kind. The capital of a company is reduced based on the reduction in

[122] Stamp Duty Proclamation, 1998, art. 6(5), proclamation No. 110, **Federal Neg.Gaz**. year 4 no.36 ; In addition, the schedule attached to the proclamation clearly identified that instruments chargeable with stamp duty, basis of valuation and rates of stamp duty.

[123] Comm. C., art. 322(5)

[124] Id, art. 315(4)

value of the contribution in-kind when revaluation is conducted and this is reasonable to behave in this way to safeguard mostly the interests of creditors. Again the law is silent regarding the rise of the values of contribution in-kind. In the normal course, shareholders should also know the amount of their company's capital so that they would expect a better business with better profit by enabling it to borrow money to the extent of its capital.[125] Though it is up to the contributor to seriously follow the evaluation, it is the writer's opinion that the law should cover this issue by allowing the contributor to obtain additional share for the value underestimated and also the MoA should be amended accordingly. No concern is given even in other jurisdictions for the issue of undervaluation.[126] To conclude, the law is more interested with overvaluation than undervaluation.

The other issue that could be raised under this subtopic is the issue of hidden contribution.

> *"It is quite common, however, that subscribers of capital who have duly paid up their contribution in cash subsequently conclude a contract with the company. The company having received the contribution in cash, uses this money to e.g. buy an asset from the subscriber. The economic effect is that of a contribution in kind."*[127]

And the German law has a mechanism to prove that whether the transaction is based on market price or not to avoid indirect contribution in-kind that would affect the interests of creditors and non- contributing members of a company.[128]

In reality, the subscriber did not provide a contribution in cash, but a contribution in-kind. "If there is a close connection between the contribution in cash and the subsequent contract

[125] On this issue it is the writer's opinion that the justification behind of the law is not clear and it is still better to consider the interests of shareholders and that of the company by stating the exact capital of a company taking into account the revaluation result of contribution in kind. It seems that the law is only interested to protect the interest of creditors of a company

[126] Of the laws of the countries consulted, e.g., France, South Korea, German, Italy, none of them concerns with the issue of undervaluation.

[127] Christian Kersting, hidden contribution in kind, *Heinrich-Heine-University of Duesseldorf / Germany - Faculty of Law - Center for Business and Corporate Law Research Paper Series (CBC-RPS),* available at: http://ssrn.com/abstract=1314983,2008(accesed on oct.20,2016)

[128] ibid

between the company and the subscriber, the approval by shareholder is important in case where there is substantial acquisition after registration".[129]

Likewise, in our country too, there may be such types of hidden agreement between company under formation through its founders and the contributing member to escape from ups and downs of contribution in-kind if made directly and it may be also arranged to overvalue the contribution. A person may not want to contribute in cash in effect or does not have at all. In this situation s/he may contribute in cash which stay for short period and then take it back under the guise of sale of his/her property to the company. So, subsequent agreement between a member and a company need to be monitored and if wrong is found, a legal remedy need to be emplaced.[130] In this regard, no provision is there to rule the problems of symbolic cash contribution in our company law. However, it is essential to impose legal duty on the member to pay the difference in value between the promised contribution in cash and the provided contribution in-kind, if difference is established later; because such subsequent transaction is not thought to be healthy. Hence, based on period of time and amount of transactions, like other experiences, questioning transaction between the company and a member appears logical.[131]

4.1.3. Burden of Title Transfer

Title transfer is an assignment of ownership from one person to another with or without payment. That is, Contributors of shares in-kind shall be bound to transfer the titles of the valued shares in kind to the name of the Company immediately after the agreements of the members on valuation, if late on the day of registration.

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[129] European Model Company Act, section 13(1), available at http://law.au.dk/emca

"If a public company acquires, otherwise than on the basis of a term of the instrument of incorporation, assets from a member within two years of the registration of the company, and the consideration paid by the company is no less than one tenth of the share capital at the time of acquisition, the acquisition shall be submitted to the general meeting for approval"

[130] Fictitious cash contribution affects not only the interest of creditors it would also harms the non-contributing members that the hidden contributor and persons that have linkage with him/her may benefit at the expenses of the others.

[131] Article L225-101- of the France commercial code; Where, within two years of registration, a company acquires an asset belonging to a shareholder which is worth at least one-tenth of its share capital, a valuer shall be appointed by a Court order to value the asset in question on his own liability, on an application by the chairman of the board of directors or the management, as the case may be. The valuer's report shall be made available to the shareholders. The routine shareholders' meeting shall rule on the valuation of the asset, failing which the acquisition shall be void.

The ownership may be related with movable, immovable and it could be also incorporeal properties. When contribution in-kind is made in establishment of a company, transfer of ownership is necessary from the contributor to company under formation that would constitute the capital of the company. In the course of transfer of ownership to a company there could be expenses that the law imposed on the transferee (i.e. company)[132] based on the nature of the property transferred.

At the time when the contributor in-kind transferred his title on immovable and special movable properties to the company, "an entry into the registers of immovable property shall be required for the purpose of transferring the ownership of immovable property."[133] Urban landholding registration proclamation stated that "a landholding use right or immovable property ownership right on landholding, unless registered in the register of landholding, may not be set up against any person".[134] At this instant according to stamp duty proclamation, it is the transferee that should pay fees on title transfer and accordingly the company under formation is expected to pay the fees charged on delivery of title deeds since it is acquiring the ownership/use right over the property. Furthermore, even in case of patent, to transfer ownership title there should be registration i.e. when there is transfer of the same to another like by means of contribution the transfer should be registered in the name of the transferee.[135]To calculate the amount of the fee charged on the transfer of title the stamp duty law stipulated that the value of the thing is taken into consideration and for register title to property 2% of the value of the property being registered is charged.[136] In case of patent, the proclamation assigned regulation that would be enacted to determine the amount of the registration fee and as the result, regulation no. 12/1997 under article 47(2) states that "payment of fee should be there for recording of a change of ownership of a title granted under the proclamation shall be subjected to payment of the

[132] Stamp Duty Proclamation, cited above at note 125

[133] Civil Code, art.1185

[134] Urban Landholding Registration Proclamation, 2014, art 47, proclamation No.818, **Federal**. **Neg. Gaz**. year 20, no.25

[135] Inventions, Minor Inventions and Industrial Designs, Proclamation, 1995, art. 6, proclamation No. 123, **Federal**. **Neg. Gaz** year 54, no. 25. This article reads that patent or application for a patent may be transferred by sale or inheritance or any other means in accordance with the law. Such transfer shall be recorded with the commission, upon payment of fees prescribed in the regulations.

[136] Schedule of Stamp Duty Rates, s. no. 13

prescribed fee."[137] In this regard, the regulation provided a detailed rules on registration fee. The amount of payment depends to whom the ownership is being transferred i.e. individual or firm and if it is to an individual the amount is 50 USD and if it is to a firm the amount of fee would be 200 USD as specified under the schedules attached to the regulation. This is one expense that usually incurred at initial occasion where there is contribution in-kind of some properties.

Now the challenging issue is when the revaluation revealed the occurrence of overvaluation and the contributor refuses/unable to adjust the difference. In this situation, it is normal to expect the withdrawal of the person and returning back of his/her property. In this condition too, there should be registration fee that the law (company law) failed to assign this particular costs. To show burdens of title transfer, the writer preferred to take an example that could better explain the matter.

Thus, assume that a person contributed a building whose initial evaluation was eight hundred thousand (800,000) birr to establish a bank. Then after three months of the establishment of the company the directors and auditors conducted revaluation that revealed the value of the building founds to be six hundred (600,000) and the contributor for any reason failed to make the difference good. In this specific instance, naturally it is logical to return back the building to the contributor. At this instant, the question is who would cover the cost of registration of the building in the name of the contributor, the company or the contributor? To answer the question, should we look at the faults of either the contributor or the members/founders/professional at first stage evaluation? Though this fee is significantly, great which is not less than twelve thousand birr (12,000), the law is silent to cover issues surrounding the so called burdens of title transfer in case when there is withdrawal of a member who contributed in-kind because of valuation. It is possible to apply the stamp duty law but it seems not logical that automatically making him liable without showing any fault on his part. Above all, it would be difficult if he does not have a means to pay for it. Hence, it would be better to clarify this issue, if the law wants to sustain the revaluation system that makes the contributor liable for any fixed value regardless of the fault of the contributor.

[137] Inventions, Minor Inventions and Industrial Designs Council of Ministers Regulations, 1997, regulation No. 12, **Fede ral Neg.Gaz**., year 3, no.27

4.1.4. Problems of Re-registration

Currently, our company law requires minimum initial capital both for PLC (the draft regulation appears about to kick out) and SC setting aside the amount required. This capital could be collected from the members in the form of cash or in-kind. The other mentionable and which is of course an extension of the preceding problem is problems of re-registration. Revaluation of contribution in-kind by directors and auditors may show an exaggerated overvaluation by members of the company. In this instance, it is the duty of the directors to adjust (reduce) the capital of the company accordingly. And, the issue of re-registration could raise if the capital of the company unable to fulfill the minimum capital required by the law or reduced from the subscribed one. As a result, re-registration could be expressed in terms of re-registration of the company or re-registration of the MoA as the case may be.

Re-registration of a company may took place when the reassessment of the contribution made in-kind founds to be excessively overvalued and the reduction brings the total capital of the company below the bottom line criterion stipulated in the code. In this case the options of the members of the company is adding extra money (property) to achieve the initial capital expected by the law. In doing so, three options may be employed to maintain the capital of the company and these are; firstly, negotiating with contributor in-kind to adjust the difference, secondly, calling other non-member person/s to be shareholder (raising of capital by issuing shares)[138] and thirdly, other members of the company may raise the capital of a company in which share would be issued in return.[139] And, if these all actions fail to bring the effort of sustaining the company from dissolution, the only option would be dissolution of a company and waiting another conducive time in the future to establish a new which indispensably requires re-registration. Plus, if there is objection to contribution of a business to a business organization, any member may move the court to dissolve the same under formation.[140] The other option is

[138] Comm. C., art. 468

[139] ibid

[140] Id, arts. 208-209, if there is no application, the business organization shall be jointly and severally liable with the contributor where the contribution is cancelled(art.209(2)

that the company may be converted to another form which also requires registration.[141] This in fact, discourage creativity and entrepreneurship ambition.

Further, reduction of capital may cause withdrawal of a contributing member that also be a factor for members' reduction in number below the legal minimum requirement and thereby causes dissolution.[142] This would be the case where the company is found among founders of five persons.

The other but interrelated problem of revaluation is re-registration of MoA. It is obvious that a change in capital of a company changes the MoA (an amendment). Though reduction of capital would not always factors for re-registration of a company, it would be a cause for a change in memorandum of association thereby re-registration of the same. To obtain access to service of registration of MoA the law requires payment of registration fee.[143]That means a company is duty bound to pay fees (however small) for registration of MoA twice. It may be contended that this particular issue is not meaningful and significant to be raised as a problem but the writer contends that irrespective of the amounts of money (fee) repayment by itself is sufficient to worsen the blame of revaluation system. To add, registering MoA now and then may overburden the work load of commercial registration officers' in Ministry of Trade.

4.2. Private Limited Company

Under this subtopic, problems close to contribution in-kind in PLC would be discussed. The discourse over problems connected with contribution in-kind is important for the reason that as far as there is contribution in-kind, the system of appraisal may not be perfectly free from any shortcoming unlike contribution in cash.

Legitimacy of contribution in-kind is not the contending issue setting aside the lacuna of the law with regard to what types of contribution is valid and not valid, useful or not useful except in the financial sector.

The difficulties associated with contribution in-kind in PLC is not that much mentionable like that of SC because of the absence of a revaluation approach adopted in latter. However, this

[141] Comm. C., arts. 546, 548

[142] Comm. C., art. 311 and 495(1/f); article 306(1) of the code requires five members to establish a share company.

[143] Stamp Duty Proclamation cited above at note 125

does not mean that there is no a problem of any kind. The most and apparent defects in relation to contribution made is the members covered by liability and its extent. In SC problem of overvaluation is attempted to be minimized through the mechanisms of revaluation that finally makes founders, directors and auditors liable for claims of third party in case the assets of the company short of satisfying their claim due to improper valuation of the contribution made, without disregarding the issues dragged by revaluation. On the other hand, ever since there is no external valuer acknowledged to conduct evaluation and the law makes the members of the company jointly and severally liable for any wrong attached to evaluation.[144] Concerning contribution in-kind in PLC, the writer chosen to compare relevant articles of the Code and proc. No. 980/2016 that specifically deals with contribution in-kind. To begin with, the code under article 519(1) stipulated that "Where a member makes a contribution in-kind, the MoA shall show the nature and the value of the contribution, the price accepted by the other members and the share in the capital allocated to the member" [145] Currently article 5(9) of the proclamation has provided only one provision concerning contributions in-kind and it required the stipulation of the agreements of the members of the business organization (PLC) on the valuation of contribution in-kind in the MoA or in the amendment of the same.[146] Hence, as it is understood from the provision of the code, the nature and the value the property, and share allocated to the contributor are details facts that need to be revealed in the MoA. On the other hand, the only requirement stipulated in the proclamation is value of the property up on which the members of a PLC agreed, however, this does not mean that the provisos of the code in this regard is amended.

Regarding liability for overvaluation of contribution in-kind, the proclamation is mute and no hint on this particular subject matter is indicated and as the result the applicability of the provisions of the code in this part is not debatable. Unlike the SC law that makes founders, directors and auditors questionable for any liability of third party due to overvaluation, the PLC law makes the members liable where there is overvaluation may be based on the assumption that they took part in the valuation process having a chance to thoroughly consider the price of

[144] Comm. C., art. 519

[145] Id, art. 519(1)

[146] Commercial Registration and Licensing Proclamation cited above at note 7,Article 5(9)

the contribution in-kind since their number is limited. Accordingly, if the property contributed found to be less useful, then the members would be jointly and severally liable to third persons for the valuation fixed for that particular property.[147] Further, "where it is shown that a contribution has been overvalued, the contributing member shall make good the overvaluation in cash. Members shall be jointly and severally liable for such payment, notwithstanding that they were not aware of the overvaluation."[148] So, the law makes the contributing member liable in that s/he should adjust the difference by paying in cash. Other members are also obliged for the payment jointly and severally. This may be understood that the joint and several liability of the members come to the picture in case the contributing member failed to correct the wrongs associated with contribution in-kind. One of the most mentionable and severe problems of contribution in-kind in PLC is the joint and several liability imposed on members who were not aware of the overvaluation at all may be who were absent due to force majeure. It may be logical to impose such liability on the members who actively participated on the valuation and applying the principle of lifting the corporate veil for any mistake occurred due to that assessment on members who aware of the overvaluation is convincing. But spreading the liability over all members including uninformed one seems unsound. The law wants to protect the interest of the third persons more than any one. Though all members are not assumed to be well informed and experienced on valuation, in order to escape from such harsh liability all members to the extent they can are expected to take part in the evaluation of the contribution made in-kind. Here, to avoid such liability, the members may totally reject any types of contribution in-kind that would affect the investment opportunity of the contributors and thereby limits the opportunity of the company to access very valuable things. The France commercial code has better solution for the issue in their Limited Liability Company[149] which is similar with our PL.

Therefore, instead of making all members jointly and severally liable indiscriminately, it is better to adopt one of the following;

[147] Comm. C., art.519(3)

[148] Id, art. 519(4)

[149]France commercial code, Article L223-9 stated that **"**If there is no auditor of the formation proceedings or if the stated value is different from that suggested by the auditor of the formation proceedings, the members shall be jointly liable to third parties for the value attributed to contributions in kind at the time of formation of the company". This is conditional and scope of liability is limited.

- Valuation by an independent and professional valuer(s) with all responsibility or
- Joint liability of members with the right to recourse against members whose contribution has been overvalued or
- Dissenting and unaware person must free from liability at least with narrow exception.

But, instead of adopting such kinds of position in the law, it is better to assign an independent and professional valuer with all responsibility for any under or overvaluation both in SC and PLC.

4.3. Conclusion and Recommendations

4.3.1. Conclusion

Undertaking business in the form of business organizations particularly in the form of SC and PLC is more successful because of the strong member's limited liability except if there is contribution in-kind. Contribution in-kind is possible in companies and this is designed to enable a person to participate in investment by contributing things having economic value.

There are basic requirements that should be fulfilled to form both kinds of companies. Among these requirements, initial capital, payment of subscribed cash shares, and valuation of contribution in-kind are among mentionable with slight differences based on the forms of companies.

It is self-evident that cash and in-kind contributions are qualified contributions to form either SC or PLC as gathered from the code. The case of service contribution is contending since the code is unclear unlike in Partnerships. In addition, assuring the usefulness of contribution in-kind itself is important because of the fact that the liability of the members is limited (SC) and no way for creditors to sue them.

Concerning valuations of contribution in-kind, the laws adopted different standard for financial and non-financial SCs. Whatsoever, valuation of the same is not an easy task and that is why the code tolerates certain margins of overvaluation (< 20%) which appears excessive. The law also requires the involvements of the members and directors for its evaluation. This is to reduce the fear of overvaluation. Therefore, valuation of contribution in-kind cannot be seen separately from the roles of members/founders and directors. In PLC too, the members are the valuers of the contributions with full responsibility.

The other points discussed in this thesis is the problems traced by contribution in-kind. The prohibitions of handing over of the share certificate, problems of over and/or undervaluation, the fee for title transfer, and problems of re-registration are mentionable. Problems in PLC is the joint and several liability of the members without any condition which could also potential for other issues.

Generally, the thesis revealed that the problems of contribution in-kind is mostly related with valuation of the same.

4.3.2. Recommendations

Based on the issues identified, some of the following points are recommended.

- Contributions of Service in companies is neither prohibited nor allowed in clear terms. So, it should be clarified and it is the writer's opinion not to recognize by considering the nature of the contribution itself.
- Unlike in the partnerships, the issue of usefulness of contribution in-kind in companies is not given concern. The question of usefulness is more justifiable in company than partnerships because of limited liability. Therefore, it is better to adopt acceptability criteria.
- Regarding the length of prohibition of handing over of share certificates, to balance the two interests it is recommendable to reduce two years requirement.
- Currently the first task of evaluation of contributions in-kind in share company is given is to the members. But it is very difficult in companies where there are hundreds and thousands of members. So, it is not convincing to assign members to value the same. Again the consequences of revaluation by directors falls on contributor which would create other problems. Therefore, a solutions that appears better is let the evaluation be conducted by an independent and impartial experts with full responsibility for under/overvaluation without affecting revaluation by directors. However, if the system of revaluation is going to be maintained as it stands, the issue on title transfer need to be clarified because making the contributor liable for registration fee while the property is returned to him due to overvaluation appears unfair.
- In case of PLC, and SCs found among founders, making all members jointly and severally liable does not give a sense. If the whole purpose is to protect the creditors and the company, one of the following may be better than the one envisaged in the code;

a. Valuation by an independent and professional valuer(s) with all responsibility or

b. Joint liability (not joint and several) of members/founders or

c. Freeing dissenting and ignorant member/founder and making liable members/founders present in the event of overvaluation.

It is, however, the thesis argued that it is better to assign an independent and professional valuer with all responsibility, that is, making the valuer liable for any damages caused to the company, the shareholders or to third parties, for any under or overvaluation and the period of revaluation should be immediate as far as possible both in SC and PLC.

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