

ADDIS ABABA UNIVERSITY
COLLEGE OF LAW AND GOVERNANCE



**RIGHTS AND PROTECTION OF CREDITORS IN ONE PERSON PRIVATE LIMITED
COMPANY UNDER THE NEW COMMERCIAL CODE OF ETHIOPIA**

BY: - YONAS SHEMELIS ID NO: - GSR/6400/14

ADVISOR: - TILAHUN TESHOME/PROF/

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RIGHTS AND PROTECTION OF CREDITORS IN ONE PERSON PRIVATE LIMITED
COMPANY UNDER THE NEW COMMERCIAL CODE OF ETHIOPIA

CANDIDATE

YONAS SHEMELIS

APPROVED BY

ADVISORS NAME TITILAHUN TESHOME/PROF/ SIGNATURE



EXAMINER/READREE NAME..... SIGNATURE

EXAMINER/READREE NAMESIGNATURE

DECLARATION

I declare that the thesis is my original work, not presented for another degree, and all sources are duly acknowledged.

Declared by: - YONAS SHEMELIS

Signature _____

Date _____

Confirmed by TILAHUN TESHOME/PROF/

Signature _____

Date _____

Acknowledgment

Through him all things were made; without him nothing was made that has been made. John 1-3

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ABSTRACT

A single member company is a business entity established by one individual with limited liability. It operates as a separate legal entity with its own rights and liabilities, posing concerns for creditors. With sole management control and relaxed regulations, the risk of business failure and misuse for fraudulent purposes is higher. Ethiopia introduced OPPLCs in 2021 to promote capital accumulation and corporate culture transfer. However, questions arise regarding creditor protection under the New Commercial Code for OPPLCs. While limited liability companies safeguard shareholders, creditors may face unfair treatment. To protect creditors, debtor control rules/statutory mechanisms, creditors' contracts-based rules, and insolvency laws are used globally. In Ethiopia, gaps in disclosure of information, capital maintenance, corporate entity treatment, contractual misuse and insolvency rules in the New Commercial Code for OPPLCs may not adequately protect creditors. Improvements are needed to enhance creditor protection, including enhanced disclosures, stronger capital maintenance, member qualifications, law enforcement against entity misuse, and prevention of opportunistic director behavior during insolvency. Reviewing Ethiopian laws regulating limited liability entities is advised for better creditor protection.

Acronyms

OPPLS.....	one person private limited company
PLC	private limited company
SMC.....	single Member Company
CC	civil and commercial Code
CA	companies Act 2006
UK	United Kingdom
IFRS.....	International Finance Reporting Standard
SPC.....	Single Person Company
IA	Insolvency Act 1986
CDDA.....	Companies Directors Disqualification Act 1986

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

One person private limited company (OPPLC) is a business organization incorporated by unilateral declaration of single person.¹ It is defined as a company that has only one person as its member. Thus, one person private limited company (OPPLC) possesses company and sole proprietorship characteristics. As in the case of other forms of company, it has the character of separate legal entity, limited liability, separate ownership, representative management, perpetual succession and artificial personality. Conversely, a one person private limited company (OPPLC) is similar with that of a sole proprietorship in the sense that it has single ownership, less legal formality, one man control and no sharing of profit and loss² Historically, the United Kingdom is the first country that paved the way to a one person company through a precedent established in its famous case *Salomon vs. Salomon & co* (1897). Act 2006 this type of company is a recent for generally you Africa and specifically to Ethiopia. It's asserted that generally, OPPLC is important for Capital accumulation, transfer of corporate Culture its use to legalize de facto OPPLC, and its use to catch up with the global corporate trend³ On the other hand, hybridized features of OPPLC create a notable complication in the interest of creditors. For instance OPPLCs are established by a single individual, who can be a natural person or a corporate entity. This type of company is unique because only one person can own all shares or contributions, limiting membership to one. The owner has full control over profits and is responsible for any losses incurred. OPPLCs have characteristics of both sole proprietorships and separate legal entities, allowing the sole member to make decisions without the need for shareholder meetings. However, this structure can present challenges in terms of governance and protecting the interests of creditors and stakeholders.⁴ Improving governance in single-member companies is crucial to address these issues and ensure fair treatment for all parties involved. Balancing the interests of creditors and the company's owner is a complex task for

¹ Commercial Code of the Federal Democratic Republic of Ethiopia, Federal Negarit Gazzete Extra Ordinary Issue, Proclamation No. 1243/2021 (Art 534 (1)

² The Institute of Company Secretaries of India, *One Man company* 2014 page 2 Published by ICSI

³ Jetu Edosa *Introducing Single Member Companies in Ethiopia: Major Theoretical and Legal Considerations*, (LLM thesis Addis Ababa University 2016) Anchor Academic publishing P-(14-22)

⁴ Natcha Rattpan *Legal Issues on Creditors Rights and Protection in Single Member Companies* (LLM Thesis Unpublished Thammasat University 2017) Page 11

directors, especially in times of financial distress or potential insolvency.⁵ Directors must act in the company's best interests, considering both creditor and shareholder interests as insolvency approaches. Failure to do so can result in personal liability under wrongful trading provisions. Directors must carefully document decisions and prioritize creditor interests as the company's financial health declines.⁶ When insolvency is imminent, creditor interests should take precedence over shareholder interests. Directors must navigate these duties diligently to protect the company's viability and avoid legal consequences. Being proactive in engaging creditor duties is essential to fulfill obligations during challenging financial times.⁷ Thus, unless these incompatible interests are balanced properly it may severely jeopardize the business sector. The Development of creditor protection firstly appeared in the Centro case when a Danish Couple decided to incorporate a business in Denmark but register it in UK in order to avoid the minimum capital requirement under Danish laws⁸

After this time the protection of creditor became an international issue because of the following reasons: - Firstly the owner of the company directly competes with the single member company business or he exploits any benefit of the single member company for own interests.⁹ Second, the owner enters into contract with the company itself and this may create conflict of interest.¹⁰ Third, the owner could dishonestly approve remuneration for him or even approve the distribution of dividend for himself as a member.¹¹ Fourth, the owner may provide inaccurate or false information, false minutes of meeting, account, annual reports.¹² Fifth, it's difficult to distinguish the assets of a single member company from the personal assets of the member.¹³ Seventh, involves setting up a single member company to avoid legal responsibilities of a failing company, known as the "phoenix syndrome". This typically occurs in closely-held companies like single member companies, where a company is re-established soon before or after its failure. The new company, called the phoenix company, usually continues the business of the failed company with a similar name, management, and assets. creditors of the failing company

⁵ Ibid

⁶ NigusieTadesse, Major Problems Associated with Private Limited Companies in Ethiopia: the Law and the Practice, LLM thesis Addis Ababa University,2009 [unpublished available at law library], p. 1

⁷ Supra note s page 12

⁸ Supra note 2 page 15

⁹ Supra Note 2 page 2

¹⁰ Ibid Page (20-23)

¹¹ Ibid

¹² Ibid

¹³ Ibid

have no legal recourse against the new company and are left to deal with insolvency. This situation arises when the failing company is burdened with obligations leading to insolvency; allowing shareholders to escape debt by relying on limited liability protection. Thus, in order to protect the interest of creditor the concerned body should create a legal framework to regulate such a gap.

Ethiopia introduces OPPLC in 2021 under the New Commercial Code of Ethiopia. We can find such declaration from Art.534, up to Art 545. In some cases or where it is appropriate the provision on private company, which are found under Articles 495 to 533 are applicable to OPPLC.¹⁴ These legal provisions are criticized for not addressing creditors' interests properly.

There are Literature on corporate creditor protection is emerging globally, with limited studies in Ethiopia specifically focusing on OPPLC creditor protection. Studies by authors like Jetu Edosa and Assamen M. Tessema have addressed single member companies and the advantages and disadvantages of introducing OPPLC in Ethiopia's legal system, but did not delve into creditor rights. Similarly, Samuel Biresaw et al. discussed corporate creditor protection in general but did not specifically cover OPPLC. Tigist Dessie's study examined creditor protection under Ethiopia's share company law, but did not include OPPLC. Overall, there is a lack of research on creditor protection under OPPLC in Ethiopia. This study aims to fill this gap and contribute new knowledge to the field.

In this thesis the researcher will make an attempt to identify and to analyze creditors' rights and protection in a one person private limited company under the New Commercial Code of Ethiopia and to come up with possible recommendations

1.2 Statement of the problem and Research Questions

A well designed business law has the objective of striking the balance between the competing interests of company owner and creditors.¹⁵ This balance can be achieved through efficient management of the company and proper legal regulation. In the case of OPPLC because of its nature, lack of efficient management of the company and proper legal regulation of the owner of the company may have repercussions on the right of creditors. Thus, the following particular problems are the subject of enquiry in this Study

¹⁴ Supra note 1 Art 54

¹⁵ R Kraakmanet the Anatomy of Corporate Law A Comparative and Functional Approach 3 Oxford University New York page 20

This study focuses on several key issues that can arise in a one person private limited company (OPPLC) when the member decides to start a new business that competes with OPPLC, or if the owner/manager enters into contracts that create conflicts of interest. Dishonest approval of remuneration or dividends and disclosure of false information can also impact the company's assets and credibility with creditors. It can be difficult to distinguish between OPPLC's assets and the member's personal assets, leading to potential misuse of company assets for personal gain. Furthermore, entering contracts with the sole member can blur party distinctions, and the reliance on a single individual for internal management poses risks if that person becomes incapacitated. Legal requirements dictate that company members and managers must be competent and free of bankruptcy or criminal offenses related to fraud.

There is also a possibility for OPPLC to convert into a multi-member company, transferring rights and obligations accordingly. Capital maintenance rules, such as minimum capital requirements and restrictions on capital reduction and dividend distribution, must be strictly adhered to in OPPLC governance to protect the interests of creditors. In conclusion, these issues highlight the importance of proper regulation and governance within a Single Member Company to avoid conflicts of interest, asset misuse, and potential insolvency risks. By ensuring transparency, accountability, and adherence to legal requirements, OPPLC can better protect the rights of creditors and maintain its financial stability in the long run. Therefore, this thesis will address the following research questions

1.3. Research Questions.

- ❖ What specific provisions in the New Commercial Code of Ethiopia address the rights and protections of creditors in one-person private limited companies?
- ❖ What are the tools or devices used under New Commercial Code of Ethiopia for protection of rights of creditors in an OPPLC?
- ❖ Are the tools or devices used under New Commercial Code of Ethiopia which deals with OPPLC adequate for the protection of creditors' rights?
- ❖ Is the regulation mechanism under the New Commercial code of Ethiopia which deals with OPPLCs proper for protection of creditor?
- ❖ How do the creditor protection rights in Ethiopia's one-person private limited companies compare to those in similar jurisdictions, such as Thailand or the UK?

1.4. Research Objective

1.4.1. General Objective

Analyzing, the New Commercial Code of Ethiopia to assess creditor rights in one-person private limited companies, effectiveness of safeguards, compliance, and identifying potential gaps or challenges in enforcing these rights within the Ethiopian business environment.

1.4.2. Specific Objectives

- ❖ To analyze the specific legal provisions within the New Commercial Code of Ethiopia that pertains to the rights and protections of creditors in one-person private limited companies.
- ❖ To assess how the limited liability structure of one-person private limited companies affects creditor rights, particularly in cases of insolvency or unlawful actions by the owner.
- ❖ To identify and evaluate the mechanisms established by the New Commercial Code to ensure that creditors can effectively recover debts from one-person private limited companies.
- ❖ To investigate the effectiveness of judicial remedies available to creditors in enforcing their rights against one-person private limited companies under the new legal framework.
- ❖ To compare the rights and protections afforded to creditors in Ethiopian one-person private limited companies with those in other jurisdictions, focusing on best practices and international standards.
- ❖ To identify any gaps or challenges in the current legal framework that may hinder effective creditor protection in one-person private limited companies, and propose potential reforms.
- ❖ To provide recommendations for future legislative amendments or reforms that could enhance creditor protections in one-person private limited companies in Ethiopia.

1.5 Significance of the Study

This study aims to enhance legal understanding by delving into the implications of the New Commercial Code of Ethiopia on creditor rights in one-person private limited companies. It seeks to promote creditor confidence by evaluating legal protections and identifying gaps in the current framework. Through comparative analysis with international standards, the study will offer insights for improving Ethiopia's legal environment. The findings may influence corporate governance practices, emphasizing the importance of creditor protection. Practical policy recommendations will be made to strengthen creditor protections. Ultimately, the study will contribute to the academic knowledge on corporate law in Ethiopia and facilitate smoother business operations for one-person private limited companies.

1.6 The scope of the Study

The study evaluates the New Commercial Code of Ethiopia in relation to the rights and protections for creditors in one-person private limited companies. It looks at how effective these provisions are in safeguarding creditor interests, ensuring compliance, and addressing any gaps or challenges in enforcement within the Ethiopian business environment. The analysis includes a review of legal provisions, implications of limited liability, creditor protection mechanisms, and overall fairness in treatment of creditors

1.7. Methodology of the Study

1.7.1. Research Type and Approach

The researcher uses a qualitative research method to critically examine the legal framework for protecting creditors under OPPLC. The main objective is to analyze existing OPPLC laws on creditor protection and identify potential loopholes. This study adopts a doctrinal research type to analyze legal rules and principles related to creditor protection.

1.7.2. Types of Data and Data Collection Tools

The study utilized both primary and secondary data from the New Commercial Code of Ethiopia regarding OPPLC. The research is doctrinal in nature and involves analyzing various legislations to address five specific research questions. The researcher conducted interviews as a primary data collection tool, specifically using a semi-structured format to interview professionals knowledgeable in company law. The semi-structured format was chosen for its flexibility in asking predetermined questions and providing clarification when needed. In addition to interviews, secondary data sources such as books, articles, reports, and internet sources were also used in the research.

1.7.3. Sampling Techniques

Purposive sampling is used to select participants based on factors like position, experience, expertise, and education. The researcher continued interviews until data saturation was reached, ensuring important data was collected.

1.7.4. Method of Data Analysis

The study utilizes qualitative research methods and data analysis. Relevant data is collected, categorized, and interpreted to identify key points. Conclusions are drawn based on the interpretation.

1.8 Limitation of the study

The issue of creditor rights protection in OPPLC of Ethiopia has not been given full attention yet, it would not be easy to find adequate reference material. Again, the researcher during this time has a significant workload. Thus there may be time Constraints.

1.9. Organization of the paper

The study consists of five chapters. Chapter one covers the introduction, including the background, problem statement, objectives, research questions, methodology, data collection method, significance, limitations, and ethical considerations. Chapter two provides a general overview of OPPLC and creditor rights protection. Chapter three analyzes creditor rights and protection under OPPLC in the New Commercial Code of Ethiopia. Chapter four concludes with recommendations.

CHAPTER TWO

Creditors' Rights and Protection under a One Person Private Limited Company: Conceptual Overview

2.1 One Person Private Limited Company: General overview

A One Person Private Company is a company with only one member.¹⁶ This type of company is defined as having one corporate shareholder entity, with legal and financial liability limited to the company itself.¹⁷ The concept of a one person private limited company was first established in the United Kingdom, with the famous case of Salomon vs. Salomon & Co in 1847-1892. In this case, Mr. Salomon, a successful leather merchant, established a limited liability company with himself as the major shareholder. The company eventually faced liquidation, with Mr. Salomon being held responsible for the company's debts. Despite some controversy, the House of Lords upheld the principle that the company is a separate legal entity from its members, establishing the basis of corporate law. This case set the precedent for single person companies, with the legal term "Salomon case" being used as a reference point for such entities.¹⁸

The concept of a one person private limited company combines elements of a company and sole proprietorship.¹⁹ A company is defined as an association of individuals who contribute money or assets to a common stock for trade or business, with transferable shares and limited liability. It is an artificial person created by law with perpetual succession and a common seal.²⁰ In contrast, sole proprietorship is a business solely owned and managed by one person, with unlimited liability and no separate legal entity.²¹ A one person private limited company incorporates characteristics of both structures; including limited liability, separate legal entity, separate ownership, common seal, perpetual succession, and single ownership and management. This unique combination can create confusion and potentially impact creditors' rights

¹⁶ Salah Mohammed et al, One Person Comparative Ccompany in Asia and Europe A Comparative study, Journal og Legal Studies v-14 9 2023 page bog 21

¹⁷ Ibid

¹⁸ Charles Wild et al Company Law (person Education Limited 2011 page 5

¹⁹ Dr. Umesh Maiya, Company law, 2021 page 20

²⁰ Supra note 19

²¹ Evans D.C, Sole Proprietorship, Partnership? Regular Corporation, NADL Journal 28 (9) 201 Page 31

An incorporated association or company is created by law or registration, resulting in a separate legal entity.²² On the other hand, a sole proprietorship does not have separate legal status.²³ A company is an artificial legal person with rights and powers similar to a natural person, while a sole proprietorship does not have the same legal recognition.²⁴ A company has perpetual existence independent from its shareholders, whereas the life of a sole proprietorship is dependent on the owner.²⁵ Shareholders' liability in a company is limited to the face value of their shares, while in a sole proprietorship; the owner's liability may extend to their private property.²⁶ Companies use a common seal and have transferable shares, unlike sole proprietorships.²⁷ Additionally, a company's property is separate from its shareholders, and its management is represented by a board of directors elected by shareholders.²⁸ In conclusion, a one-person private limited company combines characteristics of both a company and a sole proprietorship, potentially affecting creditor protection.

2.1.1 Characteristics of one person private companies in relation to creditors' interests.

Under the laws of jurisdictions that recognize such companies, one person private limited companies can be classified as either private or public companies, and are initially established by a single person.²⁹ This individual can be either a natural person or a corporate entity. The key feature of a single member company is that all shares or contributions must be owned by the sole member, limiting the number of members to one person.³⁰ As a result, the owner is the sole member of the company, responsible for all profits and liable for any losses incurred to the extent of his contributions.

One person private limited companies have hybrid characteristics, combining aspects of sole proprietorships and multi-member companies. While the sole member carries the full responsibility for the company's stability, they also enjoy the benefits of separate entity status,

²² Dr Gk kap Kapoor Taxman's Company law and Practice a Comprehensive Text Book on Companies act 2013 2013, 2017 (2nd edition) page 25

²³ Gothand Ben Business law: Sole Pproprietorship , Ccorporation Tradition, Sstructure and Guide 2017 page 78

²⁴ Supra note 17 page 23

²⁵ Ibid

²⁶ Ibid

²⁷ Dr SR Myeni, Ccompany Law 3nd Edition 2017 Asia law House page 40

²⁸ Ibid

²⁹ <<https://www.cro.ie/registration/company> accessed 14 September 2016

³⁰ Securities and Exchange Commission of Pakistan, 'Guide on Single Member company' page 3

similar to multi-member companies. This allows owners to limit their liability to their own funds, like members of multi-member companies.³¹

There are important implications of this unique structure. Firstly, single member companies do not require shareholder meetings, as there is only one member who has complete control over the company. This differs from multi-member companies, where shareholders have the right to control the board of directors. Secondly, the sole member of a single member company holds both decision-making and executive powers, without the oversight typically provided by a board of directors. This can lead to potential conflicts of interest, as the sole member may prioritize his own interests over those of the company or creditors.³²

The lack of checks and balances in single member companies raises concerns about governance and control. While this structure grants the sole member significant control, it can also impact the rights of other parties, such as creditors, employees, and business partners. Without the oversight of a board of directors or shareholders' meetings, it is difficult to consider how to improve governance in single member companies to protect the interests of all stakeholders.³³

Therefore, single member private limited companies offer unique benefits and challenges, balancing individual control with potential risks to other stakeholders. Improving governance structures and accountability measures can help address these concerns and ensure a fair and transparent environment for all parties involved in single member companies.

2.2 Overview of Corporate Creditor Protection

2.2.1 Concept of Corporate Creditor

A creditor is someone who is owed a debt or provides credit for money or goods. This can be a person, entity, country, or organization with a claim against someone else that can be adjusted and liquidated.³⁴

Understanding the types of corporate creditors is crucial for assessing risks and implementing appropriate protections. Categories include secured versus unsecured, voluntary versus involuntary, strong versus weak voluntary, short versus long-term, and public company versus

³¹ Bai Xiaojun and Su Zhenhong. 'Corporate Governance for One-man Company in View of the Theory of Stakeholders', School of Economics and Management, Shenyang Ligong University page 218

³² Ibid

³³ Ibid

³⁴ Black's law Dictionary, 8th ed s.v Creditor page 1189

private company creditors.³⁵ This paper will delve into each group to provide a comprehensive analysis.

A- Secured versus unsecured creditors

Creditors are categorized as secured or unsecured based on their claim to the debtor's assets. A secured creditor holds collateral, giving them priority over general creditors in the event of insolvency. They have a preferred position for payment. In contrast, unsecured creditors have no specific rights to the debtor's assets and rely on contracts for protection.³⁶ Secured creditors, like those in Ethiopia, are governed by security laws based on special contracts, while unsecured creditors are considered general creditors.³⁷ In case of liquidation, unsecured creditors are treated equally under the principle of paripassu. Both types of creditors face the agency problem, but secured creditors are better protected from debtor misbehavior due to collateral.³⁸ Types of unsecured creditors include debenture holders, trade creditors, consumers, tax authorities, employees, and involuntary creditors. Ultimately, secured creditors have a stronger position in recovering debts compared to unsecured creditors in case of debtor default.³⁹

B. Voluntary versus Involuntary Creditor

Corporate creditors can be classified as voluntary or involuntary based on whether they willingly entered into a credit relationship with the debtor.⁴⁰ A voluntary creditor, such as a bank or trade creditor, willingly enters into a credit relationship with the debtor, allowing them to optimize the amount and type of risk they are willing to take on.⁴¹ On the other hand, involuntary creditors, like tort victims or tax authorities, did not choose to become creditors and are unable to adjust the terms of their exposure to reflect the risks they bear.⁴²

Involuntary creditors may face similar risks as voluntary creditors, such as the opportunistic behavior of shareholders and directors leading to insolvency. These risks can result in claims being devalued or becoming worthless.⁴³ The classification of creditors into voluntary and

³⁵ Elis Tarelle, *The Role of Banks as Financial Intermediaries* 2015 page -29-41

³⁶ *Ibid*

³⁷ Addisu Damtie & Mizanie Abate *Law of Sales Module and security device*, Bahir Dar University Distance Education, 2010, p.112

³⁸ *Supra* note 36

³⁹ *Ibid*

⁴⁰ *Ibid* page 31-37

⁴¹ *Ibid*

⁴² Stephanie Ben-Ishai et al, *Involuntary Creditors and Corporate Bankruptcy*, 2011 p.257

⁴³ Reinier Kraakmaet et al, *The Anatomy of Corporate law*, 2004 ed, p.77

involuntary has significant implications for the protection available to them, either through mandatory rules or self-help mechanisms.⁴⁴

In order to protect involuntary creditors, especially in cases of tort claims, suggestions have been made to give them priority in insolvency proceedings, to purchase liability insurance, and to hold shareholders liable for excess liability resulting from risky activities.⁴⁵ The vulnerability of involuntary creditors is exacerbated by information asymmetry, limited liability, and the separate legal personality of corporate entities. By addressing these issues, the rights of involuntary creditors can be better protected in the face of corporate insolvency.⁴⁶

C. Strong versus Weak Voluntary Creditors (Adjusting versus Non- Adjusting)

Various voluntary creditors can be categorized as strong or weak based on their ability to negotiate with a corporate debtor.⁴⁷ Strong voluntary creditors, like financial institutions and bondholders, have the power to dictate credit terms and monitor the debtor's activities. They are willing to incur costs to adjust credit terms as necessary.⁴⁸ Weak voluntary creditors, such as suppliers and employees, lack bargaining power and rely on debt covenants for protection.⁴⁹ Despite facing similar default risks, conflicts may arise between strong and weak creditors during financial distress. Strong creditors may prioritize their own interests, potentially leading to insolvency.⁵⁰ Monitoring activities by strong creditors could impact all creditors, including weak ones. While strong creditors have the upper hand in negotiations and monitoring, weak creditors must rely on protective measures to safeguard their interests.

D. Short-Term versus Long-Term Creditors

Manning/Hanks categorize a company's finance creditors as either commercial or investment creditors.⁵¹ Commercial creditors, like banks, provide short-term credit lines to corporate debtors, including small trade creditors who closely monitor their credit.⁵² Investment creditors consist of bond holders and employees with retirement claims.⁵³ Both types of creditors face similar risks, such as potential non-payment due to business misfortune or creditor

⁴⁴ Peter O. Mulbert, Synthetic View of Different Concepts of Creditor Protection, p. 370

⁴⁵ Supra note 36 page 34

⁴⁶ Ibid

⁴⁷ Ibid

⁴⁸ David, Company Law in Context, 2012 second ed p. 772

⁴⁹ Supra note 36 page 35

⁵⁰ Ibid

⁵¹ Manning/ Hanks, Legal Capital, 3 ed, 1. Reprint. 1990, p 101

⁵² Ibid page 98

⁵³ Ibid

expropriation.⁵⁴ Creditors must invest time and effort in monitoring debtors to mitigate these risks. Factors influencing monitoring efforts include loan size and duration.

Short-term creditors, like trade creditors, typically extend small credits without collateral, making it challenging to protect them against debtor misbehavior, especially if the creditor depends heavily on the debtor. In contrast, banks may have more monitoring capabilities but prioritize secured creditors over unsecured ones.⁵⁵

Long-term creditors, like bond holders, face similar risks but with a longer duration period potentially allowing debtors more opportunities for opportunistic behavior. Secured financing is more common for long-term creditors, with restrictions on the firm's asset distribution to protect creditor interests.⁵⁶ Therefore, both types of creditors must stay vigilant and invest resources in monitoring debtors to protect their investments.

E. Public Company versus Private Company Creditors

Voluntary creditors can be divided into public and private company creditors.⁵⁷ Both types face the risk of being expropriated by shareholders diverting value, leaving the firm unable to satisfy creditor claims. However, public and private creditors differ in factors amplifying this risk. Public companies benefit from limited liability, reducing monitoring costs and facilitating investment diversification.⁵⁸ Capital markets help monitor public firms and discourage excessive risk-taking. In contrast, private companies often lack separation of ownership and management, limiting monitoring mechanisms.⁵⁹ This results in lower transparency and disclosure, making information less accessible to private creditors. In privately held firms, managers who are also shareholders may prioritize personal interests over creditors'. Legislative actions have made private companies more accessible, increasing the need for creditor protection. Courts may be more willing to allow creditors to reach shareholder assets in close corporations to address these challenges.⁶⁰ Overall, creditors of private companies face greater risks due to lower transparency,

⁵⁴ Supra note 36 page 35

⁵⁵ Supra note 52 page 98

⁵⁶ Ibid

⁵⁷ Supra note 36 page 41-43

⁵⁸ Ibid

⁵⁹ Supra note 25 page 101

⁶⁰ Supra note 36

limited monitoring mechanisms, and potential opportunistic behavior from shareholder-managers.

2.3. Corporate Creditor Right Protection Mechanism

The international strategies to protect creditors' interests are complex and cannot be fully covered. This section will compare three commonly used methods: debtor control rules/statutory mechanisms, creditors' contracts-based rules, and insolvency laws, each effective in safeguarding creditors' rights in different financial arrangements⁶¹

2.3.1. The statutory / Debtor Control Creditor Protection Mechanism

This approach is used in civil law legal systems in countries like Germany, France, and Ethiopia. It involves legal restrictions to govern corporate debtors' actions and aims to reduce the probability of default and alleviate related risks.⁶² The rules focus on supervising transactions and operations conducted by shareholders and directors.⁶³ Opponents argue about the inability to provide promised information to creditors and the high costs of implementing creditor protection.⁶⁴ Advocates believe that mandatory rules help protect creditors and solve collective action problems.⁶⁵ Various protective mechanisms are employed under this approach, such as the rule of capital maintenance and mandatory disclosure of qualifications and transactions.⁶⁶

2.3.1.1 Capital Maintenance

The concept of capital maintenance is concerned with preserving certain reserves that are not normally distributable to members.⁶⁷ There are two sub-concepts in accounting: financial and physical capital maintenance.⁶⁸ The financial capital maintenance concept focuses on maintaining the financial or monetary amount of a company's net assets, while the physical capital maintenance concept focuses on preserving the physical productive capacity or resources required to achieve it⁶⁹. The purpose of capital maintenance is to protect creditors by preventing

⁶¹ Supra note 59 page 60

⁶² Samuel Maires Biresaw, Corporate Creditors Protection Rent in Ethiopia and Third world un mide To Wards A Convergence of Strategies, 2024 Chicago Journal of International law. Anglia Page 23

⁶³ Supra note 59 page 50

⁶⁴ Supra note 122 page 24

⁶⁵ Ibid

⁶⁶ Supra note 59 page 49 - 60

⁶⁷ Ibid

⁶⁸ Paul Davies Introduction to Company Law 2020 3ed calrendion Law series page 71

⁶⁹ Great Britain Department of Trade Review Document, Modern Company Law for a Competitive Economy the Strategic framework work London 1999 page 81

the distribution of capital when the assets are less than the capital account⁷⁰. However, the doctrine has faced criticism for promoting the priority position of creditors' claims without requiring a specific level of assets to be maintained and imposing substantial costs on companies.⁷¹ Overall, capital maintenance aims to retain shareholders' investment to finance the company's business and protect creditors' rights.

The regulations related to maintaining companies' capital are designed to protect the interests of creditors and shareholders.⁷² Shareholders have limited liability, while creditors are exposed to risk, prompting the need for preventive protection.⁷³ . The way this doctrine is understood and applied differs greatly between civil law and common law countries. In civil law jurisdictions, the capital maintenance doctrine is strictly enforced. These countries have clear laws that regulate capital maintenance. For example, in Germany, the law prevents returning shareholder contributions and only allows payouts from profits deemed legally available. The aim is to protect creditors, ensuring that the capital remains as a buffer for them. Distributions to shareholders are tightly regulated, requiring dividends to come only from verified profits and often needing legal processes for capital return. Courts play a critical role in enforcing these rules, protecting creditors from irresponsible financial behavior.⁷⁴ On the other hand, common law countries allow more flexibility in capital maintenance. Over time, these jurisdictions have eased strict rules, allowing companies to distribute assets with less compliance to traditional principles. While creditor protection is still important, common law countries prioritize contracts between creditors and companies, offering tailored protections. Judicial decisions significantly influence capital maintenance doctrines, leading to varied interpretations. Companies have more freedom to manage their capital through actions like share buybacks, which might be restricted in civil law countries.⁷⁵ Certain rules, such as minimum capital requirements, payment of contributions, reduction of capital, and distribution of dividends, aim to ensure financial stability

⁷⁰ Fritz Ntoku, *the Capital Maintenance Doctrine Provides Essential Protection to Corporate Creditor myth or Reality* 2005 page 21-30

⁷¹ Enrique and I Macey *Creditor versus Capital Formation the case Apprised the European Legal capital rules* (2001) page 86

⁷² *Supra* note 35 page 60

⁷³ Armour J, *'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law'* *The Modern Law Review* (May 2000, Vol. 63 No. 3 p. 355)

⁷⁴ *Ibid*

⁷⁵ *Ibid*

and protect creditors' rights.⁷⁶ Special considerations apply to single-member companies due to their unique characteristics and funding structure.⁷⁷

A. Reduction of Capital

The reduction of capital is an important action for companies that allow them to lower their share capital for various reasons, like returning extra capital to shareholders or managing significant losses. The rules and procedures for capital reduction differ greatly between civil law systems, such as France, and common law systems, like the United Kingdom.⁷⁸ In France, capital reduction follows strict rules in the French Commercial Code. To reduce capital, a company must have approval from an Extraordinary General Meeting (EGM) of shareholders. This process ensures fairness among shareholders and confirms minimum capital requirements are met. There are two main types of capital reduction:

1. Loss-Driven Reductions are used to cover losses within the company and do not return assets to shareholders. They correct financial issues rather than provide distributions.
2. Non-Loss-Driven Reductions can return extra capital to shareholders or change the financial setup of the company. In this case, creditors can dispute the reductions within 20 days after the shareholders' decision is filed.⁷⁹

The UK has implemented several approaches to maintain a company's assets to protect creditors. One such approach is the reduction of capital, which can be made by a special resolution of members and supported by a solvency statement for private companies limited by shares or court confirmation.⁸⁰ This decision can be made in writing or at a general meeting. The sole member of a single member company can also make this decision based on CA 2006, section 318. The reduction of capital is a process through which the amount contributed by shareholders is decreased. This rule can be found in Part 17, Chapter 10 of the Companies Act 2006, and can be proposed in writing or at a general meeting. The board of directors can decide whether the creditors' interest is detrimentally affected by the reduction in capital. Each director must confirm that there is no evidence that the company could not pay its debts at the date of the statement. If

⁷⁶ Supra note page 143

⁷⁷ Supra note 146 page 363

⁷⁸ Supra note 73 page 360

⁷⁹ Ibid

⁸⁰ David Kershaw, *Company Law in Context Text and Materials* (first published 2009, Oxford University Press 2009) 792

there is no reasonable ground in the conduct of the solvency statement, the directors may be liable for an offense⁸¹

Therefore, the methods of capital reduction illustrate key differences between civil and common law systems. France has strict regulatory requirements focused on creditor protection, while the UK offers more flexibility, ensuring protection through solvency confirmations or court approval. Understanding these differences is vital for companies operating internationally or considering capital changes

B. The minimum Capital Requirement

The minimum capital requirement is an important aspect of forming companies, and it varies greatly between civil law countries like France and common law countries like the United Kingdom. The overview discusses the specific capital requirements in these two legal systems and their impacts on businesses.⁸²

In France, different types of companies have specific minimum capital requirements. For a Société à Responsabilité Limitée (SARL), which is similar to a limited liability company, the minimum is set at only €1. However, many banks suggest starting with around €4,000 to build credibility and gain investor confidence. The Société par Actions Simplifiée (SAS) also has a minimum of €1, but a higher amount is recommended to improve the company's image. The Société Anonyme (SA), a more complex structure, requires a minimum capital of €37,000, with at least half of that paid up at incorporation, ensuring significant financial backing. The French Commercial Code outlines that this capital must be deposited in a bank account before company registration, safeguarding the interests of creditors.⁸³

In contrast, the United Kingdom takes a more flexible stance on capital requirements. Private limited companies (Ltd) have no statutory minimum capital requirement, allowing entrepreneurs to set up a business with as little as £1, making it easier for individuals to start small businesses. However, to establish a public limited company (PLC), a minimum of £50,000 is

⁸¹ UK Companies Act 2006 art 3(3) 642

⁸² Armour J, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law' *The Modern Law Review* (May 2000, Vol. 63 No. 3 p. 355

⁸³ *Supra* note 154 page 750-751

required, with at least 25% paid up before commencing operations, providing sufficient funding while protecting investors.⁸⁴

Overall, the differences in capital requirements between France and the UK reflect the contrasting approaches of civil law and common law systems. France emphasizes financial stability and creditor protection, while the UK's regulations offer more flexibility, especially for small businesses. .

C. Distribution of Dividend

The distribution of dividends is an important part of corporate finance, showing how companies share their profits with shareholders. The rules for dividend distribution differ significantly between civil law countries like France and common law countries like the United Kingdom, reflecting their unique legal systems and financial practices.⁸⁵

In France, dividend distribution is mainly governed by the French Commercial Code, which sets specific rules to ensure profits are shared systematically. Dividends can only be paid from fully realized profits that have been approved in the company's annual accounts. The decision to distribute dividends must happen during a General Assembly of Shareholders (GAS), where shareholders review financial statements and make decisions on profit allocation. A key requirement is that companies must keep a legal reserve, setting aside at least 5% of net profits until this reserve reaches 10% of the share capital. To pay dividends, companies need sufficient distributable profits after maintaining this reserve and must also ensure they remain solvent after distribution.⁸⁶

In the UK, the Companies Act 2006 the distribution of dividends in companies is governed by regulations aimed at protecting creditors, particularly by limiting the distribution to shareholders, as outlined in the second Council Directive on company law (77/91/EEC) and Part 23 of CA 2006. The criteria for distribution are specified in Article 15 of the Directive, emphasizing that distributions should be made from profits and subject to certain tests to ensure compliance. Under UK law, there are various methods of distribution, such as from accounting surplus, based on board decisions, or approved by a third party like the court. The common rule is that

⁸⁴ Ibid 761-763

⁸⁵ Super note 82 page 375

⁸⁶ Ibid

distributions should come from profits, following the accumulated profit test. Members who knowingly receive unlawful distributions may be liable to repay the excess amount to the company, while those unaware of the illegality are not held accountable. Directors have a duty of care, skill, and diligence when approving distributions, but liability for unlawful distributions is not solely based on this duty. Courts view unlawful distributions as breaches of trust, holding directors accountable for any losses incurred. Directors should be aware of the legality of distributions and must not rely on inaccurate financial records. In cases like *Re Exchange Banking Company (Flitcroft's Case)* [1882] Ch D 519 and *Bairstow v Queens Mout Houses Plc* [2001] EWCA Civ 712, directors were held responsible for unlawful distributions when they were aware of discrepancies in profits or suggested distributions beyond legal limits, even if the company was solvent. Therefore, the distribution of dividends is subject to stringent regulations to protect creditors and ensure compliance with legal requirements. Directors play a crucial role in approving distributions and must exercise diligence to avoid unlawful acts that could lead to liability and compensation for any resulting losses.

Overall, the rules for dividend distribution highlight clear differences between civil law and common law systems, emphasizing creditor protection and financial caution in France, while providing more flexibility in the UK.

2.3.1.2 Mandatory Disclosure

Mandatory disclosure rules in company law can provide security for creditors by requiring companies to disclose financial information when borrowing money. This strategy helps creditors establish financial relationships with companies and can compensate for the risks associated with voluntary creditor agreements⁸⁷. Limited companies, which can trade without their members being held liable for the company's debt, should be willing to disclose information publicly to benefit third parties.⁸⁸ Creditors need access to company information to assess creditworthiness and protect their interests. Mandatory disclosure involves showing information on business documents, keeping information at the registered office, providing public notification, and registering information at Companies House.⁸⁹

⁸⁷ Supra note 143 page 33

⁸⁸ Hick G SH Goo Cases and Materials on Company law 6th ed. 2008 Oxford University page 150-151

⁸⁹ Ibid 151

The rationale for mandatory disclosure is to protect creditors and promote confidence in the market by providing accurate information for informed decision-making⁹⁰. Mandatory disclosure helps prevent market failures caused by incomplete information and ensures the accuracy of financial information.⁹¹ Creditors are interested in specific details such as a company's borrowing, capital amounts, cash flow, and financial statements to assess risk accurately.⁹² The financial statements, including balance sheets, income statements, and cash flow statements, provide insights into a company's financial position, performance, and cash flows.⁹³ Auditors play a crucial role in verifying financial statements to enhance the quality of mandated disclosures.

Companies need to disclose financial information to creditors to assess events that may impact solvency. Financial statements should reflect true and fair views of a company's financial situation and comply with accounting standards⁹⁴. The adoption of International Financial Reporting Standards (IFRS) helps enhance transparency and comparability of financial information globally. The audit function ensures that financial statements are verified by independent and professional auditors.⁹⁵

In France, the rules for mandatory disclosure of company information are mainly based on the French Commercial Code, supported by laws aimed at increasing transparency and preventing financial misconduct. Key elements include: Beneficial Ownership Disclosure: From April 1, 2018, non-listed companies registered before August 1, 2017, must provide details about their beneficial owners to the French Trade and Companies Register. New companies must give this information immediately upon registration. Currently, the beneficial ownership threshold is 25%, with proposals to lower it to 10% to align with new European rules. Mandatory Disclosure Rules (MDR): France introduced these rules on July 1, 2020, in response to the EU's DAC6 Directive to combat tax avoidance. Taxpayers and intermediaries must report cross-border tax arrangements, including those created from June 25, 2018, to July 1, 2020, to ensure closer inspection. Corporate Reporting Requirements: The NRE Act imposes strict reporting duties on

⁹⁰ Sorensen, European Business Organization Law review, 2009, 255, p.262; Market in: Eidenmuller/ Schon, the law and Economics of Creditor Protection, p.97

⁹¹ R. Kraakman et al, the Anatomy of Corporate Law a Comparative and Financial Approach 3rd ed Oxford University press 2017 page 5

⁹² Supra note 143 page 33

⁹³ Hick G SH Goo Cases and Materials on Company law 6th ed. 2008 Oxford University page 150-151

⁹⁴ Information as the Cause for Reducing Uncertainties in the Communication among People.2006, p. 179

⁹⁵ Sorensen, European Business organization Law review, 2009, 255, p.262; Market in: Eidenmuller/ Schon, the law and Economics of Creditor Protection, p.97

listed companies, requiring detailed disclosures about financial performance, risk management, and sustainability. All reports must be verified by an independent auditor for credibility⁹⁶

In the UK, mandatory disclosure rules apply to company registers, records of decisions by sole members, contracts with sole members, accounts, reports, and audits.⁹⁷ Changes in company membership must be recorded to reflect the current status for creditors' protection.⁹⁸ Sole members must document decisions regarding company management, and contracts must be made in writing to prevent conflicts of interest. Proper maintenance and disclosure of financial documents enable creditors to assess company risk and protect their rights.⁹⁹ Small companies may be exempt from certain accounting and reporting duties based on turnover, balance sheet total, and number of employees.¹⁰⁰

Therefore, Both France and the UK have strong disclosure frameworks rooted in their legal traditions, with France emphasizing strict compliance and the UK adopting a more flexible approach to promote transparency, accountability, and improved corporate governance in Europe. Overall, mandatory disclosure rules in company law are essential for protecting creditors, promoting market confidence, and ensuring accurate financial information for informed decision-making. Compliance with these rules enhances transparency, reduces risks, and safeguards the interests of stakeholders in the market place.

.2.3.1.3 Member Qualification

The term "member" refers to an individual who is part of a partnership, association, corporation, guild, or similar organization.¹⁰¹ On the other hand, "qualification" pertains to a person's abilities, characteristics, or experiences that make them suitable for a specific job or activity.¹⁰² "Member qualification" specifically refers to the qualifications required for certain individuals, especially within the legal framework¹⁰³. This concept is important for protecting the

⁹⁶ The French Mandatory Disclosure Rules (MDR) On 22 October 2019

⁹⁷ Supra note 36 Elis Tarell, Basel II and the protection of creditors in company law, 102

⁹⁸ R. Kraakman et al., *The Anatomy of Corporate Law: A Comparative and Financial Approach* 3rd ed Oxford University Press 2017 page 5

⁹⁹ H. Market Creditor Protection through mkan... Disclosure European Business Organization law review V. 1 -7 page 95 -122

¹⁰⁰ Teferi Deyuu Alemi and J. Spasricha, 'Corporate Financial Reporting Legal and Regulatory Frameworks in Ethiopia' *Journal of accounting and taxation* Vol. 9(5), pp.56-67, May 2017, p. 58

¹⁰¹ Henry Campbell, *Black's Law Dictionary* 1968 page 1135

¹⁰² *Ibid*

¹⁰³ Thailand Single Member Companies Act Art 394,381-382 451-453

interests of creditors. For example, first in France, the qualifications for individuals to become members of companies are mainly defined by the French Commercial Code and the Civil Code. These requirements can differ based on the type of business entity. Here is a summary of the main types of business entities and their qualification criteria: Sole Proprietorships: This structure is for one individual acting as the sole trader, requiring no specific qualifications other than the legal ability to conduct business. Limited Liability Companies (SARL): A SARL requires at least two shareholders, with a maximum of 100. Shareholders can be individuals or other companies, and contributions to share capital can start at just 1 euro, making it an affordable option for entrepreneurs. Single-Member Limited Liability Companies (EURL): A EURL is similar to a SARL but has only one shareholder, who must meet the same capital contribution requirements. Public Limited Companies (SA): This type requires a minimum of seven shareholders with no maximum limit. Shareholders must follow specific rights and responsibilities, including participating in general meetings and decision-making. Partnerships (SNC): A partnership needs at least two partners. The partnership agreement must detail the identities of the partners and their contributions, as well as management and decision-making rules. To qualify as a shareholder in France, individuals must be at least 18 years old, have the legal ability to enter contracts, and some positions, like directors, may need individuals to have no criminal record¹⁰⁴

Second, the Single Member Companies Act in Thailand outlines qualifications and restrictions for members of single member companies. According to this Act, the member must be a Thai national who invests in cash or assets. Individuals with a criminal history, bankruptcy record or deemed incompetent are not allowed to establish a single member company. Those with a history of fraudulent behavior are also prohibited, except in certain circumstances.¹⁰⁵

The Act also covers grounds for dissolution, such as the member's death, bankruptcy, or incompetence. If no liquidator is named, the member will take on that role during the liquidation process. The liquidation must follow relevant laws, with exceptions in cases of bankruptcy.¹⁰⁶

Additionally, if a single member company is restructuring into a multi-member company, a public announcement must be made, and creditors must be notified. Creditors have 30 days to

¹⁰⁴ French commercial code enacted 1807

¹⁰⁵ Thailand Single Member Companies Act Art 3,9, 11 and 38

¹⁰⁶ *Ibid*

object, and restructuring cannot proceed without addressing objections. The dissolution grounds and restructuring process underline the significance of a sole member under this law.¹⁰⁷

Third, in the United Kingdom, qualifications for members in companies are governed by the Companies Act 2006, which specifies the requirements for different types of companies. Private Limited Companies (Ltd): These can have a minimum of one member, allowing individuals or corporate entities as shareholders, with no maximum limit. Public Limited Companies (PLC): A PLC must start with at least two members and maintain a minimum of seven thereafter. Both individuals and corporations can be shareholders. Limited Liability Partnerships (LLP): This requires at least two designated members responsible for legal compliance. In the UK, shareholders must be at least 16 years old, and there are no residency requirements, allowing foreigners to own shares in UK companies.¹⁰⁸,

Overall both France and the UK have different legal frameworks for member qualifications in companies, reflecting their unique legal traditions. France has detailed regulations outlining roles and responsibilities, while the UK's approach is more flexible concerning qualifications. Understanding these differences is important for businesses operating in either country.

2.3.1.4 Director Qualification

In France, the qualifications and requirements for corporate directors are primarily found in the French Commercial Code and specific regulations for different types of companies. There are various types of directors, such as managing directors in a Société Anonyme (SA) and a flexible role for presidents in a Société par Actions Simplifiée (SAS), where legal entities can serve. Managing directors must be individuals, while directors can be either individuals or legal entities.¹⁰⁹

For eligibility, individuals must be at least 18 years old and there are no nationality restrictions, allowing foreign nationals to serve. However, those with certain criminal convictions may be disqualified, especially if related to corporate governance or financial misconduct. Although there are no specific educational requirements by law, companies may outline desired skills or qualifications in their articles of association, and it is expected that directors possess the necessary knowledge for their roles. Directors can be held liable for mismanagement, known as

¹⁰⁷ Ibid

¹⁰⁸ UK Companies Act 2006

¹⁰⁹ French commercial code enacted 1807

faute de gestion, which includes a wide array of negligent or fraudulent actions, highlighting the concept of accountability.¹¹⁰

In the UK, the qualifications for company directors are mainly described in the Companies Act 2006. Private limited companies (Ltd) must have at least one director who is a natural person, while public limited companies (PLC) require a minimum of two directors for collaborative governance. Eligibility in the UK requires directors to be at least 16 years old, with no residency requirements, allowing both UK nationals and foreigners to be directors. Some individuals may be barred due to past misconduct, such as bankruptcies or fraud, ensuring ethical standards in governance. Although there are no formal educational qualifications required, directors are expected to have sufficient knowledge and experience for their responsibilities, with companies potentially specifying qualifications in their articles of association.¹¹¹ Directors in the UK have significant responsibilities to the company, including obligations of care, loyalty, and acting in the company's best interests. Not adhering to these duties can result in personal liability, stressing their accountability to both the company and its shareholders

Under the Single Member Companies Act in Thailand, the following regulations have been enacted to enhance creditor protection. The member himself or another person appointed by the member, who is also a resident, may hold the position of director. Similar to members, an individual who has been convicted of a crime, declared bankrupt, deemed incompetent, or held liable for improper conduct may not hold the position of director. Furthermore, the law imposes stricter prohibitions with regard to a history of misconduct. A director shall not have been convicted or imprisoned for an offense related to dishonesty or misusing property unless at least five years have elapsed since the conviction. In addition, a director shall not have been dismissed from governmental agencies due to an offense related to corruption in the conduct of their duties. Finally, unless at least five years have passed since the sentencing, a director shall not have been found guilty of an offense related to assisting, supporting, or participating in the company's misconduct, such as conducting business under false pretenses, investing on behalf of foreigners to circumvent foreign business laws, or consenting to another person's misconduct.¹¹² In short, the qualifications for directors in France and the UK reflect their unique legal systems. France and has a civil law framework with formal regulations, while the UK follows a common law

¹¹⁰ Ibid

¹¹¹ UK Companies Act 2006

¹¹² Thailand Single Member Companies Act Art 42

system with a focus on fiduciary duties and responsibilities. Understanding these differences is vital for compliance and effective governance in each jurisdiction.

2.3.1.5. Directors' Specific Duties and Liabilities

In France, the legal responsibilities of company directors, known as dirigeants, are mainly defined in the French Commercial Code. This framework covers essential duties that ensure directors act in the best interest of the company. Directors have specific obligations, including:

- **Duty of Care:** They must carry out their roles with great diligence, making informed decisions using proper research and sound judgment, particularly in difficult situations that could impact the company's success.
- **Compliance with Laws and Regulations:** Directors are required to follow all relevant laws, the company's rules, and internal regulations. Failing to do so can result in serious consequences, including liability for any breaches of duty.
- **Duty to Act in the Company's Interest:** Directors should prioritize the company's keep their decision-making transparent.¹¹³

Directors also face several liabilities: - **first civil Liability:** They can be held liable for mismanagement, which includes negligence or decisions that do not serve the company's best interests. Legal actions may be initiated by the company or shareholders, who must prove a link between the director's actions and any damages incurred. **Second Personal Liability for Company Debts:** If a company becomes insolvent, directors may be held personally accountable for debts if mismanagement contributed to the financial issues. This arises from poor decision-making or a failure to act during critical times. **Third Criminal Liability:** In serious cases, directors might face criminal charges for offenses linked to corporate governance, such as embezzlement or fraud, particularly during bankruptcy. This could result in hefty fines or imprisonment.¹¹⁴

In the United Kingdom, directors must act within their powers, promote company success, exercise care and diligence, avoid conflicts of interest, and refrain from accepting benefits from third parties.¹¹⁵ Failure to fulfill these duties may lead to legal liabilities,¹¹⁶ such as fraudulent

¹¹³ French commercial code enacted 1807

¹¹⁴ Ibid

¹¹⁵ Thailand Single Member Companies Act Art 17

trading, breach of duties, and potential criminal repercussions. The Companies Act requires private and public companies to have at least one and two shareholders respectively, as well as a director who is a natural person. Additionally, recent changes emphasize the need for directors to consider creditors' interests, recognizing their contribution to the company's capital. Safeguards are necessary to protect creditors' expectations when providing credit to the company. Apart from fiduciary duties, directors must comply with statutory provisions like promoting company success, avoiding conflicts of interest, and considering various stakeholders' interests. Section 172 of the Companies Act requires directors to promote company success for members' benefit while also considering the interests of employees, suppliers, and consumers, excluding creditors.¹¹⁷

Directors must fulfill their duty of care and skill as outlined in the Companies Act. Neglecting this duty may result in being held accountable for any losses suffered by creditors. It is advisable for directors to take a balanced approach to risks facing creditors, especially in cases of insolvency,¹¹⁸ where the interests of both members and creditors should be considered collectively.

There have been cases where directors engaged in high-risk transactions during insolvency, impacting creditors' expected claims¹¹⁹. Directors are now expected to consider creditors' interests even before insolvency, ensuring their actions benefit creditors.¹²⁰

In conclusion, directors have a responsibility to prioritize creditors' interests, especially in cases of insolvency or doubtful solvency. Court rulings have established that directors must act in the best interests of creditors when faced with insolvency, ensuring their actions generate the highest profit for creditors. Directors must consider the company's financial state and act in a manner that benefits creditors, even before insolvency occurs.

Overall, directors in both France and the UK have significant duties and liabilities defined by their respective legal systems. French law focuses on diligence and compliance, while UK law outlines specific duties augmented by common law. Understanding these differences is vital for effective corporate governance in both regions.

¹¹⁶ Ibid art 21

¹¹⁷ Supra note 185 page 200

¹¹⁸ Supra note 143 page 55

¹¹⁹ Ibid

¹²⁰ David Kershaw, *Company Law in Context Text and Material* first published 2009 Oxford University press 2009 792

2.3.1.6 Disregard of Corporate Entities

Disregard of corporate entities, known as "piercing the corporate veil," is a legal principle that allows courts to ignore a corporation's separate legal identity. This can hold shareholders or directors personally responsible for the corporation's actions or debts. This concept exists in both civil law and common law systems, with some differences in how it is applied.¹²¹

In France, the law strongly upholds the idea of separate legal identity for corporations. However, there are specific situations where courts may choose to set this aside. French courts can disregard a corporation's identity when there is clear evidence of misuse for illegitimate purposes, such as fraud or evading legal responsibilities. The main idea is that corporate structures should not be used to commit wrongdoing or harm the rights of others, including creditors.¹²²

To disregard corporate entities in France, there needs to be strong evidence showing that the corporate structure was used intentionally for fraudulent acts and that personal interests and corporate matters of the shareholders or directors are deeply intertwined. French courts also have significant discretion in applying this principle, assessing each case individually and focusing on protecting third parties and preventing wrongful behavior.¹²³

For instance, in the UK, the principle of lifting the corporate veil or piercing the corporate veil is recognized as an exception to the principle of separate legal personality. The court has the discretion to disregard the separate legal entity of a company for the sake of justice. This discretion can be exercised not only in cases specified by law but also in special circumstances where the corporate form is being abused, such as when the company is used as a facade for dishonest activities like defrauding creditors or evading obligations, or when there is a lack of distinct business and finance between the company and its members.¹²⁴

Focusing on single-member companies, the leading case, *Salomon v. Horne* [1993] Ch. 935 (Court of Appeal), established that a creditor could not enforce a former employee to repay a debt. However, there have been other cases where the court has pierced the corporate veil due to

¹²¹ Ibid

¹²² Ibid

¹²³ Hicks G & S.H. Goo, *Cases and Materials on Company law* (6th ed 2008, Oxford University press) 371

¹²⁴ Natcha Rattpan *Legal Issues on Creditors Rights and Protection in Single Member Companies* (LLM Thesis Unpublished Thammasat University 2017) 70

the abuse of the corporate form, as illustrated below.¹²⁵ In the case of *Gilford Motor Company Ltd. v. Horne* [1993] Ch. 935 (Court of Appeal), the first defendant, EB Home, was employed by the plaintiff. During his employment, an agreement was made that he would not contact the company's clients after his employment ended. However, upon termination, EB Home started his own business and undercut the plaintiff's prices. This new business, bearing the company name JM Home & Co Ltd, was owned and controlled by the second defendant, EB Home's wife, who was employed as a sole member and director of the company. In this case, the court found that the covenant had been breached and granted an injunction against both defendants, demonstrating the disregard of the corporate veil principle.¹²⁶

This decision was further emphasized in the case of *Jones v. Lipman* (1962) WLR 832. Here, the defendant had agreed to sell some land to the plaintiff. However, he subsequently transferred it to a company he had formed for that specific purpose, effectively owning and controlling the other transaction, making it impossible to request an order for specific performance. In this instance, the court disregarded the corporate veil and ordered specific performance against the defendant and his company.¹²⁷

Overall, disregarding corporate entities is a crucial legal tool in both civil and common law systems for preventing the misuse of corporate structures. French courts focus on protecting third parties, while UK courts balance limited liability with the need to address fraudulent behavior, making it essential to understand these differences in corporate law

2.3.1.7 Change of Members

In accordance with the Companies Act, the term "Subscriber" refers to a party who has agreed to become a member of the company upon its registration. This individual is then entered into the company's register of members. Additionally, any person who provides written consent to become a member and is subsequently entered into the company's register of members, as well as any individual holding shares and listed as the beneficial owner in a depository's records, is also considered a members¹²⁸.

¹²⁵ *ibid*

¹²⁶ *ibid*

¹²⁷ *ibid*

¹²⁸ Ferran Eilis, *Principles of Corporate Finance law* (first published 2008, Oxford University Press) 17

The concept of "Change of Member" pertains to the process of replacing an existing member of a company with another.¹²⁹ This concept is examined in the context of France, UK and Thai company laws.

First, in France, the legal rules for changing members shareholders or partners in a company are based on the French Commercial Code. These rules differ based on the type of corporate structure. Here are key details about companies and the process of changing members: Société à Responsabilité Limitée (SARL): Transfer of Shares: To transfer shares in a SARL, approval from other shareholders is necessary, as stated in the company's articles of association. Generally, a majority vote is needed for the transfer.¹³⁰

- Documentation: Membership changes must be well documented, requiring a transcript from an Extraordinary General Meeting (EGM), updated articles of association, and a legal announcement published in an official journal.
- Registration: The necessary documents must be registered with the relevant commercial court to update the company's registration details. Société Anonyme (SA): Shareholder Approval: Changes in membership need formal approval at a general meeting. Share transfers are usually allowed unless there are restrictions in the articles of association.
- Notification: Any membership changes must be reported to the commercial registry and published in a legal gazette for public knowledge.
- Documentation: Required papers include minutes from the meeting and updated articles of association to confirm changes. Société par Actions Simplifiée (SAS):
- Flexibility: The SAS structure allows for more flexibility in share transfers. These transfers can often be negotiated freely, barring specific restrictions in the articles of association.¹³¹

¹²⁹ Len sealy sarah worthington, Case and Material in Company law (9th edn 2010 Oxford University press page 65-66

¹³⁰ French commercial code enacted 1807

¹³¹ Ibid

Approval Process: While formal shareholder approval is not always necessary, it is common to keep current shareholders informed about new or departing members. Legal Procedures for Changing Members: To make significant membership changes, an Extraordinary General Meeting (EGM) must be held. Members must be given proper notice about the meeting's agenda and the proposed changes. After approval, the required documents need to be filed with:

The commercial court for official registration. The Bulletin officiel des annonces civiles et commerciales (BODACC) for public disclosure, ensuring transparency and compliance with legal standard. Implications of Changing Members: New members inherit specific rights and obligations laid out in the company's articles. Existing members may retain preemptive rights, allowing them to buy shares before they are offered to others, thus maintaining some control over ownership¹³².

Second in the UK, single member companies are treated similarly to multi-member companies, and their existence does not depend solely on one member. Shares of these companies are transferable in accordance with the company's Articles¹³³. In the event of the single member's passing, the heir assumes both rights and obligations in line with succession laws. Additionally, single member companies can only convert into multi-member companies by being entered into the register of company members.¹³⁴

Third, the Thai SPC law emphasizes the specific qualifications of the sole member. As the existence of companies is dependent on the sole member, a change in membership can impact creditors. Various scenarios related to this change are discussed in the Thai SPC law.

The Thai Shareholders Protection Corporation Act mandates certain guidelines for cases where shares are inherited by multiple heirs or transferred to multiple buyers. In the event of the sole member's passing, heirs must appoint a new sole member within 90 days to avoid company dissolution. Failure to do so will result in joint liability for debts. Likewise, if shares are transferred to multiple buyers, a new sole member must be elected within the same timeframe to prevent dissolution, or the company must transform into a limited company with new shareholders subscribing to shares within 90 days.¹³⁵

¹³² Ibid

¹³³ Company act 2013 section 2(55)

¹³⁴ Ibid

¹³⁵ Thailand Single Member Companies Acts. Art 33-40

Converting a sole proprietorship into a limited company requires dividing the capital into shares, notifying creditors, and registering the new entity in compliance with regulations, leading to the cessation of the SPC. This process underscores the importance of maintaining a sole member for continuous company operations. Any changes to membership, whether through inheritance, transfers, or transformation, must be carefully executed to protect creditors and ensure the company's longevity. The SPC Act emphasizes the critical role of a sole member in upholding the existence of a company, whether in cases of inheritance, share transfers, or transformation to a limited company. Adhering to the outlined guidelines is essential for operational sustainability and creditor protection.¹³⁶

Therefore, processes for changing members in France and the UK show important differences influenced by their legal systems. France's approach involves more formalities, while the UK allows more flexibility, varying by company type.

2.3.1.8 Adjustment of Transactions

The company's vulnerable transactions hold the potential to significantly impact the amount that creditors can claim. However, there are mechanisms in place to adjust the company's remaining assets in order to maximize the value of these transactions. Instead of imposing liability on relevant parties, these provisions aim to provide remedies for damage, with the primary goal of restoring the company's position or canceling vulnerable transactions.

Under UK law, there exist various remedies for vulnerable transactions. Parties with relevance to a particular transaction may file a petition to the court, seeking an order to restore the position or protect the interests of victims involved in a transaction at an undervalue.¹³⁷ This also applies to provisions for transactions at an undervalue or preferences when a company is insolvent or in liquidation. Furthermore, these mechanisms are applicable to transactions engaged in within a specific period before the onset of insolvency, and the court may, if deemed necessary, give an order to restore the position before the transaction took place.¹³⁸

In accordance with Thai law, creditors hold the entitlement to claim for the court-ordered cancellation of any transaction that was conducted with the intention to prejudice them¹³⁹. This provision remains applicable when a company becomes bankrupt or enters the general reorganization procedure. Moreover, any transaction that occurs within a relevant time before or

¹³⁶ *ibid*

¹³⁷ Commercial code of Thai art 1132

¹³⁸ Thailand single Member Companies act s. 38(1)(2)

¹³⁹ The Draft Law on Single Member Companies Act s. 38(1)

after the filing of the bankruptcy petition, or one that involves unreasonably small remuneration, is presumed to be prejudicial to creditors.¹⁴⁰ Additionally, the court is empowered to cancel a transfer or act by debtors during a specific period before or after the bankruptcy petition if it is found to bestow an advantage to any creditor over others¹⁴¹.

A contractual or self-help mechanism serves as a means through which the liability of the corporate debtor towards its creditor is regulated among the parties through contractual provision¹⁴². This self-help creditor protection mechanism views the firm as a nexus of contracts, within which all parties aim to maximize their own benefit¹⁴³. Corporate creditors seek adequate protection through the terms of the contract with the debtor. The issue of corporate creditor protection is regarded as primarily a matter of contract rather than company law.¹⁴⁴ These contractual protection mechanisms enable creditors to be provided with the level of protection they deem adequate.¹⁴⁵

When assessing the adequacy of such contractual protection, several factors are taken into consideration, including the probability of default by the debtor company.¹⁴⁶ These mechanisms are effectively preventative rather than curative, as they prevent corporate creditors from entering into contracts that fail to adequately indicate the potential for nonperformance by the debtor from the very beginning.¹⁴⁷

The self-help mechanisms are not accessible to involuntary creditors, as they lack a prior contractual relationship with the company before becoming a creditor.¹⁴⁸ The same applies to weak creditors with less bargaining power to negotiate terms of a debt contract. These creditors are commonly designated as non-adjusting creditors, as they are unable to make use of these self-help mechanisms.¹⁴⁹ The costliness of these mechanisms may render them unavailable for weak creditors. Moreover, while the self-help mechanisms restrict the opportunistic behavior of the

¹⁴⁰ F Philip Manns JR & Timothy M Todd, 'Issues Arising upon the Death of the Sole Member of a single member Ccompany LLC'

¹⁴¹ IA Part XVI: Provisions against Debt Avoidance, Transaction Defrauding Creditors s. 423-425

¹⁴² IA Part IV: Miscellaneous Provisions Applying to Companies which are Insolvent or in liquidation, Adjustment of Prior Transaction, at an undervalue or Preferences (s. 238-241)

¹⁴³ CCC s. 237

¹⁴⁴ Thai Bankruptcy Act B.E. 2483, s. 113-114 and 90/40

¹⁴⁵ Thai Bankruptcy Act B.E. 2483, s. 115-115 and 90/41

¹⁴⁶ Ibid

¹⁴⁷ Supra note 59 page 48

¹⁴⁸ Ibid page 62

¹⁴⁹ Ibid page 48

company controller, they also potentially create scope for opportunism on the part of secured creditors against unsecured creditors.

Despite being regarded as very costly, self-help mechanisms provide more flexibility for creditors by allowing them to attain the protection they require, such as charging an appropriate interest rate for the risk of default.¹⁵⁰ These mechanisms not only help to restrict the opportunistic behavior of shareholders as permitted by the limited liability doctrine¹⁵¹, but also enable corporate creditors to renegotiate or modify their credit terms.¹⁵²

2.3.1.9 Restriction on Re-use of Company Names

In France, company name regulations are mainly in the French Commercial Code. The key points regarding re-use of company names are:

- Corporate Name Selection Companies must choose unique names that are different from existing businesses to avoid consumer confusion. They should also not infringe on third-party rights, like trademarks, to protect both consumers and competing businesses
- .Legal Protection using a name similar to an existing entity can lead to civil liability if it confuses consumers or harms the original entity's reputation. French courts have ruled that misleading name usage can result in serious legal issues, highlighting the need for careful name selection
- Intellectual Property Considerations A corporate name should not conflict with registered trademarks or existing names. If another company has a registered name, a new company cannot use it without permission. Not following these rules can lead to claims of unfair competition or intellectual property violations, making careful research important.
- Changing Company Names Companies can change their names with shareholder approval. The new name must meet legal requirements and be registered. The updated name must be announced legally and recorded officially to keep the corporate identity clear.¹⁵³

¹⁵⁰ Ibid page 8

¹⁵¹ O. Mulbert, O'A Synthetic View of Different Concepts of Creditor Protection' p. 376

¹⁵² Pau Davies, Introduction to Company Law, 2nd edition, Oxford University press, USA, 2010, p. 71

¹⁵³ French commercial code enacted 1807

In the UK, the regulations on re-use of company names are mainly governed by the Insolvency Act 1986, per sections 216 and 217, individuals who have served as directors or shadow directors of a company within the 12 months leading up to its insolvency and liquidation are prohibited from using the company's name or a similar name for 5 years. Additionally, they are not allowed to manage another company with a name that matches the restricted name. Failure to comply with these regulations will make the individuals personally liable for the debts of the company.¹⁵⁴ These provisions are put in place to prevent what is known as the "Phoenix syndrome," where individuals intentionally let a company become insolvent and then establish a new company with a similar name, staff, and operations to avoid repaying debts owed to creditors from the previous company. As per sections 216 and 217 of the Insolvency Act, individuals who have served as directors or shadow directors of a company within the 12 months leading up to its insolvency and liquidation are prohibited from using the company's name or a similar name for 5 years. Additionally, they are not allowed to manage another company with a name that matches the restricted name. Failure to comply with these regulations will make the individuals personally liable for the debts of the company. These provisions are put in place to prevent what is known as the "Phoenix syndrome," where individuals intentionally let a company become insolvent and then establish a new company with a similar name, staff, and operations to avoid repaying debts owed to creditors from the previous company.¹⁵⁵

Overall Both France and the UK have established regulations on re-use of company names to prevent confusion and protect stakeholders. The French system focuses on intellectual property rights and legal distinctiveness, while the UK framework imposes strict rules after insolvency with some exceptions for business continuity. Understanding these regulations is essential for businesses to operate legally and maintain integrity.

2.3.2 Types of self-help mechanism of corporate creditor protection

In the following passage, various self-help mechanisms designed to protect corporate creditors are discussed in detail. The discussion begins with an in-depth analysis of covenants, which are critical contractual instruments governing the terms and conditions of loan agreements. Covenants are further categorized into negative and positive covenants,¹⁵⁶ each serving different

¹⁵⁴ Hicks G & S.H. Goo, *Cases and Materials on Company Law* (6th edn 2008, Oxford University Press) 371

¹⁵⁵ UK Insolvent Act Art 217

¹⁵⁶ *Supra* note 186 Paul Davies, *Introduction to company law*, p. 71

purposes in safeguarding the interests of creditors. Negative covenants are explored in detail, shedding light on the specific restrictions imposed on debtor companies to prevent activities that may disadvantage creditors¹⁵⁷. For example, restrictions on dividends, limitations on assets, and the granting of guarantees or loans are discussed in the context of negative covenants¹⁵⁸. The discussion then delves into positive covenants, providing comprehensive insights into their role in ensuring the financial stability of debtor companies and outlining the positive actions they require.¹⁵⁹

The exploration extends to the protection of creditors through the acquisition of collateral or security in the form of a proprietary claim over debtor company assets. The detailed analysis emphasizes the advantages of collateral, highlighting its role in providing secured creditors with priority rights and efficient enforcement methods in the event of debtor defaults.¹⁶⁰ Additionally, the limitations and considerations associated with relying solely on collateral as a protective mechanism are thoroughly examined.¹⁶¹

The narrative transitions to the utilization of mandatory insurance mechanisms as a safeguard against payment default risk. The detailed account underscores the proactive role of insurers in monitoring debtor company activities and the correlation between increased risk and higher insurance premiums. However, the considerable costs associated with this mechanism are also comprehensively addressed.¹⁶²

Furthermore, the text delves into the contractual arrangements between creditors and debtor companies, enabling creditors to nominate directors to the board in instances of disproportionate negotiating power. The significance of this provision in granting creditors representation within the governance structure of debtor companies and providing access to crucial operational insights is meticulously elaborated upon¹⁶³.

The discussion extends to the protective role of interest rates in mitigating credit-associated risks. A detailed examination of the risk assessment process precedes the determination of interest rates, showcasing the multifaceted components encompassed within this protective

¹⁵⁷ Supra note 36 Elis Tarell, *Basel ii and the Protection of Creditors in Company Law*, p. 48

¹⁵⁸ Ibid page 63

¹⁵⁹ Li, Xiao, *Corporate Governance in the Context of Corporate Restructuring*, Dissertation, University of Glasgow, [unpublished]

¹⁶⁰ Ibid page 65

¹⁶¹ Supra note 36 Elis Tarell, *Basel ii and the Protection of Creditors in Company Law*, p. 48

¹⁶² Ibid

¹⁶³ Ibid

mechanism.¹⁶⁴ Finally, the retention of title clause utilized by trade creditors as a self-help mechanism is intricately detailed, highlighting its specific relevance and applications within the creditor protection framework.

Another effective self-help mechanism for protecting corporate creditors involves the implementation of personal guarantees from the individuals controlling the debtor company¹⁶⁵ through this mechanism; creditors safeguard themselves from potential defaults by requesting guarantees from the company's shareholders or managers. In the event of the debtor company's failure to meet its debt obligations, the creditor has the option to take legal action against the company's controller, such as a shareholder or manager. An interesting aspect of this self-help mechanism is its ability to convey the financial stability of the debtor company to corporate creditors, potentially resulting in reduced interest rates for credit

2.3.3 Corporate creditors protection in the near of insolvency

The term vicinity of insolvency refers to a point of time called "zone of insolvency" to express the situation when the company is found in financial distress and may well be moving from solvency towards and even into insolvency¹⁶⁶. In the near of insolvency, the company's financial stability has become deteriorated to the extent that insolvency becomes imminent.¹⁶⁷ Consequently, the creditors' position in the company's liquidation will be affected by the director's acts¹⁶⁸. The important question at this juncture is what kind of protection creditors have in the time when a company is approaching insolvency and what duty is owed by directors of the company¹⁶⁹, in the vicinity of insolvency, it is common for many jurisdictions to impose creditor-regarding duties¹⁷⁰ on company directors¹⁷¹. These creditor-regarding duties are originally developed as a part of

¹⁶⁴ Ibid

¹⁶⁵ Ibid

¹⁶⁶ Andrew Keay, 'Company Directors' Responsibility to Creditors', p. 19

¹⁶⁷ Supra note 36 Elis Tarell, 'Basel II and the Protection of Creditors in Company Law', p. 95

¹⁶⁸ Ibid

¹⁶⁹ Andrew Keay 'The Shifting of Directors' Duties in the Vicinity of Insolvency' *International Insolvency Review*, 24 (2), 140-164. Available at, <https://doi.org/10.1002/iir.1236>, p. 2 (hereinafter Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency')

¹⁷⁰ Id, p.3

¹⁷¹ Ibid

common law and are now well covered under the Companies Act of 2006 and statutory provisions on wrongful and fraudulent trading found in the Insolvency Act 1986¹⁷²

A typical example of this is looking at section 214 of the UK's insolvency act 1986 which stipulation against wrongful trading. According to this provision, " if directors know or ought to conclude that there was no reasonable prospect of the company avoiding going into insolvent liquidation then unless they take every step to minimize the potential loss to creditors they will be personally liable to contribute to the company's losses if the company does end up in insolvent liquidation." Under this provision, while the company is an ongoing concern but directors continue trading regardless of financial difficulties, they will be liable for creditors. The law under art 214 it tries to impose an obligation on the director which is measured objectively and enforced by the liquidator on behalf of the creditor. Beyond that, wrongful trading remedy may only be instituted by the liquidator of the company and is applicable in the course of a winding up. But what is difficult under this provision is it is difficult for the liquidator to determine the point from which directors might be liable. According to Gautam Sundaresh, the point at which there is "no reasonable prospect that the company would avoid going into insolvent liquidation clearly arises much after a company can be said to have entered the zone of insolvency."¹⁷³

The other act which makes the director liable for creditor is the act on fraudulent trading. According to this act, if the director undertakes any kind of business of the company with the intention to defraud creditors, he will be personally responsible for the debts of the company¹⁷⁴ As far as the liability is concerned, a director who defraud creditor commits a criminal offense and can be made civilly liable¹⁷⁵. One thing that needs to be underlined here is that there is no individual action taken by a creditor against a company rather it is a collective type of remedy by

¹⁷² When we say creditor-regarding duties, it refers to a collective tool whereby creditors can be represented through a liquidator or an administrator acting on behalf of the company, see Natalia And reicheva, The role of legal capita rules in creditor protection, p. 42

¹⁷³ P L. Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency', 7 European Business Organization Law Review (2006) p. 301 at p. 309

¹⁷⁴ Natalia And reicheva, The Role of Legal Capita Rules in Creditor Protection, p. 42

¹⁷⁵ Gautam Sundaresh, in Whose Interests Should a Company Be Run? Fiduciary Duties of Directors during Corporate Failure in India': Looking to the West for Answers, 8 MICH BUS & ENTREPRENEURIAL L REV 291 (2019), Volume & Issue 2,

the liquidator who is acting in the interest of creditor¹⁷⁶ The basic difference between wrongful trading and fraudulent trading mainly lies in the burden of proof. Accordingly, in case of fraudulent trading, the intention of the director to defraud creditors needs to be proven whereas in the wrongful trading it is sufficient to prove that the director negligently decided to carry on trading at a time when there was no prospect of the company recovering¹⁷⁷. Hence, proving wrongful trading is much easier than that of fraudulent trading as fraud involves dishonesty which is a kind of opportunistic behavior that is difficult to prove.

¹⁷⁶ Maria Elena, *Fraudulent and Wrongful Trading*, p. 14 page 332

¹⁷⁷ Davies, *Introduction to Company Law*, p. 88

CHAPTER THREE

Creditor's protection under Ethiopia's one person private limited company: the law and its gap

3.1. Introduction

This chapter examines legal issues surrounding the protection of OPPLC's creditors as outlined in the New Commercial Code of Ethiopia. It will discuss both fundamental right of OPPLC's creditors and the inadequacies of the law in addressing protection of these rights. specifically addresses the rule of capital maintenance (i.e. reduction of capital, The minimum capital requirement and distribution dividend), Mandatory- disclosure, member qualification, director qualification, director specific duties and liability , disregard of corporate entities, change of member and adjustment of transaction, restriction use of company names, creditor contract based rules and insolvency rules.

3.2. OPPLC creditor protection and Gaps under the New Commercial Code of Ethiopia.

3.2.1 The rule of Capital Maintenance in OPPLC the law and Gap

In chapter two, we thoroughly analyze the Capital Maintenance rules, breaking them down into three categories: Minimum Capital Requirement, Reduction of Capital, and Distribution of Dividends. It will carefully examine how these rules apply to OPPLC within the context of the New Commercial Code of Ethiopia

3.2.1.1. Minimum Capital Requirement in Ethiopia Commercial Code for OPPLCs and its gap.

According to the New Ethiopian Commercial Code, the following minimum capital requirements apply to one person private limited companies (OPPLCs)

- The Minimum capital for an OPPLCs is 15,000 Ethiopian Birr¹⁷⁸
- The Unilateral declaration establishing the OPPLC must state the amount of capital and confirm that it has been fully paid up.¹⁷⁹

¹⁷⁸ Supra note 1 Ethiopian new commercial code Art 535

¹⁷⁹ Ibid Art 534 (3)

- The member is not personally liable for the Company's debts as long as he/she has fully paid the capital contribution¹⁸⁰

The concept of assets in New Commercial Code of Ethiopian revolves around the original shareholder contributions, including shared values, premiums, and reserves derived from company profits. These assets are vital in addressing creditor claims, as they represent the available resources to satisfy debts. It's important to note that creditors' recourse to shareholders is limited if the shareholders have fulfilled their promised contributions. However, there are noteworthy issues with the current New Commercial Code of Ethiopian.

One major concern is the nominal minimum capital requirement, which is set at 15,000 Ethiopian birr. This amount is deemed insufficient for providing support to companies in financial distress, as it can be withdrawn shortly after incorporation. The law only mandates a declaration that the capital is fully paid up, without an effective mechanism to verify actual contributions. This lack of oversight undermines the intended purpose of minimum capital requirements, making it easy for shareholders to evade liability. Another issue is the mismatch between the minimum capital requirement and the company's activities or associated risks. This discrepancy implies that the minimum capital may not effectively serve as a practical safeguard for creditors. Furthermore, the failure to account for inflation further reduces the effectiveness of this requirement, leaving creditors vulnerable during economic instability.¹⁸¹

In comparison to many Continental European jurisdictions, Ethiopian law's approach to defining assets and setting minimum capital requirements poses challenges for creditor protection. This is particularly noticeable when contrasted with common law countries like the UK, which do not impose such requirements on private companies as civil law legal system. These differences underscore the varying approaches to corporate governance and creditor protection. While public companies often face stringent capital requirements, private companies in Ethiopia may operate under significantly looser regulations, leading to increased risks for creditors.¹⁸² In conclusion, the challenges outlined in the New Commercial Code of Ethiopia regarding the definition of assets and the imposition of minimum capital requirements underscore an urgent need for a thorough reevaluation of the current laws. This reassessment is crucial in bolstering creditor

¹⁸⁰ Ibid Art 536 (2)(9)

¹⁸¹ Interview with Ato Adamu Sheferwe Senior Legal Attorney July 26 2024

¹⁸² Supra note 5 page 43

protection, ensuring that businesses are equipped with adequate resources to fulfill their financial obligations reliably. Furthermore, single-member companies in Ethiopia must operate within a stringent regulatory framework that prioritizes the interests of their creditors. By doing so, these businesses can function within a system meticulously designed to uphold financial stability and promote responsible practices, much like the regulatory environment established in France.

3.2.1.2. Reduction of capital

In Ethiopia, the law governing One Person Private Limited Companies (OPPLC) does not have a direct provision for reducing capital. However, Articles 545 and 527 (2) indicate that the rules for share companies under Articles 462-470 can indirectly apply to OPPLCs. According to these laws, the board of directors must submit proposals for a capital reduction to auditors at least fifteen days before an extraordinary general meeting is held to approve the reduction. The auditors will then provide their opinion at the meeting. After the capital reduction, the company must update the commercial register, publish the change in a widely circulated newspaper, and post it on the company website.¹⁸³

There are two types of capital reduction: one due to losses and one not based on losses.¹⁸⁴ The former deals with the reduction of capital, which can be done by lowering the par value of shares or exchanging old shares for a lesser number of shares. Shareholders with an insufficient number of shares for either acquisition or exchange must acquire more shares or sell their shares to another shareholder within the set period.¹⁸⁵ An extraordinary general meeting can authorize the reduction and compensate shareholders before any profit distribution.¹⁸⁶ Creditors holding preexisting rights must be paid or guaranteed before any reduction is adopted¹⁸⁷. If capital falls below the legal minimum due to losses, it must be increased within a year. Failure to do so may lead to company dissolution.¹⁸⁸

In the case of a reduction of capital not driven by shareholders, the capital must be maintained during a capital decrease¹⁸⁹. Creditors with claims before the resolution announcement can

¹⁸³ Supra note 1 Art 462-463

¹⁸⁴ Ibid Art 464

¹⁸⁵ Ibid Art 465

¹⁸⁶ Ibid Art 466

¹⁸⁷ Ibid Art 467

¹⁸⁸ Ibid Art 468

¹⁸⁹ Ibid Art 468

object to a capital reduction over 10% within three months. The court can dismiss objections or request payment guarantees. Capital reductions can only proceed after the objection period has passed.¹⁹⁰ The decision on capital reduction must be documented in the company's minutes within a month and posted on the website.¹⁹¹

In OPPLCs, like those in Ethiopia, efficient corporate management and strong regulatory oversight are challenging due to the lack of shareholder meetings or a separate board of directors, making it difficult to implement legal provisions regarding capital reduction. In the UK, directors must provide a solvency statement or seek court approval for such decisions to avoid liability. In Thailand, approval from members suffices. The experiences in different jurisdictions highlight the importance of proper management in OPPLCs to ensure legal compliance and financial stability.¹⁹²

Therefore, the absence of a robust corporate management framework, coupled with a weak formal regulatory system and institutions that prioritize creditor interests, particularly in contrast to the civil law legal framework found in countries like France, creates significant challenges for Ethiopians (OPPLCs). This situation results in a deficiency of essential checks and balances, which in turn undermines the capital reduction process. As a consequence, the rights and interests of creditors are adversely affected, leading to a precarious financial environment that lacks transparency and accountability.

3.2.1.3 Distribution of Dividend

The New Commercial Code of Ethiopia does not contain specific provisions that govern the distribution of dividends by One Person Private Limited Companies (OPPLCs). However, it is stated that receiving dividends in excess of the legally allowed maximum can lead to joint and several liabilities for shareholders. To address this issue, OPPLCs must follow the rules that are applicable to share companies as outlined in Articles 545 and 530 of the Code.

Regarding the legal framework for dividend distribution, dividends can only be distributed to shareholders from net profits as reflected in the approved balance sheet. Any distribution contrary to this regulation may result in both criminal and civil liabilities for the company

¹⁹⁰ Ibid Art 470

¹⁹¹ Ibid Art 471

¹⁹² Ibid Art 472

officials involved. The responsibility for deciding the methods of dividend distribution and the payment dates lies with the general meeting of shareholders, and the distribution must occur within four months following the resolution for profit distribution. Upon the establishment of the payment date,¹⁹³ shareholders become creditors for their due dividends, and unlawfully distributed dividends cannot be reclaimed.¹⁹⁴

After the balance sheet is approved, it must be submitted to the Ministry of Trade within thirty days and posted on the company's website¹⁹⁵. Importantly, the approval of the balance sheet does not absolve company officials of their liabilities, emphasizing the need for accountability.¹⁹⁶

The regulations surrounding dividend distribution are intended to protect third-party creditors of companies. However, enforcing these rules in OPPLCs is challenging due to the lack of a robust corporate management system and weak regulatory institutions. It is essential to safeguard the company's total assets and ensure that creditors can claim a portion of these assets by enforcing these regulations.

The New Commercial Code of Ethiopia introduces a distinctive approach to the distribution of dividends, notably stating that shareholders are generally not obligated to return dividends that have been distributed unlawfully. This rule particularly excludes specific scenarios, such as those involving family-owned businesses or cases where financial statements have not been properly adhered to. While this leniency may benefit shareholders by providing them with greater flexibility and protection, it raises significant concerns for creditors, whose financial interests could be jeopardized. Furthermore, the establishment of One Person Private Limited Companies (OPPLCs) under this same legislative framework has not adequately strengthened the safeguards for creditors. Key challenges persist, particularly regarding the enforcement of regulations governing dividend distributions. A considerable lack of effective regulatory oversight exacerbates these concerns, leaving creditors at risk and vulnerable to potential financial losses.

In this context, it becomes pertinent to consider whether the structure of Ethiopian one-member companies could align more closely with practices observed in other civil law jurisdictions, such as France. In such countries, the legal framework emphasizes stringent regulations and a codified

¹⁹³ Supra note And 438

¹⁹⁴ Ibid Art 439

¹⁹⁵ Ibid Art 441

¹⁹⁶ Ibid Art 440

legal approach, with a strong focus on protecting creditor interests. This comparison highlights significant gaps in the current Ethiopian framework and suggests that a reevaluation of creditor protection mechanisms may be necessary to ensure a more balanced and fair corporate environment.

3.2.2 Mandatory Disclosure

The New Commercial Code of Ethiopia has introduced specific disclosure requirements for One Person Private Limited Companies (OPPLCs) to promote transparency and accountability within the business environment. These requirements are crucial as they ensure that stakeholders, especially creditors, have access to reliable information about the company's operations and financial health. Disclosure requirements under the New Commercial Code of Ethiopia mandate OPPLCs to provide comprehensive unilateral declarations. These declarations must include information about the sole member, company details, appointed auditor, establishment specifications, and records of decisions made during general meetings.¹⁹⁷ Any changes to the company declaration must be registered within one month, and members can be held accountable for damages resulting from misleading information.¹⁹⁸ In a similar manner of interpretation, this regulation mandates that private limited companies and share companies disclose specific information.

In addition to general disclosure requirements, the Financial Reporting Proclamation No. 847/2018 requires OPPLCs to furnish comprehensive financial statements. These statements should encompass balance sheets, profit and loss accounts, and statements of changes in equity, cash flow statements, and explanatory notes. Compliance with International Accounting and Auditing Standards, including the International Financial Reporting Standards (IFRS), is also mandatory to ensure transparency and reliability in financial reporting. However, OPPLCs face practical challenges in fully adopting these standards due to factors such as weak regulatory institutions, lack of awareness, and limited expertise among company officials.¹⁹⁹

Accessibility of financial statements can be challenging for creditors, especially those located outside the capital city. The New Commercial Code of Ethiopia lacks specific disclosure

¹⁹⁷ Ibid Art 439

¹⁹⁸ Ibid Ant 542

¹⁹⁹ Interview with Amelewereke Mulu Ministry of trade Licensing desk head may, 27 2024 and with Ato Girma Belachwe Ethiopian Audit board expert June ,12 2024

provisions aimed at protecting creditors, creating challenges for them to assess potential risks associated with their investments in OPPLCs.²⁰⁰ While the New Commercial Code of Ethiopia aims to enhance transparency by requiring key disclosures from OPPLCs, there are notable challenges that undermine effective implementation and creditor protection. The lack of sufficient verification procedures and regulatory oversight can lead to misleading financial information, making it difficult for creditors to obtain reliable data. Furthermore, existing regulations do not compel shareholders to return unlawfully distributed dividends, except in specific cases involving family companies or non-compliance with balance sheet requirements. This mercifulness can further jeopardize creditors' interests.

Therefore, the New Commercial Code of Ethiopia sets forth vital disclosure requirements for (OPPLCs) that aim to promote transparency and accountability in the corporate sector. However, significant challenges persist in effectively implementing these requirements and safeguarding the interests of creditors. For instance, many civil law countries, such as France, have successfully established comprehensive financial reporting practices bolstered by modern technology. These rigorous standards play a crucial role in protecting the interests of creditors, ensuring that they have access to reliable and up-to-date information about the financial health of companies. To enhance the business environment in Ethiopia, it is essential to strengthen disclosure requirements further, improve regulatory oversight, and rigorously enforce international financial reporting standards. By addressing these critical gaps, Ethiopia can not only better protect the interests of creditors but also foster a climate of greater trust and stability within the corporate sector. Such efforts will contribute to a more robust and transparent economic landscape, encouraging investment and fostering sustainable growth.

3.2.3 Member Qualification

The New Commercial Code of Ethiopia under Article 536(2) outlines specific requirements for One Person Private Limited Companies (OPPLCs). These requirements aim to ensure transparency and accountability by mandating the inclusion of crucial information in unilateral declarations. This information includes the full name, nationality, and address of the sole

²⁰⁰ Ibid

member, as well as the name of a company nominee who will act on behalf of the member or their heirs in case of death, absence, or legal incapacity.²⁰¹

Comparing New Commercial Code of Ethiopian to those of Thailand concerning single-member companies reveals that Thai law offers stronger protections for creditors. For instance, the Thai Act explicitly prohibits juristic persons from establishing single-member companies to ensure limited liability against creditors and protect their interests.²⁰² Furthermore, Thai law imposes strict qualifications for individuals interested in forming single-member companies, barring incompetent individuals, those with a history of fraud convictions, and individuals under receivership. These measures protect against issues related to insolvency and debt and ensure that only qualified individuals operate single-member companies, thereby safeguarding creditors.²⁰³

In contrast, the Ethiopian legal framework for OPPLCs lacks specific qualifications for members and nominees, raising significant concerns about creditor protection and corporate governance. The absence of clear criteria may lead to individuals with questionable backgrounds exploiting the OPPLC structure, potentially resulting in fraudulent activities and financial mismanagement.²⁰⁴ The lack of safeguards in New Commercial Code of Ethiopian may increase the risk for creditors, as the absence of stringent member qualifications could allow unscrupulous individuals to operate companies without adequate oversight. Additionally, the OPPLC structure could be misused by individuals seeking to evade liability or engage in dishonest practices, jeopardizing the interests of creditors.

To address these gaps, it is vital for New Commercial Code of Ethiopian to introduce clear qualifications for members and nominees. These qualifications could include minimum age and competency requirements, restrictions based on criminal history, and provisions for individuals under receivership to protect against further insolvency issues.

In summary, the New Commercial Code of Ethiopia introduces important disclosure requirements for (OPPLCs), yet it does not sufficiently safeguard the interests of creditors when compared to the more robust regulations found in France and Thailand. One notable issue is the

²⁰¹ Supra note Art 536 (2)

²⁰² Supra note 5 page 76-77

²⁰³ Ibid

²⁰⁴ Ibid

lack of clearly defined qualifications for membership, which raises concerns about the competency and accountability of individuals involved in the management of these companies. Additionally, the absence of a strong regulatory framework further exacerbates this vulnerability, leaving creditor interests at risk. The strict member qualifications imposed by the code could inhibit not only effective corporate governance but also deter potential investment. To cultivate a more dependable business climate, Ethiopia needs to establish explicit qualifications and protective measures.

3.2.4 Director Qualification

The New Commercial Code of Ethiopia introduces a unique management structure for One Person Private Limited Companies (OPPLCs), deviating from traditional corporate governance models. Instead of a board of directors, the management of an OPPLC is entrusted to a General Manager, who can either be the sole member of the company or another appointed individual. This manager is given full authority to pursue the company's business objectives, similar to a manager in a Private Limited Company.²⁰⁵

The New Commercial Code outlines the role of the General Manager but doesn't specify qualifications for this position, raising concerns about corporate governance and creditor protection. In contrast, regulations governing share companies in Ethiopia require board members to meet specific qualifications regarding age, moral character, and criminal record. These qualifications are crucial for maintaining integrity and accountability within the management structure of Share Companies.²⁰⁶

It remains unclear whether the qualifications for share company directors can be applied to the General Managers of OPPLCs. This creates a potential loophole in the regulatory framework, allowing individuals without the necessary qualifications or integrity to manage OPPLCs. Comparing with Thai regulations, the Thai Single Member Company Act imposes strict qualifications on individuals who can serve as directors in single-member companies, prohibiting

²⁰⁵ Supra note 1 Art 545

²⁰⁶ Ibid Art 515

those with criminal records related to dishonest conduct and corruption.²⁰⁷ This approach safeguards creditors and enhances the stability and credibility of single-member companies.²⁰⁸

The absence of specific qualifications for General Managers in Ethiopian OPPLCs raises concerns about creditor protection. Without clear standards for managerial competence and integrity, there is a heightened risk of misuse of the OPPLC structure, potentially leading to fraudulent activities that jeopardize the interests of creditors. To address these concerns, Ethiopian lawmakers should consider establishing clear standards for the qualifications of General Managers in OPPLCs, drawing inspiration from the Thai model. Potential reforms could include setting minimum age and competency requirements, implementing criminal background checks, and preventing individuals under receivership from assuming managerial roles in OPPLCs.

The absence of defined qualifications for general managers in (OPPLCs) presents serious challenges to both creditor protection and effective corporate governance. Establishing well-defined standards that evaluate managerial competence and ethical integrity is essential. By drawing inspiration from successful practices implemented in other civil law jurisdictions, such as France and Thailand, Ethiopia can take significant strides toward safeguarding the interests of creditors. This approach not only aims to enhance accountability within corporate structures but also promotes sustainable economic growth throughout the nation. Implementing such standards will help create a more stable and transparent business environment, ultimately benefiting all stakeholders involved.

3.2.5 Directors Specific Duties and Liabilities.

Understanding the power and duty of an OPPLC Manager requires reading of the legal provisions for private limited companies and share Companies together.²⁰⁹ In a one-person private Limited Company in Ethiopia, the manager has the responsibility of company management in the absence of director; the general manager of private Limited company has powers and duties defined by the share company's law. If the company is managed by a board of directors, Specific provisions of share company apply to the manager's powers.

²⁰⁷ Supra note 5 page 66

²⁰⁸ Ibid Art

²⁰⁹ Supra note art 541(2)

The manager has the full authority to act on behalf of the company if there is no board of directors.²¹⁰ Except for restrictions in the memorandum, the manager can be held liable for any damages caused by a breach of duties.²¹¹ In a share company the general manager is appointed by the board of directors and is responsible for day to day management representing the company. In dealings, preparing budgets and managing employees.²¹²

Directors are responsible for managing finance, governance risk management, information provision, and ensuring company success. They must act in good faith for the benefit of shareholders and exercise independent judgment and diligence in their responsibilities²¹³ UK SMS law directors have duties to stakeholders promoting company success. They are also liable to creditors especially in cases of insolvency facing penalties for malpractices or wrongful trading. Furthermore, directors may be held accountable under tort law CCC for negligent harm intentional Creditor²¹⁴ Therefore according to the New Commercial Code of Ethiopia concerning OPPLC management of the company through manager the duties of the manager is not specified clearly

Thus, the new Commercial Code in Ethiopia introduces a general manager role for One Person Private Limited Companies (OPPLCs) but lacks provisions on specific duties and liabilities for these managers, especially concerning creditors. In contrast, the UK has comprehensive director duties under SME laws, promoting company success and protecting creditor interests. The concentrated power structure in OPPLCs, where the owner holds multiple roles, can lead to harmful decisions for creditors. To enhance creditor protection, Ethiopian lawmakers should introduce clear duties and liabilities for OPPLC managers, including acting in good faith, independent judgment, and penalties for malpractice. Aligning with international best practices will improve corporate governance and foster a stable business environment in Ethiopia

3.2.6 Corporate Veil Piercing

In chapter two the writer examined the legal concept of piercing the corporate veil, which involves disregarding the separation between a corporation and its shareholders. According to OPPLC, despite Article 534 Sub Article 3 of the code on the member's limited liability,

²¹⁰ Ibid Art 515

²¹¹ Ibid art 516

²¹² Ibid art 337-338

²¹³ Ibid art 315-318

²¹⁴ Supra note 227 page 86-87

individuals with control over one-person private limited companies can be held jointly and severally liable if they commit certain actions. Such actions include unlawfully jeopardizing the company's interests, mixing company assets with personal property, failing to maintain a separation between their own identity and the company's, providing misleading financial information, using company assets for personal gain without proper payment, and receiving excessive dividends, among other acts.²¹⁵

In the UK, cases of single-member companies have seen the application of piercing the corporate veil, such as when the company was created for fraudulent reasons or had inadequate capital. The court may decide to hold members personally liable for the company's debt, even though not specifically mandated for single-member companies. The doctrine is more likely to be applied due to the sole person's control and potential for misconduct.²¹⁶

In Ethiopia, where the management system is complex with both share companies and private limited companies, there are various issues related to the concept of piercing the corporate veil. It is necessary to include the company's objects clause in its memorandum, as failure to do so could lead to the company's dissolution and the imposition of provisional measures. There are also restrictions on the authority of company directors and managers, with legal significance placed on the doctrine of ultra vires in private commercial companies. The stringent requirements for amending the objects clause create a favorable environment for the application of the doctrine of ultra vires in Ethiopian commercial law.²¹⁷

This doctrine plays a crucial role in ensuring that companies adhere to their stated objectives, promoting the culture of incorporation in the country. However, there is a lack of clarity regarding the consequences of ultra vires acts by companies and their agents, leading to commercial uncertainty for shareholders and stakeholders. The country's commercial regime is criticized for not clearly defining the liability of company agents for such acts, particularly in cases where minority shareholders oppose changes to the company's objects. This issue is exacerbated in owner-managed private limited companies, where a single individual holds all roles within the company, giving them complete control. Overall, there is a need for clearer legal

²¹⁵ Supra note 1 art 543

²¹⁶ Supra note 5 page 86

²¹⁷ Ibid

guidelines to address the implications of ultra vires acts and protect the interests of all stakeholders in New Ethiopian Commercial Code specially OPPLCs laws ²¹⁸

The New Commercial Code of Ethiopia dealing with OPPLCs includes the provisions discussed above. This law aims at protecting creditors. However, enforcing this law can be challenging due to the requirements to prove intentional unlawful acts that harm the company or its creditors, such as asset mingling, failure to separate personal from company assets, misleading financial disclosures, personal benefit from company assets without proper compensation, and excessive dividend payments. These situations make it difficult to pierce the corporate veil of an OPPLC.²¹⁹

Therefore, in One Person Private Limited Companies (OPPLCs), piercing the corporate veil is crucial for accountability in Ethiopia. The Commercial Code holds individuals liable for actions that harm the company's interests, like mixing personal and company assets. However, complexities in Ethiopian commercial law, such as unclear consequences of ultra vires acts, create challenges. These issues and proving intentional wrongdoing hinder creditors from holding individuals responsible for corporate misconduct. Clear legal guidelines are needed to strengthen creditor protection and promote accountable governance.

3.2.7 Change of Members

The Commercial Code of Ethiopia lacks specific provisions for changing members within One-Person Private Limited Companies (OPPLCs), instead referring to regulations for Private Limited Companies (PLCs) under Art 545 of the OPPLC. The code requires any transfer of shares to be documented in writing and recorded in the share register to be valid. In the absence of restrictions in the memorandum of association, shares can be freely transferred among members. However, before selling shares to an external party, the offering member must disclose the price to other members and offer them the right of first refusal under the same conditions. If existing shareholders do not accept the offer within 15 days, the member may proceed with the external offer.²²⁰ Share transfers outside the company require approval from members holding at

²¹⁸ Ibid

²¹⁹ Ibid

²²⁰ Supra note 1 Art 508

least three-quarters of the capital, unless specified otherwise in the memorandum of association.²²¹

When execution is levied on a member's share in a company, the process of admitting an external party as a new member requires majority approval from existing members. If the majority does not consent, the share can be transferred to another member or purchased by the company itself, with the payment potentially coming from capital if there are no distributable reserves. This action results in a reduction of capital, which imposes joint and several liabilities on the shareholders for obligations incurred by the company before this reduction.

The implications of this process are significant. If the company ends up with more than one member due to the admission of a new member or the transfer of shares, it transitions from being a single-member company to a multi-member company. This change alters the legal and operational dynamics of the organization, particularly in terms of liability and governance.

In a single-member company, the sole member enjoys a unique set of rights and responsibilities, including simplified decision-making and liability structures. Transitioning to a multi-member company introduces complexities such as the necessity for consensus among members on various matters, the potential dilution of control for the original member, and the need for more formal governance structures. Additionally, the increased number of members could affect the company's tax status and regulatory obligations, as different jurisdictions may have specific rules governing multi-member entities compared to single-member ones.

Ultimately, this shift not only affects the internal structure of the company but also its external relationships, particularly with creditors and regulatory bodies, as the liabilities and obligations become shared among a larger group of individuals. The text thoroughly outlines the devolution of shares in the case of a member's passing, the requirements for share certificates, and the regulations regarding the register of shareholders. It also discusses the conditions under which a company can purchase its own shares from shareholders and the possible implications for creditors.²²²

Moreover, the passage examines the complexities of membership changes within One Person Private Limited Company (OPPLC), emphasizing the challenges associated with conducting

²²¹ Ibid Art 509

²²² Ibid Art 511 and Art 512

these procedures, given that only the member has the authority to approve or oppose share and membership transfers. This lack of oversight may potentially impact creditors, as ownership changes could transpire without their involvement. The passage also highlights the absence of explicit creditor protections if an OPPLC transitions to a multi-member structure, raising concerns about potential implications for creditor interests. It stresses the need for regulations mandating notification of creditors before any changes in membership occur within OPPLCs, to ensure transparency and safeguard creditor interests.

The absence of specific guidelines on membership changes in the New Commercial Code of Ethiopia underscores the necessity of establishing clear regulations to address this complexity and ensure transparency and creditor protection within OPPLCs.

3.2.8 Adjustment of Transaction

The New Commercial Code of Ethiopia focuses on addressing the issue of transactions in the context of One Person Private Limited Companies (OPPLCs), with a specific emphasis on preventing the deliberate release of misleading information about a company's financial status that could potentially harm creditors.²²³ While the direct law related to the adjustment of these transactions is not clearly outlined, there are provisions in place that aim to prevent such misleading practices.

When compared to other jurisdictions such as the UK and Thailand, it becomes evident that there are mechanisms in place to protect creditors from vulnerable transactions. In the UK, parties can petition the court to restore assets or protect victims of undervalued transactions. Similarly, Thai law allows creditors to seek the cancellation of transactions aimed at prejudicing them, especially in cases of insolvency or bankruptcy. Both the UK and Thai laws provide remedies for adjusting undervalued transactions and preferences to safeguard creditors' rights.²²⁴

It is essential for the New Commercial Code of Ethiopia to be amended to incorporate similar protections for creditors, reflecting the practices and remedies seen in the UK and Thailand. By enhancing creditor protection through relevant laws and regulations, single-member companies in Ethiopia can be held accountable for engaging in transactions that unfairly disadvantage

²²³ Ibid art 543 (4)

²²⁴ Supra note 5 page 86-87

creditors.²²⁵ Ultimately, these changes will serve the overall integrity and fairness of the New Commercial Code of Ethiopia. Therefore, it's important to introduce amendments to the Code to offer similar creditor protections, promoting fairness and transparency for investors and creditors.

3.2.9 Restriction use of Company Name

In chapter two of this paper, the discussion revolves around the potential impact of re-using Company names post-dissolution on creditor interests. The new commercial code of Ethiopia addresses one person private company (OPPLCs) by requiring the inclusion of member details such as name, nationality and address.²²⁶ However, there is ambiguity regarding the prohibition of re-using company names placed with no explicit restriction in place.

Comparative experiences from countries like the UK and Thailand highlight measures such as prohibiting individual who served as directors within 12-months before a company's insolvent liquidation from using similar name for a new business for five years. Failure to comply can result in personal liability for the debts of the former company. These provisions aim to combat the issue of phoenix Syndrome where individuals evade liabilities by letting a company go insolvent and subsequently starting a new one with a similar name and assets, leaving Creditors unable to recover their dues.²²⁷ Therefore, the New Commercial Code of Ethiopia does not have specific rules on reusing company names after dissolution, potentially risking creditors. In contrast, countries like the UK and Thailand prevent such practices to protect creditors and improve business integrity. To enhance Ethiopia's business environment and deter fraud, clear restrictions on reusing company names should be included in the New Commercial Code of Ethiopia, aligning with international standards.

3.3 Self-help mechanism Creditor Protection

The New Commercial Code of Ethiopia does not directly address contractual creditor protection but indirectly relates to it by prohibiting actions that could harm the interests of the company or its creditors. Action such as mixing company assets with personal property or failing Company

²²⁵ Ibid page 96

²²⁶ Supra note 1 art 536 (2) (b)

²²⁷ Supra note 227 page 58-59

to distinguish between the company and its owner²²⁸ can adversely affect creditors, however creditors can protect their right through Contractual agreements.

In Ethiopia, the securities law provides strong protection for corporate creditors including recognition of various types of securities such as mortgages²²⁹, pledges²³⁰ and business shares²³¹. Registration of securities is rigorously required to²³² safeguard creditors interest's priority right of secured creditors in asset enforcement and distribution are guaranteed, with mechanism like public auctions for selling mortgaged proper ties or businesses.²³³

3.4 Creditor Protection through Insolvency rule

The New Commercial Code of Ethiopia primarily focuses on corporate bankruptcy law aiming to protect the interest of corporate creditors during insolvency proceedings²³⁴. The main objective is to safeguard the legitimate interests of creditors, with priority on maximizing the value of the debtor's assets for creditor's recovery the law prohibits actions that compromise creditors interests without majority approval In addition, the law emphasizes the timely and efficient liquidation of the debtor's business to enhance recovery prospects for creditors²³⁵

Furthermore the law allows for the establishment of a creditors' committee to oversee proceedings and ensure creditor have a say in activities and information sharing. It guarantees.. equitable participation in distributing not proceeds from debtors assets and establishes rules for priority ranking of creditors' claims secured creditors have preferential right to realize proceeds from security protecting all creditors interests²³⁶

Nevertheless, the New Commercial Code of Ethiopia also addresses the dissolution of companies without liquidations particularly for one person private limited companies. All assets are assigned to the member upon dissolution if debts are settled but the member becomes person all

²²⁸ Supra note 1 art 545

²²⁹ Civil code of Ethiopia 1960 art 3041

²³⁰ Ibid art 2825

²³¹ Ibid art 329

²³² Ibid art 143-44, 122,42 art 3052-58 3118,1186 1193 22 67 (2), 171-75 178-86 1006 1007

²³³ Supra note 1 art 705-825

²³⁴ Supra note 1 art 705-825

²³⁵ Ibid

²³⁶ Ibid

liable for post-dissolution creditors within a specified time frame. The member can choose liquidation if preferred²³⁷ while the Ethiopian OPPLC laws does not emphasize creditor right other Countries like the UK prioritize creditors' interest during insolvency with directors' duties shifting to protect claims secured creditors have greater control and protection while unsecured creditors have limited rights. In Germany secured creditor have substantial control in restricting while in France court control prevails prioritizing certain claims over others.²³⁸

In summary, creditor protection in insolvency proceeding varies by country with the level of protection corresponding to the rights provided strong creditor rights enhance protection while weaker right lessen it. The goal of insolvency law is to minimize losses for creditors and ensure a fair distribution of assets in company dissolution case.

²³⁷ Ibid art 544

²³⁸ Supra note 122 page 48-50

CHAPTER FOUR

4. Conclusion and Recommendation

4.1 Conclusions

The concept of a one-person private limited company in the United Kingdom presents a unique legal entity with implications for creditors' rights and protections. The challenges in governance and control raise concerns about potential conflicts of interest and the impact on the rights of creditors, employees, and business partners. It is crucial to address these concerns by implementing improved governance structures and accountability measures to ensure a fair and transparent environment for all stakeholders involved in single member companies. Understanding the categories of corporate creditors, such as secured versus unsecured, voluntary versus involuntary, and the distinctions between public and private company creditors, is essential for assessing risks and implementing appropriate safeguards to protect creditor rights and interests in the face of corporate insolvency. The multifaceted issue of creditor protection in corporate law is effectively addressed through debtor control rules/statutory mechanisms, creditors' contracts-based rules, and insolvency laws, each contributing to safeguarding creditors' rights in different financial arrangements.

Furthermore, the analysis of creditor protection under the New Commercial Code of Ethiopia reveals significant gaps and complexities, emphasizing the need for clearer guidelines and stronger protections to ensure fair treatment of creditors. By prioritizing creditor rights and ensuring equitable treatment in insolvency proceedings, the legal framework can contribute to the overall stability and trust in corporate governance, benefiting both creditors and companies alike.

4.2 Recommendation

- Increase the minimum amount of money that must be invested to start a business to account for the various financial risks involved in different types of businesses. Consider industry standards and inflation when setting this amount, so it stays relevant over time.
- Make it mandatory for businesses to have their financial contributions audited by an independent party when they start and regularly after that to make sure the money is available to pay back loans if the business fails.

- Have different minimum investment amounts depending on the type and size of the business to make sure they have enough money to operate.
- Create rules about reducing the amount of money a business has invested, requiring a detailed check of their financial health and ways to protect the people and companies they owe money to.
- Set up a formal system for making decisions and keeping records for businesses, and have an independent person check their finances to be sure they are following the rules.
- Have stricter rules about when a business can pay out profits to its owners, making sure the business is financially healthy and that they can take back any profits paid out illegally to protect the people and companies they owe money to.
- Offer training and information campaigns to teach business owners and creditors about their rights and responsibilities under the New Commercial Code, so they better understand the rules about keeping enough money invested in their businesses.
- To improve transparency, we should require companies to provide detailed financial statements, management discussions, and risk assessments. This should go beyond just balance sheets and profit and loss accounts to include cash flow statements, changes in equity, and explanatory notes.
- Make sure that external auditors regularly check for compliance with reporting standards and identify any issues early. Companies should upload these documents to a central online platform accessible to creditors and the public. They should also promptly publish any major changes in newspapers and on their websites.
- Offer training on financial transparency and disclosure requirements, and enforce consequences for false financial information. Additionally, we should form advisory committees with representatives from creditor groups, regulatory bodies, and business associations to provide feedback on disclosure practices and propose improvements
- To be eligible to start an OPPLC, one must be at least a certain age, have the legal capacity to enter into contracts, and have a clean criminal record. Rules for choosing people to lead OPPLCs should include background checks and qualifications to make sure leaders are

capable. Members need to tell creditors about their financial history and any past business failures so that creditors can make informed decisions. We should have regular reviews of members' qualifications and activities, like requiring them to submit reports each year. Authorities should have the power to watch over and make sure everyone follows the rules, possibly by getting more resources for inspections. Teaching programs for people who might want to start an OPPLC about their responsibilities and legal consequences would help people know and do the right thing.

- Managers at OPPLC must meet specific qualifications, including being of a certain age, having a good character, and having a clean criminal record without any fraud or theft convictions. Individuals who have been declared insolvent or have a history of fraud cannot take on managerial roles to ensure responsible leadership. Nomination guidelines should include background checks to choose capable and trustworthy nominees to protect the interests of creditors. Managers must disclose their financial history and past failures to creditors for transparency. Annual reports on legal status and financial changes should be implemented to review qualifications and business activities periodically. Regulatory bodies need to be strengthened to monitor compliance with manager requirements, possibly through increased inspections. Educational programs should be offered to potential managers to educate them on their responsibilities and legal obligations, emphasizing the importance of maintaining a positive reputation.
- To better protect creditors, we propose expanding the grounds for piercing the corporate veil to include situations like having too little money in the business, moving assets dishonestly, and using the company for illegal purposes.
- Explicit rules are needed for change of members in OPPLCs, including transferring shares, required documents, and approval timelines. These rules should include a clear definition of a "transfer" and when it can happen. OPPLCs must inform creditors in writing before any membership changes, giving details about the new member, transfer, and potential financial impacts.
- The rights of heirs and successors, if a member dies, should be explained, including share transfer processes and obligations towards existing debts. Rules for moving from single-member to multi-member structures need to be set, explaining existing creditors' rights and obligations during this change. Government bodies should monitor membership changes in OPPLCs and ensure compliance, with possible audits and penalties for not following the

rules. Guides and workshops should be made for OPPLC members and creditors to explain the new rules, rights, and how membership changes work, promoting following the rules and transparency.

- Amend the Commercial Code to include rules that allow creditors to ask the court to change transactions that are undervalued, fraudulent, or harmful to creditors. Create ways for creditors to question deals that hurt those, including changing undervalued deals. Set rules for finding undervalued deals and show all important deals in financial statements. Make sure OPPLCs act in the best interests of the company and creditors, with punishments for not doing so. Give regulatory bodies the power to watch and look into deals and punish anyone who doesn't follow the rules. Make educational programs for creditors and OPPLC members about their rights and how to deal with deals that are not clear, through workshops and online resources.
- To prevent individuals who previously served as directors or managers of insolvent companies from using the same or similar company name for a set period, such as five years, a new law should be introduced. This is to stop the Phoenix syndrome.
- Make it easier for creditors to take action if a borrower doesn't pay. Speed up the process of registering securities online. Set rules for how to take and sell assets if a borrower doesn't pay. Create a fund to help creditors if a borrower doesn't pay.
- Make the Commercial Code easier to understand by clearly stating the rights and duties of lenders in bankruptcy cases.

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