ADDIS ABABA UNIVERSITY

COLLEGE OF LAW AND GOVERNANCE STUDIES

SCHOOL OF LAW

LL.M IN BUSINESS LAW

CAPITAL MAINTENANCE IN ETHIOPIAN NON-FINANCIAL SHARE COMPANIES: THE LAW AND THE REALITY ON THE GROUND

BY: YOMILATA MANDO

JUNE, 2020

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Capital Maintenance in Ethiopian Non-Financial Share Companies: The Law and the Reality on the Ground

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Declaration

I declare that this thesis is the original work of my effort and that it has not been submitted, in whole or in part, in any previous application for a degree and all sources of materials used in the thesis have been duly acknowledged.

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Table of Contents

Acknowledgement i

Table of Contents ii

Abstract iv

Acronyms and Abbreviations v

CHAPTER ONE 1

INTRODUCTION 1

1.1. BACKGROUND OF THE STUDY 1

1.2 Statement of Problem 3

1.3 Research Questions: 7

1.4. General Objective of the Study 7

1.5 Specific objectives of the Study Are: 7

1.6. Research Methodology 7

1.7 Scope of the study 8

1.8 Literature Review 8

1.9 Organization of the Paper 8

CHAPTER TWO 9

2. GENERAL OVERVIEW OF CAPITAL MAINTENANCE AND NON-FINANCIAL SHARE COMPANIES CAPITAL 9

2.1 An Overview of Development of Capital Maintenance Doctrine 9

2.2. The Concept of Non-Financial Share Companies Capital 10

2.3. Statutory Rules Related to Companies' Capital Maintenance 11

2.4 The Importance of Capital Maintenance for Non-Financial Share companies 18

CHAPTER THREE 21

3.1 The Dicotomy between "Non-Financial" and "Financial" Share Companies in Ethiopia.. 21

CHAPTER FOUR 26

4.Analysis of the Ethiopian Legal Framework Governing Non-Financial Share Companies Capital Maintenance and the Practice **..... 26**

4.1 Conceptual Frame Work of Capital under Ethiopian Company Law 26

4.2 Legal Rules Relating to Capital Maintenance and its Adequacy in Ethiopian Non-Financial Share Companies 27
4.2.1 Company Acquisition of their Own Shares 27
4.2.2 The companies providing Financial Assistance for Acquisition of its Own Shares and Those of its Holding Companies 31
4.2.3 Share Cross-Holding Companies 32
4.2.4 Company's Distribution 35
4.2.5 Companies Capital Reduction 37
4.2.6 Raising of Company's Capital 40
4.3. The Practice of Capital Maintenance 43
CHAPTER FIVE 51
5.CONCLUSION AND RECOMMENDATION 51
5.1. Conclusion 51
5.2. Recommendations 52
Bibliography **........ 55**

Abstract

Maintenance of non-financial share companies' capital requires adherence to the capital maintenance rules like restricting acquisition of its shares by company and financial assistance for acquisition of its shares or those of its holding company. Moreover, company distributions, companies' shares cross-holding, capital reduction and capital raising are part of capital maintenance rules. Restricting such improper return of capital to shareholders helps to protect depletion of company's capital in particular and company's assets in general. With this respect this paper assessed the importance of capital maintenance and the adequacy of law governing this area and the practical aspect of Non-financial share companies' capital maintenance in Ethiopia. The study employed qualitative research method. As a result relevant laws are analyzed with proper literatures. Furthermore, case study, in-depth interview and companies' document evaluation are undergone to explore the realities related subject under consideration. The study founded that there is rare practice of company acquisition, financial assistance and share cross-holding. However, company distribution practice is rampant. Unlike this capital reduction practice is rare. When it comes to capital raising, direct equity capital raising practice is very limited one. Apart from this all rules of capital maintenance have legal gaps. Therefore, the provisions of commercial code governing capital maintenance should be revisited to address the gaps and practical problems for proper companies' capital maintenance and to enhance the corporatization and public wall fare aimed to be achieved at nation wise.

Acronyms and Abbreviations

BO:	Business Organization
CC:	Commercial Code
DARA:	Document Authentication and Registration Authority
EPS:	Earnings per Share
ERCA:	Ethiopian Revenue and Custom Authority
FFIC:	Federal First Instance Court
FHC:	Federal High Court
IPO:	Initial Public Offer
NFSHC:	Non-Financial Share Company
MFI's:	Micro-Financial Institutions
NBE:	National Bank of Ethiopia
OHADA:	Uniform Act on Commercial Companies and the Economic Interest Group
PLC:	Private Limited Company
SEO:	Seasoned Equity Offering
TM:	Ministry of Trade and Industry
CRLP:	Commercial Registration and Licensing proclamation
UK:	United Kingdom
USA:	United States of America

CHAPTER ONE

INTRODUCTION

1.1.BACKGROUND OF THE STUDY

Irrespective of their type, all companies have their capital. Albeit different types of capital which are known in different disciplines, companies' capital is what acquired from contribution made by shareholders either in cash or in kind.[1] This Capital becomes a significant concern of company law and maintenance of such capital acquired importance for creditor's protection.[2] Moreover, capital is considered as crucial to provide safeguards to ensure that fraudulent or careless practice in the formation of a company does not affect the financial solidity, credit worthiness and profitability of the new company and other way deemed to be a general security for the payment of debts of the company.[3]

As a fundamental principle of company law, company's capital must be maintained and company's capital maintenance is understood as one of the main concerns of company law.[4] In nut shell, capital maintenance concerns with restricting limited liability companies freedom from returning funds which were originally subscribed for shares by shareholders.[5] This objective of capital maintenance is achieved through enforcing capital maintenance rules developed from capital maintenance doctrine. These rules restricts companies from acquiring their own shares, financial assistance for acquisition of its shares and those of its cross-holding companies, making company distribution, share cross-holding, capital reduction and capital raising by improper

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[1]FikaduPetros, *Ethiopian Company Law* (2[nd]edn, Far East Trading Pvt. Ltd. Co, Addis Ababa 2016)95.

[2] Fritz Nitoko Ewing, 'Capital maintenance doctrine provides essential protection to corporate creditors: Myth or Reality?'(Ph. D Thesis, Adelaide University 2003).

[3]NigusieTadesse, 'Major Problems Associated with Private Limited Companies in Ethiopia: The Law and the Practice' (LL.M thesis, Addis Ababa University 2009).

[4]FikaduPetros (n 1)102.

[5] Fritz Nitoko Ewing (n 2)4.

ways.[6] Consequently, capital maintenance acquired importance concerning the maintenance of companies' capital in particular and assets in general from illegal depletion.[7]

Ethiopia doesn't have Company Act like other jurisdictions. However, the Commercial Code regulate about company. This law regulate private limited companies and share companies.[8] The phrase Share Company is not defined directly under the Commercial Code. However, it's defined in terms of the features of the share company and it connotes a type of company whose liability is limited on its assets.[9] Share Company can be classified as Financial Share Companies and Non-financial Share Companies from special protection and regulation given to Banks, Insurance, and Micro-Financial Institutions as Financial Share Companies.[10]Accordingly, financial share companies are governed by other laws apart from the CC and they are licensed by National Bank of Ethiopia.[11]

Ethiopia share company law addressed capital maintenance concerning acquisition, distribution, financial assistance, cross-holding, capital reduction and capital raising.[12] However, the legal regimes governing capital maintenance don't cover all scenarios that can possible depletes company's capital. However, FSHC's are regulated tightly in terms of regulatory regime and there is regulatory organ with strict supervision and follow up particularly on the area of banking, insurance and micro-financial institutions in general and particularly concerning capital maintenance.[13] These regulatory regime and regulatory organ is out of what is prescribed in the

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[6] Md. Saidul Islam, 'The doctrine of capital maintenance and "Its statutory developments: An Analysis' "The Northern University Journal of Law" (2013) Volume IV ISSN 2218-2278, 47, 48.

[7]ibid 48.

[8] Co., C., Art.304-543 Book two, Title VI and VII.

[9] ibid. Art.304.

[10]Hussein Ahmed, 'Overview of corporate governance in Ethiopia: the Role, Composition and Remuneration of Boards of Directors in Share Companies' (2012) Vol. 6 No.1 MIZAN LAW REVIEW 46.

[11] Commercial registration and Licensing proclamation, 2016, Art.21, No. 980, Fed., Neg., Gaz., Year 22, no.101.

[12]FikaduPetros (n 1)102-116.

[13]MekonenKassahun, 'Financial Regulation and Supervision in Ethiopia' (2014) Vol.5, No.17, 2014, (Journal of Economics and Sustainable Development)<www.iiste.org> accessed on 14 March 2019

CC for capital maintenance. On the basis of such tight regulation and supervision, FSHC's are maintaining their capital properly.[14]

However, looking into some individual provisions governing capital maintenance of the Ethiopian NFSHC's and their short comings, the practical activities affecting companies' capital maintenance raise questions as to the adequacy of the existing legal rules. Turning to the real world, various capitals depleting practice like; improper distribution, failing to call unpaid capital, over valuation of contribution in kind, improper capital increasing and others are observable.

Besides, company's assets needs prudent protection given its susceptibility for depletion and its importance for company's business operation. Moreover, company's assets need to be maintained from being striped. Therefore, the legal regime governing this aspect needs to be assessed with its practical enforcement to identify its loopholes and forward the way out to address them with advent of enhancing safe operation of NFSHC's capital in particular and asset in general.

1.2 Statement of Problem

Some Share companies' capital depleting activities are out of the realm of capital maintenance rules. Such scenarios are inherent in the company's business operation. However, depletion of company capital in particular and company assets in general through returning capital to shareholders requires and other ways depletions of assets requires proper regulation to protect multiple stakeholders' interests.[15]

As a result, the importance of capital maintenance rules can't be undermined even if it fails to address the capital depletion that happens in the normal course of company's business operation.[16] The notion of limited liability as an entitlement for shareholders, restricts creditors from proceeding against the private property of shareholders and the erosion of this privilege on

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[14]Data obtained from NB department of banks, insurance and MFI supervision, on February 12, 2019

[15] Susan McLaughlin, *Unlocking Company Law* (2ndedn, Routledge USA and Canada 2013)190.

[16] Fritz Nitoko Ewing (n 2)28 and 144.

other side frustrate investors from investing in equity capital.[17] These become paradox for corporate business because limiting shareholders liability is necessitated to promote investment while the creditors' interest also needs protection. So, limited liability of shareholders needs to be regulated by state in the interest of the creditors and the investing public.[18] Therefore, capital maintenance rules can be considered as a panacea to unravel such dilemma.

In Ethiopia currently, more than three hundreds seventy non-financial-share companies are registered at the MoTI and engaged in different business activities.[19] Moreover, the Ethiopian government is making moves towards privatizing partially or fully public enterprises into non-financial share companies.[20] This indicates a proliferation of NFSHC's and this requires comprehensive legal regime and its effective enforcement.

As to the law governing share companies from its birth to death the 1960 Ethiopian CC have legal regime which regulate Share Companies capital maintenance.[21] However, Ethiopian company law remain untouchable cast for more than half of century since its enactment. In this respect, the study undertaken by team of experts founded the incompatibility of existing Commercial Code to cop up with socio-economic realities of the nations.[22]

This legal regime doesn't adequately address all aspects of capital maintenance of Non-financial Share Companies. Among others, Ethiopian CC allows NFSHC's to acquire its shares from net profit on the basis of general meeting decision.[23] But, the law didn't addresses the duration for how long shares acquired by company will last within the given company treasure under boards

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[17] Peter Muchlinsk, 'Limited Liability and "Multinational Enterprise": A Case for Reform' Cambridge Journal of Economics (2010) 915 Advance Access Publication, 915-92<http://cje.oxfordjournals.org/>accessed on 27 March 2019.

[18] Md. Saidul Islam (n 6)48.

[19] Data Base Kept at Ministry of Trade and Industry, Commercial Registration and Licensing Directorate.

[20] Bilal Derso, 'What's Behind Ethiopia's Move to Privatize Public Enterprises 'the Ethiopian Herald (Addis Ababa 13 June 2018.

[21] Co.C., Book II Title VI.

[22] Fourteen Team of Experts, Position of the business community on the Revision of the commercial code of Ethiopia, prepared by a team of fourteen national experts, (AACCSA, Sida 2009) P. 5).

[23] Co. C. Art.332.

of directors control and the amount of such acquisition. The absence of such control creates the possibility of abuses related to share price negotiation and manipulation that happens through members' reduction by boards of directors.

Apart from this, financial assistance controlling rules ban financial assistances to be made in the form of loan and advance payments for acquisition of company's shares.[24] However, this part of the rule ignore the possibility of capital depletion through providing security for the loan made for acquisition of company's shares and remission of debt for acquisition of company's shares and those of its cross-shareholders. Furthermore, such legal gap pave the way for company governors to use company assets or capital to monopolize the company.

NFSHC's can make distribution of dividend from net profit supported by approved balance sheet.[25] Apart from this, there is an emerging practice of disguised distribution or dressed up distribution in which companies' capital in particular or assets in general can be distributed through transactions made by companies. The CC is silent with respect to regulating the transaction companies make. Absence of such regulation paves the way for company's capital depletion.[26]

Furthermore, provision governing cross-holding among share companies restrict, cross-holding of 10% and more than 10% of capital between two share companies.[27] However, the law ignores the instances of share cross-holding among more than two share companies while it obviously creates opportunity to form companies by either one or two company's capital. Capital reduction is another issue regulated as one aspect of Share companies' capital maintenance in CC. Both loss based or without loss capital reductions instances are well recognized. However, the law is silent as to the requirement and the organ which make asset reappraisal for the purpose of such capital reduction while depreciation is obvious.

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[24] ibid Art.334.

[25] ibid.Art.458.

[26] Andreas Cahn,' Capital Maintenance in German Company Law' Institute for Law and Finance 146<https://www.ilf-frankfurt.de/fileadmin> accessed on 20 April 2019.

[27] Co.C.Art.344.

Concerning capital raising, among others capital increment can be made through making contribution in kind.[28] Even if, the CC entrusted the power to valuate contribution in kind to the MoTI, the commercial registration and licensing proclamation empowers members of the company for valuation of contribution in kind.[29] However, this restores the fear of over valuation and difficulty may arise on the area that requires expertise knowledge.

Moreover, there are practical problems observable with respect to maintenance of NFSHC Capital. Practically, transfer of value between the company and others either at higher than or less than arm's length price which is regarded as disguised distribution are noticeable. On the area of capital reduction, even if the practice of capital reduction is very rare, it's undertaken without making proper reappraisal of the company assets and this creates doubt and confusion weather is really required.

Concerning capital raising particularly, the valuation of contribution in kind by company members is resulting with domination of share ownership in case of company founded among the founders. Furthermore, failure to call unpaid capital and answering such calls are noticeably problems exposing the company for unnecessary expenses of litigation through requesting declaration of membership withdrawal by court rather than taking the legal measures of redeeming such shares.

These capital depletion problems needs to be medicated, unless company's investment continuity will face challenge, likewise equity capital investors will frustrate from investing into equity capital. Therefore, the Ethiopian regulatory regime of capital maintenance compatibility with existing socio-economic realities of the societies is questioned. Thus, this study will assess the regulatory regime of the subject and its practical aspect that have great importance for stakeholders.

[28] ibid Art.480.

[29] Commercial Registrations and Licensing Proclamation 2016 Cited at note 11, Art.5 (9).

1.3 Research Questions:

1. Why is capital maintenance important for Non-financial Share Companies?
2. Are Ethiopian laws adequate to regulate capital maintenance of Non-financial Share Companies?
3. What is the reality on the ground with respect to maintenance of capital in Ethiopian Non-financial Share Companies?

1.4. General Objective of the Study

The general objective of this study is to examine capital maintenance in Ethiopian Non-financial Share Companies both as provided in law and in actual practice. In critically analyzing the adequacy of the provisions of the CC on capital maintenance and in assessing the reality on the ground, the study aims to help policy decision-makers to be aware of the law relating to capital maintenance as well as the problems detected in implementing the law by Ethiopian courts especially, Federal courts.

1.5 Specific objectives of the Study Are:

4. To assess the importance of capital maintenance for non-financial share companies
5. To examine the adequacy of Ethiopian legal regime governing capital maintenance of non-financial share companies; and
6. To explore the practice of non-financial share companies capital maintenance in Ethiopia.

1.6. Research Methodology

This research substantially employs qualitative research methods. Primary data like relevant laws that deal with the issue of NFSHC's capital maintenance in Ethiopia were collected, analyzed, interpreted and examined. Moreover, as secondary source of data courts cases, relevant literatures related to the subject matter both from foreign and domestic sources like books, journals, unpublished materials, newspapers and others will be collected from library and internet source and analyzed alongside major conceptual, theoretical, legal and practical frameworks of NFSHC's capital maintenance in Ethiopia.

As examination of law alone doesn't reveal what exist on the ground, an effort was made to collect other primary data relating to practical aspect. Therefore, data related to the practical aspect of subject matter under study are collected through an interview and document analysis.

Concerning sampling, purposive sampling was employed to undertake an interview with members of boards of directors, founders of companies, officers of MoTI and DARA, judges, academicians and lawyers. With respect to type of interview question, unstructured interview questions were administrated. Finally, data collected was analyzed narratively and descriptively.

1.7 Scope of the study

This research is limited to examine the importance of capital maintenance for NFSHC's, the adequacy of its rules and practice related to NFSHC's. In this regard, capital maintenance rules like; acquisition, financial assistance, share cross-holding, company distribution, capital reduction and capital rising were assessed. Accordingly, the capital raising aspect limit itself only on the valuation of contribution in kind, valuation of share price and calling unpaid capital excluding debt finances, and other aspects of equity financing.

1.8 Literature Review

Different researches have been conducted on the Ethiopian company law and practice. However, none of them dealt with the capital maintenance of Ethiopian companies. Therefore, this study explores particularly about the capital maintenance of Non-financial Share Companies in Ethiopia.

1.9 Organization of the Paper

The paper constitutes five chapters. The first chapter encompasses background of the study, statement of the problem, research questions and objective of the study, research method, literature review, scope of the study and its organization. The second chapter presents the general overview of development of companies' capital maintenance doctrine. Moreover, this part assess about the definition of capital maintenance and its statutory rules like; acquisition, financial assistance, company distribution, shares cross-holding, capital reduction and capital raising. Finally, importance of capital maintenance for Non-financial Share Companies is addressed in this chapter.

The third chapter addresses the dichotomy between financial and non-financial companies. The fourth chapter address about the analysis on the Ethiopian legal frame work governing non-financial share companies' capital maintenance rules, its adequacy and the practice. The final chapter presents conclusion and recommendations of the study.

CHAPTER TWO

2. GENERAL OVERVIEW OF CAPITAL MAINTENANCE AND NON-FINANCIAL SHARE COMPANIES CAPITAL

2.1 An Overview of Development of Capital Maintenance Doctrine

Companies have separate legal existence from their shareholders which resulted with development of limited liability of shareholders.[30] This limited liability prevents creditors from proceeding against the private property of shareholders other than company's assets. As a result, company creditors may face risk when company capital gets depleted.

Thus, limited liability creates a conflict of interest between shareholders and creditors.[31] It becomes a dilemma whether to avoid limiting shareholders liability to protect creditors or keep shareholders liability as limited. Lifting shareholders limited liability frustrates equity capital investors and discourages corporatization in general. Moreover, disregarding creditors' protections also discourage debt financing so long as, equity capital alone is not sufficient to finance companies business operation.[32]

This problem solved up on the development of capital maintenance doctrine through serious of judicial interpretations under common law.[33] As a fundamental principle of company law, companies must maintain their capital from dissipation.[34]From the cases which the principles of capital maintenance arose, Trevor v Whitworth case is a notable one. In this case, company bought back almost a quarter of its own shares and during liquidation one of its shareholder claimed for the retrieval of capital.[35] The House of Lords ruledthe act of company as 'Ultra Vires' declaring that the company couldn't purchase its own shares so long as it would have

[30] Susan McLaughlin (n 15)65.

[31] Mayson, Franch and Rayn, '*Comoany Law' (*34[th]edn Oxford University Press, England 2017)200.

[32] Peter Muchlinsk (n 17)915.

[33]Md. Saidul Islam (n 6)48.

[34]FikaduPetros (n 1)102.

[35] Md. Saidul Islam (n 6)48.

capital reducing effect.[36] As a result of this court case, one aspect of capital maintenance doctrine which restricts companies from acquisition of their own shares emerged.[37]

Another bench mark case for the development of capital maintenance doctrine is Flitcrofts Case. In this case, false account reports of Exchange Banking Company presented to shareholders. On the basis of this report, distributions were declared though a company had bad debts and no distributable profits.[38] Lord Jessel MR provoked the idea of proper maintenance of company's capital from returning to shareholders rather than by duly and legally established measures.[39] From this ruling, rules restraining companies from making unduly recognized capital reduction and company distributions were developed under capital maintenance doctrine.[40]

The development of capital maintenance doctrine traces back to the above court cases. Finally, the prohibition against returning or reducing the share capital of company except when company law allow was established under common law jurisprudence as capital maintenance rules on the basis of this doctrine.[41] Moreover, companies are imposed with the duty to keep intact their capital and courts are mandated to supervise depletion of capital whether lawful or unlawful.[42] Finally, capital maintenance rules received recognition under many states domestic company law.

2.2. The Concept of Non-Financial Share Companies Capital

Company laws of many jurisdictions considered share capital of companies as initial money required for the operation of company business.[43] So, a company's capital can be understood as

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[36]Exchange Banking Co, Flitcroft's Case (1882) 21 Ch.

[37] Md. Saidul Islam (n 6)48

[38] https://www.coursehero.com/file/p439l1d/In-re-Exchange-Banking-Co-Flitcrofts-case-1882-21-Ch-D-519-Its-a-

[39] Md. Saidul Islam (n 9)48.

[40] ibid.

[41]RehanaCassim, 'The capital maintenance concept and share repurchases in south African law' (2018) The International company and commercial law review 188-191, 1<researchget.net>accessed on 15 March 2019.

[42] Md. Saidul Islam (n 6)47.

[43] Ashok K. Bagrial, '*Company Law*' (12 edn, Vikas Publishing House PVT LTD, Delhi 2014)206.

the contribution made by the shareholders either in the form of cash or in kind and such capital is divided into the small parts called shares with its own nominal values.[44]

The term share capital can be used interchangeably with equity capital in most company-related literatures and companies' capital maintenance.[45] Furthermore, share capital is an equity capital of company unless the company has class of shares in which such special class of shares capital can be considered as equity capital.[46] Company law gives high focus on the capital in terms of its collection and maintenance in order to enhance creditors' protection one way and preservation of companies' capital in particular and assets in general.[47]

2.3. Statutory Rules Related to Companies' Capital Maintenance

The development of capital maintenance doctrines resulted with rules restraining companies from acquiring their own shares without duly established legal procedure.[48] Apart from the difference in substantive regulatory frame work, many jurisdictions have made capital maintenance rules part of their domestic company law. For instance, capital maintenance rules are part of 1890 England's Company Act.[49] Moreover, in order to have bird's eye view understanding about each of these capital maintenance rules and companies activity entails companies capital depletion in particular and assets depletion in general, it's better to glimpse over each of them.

Company acquisition is a scenario in which companies acquire its own shares and it is subject to control under capital maintenance rules because of being considered as way of returning capital

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[44] Ashok K. Bagrial,(n 43)

[45] Susan McLaughlin (n 15)145.

[46] ibid. 147-148.

[47]John Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law?'(1999) ESRC Centre for Business Research, University of Cambridge Working Paper No. 148, 2-5<citeseerx.ist.psu.edu>accessed on 30 April 2019.

[48]NdihuoRabuli, 'Capital Maintenance Rules and Distribution Focusing on Section 46 and 48 of the Companies Act 2008' (Mater of Law Thesis, University of Pretoria 2016)4 https://repository.up.ac.za accessed on 20 March 2019.

[49]Md. Saidul Islam (n 6)50.

to shareholders.[50] Lord Justice Watson in Trevor V Wit Worth stated that, "No part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.''[51]

These rules protect creditors and shareholders of a company, especially those in minority position. Since the prohibition of a company to purchase of its own shares helps to control directors from authorizing a purchase in order to monopolize the company governance and to remove troublesome shareholders.[52] Restriction related to acquisition protects shareholders and creditors' interests through addressing the risk of insolvency that may arise from acquisition and seeks to ensure fairness among stakeholders.[53] Furthermore, the restriction may avoid informal liquidation of company assets through controlling free acquisition.[54]

Companies' capital acquisition can be practiced by acquisition methods like; market purchase, an off-market purchase and a contingent purchase in some jurisdictions.[55] Companies can acquire their own shares for many reasons. Mainly, companies acquire back their own shares when executive directors have taken shares in the company and later on decided to leave the company.[56] Another reason for acquisition is to avoid the introduction of new outsider when the shareholders are in dispute and there is no possibility of compromise especially when there is restriction against new comers.[57]

Moreover, a company may make acquisition to change the capital structure of the company.[58] Furthermore, companies acquire their share to substitute dividend by the buy-back as both of

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[50] Fritz Nitoko Ewing (n 2)41.

[51] ibid.145.

[52] ibid 46.

[53] ibid 54.

[54]People.stern.nyu.edu.admodar.pdfiles.papers.beydiy.

[55] England Company Act 2006 s143-145 and s159-181.

[56]Charles Wild and Stuart Weinstein, '*Company Law' (*15th edn, Longman 2011)173.

[57] ibid.

[58] Uttar Pradesh, India AlkaMunjal Amity University Uttar Pradesh, 'The Impact of Regulations and Technology on Business Environment in India: "Corporate Restructuring through Share buybacks",

them are the mechanism for returning capital to the shareholders. In this case, companies make buy-back to return excess capital.[59] Moreover, excess cash can be avoided by share buy-back and this is done to reduce the agency conflict by judicious returning of capital to shareholders and to save the company from the risk of investing in negative projects.[60]In conclusion, acquisition can cause depletion of capital if not made on the basis of the duly established legal procedure and legitimate legal grounds discussed above.

Apart from acquisition, financial assistance is a scenario in which a given company acquire its own share. This is done when a company provides funds to buy its own shares or provide guarantees for the loan used to buy its own shares/those of its cross-holding or give indemnity to the lender or secure the loan by giving a charge over its assets to the lender or remission of such debt.[61]Financial assistance rule is considered in conjunction with capital maintenance rules and it's an extension of rules against company purchase/trading or trafficking on its own shares as put by Lord Greene.[62]This rule is the bastion of the rules in Trevor V Whitworth case.[63]

Financial assistance prohibition is rooted in the philosophy that, anyone who buys share has to buy from his personal property.[64] In this regard, Lord Denning summed up financial assistance as "Cheating." Above all, the prohibition aimed at protection of creditors and shareholders against exposure of possible risk of company's capital depletion.[65] As a result, company's capital remain intact from mischeef by the company governers and shareholders. The creditors will be safe from the risk of company insolvency that might happen as a redsult of finacial assistance made in the forms meantioned above.[66]Lord Greene suggested that the prohibition was developed to address

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(2018) Vol.12 Issue: 2, Accounting, Business and Finance Journal, 118 <uvarma@ibsindia.org> accessed on 20 march 2019 118-119.

[59] ibid.

[60] https://www.investopedia.com › investing › Stocks › Dividend Stocks.

[61] Charles Wild and Stuart Weinstein (n 56)183.

[62] Susan McLaughlin (n 15)203.

[63] Fritz Nitoko Ewing (n 2)165.

[64]BalkrishnaParab, 'Capital maintenance'<mesmerizers.file.wordpress.com> accessed on 15 March 2019.

[65] ibid.

[66] Maisie Ooi, 'The Financial Assistance Prohibition: "Changing Legislative And Judicial Landscape" (2009), Singapore Journal of Legal Studies, 135, 148.

leveraged buy-outs (a mischief whereby, a person who has obtained a loan from a company in order to purchase a majority of a company shares and arranged ways to monopolize the company).[67]

In conclusion, financial assistance rules prohibit companies from making advance payment, guarantee, remission of debt or loan made for acquisition of its own shares or those of its holding companies.

Another company activity which results with returning capital for shareholders and entails assets depletion in general and capital in particular is distribution. Unlike its ordinary definition, company distribution under capital maintenance realm is concerned with restricting payments out of capital.[68] Therefore, company distribution has rules which aims to maintain company's capital through restricting companies from paying back capital to shareholders prejudicially to the interest of creditors and other stakeholders. As a result, dividends and other type of distributions are paid only from the distributable profits of the company.[69]

Apart from this, transfer of values between a company and its shareholders and/or other companies is considered as disguised distribution due to the effects of such transactions on the stakeholders' interest through depleting company capital and assets.[70]

In conclusion, restrictions imposed on the company distribution maintain company capital both from direct or indirect depletion. Actually, the regulatory frame work varies from jurisdiction to jurisdiction but, whatever all is aims at controlling improper depletion of company's capital in particular and assets in general.

Share cross-holding as another scenario of companies' activities of acquiring its own share, defined as the practice of publicly traded companies strategically owning each other's shares. Share cross-holding between two or more companies occurs when one company subscribes share

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[67]In VGM Holdings and Wallersteiner V Major Case.

[68]Stephen A. Ross, Randolph W. Westerfield, Bradford D. Jordan, '*Fundamental of Corporate Finance'* (6[th]edn Mc Graw-Hill Higher Education, USA 2003) 606.

[69] Charles Wild and Stuart Weinstein (n56)195.

[70] Andreas Cahn (n 26)6.

of another company and in return that other company also purchases shares of its member company.[71]

This regulatory restriction is aimed to control evasion of capital by the company through share cross-holding which entails depletion of cross-holding companies' capital through share acquisition and such practice bar the entrance of new capital into the economic transaction.[72]

In conclusion, companies are imposed with restrictions from shares cross-holding under the realms of capital maintenance. Because companies may be established by using single company capital. So, such practice can be controlled either through complete ban or through putting threshold limitation. Whatever, restrictive role is provided, it helps to control fraud activity in which many companies may cross-hold each other's or the same capital, while the sum of that capital doesn't exist in the strict sense.

Moreover, capital reduction is one aspect of returning the capital to shareholders from capital maintenance perspective.[73] Moreover, House of Lords considered return of share capital to the shareholders as reducing the capital making company unable to pay its creditors.[74] This restriction is philosophically justified on the assumption that, capital could not be returned to shareholders except through distribution of legitimate dividend and on wind up after satisfaction of others liabilities.[75] Illegitimate capital reduction may prejudice the company's ability to pay its creditors even though it might not necessarily lead to insolvency with respect to creditors' interest protection.[76] Besides, this reduction of capital have the effects of varying shareholders rights. It may entailsabrogation or variation of the class right of shareholders.[77]

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[71]MehamedAliye, 'Affiliate Companies in Ethiopia: Analysis of Organization, Legal Frame Work and The Current Practice' (LL.M Thesis, Addis Ababa University 2010)49.

[72]Takao Kobayashi, 'Cross-Shareholdings and Equity Valuation in Japan' (University of Tokyo 2002) <https://www.saa.or.jp>accessed on 14 April 20019.

[73]Balkrishna Parab (n 64).

[74]Re Exchange Banking Co, Flitcroft's Case (1882) 21 Ch.

[75]www.mondaq.com › Shareholders › Capital+Reduction.

[76] Fritz Nitoko Ewing (n 2)143.

[77] ibid 127-128.

Depending on the rationales why such capital reduction is undertaken, reduction can be either due to loss or without loss. Capital reduction without loss happens when companies decide to reduce their share capital due to excess capital and such reduction is made if there is no better investment opportunity for company.[78]

This type of capital reduction can be easily done through reducing the nominal value of shares proportionately. This approach does not have exclusionary effect whatever the value of shares on any shareholder.[79] But if reduction is made in terms of replacing the existing shares by new less number of shares that would have negative effect even on withdrawing membership by minority shareholders.[80]

Whatever the cause for capital reduction, reduction potentially affects the creditors' interest.[81] Therefore, creditors have to be given the opportunity to object such reduction before a court for their debt to be paid or secured. That is why law requires the court approval for capital reduction.[82] However, this practice is not common in all jurisdictions.

In conclusion, capital reduction is restrained to protect creditors and stakeholders. Whether its loss based or without loss capital reductions both have the effect of returning capital to shareholders in terms of creditor's protection if not based on legitimate legal procedure. Therefore, companies' capital reduction should be within the possible limits and control of the law to avoid capital and assets depletion and protection of creditors and minority shareholders.

Controlling companies capital increasing is one aspect of capital maintenance rules. The phrase capital raising does not have literal meaning. However, it is understandable as one aspect of company financing.[83]Equity capital raising is the process of raising company's capital through

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[78]Balkrishna Parab (n 64).

[79]https://www.informdirect.co.uk › shares › share-capital-reduction-explained.

[80]*'Capital reorganization, reduction, and reconstruction' (1 Dec 1994)*https://nscpolteksby.ac.id> accessed on 19 June 2019.

[81]*Capital reorganization (n 80)592.*

[82] ibid.

[83] Stephen A. Ross, Randolph W. Westerfield, Bradford D. Jordan (n 68)528.

issuing new shares and attracting new investor.[84] This way of raising capital for share companies includes the numbers of shares company issue, the nominal value of such shares and how those shares are structured.[85]

Let alone other ways of capital raising for share companies, equity financing have alternative issue methods like public issue (initial public offer (IPO), Seasoned Equity Offering (SEO)) and Private Issue and all these are subject to strict regulation for the proper protection of stakeholders interest.[86]

In relation to company capital raising, regulating proper valuation of the value of contribution made in kind is detrimental to the protection of stakeholders' interest. The value of capital assigned to such contribution should be equal to the value of such assets.[87] In this regard, there are two approaches namely, "Independent Evaluation" and 'Directors Honest Estimate' test 'Good Faith' test.[88] With respect to 'Directors Honest Estimate' approach directors bear the duty to estimate the contribution in kind faithfully and present resolution to the shareholders for approval.

Another issue worth to be discussed in relation to equity capital raising is pricing the shares. Issuing share below its nominal value is prohibited and the prohibition is aimed at protecting creditors and existing shareholders interest particularly.[89]

Calling unpaid capital for which shareholders have subscribed is another issue of equity capital raising. A company has the right to call uncalled capital which is subscribed by each shareholder.[90] Even when company with uncalled share capital becomes insolvent and

[84] Hugo Kerbib, 'Comparative Corporate Law: The US and the French SA' (LL.M Thesis, Dauphine University 2016-2017)18.

[85]LulekwaMakapela, 'Capital Rules in the New Companies Act No. 71 of 2008' (LL.M Thesis, University of Pretoria 2010)8-9.

[86] Stephen A. Ross, Randolph W. Westerfield, Bradford D. Jordan (n 68)528-529.

[87] Fritz Nitoko Ewing (n 2)338.

[88] ibid 385.

[89] Susan McLaughlin (n 15)172.

[90] ibid 167.

liquidation goes on, the liquidator can require the shareholder to pay unpaid share capital, to the creditors.

In conclusion, stakeholders' interest needs attention with respect to proper valuation of contribution in kind, calling unpaid capital and prohibition against issuing shares at less than par value. Because, it help companies to sustain its business operation safely in general and to protect both shareholders and creditors interest in particular.

2.4 The Importance of Capital Maintenance for Non-Financial Share companies

Capital maintenance has substantial importance for companies. Those are, capital maintenance plays crucial role of preserving share capital of companies from being returned to shareholders in the form of acquisition, capital reduction, capital raising, financial assistance, distribution and capital cross-holding.[91]

Particularly, restriction on share cross-holding among companies has the importance to control the depletion of capital by companies through using the same amount of capital for other companies' formation.[92] Apart from this, capital maintenance helps companies to be protected from asset-strapping take-over which prohibits companies from acts that bring leveraged buy-outs risk against creditors.[93] The transaction between company and other may be conducted at less than arm's length prices and this depilates companies' assets unless controlled by regulatory devisees' of capital maintenance.

Moreover, capital maintenance creates sense of belongingness and inspires the public to invest in equity showing proportionate interest of shareholders in company and enhances credit

[91] Md. Saidul Islam (n 6)49.

[92] Andreas Cahn (n 25)16-17.

[93]Alison Sneddon, 'Do the Rules on Capital maintenance' Achieve Any Useful Purpose? 'Edinburgh Student Law Review, 17, 29 <https://heinonline.org/HOL/License> accessed on 27 February, 2019.

worthiness of company.[94] Without maintenance of such capital companies business will be nightmare.

Capital maintenance enhances companies' debt financing through restraining return of capital to shareholders. As a result, creditors and stakeholders interests are protected.[95] Apparently, when companies opt to finance their business through debt financing, creditor gives credit to a company with the belief that capital of company shall be applied only for its business purpose.[96] Actually, the sufficiency of capital for such business purpose depends on the extent of company capital and finance required for such business operation.

Furthermore, capital maintenance plays enormous role through reconciling the dilemma between limited liability and creditors' protection and enhance corporate finance.[97]. This importance of capital maintenance is subjected to many critics. Among those critics, companies' capital is considered as inadequate for creditors' protection and capital maintenance rules are considered as unnecessary restrictions upon companies' activity.[98] Moreover, capital maintenance is regarded as costive in relation to expert valuation of company assets and court approval of capital reduction proposal.[99]

Additionally, capital maintenance is criticized as "one size fits all" approach imposition. Consequently, it lacks effectiveness due to subjective circumstances and individual features of a business.[100] Moreover, the rules restricting company acquisition and distributions are criticized

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[94] Kathleen Van Linde, 'The Regulation of Conflict Situations Relating to Share Capital'2009 University of Johannesburg 36 <https://www.academia.edu> accessed on 14 April 2019.

[95]Ndihuo Rabuli (n 48)4.

[96]Re Exchange Banking Co, Flitcroft's Case (1882) 21 Ch.

[97] Christopher J. Cowton, 'Putting Creditors in Their Rightful Place: Corporate Governance and Business Ethics in the Light of Limited Liability' [2011] 102(1):21-33 Journal of Business Ethics<https://www.researchgate.net>accessed on 19 April 2019.

[98] Alison Sneddon (n 93)25-28.

[99] ibid. 36.

[100] Paul P. Davies, '*Introduction to Company Law'* (2nd edn, Clarendon Law Series 2010)91.

as having negative effect on the equity markets efficiency and liquidity of shares. As a result, equity investment will be restricted.[101]

Actually, the preservation of capital alone may fail to protect creditors' interest in the strict sense.[102] However, that failure does not erode the importance of capital maintenance with regards to maintaining capital and protecting stakeholders' interest to the possible extent. Furthermore, capital maintenance is not intended to address company insolvency rather it is to prevent the practices that have negative impacts on the capital and assets of the company. This objective ispractically and logically justifiable as it protects company's capital from dissipation by the shareholders and company administrators.[103] Moreover, capital maintenance rules adherence is less costive in relation to solvency statement adopted in some jurisdictions.[104] Furthermore, restriction imposed on acquisition and distribution are advantageous than ignoring such restrictions.[105]

In conclusion, capital maintenance importance focus on the protection of multiple interests like; creditors, investor protection, especially for minority shareholders through protecting companies assets from illegal depletions.

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[101] Alison Sneddon (n 93)29-30.

[102] Andreas Cahn (n 25)2.

[103] Alison Sneddon (n 93)34.

[104]Foundation for Economic Education, 'Discussion Paper On Alternatives toCapital Maintenance Regimes' (2007)7

[105] Hugo Kerbib (N 81)17.

CHAPTER THREE

3.1 The Dicotomy between "Non-Financial" and "Financial" Share Companies in Ethiopia

Ethiopian Commercial Code recognized many forms of BO and Share Company is one form of such business organizations.[106] The CC defined a share company as a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company.[107] Likewise, some writers regard Share companies as "Publicly held companies".[108] Apart from this, the Banking Business Proclamation defined "Company" as a Share Company which is defined under the CC of Ethiopia.[109] Similarly, the Insurance business proclamation defined ''Company" as a share company as defined under the CC, the capital of which is wholly owned by Ethiopian nationals or organizations wholly owned by Ethiopian nationals and registered under the laws of, and having its head office in, Ethiopia".[110] Moreover, Micro-Financing Business Proclamation defined "Company" as a share company as defined under the CC of Ethiopia and adds the definitional elements put by Insurance Business proclamation.[111]

Ethiopian CC doesn't differentiate between share companies as 'financial and non-financial share companies'.[112] However, share companies can be dichotomized as financial and non-financial share companies on the basis of business activity they engage in, legal regime governing such business area and their regulatory organ. Thus, banks, insurances and micro-finance institutions are regarded as financial share companies, while companies that don't engage in this business are called Non-financial Share Companies.[113] Moreover, financial institutions encompass capital goods finance company, postal savings, and money transfer

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[106]FikaduPetros, 'Emerging separation of ownership and Control in Ethiopian Share Companies: Legal and Policy Implications' (210) Vol. 4 No.1 MIZAN LAW REVIEW 1.

[107] Co. C., Article 304.

[108] Hussein Ahmed, (n 10)8.

[109] Banking Business Proclamation, 2008, Art.2 (5), Proc. No. 529, Fed. Neg. Gaz., Year 14 No. 57.

[110] Insurance Business Proclamation, 2012, Art. 2(8), No.746, Pro. Fed. Neg. Gaz., Year 18 No. 57.

[111] Micro-Financing Business Proclamation 2009, Art. 2(3), No.626, Pro. Fed. Neg. Gaz., Year 15 No. 33

[112] Hussein Ahmed, (n 10)10.

[113] ibid.

institution, an institution providing financial service through digital channels or such other similar institution as determined by the National Bank of Ethiopia.[114]

Apart from the business type in which FSHC's engage, their formation and operation requires compliance to the particular proclamations, regulations, subsidiary directives and guidelines other than 1960 Ethiopian CC..[115] For instance, share companies engaged in banking business have to comply with the Banking Business Proclamation No.592/2008, 1159/2020 and other subsidiary laws issued by the NBE. Similarly, insurance companies have to comply with Insurance Business Proclamation No.746/2012 and directives and procedures of the NBE. Likewise, MFI's are governed by Proclamation No.626/2009, 1164/2020 directives and procedures issued by the NBE.[116] However, NFSHC's are governed by book II title VI chapter one up to eight and other particular laws prominent to the particular business area a given company opted to operate.[117]

The importance of FSHC's to stabilize macro and microeconomic situations required unique regulatory organ and regulatory regime.[118]As a result Ethiopian FSHC's are regulated by NBE from their formation and dissolution.[119] However, NFSHC's are registration, certification and legal personality is regulated by MoTI, regional trade bureaus and other concerned authorities.[120] Furthermore, FSHC's are regulated differently and strictly on the area of minimum capital requirements, capital adequacy, ownership, accounting, valuation, liquidity, solvency, acquisition, capital reduction, capital cross-holding (joint holding) and others due to their special

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[114] Micro-Financing Business (Amendment) Proclamation 2020, Art. 6, No.1164, Pro. Fed. Neg. Gaz., Year 15 No. 33

[115] Hussein Ahmed, (n 10)47.

[116] ibid.

[117] Co. C. Article 304 -509

[118]Macey, Jonathan R. and O'Hara, Maureen, 'The Corporate Governance of Banks', (2003), Vol. 9, No. 1 Economic Policy Review, <https://ssrn.com/abstract>accessed on March 10, 2020.

[119]

[120] Commercial Registrations and Licensing Proclamation, 2016, Cited above at note 11, Art. 21(4).

characteristics.[121] In this regard, capital maintenance of Financial Share Companies in general and banks in particular is highly regulated.[122]

Finance is a lung for any economic development, ubiquitous and conveyance by nature and carries unavoidable and endogenous problem called financial crisis. Therefore, the sector is especially eye-catching and requiring regulatory treatment.[123] These unique characters give rise to its role in prudential regulation, with minimum capital requirements being seen as a way of protecting other stakeholders.[124]In terms of minimum capital requirement Ethiopian financial share companies are required by law to have fully subscribed and partly paid up share capital before commencement of their business.[125]Particularly, a share company which intends to operate banking business has to deposit 500,000,000 birr in the closed bank account designated by the bank under formation as minimum paid up capital.[126]Likewise for general and long term insurance business share company formation 75, 000,000 birr minimum paid up capital is required.[127]As such, MFI's is required to deposit 2, 000,000 birr as minimum paid up capital requirement for the share company to operate micro-financing service.[128]However, NFSHC's

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[121]Rowan Trayler, **‘Corporate** Governance in Banking’ **Benton** E. Gup (ed), **‘**A Survey of Corporate Governance in Banking: Characteristics of the Top 100 World Banks’ (Edward Elgar Publishing2007).

[122]Rowan Trayler,‘Corporate Governance in Banking’ Benton E. Gup (ed), **‘**A Survey of Corporate Governance in Banking: Characteristics of the Top 100 World Banks’ (Edward Elgar Publishing2007).

[123]Lawrence J. White, The Role of Financial Regulation in a World of Deregulation and Market Forces, (1999)<**https://www.imf.org/external/pubs/ft/seminar/1999/reforms/white.htm**> accessed on 18 December 2018)

[124]Kavi Devis, ‘Bank Capital Adequacy: Where to know?’ 2019< www.reserachgate.net> Accessed on April 2, 2019

[125] Solomon Abay, ‘Financial Market Development, Policy and Regulation: The International Experience and Ethiopia’s Need for Further Reform’ (PHD Dissertation, University of Amsterdam 2011)

[126]Licensing and Supervision of Banking Business Minimum Capital Requirement for Banks Directives No. SBB/50/2011 Article 4.

[127]*ELLENI ARAYA,* ‘NBE orders insurance companies to raise paid up capital tenfold’ Fortune Addis (Addis Ababa April 14, 2013).

[128]*ELENI ARAYA,* ‘NBE’s New Directive Lifts Microfinance Paid up Capital to Two Million Birr’ Fortune Addis (Addis Ababa October 06, 2012).

minimum capital must be 50,000 birr and above, while only quarter of the registered capital is required to be deposited minimum paid up capital in the closed bank account by the name of company under formation.[129]

Moreover, FSHC's like banks and micro-finance are required to meet capital adequacy requirement and insurance companies are required to meet solvency test.[130]Particularly, capital adequacy makes the banks to ensure their capacity to meet their liabilities and other risks like credit risk, market risk and operational risk. Applying minimum capital adequacy ratios serves to protect depositors and promote the stability and efficiency of the financial system.[131]Moreover, banks, insurers and microfinance institutions are prohibited from redeeming their shares and reducing their capitals voluntarily without prior written approval of the NBE.[132]Particularly, in banks "No person, other than the Federal Government of Ethiopia, may hold more than five percent of a bank's total shares either on his own or jointly with his spouse or with a person who is below the age of 18 related to him by consanguinity to the first degree."[133]Not only that, if any one person own or holding more than 2% (two percent) of share capital of any given banking company; it he/she may not hold a share in other banking company.[134] These limitations help to control domination possibility which paves the way for assets dissipation.

Concerning cross-holding between/among banks,it may own shares in sister banks up to 5% (five present) and the bank may hold up to 20% in respective insurance.[135]In Insurances companies,

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[129]Co. C. Article 306.)

[130]Solomon Abay, (n 125)48.

[131]YonasMekonnen, 'Determinants of Capital Adequacy of Ethiopia Commercial Banks' (2015) vol.11, No.25 ISSN: 1857 – 7881 European Scientific Journal 1857- 7431

[132]Solomon Abay, (n 125)48.

[133] Banking Business Proclamation, 2008, Art.2 (5), Proc. No. 529, Cited above at note 120, Art.12.

[134] ibid. Art.12.

[135]National Bank of Ethiopia, DIRECTIVE No. SBB/12/1996 Limitation on Investment of Banks issued pursuant to authority vested in it by Art. 36 of Licensing and Supervision of banking business proclamation No. 84/9.

"No person, other than the Federal Government of Ethiopia, may hold more than five percent of the total shares of an insurer, either on his own or jointly with his spouse or with persons who are below the age of 18 and related to him by consanguinity to the first degree."[136] In Micro-financial Institutions, the amount of shares a person can acquire is subjected to limitation on the basis of directive to be issued by national NBE.[137]Limiting ownership helps for controlling insider abuse and embezzlement by those having substantial influence on the enterprise.[138]

Contribution in kind is valued by professional assessors acceptable to the NBE and only up to twenty five percent of the paid up capitals of the banks and ten percent of the paid up capitals of the microfinance institutions accepted as capital contributions above the required minimum capital by the banks and micro-finance institutions.[139]

Moreover, the transactions like; investments of banks, and a loan, advance or other credit facility, financial guarantee or any other commitment or contracts given by a bank, directly or indirectly to a person shall be determined by directive to be issued by the NBE to control mechanisms on the basis of conditions and limitations.[140]Unlike this, NFSHC members are empowered to valuate contribution in kind and the amount such contribution may occupy is not limited in the minimum paid up capital of the given company.[141]Even if not exhausted at all, these features dichotomize financial share companies from non-financial share companies. Particularly, with respect to capital maintenance, the existence of strict regulatory regime and regulatory organ mark dichotomization apart from the inherent nature of the business like banking, insurance, micro-finance and others.

[136] Insurance Business Proclamation, 2012, cited at note 110 above Art. 12.

[137] Micro-Financing Business Proclamation 2009, cited at note 111 Art. 10.

[138]GetnetTemechew, 'Investment Limitations in and by Banks in Ethiopia Prepared' (Master of Business Law, Addis Ababa University2010)

[139]Solomon Abay, (n 125)48-49.)

[140] Banking Business Proclamation, 2008, Art.2 (5), Proc. No. 529, Cited above at note 120, Art.12.

[141]Commercial Registrations and Licensing Proclamation, 2016, Cited above at note 11, Art.5 (9).)

CHAPTER FOUR

4. Analysis of the Ethiopian Legal Framework Governing Non-Financial Share Companies Capital Maintenance and the Practice

4.1 Conceptual Frame Work of Capital under Ethiopian Company Law

Ethiopian Commercial Code defines Capital as "The original value of elements put at the disposal of the undertaking by the owner or partners by way of contribution in cash or in kind.[142]Apart from this, Article 312(1) (a) puts full subscription of full capital and one fourth cash payment of subscribed capital as precondition for company formation.[143] However, this provision fails to define what does it mean by capital despite it is understandable through cross reading with Article 80 of CC that company capital constitutes the contribution made either in cash or kind.

Moreover, Investment Proclamation No. 1180/2020 under article 2(3) defined capital as local or foreign currency, negotiable instruments, machinery or equipment, buildings, working capital, property rights, patent rights or other business assets.[144] Furthermore, Art. 11(10) of the Commercial Registration and Licensing Regulation No. 392/2016 allows intellectual property rights like copy rights and patent rights to be considered as capital.[145] In relation to this, Article 206 of the Commercial Code talks about the possibility of contributing business for the formation of a BO.[146] Business is defined as an incorporeal movable consisting of all movable property brought together and organized for the purpose of carrying out any of the commercial activities.[147]Incorporeal movables include incorporeal elements like; good will, trade name, patent right and copyright.[148]

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[142] Co., C., Art.80.

[143]ibid Art.312 (1) (A).

[144] Investment Proclamation, 2012, Art .2(3), Proc.No.1180, Fed.Neg.Gaz., Year 26, no.28.

[145] Commercial Registration and Licensing Regulation, 2016, Art.11 (10), Reg.No.392, Fed. Neg. Gaz.Year 23, No.3.

[146] Co., C., Art.206.

[147] ibid Art.124.

[148] ibid Art.127.

The definition of capital given hereabove is understood as share capital which is acquired from contribution made from shareholders of the company either in cash or in kind. This definition of capital is different from definition given by other disciplines and it is bound to share capital under capital maintenance doctrine as mentioned here before.[149] From this, we can deduce that law excluded contribution of skill from the ambit of capital and focused on the things that can be valued in terms of money.

4.2 Legal Rules Relating to Capital Maintenance and its Adequacy in Ethiopian Non-Financial Share Companies

The doctrine of capital maintenance resulted with the development of capital maintenance rules which prohibit companies from acquiring their own shares except on some legally established grounds.[150]Capital maintenance is one area of regulation under Ethiopian Share Company law with the objective of protecting creditors' interest and companies' assets depletion mainly.[151]

In Ethiopia the legal regime governing share companies are included in the 1960 Commercial Code. Particularly, Book II Title VI devotedmany provisions for the maintenance of share companies' capital.[152] These rules prescribes limitation on company acquisition of their own share, financial assistance for the acquisition of their own shares, shares cross-holding, company distribution, capital reduction and capital raising irrespective of their shortcomings to address all these issues clearly.[153] These individual rules are dealt with below.

4.2.1 Company Acquisition of their Own Shares

The legal regime on Ethiopian Share Company allows a company to acquire its own share if and only if the acquisition is decided by the meeting of shareholders and subject of the purchase is from net profit and shares are fully paid.[154] Generally speaking, acquisition of capital is not

[149] Fikadu Petros (n 1)95.

[150] Md. Saidul Islam (n 6)48.

[151]FikaduPetros (n 1)102.

[152] Co., C., Book II Title VI.

[154] Co. C., Art. 332(1).

prohibited. However, the law puts down preconditions to undertake such acquisition. So, it will not be appropriate for a company to acquire its capital unless these precognitions are fulfilled.

The Ethiopian CC recognizes three instances of Share Companies' acquisition of its own shares.[155] Firstly, company can acquire its own share through redeeming redeemable shares from shareholders on the basis of the sale contract made between the company and its shareholder. As provided under Article 337 of CC, if a company issue dividend shares, such shares are subject to redemption upon the payment of share values by company from profits or reserve funds without reducing the capital of the company.[156] Additionally, under Article 483 of CC, the possibility of redemption which may result from amortization is prescribed. Such redemption can be made only from the profit and non-legal reserve of the company without reducing the capital of the company.[157] These instances give opportunity for company to solicit huge amount of capital in the formative stage and payback such capital to shareholder from profits or reserve funds without reducing capital. Here, the law gives a prudent standard of care for maintenance of capital.

Secondly, Article 342(5) of the CC prescribes that a company can redeem back the shares of shareholders who did not answer a call for the rearranging par value of shares after offering to the market through public auction and if not sold through such auction.[158] Furthermore, Article 463 allows the company to buy-back its share when the shareholders opt to withdraw from company membership.[159] Finally, a company can acquire its own shares when the meeting of the company decided such acquisition as provided under article 332 and 333 of the CC. The acquisition allowed under article 332(1) can be made when a company decides to raise its capital.[160]

[155]FikaduPetros (n 1)104.

[156] Co. C., Art. 337.

[157] ibid Art. 483.

[158] ibid Art.342 (5).

[159] ibid Art. 463.

[160] ibid Art. 332 and 333.

In fact, the purchase of one own share by company is a dangerous transaction for the creditors of the company if it entails capital reduction.[161] As can be understood from cumulative reading of above provisions, Ethiopia company law did not prohibit share companies from acquiring their own shares. However, the law allowed acquisition with great care for preservation of capital. As can be understood from Article 337 of the CC, the payment to be made to the shareholder is either from profits or reserve funds.[162] Additionally, under Article 333(4) if the pre-emptive right is given to the company due to the restriction imposed on the free transfer of shares by shareholders; such payment cannot be made out of the reserve funds.[163] Apart from the absence of clarity whether such fund is legal or optional reserve fund, acquisition from capital is not possible.

With respect to acquisition of shares made due to shareholder failing to meet calls, the law makes utmost care for third part through ordering the company to reduce the capital. Such acquisition is made in the absence of either net profits or reserve funds, through reducing companies capital as provided under Article 332(3) and 342(5, 6) of CC.[164] Furthermore, Article 483 allow amortization to be made only from non-legal reserve funds and profits. Moreover, the law requires the fulfillment of the preconditions under Article 332(1) when companies receive its own shares in pledge. Because, Article 332(4) of Commercial Code seems to make a cross-reference to sub (1) of the same provision.[165] One academician argues that our company law encompasses compatible provision on controlling acquisition in relation to other jurisdictions.[166] But, our law has some shortcomings or legal loopholes that need to be addressed.

Ethiopian company law seems not to be strict allowing acquisition to be made either from profits and/or reserve funds, because the company may be unable to pay its debts after such acquisition though the acquisitions are made from profits, net profits or/and legal or reserve funds. With

[161]Winship. P., '*Background Document of Ethiopian Commercial Code of 1960'* (Artistic Printers, Addis Ababa 1972)62.

[162] Co. C., Art.337.

[163] ibid Art.333 (4).

[164] ibid Art.332 (3) and 342(5, 6).

[165] Fourteen Team of Experts, (n 22)22.

[166]FikaduPetros (n 1)105.

respect to the extent of acquisition, some jurisdictions like French put 10% limitation on the extent and amount of capital to be acquired though legal requirements are complied with.[167]Such limitations are justified on controlling abuse of the buy-back power by the company and to avert forced shareholders membership exclusion to create dominance, if such limitation is lifted.[168] There are no limits set out by our company law. Conversely, it's argued that rather than the amount of shares to be acquired the law has to worry about the duration for which the redeemed shares stay in the company's treasure.[169] Once acquired by company shares are kept in the treasury of the company and this entails a sort of governance dysfunction through taking the control power on share from shareholders to board of director.[170] Because the board may manipulate using this opportunity unless the duration of keeping those shares in treasury is shortened. This should be the concern of the law from the perspective of capital maintenance as he argued. Regarding the amount of shares, the investors should be left free to decide.[171]
Actually, limiting the time duration shares are expected to be kept in the company treasures needs to be addressed. However, setting free investors from acquisition related restriction goes against the objective of controlling acquisition which involve protecting creditors interest in particular and stakeholders interest in general though controlling abuse and domination possibility by few shareholders (directors) through putting huge amount of share in company treasury and making them vote less.

Additionally, the law did not address the remedies for the non-consented shareholders and creditors on the acquisition. For instance, UK company law allow them to object through applying to the court for the cancellation of the resolution for acquisition.[172] Therefore, the provisions of CC regulating NFSHC's acquisition has to address these legal loopholes for effective maintenance of company capital in particular and assets in general.

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[167] C.Com Art.225-251.

[168]Fritz NtokoEwang (n 2)82.

[169]Interview with FikaduPetiros, Lecturer of law, School of Law, done at his office in Addis Ababa University (Addis Ababa 6 August 2019).

[170] ibid.

[171] ibid.

[172] Charles Wild and Stuart Weinstein (n 56)176.

4.2.2 The companies providing Financial Assistance for Acquisition of its Own Shares and Those of its Holding Companies

Companies' financial assistance control is obvious extension of rules against company purchasing, trading, and trafficking on its own shares as Lord Greene argued.[173] There is an argument that financial assistance for another person for acquisition of company ownsshares are another aspect of company acquisition of its own share.[174]The effect of financial assistance on the company's capital remains the same with acquisition.[175]However, acquisition is different from financial assistance because in the former case a company by itself acquires the shares, while in the latter case the financial assistance may be to other physical or legal persons.[176]

In relation to restricting financial assistance, Second directive on European Company Law prohibits companies form provision of advance funds, making loans, provide security, with a view to finance the acquisition of its shares by a third party.[177] Article 334 of Ethiopian company law prohibits share companies from making either advance payment or loan to enable third parties to acquire shares.[178] Unlike the laws of other jurisdictions, this article fails to provide about the scenario in which a company may provide financial assistance through providing security. Apart from these legal lacunas, Article 334 CC lacks clarity whether the prohibition can be extended to share cross-holding companies. Provisions of security for acquisition of shares and financial assistance for acquisition of shares in share cross-holding companies are among the legal gaps under Ethiopian company law.[179]

Moreover, financial assistance made by company cover the instances when a company waives the right to recover debt from a person, so that a person buys the shares of the company.[180]

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[173] Susan McLaughlin (n 15)203.

[174]FikaduPetros (n 1)105.

[175] ibid.106.

[176] Susan McLaughlin (n 15)188.

[177] Directive (EC) 2 Second European Council Directive on Company law [1976]1.

[178]Co.C., Art.334.

[179]Interview with Fikadu Petros (n 169).

[180] Charles Wild and Stuart Weinstein (n 56)183.

Moreover, the prohibition addressed financial assistance made through remission of debt both before and after acquisition of the shares in jurisdictions like England.[181] A company's management may make management buy-outs at lower price and make dealing by company finance.[182] This is another issue where in Ethiopian company law controlling financial assistance is not addressed. Unless financial assistance in the form of securities is regulated, companies cannot with stand management buy-outs problem.[183]

Moreover, Article 334 of CC does not touched the exceptional scenarios in which company may be allowed to make financial assistances related to its business purposes and allotment of bonus shares for shareholders.[184]But, that is tolerable if and only if made in good faith and in the best interest of the company. It has to be noted that all the above discussed exceptional grounds of financial assistance are workable provided, the net asset of the company outweigh its liabilities.[185] Hence, the recognition of such exceptional cases is better to promote commercial desirable transactions.

4.2.3 Share Cross-Holding Companies

Cross-holding is one aspect of corporate grouping.[186] Share cross-holding between two or more companies occurs when one company subscribes shares in another company and in return that other company also acquires shares of its member company.[187] Share cross-holding either between two companies or more than two companies has high negative impact on capital maintenance.[188]

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[181] ibid 182.

[182] ibid.

[183] ibid.

[184]FikaduPetros (n 1)106.

[185] England Company Act, s 681(2b).

[186]Ian Ramsay and GeofStapledon, 'Research Report Corporate Groups *In* Australia: Centre For Corporate Law and Securities Regulation' (Melbourne University 1998)<https://law.unimelb.edu.au>accessed on 10 February 2019.

[187]Mehamed Aliye (n 71)49.

[188]FikaduPetros (n 1)106.

Companies share cross-holdings have two consequences. First, companies evade their capital through forming other companies and acquiring shares in that company. This is a clear case of acquisition of its own shares which is allowed only exceptionally.[189] Second, such cross-holding might result in majority control which leads the company to be influenced and dependent on the majority holding company. As a result, majority holding company may escape liability and stripe an asset.[190] This depicts that, cross-holding hosts multiple conflicts of interest like; the interest of group, interest of minority shareholders, the interest of creditors and the interest of the majority shareholders.[191] Reconciliation of these diverse conflict of interest needs regulatory framework for companies cross-holding.[192]

Many jurisdictions in principle don not ban cross-holding, rather they set conditions and limitation threshold. Belgium law controls cross-holding through setting limit. Thus, subsidiary company cannot acquire 10% of voting share out of the capital of the parent company and subsidiary of subsidiary company cannot acquire shares in a parent company.[193]

Rules related to companies share cross-holding found in Ethiopian CC does not impose complete ban on share cross-holding. It rather restricts it to certain percentage.[194] Article 344 of CC is the only legal rule regulating cross-holding between share companies in Ethiopia. The provision prescribes that, when ten percent of the capital of one company is held by another company, the latter company cannot hold capital in the former company.[195] However, as opposed to laws of other jurisdictions stated above, the law did not impose complete ban on share cross-holding.

Question arises when companies' cross-hold contrary to what is provided by Article 344(1) of CC and sub-article 2 of the same provision states that, when companies' cross-holds ten percent and more than that of each other capital, those companies are duty bound to declare their cross-

[189]Mehamed Aliye (n 71)49.

[190] ibid

[191] ibid 26

[192] ibid.

[193]FikaduPetros (n 1)107.

[194]Mehamed Aliye (n 71)49.

[195]Co.C., Art.344.

holding to MoTI which shall require the reduction of their cross-holding to the extent permitted through agreement. If the companies fail to reduce their cross-holding as such, the company cross-holding with a less amount may be forced to sell it to another company.[196]

The problem comes when the cross-holding of both companies are equal and the measure under sub-article 2 above fails due to equal cross-holding. The law orders both companies to reduce their holding to less than ten percent of the capital of each other. Furthermore, the law require from the companies to furnish sworn statement as to their compliance with sub-article 2 and 3 of article 344 of CC.[197]

The law is silent on the legal measure to be taken if companies fail to provide such information to the MoTI.The MoTIshould reject registering cross-holding exceeding the legal limit. Moreover, the law did not set out the time limit within which the company is expected to comply with the rule. Furthermore, the issue of bearing creditors liability if court action is brought against one of such cross-holding company beyond legal limit needs an answer with for the purpose of creditors' interest protection.

The article 344 of the CC do not address cross-holding among more than two companies.[198] Other study confirm the same problem with regard to this provision. Different type of affiliations may have serious repercussions on the creditors and minority shareholders right.[199] The absence of addressing cross-holding among more than two companies' amounts to allowing multiple parent subsidiary to cross-hold each other capital without any limit.[200]

Initially, article 344 of Commercial Code was intended to forestall the fraud which may resulted from cross-holding.[201] However, the intended result cannot be achieved taking into account the legal lacuna on the rule controlling cross-holding. As a result, the purpose of maintaining share

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[196]ibid. Art.344 (2).

[197] Co. C., Art. 344(4).

[198]FikaduPetros (n 1)107.

[199] Fourteen Team of Experts (n 22)22.

[200]Interview with Fikadu Petros (n 169).

[201]Winship. P., (n 161)65.

companies capital through controlling cross-holding is defeated.[202]Therefore, regulatory realm of law has to cover such complex cross-holding of NFSHC's to maintain their capital properly.

4.2.4 Company's Distribution

As a result of such prohibition, dividend and other types of company distributions are made only from distributable profits of the company.[203]England company law prohibits companies from making distribution in the absence of distributable profits proofed by duly approved balance sheet (distribution only after its net assets exceeds the aggregate of its called-up share capital).[204]

Ethiopian company law prescribes distribution of dividends as the right of shareholders. Such dividends are to be distributed only from net profits of the companies.[205] The law gives priority to the deduction of expenses, charges and allowances from the net income of the financial year in order to determine net profit.[206]Furthermore, sub-article 2 of the same provision specifies that, determination of distributable profits adds carrying forward previous losses which is not written off and other revenues and distributable reserve funds on the basis of general meeting decision.[207] Moreover, legal reserves must be deposited before making any distribution.[208]

The law regards dividends distribution made without profits secured on the basis of approved balance sheet as fictitious dividend and persons making such distributions are civilly and criminally liable.[209] Besides this, the approval of balance sheet by general meeting may not relive directors, auditors and manager from liability in relation to the company management.[210]

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[202]FikaduPetros (n 1)108.

[203] Charles Wild and Stuart Weinstein (n 56)195.

[204]England Company Act, 2006 s 830 and 831

[205] Co. C., Art.458.

[206] ibidArt.452

[207] ibid

[208] ibidArt.456.

[209] ibidArt.458.

[210] ibidArt.460.

Out of company administration organs, boards of directors have ample of opportunities to influence auditors for declaration of fictitious dividend at the absence of net profit.[211] That is why the law prescribes their civil and criminal responsibility though the balance sheet is approved by the general meeting.

Consequently, the distribution made contrary to the law or such fictitious dividends can be claimed back in the case of a family company and if it's made in the absence of balance sheet or if it is made contrary to the approved balance sheet.[212] All the above provision depicts the strict protection offered for capital maintenance through imposition of strict ban on companies to distribute dividends only if and only if there is a net profit shown in the approved balance sheet.[213]

Additionally, the transfer of values between the company and shareholders and between related parties considered as disguised distribution due to the effects of such transactions on the stakeholders interest.[214]Disguised distribution is recently developing narrative of the company distribution.

On transactions between or among companies and company and its shareholders, the Ethiopian CC is silent. Rather, the devotion is made on controlling the transaction between directors and its company.[215] But, transaction between the company and its shareholders including transaction between related parties which are regarded as disguised distributions should be under the regulatory realm of capital maintenance rules for stronger reason of proper maintenance of companies' assets and effective protection of creditors' interest.[216] Because, such transactions may be made at either higher than or less than arm's length prices.[217]

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[211]FikaduPetros (n 1)109.

[212]Co.C., Art. 459.

[213] ibid Art. 458.

[214] Andreas Cahn (n 26)6.

[215] Interview with YimerMitiku, Attorney and Consultant of Law at Federal Courts, done at his office in Addis Ababa (Addis Ababa 9 August 2019).

[216] Andreas Cahn (n 26)20.

[217] ibid.6.

In this regard, Ethiopian CC has addressed the issues related to actions in relation to directors' duties and derivate actions on behalf of the company.[218] But, it is questionable on what basis legal answerability for failure to discharge duties can be established with respect to transaction at less than arm's length without having rules relating to the valuation of the market value of goods to determine its market value on the basis of arm's length price principle.

4.2.5 Companies Capital Reduction

In England, a public company may reduce its share capital on the basis of resolution approved by court.[219] Reduction statement has to be submitted and registered with company register before the reduction takes effect.[220] Furthermore, an application has to be made to court for approval of the resolution after submission of such statement to the company's register.[221] Furthermore, such reduction can be done either through reducing the nominal value of shares or by reducing the number of shares.[222]

Capital reduction is possible under Ethiopian CC and the ways and the situations in which such reduction can be effected and situations are mentioned explicitly.[223] The CC mentions both loss based capital reduction from Articles 486-490 and non-loss based capital reduction from Articles 492-494 of the same.When we talk about each of them specifically, loss based capital reduction is inevitable. So, the law is weighed in light of the treatment and protection it offered to the right and interest of creditors and shareholders and/or companies asset protection.[224] Loss based capital reduction made through replacing old numbers of shares by new shares may fail to protect shareholders equality interest properly.[225]

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[218] Co. C., Art.365, 366 and 367.

[219] England Company Law Act, 2006 s 641(1b).

[220] ibid. 2006 s 644.

[221] ibid. 2006 s645.

[222] OHADA, Art.367.

[223]FikaduPetros (n 1)110.

[224] ibid.

[225] ibid.

Article 487(1b &2) of the CC prescribes that capital reduction takes place through exchange of older shares by less number of new shares unless the shareholders with small number of shares increase their share number or sell their shareholding.[226] Obviously, this may easily kick out shareholders with small number of shares from company.

Loss based capital reduction can be undertaken through reducing the par value of shares.[227] Some argues that this method can be a solution for the problem of membership kick out that may be created due to capital reduction through reducing the number of shares as discussed here above.[228]

In terms of creditors' protection, in whatever method the reduction are made, creditors holding right prior to publication of reduction and those who noticed reduction have the right to oppose the adoption of resolution for reduction or the payment of any distribution. Such action is acceptable if the creditors were not paid or received guarantee for the payment of their claims.[229]

Apart from opposing the payment of compensation to shareholders as a result of capital reduction until the capital of a company is restored the creditors have secured right on a company. However, the creditors cannot ban capital reduction.[230] Our company law is a relaxed one relative to other jurisdictions which require court approval in addition to general meeting resolution.

However, court approval requirement is subject to critic as exposing company for additional cost.[231] As far as I know court as law interpreting organ may not be equipped with the expertise to investigate the audit reports related to capital reduction. In this regard, the Ethiopia Commercial Code and Australian company law seems better which require disclosure as requirement through notifying the Australian securities and investment commission to give

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[226] Co. C., Art.487.

[227]ibid. Art.487.

[228]FikaduPetros (n 1)111.

[229] Co. C., Art.489.

[230]Fikadu Petros (n 1)111.

[231] Alison Sneddon (n 93)33.

relevant information to creditors and the public in general. As result, interested party can apply to the court for opposition.[232]

Especially, the position of our CC seems very strong through allowing creditors to oppose the adoption of reduction resolution at earliest stage under article 489. The drafter of the CC stressed on the effect of capital reduction on the rights of creditors depending on the cause for reduction and the type of reduction.[233] Whatever the case, this type of reduction requires strong scrutiny because such reduction reduces the shareholders liability on relation to creditors' right.[234]
Capital reduction without loss is another scenario recognized by CC.[235] In capital reduction without loss, creditors who secured their right before publication of notice for reduction can oppose such reduction exceeding 10% of capital before the court of law within three months as of such publication. The court may disallow such objection or order the company to pay the claimant or toprovide adequate guarantee for payment. The law prohibits the reduction to be made before expiry of three months grace period.[236] The law ban reduction before expire of three months grace period even if no creditor applied to the court and this give creditors more chance to control capital reduction.

Companies may reduce capital to return excess capital to the shareholders if there is no better investment opportunity. Another cause for reduction under the CC is reduction related to unpaid share par value.[237] Such reduction is made to extinguish or reduce the liability on any of its share in respect of share value which is not represented in the company capital due to being lost or not paid yet. Furthermore, such reduction can be made to avoid excess capital.[238]

There are some problems with regard to capital reduction regulation under CC. The provisions prescribe that, capital reduction proposal should be sent to auditors and the auditors need to make report to the meeting of shareholders and the reasons for such reduction. Weather it is loss based

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[232]Fritz Ntoko Ewang (n 2)142.

[233]Winship. P. (n 161)70.

[234]Capital reorganization, (n 80).

[235] Co. C., Art.491.

[236] ibidArt.493.

[237] ibidArt.342 (6).

[238] Charles Wild and Stuart Weinstein (n 56)166.

or not, capital reduction requires the capital reappraisal which means capital which is invested over the business and held by different assets has to be reappraised before reducing the capital and this is the procedure or process of capital reduction.[239]

The law remains silent as to whether such assets be revalued and the organ which conducts such revaluation. Unless such revaluation is made, how the actual value of company asset is identified and reduction is made. For instance, how would the value of shares be reduced as per Article 487(a) without knowing the value of company assets? This is an obvious gap thatneeds to be addressed in the CC which is being drafted.[240]

4.2.6 Raising of Company's Capital

Equity capital raising can be made in various ways. Among others, it can be made by increasing the par value of existing share or by issuing new shares.[241] Such newly issued shares payment can be made in cash, through contribution in kind, by paying of current debt with shares and by conversion of debentures in to shares.[242] Contrary to capital reduction, capital increasing does not have holistic impact on the company creditors from the perspective of capital depletion.[243] However, issues like proper pricing of shares, proper valuation of contribution in kind and calling unpaid capital have negative bearing on the creditors' rights.[244] Therefore, the current sub-topic limits itself to the aspects of capital raising that might affect creditors rights rather than dealing with each and every aspects of capital raising.

Dealing with some aspects of capital raising that have negative bearing on capital maintenance, proper valuation of contribution in kind needs close attention and serious scrutiny.[245] TheCC allows Share Companies to increase their capital through accepting contribution in kind.[246] However, the law did not define what constitutes contribution in kind. In relation to this,

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[239]Interview with Fikadu Petiros (n 169).

[240] ibid.

[241] Co. C., Art.464.

[242] ibid

[243]FikaduPetros (n 1)112.

[244] ibid.

[245] Fritz Nitoko Ewing (n 2)338.

[246] Co. C., Art.480.

Investment Proclamation number 1180/2020 considered negotiable instruments, machinery or equipment, buildings, property rights, working capital, foreign currency, patent rights, or other business assets as capital.[247] Apart from this, Trade Licensing and Registration Regulation No.396/2016 allows intellectual property rights such as patent and copyrights to be contributed as capital upon the authentication of shareholders' resolution by the public notary.[248] This depicts that the scope of contribution in kind is becoming wide and requiring special expertise knowledge for the estimation of such contributions. Irrespective of this, Article 480 of the CC made reference to Article 315, 321 and Article 322 of CC and Article 315 of the same empowers MoTI experts to make valuation of contributions in kind.[249]

However, Proclamation No.980/2016 Article 9(5) stipulates that, "The agreement of founders or members of the business organization on the valuation of contribution in kind shall be stipulated in the memorandum of association or in the amendment of the memorandum of association."[250] Thus, it's clear that, during capital raising the power to valuate contribution in kind is given to the founding member of the company. Taking into account the combination of members and the subject matter of contribution in kind as mentioned above, the researcher believe giving the valuation power to company members give rise to practical problem against a company, its shareholders and creditors with respect to contributions that requires expertise knowledge for valuation. Besides this, practical implementation may be difficult for a company member due to absence of expertise knowledge. The drafters of CC understood valuation of contribution in kind as an issue to be handled carefully because it might entail over valuation.[251]

As of the researcher understanding, vesting the authority to valuate at MoTI is intended to tackle the fear of over valuation that comes through giving such power to shareholders or founders of a company. Because the value of an asset which is contributed as capital of a company must

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[247] Investment Proclamation, 2020, cited above at note144, Art.2(3).

[248] Commercial Registration and Licensing Regulation, 2016, Art. 11(10) Reg.No.392, Fed. Neg. Gaz. Year 23, No.3

[249] Co. C., Art.315.

[250] Commercial registration and licensing proclamation, 2016, cited above at note 11, Art.5 (9).

[251]Winship. P. (n 161)62.

accordingly represent the shares assigned to that asset.[252]Unlike this in England valuation of contribution in kind is undertaken by an independent expert having the required experience and knowledge.[253]The position of these countries' laws and the CC on the area of PLC which make shareholders jointly and severally liable for their valuation is good from the perspective of protecting stakeholders' interests. Thus, the position of the CC seems effective through preventing overvaluation and the resultant exaggeration of capital. This has paramount importance to maintain capital as security to creditors.[254]

Moreover, it is argued that valuating property situate on a land is challenging due to land policy Ethiopia follows while capital is not founding members concern only. Hence, the legislator has to revisit this from the perspective of protecting public interest.[255] Furthermore, over valuation of contribution in kind affects credit worthiness of companies especially, when banks make property valuation for collateral attachment in relation to loan contract they inter into with companies.[256]

Another issue relating capital raising is calling unpaid capital share par value of a company. Actually, it is mandatory precondition for the share companies that all the subscribed capital must be fully paid to undertake further equity capital solicitation.[257] When a company with unpaid capital becomes insolvent and liquidation goes on, the liquidator can require the shareholders to pay unpaid capital to the creditors.[258] In this regard, Article 342 (1) of CC impose joint and several liability on the holders, previous assignees and subscribers. Moreover, a subscriber who fails to pay shares par value on due date shall be forced to pay legal interest rate when no rate is fixed in the article of association.[259] Hence, calling unpaid shares par value matters for creditors and shareholders' right and a company itself from the perspective of

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[252] Fritz Nitoko Ewing (n 2)338.

[253] England Company Act, 2006 s 593 and 1150.

[254] Fourteen Team of Experts (n 22)20.

[255]Interview with Fikadu Petiros (n 169).

[256] Interview with HayileTekilearegay, Attorny and consultant of law at Federal Courts, done at his office in Addis Ababa Ethiopia (Addis Ababa 12 august 2019).

[257] Co. C., Art.467.

[258] Susan McLaughlin (n 15)167.

[259] Co. C., Article 342(1) and (3).

maintaining the company's capital.[260] With respect to grace period to pay unpaid shares par value, CC as it provides five year permissive period for the subscribed capital to be called.[261]

With respect to equity capital raising, valuing shares par value matter. In relation to this, issuing share below nominal value is prohibited with a view to protect creditors and existing shareholders.[262] Issuing share below par value affects the existing shareholders interest in comparison to the creditors because share capital is traditionally regarded as the a financial caution for the creditors of the companies.[263] In relation to this, even if our CC does not deeply regulate underwriters and the absence of securities regulation and market, article 326 of the CC prohibits issuing shares at the price less than their par value.[264] These protects creditors' interest through averting the allotment of share in the absence the capital/asset representing that number of shares.[265]

The legal regime currently governing valuation of contribution in kind fails to address many issues. The law did not address the liability of members undertaking valuation of contribution in kind in case they commit any mistake or fraud. Apart from this, it is questionable whether the third party who sustains damage due to valuation made by members can bring legal action and the time framework within which such actions can be brought. Furthermore, whether the valuation is needed to be made on the basis of market value or book value is ignored by law.[266] Failing to consider, this seems like talking the issue of valuation of contribution in kind as that of shareholders alone, while public interest cannot scrap off this realm of the law and practice.

4.3. The Practice of Capital Maintenance

When we come to the practical aspect, this study cannot dare to conclude on the uniformity or diversity of the practice due to the absence of empirical data. However, the writer tries to depend

[260] ibid.

[261] Co. C., Art.338.

[262] Susan McLaughlin (n 15)172.

[263] ibid.

[264] Co. C., Art.326 (1).

[265]FikaduPetros (n 1)112.

[266]Interview with Fikadu Petros (n 169).

upon interview results, case studies, and company working documents, to undertake evaluation of company capital maintenance practice in Ethiopia. The practice of NFSHC's acquisition of one's own shares is rare in Ethiopia.[267] Companies may acquire shares in case shareholders fails to answer call capital. In this regard, companies allow shares to be transferred to third party or out sider rather than acquiring for themselves after offering to the public auction.[268]

For instance, the meeting of Board of Directors of TesfachinYegebeyaMaikel Sh. C held on 01/10/2003 approved the transfer of about 740 shares among existing shareholders and new members who bought the shares from the shareholders have not paid shares value.[269]An interview with Manur Mohamed who has been serving as the manager of 'Chalalak' branch of Federal Document Authentication and RegistrationAuthority, he came across only 'Cherkos Share Company' which cancelled shareholders register due to his failure to pay unpaid share value and registered that shares by the name of a company.[270] Even if, such cancellation expected to be done after sell by auction this company cancelled such share without any auction.[271]

Making financial assistance in the form of advance payments, loan, guarantee and forfeiture of debt is not observable.[272]Indirectly company's assets are being invested for this purpose through taking money in the form of per diem by boards.[273]Audit finding of some companies reveals excessive and contentious remuneration and per diem expenses made by boards. Otherwise, direct loan or advance payments or other forms of financial assistance directly made by

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[267]Interview with Hayile Tekilearegay (n 256).

[268] Interview with TokumaDaba (Dr), Attorney and Consultant at law, done at her office (Addis Ababa 13 March 2020).

[269]Munities of boards of directors of TesfachinYegebeyaMaikel Sh. C on the date 01/10/2003, available at the head office of the company accessed on 07 August 2019.

[270]Interview with Manur Mohamed, Cheleleki Branch manager of document evaluation and authentication authority, done at his office in Addis Ababa (Addis Ababa 13 August 2019).

[271] Interview with Tokuma Daba (Dr), (n 268).

[272] ibid.

[273]Interview with Hayile Tekilearegay (n 256).

companies are not observable in Ethiopian NFSHC's practices.[274] For instance, the directors of one of WALIF sister companies made remuneration payments to themselves to finance their capital subscription even before the amount of remuneration was approved by general meeting.[275] It is undeniable that these practices depletes the capital and assets of a company. The limits on the availability of data as to the practice of direct financial assistance by companies doesn't guarantee that NFSHC's do not make any form of financial assistance.

Moreover, the authorities have not entertained the case relating to cross-holding beyond the legal limits prescribed by law so far.[276] The writer of this thesis did not found NFSHC's practice which fits strict definition of cross-holding is not observed.[277] Furthermore, Federal Documents Authentication and Registration Authority manager says that the practice of cross-holding is rare.[278] It is in PLC groupings and financial share companies' that cross-holding practice is observable.[279]

When it comes to the practical aspect of companies' distribution, the reality on the ground somehow matches with what the law prescribes. The law controls company distribution to regulate improper return of capital to shareholders.[280]However, in some court cases like; Mr. LiulShiferaw& 7 others and Hidase Transport Sh. C, the plaintiffs claimed back their share capital. The FFIC rejected the claim justifying the liability of shareholders to the extent of their shareholding for the debt of the company. So, no such payment can be made until audit is undertaken.[281] Once share capital is paid to company, paying back such share capital to

[274] Interview with NatayeKasa, Certified accountant at A.H Authorized Auditor both in Ethiopia and UK, done at his office in Addis Ababa (Addis Ababa 14 August 2019).

[275] Interview with WorkinaChala, General Manager and Founder of WALIF Sister share Company, done at his office in Addis Aababa (Addis Ababa 8 August 2019).

[276] Interview with Nataye Kasa, (n 274).

[277]Mehamed Aliye (n 71)45.

[278] Interview with Solomon Sileshi, Document Evaluation and Authentication Authority Ckelelak Branch document authentication directorate director, done at his office in Addis Ababa (Addis Ababa 13 August 2019).

[279]Mehamed ALiye, (n 71)45.

[280]Balkrishna Parab (n 64).

[281]LiulShifarawu V Hidase Transport Sh. C (First Instance Ct., (2003) No.185748) unpublished.

shareholders amounts improper returning of capital and putting creditors at risk unless valid audit is undertaken.[282]

In relation to dividend distribution, auditors prepare balance sheet and identify profits after deduction of general costs, allowances, and other charges and of amortization. Then, net receipts of the financial year are identified as profits and then distributable profits are declared accordingly.[283] For instance, in a case between Raya Brewery Sh. Company and Mr. TewoldeYohanis, the plaintiff Mr. Tewolde claimed dividend payment for the last financial years of the company or return of his capital.

However, the profit the company earned in the given financial year of 2010 is not declared as distributable profit because the company losses for the last two years were not written off.[284] Given the absence of distributable profits declared on the basis of duly approved balance sheet by general meeting for dividend distribution to be made, the court rejected the claim of plaintiff.[285] Company can be debtor of shareholders and forced to pay dividend if and only if there is distributable profits and approved by general meeting.[286] The law clearly lays down that profit distribution must be from net profit based on the approved balance sheet of the company.[287] Because our law clearly provides that distribution of dividend has to be made from net profits only.[288]

Unique practice concerning distribution made through payment made by Addis Fana Sh. C for its unemployed shareholders in the form of salary is worthy to be noted. Such payments were

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[282] Interview with MekaNesru, Federal First Instance Court, Lideta Bench, done at his office, (Addis Ababa 27 June, 2019).

[283] Interview with Nataye Kasa (n 274).

[284] General meeting munities of Raya Brewer Share Company, done on 16/03/2016 EC, available at the head office of the company, accessed on July 15, 2019.

[285]TewoldeYohanis v Raya Brewer Sh. C (Federal First Instance Ct., (2010) No.16983) unpublished.

[286]Interview with AshenarLmecha, Federal First Instance Court, Arada Bench, done at his office, (Addis Ababa 27 June, 2019).

[287]Co.C., Art.458.

[288]Co.C., Art. 456 and 458.

presented as a company expense.[289] ERCA intervened into the controversy created between a company and labor union claiming bonus payment and salary increment for a company employees. The union justified that a company made such payment due to the existence of profit even if not approved by balance sheet as profit which as per the collective agreement force a company to make bonus payments and increase salary.[290] Likewise, ERCA took the act of a company as tax evasion. Based on article 458(2) such payment is illegal.[291]

NFSHC's are making disguised distribution in relation to transactions made by them or with tem either to sell or buy assets.[292]Through this practice companies assets are being depleted improperly.

Talking about capital reduction practice, currently it is prohibited as of 1999 EC by the decision of MoTI.[293] It is under rare cases that the MOTI may allow loss based capital reduction on the basis of an application made to it and an investigation is made by the MoTI following such application. After the prohibition, only three losses based capital reduction are processed in the last four years.[294] The documents relating loss based capital reduction is authenticated if only supported by a letter from MoTI.[295] Practice of capital reduction without loss and reduction related to buy-back is not observable.[296] Most of the requests even if they are not accepted, relates to loss based capital reduction.[297] The prohibition is made to curb arbitrary capital reduction made to escape tax liability.

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[289] Interview with Tokuma Daba, (n 268).

[290] ibid.

[291] Co. C. Article 458(2).

[292] Interview with Tokuma Daba, (n 268).

[293]Interview with NigistIshetu, Director of Company's Affairs Support, Minstry of Trade of Ethiopia, done at her office (Addis Ababa 12 August 2019).

[294] Interview with MitikuwaAdunya, Trade Registration and License Supervisor, Ministry of Trade, done at his office, (Addis Ababa 19 November, 2013)

[295] Interview with Manur Mohamed (n 270).

[296] Interview with Mitikuwa Adunya (n 294).

[297] ibid.

Therefore, MoTI decided to ban recognizing capital reduction made by companies in general and NFSHC. But, under exceptional cases, with very strict investigation to be made by committee recruited by the Ministry, very few companies have succeeded in having their capital reduced after the prohibition as of 1999.[298] The prohibition itself seems to be arbitrary rather than being a means to control arbitrary capital reduction. As of the researcher's understanding, it has to be lifted and the rule has to be strict in securing whether the paid up capital of a company is truly deposited in the blocked bank account.

On the ground, capital raising has diversified practices. In addition to that, the formal capital raising is recent and rare practice in Ethiopia and there is absence of empirical data.[299] The prevailing practice on this area indicates that companies formed among few persons or families make capital injection when company suffer loss in the business operation on the basis of their share ownership while they do not have any duty to pay this capital. This practice is rooted on the perception that, company is perceived and believed as the personal property of the shareholders, especially founders.[300] But in the strict sense, this is not capital raising that fall under the regulatory realm of Commercial Code.

Another practice is noticeable with respect to companies formed by individual traders of Addis Ababa. Trader's previously using the plot of land so called "Medeb" form non-financial share companies and make share allotment among them. They collect certain amount of money monthly and after certain period of time they allot that money as share capital in proportion to their shareholding and consider as if their company raised capital.[301] For instance, YEKA YE SHOLA FIRE Share Company in which the researcher observed the shareholders extra-ordinary meeting undertook its capital raising this way. This is not unique practice to few NFSC's; rather, many companies have habituated this practice.

[298] Interview with YimerMitiku, (n 215).

[299] ibid.

[300]Interview with HayileTekilearegay (n 256).

[301]Interview with TewodrosTeshome, Founder and manager of Yeka Shola Fire Sh.C, done at his office in Addis Ababa (Addis Ababa 05 August 2019).

It is noticeable that over valuation of contribution in kind are resulted in undermining the credit worthiness of companies.[302]Though not proved by empirical data the practice of over valuation of contribution in kind is observable. There is a case in which such over valuation resulted in domination of share ownership in the company capital with regard to company formed by the merchants around Merkato in which an interviewee is shareholder and board member with reluctance to reveal the name of company.[303] Besides this, there is no cross check of such valuation report by the MoTI.[304] Valuation of contribution in kind should be made by independent expertise trained and certified by the proper authority like financial companies in which NBE train and certify expertise for such valuation. Valuation by independent experts extinct the fear of over or under valuation.[305]

In the area of calling unpaid share per value it is noticeable that companies raise capital through public subscription before full payment of previously subscribed capital.[306] For instance, in the WALIF Share Company out of the subscribed capital only half is paid while the rest remain unpaid; the company is raising additional capital through public solicitation as of 2009.[307] Some companies do not force their shareholders to pay the capital they have subscribed. For instance, one of the shareholders of TIMRET Agro-Industry Share Company subscribed 1000 shares each having nominal value of 1000 birr. Out of this entire share values the subscriber has paid birr700, 0000 within the time frame work provided by article of association. But 300,000 birr where not paid and the company didn't take any measure against such shareholders where the legally prescribed five years expired and the company's loss of capital lead to its dissolution.[308]

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[302]Interview with HayileTekilearegay (n 256).

[303] Interview with TewodtrosKehabityimer, Founding member and General Manager of YesholaFira Sh. C done at his office, on 20 July 2019.

[304] Interview with Mitikuwa Adunya (n 294).

[305] Interview with Tokuma Daba, (n 262).

[306]Interview with Hayile Tekilearegay (n 256).

[307] Interview with Gololcha Bali, Founding member and GM of WALIF Sh. C, done at his office Addis Abeba (Addis Abeba 6 August 2019).

[308] Interview with TafeseMesfin, Member of boards of director of TIMRET Agro industry, done at café (Addis Ababa 07 August 2019).

Similarly, WALIF Share Company formative act put two years grace period for calling unpaid share par values. But, one year has gone by after the two years lapsed and the company did not take any action till now.[309] In relation to this, DARA does not refer the existing company documents before evaluation and authentication of capital increasing minutes whether previously registered capital is whole paid or not.[310]

In this regard, there is a decision rendered by FFIC in the case between YesenbetGebeyaNigid Sh. C, in which the plaintiff prayed to the court for forced payment of subscribed capital or for an order for the defendants W/o AsoseAyele and 103 individuals to withdraw from the company. The court decided that a company can take measure as per Article 342 of the CC if the subscribers are not willing to answer call for the capital as per the law and article of association.[311]

Actually, the company had to acquire back the shares on which the capital was not paid rather than claiming the payment before the court and reduce its capital as such if not sold by auction. The law clearly empowered companies to take measures prescribed under article 342 of CC. Therefore, companies can either sell or acquire such shares and reduce its capital.[312] Taking legal measures prescribed by law at company level is very economical for companies and reduce court congestion.[313]

The practice of NFSHC's capital maintenance do not completely concedes with legal provisions governing this issues. Most of capital depleting activities observable practically relates to legal gaps of existing CC and in effective enforcement of existing legal regime.

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[309] Interview with Gololcha Bali (n 307).

[310] Interview with Manur Mohamed (n 270).

[311]YesenbeteGebeyaNigid Sh. C v AsoseAyele (Federal First Instance Ct., (2010) No.163860) unpublished.

[312] Interview with Ashenar Lmecha, (n 286).

[313] Interview with Meka Nesru, (n 282).

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION

5.1. CONCLUSION

Capital maintenance have an importance for companies to properly exploit its capital for its legitimate purpose. This enhance its business operation through restraining improper return of capital to shareholders in particular and protects assets depletion in general. Companies may return its capital through capital reduction, capital raising and company distribution. Share cross-holding, financial assistance and acquisition are another instances in which companies may return its capital for shareholders. Moreover, disguised distribution is another instance of returning capital for shareholders and asset-stripping which can be controlled by capital maintenance.

Though Book II of 1960 Ethiopian CC has included the legal regime governing NFSC's capital maintenance rules, such rules are not adequate to protect the company's capital and assets from depletion.

Capital maintenance rules governing non-financial share companies acquisition of their share fail to address the possible amount of shares a company can acquire (what extent one company can acquire its capital) and the possible period shares acquired by company can be kept in the company treasure. The legal provision intended to control provision of financial assistance did not addresses the possibility of financial assistance in the form guarantee for loan made and remission of debt by company to acquire its shares and/or those of its holding companies.

The legal regime regulating company distribution didn't address about the possibility of capital dissipation through disguised distribution in the form of transactions to be made between/among related companies, companies and its shareholders and non-shareholders by transacting at less than arm's length and higher than arm's length. Though CC has regulated about cross-holding of shares between companies, this legal provision fails to address the possibility of shares cross-holding among more than two companies and the time framework within which companies are expected to comply directions given under Article 344 of CC and the answerability aspect in case court action is brought against shares cross-holding companies. Though CC has regulated

both loss based and non-loss based reduction of companies' capital, it fails to regulate about reappraisal of companies assets.

Even though CC give the power to evaluate the value of contribution in kind made from company formation and capital raising to the MoTI expertise, newly enacted proclamation gives this power to the member of company. However, this law fails to address about the liability of such valuators and the measures third part and company can take against them when their valuation sustain problem.

NFSC's acquisition and financial assistance practice is almost not observable on the ground. Practically, NFSHC's are making disguised distribution through transacting both at less than and higher than arm's length price. Particularly there is a company which made distribution in the form of salary for all its shareholders under the guess of employee's salary payment. Though commercial code allows companies to make capital reduction, companies are prohibited to do this practically, while only few companies had allowed to practice this based on top down cross-cheek by the MoTI, through making reappraisal of assets by committee selected by the MoTI.

Though companies have the right to call subscribed capital within five years as of subscription, with right to take further measure to sell such unpaid share or redeem, some companies are founded failing to call such capital, while others goes to court for such unpaid share value to be paid based on court order.

5.2. RECOMMENDATIONS

The writer would like to make the following recommendations:

1. The draft CC shall fill the legal gaps in the existing CC concerning possible amount of shares a company can acquire and time duration an acquired shares may be kept in the company's treasury. This help to control the possibility of abuse concerning price negotiation and reducing the membership, and manipulation by board of directors. Addressing these legal gaps help companies to control the possibility of monopoly, abuse and domination by majority. These legal gaps may result with fraudulent transaction, control of manipulation of market price and distortion of market information in the form of insider dealing and others.

2. The draft CC should come up with provision filling the legal gaps in the existing CC, concerning financial assistance Non-financial share companies can provide for persons and /or company through guarantee of loans made to acquire shares and remission of debt made to acquire shares in the given company or its cross-holding companies. These legal gap pave the way for syndicate or governing staff of the company to abuse their office through using company funds to finance share acquisition. Moreover, loans may be obtained to finance share acquisition and they pay the loan after controlling company. Closing these gaps enable companies, to tackle mischief made to manipulate the share price by financing for acquisition of company's own shares. Moreover, the practice of using the company assets to pay off the debt incurred to buy the share of company should be tackled.

3. The gaps absurd in the existing CC relating to valuation of company assets when NFSHC's undertaken transactions to buy or sell assets should be filled by the draft commercial code. Unless such legal lacuna is closed, it pave the way for asset-stripping in general and capital dissipation through disguised distribution particularly. The regulatory regime which entrust either directors or independent expertise to determine the proper values of assets need to be included to avoids companies' assets depletion.

4. The gap relating to cross-holding among more than two companies, the time framework within which companies are expected to comply with the directions given by the MoTI under Article 344 of the CC shall be filled. Moreover, legal lacuna related to legal answerability among cross-holding companies when legal action is brought against cross-holding companies should be made clear to avoid confusion. Closing such legal gaps help to avoid the fraud that leads the depletion of capital and assets through using the same amount of capital for two or more than two companies. Forming cross-holding based on management structure in which especially the parent company influence subsidiary company in related party transaction and strip an asset of subsidiary against the interest of minority and creditors. Moreover, to make the law enforcement effective, the confusion related to time with in which the companies are expected to show their obedience for direction given by MoTI should clear. Additionally, providing clarity for the legal answerability concerning the court action may be brought against one of such cross-holding companies are required to protect third part interest.

5. The gaps related to reappraisal of companies' assets in case of capital reduction and the principle of equality for shareholders that suffer expulsion concerning loss based capital reduction should be filled by the draft commercial code. Capital reduction requires the capital appraisal which means capital which is invested over the business and held by different assets has to be reappraisal before reducing the capital. Therefore, it is effective to control capital depletion and asset striping that might happen in the form of disguised distribution and valuation role has to be left to an independent expert.

6. The legal regime governing capital raising of non-financial share companies, should cogitated having public interest in general and creditors interest especially concerning valuation of contribution in kind. It is effective to control over valuation that might happen in the form of disguised distribution if estimation role is left to an independent expert. Optionally, if the valuation power given to the company members should be retained, it must be in coincidence with the joint and several liabilities for their activity. Moreover, time framework for the enforcement of such legal answerability needs attentions so long as the interest of third party is concerned.

7. The measure intended to control arbitrary capital reduction by MoTI through issuing circular latter should be based on enacting the appropriate law. Addressing all these issues enhance the importance of capital maintenance for protection of companies' capital in particular and companies assets in general.

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