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Introducing Single Member Companies in Ethiopia
Major Theoretical and Legal Considerations

Jetu Edosa Chewaka

March 2014

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A Thesis Submitted in Partial Fulfillment for the Award of Masters Degree of Law (LL.M)
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APPROVAL SHEET

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DECLARATION

I declare that the thesis is my original work and has not been presented for a degree in any other University and that all sources of materials used in the thesis have been duly acknowledged.

Declared by

Jetu Edosa Chewaka

Confirmed by

Associate Professor Zekarias Keneaa

Addis Ababa University
(March 2014)

Dedication

To my mother, Chaltu Bakala Sarda, who has suffered and devoted much of her life to see the success of her only son and to my grandmother, Nugusee Galataa Gammachuu, who thought me the wisdom of patience and hardworking in the early days of my childhood.

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Jetu E. Chewaka

March, 2014

ACRONYMS AND ABBREVIATIONS

ADM	Annual General Meeting
AG (AktG)	Aktiengesellschaft, German Stock Corporation
Art.	Article
BGB	German Commercial Code
RCCC	Revised Committee of the Commercial Code
CFA	Communauté financière africaine
CSA	Central Statistics Authority
ETB	Ethiopian Birr
EU	European Union
EURL	<i>Entreprise unipersonnelle à responsabilité limitée</i> , French Single Member Company
FDI	Foreign Direct Investment
GmbH	<i>Gesellschaft Mit Beschränkter Haftung</i> , German Private Limited Company
GmbHG	<i>Gesetz betreffend die Gesellschaft mit beschränkter Haftung</i> , German Private Limited Companies Act
LLC	Limited Liability Company [Corporation]
MIDROC	Mohammed International Development Research and Organization Companies
MoMiG	<i>Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen</i> , Law for the modernization of Limited Liability Companies Act and for Combating Abuses
OHADA	<i>Organisation pour l'Harmonisation en Afrique du Droit des Affaires</i>
PLCs	Private Limited Companies
SA	Société anonyme, French Stock Corporations
SARL	Société à responsabilité limitée, French Private Limited Company
SCs	Share Companies
Sec.	Section
SMCs	Single Member Companies
SMEs	Small and Medium Enterprises
SMPLCs	Single Member Private Limited Companies
UK	United Kingdom
USA	United States of America
USD	United States Dollar
WTO	World Trade Organization

Abstract

In increasingly universalizing world, operating business in the form of company is apparently becoming an indispensable aspect of modern commercial life. The major reason that led the corporate form as the principal method of organization of commercial activity, among other things, is its advantage of limited liability. Limited liability, in its classical sense, implies the insulation of individual shareholders composing the company from the liability of company debts. Yet, the traditional corporate legal theory has confined the advantage of limited liability within the purview of multimember corporations, making it inaccessible to solo investors. However, quite recently, the historical relic of corporate theory that view corporations as a legally personified body of numerous subscribers of shares has undergone a sharp evolution, as have many other business practices and their legal bases. The purpose of this thesis is to look into notable literatures on major corporate theories and analyze whether it would be applicable to single member companies. It also seeks to compare major legal frameworks governing single member companies in comparative jurisdictions to show the legal and theoretical implications of introducing single member companies into the Ethiopian corporate legal system. The thesis also juxtaposes the best practices of comparative jurisdictions on how they tried to regulate SMCs focusing on areas of concern as a window of options for the Ethiopian legislators. The thesis looks into the Commercial Code provisions on PLCs and critically examined it to ensure its compatibility with the situations of SMCs. After weighing the ramifications of both Share Companies and Private Limited Companies, the thesis argued that Ethiopia should introduce SMCs in the form of the latter given the peculiar nature of SMCs. Finally, the writer forwarded list of recommendations for the legislators to amend certain provisions of the Commercial Code that contradict with the existence of PLCs having a single member and to introduce additional provisions that address the concerns of SMCs in order to protect creditors rights.

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Chapter One

1. Introduction

1.1. Background of the Study

In the modern world, operating business in a corporate form is apparently becoming an indispensable aspect of commercial life. The major reason that led the corporate form as the principal method of organization of commercial activity, among other things, is its advantage of limited liability. The insulation of individual shareholders composing the company from the liability of company debts and the distribution of responsibility for the corporation among managing officials are the basic reasons.¹ Yet, the traditional corporate legal theory has confined advantages of limited liability within the purview of multimember corporations, making it inaccessible to solo investors.²

However, quite recently, the historical relic of corporate theory as a legally personified body of numerous subscribers of shares has undergone a sharp evolution, as have many other business practices and their legal bases.³ Corporate laws began to afford single shareholder as an incorporator by adapting corporate rules that were in the past designed to regulate the corporate aspects of numerous partners.⁴ More specifically, in the present day commercial life, the legal formality that a company should be incorporated only after the agreement of two or more than two founders or subscribers is considered as a “legal idiosyncrasy.”⁵ The reason behind this view, according to Latty, is attributable to the fact that the minimum membership requirements to be complied with *carry no implication of a mandatory public policy*, and by no means carry an implication of requiring several shareholders at all times.⁶ He further argued that “*there is no magic in numbers*” and there is no public policy which says that two or more than two persons may limit their liability and acquire a legal personality different from their individual personality, but that one-man cannot.⁷

¹ Douglas and Shanks, *Insulation from Liability through Subsidiary Corporations*, 9 Yale Law Journal 193, 193 (1939).

² Mario Rotondi, *Limited Liability of the Individual Trader: One-Man Company or Commercial Foundation?* 48 Tulane Law Review 989, 989 (1974).

³ E. R. Latty, *A Conceptualistic Tangle and the One-or Two-Man Corporation*, 34 North Carolina Law Review 471, 477 (1956).

⁴ Warner Fuller, *The Incorporated Individual: A Study of the One-Man Company*, 51 Harvard Law Review 1373, 1374 n. 8 (1938).

⁵ Latty, *supra* note 3.

⁶ *Id.*

⁷ *Id.*

On top of the above points, scores of reasons have emerged that dictate corporate laws to adapt to the specificities of Single Member Companies (SMCs) in the modern commercial world. The relevant one relates to the importance of the idea that propels the extension of limited liability to sole traders, be it in their level of economic development as micro, small or medium enterprises.⁸ Limited liability is widely regarded as a means to encourage entrepreneurship and contributes to business organizations that boost the economy.⁹ Though arguments vary on whether the privilege of limited liability should be accessible to all forms of businesses, the idea that it should be unrestricted and attractive to small business owners has been widely discerned.¹⁰ Therefore, the core objective behind the recognition of this new separate legal entity remained on the increase in economic activities that in turn demand separation of personal and business liability of the individual's enterprises.

On the other hand, however, the intricacies associated with the SMCs as a new emerging concept of companies raises the concern that it is not an easy task to apply the traditional corporate theories and legal principles without the critical evaluation of their symbiosis.¹¹ Among other things, concerns such as risks associated with granting limited liability on business responsibility, protection of creditors, corporate management, and corporate taxation are very few to mention.¹² The bottom line is, however, today, the idea of private or public companies comprising one member is not any more novel in modern discourse of corporate law, though debates on how to design an appropriate legal vehicle is unabated.¹³

Therefore, designing suitable legal regime that broacher this new idea is a leap forward to the existing commercial fraternity and corporate legal history. In view of such necessity,

⁸ It should be noted that the characterization of micro and small business varies from country to country. But, the arguments both for and against limited liability in this paper is not confined to only such enterprises which in Ethiopia are characterized based on financial capacity – minimum and maximum paid up capital. Yet it should also be clear from the outset that as much as the argument goes, limited liability as will be argued later in various chapters of the paper, should not also be restricted to every able sole investor who is willing to incorporate a company which as matter of fact may include micro, small, medium or large business enterprises owned by single individuals or their families.

⁹ For discussions on this matter see J. Freedman and M. Godwin, *Incorporating the Micro Business*, in A. Hughes and D.J. Storey (eds) *Finance and Small Firm* (London: Routledge 1994).

¹⁰ See Judith Freedman, *Limited liability: Large Company Theory and Small Firms* 63 *Modern Law Review* 317, 318-19 n.3 (2000). See also Chen Jianlin, *Clash of Corporate Personality Theories: A Comparative Study of One-Member Companies in Singapore and China*, 38 *Hong Kong Law Journal* 425, 425 (2008) See also Andrew Hicks & S. H. Goo, *Cases and Materials on Company Law* 8 (New York: Oxford University Press, 5th ed, 2004).

¹¹ *Id.* see at Jianlin

¹² *Id.*

¹³ Mazhar Ilahi, *Legislative Transplant of Single Member Company in Islamic Republic of Pakistan: Anomalies in the Companies Ordinance 1984*, 34 *Statute Law Review* 95 n.1 (2013).

reforming corporate law to suit the needs and specificities of SMCs is not only fashionable but also inexorable in the face of its national and international imperative. Realizing such imperatives, various jurisdictions around the world have already recognized the vitality of SMCs on their corporate system. To mention but few, the Organisation pour l'Harmonisation en Afrique du Droit des Affaires' (OHADA) countries of West Africa, member countries of the European Union that includes but not limited to England, Germany, and France, and East Asian countries with emerging economies such as the Peoples Republic of China including several others have recognized SMCs in their corporate legal systems.

In Ethiopia, despite its national and international imperative, the introduction of SMC is belated. Its desirability to Ethiopia's corporate development is not debatable in both academic and business communities. According to the recommendation forwarded by a team of national experts entrusted with commenting on the revision of Ethiopian Commercial Code of 1960,

“It is suggested that a one-member company should be introduced and the following justifications are forwarded: a) It is not logical to force an investor to look for another person usually a straw man to form a company; b) It gives investors the opportunity to separate property allocated for business and their personal property; and c) In modern business, capital is more important than the individual.”¹⁴

As noted before, theoretically, given the increasingly important role of limited liability in the modern age of commerce, the recognition of SMCs in Ethiopia would serve as an attractive business vehicle to businesspersons who want to limit their personal liability.¹⁵ Particularly, the introduction of limited liability to sole proprietors may serve as an incentive to sole investors who wish to incorporate a company which in turn facilitate

¹⁴ See Recommendations and Position Paper of the Business Community on the Revision of the Commercial Code of Ethiopia 20 (Prepared by A Team of Fourteen National Experts, Private Sector Development Hub/Addis Ababa Chamber of Commerce and Sectoral Associations, 2008) [Hereinafter, A Team of National Experts]

¹⁵ Studies show that most of the smallest Ethiopian businesses are not organized as companies but as sole proprietorships. It is argued that, those businesses have little or no reason to be companies; for example, limited liability has little meaning for small-scale business, especially when business is done on a personal basis. However, this same study recommend Ethiopia should reform its company laws so that it “best serve the needs of *closely held businesses*, both large and small, and to conform to modern law in other countries,” particularly allowing single-member companies and make clear that a company may have any number of wholly-owned subsidiaries (thus revising Article 510). See Booz Allen Hamilton: Ethiopia Commercial Law & Institutional Reform And Trade Diagnostic 22 (United States Agency for International Development, 2007) [Hereinafter Commercial Law Reform and Trade Diagnostic].

corporate form of business operation in Ethiopia.¹⁶ According to the National Survey conducted by Ethiopian Central Statistics Authority (CSA, 1997), sole proprietors operated 82 percent of urban enterprises in Ethiopia.¹⁷ Therefore, introducing SMCs creates a good opportunity to transform sole proprietorship form of business into corporatized business entities. Against these backdrops, this thesis is devoted to examine major theoretical and legal considerations that ought to be taken into account in introducing SMCs in Ethiopian legal system.

1.2. Statement of the Problem and Research Questions

Legally speaking, any person who wants to operate a business through an incorporated legal entity in Ethiopia is required to comply with the minimum requirements of two partners in the case of Private Limited Companies (PLCs) and five in the case of Share Companies (SCs).¹⁸ Studies shows that more than 95 percent of Ethiopian corporate business forms are dominated by PLCs with loose regulatory schemes.¹⁹ Except for financial SCs that include banking, insurance and micro-finance institutions, it is observable that all other non-financial PLCs and SCs are loosely regulated. Therefore, in the presence of these challenges, introducing SMCs pose further problems unless legal frameworks are aptly designed.

On top of these bottlenecks, it is very difficult to find reliable data that unfolds the real identity of members of the incorporated PLCs in Ethiopia. However, a random look at the Companies Register at the Federal Ministry of Trade shows that there are various PLCs that are owned by family members in which spouses and children hold shares of the company. There also exists a critique that PLCs are family held businesses in which family members or close relatives or friends as members are enlisted only to meet the minimum membership requirements. This clearly indicates how investors in Ethiopia were/are forced to incorporate PLCs with the help of family members to comply with the minimum two-

¹⁶ This trend is particularly important to bring about underground economies to be documented and thereby alleviate tax evasion problems. See, Gebrehiwot Ageba and Wolday Amha, *Micro and Small Enterprises (MSEs) Finance in Ethiopia: Empirical Evidence*, 22 Eastern Africa Social Science Research Review 63-86 n.1 (2006).

¹⁷ *Id.*, at 64. See also see generally Endalkachew Mulugeta, *Underlying Causes of Micro and Small Business Failures in Addis Ketema Sub City: A Case Study* (Addis Ababa University, unpublished MA Thesis, 2008).

¹⁸ Commercial Code of the Empire of Ethiopia, Proclamation No. 166/1960 [Hereinafter Commercial Code of Ethiopia] Art. 307(1): "A [Share] Company may not be established by less than five members." Art. 510(2): "A private limited company shall not have less than two or more than fifty members."

¹⁹ See generally Nigusie Tadesse, *Major Problems Associated with Private Limited Companies in Ethiopia: The Law and The Practice* 64 (Addis Ababa University, unpublished LLM Thesis, 2009).

person requirement under the Commercial Code. This situation inexorably creates a PLC that totally constitutes a marital business estate.

Therefore, in the absence of legal regime that recognizes SMCs, the tendency to incorporate PLCs with the use of “dummy” members will be a reality behind the closed doors. This situation in turn creates the problem of *de facto* single member companies in which the actual owner of the company is a sole person – the others being nominal shareholders, whom sometimes the major shareholder causes the others to issue a power of attorney for him, in which case he does all that needs to be done. This fact indicates that if we do not recognize *de jure* SMCs, we are promoting *de facto* SMCs. The prevalence of these conditions poses two main problems. From the corporate law point of view, absence of legal recognition of SMCs creates the difficulty of providing appropriate guidelines for the regulation of such *de facto* SMCs. This situation may further create the difficulty to safeguard the interest of creditors without first contemplating the existence of *de facto* SMCs. From the shareholders point of view, an investor may be forced to find somebody to act as nominal shareholder. This situation also bears risk of future conflict of interests between the major shareholder and nominal shareholder. Therefore, unless *de jure* SMC is being introduced into the Ethiopian corporate landscape, one may argue that the existence of such *de facto* single member PLCs in Ethiopia create unnecessary and complex business schemes, which may not be contemplated by the existing corporate law.

Furthermore, attracting foreign investors to engage in business activities in Ethiopia is given due attention to mobilize foreign capital in the form of Foreign Direct Investment (FDI). Yet, unlike other jurisdictions, the menu of corporate form is only limited to multimember PLCs and SCs. Therefore, in order to catch-up with the international trend, introducing companies that could be incorporated with single person with the benefit of limited liability may serve as an additional alternative for foreign investors. According to Eliot, limited liability is regarded as “*corporation’s most precious characteristic and by far the most effective legal invention made in the nineteenth century.*”²⁰ Hence, limited liability would serve as an incentive to attract investors and entrepreneurs who fear personal liability to operate business in a corporate form.

On the other hand, if SMCs are to be introduced into the existing Ethiopian corporate law, determining which forms of companies fits the rubric of sole shareholder and the justifications for doing so needs to be addressed in a germane way. Should Ethiopia

²⁰ Bernard F. Cataldo, *Limited Liability with One-man Companies and Subsidiary Corporations*, 18 Law & Contemporary Problems 473 (1953).

introduce a SMC as a new legal entity? Should it be in the form of PLCs or in the form of SCs? Hence, answers to these questions require weighing of the options. As noted above, despite the proliferation of *de facto* single member PLCs in Ethiopia, it is widely discerned that the Commercial Code provisions of PLC is “fraught with problems.”²¹ In this regard, a comparison of PLCs and SCs made by Porter is significant. According to Porter, SCs provisions of the Commercial Code “provide the best protection to investors against unlimited liability [b]ecause of the potential unlimited liability of managers in a PLC and the unclear status of other shareholders.”²² After critical examination of unlimited and limited liability provisions of the Commercial Code of Ethiopia, Porter argued that, “any person who wants to start a firm or to invest in one and who is concerned about personal liability, will form or invest in SC.”²³ Porter further argued that SC “offers the best protection against unlimited liability of any arrangement created by the Commercial Code”.²⁴ He finally recommended that such “protection should be extended to one owner of a company instead of limiting it to a company with five owners.”²⁵

However, despite Porter’s recommendation, fifteen years ago, the “Draft Commercial Code of Ethiopia” prepared by the Federal Ministry of Justice in its Article 510 clearly show that, if a SMC is to be introduced in Ethiopia, it should be in the form of a PLC. It seems that SMCs in the form of a PLC is an option at the disposal of legislative drafting. As such, introducing single member private limited companies without the necessary amendments to the existing PLCs provisions of the Commercial Code would possibly create multiple anomalies that exacerbate problems associated with SMCs. Hence, it requires prudence to appreciate the fact that designing a legal scheme capable of accommodating SMCs is potentially a challenging task that requires a critical review of the existing corporate law. This thesis therefore, attempts to examine major theoretical and legal principles in order to help the legislators in considering the regulatory regime for SMCs. Consequently, given the above statements of the problem, the thesis will be guided by the following set of key research questions.

1. What are the major factors that necessitate the introduction of SMCs into Ethiopian corporate legal system?

²¹ Tadesse, *supra* note 19, at 149. See also Michael P. Porter, *Unlimited and Limited Liability in the Commercial Code of Ethiopia* 4 Ilsa, *Journal of International & Comparative Law* 1083 (1998).

²² *Id.*, Porter, at 1104

²³ *Id.*, at 1105.

²⁴ *Id.*

²⁵ *Id.*

2. To what extent would the existing multimember corporate theories be applicable to SMCs?
3. What are the major concerns associated with the regulation of SMCs in general?
4. In what way would the legislators be expected to adopt legal regimes governing SMCs in Ethiopia without substantially affecting the existing corporate legal structure?
5. What mechanisms would be expected to be introduced into the Ethiopian corporate law in order to effectively regulate SMCs and protect the rights of creditors?

1.3. Objectives and Significance of the Study

Ethiopia is currently witnessing the proliferation of business organizations despite the many legal problems associated with their regulation. An attempt to introduce SMCs in Ethiopia, therefore, requires designing prudent legal and institutional infrastructure. A “*Team of Fourteen National Experts*” referred earlier also commented that the concepts of “*SMC should be integrated based on a study on the ramifications and implications of introducing such a company.*”²⁶ Thus, reforming the Commercial Code provisions of company law in a way to accommodate SMCs is very imperative. As such, this thesis plays a pivotal role in examining the theoretical and legal ramifications of SMCs in general and shows its implication on the existing company law. Generally, the main objective of this thesis is to investigate the theoretical and legal considerations that would help to introduce SMCs into the Ethiopian corporate system. Specifically, the objective of the thesis is to examine suitable legal regimes adaptable to the situations of SMCs in order to safeguard the rights and interests of creditors.

In terms of significance, this thesis would help lawmakers as an input to make an informed decision in considering the ramifications of the theoretical and legal frameworks for the introduction of SMCs into the Ethiopian legal system. This thesis is significant in providing a blue print for the *de lege ferenda* of SMCs. Particularly, given the novelty of SMCs in the Ethiopian context, the thesis also attempts to provide new insight into our existing knowledge of corporate legal theories. The thesis also adds to the existing Ethiopia’s corporate law literature that is emerging recently. As such, the investigated

²⁶ Douglas and Shanks, *supra* note 1, at 34.

literatures and legal frameworks may serve as important references for further researches on the subject area within which SMCs could be more refined.

1.4. The Scope and Limitations of the Study

In terms of scope, the study focuses on major theoretical and legal considerations in order to introduce SMCs in Ethiopia. Thus, it is mainly forward looking in the sense that it tries to propose “legal” principles that ought to be applied to SMCs. But, for theoretical insights, it is based on the existing theoretical and legal principles capable of adaptability to the situation of SMCs. In particular, the study looks into the theoretical issues on the origin of corporations, legal personality, limited liability, corporate veil-piercing, corporate management, and corporate taxation both in general and in its specific applicability to SMCs. The thesis then tries to analyze foreign jurisdictions in order to draw lessons in the part of the paper that examines the prospect of SMCs in Ethiopia. As such, it should be clear from the outset that the scope of the thesis is limited to the theoretical and legal considerations in the context of private companies and will not deal with the public enterprises wholly owned by the government or state.

In terms of limitations, the concept of SMCs did not yet get full attention by legal scholars in Ethiopia. Accordingly, it would be not easy to find adequate published legal researches or documents except for few unpublished works. The undergraduate work conducted by Zelalem Teka tries to examine the desirability of SMCs in Ethiopia.²⁷ This paper, though not full-fledged enough to address the theoretical bottlenecks associated with SMCs, has attempted to suggest and comment on some basic provisions of the Commercial Code that are applicable to SMCs. The other independent unpublished work by Assamen M. Tessema has tried to recommend the recognition of SMCs in Ethiopia by attempting to decipher its relevance to Ethiopian legal system.²⁸ In the business and finance sphere, there is a large body of non-legal literature on the Ethiopian private business sector. However, these studies do not analyze the strategic importance of linking corporate form and business enterprises, at least at the theoretical level, making them less significant for this study.

Therefore, a more systematic approach that investigates the theoretical and legal frameworks of SMCs should be conducted in comparative perspectives to further enrich

²⁷ Zelalem Teka, *The Desirability of Single Member Companies in Ethiopia and the Need to Reform Our Company Law* (Unpublished LLB senior essay, Addis Ababa University, 2006)

²⁸ Assamen M. Tessema, *Comparative Single-Member Companies of Germany, France and England: A Recommendation to Ethiopia*. (Dec 22, 2012). <http://ssrn.com/abstract=2193070>.

existing knowledge on the subject matter and persuade Ethiopian legislators to introduce SMCs. Though this thesis is not necessarily definitive on the question of how best to accommodate SMCs in the Ethiopian corporate legal system, it is hoped that it would show the possibility to do so in a harmony with the principles that guide multimember corporations.

1.5. Research Method and Methodology

This thesis is based on a qualitative method of data collection techniques. As such, the study makes use of primary and secondary sources. In order to accomplish the study, the thesis employs doctrinal, theoretical, reform orientated, and comparative legal research methods. According to Michael Pendleton, doctrinal research method provides a systematic exposition of the legal principles and analyzes the relationship between rules, and further explains areas of difficulty in order to predict future developments.²⁹ Hence, by employing traditional doctrinal analysis existing legislations, as primary sources, will be searched and analyzed in order to arrive at a more comprehensive understanding of the research questions. Theoretical, in the sense that the thesis fosters a more comprehensive understanding of the conceptual bases of legal principles and of the combined effects of a range of rules that touch on a particular area of SMCs.³⁰ Hence, the thesis relies on secondary sources such as books, journal articles, working papers, archival documents and internet sources to review the conceptual basis of legal principles that deals with SMCs. Reform oriented, because it intensively evaluates the adequacy of existing rules and recommends changes to rules found wanting.³¹ Comparative, in the sense that legal literatures and materials from the jurisdictions of selected countries would be investigated and analyzed systematically mainly because of the increasing influence of the supra-national legal materials that help to facilitate our understanding of the operation of SMCs for the benefit of Ethiopia.³² As such, legislations from selected jurisdictions and Ethiopia will be analyzed in order to provide a systematic exposition of legal regimes relevant to SMCs.

²⁹ Michael Pendleton, *Non-empirical Discovery in Legal Scholarship – Choosing, Researching and Writing a Traditional Scholarly Article*, in *Research Methods for Law 159* (Mike McConville and Wing Hong Chui's, ed., 2007).

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

1.6. Structure of the Study

This study is structured into an introductory chapter including other four main chapters. The introductory chapter gives a background, sets the research problems and questions, objectives and significance of the study, sets scope, limitations and methodology of the study. Chapter two attempts to conceptualize SMCs by reviewing relevant legal literature. It defines and clarifies the concepts of SMCs and compares and contrasts them with other forms of commercial entities. It also discusses the significance of SMCs in general and their desirability in the context of Ethiopia in particular. Chapter three deals with major corporate theories in general and in the context of SMCs in particular. The chapter attempts to examine the validity of multimember corporate theories in the context of SMCs. It mainly focuses on concession and contracts theories on the origin of corporations; theories of separate legal personality and limited liability; theories of corporate governance and corporate veil-piercing, and theories of corporate taxation as a major theoretical considerations. Chapter four investigates legal vehicles designed to regulate SMCs in selected comparative jurisdictions. The chapter tries to look into the rules and principles that regulate SMCs in the company legislations of selected countries hoping to enrich legal principles for the regulation of SMCs. The chapter, in particular, focuses on warnings of possible difficulties and opportunities to stand back from one's own corporate legal system and look at it more critically. Chapter five focus on regulatory proposals for introducing SMCs into the Ethiopian legal system. The chapter looks at the existing companies law of Ethiopia and juxtaposes it with the best practices of the comparative jurisdictions under investigation. The chapter, in particular, deals with designing rules that regulate formation and transformation of SMCs, organization of SMCs and regulatory safeguarding measures to protect creditors' rights, dissolution and winding up of SMCs. Chapter Six concludes the major points of the thesis and provides recommendations for the legislators in order to introduce SMCs into the Ethiopian corporate law.

Chapter Two

2. General Overview of Single Member Companies

2.1. Introduction

One of the salient features of legal norms in the modern world is that law ought to be flexible to accommodate the social, political and economic dynamics. However, sometimes the weight of tradition that always bears very heavily on legal institutions makes it difficult to bring about the desired transitions.³³ It is argued that tradition places special obstacles in the way of the acceptance of new concepts, even though, when considered without prejudice they appear to be obvious and valuable means of achieving useful ends.³⁴ Yet, traditional perceptions that only concepts that have been bequeathed to us by past generations are authoritative and sacred escort us to operate with old institutions rather than considering the adoption of new formulae to the evolving world.³⁵

One of the areas where the weight of tradition has a rebounding effect relates to the legal principles applicable to multi-member corporate philosophy. The old fashioned legal perception that limited liability fits only to the rubric of traditional juristic philosophy of multimember incorporated entity but not the “natural rights” of sole proprietorship has engulfed the modern scholarship of corporate theory and law. In its classical form, limited liabilities of companies enable group of individuals to own assets to be free of claims for the debts of the company beyond their contributions that was initially paid. For such reason, some scholars regarded limited liability as “the corporation’s most precious characteristic and by far the most effective legal invention made in the nineteenth century.”³⁶ Yet, the benefit of limited liability, which seems so natural even when a single person is thinking of limiting his liability, is not used to be fashionable up until recently. Therefore, it took some time for the old habits of thought to recede, and for there to be any kind of recognition that other elements were just as important.

The idea of extending limited liability to a single person is gaining momentum from different legal scholars and economists. Latty, for instance, argued that the legal formality that a company should be incorporated only after the agreement of two or more founders

³³ Rotondi, *supra* note 2, at 989.

³⁴ *Id.*

³⁵ *Id.*

³⁶ Cataldo, *supra* note 20 at 473.

is considered as a “legal idiosyncrasy.”³⁷ The reason, according to Latty, is that there is “no magic in numbers” and the minimum requirements to be complied with carry no mandatory public policy and hence by no means implicate the requirement of several shareholders at all times. In other words, sole shareholder of SMCs can acquire legal personality different from his individual identity on the same rationale that dictates the case of several shareholders.³⁸ As such, the reward of incorporation of a company with limited liability is as attractive and worth struggling for the solo individual on equal footing as group of individuals. Thus, in the absence of legal recognition that allows single persons to limit their liability, it remains inevitable that individual investors may resort to illegal schemes to obtain advantages of limited liability such as by incorporating companies with “straw men” as sleeping members.

Accordingly, the legal formality that prescribes that there have to be a minimum two persons to incorporate a PLC could be bypassed by enlisting the family members, close relatives and the aides of friends. Similarly, the requirement for a board of directors and other legal formalities could be met in much the same way.³⁹ In examining the USA experience, Fuller noted that the process of using “dummy directors” to incorporate a company is part of a scheme to avoid inconvenient provisions of enabling legislation.⁴⁰

The Ethiopian experience is no different from the above corporate reality. Ethiopian corporate legal system, by and large, is the product of old legal institutions that require reform to facilitate corporatization process. A random observation of Companies Register that is open for public references at the Federal Ministry of Trade indicates that family members giving rise to *de facto* SMC incorporate PLCs in Ethiopia. Against the above highlights, this chapter tries to discuss the meaning and concept of SMCs. It tries to differentiate SMCs from other forms of commercial establishments. It finally provides a review of legal literature that sheds light on the arguments for and against the recognition of SMCs and its desideratum to the Ethiopian corporate legal system.

³⁷ *Id.*

³⁸ *Id.*

³⁹ Fuller, *supra* note 4, at 1375.

⁴⁰ *Id.*

2.2. The Meaning and Conceptual Underpinnings of SMCs

The term “company”⁴¹ refers to an artificial entity controlled by its management and membership in pursuit of business goals.⁴² As such, company is “an entity distinct from its shareholders and remain unchanged and unaffected in its identity by changes in its individual membership.”⁴³ In company law literature, the concept of company constitutes continuity of life, legal personality, limited liability, centralized management, share ownership and transferability of shares as its “core structural characteristics.”⁴⁴ According to Geu, the combination of these ingredients affects every aspect of the company irrespective of its form.⁴⁵ Yet, as we shall see in chapter two in a great depth, the traditional conception of company, in one way or another, considers company as an artificial entity established by two or more persons.

The term SMC as the name indicates refers to companies with single shareholder. A SMC is also known by other names such as “one-man company” or “one-person company” or “companies of convenience”. As one can see, the use of the term company, in the context of single member shareholder, is contrary to the traditional form since the term “company” implies a plurality of persons.⁴⁶ In this regard, M. Rotondi noted that, “no abuse or illegality is inherent in the object that SMC mean to pursue despite using the term company.”⁴⁷ Silk also noted that whatever difficulty etymologists may have in considering one person a company, the single member shareholder is not a conceptual impossibility, at least so long as the lawyers think in terms of the functions of the corporate device in a given social and economic order rather than in terms of the essential and eternal nature of corporation.⁴⁸

⁴¹ The term “Corporation” is often used interchangeably with the term “Company”. However, the term “corporation” is used in the USA legal system in broader context compared to the term Company. Likewise, the term “Company” is preferred in the United Kingdom. See Ben Pettet, *Company Law* 14 (Pearson Education Limited, 2nd ed., 2005). See also, Andreas Cahn and David C. Donald, *Comparative Company Law Text and Cases on the Laws Governing Corporations in Germany, The UK and the USA* 9 (Cambridge University Press, 2010). In Ethiopia, while the term company is used in the Commercial Code like that of UK, there are, however, entities that use the term corporation instead. For instance, “Ethiopian Electric Power Corporation” and “Fana Broadcasting Corporate” are few to mention. Hence, for the purpose of this paper, the terms “Company” and “Corporation” will be used interchangeably.

⁴² Stephen Griffin, *Company Law: Fundamental Principles* 1 (Pearson Education Limited 4th ed., 2006).

⁴³ James D. Cox, Et Al., *Corporations* 1-4 (Aspen Law and Business, 1997).

⁴⁴ See Cahn and Donald, *supra* note 41, at 9

⁴⁵ Thomas Earl Geu, *Understanding the Limited Liability Company: A Basic Comparative Primer (Part One)*, 37 South Dakota Law Review 48 (1992).

⁴⁶ *Id.*

⁴⁷ Rotondi, *supra* note 2, at 990.

⁴⁸ Jules Silk, *One-Man Corporation: Scope and Limitations*, 100 University of Pennsylvania Law Review 853 n. 6 (1952).

Having the above points in mind, it is also important to appreciate the types of SMCs. Essentially, SMC may be classified into *de jure* SMCs and *de facto* SMCs. A *de jure* SMC is a company incorporated by as a single shareholder clearly indicating in the memorandum and articles of associations that it has only one member. The sole shareholder alone shall legally assume the liability of the company to the amount he/she contributed into the company. It is vital to note that in legal systems that recognize SMCs, there is a possibility in which multimember companies could be reduced to a single membership, “because its shares have come to be held by a single shareholder.”⁴⁹

A *de facto* SMC is a company which has more than one shareholder in the founding act while in fact the company is controlled by only one genuine shareholder, the others being nominal shareholders who appear on the record for the purpose of satisfying the membership required by the law.⁵⁰ This kind of company complies with all the requirements of the applicable law, while in reality, it is a company with only one shareholder who contributes, operates and collects the profits from the company.⁵¹ Furthermore, Cataldo beautifully describes a *de facto* SMC as “a sole proprietor, operating a moderate sized business, organizes the shares excepting the few necessary to comply with the statutory provisions respecting incorporators and directors.”⁵² According to Cataldo, such company is created “in legal form” but, the principal shareholder retains in effect the exclusive control and full dominion in as much as a sole proprietor enjoyed but, this time with the desired privilege of limited liability.”⁵³ As noted earlier in this chapter, the nominal shareholders in a *de facto* SMCs are called by different names such as “dummy shareholders,” “straw men,” or “sleeping members.”⁵⁴

In general, SMC is one shareholder corporate entity in which its legal liability is limited to the assets of the company only. It is also important to note that in modern commercial life, “capital is more important than collection of individuals” and hence, it is not realistic to pressurize an individual investor capable of providing the required capital to look for another person to incorporate a limited liability company.

⁴⁹ Directive 2009/102/EC of the European Parliament and of the Council of 16 September 2009 in the area of Company Law on Single Member Private Limited Liability Companies, Art. 2.

⁵⁰ Jianlin, *supra* note 10, at 430.

⁵¹ Wang Yong, *Introduction to One Man Company*. http://www.ccelaws.com/int/artpage/3/art_2620.htm.

⁵² Cataldo, *supra* note 20, at 474.

⁵³ *Id.*

⁵⁴ Rotondi, *supra* note 2, at 1002.

2.3. Comparing SMCs with other Business Entities

It is important to highlight how a SMC is distinguished from other forms of business vehicles. Accordingly, comparison of SMCs will be made with sole proprietorships and close corporations due to their close similarity but with different liability regimes – unlimited and limited liability respectively.

2.3.1. Sole Proprietorships vis-à-vis SMCs

The terms SMCs and sole proprietorships can be easily confused unless their similarities and differences are appreciated. Both names have a single person involved in businesses distinguished from multimember companies or partnerships. In simple terms, a sole proprietorship refers to “an unincorporated business owned by a single individual.”⁵⁵ Conversely, a SMC is an incorporated business entity owned either by natural or legal person. It is common in every country that individuals may want to conduct business as a sole proprietor despite the availability of legal entity status. Under the “solitary ego” view, a sole proprietorship has no separate identity from its owner.⁵⁶ A sole proprietor alone is entitled to all profits from the business, subject to the rights of creditors, while personally liable for all business debts and obligations, including all contractual debts and all tort liabilities incurred by the sole proprietor.⁵⁷

On the other hand, a single person in a SMC has the benefit of legal protection from risks through the legal vehicle of limited liability. A key advantage for an owner of an incorporated business owned by a sole person is the idea of separate legal identity, which brings with it the right of a shareholder to limit his/her liability. Therefore, the main difference between the two forms of business vehicles lies at the hub of limited liability. For this reason, though sole proprietorships are the most vital and prevalent of all business forms in every country, they fail to participate in what has been described as “one of the law’s most economically significant contributions to business life” – the legal entity status.⁵⁸ Therefore, one may argue that the very essence of business entity run by a single

⁵⁵Angela Schneeman, *the Law of Corporations and other Business Organizations* 30 (Cengage Learning, 5th ed., 2010).

⁵⁶ Robert W. Hamilton, *Business Organizations: Unincorporated Businesses and Closely Held Corporations: Essential Terms and Concepts* 29–49 (1996).

⁵⁷ Schneeman, *supra* note 53, at 30.

⁵⁸ Larry D. Soderquist Et Al., *Corporations and Other Business Organizations: Cases, Materials, Problems* 39 (6th ed., 2005).

person in SMC is attributable to the concept of sole proprietorship particularly if single natural persons own a SMC.

In view of the above conception, it is not difficult to appreciate that the concept of SMC depicts a sole proprietorship-like features except for the privilege of limited liability. In simple terms, a SMC is a company form of sole proprietorship with the benefit of limited liability. However, for the reasons described above, SMC has advantages over the sole proprietorship form of business. Firstly, the word “company” itself has some kind of credit, which may assist the enterprise to get higher credit rank and facilitate the transaction of the company.⁵⁹ Secondly, while the liability of a sole proprietor is unlimited, the liability of an individual in a SMC is limited except in case of “corporate veil lifting” which is actually also the case in multimember companies. Thirdly, compared to sole proprietorships, business perpetuity and diversity in management is relatively better in SMC.⁶⁰

On the other hand, except for the privilege of limited liability, operating as a sole proprietorship, in contrast to operating as multi-member company, is favorable for scores of reasons.⁶¹ First, sole proprietor has full management authority of his own business. Second, there is ease in formality and reporting requirements associated with sole proprietorships. Third, compared to a company, one can start business as a sole proprietor with low cost without mandatory minimum capital requirement. Fourth, a sole proprietor is subjected to income tax scheme, and hence relieved from corporate tax. Finally, compared to company form, a sole proprietorship business can be discontinued with ease. In general, given the advantage of limited liability, there is no good reason why sole proprietorship is denied statutory benefits similar to those granted to other legal entity.⁶²

2.3.2. SMCs vis-à-vis Closed Corporations

Needless to mention it, each form of business entity is subject to a different legal regime supposedly premised on the different nature and requirements of each particular structure.⁶³ However, despite the difference in legal formalities there exist manifest

⁵⁹ Mitchell Crusto, *Unconscious Classism: Entity Equality for Sole Proprietors*, 10 Journal of Constitutional Law 230 n. 2 (2009). Empirical research showed that in addition to the protection of limited liability, many people believed that incorporation as a “company” would provide status and credibility for their businesses. See generally Freedman And Godwin, *supra* note 9

⁶⁰ Schneeman, *supra* note 55, at 30

⁶¹ *Id.*, at 31. See also Beihui Miao, *A Comparative Study of Legal Framework for Single Member Company in European Union and China*, 5 Journal of Politics and Law 4-5 n. 3 (2012).

⁶² Crusto, *supra* note 59, at 235.

⁶³ Willard P. Scott, *The Close Corporation in Contemporary Business*, 13 The Business Lawyer 741(1958).

similarities between business entities. One of such similarity is the case between SMCs and closed corporations. Here, it should be noted that the purpose of this sub-topic is not to examine the concept of close corporation in detail. It is rather, to examine the attributes of closed corporation that may help shed lights on how such companies form acquire the character of SMCs. The term “closed corporation” also called “closely held corporation” has no clearly defined meaning in the laws of various jurisdictions but attempts have been made by the writers which have fashioned their own definition with varying consequences.⁶⁴ However, despite differences different comparative lawyers agree on the bundle of special features that can be cited as marks of closed corporation. According to O’Neal, a close corporation typically has the following attributes:

“(1) the shareholders are few in number, often only two or three; (2) they usually live in the same geographical area, know each other, and are well acquainted with each other's business skills; (3) all or most of the shareholders are active in the business, usually serving as directors or officers or as key men in some managerial capacity; and (4) there is no established market for the corporate stock, the shares not being listed on a stock exchange or actively dealt in by brokers; little or no trading takes place in the shares.”⁶⁵

Firstly, the first and the second attributes of a closed corporation resemble a *de facto* SMC in which a sole shareholder requires the assistance of family members to comply with minimum membership requirements of “two-persons” to incorporate a PLC. Secondly, like SMCs, unity of ownership and control in a closed corporation is its distinctive feature compared to other forms of multi-member corporations that suffer from separation of ownership and control.⁶⁶ Particularly, flexibility of management underscores the resemblance of both forms of corporations compared to other forms of corporations such as PLCs.⁶⁷ Thirdly, similar to SMCs, a closed corporation theoretically admits the free transfer of its shares but for special reasons “closes its door” and prevents strangers from acquiring its shares.⁶⁸

⁶⁴ *Id.*

⁶⁵ Martin A. Rogoff, *Subchapter S and Selected Problems in Close Corporation Planning*, 26 *Maine Law Review* 1-2 n. 1 (1974) at *foot note*.

⁶⁶ Harwell Wells, *The Rise of the Close Corporation and the Making of Corporation Law*, 5 *Berkeley Business Law Journal*, (forthcoming 2008). <http://ssrn.com/abstract=1119280>. It is also true to the problems of minority shareholders that occur in multi-shareholder corporations.

⁶⁷ *Id.*

⁶⁸ J. Treillard, *The Close Corporation in French and Continental Law*, 18 *Law and Contemporary Problems* 546-557 (1953).

The idea here is that in as much as a single shareholder of SMC may not be interested to associate with others, associates in closed corporations also want to protect themselves against the intrusion of undesirable outsiders.⁶⁹ Generally, the similarity of both closed corporation and SMCs could be better understood when compared to the features of other corporation forms whose shares are publically traded.⁷⁰ It should be also noted that despite the minimum requirement of two persons, closed corporation is more likely to resemble SMCs than other corporate forms that require two or more persons for incorporation. Under the existing corporate law of Ethiopia, closed corporations are similar with that of private limited companies

2.4. Arguments For and Against the Recognition of SMCs

Despite their existence in corporate law history, the legal conception of SMCs has recently attracted the attention of legal scholars and economists. Particularly, owing to the nature of SMCs, whether such business entity form should statutorily be recognized have become the subjects of debate. In view of such concerns, it is vital to highlight arguments for and against the legal recognition of SMCs focusing on their ramifications and the possible way outs.

To start with, the arguments for the recognition of SMCs, it is noted that one distinguishing feature of SMCs from that of sole proprietorships is the concept of legal entity status. Thus, in order to appreciate benefits that legal entity status would bring to a sole proprietor, one need only look at the value of companies' legal entity status. One of such benefits is that it gives single investors the opportunity to separate property allocated for company business form their personal properties.⁷¹ This concept implies that by incorporating a SMC, a sole investor will normally be responsible for the loss and damage up to the money he/she contributed to the company, and thus insulates the fund contributed into the company from his/her other personal properties.⁷² The privilege of limited liability, among other things, is that it provides an incentive for some investors who are unwilling to invest for fear of personal liability. It is argued that once armed with the protection of limited liability offered against the personal liability, less affluent

⁶⁹ *Id.*

⁷⁰ Robert R. Keatinge *et al.*, *The Limited Liability Company: A Study of the Emerging Entity*, 47 *The Business Lawyer* 386 (1992).

⁷¹ Joseph A. Grundfest, *The Limited Future of Unlimited Liability: A Capital Markets Perspective*, 102 *The Yale Law Journal* 387 n. 2 (1992).

⁷² *Id.*, at 388.

investors were able to participate in the market.⁷³ The legal repercussion of entity status with limited liability is thus a SMC has the capacity to perform juridical acts such as assuming contractual obligations, the liability of which may not in principle be imputed to the sole shareholder who incorporated the company as it would have been with a sole proprietor.⁷⁴

Another important justification for the recognition of SMCs is the desire to encourage corporatization. It is argued that the instrumentality of limited liability may provide democratic access to capital between affluent and non-affluent investors that in turn helps them to mobilize their effort in the market.⁷⁵ This tendency further promotes competition among sole proprietors to transform their small and medium sized businesses by incorporating companies. A good example in point is the justification affirmed by the European Union (EU) to recognize SMCs in EU member countries. One of the economic reasons that derived the EU to recognize SMCs is the intention to complement community initiatives to encourage the creation and development of small and medium-sized enterprises.⁷⁶ Therefore, recognizing a SMC is important in bridging the existing corporate culture by motivating investors with “solitary ego” to invest their capital that may afford the company to carry out their investment plan. Some also further argue that recognition of SMCs is also important in the “documentation of the economy” which addresses the problem of tax avoidance and evasion that would have been perpetrated by sole traders.⁷⁷ So much so that, by recognizing SMC any fragmented business practice at individual level could be better coordinated and consolidated.

On the other hand, there are special concerns that accompany the recognition of SMCs. The most important concern with SMCs, as some argue, is the risks associated with bestowing limited liability to a single shareholder.⁷⁸ The fear is that the concept of limited liability could be abused and may serve a single shareholder as a “sword rather than a shield”.⁷⁹ For instance, the shareholder can lie under the shadow of limited liability

⁷³ David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?* 51 Oklahoma Law Review 438 (1998).

⁷⁴ Crusto, *supra* note 59, at 233.

⁷⁵ Jeffrey K. Vandervoort, *Piercing the Veil of Limited Liability Companies: The Need for a Better Standard*, 3 DePaul Business & Commercial Law Journal 55 (2004).

⁷⁶ Vanessa Edwards, *The EU Twelfth Company Law Directive*, 19 Company Lawyer 212-214 n.7 (1998). See also Miao, *supra* note 61, at 2.

⁷⁷ Ilahi, *supra* note 13.

⁷⁸ Vandervoort, *supra* note 75.

⁷⁹ Edwards, *supra* note 76. See also: Vincent J.G. Power, *Twelfth EEC Company Law Directive*, 1 International Company and Commercial Law Review 44-45 n. 3 (1990).

privilege and may defraud to transfer loss of the company to the creditors.⁸⁰ In many cases, however, the support for limited liability was coupled with a call for appropriate obligations to be imposed on those gaining the benefits of limited liability and on proper creditor protection.⁸¹

Another argument against the recognition of SMC is problem that relates to company management. Under conventional company law, company management involves the participation of board of directors in the supervision of the company accompanied by the checks and balance of shareholders. Nevertheless, this advantage, though not always the case, may not be available in SMCs. In such case, the sole shareholder controlling the company under his own full authority may easily turn company's property to his own advantage, such as by paying high salary to himself, which could be detrimental to the interest of company creditors. In this regard, it is argued that limited liability, as a protection designed to encourage investment, would seem unnecessary where corporate ownership and control has been concentrated in the hands of single person.⁸² Here, though both theoretical and legal principles governing SMC will be analyzed in the following subsequent chapters, it is vital to underline the concerns associated with SMC given its nature of single membership. Hence, by virtue of the economic importance of limited liability principle to sole shareholder, devising legal vehicle capable of overcoming the potential problems associated with SMC requires critical review of the existing corporate legal system. It should however be noted that there are multifaceted arguments both for and against SMCs which the thesis explore in the discussions of the theoretical parts.

2.5. The Desideratum of Introducing SMCs into the Ethiopian Corporate Law

The vast majority of Ethiopian companies are both small sized and family companies held by few owners.⁸³ In particular, it is affirmed that most of the smallest Ethiopian businesses are not organized as companies but as sole proprietorships.⁸⁴ So, the question is how could it be possible to transform such small sized family businesses into a new corporate landscape? Would any attempt to introduce the legal vehicle of limited liability for sole proprietor be of any help to play its part in encouraging private sector corporate

⁸⁰ Zhu Ciyun, *Analysis to the Advantages and Disadvantages of One-man Company and the Legislation for One-man Company*, *China Civil and Commercial Law*. <http://www.civillaw.com.cn/article/default.asp?id=22452>>

⁸¹ Freedman, *supra* note 7, at 325.

⁸² Cataldo, *supra* note 20.

⁸³ Commercial Law Reform and Trade Diagnostic, *supra* note 15, at 19.

⁸⁴ *Id.*

development? Given the forgoing justifications for the recognition of SMCs in general context, it is of paramount importance to unveil the desirability of introducing SMCs and factors that trigger its legal recognition in the context of Ethiopia. Generally, one can identify scores of potential factors that dictate the introduction of SMC in Ethiopia.

The first factor relates to the importance of capital over associations of persons to incorporate a company.⁸⁵ In the past, it is widely discerned that the main reason behind the promotion of associations of persons is the desire to pull resources and knowledge together. Currently, this kind of justification is old-fashioned (though it could not *in toto* be relegated) because a single individual may comply with the minimum capital required to incorporate a company alone. Hence, it is economically unimportant to force an investor to look for another partner in order to establish a company to run his investment plan. In addition, though a skilled partner is an important aspect for the success of a company, developments in technology and innovations in management skills, compared to the past made it possible for an investor to hire top-notch managers that fills the human resource gaps of the company.

The second deriving factor for the recognition of SMC is the desire to transform corporate culture.⁸⁶ Recently, it is observable that the market for incorporation of companies in Ethiopia is increasing due to government's attention to private sector development.⁸⁷ However, two tendencies considerably hinder the pace of corporate business development. The first tendency can be attributed to the existing "kiosk mentality" that resulted in the persistence of underground economy. Hence, the pace of corporate development may lag unless reform of company law that fits to such "solitary ego" is designed to further promote competitiveness. Therefore, in such situations, it is possible to encourage Ethiopian investors to invest his capital by incorporating SMC.⁸⁸ Therefore, it may be argued that introducing SMCs into the Ethiopian legal system may help in transforming the existing corporate culture and encourage further competition among sole proprietors.

⁸⁵ A Team of National Experts *supra* note 14, at 20.

⁸⁶ Commercial Law Reform and Trade Diagnostic, *supra* note 15 at 18: "Good company law (...) can encourage new investment—and provide investor protection—by setting forth clear and objective rules for a company's ongoing internal governance; it can encourage entrepreneurship by making it easy to start up and register a company; and it can encourage businesses to come out of the underground economy into the publicly registered, taxpaying economy."

⁸⁷ *Id.*, at 1-2

⁸⁸ It should be important to note that it is not the behaviours of every individual to closely work with other partners. Some also may fear liability to operate business as a sole proprietor, making limited liability as an incentive more economically appealing.

The third factor that necessitates the introduction of SMCs into Ethiopian corporate legal system is the need to address the conflict between the realistic economic demand and the legal requirement. As noted before, in current Ethiopia, *de facto* single member PLC is the reality behind the closed doors. A very good example is “MIDROC Ethiopia Investment Group Companies” and “affiliate companies owned Sheik Mohammed Hussein Ali Al-Amoudi and by his close relatives (families) respectively.”⁸⁹ This very fact clearly indicates how existing private limited companies in Ethiopia are overwhelmingly dominated by family businesses that gave birth to the *de facto* SMCs. Hence, in the absence of legal and regulatory schemes, the existence of such *de facto* single member PLCs would bring a formidable challenge to the existing corporate legal system.

As noted before, if we fail to recognize SMCs in Ethiopia, which, as a matter of fact is an economic reality, we are on the other hand, promoting the illegal schemes of *de facto* incorporation of SMCs, which ultimately defeats the purpose for which the existing corporate law have been established. This is not desirable both to the shareholders and to corporate legal system for two basic reasons. The reason in the former case is that an investor who has tried to find another partner to act as dummy shareholder to comply with the legal requirement of “two persons” to incorporate PLCs, who in the future bear the risk of conflict of interest between the dummy shareholder and him. The reason in the latter case is that, if the legal status of SMC is not going to be a reality, it would be difficult to provide appropriate guidelines for the development of *de facto* SMCs. The impact of lacking corporate legal principle that caters for the needs of SMCs could largely be felt in creditor protection and other concerned parties. Hence, ignoring the economic and regulatory impact of *de facto* SMCs undermines the existing corporate legal system.⁹⁰

The last but not least factor that necessitates the introduction of SMCs into the Ethiopian corporate system is the imperative to catch-up with the global corporate trend. Currently, the Ethiopian government is encouraging foreign companies to invest their capital in Ethiopia. So, one of the legal incentives that would help realize the attraction of foreign investors is harmonizing corporate legal system with the corporate legal system of the investors’ countries of origin. As we shall see in chapter four, many countries around

⁸⁹ See the Official website of Mohammed International Development Research and Organization Companies (MIDROC) Ethiopia. <http://www.midroc-ethiopia.com.et/>. It clearly indicates that Sheik Mohammed Hussein Ali Al-Amoudi is the “Owner and Chairman” of MIDROC Ethiopia, a private investment group with 41 companies.

⁹⁰ It should be noted that in terms of opportunity, the prevalence of *de facto* SMCs in Ethiopia could reduce the cost of transforming such company to *de jure* SMCs. This may reduce wastage of resources that would otherwise cost the dissolution and liquidation of “two member” private limited companies, which is in fact Single member private limited company.

the world have disposed of the bottleneck of traditional corporate legal culture by recognizing new form of company incorporation – SMCs. Therefore, it could be argued that with the advent of Ethiopia’s membership to the World Trade Organization (WTO) the desirability of recognizing SMCs seems to be a matter of compelling corporate legal reform, of which introducing SMC is a substratum. Yet, lack of appetite for reforming corporate legal systems on the part of Ethiopia poses a big challenge to the existing corporate law, which has already celebrated its fifty years anniversary.

Chapter Three

3. The Applicability of Corporate Theories to SMCs

3.1. Introduction

The demand for the privilege of limited liability by single proprietor is challenging the traditional theories of corporations and corporate law. Legal concepts designed to serve the needs of multi-member corporations in the past have become inadequate in a world where business could be operated by individual tycoons without the need to search for partners. Therefore, social and economic reality inevitably force legislature to respond to the dictates of dynamism by either fashioning new corporate doctrines or reformulating the existing ones inherited from the past to the changing corporate world.⁹¹ The question is however, is it palatable to apply traditional views on corporate legal theories in the context of SMCs? In a bid to answer such a question, and other related issues, this chapter labours to analyze traditional theories of corporation that is fashioned according to the corporate philosophy of multi-member business entity.

To the extent possible, the chapter tries to evaluate whether the existing major corporate theories suits the specificities of SMCs without difficulties. It should be noted from the outset that this chapter is not intended to delve into an ideological morass on the epitome of a normative question whether there is, or should be, an easily identifiable and holistic theory for understanding the nature and structure of SMCs. The purpose of this chapter is not to invent the wheel as it is already invented. As Dawkins put it, it is intended to neither propose a new theory nor unearth a new fact. However, as Dawkins argued, it only intends to contribute an insight into the existing bodies of corporate legal knowledge through new way of seeing old theories or facts. A change of vision argued Dawkins, can, at its best, achieve something loftier than a theory. It can usher in a whole climate of thinking, in which many exciting and testable theories are born, and unimaginable facts laid bare.⁹² Accordingly, theoretical issues in the juristic philosophies of multimember company will be juxtaposed in order to offer insight into “theories” applicable to SMCs. It should, however, be noted that it is difficult to investigate the whole body of scholarship on corporate theory in order to produce doctrines or principles applicable in interpreting

⁹¹ Richard M. Buxbaum, *Corporate Legitimacy, Economic Theory, and Legal Doctrine*, 45 Ohio State University Law Journal 517 (1984).

⁹² Richard Dawkins, *The Selfish Gene* xvi (Oxford University Press, 3rd ed., 2006). See also Thomas Earl Geu, *A Single Theory of Limited Liability Companies: An Evolutionary Analysis*, 42 Suffolk University Law Review 507 (2009).

and understating SMCs. As such, focus is made to examine major theoretical considerations that are more relevant to address theoretical gaps in the contexts of concerns raised by SMCs.

3.2. Major Theories on the Origin of Corporations

In legal literature, it is widely discerned that the major problem of corporation is lack of a proper theoretical basis.⁹³ Part of the reason is attributable to the fact that mainstream legal research on corporations has, as its starting point, legal norms applied and interpreted by courts.⁹⁴ As such, the existence of vast number and diversity of legal norms give rise to the difficulty of defining their common characteristics and formulate theories that would explain aspects of corporations in a germane way.⁹⁵ An attempt to fill the theoretical gaps by using economic theories as a model also resulted in difficulty since economic theories are not necessarily compatible with the existing legal norms.⁹⁶ Within such vast horizons of legal norms, corporate law theory, therefore, constitutes a body of legal writing which is primarily concerned with the exposition of the legal rules both in descriptive and normative aspects.⁹⁷

The descriptive aspects of company law involves examining the operation of legal rules and the structures produced by them in an objective and contextual way, particularly by spotting an underlying consistency or flaws contained in the rules.⁹⁸ The normative aspect of company law, on the other hand, relates to the moral justification of legal rules or structures by either proposing whether they ought to change or remain as they are.⁹⁹ However, it is argued that the normative aspect of company law lends itself to the dynamism of a legal theory as it tries to generate arguments that are of fundamental social, economic and political importance.¹⁰⁰ Hence, the normative aspect of corporate legal theory will be trying to tell us what sort of company law we have, and what sort of company law we ought to have. Yet, what company law we have and what we ought to have, is inextricably linked to the theory that explains the origin of corporation.

⁹³ Petri Mantysaari, *Organizing the Firm: Theories of Commercial Law, Corporate Governance and Corporate Law 2* (Springer Dordrecht Heidelberg, 2012).

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ Pettet, *supra* note 41, at 47.

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

Accordingly, there are two major corporate theories that are developed to explain how corporations come into being – the concession and contract theories.¹⁰¹

To begin with, the essence of the concession theory reclines on the conception that the legal power of corporation derives from the will of the state.¹⁰² According to this theory, recognition and acceptability of the corporation emanates from state’s legal validation process.¹⁰³ This theory further contends that a company was a fictional entity created by the exercise of state power.¹⁰⁴ The scheme in this form also provided a justification for state regulation of companies, for in giving the concession, the state had done something gratuitous or special, in return for which it could expect the right to regulate companies.¹⁰⁵

On the other hand, the contract theory sought to show that companies were associations formed by the agreement of the shareholders.¹⁰⁶ Unlike the former theory, contract theory, as the name indicates, propounds that recognition and acceptability of a corporation emanates from the willingness of shareholders and that, as such, there was no reason why they should need to obtain permission from the legislature in order to establish it.¹⁰⁷ Thus, the theoretical setting that influences the origin of corporation may influence the direction of legal understanding and hence is a significant factor in legitimizing the nature and concept of business entity. Similarly, it is also important to note that to some extent, the relevance of theory in providing justifications for state intervention influence legal doctrine while it may in turn be influenced by legal doctrine.¹⁰⁸

3.3. The Applicability of Multimember Corporate Theories to SMCs

As noted before, SMC is a new business vehicle designed on convenience basis to accommodate the demands of investors who are willing to operate business venture in solo by forming a legal entity that has an advantage of limited liability. However, there are theoretical hurdles that impede the incorporation of a company with a single membership. Generally, one can at least identify two major theoretical obstacles in justifying the

¹⁰¹ Cohen, *supra* note 73, at 435

¹⁰² Adolf A. Berle, *The Theory of Enterprise Entity*, 47 *Columbia Law Review* 344 n. 3 (1947).

¹⁰³ J. Dewey, *The Historic Background of Corporate Legal Personality*, 35 *Yale Law Journal* 669 (1926).

¹⁰⁴ Cohen, *supra* note 73, at 345

¹⁰⁵ *Id.*, See also Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 *Maryland Law Review* 85 (1991).

¹⁰⁶ M. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 *West Virginia Law Review* 203 (1985).

¹⁰⁷ There also views that advance that “corporation no longer could be regarded as the product of state permission or concession.” See Bratton, *The “Nexus of Contracts” Corporation: A Critical Appraisal*, 74 *Cornell Law Review* 436 (1989).

¹⁰⁸ D. Millon, *Theories of the Corporation*, *Duke Law Journal* 201(1990).

incorporation of SMCs in every jurisdiction. The first obstacle relates to the fact that the theoretical architecture of traditional company law is designed based on “contract theory” which requires the partnership of two or more shareholders. The second obstacle relates to the reluctance of state to recognize SMCs owing to, but not limited to, the “concession theory”. The question is, therefore, is it plausible to apply traditional corporate theories to influence the existing legal doctrines as stepping-stone to the legitimization of SMCs? As noted before, the theorization that underpins the origin of corporations in general also helps in explaining the origin of SMCs on similar logical equivalence. The major task here is, therefore, to closely examine these traditional corporate theories and see to it whether it fits the fixture of single member corporate entity without conceptual difficulties.

3.3.1. Contract Theory on the Origin of SMCs?

As indicated before, on the origin of corporations, the contract theory contends that the existence of corporate entity would be determined by the agreements of the shareholders.¹⁰⁹ However, some argue that the idea that a company is a contract foundation, or that it is principally based on contract to the exclusion of other legal mechanisms, is not easy to defend.¹¹⁰ Some of the weaknesses of the contract theory relates to the impossibility of creating legal personality under any legal jurisdiction by contract alone, without legislative intervention.¹¹¹ As such, company law consists of a regulation by the state, and is therefore not totally left to the private contractual scheme in any true meaning of the term. Thus, the role of the state in the formation of companies as a legal entities and that there are legal rules governing them is a difficult task to deny.

A further “nail in the coffin,” as the saying goes, about the contractual theory is the use of contract as an essence of company in large multi-member public companies. In the normal conceptions of contract, argued Foster, it is very difficult to succumb that members of multi-member public companies, most of whom will never be in any sort of contact with each other, are in real contractual terms.¹¹² According to Foster, the problem of contract theory is largely felt in the case of SMCs that come into being due to the legislative recognition of the state but not through the instrumentality of contract, which at least considers two persons. The later approach gave birth to the “institutional theory” for

¹⁰⁹ *Id.*, for more in-depth discussion see also N. Butler Henry, *The Contractual Theory of the Corporation*, 11 *George Mason University Law Review* 99-123 n. 4 (1989).

¹¹⁰ Nicholas H. D. Foster, *Company Law Theory in Comparative Perspective: England and France*, 48 *the American Journal of Comparative Law* 586 n. 4 (2000).

¹¹¹ *Id.*

¹¹² *Id.*

the origin of SMCs. According to the institutional theory, a company, as a functional legal entity, can be instituted in the situations provided for by legislation, by unilateral acts of a single person.¹¹³

However, the enterprise theory was developed in order to strike balance between these two seemingly different theories yet pursuing similar purposes – both justify the origin of an incorporated business entity through unilateral acts.¹¹⁴ According to the enterprise theory, the functional definition of company as associations of persons or institution of a single person does not in any way anticipate the nature of legal organization of the enterprise.¹¹⁵ Basically, an enterprise could be viewed as an economic activity concerned with the production and distribution of goods and services, and a focus of interests of the shareholders, managers, creditors and other stakeholders.¹¹⁶ In this context, company is not necessarily a fusion of individuals with more than one partner, rather an operational organization that manufactures and supplies goods and services.¹¹⁷ Though legislation or contract, as the case may be, determines the nature of the organization and its authors, the enterprise theory emphasizes on the importance of the object of legal organization.¹¹⁸ Hence, while company as a legal entity according to enterprise theory, facilitates the economic activities noted above, company law balances out the different interests and then enforces that balance.¹¹⁹

Whether one regards the above attempts as a more organized and coherent analysis, or as an artificial forcing of concepts into a straitjacket, the idea that the volition of a single person to operate business in the form of company separate from the personal identity of a person who constitutes it should at least be clear.

3.3.2. Concession Theory on the Origin of SMCs

The other competing theory of corporations that has been long considered as an obstacle to the recognition of SMCs is the concession theory. As indicated above, concession theory

¹¹³ See French Civil Code, Art. 1832 as amended to provide for one-member companies in which a *société* that was previously instituted by two or several persons based on contract “*can be instituted, in the situations provided for by statute, by the act of will of a single person.*” See Foster, *supra* note 107, at 597 for further explanation.

¹¹⁴ Foster, *supra* note 110, at 600-601.

¹¹⁵ *Id.*, at 601.

¹¹⁶ *Id.*

¹¹⁷ *New Turkish Commercial Code: A Blueprint for the Future*, Pricewaterhouse Coopers (PwC), 11 (April 10, 2012). https://www.pwc.com.tr/en_TR/TR/publications/ttk-assets/pages/ttk-a_blueprint_for_the_future.pdf.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

contends that corporation may come into being depending on the willingness of the state. Although state as an author of corporations is considered as a historical relic, the concession view of the corporation continues to influence corporate law.¹²⁰ As indicated before, part of the reason emanates from the normative aspects of corporate law theory as a reflection of economic, social and political dynamics of existing situations that dictate states to examine what sort of company law they have, and what sort of company law they ought to have in the future. Thus, by enacting new rules or through the interpretations of the existing legal doctrines states may influence the traditional corporate theory and hence create a favorable legal ground for the introduction of SMCs.

Therefore, according to concession theory, the coming into existence of a company owned by a single person is determined by concession of the state legislature which then is equally entrusted with the power of regulating company by devising appropriate legal and institutional infrastructures. Hence, states, according to the concession theory, are equipped with the legislative power to shape and reshape the existing legal doctrines of corporations so as to adapt it to the specificities of a company owned by a single investor. By so doing, states through their inherent legislative power could fashion the future directions of their corporate legal system based on social, economic and political realities of the time. Thus, there is no inherent problem in the very tenets of concession theory, if states desire to reformulate existing legal doctrines to accommodate SMCs.

3.3.3. The Theories of Legal Personality for SMCs

The theories of legal personality are classically expressed in terms of the “colossal quarrel” between the realist theory and the fiction theory of corporate law.¹²¹ The realist theory saw legal personality as intimately associated with an organization as a way of granting the protection and benefit of legal rights, and hence should only be granted to organizations formed on contract basis.¹²² The central tenets of legal personality, therefore, rest on the idea that a company, as a creation of contract, can sue and be sued in its own corporate name.

On the other hand, the fiction theory of legal personality denies the existence of the link between organizational form and the benefits of legal rights and maintained that legal

¹²⁰ Ribstein, *supra* note 105, at 86.

¹²¹ Foster, *supra* note 110, at 602.

¹²² James Nicholas, *Separate Legal Personality: Legal Reality and Metaphor*, 5 Bond Law Review 218 n.2 (1993), at foot note 5.

personality is a mere fiction granted by the concession of a legislator.¹²³ Hence, this theory is not concerned with the minimum membership requirement of persons that constitutes the organization, but on the tenet of separate legal treatment between the organization and its members.

From the above discussion, the concept of legal personality in the context of SMCs derives its force of theoretical validity from the fiction theory of corporations. Thus, there is no inherent conceptual problem if we apply the conception of separation of legal personality in the context of SMCs as long as its importance relates to separate legal identity of the company and its shareholder. This shows that with the introduction of SMCs in most jurisdictions, the realist theory has already casted considerable doubts while the fiction theory became more prominent in the corporate landscape.

3.3.4. The Theory of Limited Liability for SMCs

The term limited liability refers to the ability of a shareholder in a company to risk only assets or capital that such individual invests in the corporate entity.¹²⁴ In simple terms, a shareholder in a limited liability company is not liable for the debts and obligations of the company and vice versa except in case provided by the law. As noted above, the notion of limited liability flows directly from the concept of separate legal personality.¹²⁵ The genesis of limited liability doctrine in the context of *de facto* SMC traces its roots to the famous English case, “*Salomon v. Salomon & Co*” of 1892.¹²⁶ In this case, Salomon decided to incorporate limited liability company to carry out his business by using six members of his own family including himself.¹²⁷ In order to fulfill the seven member legal formality under the English Limited Liability Act of 1855, Salomon designed a scheme in which he successfully used his wife, his daughter and four of his sons to sign the memorandum of association, each with a subscribed share.¹²⁸ The subscribers meeting appointed Salomon and his elder sons as the directors of the company. Salomon then sold his previous leather and boot manufacturer to a company he formed, in return for fully paid-up shares in it,

¹²³ *Id.* sees also W. Machen, *Corporate Personality*, 24 Harvard Law Review 265 n. 4 (1911).

¹²⁴ Vandervoort, *supra* note 75

¹²⁵ David Milman, *National Corporate Law in A Globalised Market: The UK Experience in Perspective* 66 (Edward Elgar Publishing Limited, 2009).

¹²⁶ The concept of limited liability was first adopted in the United State of America in the early 19th century then in English law in 1855 via the Limited Liability Act. *Id.*

¹²⁷ Charles Wild and Stuart Weinstein, *Smith and Keenan’s Company Law* 4 (Pearson Education Limited, 2009).

¹²⁸ *Id.* Of course there is no problem in carrying business activity with members of once own family. But this is not what the law is meant for – designed to mobilize capital from different sources not from single sources as the one in Salomon case.

allotted to him and members of his family. He also received an acknowledgement of the company's indebtedness to him, in the form of secured debentures that were later mortgaged to third party outsider. As such, Salomon was entitled to be paid before the unsecured creditors as the debentures were secured by a charge on the company's assets ranked in priority to the creditors.¹²⁹

Nevertheless, a year after its formation, the company went into liquidation at the behest of unpaid trade creditors. Though the assets of the company were sufficient to pay off the Salomon's debentures, the creditors, however, would remain unpaid. The unsecured creditors claimed all the remaining assets on the ground that the company was a mere agent for Salomon. Contrary to the claims of the unsecured creditors, the then English Court stated that,

“the company is at law a different person altogether from the subscribers to the memorandum; and though it may be that after incorporation the business is precisely the same as was before, and the same persons are managers, and the same hands receive the profits, *the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.*”¹³⁰ (Emphasis added).

Therefore, the Salomon case ever since popularized separate personality and limited liability as the twin principles of corporation that go hand in hand with limited company as an engine of business. The crystallization of “*Salomon principle*” shortly after the British industrial revolution contributed to the pace of commerce and capitalism by encouraging individuals to provide money for businesses without fear of liability if the company became insolvent.¹³¹ It is also widely regarded as a device that encourages entrepreneurship and makes a major contribution to the law of business organization.¹³² This impetus further increased the country's economic prosperity, as more people were willing to take risks with their money within the safety buffer of limited liability.

However, the Salomon principle, in the context of limited liability companies has brought about concerns with further ramifications on the rights of unsecured creditors

¹²⁹ *Id.*, see also Pettet, *supra* note 41.

¹³⁰ *Id.*

¹³¹ Steven C. Bahls, *Application of Corporate Common Law Doctrines to Limited Liability Companies*, 55 Montana Law Review 56 (1994).

¹³² Freedman and Godwin, *supra* note 9, at 1

who were unaware as to the risks of dealing with companies such as the one that the Salomon case had already portrayed.¹³³ The idea here is that unless a precaution is made, limited liability could be used as a “*sword rather than a shield*” which could be more fishy in company owned by a single shareholder.¹³⁴ Thence, to address the concerns posed by the concept of limited liability, different theoretical approaches have been widely discerned in the mainstream corporate law literature.

Generally, there are debates as to whether limited liability is a privilege conferred by the state, and hence should be regulated or whether it can be regarded as a term of the contract among the shareholders and creditors as an exercise of freedom of contract.¹³⁵ The chorus of scholars in the former case, contend that limited liability should be granted by concession of the state.¹³⁶ Accordingly, an act of incorporating limited liability business provided within the scheme of legal rules suffice for states to regulate limited liability for which piercing the corporate veil is justified as a protection of creditors rights.¹³⁷ On the other hand, the latter approach contends that legal rules providing for limited liability is irrelevant because the parties can contract for limited liability and hence rejects the conception of limited liability as state conferred privilege. The contractual approach to limited liability can be regarded as a term of the contract among shareholders and creditors which, as some argue, is a wealth maximizing for both creditors and owners. Accordingly, if the theorization of contractual approach to limited liability is to be accepted, its significance to sole proprietorship business is threefold.

First, in jurisdictions that are reluctant to recognize SMCs, the freedom to limit personal liability by the sole proprietor can be considered as a private sanctuary for sole proprietors. Second, transaction costs accompanying the incorporation of SMCs for want of state-conferred privilege of limited liability will be reduced in as much the same way as filing for sole proprietorships yet with the advantages of an incorporated business entity. Third, the contractual approach avoids problem of state-conferred limited liability that was more felt in the case of SMCs. It is argued that state-imposed limited liability is considered unfair to creditors since it creates moral hazards that result in the reckless behaviour of the

¹³³ It is argued that unless a mechanism to protect from the abuse of limited liability is designed creditors would not extend credit to a limited company without reference to its stated business objects and so to allow companies to engage in commerce beyond those parameters would threaten creditors. See Milman, *supra* note 125, at 46.

¹³⁴ Edwards, *supra* note 76, at 212.

¹³⁵ Ribstein, *supra* note 105, at 82.

¹³⁶ *Id.*

¹³⁷ *Id.*

sole entrepreneur that runs the company.¹³⁸ Eventually, the idea that limited liability should be positively encouraged for firms previously run as sole proprietorships has been widely accepted in the literature. However, it is also widely cautioned that this positive conceptual underpinning should not be understood as sending out an unfortunate message to business owners in a way to undermine the importance of personal responsibility for business actions.¹³⁹

3.3.5. Piercing the Corporate Veil of SMCs

As noted above, the principle of corporate veil piercing generally emanates from the contention that the privilege of limited liability conferred on the company is unfair to creditors and other stakeholders.¹⁴⁰ In other words, it is alleged that limited liability creates moral hazard or reckless behaviour on the part of the shareholders in which rigid adherence to it will sometimes lead to unjust outcomes unless veil-piercing mechanism is employed.¹⁴¹ Hence, corporate veil-piercing principle underscores the “*limits to the limited liability*” though justifications for its application vary from country to country.¹⁴² In the USA, for instance, limited liability of a corporation could be pierced on the grounds such as “failure to observe formalities, inadequate financing, commingling of assets and fraud of creditors or other third parties”.¹⁴³ In addition, grounds such as “achieving justice” or “equity,” are also used to justify the judicial power of courts to pierce the corporate veil.¹⁴⁴ In England, lifting corporate veil is prohibited except in case where only special

¹³⁸ For more detailed discussion, see Freedman, *supra* note 10, at 329. Conferring limited liability to Single Member Company was criticized on the ground of absence of separation of ownership and control. See also Wells, *supra* note 66.

¹³⁹ Paddy Ireland, *Limited Liability, Shareholder rights and the Problem of Corporate Irresponsibility*, 34 Cambridge Journal of Economics 837-856 (2010). This paper argues for the illumination of limited liability as “the corporate legal form was, and is, in large part a political construct developed to accommodate and protect the *rentier* investor – a construct which institutionalizes irresponsibility.” Mitchell also argued that *Irresponsibility* was now firmly built into the corporate legal form that the no-obligation, no-responsibility, no-liability nature of corporate shares permits their owners – or their institutional representatives - to enjoy income rights without needing to worry about how their dividends are generated. They are not legally responsible for corporate malfeasance and in the event of failure only their initial investments are at risk. See generally L. E Mitchell, *Corporate Irresponsibility: America’s Newest Export* (Yale University Press, 2001).

¹⁴⁰ For more theoretical discussions, see James A. Brander and Barbara J. Spencer, *Moral Hazard and Limited Liability: Implications for the Theory of the Firm*, 30 International Economic Review 833-834 n. 4 (1989).

¹⁴¹ Vandervoort, *supra* note 75, at 57.

¹⁴² For more comparative approaches see Sandra K Miller, *Piercing the Corporate Veil among Affiliated Companies in the European Community and in the US: A Comparative Piercing Approaches Analysis of U.S., German, and U.K. Veil-piercing Approaches*, 36 American Business Law Journal (1998). See also Thomas K. Cheng, *The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines*, 34 International & Comparative Law Review 329 (2011).

¹⁴³ Jeffrey F. Beatty and Susan S. Samuelson, Introduction to Business Law 348 (South-Western Cengage Learning, 3rd, 2010). For more specific discussion see Frank H. Easterbrook and Daniel R. Fischel, *Limited Liability and the Corporation*, 52 The University of Chicago Law Review 109 n. 1 (1985).

¹⁴⁴ Pettet, *supra* note 41, at 25.

circumstances exist indicating that it is a “*mere façade concealing the true facts*”.¹⁴⁵ According to the “mere façade test,” a court is prohibited to pierce the corporate veil unless it discovered that the shareholder is operating interposed as shams or for some ulterior motive, or with impropriety that is prejudicial to the interest of third party or creditors.¹⁴⁶ Unlike the practices in USA, the idea that a court is free to corporate veil-piercing merely because justice so requires was firmly rejected in England thereby upholding the *Salomon* principle.

As indicated above, it is clear that the *Solomon* case represents a classical example of *de facto* SMCs in the history of corporations in which family members were used to comply with the legal minimum membership requirements to establish a limited liability company. As such, corporate veil-piercing principle could be easily applicable to *de jure* SMCs without conceptual difficulty. Yet, the arguments that SMCs are exceptionally risk for creditors has affected the propensity of corporate piercing in the context of SMCs.¹⁴⁷ The crux of the argument lies in the nature of SMCs. The first argument relates to “unity of ownership and control” in SMCs.¹⁴⁸ According to this argument, corporate veil-piercing in the context of SMCs are frequent because the sole shareholder would often be the sole managing director of the company giving rise to the unity of ownership and management rights. It is contended that such state of affairs in turn creates the tendency to commingle personal and company assets which may jeopardize the rights of creditors. The Second arguments relates to the absence of internal check and balance within SMCs. Unlike multimember companies, SMCs are not required by law to put up within it the structure of three governing bodies – the shareholders meeting, the board of directors and the board of supervisors.¹⁴⁹ While such exemption aims to increase the efficiency of SMCs implying its genome of sole proprietorship, it at the same time opens the door for opportunism which would make the occurrence of corporate veil-piercing more likely.

Though the jurisprudence of corporate piercing in the USA generally varies from court to court, it however, has long reflected the skepticism about the SMCs. For instance, the Maryland court argued that, “this court does not think the law contemplates that one may

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ Maizes Rachel, *Limited Liability Companies: A Critique*, 70 St. John's Law Review 575-608, 593 n. 3 (1996).

¹⁴⁸ *Id.*, at 575.

¹⁴⁹ As seen before, one-person companies lack the mutual checks among shareholders as in ordinary multi-shareholder companies. It is presumed that the shareholders of a company, out of the motive of protecting their own interest, would keep an eye on each other so that none can use the company to serve his or her self-interest. Such mutual checks unfortunately cannot always take place in SMCs.

incorporate an established business of his own, continue to own and control it as before, and at the same time, for his personal benefit, put beyond the reach of prospective creditors all the assets of the corporation.”¹⁵⁰ It is based on such view that some argue that the court should not permit a SMCs to play hide-and-seek by assuming the dual role of human being, on the one hand, and that of corporation, on the other.¹⁵¹

Research findings on the propensity of corporate veil-piercing in the context of SMCs vary from time to time. The study conducted by Professor Thompson in the context of USA revealed that the number of shareholders makes a difference in the propensity of courts to pierce the veil of corporations.¹⁵² Accordingly, those with only one shareholder were veil-pierced in almost 50 percent of the cases but for two or three shareholder corporations, the percentage dropped to just over 46 percent, and for corporations with more than three shareholders, the percentage dropped to about 35 percent. On the other hand, another empirical study published more recently, has rebutted a correlation between an increase in the number of shareholders and decrease in piercing and whether the number of shareholders made a difference in the courts likelihood of veil piercing. According to this study, while the piercing rate of corporations with one shareholder is 40 percent, the percentage for corporations with two or three shareholders rose to 49 percent.¹⁵³

In a nutshell, the *Salomon* case has already established a cardinal principle that though the business of a company may after incorporation be precisely the same as was before, and the same persons are managers, and the same hands receive the profits, the shareholder as a member is not liable “in any shape or form” so long as no fraud is committed upon creditors.¹⁵⁴ It seems that courts in the USA find it erroneous to assume that judicial action will be limited to the general rules of preventing wrong, protecting fraud, and the defeat of public convenience to justify corporate veil piercing. In addition, there is a marked tendency to disregard corporate legal personality in those cases where adherence to the concept of corporateness will result in inequity or will prevent a full settlement of the dispute between the real parties in interest in a given situation.¹⁵⁵ Unlike England’s

¹⁵⁰ Cataldo, *supra* note 20, at 480.

¹⁵¹ *Id.*, at 481.

¹⁵² Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 Cornell Law Review 1054-1055 (1991). See also Charles W Murdock, *Limited Liability Companies in the Decade of the 1990s: Legislative and Case Law Developments and Their Implications for the Future*, 56 Business Lawyer 509 (2001).

¹⁵³ See Lee C. Hodge and Andrews B. Sachs, *Piercing the Mist: Bringing the Thompson Study into the 1990s*, 43 Wake Forest Law Review 52 (2008).

¹⁵⁴ See Charles Mitchell, *Lifting the Corporate Veil in the English Courts: An Empirical Study*, 3 Company, Financial And Insolvency Law Review 21-22 n. 15 (1999).

¹⁵⁵ Cataldo, *supra* note 20, at 380-81.

approach of limiting judicial action on corporate veil piercing based on well-recognized rules, courts in the USA may move freely in deciding a case on the merits.¹⁵⁶ Hence, as indicated before, the latter approach of single member corporate veil piercing is radically at odds with the whole concept of corporate personality and limited liability cemented in the decision of the Salomon case.

Therefore, the doctrine of piercing the corporate veil of SMCs should be carefully weighed in terms of its potential repercussions. As indicated above, sole shareholder of a limited liability company represents and constitutes an incorporated venture, on one side, and an individual, on the other side. In as much as the complete dominion and superior knowledge of the sole shareholder provides an array of potentials for the company, it also carries opportunities for manipulation and maneuvering. Accordingly, the doctrine of corporate veil-piercing in the context of SMCs is very likely unless two basic requirements are fulfilled.

First, SMCs must operate the business on a corporate footing and thereby maintain and preserve the separate identity of the venture.¹⁵⁷ This condition, among other things, requires carrying the business in the name and on behalf of the company but not as if it were the individual business of the sole shareholder; avoiding the making of contracts for the business in his own name; avoiding keeping of individual bank account without separate accounting of individual funds and incomes acquired from the company business; avoiding the withdrawal of money from the company business for personal needs are few precautions to mention.¹⁵⁸ In the absence of these precautionary measures, single shareholder of a company limited by liability should not be allowed to benefit from limited liability in case of subsequent insolvency of the business. The logic behind this rule is that a single shareholder of a company limited by liability should stand where he/she placed him/her self since he/she failed to draw a red line between the individual and the corporate affairs that would have been expected in the normal course of things. Likewise, under such circumstances the sole shareholder will be personally liable for obligations incurred in the execution of the business.

Second, SMCs must establish their business enterprises on an adequate financial basis.¹⁵⁹ As indicated in chapter two, one basic reason in support of incorporating SMCs is that it is not fashionable to force individual investors to associate themselves with persons

¹⁵⁶ Vandervoort, *supra* note 75.

¹⁵⁷ Fuller, *supra* note 4, at 1381.

¹⁵⁸ *Id.*, See also Cataldo, *supra* note 20, at 482-483.

¹⁵⁹ Cataldo, *supra* note 20, at 483.

as long as he/she is capable of fulfilling the minimum capital requirement set by the law. In other words, as the price for the privilege of corporate personality and limited liability, it is proper to require a sole shareholder to finance his company in such a way as to enable it to meet the normal and expected strains of a business of the size and character involved.¹⁶⁰ On the contrary, failure to honor this standard which justifies the very existence of SMCs could be an indication of a “device and sham, a mask, which the single shareholder holds before his face in an attempt to avoid personal liability for any sums advanced as loans to the company under the guise of limited liability.”¹⁶¹ In such case, lifting corporate veil is justified in order to impose upon him personal liability for obligations incurred in the operation of the business and will preclude his sharing as a creditor for sums advanced as loans to the business.

3.3.6. The Theory of Single Member “Corporate Governance”

The modern concept of “corporate governance” can be roughly understood as systems or structures through which the objectives of a company are set and the means of attaining those objectives and monitoring performance are determined.¹⁶² It is widely argued that a company is a collection of assets which have arisen from capital contributions of the shareholders and retained profits arising from the trading activities of the company and from inputs made by creditors.¹⁶³ In this context, corporate governance answers the question such as what system is there to ensure that the providers of capital get expected return on their investment. So much so that, corporate governance involves a set of relationships between a company’s management, its board of directors, its shareholders and other stakeholders such as creditors.¹⁶⁴

On the other hand, in classical economics, a firm is regarded as a production function and personified by an “owner-manager-entrepreneur” that directs the production.¹⁶⁵ Hence, the existence of owner-manager-entrepreneur is a precursor to SMCs and therefore predates the conception of firm as a contract between owners. Despite such conceptual underpinnings, SMCs are viewed as not possessing the managerial agencies – stockholders, directors, or officers – contemplated by the conception of corporate governance indicated

¹⁶⁰ *Id.*, at 492.

¹⁶¹ *Id.*

¹⁶² OECD Principles of Corporate Governance 11 (2004).

¹⁶³ *Id.*

¹⁶⁴ *Id.* In this paper, the term “corporate governance” will be used interchangeably with the term “corporate management.”

¹⁶⁵ Mantysaari, *supra* note 93, at 9.

above.¹⁶⁶ SMCs, wherever they exist, are viewed as dormant or inactive corporations that exist only for the purpose of holding legal title of the property for the use and benefit of the single shareholders who become seized of the beneficial title to the property. Hence, according to this conception, SMCs can no longer act as corporations since their decisions are the decisions of the single shareholders, and their actions are the actions of the single shareholders.¹⁶⁷

The idea that view a SMC as “inactive corporation” incapable of processing the structures of corporate governance emanated from the view that corporation is a legally personified body of numerous shareholders based on which corporate governance has been pictured. Implicit in the existence of numerous shareholders is the view that members of the management and board of directors are appointed from among such shareholders who pass decisions or act on behalf of the corporation after series of meetings unlike the case of SMCs, whose decision and action is supposed to be the decisions and actions of the single shareholders. However, the idea that a SMC is devoid of a structure that put up corporate governance resonated from the failure to appreciate the exceptionality of a company solo incorporated.

In the modern corporate governance theory, unlike the traditional way of looking at the advantages of numerous partners for want of managerial skills, technological innovations and the availability of top notch managers has already made it possible to hire skilled human resource in order to efficiently run the business of SMCs. Hence, it is not difficult to structure the “managerial agencies” of SMCs through the appointment of non-member directors and hiring necessary managers or officers from the labour market as was done in multimember corporate management. As such, the argument that propels SMC is devoid of corporate governance structure simply because of the “managerial agencies” that constitute it should be appointed from among members of shareholders as a precondition for the effectiveness of corporate governance becomes futile and unrealistic.

On the other hand, the very tenets of corporate governance as indicated before depend, largely, on attaining business objectives of the company capable of ensuring the interests of investors and other stakeholders. Hence, as far as the primary purpose of corporate governance is directly or in directly related to the performance of its system to accomplish the business objectives of the company, the fact that a single member shareholder or multimember shareholders constitute a company bears no magic. Likewise,

¹⁶⁶ Latty, *supra* note 3, at 476.

¹⁶⁷ *Id.*

in modern corporate world, viewing company as an accumulation of assets that have arisen from capital contribution, retained profits arising from the trading activities of the company and from inputs made by creditors of the company is more important irrespective of the number of individuals holding the shares.

In a nutshell, the nature of SMCs in which management being vested with increased powers of control in the hands of owner-manager, simply depicts the importance of SMCs as a sole proprietor like feature who runs his own business with greater flexibility. This situation further unfolds the hybrid nature of SMCs making it a more attractive legal vehicle compared to the complex nature of corporate governance of multimember companies.

3.3.7. The Theory of Single Member Corporate Taxation

Another important corporate theorization relevant to address concerns of SMCs is taxation issues. One reason why incorporating a limited liability company has been a favoured form of business organization is its advantages as an important vehicle for tax planning.¹⁶⁸ However, the vital issue is whether the principle of limited liability and separate personality should also be applied to recognize the single shareholder and the corporation as distinct legal persons for taxation purposes. Theoretically, two solutions can be forwarded. The first solution is a “*tour de force*,” cutting the “Gordian knot,” by declaring that a separate legal personality of SMCs simply does not exist for taxation purposes.¹⁶⁹ The second solution which is based on the premise of separate personality is declaring that each is subject to taxation separately.¹⁷⁰

The first approach follows that SMCs would be considered as a “disregarded entity” and the owner is taxed in the same manner as a sole proprietor.¹⁷¹ For instance, in case of employment tax, the owner of the SMC, and not the entity itself, is treated as the employer and hence liable for employment tax. It should be noted, however, that though employees are actually employed by the SMCs for non-tax purposes, the tax liability of the entity is

¹⁶⁸ James S. Hausmau, *The “One-Man Company”: Some Principles of Taxation*, 13 McGill Law Journal 265(1967).

¹⁶⁹ S. Kleinberger and G. Bishop, *The Single-Member Limited Liability Company as Disregarded Entity*, (2010). <http://apps.americanbar.org/buslaw/blt/content/articles/2010/08/0002.shtml>.

¹⁷⁰ *Id.* See also Armando Gomez, *Rationalizing the Taxation of Business Entities*, 49 The Tax Lawyer 296 n. 2 (1996).

¹⁷¹ Schneeman, *supra* note 55, at 203. See also Mary Fitzsimons, *Have Disparities in State Tax Treatment of Single Member Limited Liability Companies Created a Tax Overlap for Interstate Businesses?* 3 Entrepreneurial Business Law Journal 22 (2008).

disregarded in favour of the sole shareholder.¹⁷² In simple terms, there is no limited liability for taxation purposes and hence sole member is automatically liable for the separate employment tax debts. Likewise, the income earned by SMCs flows through to the single owner of the company and is added to his personal income and taxed once at the income tax rate of the individual owner.¹⁷³ However, the issue is whether it becomes theoretically appropriate to directly levy on the assets of SMCs to satisfy the separate tax debt of the sole member. As indicated above, SMCs alone are responsible for the debts, obligations, and other liabilities of the company. Conversely, a SMC is not responsible for the separate debts, obligations, and liabilities of a sole member by the mere status of a member as the sole shareholder of the company. However, when the personal asset of a single member could not directly satisfy the separate tax debt, it is reasonable to levy on the assets of SMC in the same vein as corporate veil is pierced to satisfy the debts of the company from the personal assets of the single member.¹⁷⁴

The second approach simply considers the personality of SMCs as separate from the sole owner, and hence tax liability of the two distinct personalities could be accounted separately. According to this approach, corporate income of SMCs may be subject to double taxation—once at the corporate level when the corporation receives the income, and second at the shareholder level when dividends are received.¹⁷⁵ However, in order to avoid such double taxation, SMCs may disregard corporate entity by merely using the corporation as “agent” or a “sham”, or “alter ego”.¹⁷⁶ For instance, in the Canadian “Gramophone case”, the court opined that a corporate personality will be disregarded if a person, in a position of owning all the shares of the company, causes such an arrangement to be entered into between himself and the company as will suffice to constitute the company his agent for the purpose of carrying on the business.¹⁷⁷ The court further reiterated that the business of the company in such case would become, for all taxing

¹⁷² *Id.*, at Fitzsimons.

¹⁷³ Pomy Ketema, *Did the Federal Check-the-Box Regulations Open Up a State Tax Pandora's Box? A Reflection on State Conformity to the New Federal Classification Scheme of Single-Member LLCs*, 82 *Minneapolis Law Review* 1659-60 (1998).

¹⁷⁴ Here, if the single member knows that the company is not liable for his own separate tax debt, fraudulent tax avoidance may probably occur.

¹⁷⁵ Schneeman, *supra* note 55. For more discussions see also Ingrid L. Lenhardt, *The Corporate and Tax Advantages of a Limited Liability Company: A German Perspective*, 64 *University of Cincinnati Law Review* (1996).

¹⁷⁶ D. S. Kleinberger and C. G. Bishop, *The Single Member Limited Liability Company as Disregarded Entity: Now You See it, Now You Don't*, (2010). <http://ssrn.com/abstract=1559401>

¹⁷⁷ Schneeman, *supra* note 55.

purposes, the business of the single member though whether this consequence follows in each case is a matter of fact left for the court to be determined.¹⁷⁸

The issue is, however, if the test of “agent” is applied to ignore corporate entity, it is difficult to see how there could not be a finding in every case of SMCs that the company is merely acting as agent for its shareholder. Obviously, the solution is still to apply the principles of corporate piecing when the affairs of the single member and those of the corporation is not expressly separated or confused or intertwined in such a way that it is not clear for the third parties whether it is the corporation or the single shareholder that is carrying on the business. In simple terms, if the single shareholder disregards the corporate entity, he cannot expect outsiders to be bound by the separation of shareholder and corporation.¹⁷⁹

¹⁷⁸ *Id.*

¹⁷⁹ Daniel S. Goldberg, *The Tax Treatment of Limited Liability Companies: Law in Search of Policy*, 50 the Business Lawyer 1005(1995).

Chapter Four

4. Major Legal Frameworks for SMCs in Comparative Jurisdictions

4.1. Introduction

The competition for foreign capital has led to an urgent need to have an attractive company law among different countries. Particularly, reforming company law is becoming fashionable and receiving considerable attention from the point of view of allowing domestic companies to function in a more flexible, effective and dynamic commercial world. One of the new international trends that require states to reform their company law is the need to introduce or recognize SMCs into their existing corporate legal system. In this situation, an enactment of cogent legal principle is not only a demanding task but also a necessary footstep in order to effectively deal with the issues arising from the conceptions of SMC. Thus, given the international imperatives, which have also resulted in an increased awareness of other legal systems, and a much greater potential for the borrowing of ideas, the search for these principles can no longer be restricted to one's own jurisdiction.¹⁸⁰

Based on the above prelude, major legal issues concerning SMCs of selected comparative jurisdictions would be analyzed as an important part of this thesis. More specifically, it is vital to indicate how SMCs generally operate and how they are regulated in these selected countries in order to learn from their experience for the benefit of the future SMC law of Ethiopia. In order to undertake these tasks, there are some points that should be clear from the outset. The first point is that the selections of countries for comparative analysis are based on three basic merits. Accordingly, the justification for the selection of French, Germany, and England's legal regimes is based on the corresponding similarity of their company law structure with that of Ethiopian company law.¹⁸¹ As such, examining how Civil and Common Law jurisdictions regulate SMCs is important to draw a lesson from their experiences for the benefit of Ethiopia. The justification for selection of China is because this socialist civilian country has succeeded in bringing about economic development by attracting foreign capital by reforming its company legislation, which

¹⁸⁰ Foster, *supra* note 110, at 575.

¹⁸¹ Commercial Law Reform and Trade Diagnostic, *supra* note 15, at 18-19: "Ethiopian Share Company roughly corresponds to French SA, a German AG or English Public Limited Company. Likewise, Private Limited Company roughly corresponds to a French SARL, a German GmbH, an English Private Limited Company, or a United States Limited Liability Company."

Ethiopia has recently been imitating. Finally, legal principles adopted both by the OHADA and European Union will be compared to draw lessons from their “minimum legal standards” designed to regulate SMCs that would benefit Ethiopian lawmaker as a legislative guidance for introducing SMCs.

The second point is that the discussion will be restricted to the analysis of comparative regimes particularly designed to pinpoint legal remedies available to redress major concerns associated with the SMCs. Finally, it should be noted that these issues will be dealt with thematically so that the respective treatments of SMCs in each country are discussed side-by-side in order to avoid, as far as possible, the “country-report” style, whereby the systems are presented largely separately from each other.

4.2. Formation of SMCs

The conception that a single person may incorporate a company has been recognized in comparative jurisdictions under consideration.¹⁸² The statutory recognition of SMCs has led to the abolishment of the rule that an existing multimember company should be dissolved where the number of shareholders is reduced to one person because its shares have come to be held by sole shareholder. This section tries to investigate rules governing form, founder, minimum capital, and publicity requirements for the formation of SMCs.

4.2.1. Form of SMCs

In most jurisdictions, a business may be incorporated either as a private or public limited companies. Though there are slight differences across jurisdictions, there are also common features that could be pinpointed to differentiate between the two forms. Features such as minimum membership and capital requirements, corporate governance structures, capacity to trade shares, and the economic size of the company forms are some differentiating

¹⁸² UK Companies Act, Sec. 7(1) (2006); German Private limited Companies Act (*Gesetz betreffend die Gesellschaft mit beschränkter Haftung, GmbHG*) Sec. 1 (1892), last amended by *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen, MoMiG – Law for the modernization of Limited Liability Companies Act and for combating abuses of November of 2008*) [hereinafter German Private Limited Companies Act] and German Stock Corporation Act (*Aktiengesellschaft, AktG*) Sec. 2 (1965), last amended by article six of the German Restructuring Act 2010) [hereinafter German Stock Corporation Act]; French Commercial Code, Art. L.223 (updated as of 2006); The European Economic Community Directive on Single-Member Companies, Directive 2009/102/EC, Art. 2 (2009) [hereinafter Directive 2009/102/EC]; Companies Law of the People’s Republic of China, Art. 58 (2006) [hereinafter Companies Law of China]; OHADA Uniform Act on Commercial Companies and Interest Groups, Art. 5 and 385 (1995) [hereinafter OHADA Uniform Act].

features to mention.¹⁸³ Accordingly, private companies in many countries are primarily designed for small and medium sized businesses with minimum number of at least two members, lesser capital requirements, flexible management structure and without the power to offer shares to the public. Conversely, public companies are designed for large-scale businesses, complex corporate structure and higher capital requirements and at least five to seven numbers of members for their incorporation. Thus, the legal recognition whether one person would incorporate either of the two companies or both forms consequently affects the features of SMCs in terms of the above differences.

Under French corporate law, a single person may incorporate *Entreprise unipersonnelle à responsabilité limitée* (EURL).¹⁸⁴ This form of “One-Person Company” is a type of private limited companies, (*Société à responsabilité limitée*, SARL), formed by single shareholder which operates like SARL. Therefore, a EURL, like SARL, is not permitted to offer shares to the public and is designed for small to medium-sized businesses. On the other hand, public limited companies, (*Société anonyme*, SA), which is suitable for big companies who want to raise capital through the sale of shares to the public can only be incorporated by seven persons.¹⁸⁵ Therefore, in France, a single person is not permitted to establish SA.

The justification for denying single founder to form public limited company in France primarily rests on the French tradition of keeping the two forms of companies apart. It is argued that France, as a chief architect of the civil law legal system, is not interested in introducing single member SA despite the harmonization efforts of European company laws.¹⁸⁶ Two reasons are identified for such lack of interests for single member public companies in France. Firstly, the French legislature seems to have a very rigorous position on the formality requirements of public limited companies when compared to, for example, its German counterpart.¹⁸⁷ Secondly, under the French corporate system, special emphasis is given to public limited companies rather than PLCs given the high stake of

¹⁸³ Pettet, *supra* note 41, at 15.

¹⁸⁴ See the French Civil Code, Art 1832 (amended July 1985). For more discussions, see also *Concepts of French Law Relating to Commercial Companies*, Lex Fori International Lawyers (2001). http://www.leffori.net/concepts_of_french_law_relatng_.htm.

¹⁸⁵ French Commercial Code, *supra* note 182, at Art. L-225-1.

¹⁸⁶ Assamen, *supra* note 28, at 20.

¹⁸⁷ For instance, the minimum capital requirements to incorporate stock Corporation in France is more than double compared to that of Germany. See German Stock Corporations Act, Sec. 7: it is 50,000 Euro and that of France see French Commercial Code, Art. L-224-2: it must be at least 225, 000 Euro if the company offers its shares to the public and at least 37, 000 euro if no public offering.”

public interest if a single founder should be allowed to engage in these forms of businesses.¹⁸⁸

Similar trend is also found in the corporate law of China. In the same vein, one person may incorporate one shareholder company with limited liability.¹⁸⁹ However, less than two and more than two hundred members may not incorporate a company limited by shares.¹⁹⁰ Though it is difficult to reckon from the readings of China's new company law, it seems that the notion of public interest due to the nature of public offering of shares of public limited companies has influenced the pro-socialist civil law China.

Unlike, the approach in the two previously mentioned jurisdictions, a single person, both in the UK and Germany is permitted to incorporate both forms of companies. In the UK, while Section 1(3A) of "Single-Member Private Limited Companies Regulation of 1992" allows single person to incorporate private company limited by shares or guarantee, the decision to permit a single person to incorporate public limited company came into effect through the Companies Acts of 2006.¹⁹¹ Likewise, a single person in German may also incorporate either private limited company (*Gesellschaft Mit Beschränkter Haftung*, GmbH) or public limited company (*Aktiengesellschaft*, AktG).¹⁹² Yet, what reasons could be attributed to both the German and the UK's approach to allow single person to incorporate public limited company unlike France and China's jurisdictions? Part of the reason, as indicated before, emanate from the decision to harmonize one's own company law in order to attract sole entrepreneurs, which could be explained by the competition scheme in EU economic community.¹⁹³ Moreover, part of the other reason hinges from the fact that unlike the concerns of France and China over the consequences of permitting single member public companies, it is argued that legislators in England and Germany had in mind creditors' protection that is also complemented by their robust court decisions.¹⁹⁴

¹⁸⁸ In French corporate law, private limited companies cannot conduct insurance, investment and saving businesses and these commercial activities are reserved for public limited companies.

¹⁸⁹ Companies Law of China, *supra* note 182, at Art 58.

¹⁹⁰ *Id.*, at Art 79.

¹⁹¹ UK Companies Act, *supra* note 182, at Sec. 7. The term "limited by shares" is the same as in the civil law share company used to refer liability of shareholders to the extent of their contributions; the term "limited by guarantee" is specific used to refer primarily for non-profit organizations even without share capital or shareholders. The guarantors have to pay post-investments from their personal assets if the company in the end of its existence stays without assets to pay debts.

¹⁹² See German Private Limited Companies Act, Sec. 1 and German Stock Corporations Act, Sec. 2.

¹⁹³ Directive 2009/102/EC, *supra* note 49, Art. 6.

¹⁹⁴ Beretka Katinka, *Concept of Single Member Companies in the light of EU Harmonization: Comparative Analysis of Serbia, Germany, United Kingdom*. (2010). Available at: http://www.etd.ceu.hu/2010/beretka_katinka.pdf.

At regional level, a comparison of both the EU and the OHADA countries¹⁹⁵ are crucial in a bid to understand how corporate laws have been designed to avoid differences as to the form of SMCs across boundaries. The EU harmonization effort has been tasked to limit the risks resulting from wide discrepancies among member states' rules as regards protection of shareholders, creditors and third parties in general.¹⁹⁶ In the same vein, the idea behind the creation of the OHADA system also sprang from the will to strengthen the African legal system by enacting a secure legal framework for the conduct of business in Africa, which is viewed as essential to the development of the continent.¹⁹⁷ With regard to the issue under consideration, both EU and OHADA frameworks provide that SMCs could be established as both private limited and public limited companies.¹⁹⁸ However, unlike the OHADA framework that managed to create uniformity across member states under a unified body of law, the EU Directive offers too much discretion to member states to design national solutions for establishing SMCs which need not be the same with the Directive's rules.¹⁹⁹ Eventually, the trend of incorporating SMCs as either private limited companies or public limited companies has been receiving attention due to the harmonization efforts that attempts to insure uniformity of rules across the globe despite the reluctance of some countries such as China and France.

4.2.2. The Founders of SMCs

As indicated above, the legal notion that single person may establish both private and public limited liability company is recognized in comparative jurisdictions except the cases of Chinese and French public limited companies. In all previously considered jurisdictions, both natural and legal persons are allowed to incorporate SMCs. Nevertheless, whether only natural or legal persons should be allowed to incorporate several SMCs are concerns that need to be addressed through adequate precaution. As such, as we shall see in what

¹⁹⁵ OHADA is an organization that was created by a treaty signed among Central and Western Africa countries with a civil law tradition (with the notable exception of Cameroon with common law tradition) in Mauritius on 17 October 1993. See Boris Martor Et Al., *Business Law in Africa: Ohada and the Harmonization Process 1* (Global Marketing Briefings (GMB) Publishing Ltd, 2nd ed. 2007).

¹⁹⁶ Don Berger, *Harmonization of Company Law under the Common Market Treaty*, 4 *Creighton Law Review* 212 (1971).

¹⁹⁷ Boris Martor Et Al., *supra* note 195.

¹⁹⁸ Directive 2009/102/EC, *supra* note 49, at Arts. 2(1) and 6. See also OHADA Uniform Act, Arts. 309 and 385.

¹⁹⁹ For instance the Directive 2009/102/EC, indicated before, in Article 6 hints that permitting Single-Member Private Limited Company is mandatory while member states who wish to allow public companies (stock corporations) to be Single-Member Companies are not precluded. That is the reason why some of the member states as noted before, allow a stock corporation to be a single-member company, unlike the others.

follows, countries and/or regions being compared have a different approach to address risky elements that accompanies these concerns.

In France, there is no restriction on a natural person to be a sole member of several SARLs.²⁰⁰ Nevertheless, a single member SARL may not create another single member SARL. This means that there is no restriction for a natural person to engage in other activities in his own personal name and at the same time to be a member of other single or multimember companies. Hence, what is prohibited is that “*a limited liability company may not have as its sole shareholder another limited liability company composed of a single member.*”²⁰¹ The idea behind this latter conception is that a sole investor once permitted to establish SMC should not be given another chance to multiply the autonomous operations of this same SMC and divide its patrimony *ad infinitum* which would open to deceitful business practices.

The trend in the Companies law of China is also similar to French except for some deviations. In China, either natural or legal person can incorporate a SMC.²⁰² However, the right enjoyed by natural person is different from that of a legal person. Accordingly, a natural person may *only make investment for the incorporation of one one-person company* with limited liability.²⁰³ Thus, unlike the trend in France, an individual in China is not permitted to invest in more than one SMC with the benefit of limited liability.²⁰⁴ Yet, there is no similar restriction on a SMC established by a legal person in China.²⁰⁵ In short, a SMC in China may make investment by incorporating several other new SMCs giving birth to chain of SMCs that is, however, prohibited in the French legal system.

In Germany, the founder of a SMC may be natural or legal person.²⁰⁶ Like the approach in France, there is no restriction on how many times, a natural person being a single member shareholder may have the same status in other single or multimember companies.²⁰⁷ Unlike France, but similar to the trend in China, a legal person as controlling parent company in Germany could be the single member of another SMC.²⁰⁸

²⁰⁰ Under the basic text of the French Commercial Code on Commercial Companies, a natural person might be the sole associate of only one Limited Liability Company. See Art. L223-5. See also D. Radenkovic Jocić, *A Single Member Company - Convenient or not for the Founders*, 2 Economics and Organization 213 n. 3 (2005).

²⁰¹ French Commercial Code, Art. L223-5.

²⁰² Companies Law of China, Art. 58.

²⁰³ *Id.*, Art. 59.

²⁰⁴ *Id.*, see also Gordon Y. M. Chan, *Rethinking the Legislation for One-Person Companies in China*, 33 Company Lawyer 87-93 n. 3 (2012).

²⁰⁵ *Id.*, For more detailed comparative analysis on Chinese One-Person Company see generally Jianlin, *supra* note 10.

²⁰⁶ German Private Limited Liability Act, Sec. 1; German Stock Corporations Act, Sec. 2.

²⁰⁷ Jocić, *supra* note 200, at 212.

²⁰⁸ *Id.*

In the UK, similar to the trend in Germany, there is no restriction on either natural or legal persons to incorporate SMCs.²⁰⁹ However, there is no clear indication under the UK Companies Act as to whether a single individual could invest in only one SMC or in several SMCs. But, logically, so long as a company in the UK could be incorporated by either natural or legal person irrespective of its being a SMC or not, it could be argued that the UK Companies Act does not prohibit both natural and legal person from incorporating several SMCs.²¹⁰

The regional harmonization attempt under the EU SMCs Directive provides range of preferences for member states. Accordingly, member states may either permit or prohibit a natural person to be or not to be the sole member of several other companies. The Directive indicates that member states may lay down special provisions or penalties as to whether a SMC or any other legal person could be or could not to be the sole member of a company.²¹¹ Therefore, member states of the EU may allow or restrict the number of SMCs that an individual may form as was done in Germany and UK, and France respectively. Under the OHADA Uniform Act, any individual or corporate body may be a sole member of a commercial company.²¹² However, like the UK and Germany, there is no clear stipulation on the limitations or prohibitions of natural or legal person to be the sole member of several single member private and public limited companies.

The pertinent question is why did some of the jurisdictions under consideration prohibit chain of SMCs while others do permit and still some others are silent in providing clear legal stand on the subject matter? The argument propelled for the prohibition of chain of SMCs lays in the fear that a legal person as single founders of more than one company may create an “*abusive pyramids*” or “*daisy chains of SMCs*” where the SMCs’ main or only assets are their shareholding in another company.²¹³ The point is that a chain of SMCs may be a device for abusive behaviours that is prejudicial to the interest of subsidiary SMCs creditors. It is argued that the liability danger presented by the single member corporate groups might make them completely open to misuse.²¹⁴ As indicated before, if allowed, SMC might establish another single member subsidiary company that

²⁰⁹ UK Companies Act, Sec. 7(1).

²¹⁰ *Id.*, Sec. 1159(2); this section determines what a wholly owned subsidiary means that is applicable to every company form. For further analysis on this matter see Katinka, *supra* note 194.

²¹¹ Directive 2009/102/EC, Art. 2.

²¹² OHADA Uniform Act, Arts. 5 and 7.

²¹³ E. Muzaffer, *Single-Member Companies in Turkish Law*, Legal Hukuk Dergisi 1269 Issue 64 (2008). <http://ssrn.com/abstract=1158421>. See also Jean-Jacques Daigre, *The Sole Proprietorship Company in French Law* (1990). <http://henricapitantlawreview.net/article.php?lg=en&id=307>.

²¹⁴ *Id.*, Muzaffer, at 12.

operates under control of parent SMC creating multiple layers of subsidiary chains resulting in the division of assets *ad infinitum*. Hence, this might create danger for creditors of the subsidiary SMCs.

On the other hand, it is argued that the idea of separation of ownership and control may be obtained through the devise of chain companies with multiple voting rights.²¹⁵ As such, restriction of chain of companies could be problematic since parent SMCs might need to establish more than one subsidiary SMCs to conduct high scale business.²¹⁶ Thus, the proposed restrictions on the freedom of a company to be the sole member of another company may meet with resistance from owners of SMCs. It is, therefore, crucial to strike a balance between these two competing interests. In this regard, the discussion on the practice of Germany is imperative.

According to the German practice, tries to strike the balance on the one hand by safeguarding protection of creditors and on the other hand, by carefully weighing the veil piercing of SMCs so as not to undermine the privilege of limited liability. Accordingly, three conditions must be fulfilled for the liability of single member company groups. First, the single member has to be a SMC set up in the form of a group either by natural or legal person.²¹⁷ Second, there has to be a special closeness within the group of this kind of companies.²¹⁸ Third, the parent company has to influence the interests of the controlled subsidiary SMCs.²¹⁹ Hence, if the above three conditions were met three level liabilities of a SMC that owned several companies including other SMCs were suggested: (a) *compensation for loss suffered by the subsidiary* (b) *liability based on detrimental and lasting mismanagement* (c) *liability of the parent company for individually damaging measures*.²²⁰

4.2.3. Minimum Capital Requirement for SMCs

A minimum capital requirement rule obliges those incorporating a business entity to place assets of at least the specified minimum value into the corporate asset pool.²²¹ As indicated

²¹⁵ It is particularly argued that allowing corporate groups already having power and sufficient capital to establish SMCs will help them to allocate such capital to a fully owned subsidiary that will be beneficial for their business efficiency. *See id.*, at 8.

²¹⁶ *Id.*, at 14.

²¹⁷ Jocić, *supra* note, 200, at 213. *See also* Daniela Weber-Rey, *Insolvency of a German Limited Liability Company: De Facto Shareholders, Group Liability for Individual Shareholders*, 7 *Pace International Law Review* 523 (1995). <http://digitalcommons.pace.edu/pilr/vol7/iss2/8>.

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ *Id.*, at 213.

²²¹ John Armour, *Legal Capital: An Outdated Concept?* (University of Cambridge Working Paper No. 320, 2006). <http://www.cbr.cam.ac.uk/pdf/WP320.pdf>.

before, the basic reason for the recognition of SMC is the idea that capital is more important than association of persons. If this is the case, a single person is required to provide minimum capital requirement set for the incorporation of a SMC. As such, setting a minimum capital requirement encourages equity financing and minimizes concern of creditors' protection. According to the mainstream corporate law, an incorporation of business entity requires an investor to provide in-cash or in-kind contributions.²²²

However, it should be noted that the practice of countries over the desirability of setting minimum capital requirement is varied. There are recently emerging legal commentaries that generalize "minimum capital is no longer an appropriate conceptual apparatus to employ in safeguarding the interests of creditors."²²³ Nevertheless, the problem with this generalization is that it does not account for the special nature of SMCs that, as indicated before, warrants exceptional treatment. Particularly, the effect of inadequate capitalization on shareholders responsibility has received increasing attention and emphasis. It is widely discerned that it is natural for an entrepreneur to shift, as far as possible, the risk of business failure from his own shoulders to those of company creditors.²²⁴ Therefore, in order to overcome this problem, "*one risk-dodging device*" could be setting rules on minimum requirement of registered capital for SMCs. In view of these competing stakes, it is vital to investigate how the jurisdictions under consideration approach minimum capital requirements for SMCs.

The EU SMCs Directive has recognized "*the risks that SMCs may present as a consequence of having single members.*"²²⁵ However, the EU Directive gives preference to member states to device or lay down rules in order to ensure that the subscribed capital of SMC is paid.²²⁶ Therefore, the existence and scope of minimum capital requirement for private companies is left to member states whereby widely differing stances are taken. However, for public companies, the EU Second Company Law Directive mandates the minimum share capital of at least 25,000 Euros of which 25 percent need actually be paid up on formation.²²⁷ This indicate that the minimum capital requirement devised for public limited companies at the regional level applies to single member public limited companies in default of specific rules in the members states.

²²² See for instance the Commercial Code of Ethiopia, Art. 80(1).

²²³ In the common law corporate legal system such as UK and USA, "whilst legal capital rules have fallen out of favour as a means of protecting creditors, the principles for which they stand continue to be taken seriously in continental European countries." *Id.*

²²⁴ Fuller, *supra* note 4.

²²⁵ See Directive 2009/102/EC, at preambular paragraph 5.

²²⁶ *Id.*

²²⁷ EU Second Council Directive 77/91/EEC [1977] OJ L26/1, Arts. 6(1) and 9(1) (1976).

As indicated before, under both UK Companies Act and Single Member Private Limited Companies Regulations, a single person might incorporate both public and private limited companies respectively. According to the UK Companies Act, public limited companies are not allowed to operate business or exercise any borrowing powers unless the authorized minimum share capital is contributed, which in the absence of special provisions, is also applicable to single member public limited companies.²²⁸ The authorized minimum in relation to the nominal value of public company's allotted share capital is 50,000 Pound, or the its *euro* equivalent.²²⁹ But, there is no minimum capital requirement concerning private limited companies which likewise also apply to SMCs.²³⁰ A similar trend is also recently followed in France and there are no requirements concerning the minimum capital of French SARL, which may also have a single member as indicated before.²³¹ Nevertheless, unlike France and UK, the minimum amount of registered capital for SMCs in China should be 100,000 Yuan and the capital contributions should be made in one lump-sum as stipulated by the articles of association of the company.²³²

In the case of Germany, the minimum capital requirement for establishing private limited companies which could also be incorporated by sole person is *euro* 25, 000 of which at least *euro* 12,500, (i.e., the total value of the cash contribution plus any contribution in kind) must be actually contributed into a bank account.²³³ Accordingly, the company can't be registered until at least one-fourth of the contribution required to be paid in-cash has been paid, and any contribution in-kind, which was agreed upon, has been placed at the disposal of the company.²³⁴ In addition, security must be provided in respect of any remaining part of the cash contribution which is uncalled.²³⁵ Likewise, the "minimum par value of the share capital" to establish single member public limited company is *euro* 50, 000.²³⁶

²²⁸ UK Companies Act, Secs. 761-765.

²²⁹ *Id.*, Sec. 763.

²³⁰ *Id.*

²³¹ French Commercial Code, Art. L.223 -2. This provision provides that "the amount of the company's capital is determined by the memorandum and articles of association. It is divided into equal capital shares." According to the Law Concerning the Economic Initiative, *loi pour l'initiative économique* (2003), it is possible to form private limited company of *euro* one (1).

²³² Companies Law of China, Art. 59

²³³ German Private Limited Liabilities Act, Sec. 7(2) and German Stock Corporations Act, Sec. 36 (2) and 42. See also Minkand Gu, *Understanding Chinese Company Law* 70-72 (Hong Kong University Press, 2010); Mads A. And Frank W., *European Comparative Company Law* 70 (Cambridge University Press, 2009).

²³⁴ *Id.*

²³⁵ German Private Limited Liabilities Act, Sec. 7(2).

²³⁶ German Stock Corporations Act, Sec. 8.

Under the OHADA Uniform Act, despite the difference in the amount of the capital between private and public limited companies, there is no distinction between the sole and multimember companies concerning minimum capital rules. Accordingly, the registered capital of a private limited liability company is at least one million CFA francs (*Communauté financière africaine*) and it should be divided into equal shares whose face value may not be less than five thousand CFA francs.²³⁷ Likewise, the minimum authorized capital for public limited company is fixed at ten million CFA francs and should be divided into shares of a face value of not less than ten thousand CFA francs.²³⁸ Moreover, it should be fully subscribed before the date of signature of its Articles of association or holding of the constituent general meeting.²³⁹ Like Germany, at least one quarter of the face value of shares representing contributions in cash should be paid-up during capital subscription, while the rest should be paid-up within a period of not more than three years from the date of registration of the company.²⁴⁰

4.2.4. Publicity Requirements

Generally speaking, publicity of a SMC entails the communication to the public that a limited liability company run by a single person is duly incorporated to undertake commercial activities.²⁴¹ As noted before, due to the owner-manager characteristics of SMCs, the possibility of confusing personal and corporate identity in the eyes of third parties is very high. As such, publicity requirement of SMCs as to their incorporation or transformation is important to protect creditors.²⁴² It is indicated that the interest of

²³⁷ OHADA Uniform Act, Art. 311.

²³⁸ *Id.*, Art. 387.

²³⁹ *Id.*, Art. 388.

²⁴⁰ *Id.*, Art. 389.

²⁴¹ Publicity requirements are not limited to the registration of single member companies only. Though publicity requirements vary across different legal jurisdictions with controversies over what information of companies in general should be disclosed or not. For instance, any subsequent amendments to these; publicity to the appointment, the termination of duties, as well as the names of persons who, as a legally constituted organ of the company or as members of such an organ have the power to bind the company, to represent it both in and out of court alone or jointly, or take part in the administration, publicity of balance sheets and the profits and loss statement of companies, transfer of companies registered office; dissolution of the company; judicial decisions declaring a company to be null and void; the appointment and names of a company's liquidators, as well as their powers, the termination of liquidation; publication of all documents and entries kept in commercial register in official government publication, and the cancellation of the company in the Commercial Register. *See generally*, the EU First Council Directive on the Coordination of the Protective Provisions of the Member States Concerning Companies in the Interest of Shareholders and Third Parties, [1968 J.O. No. L65/8].

²⁴² It should be noted that in addition to publicity other formalistic requirements such as Articles of Association and registration is common to all forms of incorporated business without which operation of business is prohibited. Due to the special importance of publicity, focus will be made to investigate publicity rules designed for SMCs.

creditors would not be affected simply because limited liability is legally granted to a sole proprietor. However, it must be conceded that a limited liability conferred on a company owned by one person may be prejudicial to potential creditors unless the occurrence of this fact is publicized in the form of public notice or entered in a Commercial Register accessible to third parties.

The OHADA Uniform Act provides general provisions for the publication as to the formation of a company after registration. Accordingly, one person SARL or SA is required to publish notice of its establishment in publication legal notice and daily newspapers.²⁴³ In case of transformed SMC, notice of transformation should be inserted in the newspaper empowered to publish legal notice.²⁴⁴ Unlike the generality of OHADA system, the EU Company law addresses publicity issues of SMCs specifically. Accordingly, the 2009 EU directives on SMCs states that “where a company becomes a SMC because all its shares were held by a single person, that fact together with the identity of the sole member, must either be recorded in the file or entered in the register within the meaning of article 3 (1) and (2) of Directive 68/151/EEC or be entered in a register kept by the company and accessible to the public.”²⁴⁵

As noted before, this disclosure requirement regarding the transformation of a SMC due to reasons such as share transfer or the death of other shareholders is vital for contracting parties who may not know the occurrence of these facts. Disclosure requirement may avoid the temptation of sole shareholder who in the absence of other shareholders may possibly engage in fraudulent conduct damaging interests and rights of third parties and other stakeholders. However, some argue that the EU Directives’ option of disclosure in the company’s own register means that the central register may not contain information that is clearly of relevance for contracting and other third parties.²⁴⁶ In order to avoid such legal anomalies, it is necessary to provide some regulations on such circumstances. Accordingly, it is suggested that, “when the number of shareholders decreases to one, the single shareholder shall report the decrease and his name to the registry for registration and publication. If the single shareholder fails to do so, he shall be personally liable for the commitments the company assumes in the meantime.”²⁴⁷ On top of this, whether a SMC that is initially established in that form is required to abide by the disclosure requirement in the same way is not clear from the readings of the Directive. It

²⁴³ See OHADA Uniform Act, Arts. 257-262.

²⁴⁴ *Id.*, Art. 265.

²⁴⁵ Directive 2009/102/EC, Art. 3.

²⁴⁶ Muzaffer, *supra* note 213. See also Edwards, *supra* note 76, at 211.

²⁴⁷ Janet Dine et al., *Company Law in the New Europe* 178 (Edward Elgar, 2007).

seems that if SMCs are originally established in that form, third parties willing to contract transactions may be aware of this fact since the name of company and its shareholder is obviously registered in the commercial register or any other publication media including its status as a limited liability company.

The publicity of SMCs in European countries such as Germany, England and France is also regulated as a mandatory formality requirement. In Germany, the consolidation of shares into the hands of one shareholder (or additionally in the hands of the company itself) must always be notified to the Commercial Register without undue delay.²⁴⁸ Similar to the EU SMCs Directive 2009, however, there is no specific legal provision that mandate publication of SMC in its original form though the general rules may apply. Yet, the UK Companies Act 2006 has filled this gap by specifically requiring the publication of the formation and transformation of both forms of SMCs. Accordingly, a statement that a limited company has only one member should be entered in a company's register of members.²⁴⁹ Similarly, the number of multimember limited liability companies may fall to one. When such state of affairs occurred, a statement that the company has only one member and the date on which the company became a company having only one member should be entered in the company's register of members with the name and address of the sole member.²⁵⁰ It may also happen that the membership of a limited company increases from one to two or more members. In the same legal procedure, upon the occurrence of this state of affairs, a statement that the company has ceased to have only one member, and the date on which that event occurred should be entered in the company's register of members, with the name and address of the person who was formerly the sole member.²⁵¹ In France, the common principles governing the publicity requirement of all commercial companies is also applicable to SMCs without any distinction. Accordingly, a single person SARL, after registration in the register of commerce, is required to be published in the official bulletin (*Bulletin officiel des annonces commerciales*).²⁵²

In the People's Republic of China, a SMC is required to clearly indicate whether the investment is made by natural person or a legal person during registration. It is also required that this fact should be stated clearly in its business license.²⁵³ Furthermore, there

²⁴⁸ German Private Limited Companies Act, Sec. 40(2).

²⁴⁹ UK Companies Act, Sec. 123(1).

²⁵⁰ *Id.*, Sec. 123(2).

²⁵¹ *Id.*, Sec. 123(3). The Act also provides criminal sanction for failure to comply with these rules. *Id.*, Sec. 123(4).

²⁵² Michael R. Will, *Recent Modifications in the French Law of Commercial Companies*, 18 *The International and Comparative Law Quarterly* n.4 (1969).

²⁵³ Companies Law of China, Art. 60.

are general legal provisions that require re-registration of any alterations of business license by company registration authority.²⁵⁴ The most important aspect of Chinese company law relevant to SMC is the right of the public to apply to the company registration authority for inquiry services about the registered company.²⁵⁵ This provision is crucial for third party creditors to access any relevant information regarding the status of SMCs.

4.3. Management Structure and Control of SMCs

As noted before, one of the practical challenges in relation to SMC is the absence of check and balance system in the company management, a function which has been traditionally accomplished between the interplay of board of directors, shareholders' meeting and board of supervision. In the absence of traditional corporate management structure, it is understood that devising appropriate mechanism is an important step to minimize risks and concerns posed by an incorporated sole proprietor. Therefore, whether a SMC should have sole member managing director or should have to appoint one or more than one non-shareholder director(s); whether one person present at the meeting of SMCs suffice to pass a valid resolutions or decisions; whether all business decisions concerning SMCs should be recorded in writing and its further publicity are required should have to be addressed clearly.

4.3.1. The Case of “One-man Board of Director”

As was previously noted, a SMC is a hybrid form of business organization that borrows the twin concepts of separate legal personality and limited liability of a company form but retains the salient features of conventional sole proprietorships. In this context, a SMC is expected to depict the flexibility of sole proprietorship in which its internal management structure could be adopted freely as desired, while its corporate nature require it to depict certain thresholds of corporateness. It is unavoidable that a SMC uses an individual, who acts on behalf of the company thereby representing its “directing mind and will.”²⁵⁶ Therefore, in order to operate business mainly by entering into contractual transactions with third parties, a manager or director who is entrusted with the power of taking legally binding decisions representing SMC has to act from the center.

²⁵⁴ *Id.*, see Art. 7; the business license of a company should clearly state such items as the name, domicile, registered capital, actually received capital, scope of business and name of the legal representative of the company.

²⁵⁵ *Id.*, at Art. 6.

²⁵⁶ Pettet, *supra* note 41, at 15.

Thus, a sole member who may frequently be a sole director manager should be a person whose state of mind should be attributed to the SMC. In view of these facts, whether the direction and control of SMC by a sole shareholder could constitute one-man board of director or whether the management structure of SMCs should be similar to that multimember company depends on whether the single shareholder opted using non-member managers, directors, or neither. As such, a look into the company law of selected countries on how such legal issues are regulated is an important task. Finally, but yet most importantly, whether a sole shareholder director or manager, as the case may be, could exercise all powers exercised by the directors, and shareholders' meetings of multimember companies requires as much the same legal scrutiny.

To begin with, in both OHADA and EU jurisdictions, a sole member is responsible for the management of his own SMC. Obviously, a company owned by a single shareholder (unless non-shareholder directors are appointed) cannot be managed by a board of directors but must have a manager or director that runs the affairs of such company. Under the OHADA Uniform Act, both public and private limited companies wholly owned by an individual shareholder cannot have a board of directors.²⁵⁷ Likewise, though it is not evident from EU SMCs Directive and its Regulation, the fact that a single shareholder should be responsible for the management of a SMC is clear from these legal regimes. On the other hand, whether non-member manager(s) or director(s) could be appointed to the boardroom of SMC is not clearly provided in the both OHADA and EU legal regimes. The OHADA Uniform Act also provides rules wherein a corporate body sit on the board as director by appointing natural person representative.²⁵⁸ As indicated before, such trend is particularly crucial in jurisdictions that permitted SMCs to incorporate chain of SMCs.

In France and Germany, though there is no restriction on the right to choose between board of directors and owner managing director, single member private limited companies are not forced to have a supervisory board.²⁵⁹ However, it is mandatory for German public limited companies with one shareholder to have a supervisory board.²⁶⁰ French single member private limited companies and German single member private and public limited companies can be managed by one or more persons who are placed under the director and

²⁵⁷ OHADA Uniform Act, Arts 494 and 417.

²⁵⁸ The corporate body may be represented by permanent representative who either be a shareholder or non-shareholder. *Id.*, at Art. 421.

²⁵⁹ German Private Limited Companies Act, Sec. 52(1): private companies usually do not have supervisory boards, but are permitted to establish one on a voluntary basis.

²⁶⁰ Cahn and Donald, *supra* note 41, at 450.

control of the sole shareholder.²⁶¹ In UK, the Companies Act provides for sole member director that manages and controls SMC though articles of association may further provide for more directors which could obviously be appointed from non-members.²⁶²

In China, sole member managing or executive director can manage SMC, but like OHADA, it is not permitted to set up board of directors.²⁶³ It is clearly indicated that board of directors of company with limited liability should be composed of three to thirteen members, and the set up of shareholders assembly by one-person company is prohibited.²⁶⁴ Similarly, it is not evident from the reading of the Companies law of China as to whether SMC is allowed to appoint non-shareholder director or deputy managing director that could assist the sole shareholder manager. Nevertheless, it is argued that like all other jurisdictions, the articles of association are intended to be adaptable to meet specific corporate management needs of SMCs and may fill the gaps on such as the above matter.²⁶⁵

Another corporate management aspect relevant to SMCs relates to the powers of single shareholder managing director. As already indicated, the power in the context of traditional corporate governance principle is in the hands of shareholders, directors, and in some cases supervisors. In the context of SMCs, all powers that emanates from articles of associations and default rules under the company law, which previously devolved separately on directors and shareholders, might fall under the monopoly of the single shareholder who is frequently a sole director of the SMC. Accordingly, the single shareholder, who is often the managing director of the company, is entrusted with the power to represent and control his own SMC in all its dealings with third parties in the interests of the company within the bounds of the articles of association and the legal limits. The SMC is, therefore, bound by all acts of the sole managing director to the third parties and other stakeholders. In short, one can safely argue that except in case where articles of association of SMCs provide for appointment of non-member directors as a mandatory requirement of the law, “*one-man board of director*” is inevitable in jurisdictions under consideration.

²⁶¹ *Id.*, at 283.

²⁶² UK Companies Act, Sec. 151. According to this Act, “every private company must have at least one director who is a natural person and every public company at least two directors.”

²⁶³ Companies Law of China, Arts. 51 and 52. But, it should be noted that a closer look of these two articles reveals that the use of executive director is used in reference to a limited liability company (...) “that has relatively small number of shareholders and is relatively small in scale” which could be applicable to one person companies. See also Jianlin, *supra* note 10, at 428.

²⁶⁴ Companies Law of China, Arts. 45 and 62.

²⁶⁵ Steven M. Dickinson, *Introduction to the New Company Law of the People's Republic of China*, 16 *Pacific Rim Law & Policy Journal* 2 n.1 (2007).

4.3.2. Rules on Meeting and Quorum

As indicated before, there are powers that should be exercised by a “one-man board of director” in order to run acts of management on behalf and in the name of the SMC. Obviously, these powers are exercised on day-to-day basis or at arms-length, which may accompany the passing of binding decisions by holding a one-man meeting that will arise in diverse situations. However, in order to convene a proper meeting that reflect “the mind and the will” of a SMC, the appropriate procedural rules and regulations should have to be orderly fashioned to duly bind the company. Therefore, the reason for the requirement for meetings lay in the fact that shareholder(s) may attend either in person or by proxy in order to debate and vote on matters affecting the affairs of a company

Accordingly, how would the terms “meeting” and “quorum” be construed in the context of SMCs management? General speaking, the word “meeting” prima facie means a coming together of at least more than one individuals so that they will be able to discuss matters in which they have a common interest in an orderly fashion.²⁶⁶ As such, the holding of any meeting essentially requires at least two persons having flesh and blood. On the other hand, the word “quorum” denotes the minimum number of members of a company whose presence at a meeting of the members is required in order to make the proceedings of the meeting valid.²⁶⁷ In the past, owing to such lexical meaning, whether one-person attending the “meeting” suffices a quorum to pass a decision that binds the company has been argued in the courts. A good example in point can be found in the decision of an Indian State High Court case, “*State of Kerela v. West Planters Agencies Ltd.*” The court reasoned that,

“[T]he notion of one man calling a meeting of himself, going to that meeting to meet himself, electing himself to the chair, presiding over himself, laying before himself the matters to be considered, and, after having discussed these matters with himself, passing resolutions with regard to them and, perhaps proposing a vote of thanks to himself, sounds Gilbertain that we should think that unless the words used expressly or by necessary implication, point to it, the legislature could not have contemplated such a thing.”²⁶⁸

²⁶⁶ Black’s Law Dictionary 1004 (8th ed. 2004).

²⁶⁷ *Id.*, at 1284.

²⁶⁸ *State of Kerela v. West Planters Agencies Ltd.*, (1958) 28 Comp Gas 13 (Ker) cited in K.R, Chandratre, *One Member Present May constitute a Meeting* (2011). Available at: http://pm.khaitanco.in/doc/Know%20how/Articles/6045_1.pdf. (Accessed on 12, September, 2013).

Thus, three basic points can be drawn from the above observation of the court. First, the reasoning of the court depicts the terminological underpinnings of understanding “meeting” as a coming together of two or more persons that has been well established in the context of traditional multimember companies. Second, in the absence of any appropriate mechanism to ensure transparency of the meeting, the reasoning further shows that one person present at a meeting, as the case may be, turns out to be the rehearsal time to device trick methods to transfer risks that is prejudicial to the company and its creditors. Third, the court on the other hand, hinted that one member present at a meeting may qualify quorum for meeting which however should be backed by legal rules that have intended to treat one person “meeting” as an extended legislative meaning to cover that case. As indicated before, rules that recognize one member present at the meeting to constitute a valid quorum has been already introduced fundamentally changing the orthodox position of companies as constituting more than one individual. As we shall see in what follows, legal provisions that provide one-man present at a meeting of SMC as a “quorum” and hence constitutes a valid meeting have been duly recognized in jurisdictions under consideration. The most important aspect the rules regulating meeting of one-man present is the part the addresses evidential problems with regard to what was done at the meeting.

Under the OHADA system, the sole shareholder of single member private and public limited companies can take decisional powers that fall within the jurisdictions of both extraordinary and ordinary meetings.²⁶⁹ It is mandatory for the single shareholder to take all the decisions falling within the powers of the annual ordinary general meetings within a period of six months following the fiscal year.²⁷⁰ Accordingly, the decisions are taken upon the reports of the managing director and of the auditor who should compulsorily attend the general meeting.²⁷¹ In order to avoid evidential problems associated with meetings in SMC, the OHADA Uniform Act obliges the single shareholder to take the decisions in the form of minutes that should be filed in the records of the company.²⁷² Most importantly, all decisions taken by the single shareholder should be published in a newspaper carrying legal notices as if they had been taken by the general meeting.²⁷³

The UK Companies Act also provides that in a company limited by shares or guarantee and having only one member, the presence of one qualifying person suffice a quorum at a

²⁶⁹ OHADA Uniform Act, Art. 558.

²⁷⁰ *Id.*, Art. 559.

²⁷¹ *Id.*, Art. 721.

²⁷² *Id.*, Art. 560.

²⁷³ *Id.*, Art. 561.

meeting.²⁷⁴ In order to avoid evidential problems, the act imposes a requirement on a SMC to take any decision in the form of a written resolution, or for the single member to provide the company with a written record of the decision.²⁷⁵ However, it may be argued that the UK approach on this issue does not completely address the practical problems associated with the decisions of “one-man meeting” since proving what decisions have been taken and failure to comply with the requirements stated does not invalidate the decision.²⁷⁶ Yet, it is argued that the approach performs an important function by emphasizing the distinction between a sole member deciding on a course of action and a resolution of the company that is recorded by the single member that should be signed and dated.²⁷⁷

The approach of the EU is somewhat more precautionary.²⁷⁸ Accordingly, the sole member of a SMC can either dispense with the holding of Annual General Meeting (“AGM”) or exercise all the powers exercisable by private companies limited by shares or guarantee in general meeting without the need to hold such meeting for that purpose.²⁷⁹ In the former case, though the sole member or the auditor may hold AGM by providing notice to the SMC, he/she will not be relieved from any liability incurred due to the default in holding AGM.²⁸⁰ In the latter case, any provisions of private companies limited by shares or guarantee regulating general meetings which enables or requires any matter to be done or to be decided by a company or requires any matter to be decided by a resolution of the company is deemed to be satisfied by the decisions of sole member without holding a general meeting.²⁸¹ However, the sole member of a SMC is not empowered to exercise the power to remove an auditor from office without holding of general meeting.²⁸²

Evidentiary matters as regards the recording and writing of decisions and failure to comply with such rules under the UK Companies Act are a verbatim of the ECs SMCs

²⁷⁴ UK Companies Act, Sec. 318.

²⁷⁵ *Id.*, Sec. 357(2).

²⁷⁶ Although failure to comply with the requirement of recording the decisions taken by the sole member does not affect its validity, it results in criminal liability punishable by fine on summary conviction. *Id.*, see Sec. 357(3, 4, 5).

²⁷⁷ *Id.*

²⁷⁸ This regulation is enacted to implement Council Directive No. 89/667/EEC on single-member private limited liability companies but now repealed by Directive 2009/102/Ec.

²⁷⁹ European Communities Single-Member Private Limited Companies Regulations, [S.I. No. 275/1994], Art. 8(1) (1994). See also Directive 2009/102/EC, Art. 4(1) (2).

²⁸⁰ ECs Single Member Private Limited Companies Regulation, Art. 8(2).

²⁸¹ *Id.*, Art. 9(3).

²⁸² *Id.*, Art. 9(2); The decision made by the sole member should be drawn up in writing and notified to the company.

Regulation except for additional paragraphs.²⁸³ The additional paragraphs under this Regulation require the notifications of the decisions taken by way of written resolutions or a written record made by sole member to be further recorded and retained by the SMC in a book or by some other suitable means maintained for the purpose.²⁸⁴ But, unlike UK, the ECs SMCs Regulation obliges SMCs to notify in writing as to the exercise of any power, rights or obligations by the sole member to the registrar of companies and be recorded by him.²⁸⁵

The regulation of meeting in SMCs under the Chinese Companies law is very different from the other jurisdictions under consideration. As a result, not all powers and functions that can be exercised by the meetings of shareholders assembly or board of directors, within the context of multimember companies are exercisable by the sole member.²⁸⁶ In other words, a sole shareholder executive director of one-person private company in China is prohibited to set up shareholders assembly. It is allowed only to exercise the power of such assembly that relates to the power to “decide on the operational policy and investment plan of the company.”²⁸⁷ It is argued that the single shareholder status of one-person company means that shareholders’ meetings are redundant.²⁸⁸

As indicated before, other powers exercisable by shareholders meetings such as examining and approving the annual financial budget plan and final accounts plan of the company; adopting resolutions on the increase or reduction of registered capital of the company; amending the articles of association of the company; and other functions and powers provided for in the company’s articles of association are not allowed to be exercised by single shareholder.²⁸⁹ The only justice that has been done by the Companies law of China relating to the concerns of one-person meeting is that it obliges the sole shareholder to write and sign the decisions on the matters indicated above before keeping it for the record in the company.²⁹⁰

²⁸³ *Id.*, compare ECs Single Member Private Limited Companies Regulation, Art. 9 and UK Companies Act, Sec. 318.

²⁸⁴ UK Companies Act, Sec. 318.

²⁸⁵ ECs Single Member Private Limited Companies Regulation, Art. 9(6).

²⁸⁶ Companies Law of China, Art. 62. This English version of the provision is not clear as to whether the shareholder is mandated to keep recording of decisions only when he makes a decision on the matters specified in the first paragraph of Article 38 or whether the decisions taken regarding matters specified under the other paragraphs of this same law is not subjected to the requirement of keeping recording of decisions.

²⁸⁷ *Id.*

²⁸⁸ Jianlin, *supra* note 10, at 428.

²⁸⁹ Companies Law of China, Art. 62 and 38. Compare also Art. 47. The specific determination of powers exercisable by the sole shareholder under Art. 62 made use of cross reference as mandated under Art. 58 that tries to fill gaps in the provisions.

²⁹⁰ *Id.*, Art. 62.

In Germany, the powers in respect of matters falling within the competence of board of directors or shareholders meeting under both multimember GmbH and AktG could be generally exercisable by single shareholder manager.²⁹¹ Accordingly, the managing director of single person GmbH and AktG is responsible for the operation of the business, and he represents the GmbH and AktG in its dealings with third parties.²⁹² In addition, it is provided that under both GmbH and AktG Acts, the non-member manager(s) of SMCs may be appointed as per the rules enshrined under the articles of associations.²⁹³ In case where, more than one non-member managing directors are appointed, these managing director(s) are bound by the instructions and decision(s) of the sole shareholder and are also liable for the financial losses for lack of due diligence even if they have acted in accordance with the single shareholder's resolution.²⁹⁴

Furthermore, unlike the EU and UK approaches, matters of quorum and dispensation with holding of a general meeting in the context of SMCs are not specifically addressed under both German Companies Acts. However, it is noticeable from the legal provisions on the regulation of recording of resolution particularly under section 48(3) of GmbH Act that one shareholder present in any decisional forum suffice to pass a resolution on matters falling within the powers of both managing directors and shareholders' meetings in general. Like the trend in other jurisdictions, this article obliges the shareholder of a SMC to record decisions or resolutions in writing and sign immediately once they have been passed. Similar general provision that may be applicable to single member public limited company could also found be under article 130 of the German AktG Act that regulate the recording of resolutions of meeting in minutes of proceedings in the form of a notarial deeds.

In France, rules applicable to EURL, generally speaking, are those applicable to SARLs, insofar as they are compatible with the needs of a single member.²⁹⁵ Accordingly, EURLs can be managed by one or several managers (*Gérants*), who are natural persons but do not have to be company shareholders.²⁹⁶ However, in case where a single member is a sole managing director, it is understood that the sole shareholder alone holds the prerogatives and powers of all of the shareholders of the classic SARL. It is clearly provided

²⁹¹ German Private Limited Liability Act, Sec. 35 (4) and German Stock Corporations Act, Sec. 76(2).

²⁹² *Id.*, Sec. 37(2) and 78.

²⁹³ German Private Limited Liability Act, Sec. 46 (5, 6).

²⁹⁴ *Id.*, Sec. 43(1), 64, and 84 and German Stock Corporations Act, Sec. 3(2).

²⁹⁵ M. Andenas and F. Wooldridge, *European Comparative Company Law* 112 (Cambridge University Press, 2009).

²⁹⁶ *Id.*, at 283.

that, “the sole shareholder exercises the powers that devolve on the shareholders’ meeting by operation of the provisions of this chapter.”²⁹⁷ Hence, the single member in its capacity both as a sole managing director and as a shareholder may decide unilaterally all matters falling within the competence of managers and shareholders’ meeting – ordinary and extraordinary decisions.²⁹⁸ Among other things, the sole shareholder must prepare the inventory, the annual financial accounts and the management report in his capacity as the manager and to approve them in his capacity as the shareholder.²⁹⁹ Regarding evidential matters, the decisions taken by the single shareholder instead of and on behalf of the general meeting must be recorded in a register.³⁰⁰

4.4. Regulating Contracts Between Sole Member and the SMCs

A sole proprietor who is both an active manager of a SMC and the sole owner of the business finds himself in a newfangled situation.³⁰¹ On the one hand, legal theory requires that he operate in an atmosphere that calls upon him to follow a ritual that involves treating the company as though it were something apart from himself.³⁰² This could be a very difficult habit pattern harder to maintain and less natural than when a number of individuals are involved in common enterprise.³⁰³ On the other hand, as an entrepreneur, as far as possible, he may attempt to either shift the risk of business failure from his own shoulder to those of corporate creditors or abuse the shield of limited liability to advance his own personal interest.³⁰⁴ It is a widely agreed principle of corporate law that the risk of conflict of interest in case of transactions between a company and its shareholders is unavoidable.³⁰⁵ In such case, it is usually difficult to distinguish whether the single owner manager concludes a contract in self-interest or genuinely acts on behalf of a SMC. In short, it is easy for the single person to insulate assets of a SMC to his own personal advantages, which consequently, affects the creditors of such company.

²⁹⁷ French Law of July 24, 1966 on Commercial Companies, Art. 362(2) (Law No. 66-53/1966).

²⁹⁸ *Id.*, Art. 60-1: Ordinary decisions on the appointment and removal of the manager, approval of contracts with the company, approval of the accounts and appropriation of profit or treatment of loss, etc and extraordinary decisions to amend the memorandum and articles of association, increases and decreases to capital, etc are few to mention.

²⁹⁹ *Id.*

³⁰⁰ *Id.*, Art. 60-1.

³⁰¹ Fuller, *supra* note 4, at 1379.

³⁰² *Id.*

³⁰³ *Id.*

³⁰⁴ *Id.*, at 1381.

³⁰⁵ Luca Enriques, *The Law on Company Directors’ Self-Dealing: A Comparative Analysis*, 2 International and Comparative Corporate Law Journal 297 Iss. 3 (2000); See also Michael C. Jensen and William H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 Journal Of Finance And Economics 305 (1976).

Therefore, if a sole shareholder is to obtain limited liability through the corporate device, he should be required to act in such a way that those dealing with him will be perfectly aware that he is acting through the limited liability medium.³⁰⁶ Therefore, in order to solve the issue of conflict of interest, a safeguarding mechanism that tries to ensure the health of the transactions between SMC and that of sole shareholder should be devised. It should be noted, from the outset, that transaction between the single member and the SMC is not prohibited in all comparative jurisdictions under consideration. Let us see how jurisdictions under consideration approach the matter.

If we are to begin from the EU SMCs directive, it provides that, “contracts between the single member and his company as represented by him, [whether as a director or otherwise] shall be recorded in minutes or drawn up in writing.”³⁰⁷ Same legal stipulation is also found in the ECs SMCs Regulation noted before, but is more specific and follows a more realistic approach. It may happen that under the relevant law, the nature of the transaction may not require the contract to be in written form. Sometimes, though written form is a mandatory requirement for the validity of such transaction, the sole member may not comply with the requirement owing to different factors. In such situations, it is mandatory under the regulation to either immediately set out the terms of the contract in a written memorandum or record in the minutes of the first meeting of the director(s) of the company following the making of the contract.³⁰⁸ However, the question whether a contract between the non-shareholder managing director and SMC should be recorded in written form or set out in written memorandum is not specifically provided.³⁰⁹ The reading of another provision of the regulation somehow reveals the fact that every officer of the company in default of the above requirement is guilty of an offence liable on summary conviction to fine.³¹⁰ But, whether the phrase “every officer” in this regulation refers to every defaulting director and hence required to apply the requirement is not clear.

The regulation further provides two rules on the matter under consideration. On the one hand, the regulation does not preclude the operation of any other enactment or rule of law that may apply to contracts between a company and a director of that company in the member states provided the minimum safeguard noted above has been insured.³¹¹ On the other hand, the mandatory rules indicated above will not apply to contracts entered into in

³⁰⁶ Fuller, *supra* note 4, at 1380.

³⁰⁷ Directive 2009/102/EC, Art. 5 and 13 (1).

³⁰⁸ ECs Single-Member Private Limited Companies Regulation, Art. 13 (1).

³⁰⁹ This is particularly the case where SMC has more than one director obviously the other directors being non-shareholders in the company.

³¹⁰ ECs Single-Member Private Limited Companies Regulation, Art. 13(5) and Art. 14.

³¹¹ *Id.*, Art. 13(4).

the ordinary course of the company's business.³¹² This latter rule is simply a restatement of the principle that a sole member who is a director of the SMC is a representative of such company who operate business acting on its behalf. In such case, however, it is understood that the fiduciary duty and other obligations required under agency law may apply to the situation.

The UK Companies Act directly adopted all safeguarding measures discussed in the EU SMCs above with few exceptions.³¹³ On the one hand, the UK Companies Act clarified the rules under the ECs SMCs regulation by further considering “shadow director” as a director,³¹⁴ and in that case, applying the same rule regulating the contract between the SMC and the shadow director alike. On the other hand, whether the written formality should or should not have to be applicable to contracts entered into in the ordinary course of the company's business is missed out.

In the German legal system, both GmbH Act and the Civil Code regulate contracts made between the sole member and the company under his own control.³¹⁵ Under the GmbH Act, any business conducted between the SMC, represented by its shareholder-managing director, and its shareholder should be recorded in a memorandum or minute or any other type of record completed immediately after the business has been transacted.³¹⁶ Similar to the EU and UK, this rule also applies to situations where sole shareholder is not a managing director but acting as a private person.³¹⁷ Moreover, the approach under the German Civil Code has interesting solution regarding issues of “multiple representation” problem overlooked particularly under both the UK Companies Act and EU SMCs Directive and Regulation. Accordingly, unlike the case of the EU and UK, the managing director (be it a single member or non-member) who representing the SMC in ordinary course of the company's business enters into the contract with third party, is required to record or minute such contract.³¹⁸ It is argued that such application of additional rule of law under the German Civil Code further creates more transparency in the transaction

³¹² *Id.*, Art. 13(2).

³¹³ UK Companies Act, Sec. 231.

³¹⁴ *Id.*, Art. 251: A “shadow director” refers to “a person in accordance with whose directions or instructions the directors of the company are accustomed to act. A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity.”

³¹⁵ German Private Limited Companies Act, Sec. 35 (4); See also German Civil Code (*Bürgerliches Gesetzbuch*, BGB) Sec.181 (1896): [hereinafter German Civil Code]: “An agent may not, unless otherwise permitted, enter into a legal transaction in the name of the principal with himself in his own name or as an agent of a third party, unless the legal transaction consists solely in the performance of an obligation.”

³¹⁶ Unlike the German Private Limited Liabilities Act, the German Stock Corporations Act does not contain precise provisions that regulate the contracts of sole member and the company.

³¹⁷ Muzaffer, *supra* note 213, at 12.

³¹⁸ *Id.*

between the shareholder director or non-shareholder directors and the SMC on the one hand and the SMC represented by these directors and third parties on the other.³¹⁹ It is also further argued that the German law on self-contracting is not restricted to contracts, but relates to all business that the single shareholder may conduct with its company.³²⁰

In China, issues of contracts between the sole member-managing director and SMCs are not specifically regulated. Unlike the case in other jurisdictions, it is not evident from the Companies law of China whether a sole member enters into a contract with the company and whether such contract should be in writing or recorded in any form. However, one may apply general provisions of the companies law of China to regulate matters of contracts or business transactions between the shareholder, managers and third parties with certain modifications. Accordingly, director or manager of a company is prohibited to enter into a contract or conduct a business transaction with this same company in violations of stipulations of articles of associations or without prior consent of shareholders assembly.³²¹ If we modify this legal provision to the context of SMCs, a single shareholder can enter into a contract with the SMC after first authorizing the contract of business transaction in his capacity as a shareholder and managing director of the company, which, as indicated before, should be recorded in writing.³²² Thus, a single shareholder in its capacity as a shareholder, director or actual controller of a company is prohibited to take advantage of their unicity relations to damage the interests of the company.³²³ One form of taking such advantage is abuse of written formality of the transactions or abuse of rights through frauds during contractual agreements.

Therefore, a single shareholder will be liable to pay compensation to the company in case of loss due to the contravention or disregard of these legal provisions³²⁴ paving the way to corporate veil piercing. Hence, one may argue that the Chinese approach is reactive to such matter through the application of the principles of disregard of corporate personality. Similar line of argument could be drawn when a sole shareholder in its capacity as managing director tries to provide loan from the funds of the SMCs to another person or using the property of the company to provide guarantee for another person.³²⁵ More specifically, if the shareholder fails to maintain adequate distance between the

³¹⁹ D. Weber-Rey, *Germany: Company Law: Single Member Companies*, 4 *International Company & Commercial Law Review* 88 n.5 (1993).

³²⁰ *Id.*

³²¹ Companies Law of China, Art. 149(4).

³²² *Id.*, Art. 62.

³²³ *Id.*, Art. 21.

³²⁴ *Id.*, Art. 20.

³²⁵ *Id.*, Art. 149(3).

finances of the company and the personal finances, the shareholder will lose the protection of limited liability and will have joint financial liability for company debts.³²⁶ Eventually, it is the general principle under the Companies law of China, that a shareholder of the company is prohibited from abusing his rights to damage the interests of the company; abusing the independent status of the company as a legal person or the limited liability of shareholder to damage the interests of the creditors of the company.³²⁷

In France, the conclusion of contract between SMC and the single shareholder manager should be mentioned or has to be acknowledged in the Register that also records all the decisions made by the single member.³²⁸ However, any agreement between a manager who is not a member and the EURL require prior approval by single shareholder meeting.³²⁹ The contracts that are not approved remain valid, but the relevant manager or member is liable for any loss that occurs to the company because of the contract being concluded.³³⁰ The requirement of entering agreements in the register of decisions where the shareholder is involved and the approval of agreements by meeting of a shareholder where a non-member is involved will not be applicable if the “*agreements relate to ordinary transactions conducted under normal conditions.*”³³¹ Likewise, a manager and member including their spouse and relatives in the ascending and descending line of the persons is prohibited to contract for loans from the EURL or from having the EURL consent to overdrafts by him a current account or otherwise, and from having the EURL secure or guarantee their obligations towards third parties.³³² The contract that has been entered into with the company in breach of this rule remains “*null and void,*” but the managers and the sole member will be jointly or severally liable, according to the circumstances, to the company or to third parties for breaches of this legislative or regulatory provision.³³³

A similar trend like in France is followed under the OHADA system though the rules governing agreements between sole shareholder and the SMC are generally designed in such a way to regulate all commercial companies. Thus, the general rules designed under the OHADA Uniform Act to govern the matter are clear that it could be applicable to the

³²⁶ *Id.*, Art. 64.

³²⁷ *Id.*, Art. 20.

³²⁸ Dunn E., *Single-member Private Limited Liability Companies: 12th Company Law Directive*, 1 European Business Law Review 7 Iss. 1 (1990). See also French Law on Commercial Companies, as amended (Law of July 24, 1966), Art. 51 and French Commercial Code, Art. L223-19.

³²⁹ French Commercial Code, Art. L223-19.

³³⁰ *Id.*

³³¹ *Id.*

³³² *Id.*, Art. L223-21; the exception to this rule is “current commercial transactions entered into subject to normal terms and conditions in case such company operates a financial establishment and legal personality except the legal agents of members that are legal personalities”.

³³³ *Id.*, see also Art. L223-22.

situations of SMCs with slight modifications. Under the provisions governing both SA and SARL, which may only have a “sole proprietor,” to use the OHADA Uniform Act term, three types of agreements could be identified.

The first one is a regulated agreement that is concluded directly or indirectly between single member SA or SARL and one of its manager(s) or its single shareholder.³³⁴ However, regulated agreement should be authorized before it is entered by the decisions taken at the ordinary or general meeting.³³⁵ As such, single member managing director may call himself to a general meeting for the authorization of the agreements entered into between the SMC and himself or between his relatives and the company as the case may be. As indicated before, it should be recalled that in such a case, the decisions taken by single member regarding the authorization should be recorded in writing and published in a legal notice. In addition, like the French approach, the fact that there are agreements concluded between single member SARL, and the sole proprietorship should merely be entered in the record of deliberations.³³⁶ In all cases, except only where they are annulled because there has been fraud, regulated agreements are fully effective as regards third parties, despite their non-approval by the shareholder(s).³³⁷ However, a shareholder managing director may be held liable for any damage caused to the SMC by any regulated agreement to which he is a party and has not obtained the required authorization.³³⁸

The second non-regulated agreement relates to routine, ordinary and normal transactions, which do not require an authorization.³³⁹ The phrases “routine” or “ordinary” transaction refers to those transactions that are habitually undertaken or carried out by a company within the framework of its activities.³⁴⁰ Likewise, the phrase “normal conditions” is defined as those conditions that are applied, for similar agreements, not only by the company in question, but also by the other companies in the same sector of activity.³⁴¹ But, these terminological definitions, as some argue, are considered vague and it would be prudent to apply the procedure for regulated agreements if there is the

³³⁴ See OHADA Uniform Act, Arts. 438 and 350.

³³⁵ *Id.*

³³⁶ *Id.*, Art. 355. However there it is not evident from the SA provisions as to whether the same rules apply.

³³⁷ *Id.*

³³⁸ *Id.*

³³⁹ *Id.*, Arts. 439 and 352.

³⁴⁰ *Id.*, some writers also use the term interchangeably with term “*day-to-day operation*.” See Boris Martor Et Al., *supra* note 195, at 95.

³⁴¹ OHADA Uniform Act, Arts. 439 and 352; the term “normal conditions” is also used interchangeably with “*arm’s length terms*.” For more discussions on this matter see Boris Martor et al., *supra* note 195.

slightest doubt, particularly in SMCs, as to whether or not a particular agreement falls within these definitions.³⁴²

Finally, the third type of agreement is a prohibited agreement whereby an individual shareholder or a manager or one of their close relatives contracts a loan from the SMC, obtains an overdraft on a current account or otherwise receives a financial benefit from the company, or obtains from the company an endorsement or guarantee of his obligations towards third parties.³⁴³ If such agreements are entered into despite the prohibition, they may be declared null and void.³⁴⁴

4.5. Rules on Accounting, Auditing, Reporting and Disclosure

As indicated before, a SMC, as a business vehicle was primarily intended to promote choice for sole proprietor by providing the advantage of limited liability with flexibility of business operations. The question is how would the benefit of sole proprietorship and the corporate form be obtained? On the one hand, the advantages of sole proprietorship would be enjoyed by taking practical consideration that may include but not limited to simplifications of corporate features such as the dispensation of accounting, auditing and disclosure requirements.³⁴⁵ As such, forcing SMCs to abide by rules of bookkeeping, auditing and disclosure requirements seems a contrasting proposition to the conventional rules of sole proprietorship.³⁴⁶ On the other hand, despite sole proprietor like features, SMC is a different creature. In the absence of appropriate accounting, auditing and disclosure requirements, risks to the creditors will increase naturally with a backfiring effect on SMC. Among other things, creditors may protect themselves by demanding adequate securities in return for loans to the SMC, which make it a more burdensome business entity.

Therefore, a method of blending the salient features of sole proprietorship and corporate form require a careful look at the various legal provisions, piecing them together to construct a “new business organization form” in order to secure the desired benefits. Before passing into the piecing of the legal provisions, it is crucial to note on some crucial

³⁴² See Boris Martor et al., *supra* note 195, at 96.

³⁴³ OHADA Uniform Act, Arts. 356 and 450. This prohibition is also applicable to spouses, ascendants and descendants of the manager and sole proprietor.

³⁴⁴ *Id.*, Art. 356.

³⁴⁵ M. Rizal Salim, *Limited Liability Partnership in Malaysia: A Corporate Governance Perspective*, International Company & Commercial Law Review (2013). http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2329493.

³⁴⁶ For instance, there are controversies about the requirement that the balance sheet and the profit and loss statement of companies mandatory publicity requirements. It was argued that limited liability companies, which generally are family-owned enterprises and do not seek capital from the public, should not be subjected to such disclosure of their financial condition. See Berger, *supra* note 196, at 215-216.

issues at hand. As indicated before, a public interest is not affected by granting limited liability to a sole proprietor. However, the unique character of a sole proprietor with limited liability yet with lack of “separation of ownership and control” may make the protection of public interest susceptible to problems.³⁴⁷ In the absence of separation of ownership and control, protection of creditors as a public interest is exacted with degree of financial responsibility on the part of the SMC for the benefits conferred as part of the *quid pro quo* scheme.³⁴⁸ Basically, the protection of creditors when limited liability is conferred on a business entity such as SMC is twofold – “notice and separate fund and record keeping.”³⁴⁹ It is argued that the main reason why businesses fail is the weakness to keep accurate accounts, which is of course regarded as one of the advantage of the corporate concept.³⁵⁰ The whole idea is that, if the business is regarded as a separate person, it is easier to convince creditors and other stakeholders involved that business accounts are kept from personal accounts.³⁵¹ Therefore, keeping accounting and other records as will sufficiently explain the transactions and financial positions of the SMC will only benefit the business. This trend is crucial since it enables profit and loss accounts to be prepared in the form of balance sheet.³⁵²

The question whether accounts of SMC should be audited and whether such auditing report should be disclosed to the public is also another vital issue that needs considerations. As such, whether a SMC should have to hire or appoint an auditor to that effect in order to ensure the objectives of transparency and responsibility within SMCs is an equal concern. As indicated before, hiring or appointing auditor by the SMC is desirable but might be onerous. Yet, if accounting and record keeping is not substantiated with auditing requirement, it is very difficult to ensure financial responsibility of the sole shareholder in the face of high probability of commingling of personal assets with that of business assets. Thus, in the absence of an auditable accounting and record keeping, it could be difficult for the SMC to win the confidence of creditors. Positively, if appointing auditor is mandatory for the SMC, what would auditing and reporting requirement be expected to cover? In the company law literature, there exists a common understanding that reporting should cover activities on operations of major economic, financial or

³⁴⁷ Robert A. Kessler, *With Limited Liability for All: Why Not a Partnership Corporation?* 36 *Fordham Law Review* 265-66 (1967). <http://ir.lawnet.fordham.edu/flr/vol36/iss2/4>.

³⁴⁸ *Id.*

³⁴⁹ *Id.*

³⁵⁰ *Id.*

³⁵¹ *Id.*

³⁵² *Id.*

patrimonial importance effected by the company.³⁵³ It is further argued that reporting should in particular deal with operations in which the manager or director, exercising direction and control over the company or third parties have an interest.³⁵⁴

In the Peoples Republic of China, SMCs are required to make a financial report audited by an accounting firm by the end of every fiscal year.³⁵⁵ Hence, it is understood that SMCs in China is required to keep accounting record based on accounting principles so that an accounting firm would audit it. Therefore, at the end of every financial year, a SMC in China is required to appoint an auditor from an accounting firm but as such not required by law to hire auditor that follow up operation of the one-person company.

Under the OHADA Uniform Act, the appointment of an auditor in SARL that could be owned by sole proprietor is optional unless it becomes mandatory due to certain thresholds as to capital, turnover and personnel.³⁵⁶ However, the appointment of at least one statutory auditor is mandatory for *Société anonyme*, which could also be owned by single proprietor.³⁵⁷ In both cases, auditors are entrusted with the power to audit management reports and accounts before it is presented to the general meeting for approval.³⁵⁸ In the absence of auditor, the management of SARL is required to prepare management report and annual summary of financial statements at the end of each fiscal year.³⁵⁹ As indicated before, in case where the single shareholder director prepares the reports and annual financial statements of the SMC, he may also be required to call annual general meeting to approve the report and accounts prepared by him.

In France, EURL, like multimember SARL, is generally required to file approved annual accounts and annual reports with the court registry in order to be annexed to the Commercial and Companies Register.³⁶⁰ However, EURLs are exempt from the requirement to prepare management report when the single shareholder personally assumes the management, and if at the end of a financial year, one of the thresholds is reached relating to the amount of the balance sheet, the out of taxes turnover, and an average number of employees during the financial year.³⁶¹ Like the OHADA approach,

³⁵³ Andenas and Wooldridge, *supra* note 295, at 329.

³⁵⁴ *Id.*

³⁵⁵ Companies Law of China, Arts. 63 and 165.

³⁵⁶ OHADA Uniform Act, Art. 276.

³⁵⁷ *Id.*, Art. 702.

³⁵⁸ *Id.*, Art. 710 and 713.

³⁵⁹ *Id.*, Art. 137 *et seq.*

³⁶⁰ French Commercial Code, Art. L.232 -22 I.

³⁶¹ *Id.*, Art. L232-1, *See* for the detailed discussions on this matter; “France, Annex 1.F”, available at http://ec.europa.eu/enterprise/policies/sme/businessenvironment/files/annexes_accounting_report_2011/france_en.pdf. (Accessed on Nov. 7, 2013).

the appointment of statutory auditor is optional for single member SARL though it is not prohibited from having an auditor.³⁶² Thus, similar to the German and UK approach, small and medium-sized SMCs in France are not subjected to annual statutory audit.³⁶³ Regarding publication, single member SARLs are only required to file annual reports and annual accounts (balance sheet, income statement, notes and the management report) with the court registry, in order to be annexed to the Commercial and Companies Register after its approval or in the event of refusal of approval or acceptance, a copy of the deliberations of the meeting or of the decision of the sole proprietor.³⁶⁴ The filing simplifications are also available in respect of the income statement, with an exemption from the requirement to analyze the gross profit figure, and in respect of the notes to the financial statements, with exemptions, in particular, from the requirement to analyze sales by areas of activity and by geography.³⁶⁵

Under ECs SMCs Regulation, a SMC is required to appoint an auditor who cannot be removed from the office without the requirement of holding annual general meeting.³⁶⁶ When it comes to auditing and reporting, sole shareholder director and auditor of SMC under the EU regulation 1994 are required to prepare reports of director attached to the balance sheet and reports of accounts respectively before the AGM. However, in case where SMC dispensed with the holding of annual general meeting as indicated before, sending of the reports and accounts to the annual general meeting of the SMC is deemed to be satisfied were the said accounts and reports are sent to the sole member of the SMC.³⁶⁷

In the German legal system, the managing director of SMC is responsible for the operation of the business, and represents the single member GmbH in its dealings with third parties. He is also responsible for proper bookkeeping and for preparing the annual financial statements of the company following proper accounting procedures including management report.³⁶⁸ However, whether the accounts of SMC in Germany is subjected to auditing and disclosure requirements depend on its size identified on the criteria of net

³⁶² *Id.*, Art. L223-35; *see also* Christopher J Mesnooh, *Law and Business in France: A Guide to French Commercial and Corporate Law 32* (Kluwer Academic Publishers, 1994).

³⁶³ *Id.*, *see also* French Commercial Code, Art., L223-35, L232-1 and L232-2.

³⁶⁴ *Id.*, Art. L232-22.

³⁶⁵ *Id.*

³⁶⁶ ECs Single-Member Private Limited Companies Regulation, Art. 9(2).

³⁶⁷ *Id.*, Art. 8(5-7).

³⁶⁸ German Commercial Code, (*Handelsgesetzbuch*, HGB), Sec. 264 and 289. Requirements as to the form and contents of the annual accounts of a GmbH are set forth in German Commercial Code Secs.242–256 and 264–289 and in German Private Limited Companies Act, Sec.42 and *see also* Sec.30 *et seq.*

turnover, total balance sheet and number of employees.³⁶⁹ Accordingly, for non-audited sole member GmbH, *only the balance sheets and notes* must be deposited with the Commercial Register.³⁷⁰ However, the financial statement of an audited single member GmbH must also be deposited with the Commercial Register and those of certain size must, however, be published in the Federal Gazette.³⁷¹

Similar to the German and France jurisdictions, one can also find classification of small and medium sized companies in the UK. In principle, every company in the UK must keep accounting records irrespective of its size which show and explain business transactions and disclose the financial position of the company at any point in time with reasonable accuracy.³⁷² The accounting records must contain entries from day to day of all sums of money received and expended by the company, and the matters in respect of which the receipt and expenditure takes place, and a record of the assets and liabilities of the company.³⁷³ Similarly, it is also provided that every company's annual accounts for a financial year must be audited.³⁷⁴ But, exemption is given to small business entities that may also constitute SMCs. Hence, small and medium-sized SMCs can prepare and file abbreviated versions of their accounts and do not need to have their accounts audited at all and are not required to appoint an auditor.³⁷⁵ Regarding publications, the general principle is that accounts for both single member public and private limited companies should be delivered to the Companies House within six and nine months of the companies accounting financial year. Yet, small and medium-sized SMCs may be entitled to submit *abbreviated versions of accounts* to the Companies House.³⁷⁶

4.6. Transformation of SMCs

In the legal parlance, transformation of a company occurs when the company changes its legal form by the decisions of the shareholder(s).³⁷⁷ As indicated before, one person may form an incorporated SMC from the beginning or a multimember company may be transformed to a SMC due to the occurrence of events because of which all shares of a

³⁶⁹ German Commercial Code, Sec. 316 (I) and 267 (I).

³⁷⁰ *Id.*, Sec. 326 (I) and 325 (I).

³⁷¹ *Id.*, Sec. 325 (II).

³⁷² UK Companies Act, Sec. 386.

³⁷³ *Id.*, Sec. 475.

³⁷⁴ *Id.*

³⁷⁵ *Id.*, Sec. 477.

³⁷⁶ “*Abbreviated account*” is a shortened version account which provides less information. *See generally*, The Companies and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations 2012, UK).

³⁷⁷ OHADA Uniform Act, Art. 181.

multimember company falls into the hands of the single person. Therefore, the right to transform multimember companies into SMCs and vice versa is important to ensure versatility of business operations. Generally, two practical advantages of company transformation could be identified. First, it safeguards the continuity of corporate life of multimember companies from the risk of dissolution by the mere fact that the number of their members is reduced to one. As such, transformation ensures the continuity of corporate life making it consistent with the doctrine of separate legal personality that accords SMCs a perpetual life. Second, company transformation may help small sized SMC to transform itself into either medium or large sized enterprise.

In ECs SMCs Regulation, a private limited company previously registered with two or more subscribers may become a SMC, where the number of members is reduced to one and all the shares in the company are registered in the name of a single person.³⁷⁸ Similarly, conversion of SMCs into multimember private limited company is not prohibited but ceases to be a SMC where the number of members increases to more than one but does not exceed fifty.³⁷⁹ In a similar fashion, limited companies of either single or multimember shareholder in the UK and Germany will not be dissolved by the reason of consolidation of shares in the hands of one person.³⁸⁰ According to the UK Companies Act, when a multimember company became a SMC for the reason indicated before, the name, address of the sole member; a statement that the company has only one member; and the date on which the company became a company having only one member should be entered in the company's register of members.³⁸¹ Similarly, when a SMC became a multimember company, the name and address of the person who was formerly the sole member; a statement that the company has ceased to have only one member; and the date on which that event occurred should be entered in the company's register of members.³⁸² Unlike the UK, company transformation in Germany is regulated by separate legal regime called *Umwandlungsgesetz* (Law Regulating the Transformation of Companies).³⁸³

³⁷⁸ ECs Single-Member Private Limited Companies Regulation, Art. 5 (1).

³⁷⁹ *Id.*, Art. 6(1).

³⁸⁰ UK Companies Act, Sec. 123(2); German Private Limited Companies Act, Sec. 19 and 7; German Stock Corporations Act, Sec. 36(2) and 42; the German Law Regulating the Transformation of Companies (*Umwandlungsgesetz*), Sec. 1(1) *et seq.*

³⁸¹ UK Companies Act, Sec. 123(2).

³⁸² *Id.*, Art. 123(3).

³⁸³ Unlike other legal jurisdictions under considerations, the legal basis of company transformation is not evident from both German Private Limited Companies Act and German Stock Corporations Act. Such matters would be regulated under the "Transformation and Transfer of Assets Act". See at <http://www.kpmg.com/CH/en/Library/Articles-Publications/Documents/Legal/pub-20130730-comparison-of-stock-corporation-ag-sa-en.pdf>. (Accessed on Nov. 2, 2013).

In France and OHADA countries, the transformation of a single person SARL into another type of multimember company takes place under the usual conditions without any particular restrictions, subject to compliance with the legal requirements that are applicable to the new form of company selected.³⁸⁴ As indicated before, where one person SARL is converted into multimember SARL, there is no transformation *stricto sensu* in both legal jurisdictions as it still involves SARL and the rules that govern it. However, unlike the OHADA system where one person SA could be simply converted into a multimember SA which still involves the same SA rules, a single shareholder SARL in France, however, involves rules designed to only regulate multimember SA. As indicated previously, one person is not allowed in France to incorporate single member SA. However, a multimember SA will not be dissolved in case where all of its shares falls in the hands of single shareholder as it may be transformed into one person SARL.³⁸⁵ In both OHADA and France legal systems, certain legal requirements must be fulfilled in order for the transformation to successfully take place. These legal requirement is similar to that of the German jurisdiction and includes the dawning up of an approved balance sheets for its first two financial years; updating articles of association; auditor's report that certify that the company's net equity is at least equal to the amount of the share capital; filling of minutes with the commercial court and publication in the legal journal are few to mention.³⁸⁶ It is only when these legal formalities are complete that the decision will be valid as against third parties.³⁸⁷

In the Companies law of China, there exists a general rules that provide for the conversion of a company with limited liability into a company limited by shares but not vice versa.³⁸⁸ As such, it seems that a single person limited liability company in China may be converted into a multimember company limited by shares. Yet, it is not evident from the Companies law of China as to whether a multimember companies limited by shares could be converted into one person limited company or could face dissolution in case where all of its shares falls in the hands of a single person.³⁸⁹ Hence, unlike France which prohibited single member public limited companies but allowed its transformation and

³⁸⁴ See FRENCH COMMERCIAL CODE, Arts, L210-6, L224-3, L223-4, L251-18, and L223-3.

³⁸⁵ *Id.*, Arts, L210-6, L224-3, and L225-245. This legal conception under French corporate law may raise an issue as to why the legislator is reluctant to recognize the incorporation of one person SA *ab initio* while it is possible for a SARL to have one person when its minimum number is reduced to one.

³⁸⁶ *Id.*, Arts. L224-3, L225-243, L225-244 and L225-245; OHADA Uniform Act, Arts, 374, 690–691, 693, 375 and 691.

³⁸⁷ *Id.*

³⁸⁸ See generally Companies Law of China, Art. 96.

³⁸⁹ Cui Zaifei, "A Comparative Analysis of One-man Company." Available at <http://www.szcourt.gov.cn/ArticleInfo.aspx?id=523>. (Accessed on Nov. 5, 2013).

restructuring into single member SARL, the Companies law of China opted for the transformation of limited liability companies into public limited companies. It seems that this rule is an extension of the legal principle that prohibits public limited companies to have one person as its sole shareholder.

4.7. Transfer of Shares and Interest of SMCs

In addition to company transformation, the other means to ensure the continuity of a SMC is disposing the shares or interests of the company to legal heir as the next sole shareholder of the SMC. In an owner-managed SMC, death of sole shareholder may result in dissolution of the company unless a legal scheme that ensures the continuity of such SMC would be devised. Generally, the risk of dissolution may be avoided in two ways. The first one is transferring the interest of SMC or *inter vivos* to legal heirs. The second legal scheme is transfer of shares or interests *mortis causa*. The former requires single member to transfer his own share to family members during his life for different reasons instead of dissolving the SMC. The latter require the nomination of a “nominee director” in the articles of association who will manage the affairs of the SMC after death of the sole member manager for an interim period. Accordingly, the nominated interim director is required to transfer the interests of the SMC to the legal heirs of the deceased single member by calling a general meeting to elect director(s) from among the legal heirs. The pivotal concern is therefore to see to it whether the jurisdictions under consideration have designed legal schemes that address issues indicated above.

In Germany, the law does not require the articles of association to place any restrictions on the transfer of shares but requires transfer to be effected via a notarial deed.³⁹⁰ However, it may be provided in the articles of associations that the transfer of share occurs after approval of the shareholder in the general meeting.³⁹¹ In France, shares are freely transferable through succession or in the event of liquidation of community of property between spouses and are freely assignable between spouses and between ascendants and descendants.³⁹² However, the articles of association may stipulate that the spouse, an heir, an ascendant or a descendant may only become a member after having been approved by the company that requires the consent and decisions of the sole shareholder.³⁹³ In case of death of the single shareholder, the articles of association may stipulate that the company

³⁹⁰ German Private Limited Liabilities Act, Sec. 15 (3).

³⁹¹ *Id.*

³⁹² French Commercial Code, Art. L223-13

³⁹³ *Id.*

shall continue with his heir.³⁹⁴ By the same token, shares may only be transferred to third parties outside the company with the consent of the single shareholder.³⁹⁵ If there are several beneficiaries, the EURL is converted into SARL. Eventually, transfer of share in EURL can take place orally but a written instrument prepared by a notary should follow it.³⁹⁶ In such case, the company must be informed of the transfer in the prescribed manner, and the transfer must be registered at the Commercial Register.³⁹⁷ Generally, one can say that in the event of death of the sole shareholder, SMC continues to exist unless the articles of associations specifically provide for its termination. Similar trend is also followed in the OHADA system but emphasis is given to articles of associations to govern the matter. So, articles of association may provide otherwise on the transfer of shares to close relatives of the shareholder during the life of the single shareholder.³⁹⁸ In the event of the death, the article of association is required to provide that the single shareholder's heirs may become shareholder(s).³⁹⁹ Like France, unless the number of heirs is one, the EURL should transform itself into multimember SARL. In any of the above case, however, the company should be notified of the transfer in a notarized deed; filing of an original copy of the share transfer deed with the company's registered office, against an acknowledgement of receipt delivered by the company's manager.⁴⁰⁰

The UK Companies Act also provides that share or interest in SMC may be transferred on the application of the transferor.⁴⁰¹ Nevertheless, in such case, the company is required to enter in its register of member the name of the transferee in the same manner and subject to the same conditions as if the application for the entry were made by the transferee.⁴⁰² In the case of death of the shareholder, personal representative executes an instrument of transfer of the share or other interest of a deceased member of a company.⁴⁰³ However, the transferee becomes a shareholder of the company only after the certificate of transferred share has been issued.⁴⁰⁴

³⁹⁴ *Id.*

³⁹⁵ *Id.*, Art. L223-14

³⁹⁶ *Id.*, Art. L223-17; This Article makes reference to Art. 221-14, which requires the transfer to be completed by a written instrument and take the form required by the French Civil Code, Art. 1690. Questions concerning the transfer of a share in an SARL are as a matter of civil law within the competence of the civil courts, whilst those concerning that of the majority of the shareholding are dealt with by the commercial courts. *See* Cahn and Donald, *supra* note 41, at 113, at *foot note*.

³⁹⁷ *Id.*

³⁹⁸ OHADA Uniform Act, Art. 318.

³⁹⁹ *Id.*, Art. 321.

⁴⁰⁰ *Id.*, Art. 317.

⁴⁰¹ UK Companies Act, Sec. 772.

⁴⁰² *Id.*

⁴⁰³ *Id.*, Art. 773.

⁴⁰⁴ *Id.*

Under the Companies law of China, transfer of share is regulated in a general way. In the absence of articles of association regulating the matter, the default rules under the law regulates transfer of share either to each other or to third parties through mutual agreements.⁴⁰⁵ Unlike the other jurisdictions noted above, issues of disposing shares or other interests of the single shareholder in the company to its legal heirs or to its close relatives are not regulated under the specific provision governing SMCs. However, reference is generally made to the provision of companies law that govern the formalities for the transfer of shareholders property rights and interests that could be applicable to the situations of SMCs⁴⁰⁶

4.8. Dissolution and Winding up of SMCs

The term dissolution may generally refer to the termination of a corporation's legal existence for different reasons.⁴⁰⁷ In this context, the life of SMC may come to an end like the death of natural person for reasons such as completion of purpose for which it is established; expiry of the term for which the company was formed; decisions of the shareholder; legislative act; and court ordered liquidation in case of insolvency are few to mention.⁴⁰⁸ This legal scheme is particularly pivotal given the sole proprietorship like features of SMCs as an exit option from the business that is proved not profitable. Thus, once the liquidation of a SMC is decided, the next legal step is winding up, "*the process of settling accounts and liquidating assets in anticipating a corporation's liquidation.*"⁴⁰⁹ Therefore, winding up of a SMC simply refers to an *en route* by which its corporate life is put to an end and its net assets or liabilities, if any, are distributed to the sole member or its legal heirs and paid to the creditors. Henceforth, like the death of a natural person, the winding up is the death knell of a SMC.⁴¹⁰

The purpose of liquidating the assets and liabilities of the SMC is to protect the rights and interests of a sole shareholder and creditors.⁴¹¹ Nevertheless, the legal consequences of winding up process vary depending on the reasons for dissolution of a SMC. As some argue, paradigm of winding up in the context of SMC compared to multimember companies' is much more simplified since there are no other members which the law

⁴⁰⁵ Companies Law of China, Arts, 72-74.

⁴⁰⁶ *Id.*

⁴⁰⁷ Black's Law Dictionary (7th ed. 1999) "dissolution".

⁴⁰⁸ Boris Martor Et Al., *supra* note 195.

⁴⁰⁹ Black's Law Dictionary, *supra* note 407.

⁴¹⁰ H.K. Sahary, Text Book on Company Law 34 (5th ed. 2008).

⁴¹¹ Carter G. Bishop, *Reverse Piercing: A Single Member LLC Paradox*, 5 South Dakota Law Review 221 (2009).

purports to protect.⁴¹² Hence, in the normal course of things, after the creditors of the company are paid, the property rights and interests of the SMC remains the personal property and interest of the sole shareholder or his legal heirs in as much the same way as the case in conventional sole proprietorships.

However, the most challenging legal discourse relating to insolvency is that it is extremely complex and it is impossible to provide anything other than a brief sketch of the many procedures and concepts that underpin the law in this field.⁴¹³ Particularly, its application to SMC is not yet much tested and hence legal commentaries regarding bankruptcy paradigm of a SMC is hard hit by the dearth of the legal literature.⁴¹⁴ The far more important question, however harder it might be, is to address the effects of bankruptcy *when the owner of a SMC encounters financial hard times – incapable of meeting current financial obligations*. As indicated before, in the absence of corporate veil piercing grounds, a single shareholder is liable to the extent of his investment in the SMC.

Theoretically speaking, property transferred in the form of contribution to or acquired by the SMC is not owned by the single member, but by the SMC.⁴¹⁵ Yet, regardless of what type of property the SMC may own, the interest of sole owner in such a company is a personal property, which has a far-reaching consequence if financial distress knocks on the door. Thus, as indicated before, whether a single member should consider bankruptcy for his own SMC or need to consider a personal bankruptcy depends on many factors including how effectively the sole member have separated the debts and assets of the SMC from his personal debts and assets. Hence, depending on this factor whether the filing of a petition in bankruptcy creates a bankruptcy estate consisting of all of the debtor's property or limited to the assets of SMC or both is determined.⁴¹⁶ However, it is argued that even in the absence of factors for corporate veil-piercing, the single member debtor may guard the assets of a SMC to defend his position in the company over those of the creditors.⁴¹⁷

The legal regimes governing liquidation and winding up of SMCs in jurisdictions under consideration is still subject to the general rules of multimember company bankruptcy paradigm except for one specific provision under OHADA Uniform Act

⁴¹² *Id.*

⁴¹³ Jeff McGeachie, England, in Frank Dornseifer (ed.) *Corporate Business Forms In Europe: A Compendium of Public and Private Limited Companies in Europe* 277 (2005).

⁴¹⁴ Carter G. Bishop, *Desiderata: The Single Member Limited Liability Company Olmstead Charging Order Statutory Lacuna*, 16 *Stanford Journal of Law, Business & Finance* 244 n.2 (2011).

⁴¹⁵ Dean A. Langdon, *Single Member Limited Liability Companies and Financial Distress* (2011). http://amicuscreative.com/global_pictures/1086//Single_Member_LLC.pdf.

⁴¹⁶ *Id.*

⁴¹⁷ *Id.*

indicated below. It could be argued that much of the legal playground for bankruptcy issues for SMC under these jurisdictions was/is entertained within the wider context of traditional corporate veil piercing doctrines discussed in chapter three. At the EU level, legal measures regarding the winding up of SMCs has not yet taken off from the ground.⁴¹⁸ Hence, whether “one size fits all” approach or separate legal regime should be considered is an ongoing agenda that constitute the *leitmotif* of the EU company law harmonization process. It is only under the OHADA Uniform Act that one can dare find specific single article that deals with the liquidation of SMCs. Under this Act, dissolution of SMC simply involves a publication *entailing total transmission of the assets and liabilities of the company to the sole shareholder without resorting to liquidation*.⁴¹⁹ However, creditors of the SMCs would be allowed to object to such liquidation before the competent court within a period of thirty days following its publication.⁴²⁰ The competent court before which the objection is presented is required to decide on the matter. Accordingly, the court shall either reject the objection as inadmissible or order the settlement of debts or order the provision of guarantees deemed sufficient if the company offers any. Therefore, the transmission of the assets and liabilities and the winding up of the company shall be effective only after the expiry of thirty days time limit for objection or where the objection has been declared inadmissible or if the settlement of debts has been effected or sufficient guarantees provided by the SMC.⁴²¹

4.9. Summary of the Comparative Analysis

The preceding comparative analysis roughly provided two basic legislative models for the regulation of SMCs. The UK, German and OHADA jurisdictions represent the first legislative modality. The Companies law of these countries provides a more “liberal” approach towards the recognition and regulation of SMCs because they permit single person to incorporate either private or public limited companies. Besides, there is no prohibitions and limits on the number of SMCs that could be established by either natural or legal person including the SMC itself. The second legislative modality is provided by the France, China and EU approaches. The approach of these legal jurisdictions compared to the previous is restrictive since a single person is generally allowed to incorporate private

⁴¹⁸ It is evident from the EU Single member companies legislations that issues of liquidation, winding up and bankruptcy are not regulated. It is seems that such matters are generally governed by the conventional company law unless member states are willing to specifically regulate the matter.

⁴¹⁹ OHADA Uniform Act, Art 201.

⁴²⁰ *Id.*

⁴²¹ *Id.*

limited companies. In the same vein, the number of a SMC that a natural or legal person may incorporate is also limited.

Despite these differences, all legal jurisdictions under considerations are similar in their approach towards SMCs on the basis of the following features. First, SMCs are construed as a variety of the existing companies be it private or public limited. In other words, all jurisdictions under comparative studies have opted to accommodate SMCs within the wider context of the existing corporate rules. The general rules governing private and public limited companies are applicable with any necessary modifications in relation to a company formed by one person or having only one person as a member. By so doing, these countries have avoided the possibility of legal duplications that may ensue from the legislative approaches of creating SMCs as third type of a company form.

Second, all jurisdictions under considerations have considerably devoted sections or special provisions in their Companies law applicable to SMCs due to their typical nature. Special rules applicable to formation, capital and publicity requirements; meetings, quorum and recording of decisions; contractual dealings with the company and its mandatory recordings, and the duties of record keeping and auditing were the major ones. Therefore, it is demonstrated that except for the introduction of few rules in order to safeguard SMCs, rules applicable to private and public limited companies could be adjusted in such a way compatible with the existence of single shareholder.

Chapter Five

5. Introducing SMCs into the Ethiopian Corporate Legal System

5.1. Introduction

Introduction of the legal basis of a company owned by a single person into the Ethiopian legal system is inevitable that would be realized sooner or later. The appetite of the government for “comprehensive and sustained economic reform” has recently paved the way for “*loosening of restraints on commerce (...) as a matter of life and death.*”⁴²² Particularly, the international imperatives of SMCs as an engine of pulling capitals, no matter how small it is, has forced states in a globalized world to design a law that regulates its existence. As indicated before, in the world of staggering competition for foreign capital, the advantages of limited liability make a SMC an attractive business vehicle. On top of that, its pivotal role in encouraging investors in developing economies like Ethiopia may help in supporting small and micro enterprises. Paradoxically, there are no legal frameworks capable of ensuring the establishment of SMCs in the private commercial sector in Ethiopia. Therefore, the most vital question is in what way would the Ethiopian lawmaker be expected to contemplate the legal vehicle that governs SMCs to make it an alternative business vehicle without on the other hand negatively impacting creditors? The answer to this question has been already half addressed in the comparative legal studies of the preceding chapters.

As noted before, the values of comparative legal study buttress the vital role of providing “windows of opportunities” from which one can emulate. It is particularly a relevant legal blueprint that would help us to deviate from the potential pitfalls of one’s own legal system. I hope that, this chapter as a fruit of previous theoretical and legal insights of an in-depth comparative study, would help to evaluate the legal assumptions on business organizations in Ethiopia. In the opinion of this writer, the relevant legal architectures of the comparative jurisdictions are useful in the modifications of the *de lege lata* of Ethiopian corporate legal system and hence may serve as a spring board for a legislative proposal of SMCs.

⁴²² Commercial Law Reform and Trade Diagnostic, *supra* note 15, at 1.

5.2. Background to Ethiopian Corporate Law

The development of Ethiopian corporate law can be dichotomized into three historical periods. The first period (1933-1974), which coincides with the Imperial regime of Haileselassie I, marked the birth of the Commercial Code into which the present company law has been integrated.⁴²³ The enactment of the Commercial Code as affirmed in its prefatory note is motivated by *the necessity of addressing the complex methods of transacting business due to the then expansion of commercial life and the increasing numbers of Ethiopian and foreign companies.*⁴²⁴ However, there were divergent views on the platitudes and projections of the prefatory note. On the one hand, scholars such as Paul Brietzke noted that the practical effects of a Commercial Code during the period of its inception have been “appearance rather than the reality of reform” – lacking an “essential link with the then Ethiopian realities.”⁴²⁵ He further noted that the Commercial Code enacted during this period was incapable of promoting development as it failed to meet the needs and demands of the then business community.⁴²⁶

On the other hand, Rene David generally justified the codification decision on the ground that it was “apparently based on the idea held in Ethiopia that codification in itself was progress, a desirable thing for the country – at least as a symbol of modernization”⁴²⁷ Regarding the influence and practicality of the law, David noted that neither a total nor immediate success must be expected in all fields from the principles on which the laws were founded as it often wait a long time to be put into practical application.⁴²⁸ Yet one may argue that despite the challenges as to the practical applicability of the Commercial Code, the first period marked the beginning of Ethiopia’s modern corporate law that help the private sector businesses to play their role in the national economy.

The second period (1975-1991) marked the downward spiral of Ethiopia’s corporate sectors and its legal and institutional development. During this period, the company law

⁴²³ The present Commercial Code of Ethiopia is the consolidated part of “The Bankruptcy Law and the Company Law of 12th July, 1933. See the prefatory note of the Commercial Code of Ethiopia (1960).

⁴²⁴ *Id.* at prefatory note.

⁴²⁵ Paul Brietzke, *Private Law in Ethiopia*, 18 *Journal of African Law* 167 n. 2 (1974). See also John H. Beckstrom, *Transplantation of Legal Systems: An Early Report on the Reception of Western Laws in Ethiopia*, 21 *The American Journal of Comparative Law* 572 n. 3 (1973).

⁴²⁶ *See id.*, at Paul Brietzke.

⁴²⁷ Rene David, *A Civil Code for Ethiopia: Considerations on the Codification of the Civil Law in African Countries*, 37 *Tulane Law Review* 193 (1963). *See also* Alfred Jauffret, General Report: Book I, Background Documents of the Ethiopian Commercial Code of 1960 1 (Edited and translated by Peter Winship, Faculty of Law, Haile Selassie I University, Artistic Printers, 1974). He noted that the need to prepare a commercial code for Ethiopia should not only take into account the economic development of those days, but *encourage Ethiopia’s future economic evolution.*

⁴²⁸ *See* David, *supra* note 427, at 203.

provisions of the Commercial Code were technically out of use and the private ownership of individual proprietorship, business organizations were limited, and some are totally prohibited under the banner of “Ethiopian Socialism.”⁴²⁹ Accordingly, major agricultural, industrial, commercial and service companies were nationalized and became state-owned public enterprises.⁴³⁰ These actions were justified based on the then socialist motto that dubbed capitalism as a means of social exploitation and a waste of business cycles. Hence, in order to halt the advance of “capitalist” system that has already beginning to cultivate its roots, the socialist regime aimed at controlling the “commanding heights” of the people and the private sector.⁴³¹

The major challenge, according to Brietzke, to the nationalized and other public companies during this time came from absence of relevant legal provisions to govern the situations of “public corporations” in the Ethiopian Commercial Code.⁴³² However, Brietzke underestimated the role of specific proclamations and regulations enacted during this period that were designed to govern state-owned corporations including nationalized “Individual Proprietorship and Business Organizations.”⁴³³ Here, though the discussion on state-owned corporations is beyond the limit of the thesis, it is however important to note how private sectors during this period were forced to play a minimal role confined to small-scale businesses. Hence, despite the rise of public enterprises as state-owned corporations, it is difficult to talk about private corporate legal and institutional developments during this time at least if it means that “capitalism” is a means for the development of private business corporation and its legal system.

The third period (1992 - *present*) could be termed as the “restoration of Ethiopian company law” and proliferation of business organizations. Unlike the first period, however, one could utterly say that Ethiopia has witnessed a major social and commercial

⁴²⁹ Those private sector businesses allowed to continue to operate under the Commercial Code will were smaller and less capitalist and the Commercial Code will have to be modified to serve these needs. See Brietzke, *supra* note 425, at 163. See also Commercial Law Reform and Trade Diagnostic, *supra* note 15, at 18.

⁴³⁰ See *id.*, at Paul Brietzke.

⁴³¹ *Id.* See also a Proclamation Relating to Commercial Activities Undertaken by the Private Sector (Proclamation No. 76/1975) Art. 4 and Art. 8 which limits the number, type and maximum capital (500, 000 ETB) required to undertake a commercial activity in the private sector.

⁴³² Brietzke noted that “nationalized companies will be run by a State-appointed manager and a workers’ committee, who will transform profits into socially-useful investments. He observed that the aims underlying the nationalizations and the new mode of public company management are incompatible with the legal structures of these companies, as dictated by the Commercial Code, and that the lack of a relevant law may generate chaos in the decision-making process.” *Id.*, at 163-164.

⁴³³ See for instance Government Ownership and control of means of Production Proclamation No. 26/1995, Arts. 2 and 4. See also public Enterprise Proclamation No. 20/1975 and its subsequent amendments. In addition, different state owned corporations were established by their own proclamations that also regulate such corporations.

dynamics. In today's Ethiopia, the provision of company law is not any more "pictured as a sophisticated body of law lying dormant waiting for the nation to grow into it."⁴³⁴ The challenge now is that this law standing alone, as we shall see, has proven its inadequacy for the conditions to date – it needs to be updated to reflect current commercial realities and the demands of the global economy.⁴³⁵ Today, though the reform of the Commercial Code is a pie in the sky, fragmented attempts are made to substantiate the company law provisions of the Commercial Code since the last two decades.⁴³⁶ Particularly, the enactment of Investment and Commercial Registration and Business Licensing Proclamations including other subordinate legislations could be a case in point.⁴³⁷ Accordingly, the present corporate legal system of Ethiopia is the combination of these legislations and the 1960 Commercial Code. It should be noted that a closer look at the design and purpose of investment legislations discloses that they are outward looking primarily designed to attract foreign capital in the form of foreign direct investment (FDI).

Generally, two "forms of companies" may be identified in the present day Ethiopia - "Ordinary Companies" and "Investment Companies". The former refers to Private Limited Companies and Share Companies wherein the 1960 Commercial Code, largely, regulates their formation, organizations and dissolution.⁴³⁸ The latter refers to companies that are largely subject to the requirements and limitations of investment laws and bilateral

⁴³⁴ See David, *supra* note 427 at 203-204 and Brietzke *supra* note 425 at 572. However, "A Team of Fourteen National Experts" positing their comments on the draft commercial code still holds the view that in the present situation of Ethiopia, "... economic and social realities have lagged far behind legal postulates." The team contend that the provisions of the Commercial Code of 1960 have not been effectively tested, save for a handful of provisions dealing with insurance, negotiable instruments, carriage of goods or persons and companies limited by shares, many of them have remained dead letters since there have been rare occasions for their practical implementation. See A Team of National Experts, *supra* note 14 at 7.

⁴³⁵ See Commercial Law Reform and Trade Diagnostic, *supra* note 15, at 4.

⁴³⁶ The reform of the Commercial Code of Ethiopia (1960) has been under way for all most close to ten years under the auspices of Federal Ministry of Justice. The French Official Aid Agency has been supporting the Ministry of Justice in its efforts to reform the Commercial Code. The Commercial Law expert, Mr. D. Ponsot is supposed to provide the Revision Committee of the Commercial Code of the Ministry with advisory services for four years, in their effort to revise the Commercial Code and the Commercial Register. However, it appeared that there were many other priorities to be addressed during the time. The revision of the Commercial Code and the Commercial Register had to, therefore, be postponed for another time. See Amha Bekele and Zemedeneh Negatu, *Company Registration in Ethiopia* 42 (Addis Ababa: Private Sector Development Hub/Addis Ababa Chamber of Commerce and Sectoral Associations, 2009).

⁴³⁷ See Investment Proclamation, No. 769/2012 and Commercial Registration and Business Licensing Proclamation No. 686/2010 (last amended by Proclamation 801/2013). These two legislations somewhat reformed the company law provisions and other Commercial Code rules in order to meet the demands of both domestic and foreign investors which some argue has "proven adequate to conditions to date". See Commercial Law Reform and Trade Diagnostic *supra* note 15, at 4.

⁴³⁸ An Ethiopian who wants start the operation of commercial activity is not required to have investment permit but only required to fulfill the formalities under the commercial code and registration at the ministry of trade and industry as per the rules of Commercial code. But, in case the trader wants investment land and other investment incentives, he may be required to apply to appropriate investment agencies for investment permits. See Investment Proclamation, No. 769/2012, Art. 12(2).

investment treaties designed to attract and regulate FDI. These investment companies also include domestic investors who want to invest in investment areas allocated to domestic investors with special incentives and other benefits. Hence, when it comes to foreign investment companies, the applicability of commercial code provisions of both PLCs and SCs are limited.⁴³⁹ Eventually, as indicated repeatedly, it should be vital to take note of the fact that the menu of company form of business organization in the investment legislations is limited to PLCs and SCs.

The diagnosis of Ethiopian company law reveals that one “*particular often-cited problem*” raised by business communities in Ethiopia is the requirement of minimum two and five number of members for the incorporation of PLC and a SC under the Commercial Code of 1960.⁴⁴⁰ The study noted that, “*such a rule serves no evident purpose and can cause considerable inconvenience and unnecessary expense and paperwork.*”⁴⁴¹ According to the observation of this study, this rule prevents a company with several shareholders from having wholly owned subsidiaries and may open the door for unnecessary business schemes such as duplication of company’s shareholders multiple times to act as identical separate owners of each of multiple, separate, commonly controlled companies.⁴⁴² The study finally raised concerns of such inappropriate scheme as it turn causes difficulties in consolidating the accounts of such companies.⁴⁴³

5.3. Legal Adjustments for SMCs

In Ethiopia, Share Companies and Private Limited Companies are the only two forms of corporations duly recognized under the Commercial Code and Investment Proclamation. In view of these two corporate forms, one of the major tasks in the design of rules for SMCs is to make a choice as to its form and the rules that govern it. Accordingly, would Ethiopian legislator opt to integrate SMCs as a new variety of Share Company (SC) or a Private Limited Company (PLC) or both or create a separate legal regime that regulates SMCs as a new type of corporate form? The answers to these basic questions depend on the informed decision of the legislator as to the ramifications of the choices. Yet, if the

⁴³⁹ The requirement of investment permits, additional documents, and authentication of foreign memorandum and articles of associations, minimum capital requirement rules only applicable to foreign investment companies and other privileges, limited business scopes are few rules to mention. *See* Investment Proclamation, No. 769/2012, Art. 10, 11, 12 (1), 14, 16.

⁴⁴⁰ *See* Commercial Law Reform and Trade Diagnostic, *supra* note 15, at 20 and the comments of A Team of National Experts, *supra* note 14, at 17.

⁴⁴¹ *See id.*, at A Team of National Experts.

⁴⁴² *Id.*

⁴⁴³ *Id.*

choice is to be made, it is understood that the necessary modifications are also required to adjust rules that had traditionally been applicable to the two forms of companies.

5.3.1. Option I – SMCs as a New Company Form?

The creation of separate legal regime for SMCs is not palatable as indicated before – no country under the comparative legal considerations has opted such legal regime. Besides, close to sixteen years ago, Professor Porter noted that the “worst” legislative approach to SMC in Ethiopia “would be to create [it as] a new kind of legal entity.”⁴⁴⁴ Such an approach, according to Porter, aggravates the complexity of the Commercial Code and creates a need for conversion of the SMC into another kind of company if more investors bought shares.⁴⁴⁵ After a critical review of both company forms, he remarked that a better solution would be to repeal those sections of the company’s law that impose minimum shareholder requirements.⁴⁴⁶ As indicated before, Porter’s remark is partially correct since legislative choice “would permit a sole shareholder to choose whichever kind of company he or she is willing to form.”⁴⁴⁷

The problem with Porter’s remark is that repealing sections of both companies provisions that impose minimum number of members would not suffice, as it seems at first glance, given the distinct features of sole proprietorship compared to that of private limited and share companies. In addition to what he has said, there are various company law provisions that contradict the new concept of SMC as indicated before. Therefore, the choice of integrating SMCs as either or both of the two forms requires critical review of the laws that govern them and their ramifications on SMCs and vice versa. Here, it should be noted that one major reason adduced to contend the design of separate legal framework for SMCs is that it may create duplication of corporate rules and principles given the private corporate nature of SMCs, which would easily be accommodated to the existing provisions of PLCs. The writer have the opinion that rather than devoting a new chapter that regulate SMCs, it would be better to devote special chapter that regulates only the special features of SMCs, other corporate rules being cross referred to general provisions governing

⁴⁴⁴ Porter, *supra* note 21, at1104-1105.

⁴⁴⁵ *Id.*

⁴⁴⁶ *Id.*

⁴⁴⁷ *Id.*, it seems that there is an apparent contradiction of arguments in Porter’s analysis. On the one hand, he argued that “it would not be necessary to change the minimum capital requirements, the management structures or any other provisions governing companies. It would only be necessary to amend the articles which contain references to a minimum number of shareholders.” On the other hand, he pushes a legislator to amend all articles of the commercial code dealing with shareholders, directors and managers and proposes no need for shareholders meeting, only signed resolutions; only one director, and no meetings, only signed resolutions.”

companies. Be as the case may be, the following analysis try to highlight some points on the legal ramifications of the two corporate forms in order to shed light on the options.

5.3.2. Option II – SMCs in the Form of Share Companies?

In Ethiopia, a Share Company refers to a company whose capital is fixed in advance and divided into shares, liabilities are only met by assets of the company, and members are liable only to the extent of their shareholding.⁴⁴⁸ The *exposé des motifs* on Share Companies reveals the fact that such company forms are designed “to encourage broad-based enterprise.”⁴⁴⁹ As indicated in the comparative jurisdictions, this company form is also designed for large-sized business with complex formality requirements compared to private limited companies. But, unlike Ethiopia, it could be incorporated by one person – the exception being China, France and EU comparative jurisdictions. The question is if Ethiopia opted to allow such corporate form for sole proprietors, would it be doable to accommodate the operational flexibility of sole proprietorship with the more complex nature of rules that regulate Share Companies?

Some legal scholars propelled Share Companies as “the best solution (...) to create one-shareholder companies (...)” in Ethiopia.⁴⁵⁰ According to Porter, “any person who wants to start a firm or to invest in one and who is concerned about personal liability will form or invest in a SC.”⁴⁵¹ Porter firmly argued that Share Companies law “offers the best protection against unlimited liability of any arrangement created by the Commercial Code and should be extended to one owner of a company instead of limiting it to a company with five owners.”⁴⁵² He further argued that as the law stands now, “the potential unlimited liability of managers in a PLCs and the unclear status of other shareholders” in those companies make it less suitable for SMCs.⁴⁵³ The “only disadvantage of a Share Company,” in Porter’s view, is the requirement of minimum five members and higher capitalization compared to PLC.⁴⁵⁴ Ponsot, a French legal expert, who is commissioned to assist in the revision process of the Commercial Code of Ethiopia, has also proposed the possibility for SCs to have only a single shareholder on condition that basic amendments would be made to the share companies’ provisions of the Commercial Code. In

⁴⁴⁸ Commercial Code of Ethiopia, Art. 304 (1, 2).

⁴⁴⁹ Jauffret, *supra* note 427, at 61.

⁴⁵⁰ Porter, *supra* note 21, at 1104.

⁴⁵¹ *Id.*, at 1105.

⁴⁵² *Id.*

⁴⁵³ *Id.*, at 1104.

⁴⁵⁴ *Id.*, at 1105.

consonance with Porter's remark, Ponsot also proposed for the abolishment of five member requirements, providing rules that confer the power of shareholders meeting on the single shareholder, and adapting the rules governing the meeting to such a case.⁴⁵⁵ Yet, Ponsot raised a concern of companies limited by shares over the problems such as organization of the managing body, the board of director and the requirement of at least three directors who are required to be shareholders.⁴⁵⁶ He finally remarked that the introduction of the SMC by shares requires a modification *quite in depth of the theoretical outline* of such form that should coincide with the introduction of simplified form of companies by shares.⁴⁵⁷

The writer of this thesis, however, firmly believes that one person should not be allowed to incorporate Share Companies for the following reasons. First, both Ethiopian and international legal practices show that SCs are primarily designed for large enterprises in view of attaining "broad based" economic goals. As noted in chapter two, SCs are suitable to pool capitals from investors who have not even seen each other before unlike closely held corporations or PLCs. As such, SCs are more suitable for group of investors who want to mobilize large resources through public subscription of shares. Hence, due to the nature in the design of such companies, their capacity to mobilize resources from different walks of life makes it more suitable to multi-investors rather than sole proprietors.

Second, the fact that developed countries such as UK and Germany have already introduced it does not guarantee that a least developed country like Ethiopia should hastily adopt it.⁴⁵⁸ Legal and technological advancements of these two countries may have helped them in easing the complexities associated with shareholding companies thereby making it less cumbersome for single person investor. Genuinely, one also should need to consider why would France, from which most companies law of Ethiopia has been adopted, become reluctant to allow one person to form a SCs. In Ethiopia, where the business is dominated

⁴⁵⁵ *Id.*, at 1105. He proposed schemes where no need for shareholders meeting but only signed resolutions; only one director, and no meetings, only signed resolutions; etc. See also P. Ponsot, *Single-Member Companies Limited by Shares: Proposals of Drafting* (July 12, 1999, copy on file with the author).

⁴⁵⁶ *Id.* at Ponsot.

⁴⁵⁷ *Id.*

⁴⁵⁸ The introduction of single member public limited companies in these two countries of EU member states is by and large is motivated by competition in order to attract foreign capital to their own national jurisdictions as a scheme of race to the bottom for investor. See Martina E. and W. Kerber (2013) *Horizontal and Vertical Regulatory Competition in EU Company Law: The Case of the European Private Company*.<http://www.andrassyuni.eu/upload/File/Forschung/Andrassy%20Working%20Papers/eckardt-kerber-28-deckblattInhaltsverzeichnis28.pdf>. (Accessed Dec. 20, 2013). See also Sebastian Mock, *Harmonization, Regulation and Legislative Competition in European Corporate Law*, 3 German Law Journal (2002). <http://www.germanlawjournal.com/index.php?pageID=11&artID=216>.

by small and micro enterprises (SMEs) in which sole proprietorships hold the lion's share, the complexity of management rules associated with a SC would make single person SC an onerous business venture. According to the "Think Small First" Report of Expert Groups on European small businesses, policy makers are required to create rules and procedures from the SMEs point of view. The report particularly indicated that rules and procedures designed for large companies create disproportionate, if not unbearable burdens for SMEs as they lack economies of scale – "one size does not fit all."⁴⁵⁹ Therefore, this concern may reveal that any adjustment of legal regimes previously designed for large businesses could make it unsuitable for sole proprietors thereby diminishing its advantage as an alternative business vehicle.

Thirdly, as noted in the preceding chapters, SMCs are more susceptible to risks of abuse due to absence of check and balance which, actually, arises from its very nature. On the other hand, Escarra noted that, unless severer legal approach is taken, SCs lend themselves to the perpetration of many forms of fraud.⁴⁶⁰ So, the combination of the potential risks inherent in the nature of both business vehicles would be an "alchemy" that utterly defeats the goal for which share company law is designed from the outset. Even if a great deal of work is done to come up with a very simple law for single shareholding company, it is still a complex legal practice which in turn defeats the operational flexibility of sole proprietorship like feature of SMCs.

Finally yet importantly, it is vital to critically evaluate the legal propositions forwarded by Porter and Ponsot on SMCs limited by shares before closing this very section. To begin with, Porter concluded that "the potential unlimited liability of managers in PLC and the unclear status of other shareholders in those companies" make share company "the best alternative" for sole proprietorship. At first glance, this idea seems that Porters observation is in line with the fight of sole proprietors for the benefit of limited liability as already indicated in this paper. But, the ultimate goal of limited liability concept is not to absolutely shield the sole proprietor from liability at all times and nor a higher degree of limited liability be taken as litmus test for providing sole proprietors with a catalogue of the two company forms. The thing is that the potential risks associated with a sole proprietor, if incorporated as a SC, is underestimated while the potential unlimited liability of PLC is overestimated. Nevertheless, given the nature of companies owned by single shareholder, in which this same person often entirely runs its affairs, the potential

⁴⁵⁹ Reports of the Expert Group, *Think Small First – Considering SME interests in policy-making*, see http://ec.europa.eu/enterprise/policies/sme/files/docs/sba/report_think_small_first_summary_en.pdf

⁴⁶⁰ Jauffret, *supra* note 427, at 61.

unlimited liability status would be normal and the least to be expected. Most importantly, if the problems regarding PLCs raised by Porter were the only reason why a sole proprietor has to ignore it, amending the defective articles of the PLC provisions of the Commercial Code as he aptly pointed would easily solve the problem thereby eventually making his argument less convincing.

Regarding, Ponsot's draft proposal, one would wonder why he took most of his time modifying the provisions of share company for introducing SMC limited by shares compared to the few modified provisions of PLC before evaluating the ramifications of both company forms. On top of this, as indicated before, French Commercial Code as amended in 2006, which is more or less similar to the Ethiopian Commercial Code, does not recognize one-person *société anonyme* (SA). However, given the international practice indicated before, Ponsot's attempt to inject SMC into the Commercial Code provisions of Share Company is more appealing to the academia rather than considering it for an immediate legislative consumption of the present commercial situations in Ethiopia. Consequently, it seems that the Revision Committee of the Commercial Code (RCCC) has already opted private limited company provisions of the Commercial Code in order to introduce SMCs as revealed in the draft Commercial Code.⁴⁶¹

5.3.3. Option III – SMCs in the Form of Private Limited Companies?

According to the Commercial Code of Ethiopia, a private limited company may be defined as a business organization “whose members are liable only to the extent of their contributions.”⁴⁶² This form of company is considered as “closed type of business organization” and as such similar to the USA closely held limited liability corporations (LLC), French SARL, German GmbH, and UK private company limited by shares due to restrictions on the transfer of share and in most cases due to lack of separation of ownership and control principles. The minimum capital requirement of 15,000 ETB indicates that PLCs may easily be incorporated with small capital thereby making it an ideal business organization for micro, small and medium enterprises. As we shall see in what follows, the management structure of PLC is more flexible compared to that of Share Company.

⁴⁶¹ See Draft Commercial Code of Ethiopia (Ministry of Justice), Art. 510 (2007). While this study is conducted the writer learned that the draft is still under deliberation.

⁴⁶² Commercial Code of Ethiopia, Art. 510.

However, there exist divergent arguments on whether the Commercial Code provisions of PLC are sufficient to address legal concerns raised in the context of this company. In the background documents to PLCs of the Ethiopian Commercial Code, Escarra noted that thirty-four articles are sufficient to regulate the organizations of this form of business organization.⁴⁶³ Nigusie Tadesse, on the other hand, contends that “the Commercial Code provisions governing PLCs are sketchy and are not sufficiently provided in a fashion to address issues of the company in question.”⁴⁶⁴ From this writer’s point of view, “(...) the provisions governing PLCs in the Commercial Code are incomplete.”⁴⁶⁵ The central assumption for this writer’s argument is though PLCs are primarily designed to suit small and medium size businesses, they are however, a dominant business vehicle for enterprises with huge capital which rivaled the stringently regulated Share Companies.⁴⁶⁶

It may be argued that these two individuals could be “correct” from their own standpoints for two basic reasons. First, from the point of view of Escarra, the PLC provisions of the Commercial Code were utterly contemplated to address company issues established with “small capital” but not designed to accommodate the needs and specificities of investors with large capital which, as Nigusie Tadesse noted, complicate the practical insufficiency of PLC provisions where large capitals were involved. Second, the practical legal insufficiency of PLC provisions, according to Nigusie Tadesse, emanates from the business reality in which PLCs are becoming more dominant business vehicles for enterprises with large capital which otherwise should have opted Share Companies.

As indicated before, the Commercial Code provisions of PLC has been designed to suit enterprises with small capital but not large capital. So, the question is where does the real problem lays? The writer of this paper holds the view that the real problem of the provisions of PLC does not inherently lay in its very purpose as an ideal and flexible legal approach to accommodate private companies with small capital. For that matter, Nigusie Tadesse tangentially noted that due to the stringent regulation of Share Companies, PLCs have become the dominant business vehicle for enterprises with large capitals outfitting the original design of the Commercial Code provisions. Hence, it is understood that the business requires rules that ensure operational flexibility, for which PLCs proved more suitability compared to SCs to the present commercial reality. It is true that when a large

⁴⁶³ Jauffret, *supra* note 427, at 69.

⁴⁶⁴ Tadesse, *supra* note 19, at 121.

⁴⁶⁵ *Id.*

⁴⁶⁶ *Id.*

capital is involved perpetrations of many forms of fraud could be more prevalent. Therefore, the solution could be either making the SC provisions more relaxed to attract investors with a large capital or make a change in the legal contour of the PLC so that it also fits the size of enterprises with large capitals.

One can understand the multifaceted legal ramifications involved in both forms of companies under the Commercial Code of Ethiopia. The writer argues that compared to Share Companies provisions, the existing Commercial Code provision of PLC is more suitable to introduce SMCs into the Ethiopian corporate system after few amendments are being made.⁴⁶⁷ As indicated before, unlike SCs, *de facto* PLCs have already mushroomed in the real corporate world. Accordingly, an attempt to introduce legal framework that buttresses the situation is a prudent legal approach that, in the long run, addresses major problems associated with this form of business vehicle. It could be strongly argued that the Commercial Code provisions of PLC are more appropriate to accommodate sole proprietorship given the operational flexibility it provides to it if incorporated as a PLC. For the cumulative reasons, indicated above, the following sections make a careful attempt to evaluate the various Commercial Code provisions of PLC including other general provisions in order to piece them together to construct legal provisions that accommodate the needs and specificities of SMPLCs. Accordingly, major focus will be made on the formation and transformation; corporate management; reporting and disclosure; corporate veil-piercing; dissolution and bankruptcy issues of PLC provisions which then juxtaposed with the best practices of comparative legal studies reviewed before.

5.4. Formation of SMPLCs

In this section, legal issues such as founder of SMPLCs, chains of SMPLCs, capital and publicity requirements, and prohibitions regarding SMPLCs will be examined side by side by piecing together the best legal practices indicated in chapter four.

5.4.1. Founders of SMPLC – Natural Person or Legal Person?

In legal parlance, “a business organization is any association arising out of a contract whereby two or more persons who intend to join together and to cooperate undertake to bring together contributions for the purpose of carrying out activities of an economic

⁴⁶⁷ It should be noted that the Revised Committee of the Commercial Code is already in favour of creating single member company as variety of new PLC.

nature and of participating in the profits and losses arising out thereof, if any.”⁴⁶⁸ Despite the contractual foundation of business organization, the definition indicates that either legal or natural persons may form PLCs. Therefore, if we make amendments the above definition of business organization, either legal or natural persons may incorporate a SMC in the form of PLC. Hence, such practice is similar to the comparative jurisdictions indicated before which permit SMCs to be incorporated by natural and legal persons. Making this decision for SMCs is pivotal for multimember companies to incorporate wholly owned subsidiaries to operate businesses for which the sky is the limit.

However, as could be understood from the above definition, the pluralistic basis of business organization arising out of contract requiring “two or more than two persons” is not in conformity with singularity of SMCs. It is indicated that the modern economic concept of company, which viewed it as “a legal mechanism for the organization of the enterprise”, has already lead to the disappearance of the classical company as being only a contractual foundation. Of course, the legal conception that views company as “capital associations” rather than “personal associations,” has long been accepted in continental jurisdictions such as French and Germany.⁴⁶⁹ Therefore, an introduction of SMPLCs into Ethiopian corporate system, as constituting single person, requires an amendment of this provision and similar others such as those governing the legal minimum number of members in the Commercial Code of 1960.

Accordingly, Articles 210 and 211 should me amended in order to make it compatible with the new concept of SMPLC. In this case, the options provided under the French Commercial Code and the proposals made by a team of fourteen national experts may be considered to adjust these two rules. Hence, in the second paragraph of Art. 210(1) of the Commercial Code of Ethiopia, the following statements might be considered.

Art. 210. - Business Organization defined.

(1) A business organization is any association arising out of a partnership agreement.

“It can be instituted, in the situations provided for by the provisions of law, by the unilateral act of a single person.”⁴⁷⁰

Similarly, the phrase *“subject to the provisions relating to a single member private limited company” as provided in sub-article 1 of the preceding article*” might be inserted at the beginning of Article

⁴⁶⁸ Commercial Code of Ethiopia, Art 210.

⁴⁶⁹ Treillard, *supra* note 68, at 546.

⁴⁷⁰ *See* French Civil Code, Art. 1832 (1804) (as amended to provide for one-member companies).

211 in order to modify the definition of partnership agreement as an exception which then read as follows.

Art. 211 – Partnership agreement

“[Subject to the provisions relating to a single member private limited company as provided in sub-article 1 of the preceding article]” a partnership agreement is a contract whereby two or more persons who intend to join 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, if any.”

Likewise, adjustments could also be made to the Commercial Code provisions of PLCs governing formation. As indicated before, SMCs may be originally formed having a single member or it may also happen that a PLC originally consisted of several members may be transformed into a SMC. This latter rule may abolish any risk of judicial dissolution due to the “reduction of the number of members below the legal minimum” upon the request of remaining member or creditors following the expiry of a reasonable period of time as indicated in article 511 of the Commercial Code.

The right to transform PLCs into Share Companies where the number of the latter members exceeds the limit of the legal maximum should be also regulated to avoid the risk of judicial dissolution in case where the company failed to comply with maximum fifty members. However, as Ponsot noted, this writer also argues that Article 511 of the Commercial Code should be deleted if a new provision is included in Article 510 in order to regulate in case where the membership of PLCs would be increased to more than the legal maximum or only a single member holds shares of PLC.⁴⁷¹ Consequently, the new additional provisions will help to solve problems associated with the existing provisions of PLCs by facilitating their transformation into Share Companies. Accordingly, the existing Article 510 of the Commercial Code provision may be amended with additional provisions being considered as follows:

Art. 510 (2)

“A private limited company may be formed by one or more persons. The number of members of a limited liability company shall not exceed fifty. If the membership

⁴⁷¹ See P. Ponsot, “Note about the Single-member companies,” (June 30, 1999, copy on file with the writer)

of a private limited company exceeds fifty, it shall be dissolved by the court on the application of any interested party after a period of one year has elapsed unless the number of members is reduced to fifty or the company is transformed into share companies during that period.”⁴⁷²

In the same vein, the following new provisions may be considered as additions to Article 510 in order to adequately regulate the situations of SMPLCs in a similar fashion as was done in comparative jurisdictions.⁴⁷³ However, existing Article 510 (3) need to be shifted further in order to ensure its logical order. Accordingly, the new additional sub-articles may look like the following;

510

“(3) – Notwithstanding sub-article (2) of this article a private limited company formed with single member shall be required to enter in the Commercial Register of members, with the name and address of such member including a statement that the company has only one member.”

“(4) – If the number of members of a private limited company falls to one, there shall upon the occurrence of that event be entered in the Commercial Register of members, with the name and address of the single member.”

(a) a statement that the company has only one member, and

(b) the date on which the company became a company having only one member.”

“(5) – If the membership of a private limited company increases from one up to fifty members, there shall upon the occurrence of that event be entered in the Commercial Register of members, with the name and address of the person who was formerly the single member—

(a) a statement that the company has ceased to have only one member, and

(b) the date on which that event occurred.”

“(6) – If a company makes default in complying with the preceding provisions, the company, and the single member is guilty of an offence and shall be liable on summary

⁴⁷² Adapted from French Commercial Code, Article L223-3 (*Order No. 2004-274 of 25 March 2004 Art. 11 Official Journal of 27 March 2004*)

⁴⁷³ Adapted from UK Companies Act, Sec.123 (2006).

conviction to a fine not exceeding ---and, for continued contravention, a daily default fine not exceeding -."

On top of the above adjustments, whether a natural person should be allowed or prohibited to form several SMCs in his individual capacity or whether such SMC should be allowed or prohibited to form other SMCs, giving rise to chain of SMCs, is highly debated in the company law literature. It is noted that the danger of chains of SMCs especially in a legal system that is not familiar to SMCs, should be addressed with precaution.⁴⁷⁴ Therefore, the new additional provision that strikes the balance between the right to form companies as wholly owned subsidiaries and the chains of SMCs resulting in the abusive division of assets *ad infinitum* should be addressed properly.

Accordingly, approaches taken in the comparative studies could be possible alternatives options at the disposal of the Ethiopian lawmakers. As indicated before, while the German, UK, and OHADA approaches are much more flexible in allowing freedom to incorporate multiple SMCs without restrictions, the Chinese and French approaches are restricted and only give such freedom for legal and natural person respectively. Among these alternatives, the French approach has been appraised as "presenting something new in the legal reform and a very important chance for companies."⁴⁷⁵ Therefore, given the new conception of SMCs to the Ethiopian corporate law, the writer argues that the French approach is more appropriate as it shuts the door to deceitful business practices and thereby safeguards the interests of creditors. Hence, new sub-article (7) of article 510 of the Commercial Code may look like the following;

510

*"(7) – A limited liability company may not be allowed to establish another limited liability company comprising only one person as its single member. In the event of infringement of the provisions of the preceding subparagraph, any interested party may apply for the dissolution of the latter illegally constituted company. In addition to being guilty of an offence punishable with fine of not less than ----, a single member and the company shall be jointly and severally liable for any damage occurred to creditors and other stakeholders."*⁴⁷⁶

⁴⁷⁴ E. Muzaffer, *supra* note 213.

⁴⁷⁵ Jocić, *supra* note 200, at 213.

⁴⁷⁶ Adapted from French Commercial Code, Art. L223-5.

It should be noted that, except in cases where necessary amendments of the provisions or additional new articles or sub-articles are warranted, an attempt to refurbish each bits and pieces of the Commercial Code provisions on PLCs is not necessary.⁴⁷⁷ As indicated before, the rules applicable to this entity are, generally speaking, those applicable to PLCs insofar as they are compatible with the existence of a single member. Hence, in order to simplify such legal task, a new general provision may be added as a sub-article (9) to Article 510 of the Commercial Code. This approach is followed by all legal jurisdictions as indicated in the preceding chapter. Therefore the following new provisions may be considered;

“(9) – “The provisions of the commercial code applicable to private limited companies formed by more than two and less than fifty persons mutatis mutandis applies in relation to a private limited company formed by single person or having only one person as a member.”⁴⁷⁸

5.4.2. Minimum Capital Rule for SMPLCs

According to the Commercial Code of Ethiopia, the term capital is defined as the “original value of the element put at the disposal of the undertaking by the (...) partners by way of contributions in cash or in-kind.”⁴⁷⁹ As Everett F. Goldberg argued, the conception of capital plays a pivotal role in the law of business organization with limited liability.⁴⁸⁰ Capital is the “life blood” of a business organization without which the operation of a business is unimaginable. Accordingly, a minimum capital rule obliges investors willing to incorporate a business entity to place assets of at least the specified minimum value into the corporate asset pool. As indicated before, some legal scholars view that minimum capital rules are “no longer an appropriate conceptual apparatus to employ in safeguarding the interests of creditors.” Yet, it is also indicated that this argument does not account for the nature of SMCs that warrants special attention compared to multimember companies. The interests of the EU on the need to regulate capital requirements for SMCs have been already crystallized in the SMCs Directive 2009 that warns EU member states on the dangers of SMPLCs. Therefore, the writer has the opinion that the minimum capital rule

⁴⁷⁷ The memorandum and Articles of association, prohibited transactions, transfer and assignment of shares, restrictions on issuance of transferable securities may applicable without difficulty.

⁴⁷⁸ Adapted from UK Companies Act Sec. 38 (2006).

⁴⁷⁹ Commercial Code of Ethiopia, Art. 80 (1).

⁴⁸⁰ Everett F. Goldberg, *An Introduction to the Law of Business Organizations*, 8 Journal of Ethiopian Law 510 n. 2 (1972).

provided for under Ethiopian company law is an important legal apparatus to safeguard the risks posed by SMPLCs as “*risk-dodging device*” given the novelty of this form of business organization in Ethiopian corporate landscape.

The minimum capital requirement to incorporate private limited companies under the Commercial Code of Ethiopia is 15, 000 Ethiopian Birr (ETB).⁴⁸¹ But, this rule is not applicable to foreign investors. According to the new Investment Proclamation, a foreign national is required to allot a minimum capital ranging from 50, 000 – 200, 000 United States Dollar (USD) without regard to the organizational form depending on the nature and type of the business activity.⁴⁸² As per the former legal regime, the amount of share shall be of equal value and shall not be less than ten ETB, though a member may hold more than one share.⁴⁸³ As per this rule, one could create legitimate PLC in which only one person has any practical interest by perfectly satisfying the requirements of the Commercial Code. That is, the minimum capital of 15,000 ETB is divided by Birr 10 par value, which is the minimum value per share, the result is 1,500 shares in which one person may keep 1,499 shares and give one share for the other person. According to Michael Porter, this scheme of the Commercial Code shows how the requirement for a minimum two number of shareholders is actually absurd.⁴⁸⁴ He further noted that it is the capital of a company which is contributed, not the number of contributors, which creates a company.⁴⁸⁵

On the other hand, whether the minimum capital rule designed for PLCs more than fifty years ago, should have to continue or requires reform also needs closer scrutiny. In this regard, two alternative legal choices are available. The first legal choice requires reducing the existing capital rules to certain threshold level. This practice goes with the comparative practice in which individual entrepreneurs are allowed to start business with nominal capital and with the benefit of limited liability. The second choice requires recognizing the present day commercial reality which could be signified by the large capitalization of PLCs as revealed in practice. This latter option requires the increasing of the existing minimum capital rules. Whatever choices are to be made, it should be noted that minimum capital rules set by the law does not represent the actual capital required to fully run the business. As indicated before, it is commonly admitted that the capital of the company should “meet the expectable strains of a business of its size and nature”.

⁴⁸¹ Commercial Code of Ethiopia, Art, 512(1).

⁴⁸² Investment Proclamation No. 769/2012, Art. 11.

⁴⁸³ Commercial Code of Ethiopia, Art. 512.

⁴⁸⁴ Porter, *supra* note 21, at 1102-1103.

⁴⁸⁵ *Id.*

Finally yet importantly, it is important to evaluate rules that govern contributions in-cash and in-kind in order to reduce risks that might be associated with a PLC owned by one-person. Regarding the contribution in-cash, the Commercial Code of Ethiopia requires the members of a PLC to contribute in lump sum or fully paid up capital as a statement to be shown in the memorandum of associations comparable to that of Chinese SMCs.⁴⁸⁶ In other words, installment payment is not allowed for PLCs thereby avoiding the complexities of additional rules that require guarantees for the unpaid up capitals as was done in other jurisdictions such as Germany for instance. However, the Commercial Code provision governing PLC is often criticized due to lack of adequate legal provisions regarding manner of administering this matter such as adducing evidence of bank statement that shows the capital is fully paid up.⁴⁸⁷ Currently, the Commercial Registration and Business Licensing Proclamation aptly solve this matter. According to this Proclamation, the registering office is required to write a letter to the bank for the capital to be contributed in cash of the PLC under formation, to be deposited in a blocked bank account.⁴⁸⁸ Therefore, a PLC under formation would not be registered until evidence that shows a bank statement that the capital to be contributed in cash has been deposited and all appropriate documents relating to contribution in kind is submitted to the registering office.⁴⁸⁹

Regarding, the regulation of contribution in-kind, Article 519 of the Commercial Code provides that memorandum of association is required to show the nature and valuation of contribution in-kind.⁴⁹⁰ The methods of valuation, the price accepted and the shares allocated to such capital are determined by the members.⁴⁹¹ In the context of a PLC with single member, what it means is that the method of valuation, the determination of price and allocating shares to such capital would be left to the single shareholder who shall be liable to third parties for any overvaluation.⁴⁹² Once again, lack of external valuation mechanism is another challenge to the Code. It is, however, provided that if it is shown that the contribution in-kind has been overvalued, the members are required to make good

⁴⁸⁶ Commercial Code of Ethiopia, Art. 517(g).

⁴⁸⁷ See for more discussions in Tadesse, *supra* note 21, at 122. He noted that due to such legal loopholes, founders of PLCs might be tempted to provide false statements in the memorandum of association, and many of them do not have paid up capital which become one sources of conflict among members and creditors.

⁴⁸⁸ Proclamation No. 686/2010, Art. 11(4).

⁴⁸⁹ *Id.*, Art. 11(3).

⁴⁹⁰ Commercial Code of Ethiopia, Art. 519(1). See Proclamation No. 686/2010, Art. 6(10) which also require the agreement of founders or members of a PLC on the valuation of contribution in kind to be stipulated in the memorandum of association or in the amendment of the memorandum of association.

⁴⁹¹ *Id.*, Art. 519(2).

⁴⁹² *Id.*, Art. 519 (3).

the overvaluation in cash despite their knowledge of such overvaluation.⁴⁹³ At this critical juncture, the pivotal question to ask is who should be externally responsible for the re-evaluation of the contribution in-kind? The answer to this question is also not addressed in the previously indicated Proclamation. However, what is provided is that once the PLC has been entered in the Commercial Register and obtained legal personality, the testimonials issued by appropriate government office which show all contributions in-kind have been transferred to the newly formed PLC is required to be submitted to the registering office.⁴⁹⁴

It should be argued that the possibility of personal liability in case of fraudulent overvaluation might make the concern for lack of external evaluator less worrisome to third parties. However, as the saying goes, “prevention is better than cure”, and the writer holds the view that new additional provisions should be introduced into the Commercial Code. The practice of France in this regard is of great guidance to address the concerns that might arise in the context of SMPLCs due to such legal gap. Accordingly, the following new sub-article to article 519 of the Commercial Code may be considered;

519 “(5)”

“If the company is formed by only one person, external formation auditor shall be appointed by the sole member. However, if there is no auditor or if the stated value is different from that suggested by the auditor, the sole member shall be personally liable for five years with respect to third parties for the value attributed to contributions in kind at the time of formation of the company.”⁴⁹⁵

This new provision may ensure accountability and responsibility in the evaluation process of contribution in-kind and thereby address the risks associated with SMPLCs in this regard.

⁴⁹³ *Id.*, Art. 519(4).

⁴⁹⁴ Proclamation No. 686/2010, Art. 11(5).

⁴⁹⁵ Adapted from French Commercial Code, Art. L223-9 (Order No 2000-916 of 19 September 2000 Art. 4 and Annex II Official Gazette of 22 September 2000 in force on 1 January 2002)

5.4.3. Memorandum and Articles of Association

The memorandum of association refers to a constitution or charter of the company that provides the foundation on which its structure is built.⁴⁹⁶ It defines the scope of the company's activities as well as its relation with the outside world thereby enabling the shareholder, creditors and those who deal with the company to know the permitted range of the enterprise.⁴⁹⁷ On the other hand, articles of association refer to a document that "governs the internal operation of the company."⁴⁹⁸ In some jurisdictions such the USA, the term "articles of incorporation" or "certificate of incorporation" or "articles of organization" would be used instead of articles of association.⁴⁹⁹ Be that as the case may be, while memorandum of association regulates the company's external affairs, the articles of association regulate its internal affairs. In Ethiopia, articles of association shall be deemed to form part of the memorandum of association and shall be attached thereto.⁵⁰⁰ It should be noted that the connotation of "association" in both terms implies the coming together of partners to incorporate a company. Pettet, for instance, argue that "there would not, it might be thought, be much point in calling them articles of *association*, if they were not meant to govern the way in which the members thereafter *associate*."⁵⁰¹ However, as indicated before, the conception of "associative" nature of a company bears no implication on SMCs. Indeed, if the legislators in Ethiopia are not comfortable with the connotation of "association" in the context of SMCs, the terms used in the USA may be borrowed. The writer however holds the view that, it is better to maintain the terms as also opted in most jurisdictions.⁵⁰²

Under the Commercial Code of Ethiopia, a PLC will be instituted when an authenticated deed, in the form of a memorandum of association, setting up the company is signed by all the members or by persons acting on their behalf.⁵⁰³ In the same way, a SMPLC may be established by subscribing his name to a memorandum. However, a memorandum of association in the context of SMPLCs should further accommodate additional features, in order to ensure the continuity of corporate life without departing

⁴⁹⁶"*Memorandum of Association of a Company*." <http://www.publishyourarticles.net/eng/articles/memorandum-of-association-of-a-company.html>. (accessed on December 20, 2013"

⁴⁹⁷ *Id.*

⁴⁹⁸ Commercial Code of Ethiopia, Art. 314.

⁴⁹⁹ See Schneeman, *supra* note 55, at 297.

⁵⁰⁰ Commercial Code of Ethiopia, Art. 314.

⁵⁰¹ Pettet, *supra* note 41, at 89.

⁵⁰² All comparative jurisdictions under consideration use memorandum and articles of association in relation to SMCs without distinctions.

⁵⁰³ Commercial Code of Ethiopia, Art. 516.

from its conventional meaning. In this context, a memorandum of a SMPLC may be required to indicate the name of the other person, as a “nominee member”, who shall in the event of the subscriber’s death or his incapacity to contract, become the actual single member of the company.⁵⁰⁴ In such cases, the law may also require the prior written consent of the single shareholder which should be filed with Commercial Register at the time of incorporation of the SMPLC along with its memorandum and articles. The law may also stipulate that the single member may, at any time, change the name of such nominee member or in case where such nominee member may withdraw his consent.⁵⁰⁵ The law may also further require that the single member is duty bound to give notice to the Commercial Register in case of changes to nominee member within such time and in such manner as may be prescribed and provided that any such change in the name of the nominee member shall not be deemed to be an alteration of the memorandum.⁵⁰⁶

5.4.4. Publicity Requirements for SMPLCs

As indicated before, all jurisdictions under consideration require the status of SMCs to be duly disclosed to the public owing to their unique characteristics. Ethiopian Commercial Code provides that a business organization shall have no legal personality until it is published in the *Commercial Gazette* and other rules regarding registration requirements have been complied with.⁵⁰⁷ However, as per the Proclamation that provides for Commercial Registration and Business Licensing, business organizations are dispensed with mandatory requirements of publicity. According to this Proclamation, PLCs simply acquire legal personality by registering in the Commercial Register, administered by the Ministry of Trade without being publicized in a newspaper.⁵⁰⁸ Yet, it is mandatory for the Ministry of Trade to open the Commercial Register of PLCs for reference of third parties.⁵⁰⁹

However, it should be noted that despite the dispensation of publicity requirements under the Proclamation indicated before, the draft Commercial Code in its Article 219 remains unchanged. A Team of National Experts commenting on the draft Commercial Code of the indicated article raised the concern of abolishing publicity of business

⁵⁰⁴ The Companies Act of India, Sec. 3(1. a) and 4(1. f) (2013).

⁵⁰⁵ *Id.*, Sec. 3(1. a).

⁵⁰⁶ *Id.*

⁵⁰⁷ Commercial Code of Ethiopia, Arts. 223 cum. 87.

⁵⁰⁸ Proclamation No. 686/2010, Arts. 9(1) and 5(1).

⁵⁰⁹ *Id.*, Art. 9(2).

organizations given the “benefit that publication gives to the public.”⁵¹⁰ The international practices as indicated in the comparative part also show the existence of different approach regarding the publicity requirements of the status of SMPLCs. Some jurisdictions require the entering of statements in a Companies Register or in a register kept by the company accessible to the public, when a company becomes a SMPLC because all its shares come to be held by a single-person. Others, however, require additional publication requirements in the newspapers or commercial gazette in both cases of the coming into existence of SMPLCs.

Hence, in Ethiopia, the dispensation of publicity of business organization in the commercial gazette could be justified in situations where a SMPLC is established initially in that form given the accessibility of Commercial Register for third parties in the Ministry of Trade. However, in case where the number of shareholders in multimember PLCs decreases to single membership, third parties may not know this fact unless it is published in newspapers accessible to the public. In the later situation, the sole shareholder may possibly engage in fraudulent conduct jeopardizing the interests and rights of creditors and other third parties. Therefore, it would be necessary to provide some regulations on such circumstances where SMCs transformed themselves after their establishment.

5.5. Organisation of the SMPLCs and Some Regulatory Consideration

As indicated before, SMCs combine the advantages of sole proprietorship in terms of operational flexibility and that of corporation in terms isolating and protecting personal property of the owner from the debts of the company. Accordingly, the law is expected to ensure operational flexibility of SMPLCs while at the same time safeguarding managerial and shareholder accountability of a single member. Such legal task requires giving priority to the sole member to adopt its internal management structure freely as desired within the limits of the law. Therefore, based on this backdrop, the following sections try to evaluate the provisions of the Commercial Code regarding the management of PLCs in general and whether it would be applicable to SMPLCs in particular.

⁵¹⁰ The Team argued that, “[I]t can be said that considering the cost of publication and the time it takes to comply with that formality, the abolition is of practical significance. Yet, the purpose of publication is divulgation with a view to protect third parties. Thus, we are of the opinion that the interest of the public and commercial security outweighs expediency of incorporation for the abolition of the publication requirement. Hence it is essential to establish and institutionalize the commercial gazette for the purpose. So we recommend the publishing of a notice in the Commercial Gazette within a certain period following registration, and that if this requirement is not complied with the Company will have to be regarded as inexistent abinitio.” See A Team of National Experts, *supra* note 14, at18.

5.5.1. Management of SMPLCs

According to the Commercial Code of Ethiopia, one or more managers can manage a PLC.⁵¹¹ The Code also provides that managers may be appointed from non-shareholder which however is not the case in Share Companies.⁵¹² Likewise, the law governing PLCs does not require the structure of mandatory board of directors. Thus, a single member of a PLC either may opt to be a sole manager of the company or may appoint top-notch non-member manager(s) from the labour market. As indicated before, comparative practice shows that board of director in SMCs is not mandatory in most legal jurisdictions. In China and the OHADA jurisdictions, the composition of board of directors in SMC is prohibited. In the Ethiopian context, however, some argue that one of the major problems associated with the organizational form of PLC in Ethiopia is lack of mandatory board of directors for PLCs.⁵¹³ As noted before, this argument only accounted for the practical problems associated with PLCs with large capital that implicated the requirement of board of directors but which however is not contemplated by the Commercial Code governing PLCs. This writer holds the view that, lack of mandatory board of directors in the context of PLCs does not by any means implicate the inherent problems of PLCs for two major reasons.

Firstly, the PLCs regulated by the Commercial Code were primarily designed to accommodate small capital enterprises apparently with small number of members. Obviously, board of directors, by and large, represent complex management structure which is more ideal for dispersed or widely held companies with unlimited number of members as clearly signified in the case of Share Companies. In this context, mandatory board of directors negates the desire to ensure operational flexibility of PLCs that has already made it the most dominant business vehicle in Ethiopia. Secondly, the desire to have a board of directors is left for the choice of shareholders and hence should not be voted out as lack in management structure of PLCs. This situation could be demanding and to some extent necessary in PLCs where the number of members exceeds more than twenty and non-member managers are appointed. This line of argument goes with the comparative practices of the UK, Germany and France which permits board of directors as an alternative management structure.

⁵¹¹ Commercial Code of Ethiopia, Art. 525(1).

⁵¹² *Id.*, Art. 347 (1): “Only members of a company may manage the company.” Art. 526. – “Managers, other than members, may be appointed by the members or by the memorandum or articles of association for such period as is considered desirable.

⁵¹³ See Tadesse, *supra* note 19, at 140 and Porter, *supra* note 21, at 1101.

The writer firmly believes that absence of mandatory board of directors in PLCs would not be a major problem for a PLC owned by a single member. It could be argued that the sole proprietorships-like characteristics of a single member in SMPLCs do not warrant the necessity of board of directors. Nevertheless, this assertion does not signify to undermine the important role of board of directors in case where SMPLCs involves non-shareholder managers.⁵¹⁴ Hence, in case where non-shareholder managers are appointed for SMPLCs, the single member may play the role of director for which Article 525 of the Commercial Code may be amended in such a way to accommodate the situation. Yet, for the exigencies of SMPLCs, this legal provision is sufficient to address the organizational needs and demands of one person Companies.

5.5.1.1. Powers of Manager(s)

It is understood that unless a non-member manager(s) is appointed, a single shareholder holds “full powers of the manger” of the conventional PLC “within the limits of the object of a single member PLC.”⁵¹⁵ Accordingly, a sole shareholder may also decide unilaterally all matters falling within the competence of shareholders’ and managers decisions in his double capacity as shareholder and manager where non-member managers are not appointed. Therefore, a sole member manager in his capacity as a shareholder approves transfer of shares outside the company (Art. 523(2)), appoint auditors (525(2)), approves change of nationality of the company and amendment of the memorandum and articles of association (536) and approves the balance sheet and the auditors’ report (Art. 537). The single shareholder in his capacity as a manager is also required to prepare the inventory and other powers provided in the articles of associations.⁵¹⁶ On the other hand, where the sole member decides to run his company by appointing managers, in addition to the powers indicated above, he may, in his capacity as a shareholder, exercise powers to appoint and dismiss managers, (Arts. 526 and 527), fix mangers remuneration (Art. 529) and exercise the right to inspect inventory, balance sheet and auditors' report (537).

⁵¹⁴ Board of directors as a core concern of company law is designed to address the agency problems associated with non-shareholders involved in the management of the company. See Brian C Cheffins, *Current Trends in Corporate Governance: Going from London to Milan via Toronto*, 10 *Duke Journal of Comparative and International Law* 5 (2000).

⁵¹⁵ Commercial Code of Ethiopia, Art.528 (1). This legal requirement makes no distinction as to whether the sole shareholder is or is not the manager even if he acts in both capacities, which is frequent and possible.

⁵¹⁶ However, provisions in the articles of association restricting the powers of the managers shall be binding only as between members and managers and shall not bind third parties even if properly published. See *id.*, Art. 528(2).

5.5.1.2. Meetings and Quorum

Whether the SMPLC decides to structure the management with a board structure or not, the sole member manager is expected to run acts of management on behalf and in the name of the company. However, in order to pass decisions capable of binding the company, a sole member manager is required to hold a meeting in a proper way. In the Commercial Code, PLCs with more than twenty members are required to take decisions at the meetings of the members.⁵¹⁷ In addition, the PLC is required to hold annual general meeting and other meetings as may be called by a manager, auditor, or members.⁵¹⁸ Conversely, a PLC consisting of twenty or less members may not be bound by the requirements of holding of annual meetings and decisions may be taken without holding other meetings.⁵¹⁹ Hence, the provisions of the Commercial Code in this regard could be applicable to SMPLCs with ease since it provides operational flexibility to the sole member with the dispensations of mandatory meetings. However, it is important to safeguard the SMPLC from arbitrary decisions made in the absence of meetings that in turn affects the interests of creditors.

It could be said that in case where non-member managers are appointed but the holding of meeting is not required by law or memorandum or articles of associations, the mandatory requirement that obliges managers to send the text of resolution and decisions to be taken by the written approval of the shareholders is an important piece of provision which tries to ensure the recording of decisions of SMPLCs.⁵²⁰ But, still this legal provision does not solve the evidentiary matters where the decisions are made by the sole member in both cases where the holding of meetings are required and not required. Unlike the international comparative practices, the Commercial Code provisions of PLC nowhere require the recording of any decision in any form whatsoever. Therefore, as we shall see later, it is important to introduce additional provisions in order to address the evidentiary problems associated with recording of decisions made in and out of meeting rooms.

Another important concern that requires attention is the requirement of quorum in order to pass valid decisions that bind the company where the holding of meeting is required. The provisions of the Commercial Code regulating classical PLC requires every member to take part in the meetings entitled to a number of votes equal to the number of

⁵¹⁷ Commercial Code of Ethiopia, Art. 525 (2).

⁵¹⁸ *Id.*, Art. 532(1).

⁵¹⁹ *Id.*, Art. 525(3) and 533.

⁵²⁰ *Id.*, Art. 533.

shares held unless the memorandum of association provides otherwise.⁵²¹ As indicated before, meeting requires the presence of at least two members that exacts the minimum numerical requirement to incorporate PLCs. In this situation, a legally binding decision may be taken by the majority of members representing more than one-half of the capital or by a simple majority without regard to the capital represented where majority is not obtained.⁵²² Likewise, the right of shareholders to take part in a meeting by proxy is not provided under the PLC provisions of the Commercial Code though such matter could be provided in the articles of association.⁵²³ Thus, in order to make such adjustments to the situations of SMPLCs, additional provision should be added to the Commercial Code in line with the practices of comparative jurisdiction. Accordingly, the following “sub-article 3” may be added to article 535 of the Commercial Code.

“(3) – Notwithstanding any provision to the contrary in the articles of associations of a PLC having only one member, one member present in person or by proxy shall be a quorum.”⁵²⁴

5.5.2. Regulatory Safeguarding Measures for SMPLCs

This section tries to examine legal provisions from the Commercial Code of Ethiopia and other comparative jurisdictions that are designed to reduce the risks associated with a PLC having sole member. In addition to the safeguarding measures discussed before, this section further considers major regulatory measures that would be considered to ensure protection of creditors and other third parties involved.

5.5.2.1. The Recording of Decisions by Sole Member

It was previously indicated that one of the major problems with the Commercial Code provisions governing PLCs is lack of legal provisions for the regulation of recording of decisions. Hence, in order to avoid such evidentiary problems associated with PLCs having a single member, it would be necessary to introduce additional rules that may require the single member to record any decision and provide the company with a written record of the decisions. The new legal provisions are also expected to provide the legal effects of

⁵²¹ Commercial Code of Ethiopia, Art. 534.

⁵²² *Id.*, Art. 535.

⁵²³ This matter is regulated under the Share Companies provisions. See *Id.*, at Art. 420(2) and 421(1).

⁵²⁴ Adapted from European Communities Single-Member Private Limited Companies Regulations 1994, Art. 10 and UK Companies Act, Sec. 318 (1).

failure to comply with the requirements of recording of decisions as regards the company and third parties. The international comparative practice shows that failure to comply with the requirements stated does not invalidate the decisions though the single member may be guilty of an offence and be held liable on summary conviction to pay fine. Accordingly, the following additional provisions applicable to a PLC that has only one member may be considered.

“Records of decisions by sole member”⁵²⁵

“Where the sole member or manager of PLC takes any decision on matters specified by the law and articles of associations, he shall, unless that decision is taken by way of written resolution which he has already forwarded to the company, provide the company with a written, signed and dated record of that decision.”

“Where the sole member notifies a decision taken by way of written resolution, or a written record of a decision taken pursuant to the preceding sub-article, to a PLC of which he is the sole member, the notification shall be recorded and retained by the company in a book or by some other suitable means maintained for the purpose and accessible to third parties.”

“If the sole member fails to comply with the preceding sub-articles, the sole member, the company and other managers, if any, of the company who is in default shall be guilty of an offence punishable on summary conviction with fine not less than -----“

“Failure to comply with sub-article ---- does not affect the validity of any decision referred to, provided that the sole member or any managers of the company shall be jointly or severally liable for the occurrence of damage caused by such default.”

5.5.2.2. Regulating Contracts Between Single Member and the Company

As indicated before, the related question of how a company enters into contractual relations with other legal persons is largely determined by the law of agency. In SMCs context, there is no principal-agent relationship though there is an owner-manager who acts representing the company. Accordingly, the fact that the sole member manager acted

⁵²⁵Adapted from European Communities Single-Member Private Limited Companies) Regulations Art. 9(4); (1994); UK Companies Acts, Sec.357 (2006); the Companies Law 2006 of the Peoples Republic of China, Art. 62(2006).

for and on behalf of the company certainly does not in point of law constitute the relationship of principal and agent between them or render that sole shareholder liable to indemnify the company against the debts it incurs.⁵²⁶

However, it does not mean that the problem of conflict of interest prevalent in the principal agency paradigm is lacking in whatsoever manner. Consequently, in order to solve the issue of conflict of interest regarding the transactions between a PLC and the sole shareholder, a supervision system should be established. If one looks at the agency law of Ethiopia, one can find the provisions on conflict of interest and contract with oneself.⁵²⁷ The point is that an agent is prohibited from entering into a a contract with himself whether acting on his own behalf or in the name of a third party.⁵²⁸ But, the problem with these provisions is that it does not account for the nature of SMCs as it requires the principal, a fictitious body, to cancel such contract, which as indicated before, is a difficult situation given the overlapping nature of principal and agent paradigm.

As indicated before, the approaches for the regulation of contracts between the sole member and the company in jurisdictions under consideration range from non-regulation, permission with strict regulation and selective prohibition. In China, there are no clear legal provisions regulating this matter despite the allocation of special section for one – person private limited company in their companies law. In the ECs SMPLCs Regulation and UK Companies Act, contracts with sole member and the company is not outrightly prohibited but required to be in written form. In the OHADA, Germany and France, only selected forms of transactions are prohibited. As such, the lawmaker is required to make choices regarding the approach that suits the context of Ethiopian corporate legal system. Thus, in view of such comparative experiences, additional legal provisions dedicated to address the needs and specificities of the PLC having one member should be included in the Commercial Code. Accordingly, the following additional provisions may be considered to regulate the matter under discussion.

⁵²⁶See *Corporate Personality: The Foundations of Company Law*. Available at: http://www.le.ac.uk/oerresources/law/companylawug/page_05.htm. (Accessed on December 23, 2013)

⁵²⁷ Civil Code of Ethiopia, Arts. 2187 and 2188.

⁵²⁸ *Id.*, Art. 2188.

*Contract with sole member who is also a director or manager*⁵²⁹

“Where a private limited company having single shareholder enters into a contract with the sole member of the company and the sole member also represents the company in the transaction, whether as a manager or otherwise, the company shall, unless the contract is in writing, ensure that the terms of the contract are forthwith set out in a written memorandum or are recorded in the minutes of the first meeting of the company, following the making of the contract, provided that this sub-article shall not apply to contracts entered into in the ordinary course of the company's business.”

“Failure to comply with this in relation to a contract does not affect the validity of the contract. However, a sole member or managers, as the case may be, are guilty of an offence and liable on summary conviction to a fine not exceeding -----.”

*“Prohibited Transactions”*⁵³⁰

“Managers and sole members shall be prohibited from contracting loans from the single member company irrespective of their form, from arranging for it to grant them a loan account or other borrowing whatsoever, or to arrange for the company to stand surety for them or act as their guarantor in respect of their obligations to third parties. Any such arrangement shall be null and void.”

“This prohibition shall also apply to the legal agents of sole member that are legal personalities, corporate bodies in which the sole member has an interest or the spouse and relatives in the ascending and descending line of the persons referred to in the preceding subparagraph, as well as to any intermediary.”

5.5.2.3. Accounting, Auditing and Disclosure Requirements

As noted before, forcing a single member PLC to abide by rules of bookkeeping, auditing and disclosure requirements may affect the operational flexibility of the company. However, in the absence of appropriate accounting, auditing and disclosure requirement rules for a SMC, right of creditors may be in jeopardy. In view of this fact, it is vital to

⁵²⁹ Adapted from European Communities Single-Member Private Limited Companies Regulations, Art. 13 (1994); Companies Act 2013 of India, Section 193(1) and UK Companies Act, Sec.123 (2006). Compare also Commercial Code of Ethiopia regarding companies limited by shares, Art. 356.

⁵³⁰ Adapted from French Commercial Code, Art. L223-21. Compare also Commercial Code of Ethiopia provisions on companies limited by shares, Art. 357.

carefully look into the various legal provisions of the Commercial Code and piece them together to construct a more simplified accounting, auditing and disclosure requirements in order to secure the desired benefits for the single member PLC.

Generally speaking, except for “petty traders,” any person or business organization carrying on trade is required to keep books and accounts (...) in accordance with the business practice and regulations...⁵³¹ Accordingly, sole proprietors and PLC alike are required to keep a journal regarding the daily entries of all dealings regardless of its nature or the manner in which they were carried out.⁵³² At the end of each financial year, a PLC is required to prepare an inventory of the assets and liabilities and balance his accounts for the purpose of preparing the final balance sheets and profits and loss accounts that should be kept in special books.⁵³³ However, the legal challenge that encounters bookkeeping and accounting requirements emanates from the Commercial Code provisions that only require the appointment of auditors in case where the PLC consists of more than twenty members.⁵³⁴ As noted before, accounting and record keeping should be substantiated with auditing requirement in order to ensure financial responsibility of sole shareholder of the PLC.

Thus, in the face of high probability of commingling personal assets, absence of an auditable accounting and record keeping would be detrimental to the interest of creditors and other stakeholders such as tax collecting authorities. Given the compulsory duty of the sole proprietors to accounting and record keeping, the appointment of at least one auditor for a PLC incorporated by a sole proprietor would safeguard the interests of creditors. As indicated by the comparative practices, at least requiring the single member PLC “*to draw up its financial and accounting report and have it audited by an accounting firm at the end of each fiscal year*” may reduce business risks associated with non-auditable accounting and record keeping trends.

Regarding disclosure of balance sheets and profit and loss statements, there is no provision in the Commercial Code that requires PLCs to file in the Commercial Register or publish such information in the Commercial Gazette. The writer holds the view that given the cost of publication, PLCs with sole member should be required to deposit the audited accounts and balance sheets with the Commercial Register at the end of each

⁵³¹ Commercial Code of Ethiopia, Art. 63 (1) and 64.

⁵³² *Id.*, Art. 66(1).

⁵³³ *Id.*, Art. 68.

⁵³⁴ *Id.*, Arts. 525 (2) and 538 (2).

financial year. This approach helps third parties to access such information since Commercial Register kept at the Ministry of Trade is open for reference.

5.5.2.4. Piercing the Corporate Veil of SMPLCs

As indicated before, it cannot be said conclusively whether veil piercing is much more likely to take place in the context of SMCs rather than in the context of widely or closely held multimember companies. Yet, it is also indicated that due to the nature of SMCs, strict separation of personal assets from that of the company could be a very difficult habit pattern harder to maintain and less natural than when a number of individuals are involved in a common enterprise. In view of these facts, it is important to highlight the Commercial Code provisions capable of addressing corporate veil-piercing issues in the particular context of PLCs with a single shareholder as a means to safeguard creditors' rights.

The first and most germane legal provision that could be applicable to PLCs with a single person is the situation of personal liability for the overvaluation of contribution in-kind. It is indicated that, priority should be given to ensure a more responsible method of evaluating contribution in-kind using external mechanisms such as independent professional auditing firms. Nevertheless, providing corporate veil-piercing rules for any eventualities is a prudent regulatory approach one would expect. Accordingly, Articles 519 (3) and (4) of the Commercial Code play a pivotal role in helping the courts to pierce the corporate veil of PLCs having a single shareholder. Therefore, the PLCs provisions that provides for the liability of members for the overvaluation of contribution in kind is very crucial to hold sole members personally liable for the damages to the third parties for overvaluation. It is also vital to note that the sole member is personally liable for such overvaluation despite the fact that the valuation of contribution in-kind has been fixed by non-member managers without his knowledge. Therefore, the sole member of PLC may not raise defenses such as hands off management or due care and diligence for any eventualities of overvaluation of contribution in kind.

However, writers such as Porter, contend that this legal provision substantially erodes the limited liability benefit of the PLC making it unsuitable for sole proprietors and a *“serious impediment to the contribution of property to a private limited company.”*⁵³⁵ As indicated before, the writer of this paper, on the contrary, contends that this provision could be maintained as an ideal veil piercing scheme for the protection of creditors that rely on the

⁵³⁵ Porter, *supra* note 21, at 1101.

valuation of contribution in kind rather than considering it as an affront to the benefit of limited liability. It could be argued that given the sole participation of single shareholder in the valuation process, the provision potentially warns the sole member for strict personal liability for any carefree method of valuation.

The second, important corporate piercing rule that could be potentially applicable to PLCs with a single shareholder is Article 530 of the Commercial Code. Unlike the previous one, this provision generally ensures the interest of the company and third parties from any act of mismanagement that adversely affect viability of SMPLCs. According to this provision, only managers (both non-member and member managers) are personally responsible for the breaches of duties to third parties under the law or articles of association. The readings of Article 531(2) of the Commercial Code hints that members who have not acted as managers could be dispensed from personal liabilities for the debts of the company where the assets of the company become inadequate in a bankruptcy. On the other hand, the law has made it clear that non-member manager and members will be personally liable for the debt of a bankrupt company unless they succeeded with the proof of *due care and diligence*. However, Porter tried to remark the insertion of “member” who is not a manger in article 531 as a “muddle,” if only managers are required to pay the debts of the company for lack of “due care or diligence.”⁵³⁶

Once again, the problem with Porter’s argument is that his interpretative approach to article 531 does not account for full readings of the messages delivered in the article. This article provides two situations in which members of a PLC could be relieved from personal liability for the debts of the company as indicated in article 531. The first obvious message is that a sole member who has not acted as a manager will not be personally liable. The second message covers a situation where members or managers alike have acted with due care and diligence. So, the term “acted” could possibly be used in reference to a member who “acted” as a manger because the only situation one could possibly imagine the requirement of “due care and diligence” from members of a PLC is in their capacity of acting as a mangers whether it could be ascertained either directly or indirectly. This line of interpretation is in consonance with the provision of Article 530 that regulates the personal liability of managers but not members to the third parties in case of breach of duties.

The relevant issue that requires solution in the context of a SMC is whether it could be convincing to allow a sole member who is not a manager to invoke limited liability so long

⁵³⁶ *Id.*

as he/she decides not to participate in the acts of management. Applying the rule that dispense a sole member from personal liability due to the mere fact that he/she never participated in acts of management of the SMC jeopardize the interest of creditors since it opens the door for deceitful business practices. The writer argues that Article 531 of the Commercial Code should be amended to provide for unlimited liability of a sole member despite allegations of hands-off management for breach of duties – due care and diligence that should include acts of omission. Hence, the bottom-line for enjoying the benefit of limited liability should be *due care and diligence* at all times. Eventually, whatever the balance of the argument could possibly resonate, the potential of piercing the corporate veil of SMPLCs under the classical rules governing PLC would be a stepping-stone to improve its effectiveness.

5.6. Dissolution and Winding up of SMPLCs

A PLC may be dissolved on the grounds applicable to all business organizations. As per the Commercial Code provision on PLCs, three categories of grounds of dissolution may be pinpointed. The first category includes a court ordered dissolution for “good cause” and dissolution at the request of any member where the term of the company has not been fixed.⁵³⁷ The second category includes judicial interdiction, bankruptcy or insolvency or death of the member in case where expressly provided in the articles of association.⁵³⁸ The third category includes loss of three-fourth of the capital of the company.⁵³⁹ The grounds of dissolution indicated in the first category lacks clarity as it is not clear as to what accounts to “good cause” for court ordered dissolution. Likewise, dissolution of the company at the request of any member is limited only to the situation where the term of the company has not been fixed. However, it is not clear why such ground of dissolution is provided while the memorandum of association mandatorily requires the term or the period of time for which the company should be fixed.⁵⁴⁰

Regarding the second category, it holds true to a multimember PLC as it should not be dissolved for the mere fact that one of the members becomes bankrupt or insolvent or died unless of course all members expressly agreed in the memorandum and articles of

⁵³⁷ Commercial Code of Ethiopia, Art. 542(1, 2). One of “good cause” ground for court ordered dissolution of PLCs could be institution of bankruptcy proceedings.

⁵³⁸ *Id.*, Art. 542(3).

⁵³⁹ *Id.*, Arts. 543(1).

⁵⁴⁰ *Id.*, Art. 517(l).

associations otherwise.⁵⁴¹ It is clearly indicated that in the occurrence of these situations, dissolution of the company may not be warrantable since share of the company of such member either may be transferable to third parties or devolve by way of succession to the legal heirs.⁵⁴² It might not be necessary still to dissolve a PLC with a single member solely for the death or legal disability of the sole member as the chance to continue the business would be very probable. In addition, it should be noted that the institution of bankruptcy proceedings could also be a ground for dissolution of PLCs. However, in case of personal bankruptcy or insolvency of the sole member of a PLC, the existing legal scheme is expected to accommodate unique features of such companies. It has previously been indicated that the probability of commingling personal assets with that of the property of company is very high. Hence, in case where the personal property of the sole member becomes inadequate to meet his own current financial obligations, the single member may deceitfully resort to the property of the company to meet these claims. Accordingly, in order to safeguard creditors of the company from such eventualities, it would be more prudent if revision of the indicated provision is considered in order to accommodate the special situation of a single member.

The other ground of dissolution is reduction or loss of three-fourth of the capital. The law provides an exhaustion of remedies before which an application for dissolution to the court of law is not admissible. The Commercial Code gives discretion to the manager to consult the members and decide whether the company should be dissolved.⁵⁴³ However, “where the manager fails to consult the members or no valid decision is taken, any interested person may apply to the court for dissolution.”⁵⁴⁴ However, this legal provision is completely devastating to the interest of creditors for two reasons. First, the fate of the company is completely left to the will of the manager who could be non-member manager to decide on whether a company should be dissolved or should not be dissolved. Second, there is no timeframe within which the manager is required to notify its decision as to whether the company should be dissolved. Hence, this situation poses a greater risk for any interested party in the face of such capital reduction since it creates a situation where managers and members buy time to conspire against the interests of such third parties.

⁵⁴¹ See French Commercial Code, Art. L223-41: “A limited liability company shall not be dissolved if a court order for the court-ordered winding-up, personal bankruptcy, prohibition from management ... or legal disability measure is made with respect to one of the members. It shall also not be dissolved by the death of a member unless otherwise specified in the memorandum and articles of association.”

⁵⁴² Commercial Code of Ethiopia, Arts. 523(4), 524, and 542(4).

⁵⁴³ *Id.*, Art. 543(1).

⁵⁴⁴ *Id.*, Art. 543(2).

Accordingly, it is important to revise this legal provision in such a way to protect creditors particularly when the capital of the company falls below the legal minimum.

The other important point is the winding up of PLC. The decision to dissolve a PLC in case of several shareholders entails the liquidation of the company's assets and liabilities. This process requires the appointment of liquidators who should take possession of the property and books of the PLC in order to liquidate assets and liabilities of the company. Unlike, the case of SCs, there is no clear provisions that regulate the winding up of PLCs in the Commercial Code. Hence, in order to safeguard the rights of creditors, introducing a legal regime that regulates liquidation in the context of SMPLCs is vital. As indicated before, comparative experiences show that except in OHADA system, liquidation and winding up issues in the context of SMC is not a settled issue. It is simply regulated within the broader context of multimember companies. In view of this fact, the OHADA approach could be adapted in Ethiopia.

“Dissolution of a Private Limited Company having single member or in which all the shares are held by one person shall entail a total transmission of the assets and liabilities of the company to such person without resorting to liquidation. Creditors of the company may object the liquidation before the competent court within a period of thirty days following its publication. The court shall reject the objection or order the settlement of debts or the provision of guarantees if the company offers any and if they are deemed sufficient. The transmission of the assets and liabilities and the winding up of the company shall be effective only after the expiry of the time limit for objection or where the objection has been declared inadmissible or if the settlement of debts has been effected or guarantees provided.”⁵⁴⁵

According to this rule, there is no requirement for appointed liquidator(s) to administer a full-scale liquidation process of dissolved SMCs. It seems that the requirement of the law that resort to “a total transmission of the assets and liabilities of the company to a sole person” of the SMC implies the situations where the sole member would easily settle the debt of the company without financial difficulties. The reason for this assertion is that the transmission of the assets and liabilities to a single member and the winding up of the company is effective only if the thirty days time limit for objection is expired or the objection has been declared inadmissible or the settlement of debts has been

⁵⁴⁵ OHADA Uniform Act, Art 201.

effected or guaranteed. The approach under the OHADA system is flexible since it tries to reduce transaction costs associated with appointing liquidators and court proceedings in case where the debts of the company could easily be settled between the sole member and the creditors of the SMCs.

However, what will happen if the asset of a SMC is insufficient to cover the debts of the company? Here, the common bankruptcy provisions of the Commercial Code could be applicable.⁵⁴⁶ Accordingly, a SMC should be declared bankrupt by the court of law for the “suspension of payments” in relation to related to his commercial debts.⁵⁴⁷ As was previously noted, the bankruptcy paradigm of a SMC is simpler for administration compared to multimember companies since there are no other members to be protected. Hence, the major task of bankruptcy proceeding in the context of a SMC is to protect the rights of creditors and other interested parties. Finally, in order to maintain the benefit of limited liability the legal principle that a sole member, who acted in due care and diligence, should be liable to the extent of his investment in the PLC unless corporate veil piercing rules applies.

⁵⁴⁶ Ethiopian bankruptcy law is generally designed to regulate “any traders” including commercial business organizations which could be applicable to single member PLC in case such company “no longer able to meet the commitments related to commercial activities.” See Commercial Code of Ethiopia, Arts. 668 and the subsequent articles) for more in-depth discussion regarding Ethiopian bankruptcy law *see generally* Tadesse Lencho, *Ethiopian bankruptcy law: A commentary* (Part I), 22 *Journal of Ethiopian Law* n. 2 (2008).

⁵⁴⁷ *Id.*, Arts. 689, 970, 971 and 1972.

Chapter Six

6. Conclusions and Recommendations

6.1. Conclusion

The introductory chapter of this thesis posed research questions to which subsequent chapters and sections of the preceding discussion targeted to provide analytical answers. The first question is what are the major factors that necessitate the introduction of SMCs into Ethiopian corporate legal system? In order to answer this question, the paper identified four major factors. The first factor relates to the need to catch up with the international corporate trend. The thesis demonstrated that, in many countries around the world, SMCs have been statutorily introduced into the existing corporate law in order to promote corporate forms of sole entrepreneurships. In this regard, it is argued introducing SMCs into the Ethiopian corporate law is not a matter of luxury, but a matter of necessity – a means to attract foreign capital and further mobilize domestic resources.

The second factor relates to the preeminence of capital over the partnerships of persons. Relying on notable legal literatures, the thesis attempted to show the international trends on how the incorporation of modern business largely relies more on capital as its “life blood” than a collection of two or more individuals. Though the thesis also indicated the importance of companies who offer shares to the public as a means to mobilize idle capitals for large investments, the role of SMCs as additional means of mobilizing capital has been emphasized.

The third factor relates to the need to respond to the demand of the business community for SMCs. Theoretically, it is indicated that there is no magic in the two-person membership requirements to incorporate PLCs. It is also indicated that such minimum membership requirements to be complied with also carry no mandatory public policy and hence by no means implicate the requirement of several shareholders at all times. In practice, research studies revealed that PLCs are dominated by family businesses forming a common estate of a matrimonial property. Legally, the minimum capital requirement allotted to PLCs have been designed in such a way that one would create a legitimate PLC in which only one person has a practical interest by perfectly satisfying the requirements of the Commercial Code. In this regard, it is indicated in the paper that the requirement for a legal minimum of two shareholders to form a PLC provided in the Commercial Code is an exercise in futility. Yet, it could be easy to understand how the

legislator hinted the importance of capital contributed to the PLC rather than the number of contributors that creates such a company. The writer stressed how the present scheme of the Commercial Code promotes unintended *de facto* SMCs in one way or another. Therefore, it is opined that unless amendments are made to the Commercial Code, the present schemes to incorporate an allegedly multimember PLCs end up in *de facto* SMPLCs which in the long run undermines the corporate system and affects the rights of a shareholder and creditors.

The final yet an important factor relates to the need to transform Ethiopian “corporate culture”. The paper, as such, stressed the instrumentality of limited liability advantages in transforming the situation of investors “kiosk mentality” by providing an opportunity to separate business property from their personal property. It is indicated that since not all investors are ready to accept personal risks in businesses, providing an opportunity of limited liability may serve as an incentive for sole investors who fear personal liability through the vehicle of SMCs.

The second question, for which the paper has attempted to provide analytical answer, is to what extent would the existing multimember corporate theories be applicable to SMCs? The paper examined and evaluated major multimember corporate theories such as contract and concession theories including others such as legal personality and limited liability, corporate veil piercing, corporate governance and corporate taxation issues. In that regard, the paper attempted to show that though the major bottlenecks for the recognition of SMCs emanates from “contract theory” which requires partnership of two or more shareholders to validly incorporate a company, its force as a theoretical and legal basis for the foundation of a company has recently faded away. The idea that a company is not necessarily a union of person with more than one partner, but an operational organisation that functions for the purpose of the realization of its scope of activity, has now quickly acquired a greater acceptance in modern corporations.

It is also further indicated that the opposition to contract theory, as a foundation of a company, was essentially involved in the notion of a grouping of persons which was illusory in terms of public policy it meant to preserve. In contemporary businesses, the idea that capital is more important than collection of individuals has proved wide acceptance giving birth to an incorporated individual. Therefore, the paper in this regard argued that, though corporate theories were traditionally design in view of multimember companies, these theories would be applicable to the contexts of SMCs without significant conceptual contradictions.

At the legal level, comparative law provided several legislative models in favor of the individual enterprise based on the reasons that were essentially economic and pragmatic. It is indicated in the thesis that there exists a widely held consensus on the appropriateness to put an end to the hypocrisy of multimember corporate legal doctrines and to eliminate the disparate treatment from the standpoint of the liability for debts. There is a great deal of legal literature that propels for the elimination of discrimination between the shareholders of multimember companies and that of sole proprietorship business as regards the right to limit their personal liability to the extent of their investment.

The third question relates to identifying the major concerns associated with the regulation of SMCs in general. It is indicated that SMCs are not without problems owing to the fact that all shares of the company is owned by a single person who, in most cases, runs the business affairs of the company. The true danger that is specific to the SMCs is the difficulty to ensure a distinction that is clear and net between the company and the sole shareholder. For this reasons, some legal commentators invoked that bestowing limited liability to SMCs in such situations is a risky venture to creditors as it reduce business responsibility due to its tendency to create moral hazards. Nonetheless, comparative law demonstrated that they are relative and should not be exaggerated. If the sole shareholder is not vigilant and does not comply with the rules designed to regulate the SMCs and the formalism of the company instruments, he runs the risk of personal liability under the doctrine of corporate veil-piercing in a similar fashion applicable to the case of multimember companies.

Despite, lack of uniformity in the approaches to regulate SMCs, the concession of states has already brought about the crystallization of new legal conceptions into the existing corporate landscape. The practice of comparative jurisdiction indicate that there exists a consensus as to the treatment of SMCs as a variant forms of the existing companies, be it in the form of PLCs or SCs. This legislative approach avoids duplication of rules and principles that would otherwise be required to create SMCs as a new business entity. It is clearly demonstrated that though the general corporate principles would inexorably be applicable to SMCs, the need for specific rules in order to regulate the specific nature of SMCs has also been emphasized. Accordingly, in addition to the requirement of some amendments to the existing multimember corporate rules, new rules that regulate specific matters in relation to SMCs were also analyzed. Among other things, rules that regulate chain of SMCs, contracts between the sole member and the company, meeting and

quorum, recording of decisions made by sole member, disclosure requirements, dissolution and winding up, to mention but few, were the major ones.

The fourth question addressed in the paper is in what way would legislators be expected to introduce “legal regimes” governing SMCs in Ethiopia without substantially affecting the existing corporate legal structure? In the same way as demonstrated in the comparative practice, the writer tried to make use of their model in the examination of the Commercial Code provisions confined to the examination of the provisions governing PLCs and other relevant legislations based on two considerations. First SMCs are variants of PLCs despite the holding of shares of the company by a single member. Thus, SMCs depict the feature of PLCs, making the existing PLC provisions more suitable to adapt. Second, PLCs are more suitable business vehicle for businesspersons owing to the management flexibility they offer compared to SCs. It is indicated that such a nature of PLC has made it to be the dominant corporate form in Ethiopia. Hence, the Commercial Code provisions governing PLCs offer a more suitable option for sole proprietors who wish to incorporate a single member PLC.

The last but not least interrelated question is, what mechanisms would be expected to be introduced into the Ethiopian corporate law in order to effectively regulate SMCs and protect the rights of creditors? In addition to the safeguarding measures already in place under the Commercial Code, it is indicated that in order to address the special concerns of a PLCs with a single member, additional rules are required to further safeguard the rights of creditors without at the same time compromising the operational flexibility of the company as was demonstrated by comparative experiences. The paper attempted to unfold major contradictory provisions of the Commercial Code that hinder the legal existence of SMCs and further inculcated additional rules that may address the concerns of PLCs because of the fact that it now has a single member. A focus is made on adapting rules that regulate SMCs in foreign countries selected for comparative analysis. Particularly, rules that regulate publicity and disclosure requirements; capital requirements; meetings and quorum; recording of decisions made by the sole shareholder in relation to the company; contracts between the sole shareholder and the company and rules that regulate the dissolution and winding up of the SMCs are the major ones.

6.2. Recommendations

It is admitted that formulating a set of rules, which can be uniformly applicable to SMCs with a complete fairness to every situation would not be an easy task. But, it is hoped that the foregoing analysis, while not necessarily be definitive on the question of how best to accommodate SMCs in Ethiopia, made it clear that it is possible to do so in harmony with the principles that guide the current PLCs if the legal principles are carefully weighed and properly accounted for. Thus, given the typical nature of SMCs, additional provisions should be integrated into the corporate structure of PLCs. Likewise, the existing provisions of the Commercial Code that contradict with the conception of SMCs should be amended. Consequently, the following major recommendations are forwarded in order to introduce single member PLCs into the Ethiopian corporate system.

- Articles 210 and 211 of the Commercial Code should be amended to allow a single person to incorporate a business organization.
- Article 510 of the Commercial Code should be amended to allow a PLC to be originally formed with a single member or become a derived single membership due to the acquisition of all the shares by a member.
- A provision that permit the transformation of existing PLCs into SMCs and vice versa should be introduced into the Commercial Code. This additional rule may address the problem associated with the existing PLCs. It would help *de facto* single member PLCs to automatically transform their status to *de jure* single membership through the transfer of all shares in the hands of a single person.
- The rule that require the disclosure or publicity of a change of status of PLCs into a single membership should be introduced. The present legal regime that provides for the dispensation of publicity of business organization in the commercial gazette could only be justified in situations where a SMPLC is established initially in that form given the accessibility of Commercial Register for the public reference. However, in the case of change of status of PLC to a single membership, creditors or third parties of the previous PLC may not get the chance to know the occurrence of such fact unless published in a newspaper accessible to them.
- Rules that govern chain or pyramidal structure of SMPLCs should be introduced. This rule should have to determine whether a natural person be allowed or prohibited to form several SMCs in his individual capacity as a sole member or whether such SMC

should be allowed or prohibited to form another SMC as a sole member giving rise to chain of SMCs. As indicated in paper, the danger of chains of SMCs may be unbearable to the existing Ethiopian corporate law. However, the writer has the opinion that instead of the overall elimination of chain of single member PLCs, limitations should be introduced especially against abusive forms when pure shareholding in another company constitutes all assets of the natural person or former single PLC.

- The provision governing a memorandum and articles of association in the Commercial Code should be amended to include for mandatory stipulation of “nominee member” who would become a sole member of a PLC in case where the single shareholder died or incapacitated.
- Optional board of director should be introduced in case where the sole member of PLC has appointed non-member managers. This is particularly important since it leaves the desirability of board of director for the choice of a sole member. This trend ensures operational flexibility of the SMCs given the sole proprietorship-like features of such company.
- The holding of meetings in the context of SMPLC should not be made mandatory in consonance with the existing Commercial Code provisions on PLCs. Such approach ensures the operational flexibility of the SMPLCs, particularly, where the single member is a sole manager of a company. However, a mandatory annual general meeting should be introduced where more than one non-member managers are appointed to run the SMPLC in which a sole member exercises the power of a shareholder.
- There is no rule that regulate the recording of decisions or resolutions of meetings in PLCs in the Commercial Code. Therefore, rules that regulate the recording of decisions or resolution of meetings in SMPLCs and rules that oblige such company to disclose the record of decisions in the company’s own register accessible to the public should be introduced. It is also recommended that the rule that provide for the liability of the company or the sole member for failure to comply should be introduced. This rule may address the arbitrariness of decisions that is likely to affect the interests of the company or third parties.
- Rules that regulate quorum and proxy in a SMPLC should be introduced. As such, the Commercial Code provisions on quorum should be amended to also include one

person present at a meeting, if any, in person or by proxy, to constitute a meeting capable of passing decisions that bind the SMPLC.

- Rules that regulate permitted or prohibited agreements between the sole member, non-member managers and their close relatives and the SMPLC should be introduced. On top of this, any other permitted contractual agreements should be recorded in a written form. The new rule would be expected to provide records of the contractual agreements in a company's own books of registry which should be accessible to third parties for references.
- Rules that require the mandatory publicity of balance sheet and the profit and loss statement of SMPLCs should be introduced into the Commercial Code. However, SMPLCs that are not financed by a capital loaned from third parties should not be subjected to such disclosure requirements.
- A rule that require a SMPLCs to draw up its financial and accounting report and have it audited by an auditing firm at the end of each fiscal year should be introduced into the Commercial Code.
- The dissolution provisions of the PLC in the Commercial Code should be amended in such a way to address the specificities of sole member. Particularly, rules that regulate the winding up of PLCs in case of either personal insolvency or bankruptcy of the SMPLC should be clearly regulated in order to avoid any eventualities associated with the typical nature of its single membership.
- Additional grounds for corporate veil piercing should be introduced. Particularly, given the nature of SMCs, grounds such perpetration of fraud, commingling of assets, use of company property for personal purpose should be introduced as few examples of such grounds.

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