



ADDIS ABABA UNIVERSITY

COLLEGE OF LAW AND GOVERNANCE

SCHOOL OF GRADUATE STUDIES

SCHOOL OF LAW

**LEGAL IMPLICATIONS OF INTRODUCING ONE MEMBER
PRIVATE LIMITED COMPANY IN ETHIOPIA**

BY: ANDENET DENBERU

ADVISOR: MR. FIKADU P. (Asst. Prof)

SEPTEMBER, 2022

ADDIS ABABA, ETHIOPIA

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Approval sheet

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BY

ANDENET DENBERU

Approved by:

_____	_____	_____
Advisor's Name	Signature	Date
_____	_____	_____
Examiner/Reader's Name	Signature	Date
_____	_____	_____
Examiner/Reader's Name	Signature	Date

DECLARATION

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

Declared By:

Name: Andenet Denberu

Signature: _____

Date: _____

Confirmed By:

Name: Fekadu Petros (Ass. Professor)

Signature: _____

Date: _____

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ACRONYMS AND ABBREVIATIONS

AG (AktG)	Aktiengesellschaft German Stock Corporation
BGB	German Civil Code
GmbH	Gesellschaft Mit Beschränkter Haftung, German Private Limited Company
PLCs	Private Limited Companies
SMCs	Single Member Companies
SMPLCs	Single Member Private Limited Companies
UK	United Kingdom

ABSTRACT

The one member company plays an increasingly important role in the modern age of commerce in which small companies proliferate. The advantage of limited liability and possible preferential tax treatment and loan facilities makes the company attractive for small business. The revised commercial code that entered into force in 2021 has reformist provisions mostly on company law. One of the most significant provisions which are novel for Ethiopia company law is with respect to one Member Company. The new commercial code allows the establishment of one Member Company in the form of private limited company. This gives wider latitude to investors in that he gets another venue to choose and also can begin business without waiting others to participate in. This research tried to assess the legal implication of introducing one member private limited company in Ethiopia. Based on the unique characteristics of one Member Company, this paper critically analysis the challenges in transition from sole proprietorship to one Member Company. The study also critically examined, whether the provision governing a one member company is sufficient to protect third party creditors by taking international best practices into account. To do this, the writer employed doctrinal legal research method by analyzing the new commercial code of Ethiopia, the federal income tax proclamation no. 979/2016 and FDRE constitution. Based on this, the study identifies as there is a challenge in transition from sole proprietorship to one Member Company from both taxation perspective and procedural complexities. Besides, based on the unique characteristics of this company type, mandatory disclosure requirements are not sufficiently provided in the new commercial code to protect creditors. Thus, the writer recommended that the law maker need to amend some provisions and also incorporate new provisions in the commercial code so as to enhance creditors protection.

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

The development of one Member Company is very much linked with the historical development of companies in general. In one way or another, countries had seriously considered the pros and cons of this form of business in their attempt to come up with the legal and institutional frame works together with ordinary companies. In almost all countries, history shows that its inclusion as part of company law had been out rightly rejected by their respective legislatures because company was conceived to be maintained and pursued by two or more natural or artificial persons.¹ True, it was considered that the term company presupposes plurality of persons. But:

Whatever difficulty etymologists may have in considering one member company or corporation to the jurist the sole stock holder is not a conceptual impossibility, at least so long as the jurist thinks in terms of the function of the corporate device in a given socioeconomic order rather than in terms of essential and eternal nature of corporation.²

Even though historically one Member Corporation was not, therefore, intellectually conceived and was considered as an abuse of, and incompatible to, the very concept of company law in general, latter this belief had gradually eroded. A single member company was supported by many jurists and writers in different countries despite the fact that their earlier attempts to recognize it in the first place were not historically warmly wellcome.

In fact, single member companies are not a new concept. Many sole proprietors who want to limit their liabilities in order to reduce their risks in operating the business incorporate a company by providing a tiny number of shares for nominees to meet the minimum requirement of the number of shareholders. These nominees are usually people who have a close relationship with the proprietor, such as wife, parent or child. This means that they must be people the

¹Mario Rotondi, 'Limited Liability of the Individual Trader: One Man company or commercial foundation' (1973-1974) 48 Tulane Law Review 989 -996.

²Jules Silk, 'One Man Corporation: scope and Limitations' (1952) 100 University of Pennsylvania Law Review 853.

proprietor can truly rely on not to cause damage to him. This type of enterprise could be called a “single member company *de facto*”, which is deemed to be a legitimate business organization. The requirement of a minimum number of shareholders has become less significant due to the development of the concept related to company law. Various jurisdictions can find no reason to stipulate the minimum number of shareholder because it tends to obstruct the growth of business and the economy as a whole.³

These problem reflects that it is inappropriate to impose the law on this issues in the current climate. Therefore, various jurisdictions have decided to recognize the concept of single member company or allow sole proprietors of business to limit their liabilities in order to reduce the aforementioned difficulties. Ethiopia is no exception and single member company is introduced in the Ethiopian legal system by the new Ethiopian commercial code that allows the establishment in the form of private limited company.

The consequences of incorporating companies are that the legal entity of the company will be separated from the sole member. There are several matters to be considered due to the adoption of this concept from a legal perspective. The distinguishing characteristics of this type of company will inevitably affect the legal principle of multi member companies, such as the limited liability members, the separate legal entity and the separation of ownership and management of the company.

Based on the hybrid characteristics of single member company, i.e while its characteristics are similar to those of sole proprietorship, it consists of a single person and the company’s existence totally depends on that person. This sole member has the same advantage as member of multi-member companies, but the company has a separate entity so that the member is able to limit his liability to the extent of his personal funds. This hybrid characteristics is problematic for creditors who engage in business transaction with single member companies because they fear that their right will be affected.

Different from multi-member companies, there are no other shareholders interests to be considered in single member companies; however, the creditors tend to be the ones who suffer

³Assamen M.Tessema, ‘comparative Single Member companies of Germany, France and England: A recommendation to Ethiopia’ (LLM thesis, 2012) ‘<http://ssrn.com/abstract=2193070>’. Accessed 3 April 2022.

from the consequences of any inappropriate conduct. Thus it could be said that the special characteristics of single member company could expose creditors who engage in business transaction with it to a greater risk.

Based on the realization of this indisputable problem, the focus of this thesis will be the legal implication of introduction of one Member Company in Ethiopia.

1.2. Statement of the Problem and Question

The one member company plays an increasingly important role in the modern age of commerce in which small companies proliferate.⁴The advantage of limited liability and possible preferential tax treatment and loan facilities makes the company an attractive business vehicle for small business.⁵This form of company shares some characteristics from both sole proprietorship and ordinary companies.⁶ Despite the many advantage of single member company, they also carry potential risks (problems). The following are some of the major ones:

- Creditors of a company may not be adequately protected as the law does not provide sufficient safeguarding mechanisms with respect to the fully paid up capital. It may also include the circumstance under which a corporate capital may be used for private purpose and the company may be established to defraud creditors.
- Sole shareholder may commingle the property of the company with those of his personal ones and create risk to creditors.
- While converting sole proprietorship into one Member Company, there may be a challenges and uncertainties.

Based on the above problems, the study tries to address (research questions);

- What are the basic characteristics that distinguish one member company from sole proprietorship?
- Whether the provision governing a one member company is sufficient to protect third party creditors?

⁴ Andrew Hicks & S.H. Goo, Cases and Materials on company Law (5thedn, Oxford university Press 2004)8

⁵ Ibid 203

⁶Assemen M. Tessema (n 3) 6

- What are the possible challenges from transition of the sole proprietorship into one Member Company?

1.3. Objective of the Study

The general objective of this research is to assess the legal implication of introducing one member company in Ethiopia company law taking the new commercial code and international best practice in to account. Within this general objective, the research has the following specific objectives:

- To detect out gaps of local provisions concerning protection of third party creditors and recommend solution.
- To examine the challenges in transition from sole proprietorship into one member company and recommend solution.

1.4. Significance of the Study

The study focus on the legal implications introduction of one Member Company and recommended solutions. Hence, it will add to the existing Ethiopia's corporate law literature that is emerging recently.

It will also have certain contributions for the legislative body, lawyers and the judges, in creating awareness, and for those who interested to invest in the area of one member private limited companies. The research will also serve as a basis and may call the attention of those who want to further research in the field. Finally, it may serve as a reference material in academic sphere.

1.5. Scope of the Study

The new Ethiopia commercial code entered into force in April 2021 has reformist provision mostly on company law. One of the most significance provisions which are novel for Ethiopian company law is with respect to one Member Company. The study delimited its scope to the legal implication of introduction of one Member Company in Ethiopia. In particular, the study focuses on challenges in transition from sole proprietorship to one member company and creditors protection in one Member Company. The experience of some selected foreign countries

jurisdiction will be analyzed for the purpose of comparisons. Consequently, the laws of United Kingdom and Germany were made part of the study.

1.6. Methodology of the Study

Regarding the methodology, qualitative method is employed for this study. To this end, both primary and secondary sources are used. As a primary source, an intense analysis will be carried out on the new commercial code provision and other laws that have to do directly or indirectly with the applicability of the legal principles of One Member Company. The study relies on secondary sources such as books, journal, unpublished materials and internet sources to review the conceptual basis of legal principles that deal with One Member Company. Finally comparative and analytical approach will be employed in the study.

1.7. Literature Review

A preliminary literature review in Ethiopia shows that this study, the legal implication of introduction one member company in the Ethiopian law, is the first of its kind. Related prior studies focused on the introduction of one Member Company to the Ethiopian legal system. Accordingly, it would be not easy to find adequate published legal researches or documents except for few unpublished works. The undergraduate work conducted by Zelalem Teka tries to examine the desirability of single member company in Ethiopia.⁷ This paper , though not full-fledged enough to address the theoretical bottleneck associated with one member company, has attempted to suggest and comment on some basic provisions of the commercial code of 1960 that are applicable to single member company.

Assamen M.Tessema⁸ addresses the issue related to comparative single member companies of Germany, France and England and has tried to recommend the recognition of SMC in Ethiopia by putting its relevance to the Ethiopian legal system. Assamen in his research examines Ethiopians company law with reference to the formation requirement, management, supervision, dissolution and winding up of single member companies in England, France and Germany. He

⁷ Zelalem Teka, 'The Desirability of Single Member Companies in Ethiopia and the Need to Reform our company Law' (Unpublished LLB senior essay, Addis Ababa University 2006)

⁸ Assamen M.Tessema (n 3)

argues that, its disadvantage do not introduce unique problems not experienced before. But its incorporation brings many advantage to the country.

Jetu Edosa⁹ on the other hand, in his unpublished work titled introducing single member companies in Ethiopia, major theoretical and legal considerations, compare major legal frameworks governing single member companies in comparative jurisdiction to show the legal and theoretical implications of introducing single member companies in to the Ethiopian corporate legal system. He also forwards the best practice of comparative jurisdiction on how they tried to regulate SMCs, focusing on areas of concern as a window of option for the Ethiopia legislator.

Finally, the writer forwards list of recommendations for the legislators to amend certain provisions of the commercial code (of 1960) that contradict with the existence of PLC having a single member and to introduce additional provision that address the concern of SMC in order to protect creditors right. All of them, however, do not deal in their study about the new commercial code of Ethiopia. In this research the writer address the legal implication introduction one member company in Ethiopia and relate these with the absence of sufficient provision and protection mechanism for third part creditors. In addition to this writer raises the necessity of having sufficient provision and protection mechanism in the newly adopted commercial code of Ethiopia.

1.8. Limitation of the Study

The concept of one Member Company did not get full attention by legal scholars in Ethiopia. Accordingly, it would be not easy to find adequate published legal researches or documents except for few unpublished works.

1.9. Organization of the Study

The study has five chapters. The first chapter comprises the proposal of the research. It encompasses background of the study, statement of the problem and question, objective of the

⁹Jetu Edosa Chewaka, 'Introducing Single member companies in Ethiopia: Major Theoretical and Legal Considerations' (unpublished LLM thesis, Addis Ababa University 2014)

study, significance of the study, scope of the study, methodology, literature review, and limitation of the study and organization of the study.

The second chapter deals with the Nature and Formation of One Member Company. Moreover, this chapter assess about the concept, historical background and benefit of one Member Company. Finally challenges in transition from sole proprietorship to one Member Company will be addressed in this chapter.

The third chapter presents creditors protection in one Member Company in comparative jurisdiction. The fourth chapter addresses about creditor protection in one member private limited company under Ethiopian law. The final chapter presents conclusion and recommendation of the study.

CHAPTER TWO

NATURE AND FORMATION OF ONE MEMBER COMPANY

2.1. Concept of One Member Company¹⁰

The term ‘company’ is derived from the latin word com “with or together” panis “bread”, which means people who get together to break bread.¹¹ As such, company is “a corporation” that carries on a commercial or industrial activity.¹² Corporation is described as “.... A body of bodies; technically, an artificial person composed of natural persons.... From the point of view of legal relationship it has group interest more or less distinguishable from the individual interest of its individual members”.¹³ This takes into account the fact that a corporation comes into legal existence if two or more persons enters into a corporate contract and it shows the separate existence of a company from its members.

However, “one member company” is a company formed by a single shareholder. Throughout the historical development of company law, question regarding minimum number of members for company incorporation had been discussed and answered differently. For a long time, the concept of one Member Company had been found an oxymoron in itself due to the above mentioned etymological meaning of the concept. Hence, general opinion of the doctrine was inclined to accept more than one founder for a company.¹⁴ However, “the use of the term company, in the context of one member shareholder, is contrary to the traditional conception since the term “company” refers a plurality of persons”.¹⁵ But the traditional conception has its own irrationalities by ignoring realities for symbolism. Some companies are in effect single member companies given their effective ownership by a single shareholder bar symbolic

¹⁰ It is a prerequisite that meaning and boarder of concepts must be explained sufficiently: A one member company is a type of corporate body that have been adopted by various jurisdiction in different names, such as one person company/corporation, one man company, single member limited liability corporation and others. These terms may be used interchangeably in this research. One member company is preferred as a topic of the research, because it is commonly used in the new commercial code of Ethiopia.

¹¹ Online etymology dictionary <<http://www.etym-online.com>> accessed 3 December 2022.

¹² Black’s law dictionary (8th edn, 2004) 846

¹³ Harry G. Henn and john R. Alexander, Law of corporation (3rd edn, west publishing co.,1983) 145

¹⁴ Salih Tayfun ince, ‘A legal effect of European union’s business law’ (1st Law and political science conference, Vienna, August 2017) 20

¹⁵ Thomas Earl Geu, ‘Understanding the limited liability company: A basic comparative primer’ (1992) 37 South Dakota law Review 48. See also jetu (n 9) 13

ownership of shares by the other members. It is, therefore, perhaps timely to revisit the case of Salomon Vs Salomon & co. Ltd.¹⁶

It is said that the respondent company is a one man company and that in this respect it differs from such (ordinary) companies as those to which I have alluded. But it has often happened that a business transferred to a joint stock company has been the property of three or four persons only, and that the other subscribers of the memorandum have been clerks or other persons who possessed little or no interest in the concern. I am unable to see how it can be lawful for three or four or six persons to form a company for the purpose of employing their capital in trading, with the benefit of limited liability, and not for one person to do so, provide, in each case, the requirement of the statute have been complied with and the company has been validly constituted. How does it concern the creditor whether the capital of the company is owned by seven persons in equal shares, with the right to an equal share of the profit, or whether it is almost entirely owned by one person, who practically takes the whole of the profit?¹⁷

Similarly, E.R. Latty stated that:

There is no magic in number and there is no public policy which says that three men may limit their liability and acquire legal personality different from their individual personality, but that one man.... Cannot.¹⁸

This rule regarding the minimum number of shareholders has been opposed by several legal scholars and courts in many jurisdictions, since they find that the imposition of these criteria is unnecessary. It is questionable why shareholders in multi-member companies are able to limit

¹⁶ In the judgment at first instance, the court of Appeal and the house of lords there were differences of opinion expressed as the weather Salomon's case was concerned with a one person company where salomon was the only 'real' shareholder and the other family members were contrived nominees, or instead a partnership type of company where provision was made for share ownership by the children of the company's founder. See Phillip Lipton, 'The mythology of Salomon's case and the law Dealing With the Tort liabilities of corporate group: An historical perspective' (2014) 40 Monash university law review 453

¹⁷ Bernard F. Cataldo, 'Limited Liability with One- Man companies and subsidiary Corporations' (1953) 18 Duke University School of Law 473

¹⁸ E.R. Latty, 'A conceptualist Tangle and the One or Two man Company' (1955-1956) 34 North Carolina Law review 477

their liabilities, while this advantage is withheld from sole trader. Due to the decline of the idea regarding the minimum number of shareholders in company law, the concept of one member companies has been explicitly recognized in the statutory law of various jurisdictions to reflect the actual circumstance in modern company law.¹⁹

Generally, to understand its idiosyncratic character, the best way in defining one member company is comparing it with some closed business vehicles: ordinary company and sole proprietorship.

2.2. Historical Background of One Member Company

The historical development of one Member Company is very much related with the development of companies in general. Countries had seriously considered the advantage and disadvantage of this form of business in their attempt to come up with the legal and institutional framework together with ordinary companies. History shows that its incorporation as part of company law had been out rightly rejected by their respective legislatures because company was conceived to be maintained and pursued by two or more natural or artificial persons.²⁰ Even though historically one member company was not, therefore, intellectually conceived and was considered an abuse of, and in compatible to, the very concept of company law in general, latter this belief had been gradually eroded.²¹ One member company was supported by many jurists and writers in different countries despite the fact that their earlier attempts to recognize it in the first place were not historically warmly wellcome.²²

Historically, the conception of one Member Company was initially affirmed by the leading case of Salomon²³. It can be said that Solomon confirmed the legitimacy of the ‘one member’ or

¹⁹ Salih Tayfun (n 14)

²⁰ Mario Rotondi, ‘Limited liability of the Individual Trader: One-Man Company or Commercial Foundation’ (1973-1974) 48 Tulane Law review 489

²¹ Assamen, (n 3) 8

²² Ibid 11

²³ Salomon v Salomon co. Ltd (1897) Acc 22

‘private company’²⁴ where, the House of Lords found no reason to restrict a sole person from incorporating a company as long as it is consistent with the regulatory requirement.²⁵

*The facts of the case are well known and need only be briefly stated. Salomon conducted a boot manufacturing business as a sole trader. He formed a company which was incorporated under the 1862 Act. The shareholders were Salomon, his wife and five children, each of whom initially held one share, thereby meeting the legislative requirement that a company have a minimum of seven shareholders. Salomon’s business—the purchase price comprising shares, a debenture, cash and the discharge of the debts of the business. After the purchase price was paid by the company to Salomon and the shares were issued, Salomon held 20 001 shares and the other shareholders each held one share. The company became insolvent soon after and went into liquidation.*²⁶

The concept of single member company was implemented into the companies Act 1985 by virtue of the companies (single member private limited companies) regulation 1992 (SI 1992/1699) and the minimum number of members of companies in the UK was reduced from two to one for this purpose. This regulation provides the measure related to single member private companies limited by shares or guarantees. It allows a single person to form a company or be the sole member and allow the rules in relation to private companies to be limited by share or guarantees to be modified for application to single member company.²⁷ Today, legal provisions relating to single member company in England are enacted in section 7 of the companies Act 2006 which allows the formation of a company with single person.

Single member companies have been explicitly recognized in the EU since 1989 pursuant to the twelfth council company law directive of the 21st December 1989 on single member private limited company (891667/EEC). This concept has been accepted and agreed by some European countries, including Belgium, Denmark, France, Germany, The Netherlands and Luxemburg and

²⁴ The term ‘private’ is used here as descriptive of a closed company restricted to a small number of shareholders whose relationship with each other is similar to that of partner or as nominees for a sole trader appointed to make up the minimum statutory number. See also Phillip Lipton (n 16) 464

²⁵ UK Companies Act 1862. 25& 26 vict.c.89, sec 6.

²⁶ Philip Lipton (n 16) 467

²⁷ UK companies Regulation 1992 ‘<http://www.legislation.gov.uk/ukxi/1992/1699/made/data.Pdf>’ accessed 3rd april 2022

has seen effective as domestic law since 1993.²⁸ Besides, the European communities (single member private limited companies) regulation 1994 provided certain rules regarding this concept.²⁹

The concept has been recognized in France since 1985 where it is known as enterprise unipersonnelle_responsabilite_limitee ('Eurl'). It was created in order to resolve the practical problem of the formality of company incorporations, which requires at least two shareholders. Consequently, several types of legal entities that could be incorporated by a sole owner were recognized under French law, such as societa par action simplifiee in unipersonnelle ("SASU"), Auto-entrepreneur and Entrepreneur individuel a responsabilite limitee ("EIRL").³⁰

A single member company in Germany is called an Einmanngesellschaft, and it was recognized by the legal reformation in 1980. Thus, Germany was one of the rare member state that had one member company friendly legislation before the adoption of EU directive.³¹

In contrast, the evolution of a single person corporation under American law took a long period. Initially, only three states allowed a single incorporator, i.e Kentucky, Wisconsin, and Michigan. By the late 1960s, more than half of the states already allow single person corporations and most of the states had a provision that allowed a single person corporation.³² Finally, single member limited liability companies were allowed all over the country since 1996 and be called a single member limited liability company ("SMLLC"). Today all the fifty states allow single person corporations and most of the state have adopted, the model Business corporation Act with or without modification a work of the American Bar association to aid states in crafting uniform laws. Under the 2016 Revision of the Model Business Corporation Act, it is stated that "one or

²⁸ Twelfth council company law directive 89/667/EEC of 21 December 1989 on single member private limited liability companies. This directive is changed by directive 2009/102/EC of 16 September 2009, OJL 258/20,1.10.2009 official journal L395,30/12/1989 0040-0042.

²⁹ Ibid

³⁰ Mads Andenas & Frank Wooldridge, *European Comparative Company Law* (Cambridge University press, 2009) 61-63

³¹ Beretka katinka, 'Concept of Single Member Companies In The Light of Eu Harmonization: Comparative Analysis of Serbia, Germany' United Kingdom' (Unpublished LLM Short Thesis, central European University 2010) 9

³² Richard M. Baxbaum, 'Commercial Law-Single Shareholder Company', (1990) 38 *American journal of comparative law* 251

more persons may act as the incorporator or incorporators of a corporation by delivering article of incorporation to the secretary of state for filing.”³³

China recognized a single member company by legislation when new company law took effect on January 1st 2006 which is a significant legislative progress in the legislation history of china. On October 27, 2005, the new “company law” was formally promulgated. The act clearly established the single member company system for the first time, with a whole section on the act. Single member company has officially found its legal base in Chinese company law ever since. This new company law is a breakthrough both amongst the legislation and in the academics.³⁴

2.3. Benefit of One Member Company

Before the acceptance, in most of the jurisdictions, de-facto one Member Company were established in order to benefit from the economic advantage of this company type. To meet the statutory requirements on the minimum number of shareholders, investors formed de-facto one member company with their family members. The reason for incorporating family companies is to combine limited liability with a completely dominant sole proprietorship.³⁵ However, as a result of conflicts among family members some, if not most, such companies did not last long. Thus, acceptance of one Member Company allows investors to safely invest a limited sum in the company and to enjoy limited liability.³⁶ Others scared of the discord that incorporating limited liability company with family members will bring, and possible loss of their family relations for business shied away from forming limited liability companies. The recognition of the single member company is a solution for such persons.

Other additional benefit of one member companies can be indicated as follows:

One member company has the advantage over sole proprietorship form of business: First, one member company bring unorganized sector of sole proprietorship in to organized version of private limited company. The organized version of one Member Company will open the avenue for more favorable banking facilities. Simply put, one member company provides access to

³³ Model Business Corporation Act 2016, sec 2.01

³⁴ Beihui Miao, ‘A Comparative Study of Legal Framework for Single Member Company in European Union and China’ (2012) 5 journal of Politics and Law 8

³⁵ Catoldo (n 17) 474

³⁶ Andrew Hicks G and S.H. Goo, Cases and Materials on Company Law (6th edn, Oxford University press 2008) 79

various credit³⁷ and loan facilities hence would encourage entrepreneurship. Second, in one Member Company, since one person holds all the shares his liability will be complete with respect to his investment in the company. His personal asset will however be protected. In sole proprietorship, however, all asset of the individual will be attached and there is no limitation on the liability.³⁸

Third, unlike sole proprietorship, business continuity and management in one Member Company is comparatively better.³⁹ The death or retirement of member of one member companies has no essential effect on its further operation, members may come and go and the company will continue to live on forever.⁴⁰ Fourth, one member companies are more trustworthy than sole proprietorships because they are required to comply with several regulations and disclose important information to the public. The relevant persons will be able to access this information before deciding to engage in a business transaction with a single member company.

Further more, in contrast to multi Member Company, one member company has the following advantage. Firstly, one member company reduces the governance cost by decreasing decision making and hierarchy cost of the company.⁴¹ This fact is especially true when the sole shareholder and director are the same natural or legal person. Besides, it also reduces the agency cost since conflict between managers and shareholders and conflicts among shareholders can not arise. Secondly, unlike multi-member company, in one Member Company when the sole owner and sole manager are the same person, information asymmetry problem does not occur.

From public service perspective, one member company will bring unorganized sector of sole proprietorship into organized version of private limited company. Various small and medium enterprise, doing business as sole proprietorship might enter into corporate domain. The organized version of one Member Company will open the avenue for more favorable banking facilities. In simple terms, it provides access to market player to various credit facilities and

³⁷ Jetu (n 9) 16. See also Mitchell Crusto, 'Unconscious Classism: Entity Equality For Sole Proprietors' (2009) 10 Journal of Constitutions Law 230

³⁸ Angela Schneeman, The Law of Corporation and Business Organizations (3rd edn, Published by west Thomson Learning 2001)1-2

³⁹ Ibid

⁴⁰ Simon Goulding, company Law (2nd edn, Cavendish Publishing Limited 1999) 13. See also Paul L. Davis, Principle of Modern Company Law (8th edn, 2008) 42

⁴¹ Oliver E. Williamson, 'Economic Institution of Capitalism' (Collier Macmillan Publisher London, 1985) 148

hence would “support small and medium sized enterprises which can squarely fit the government’s economic policy towards these business.”⁴² Besides, governments effectively govern and monitor these company types, which encourage them to be transparent so that they will pay the correct amount of tax. Similarly, governments encourage economic growth by providing tax incentives and be exempted from certain formalities.⁴³

From the investors perspective, the globalized economy in the world forces countries to have well-functioning and competitive commercial laws in order to compete with other countries to attract foreign direct investment and to encourage entrepreneurs to take part in business.⁴⁴ Single member companies are one of the best ways for a foreign investors who requires entering individually into a new market in which they do not know trust worthy local partners, as well as the market conditions and legal rules. Besides, it gives “wider latitude to investor in that he gets another venue to choose” and also can begin doing business without waiting for others to participate in.⁴⁵

Although one member company has risks in its functioning, the cost and benefit analysis shows that benefit prevail over risks considering the fact that risks can be precluded by accepting some safeguards such as piercing the corporate veil.

2.4. Sole Proprietorship Vs. One Member Company

Sole proprietorship differs from one Member Company in that:

*The sole proprietor is the sole owner of all assets of the business and solely liable for all the debts and obligations of the business. Unlike the corporation, the business of the sole proprietor is not considered a separate entity. Rather it is considered an extension of the individual. The sole proprietor is personally responsible for all legal debts and obligations of the business and is entitled to all of the profit of the business.*⁴⁶

⁴² Assamen (n 3) 39

⁴³ Hicks (n 36) 94

⁴⁴ Muzzafer Eroglu, Single Member Company in Turkish Law (Published in Legal Hukuk Dergis 2008) 1275

⁴⁵ Assammen (n 3) 38

⁴⁶ Angela (n 38) 1-2

In contrast, a single member company can be expressed as follows:

*The sole shareholder and active manager of one Man Company finds himself in a novel situation. In a realistic sense he is the owner of the business. Legal theory, however, requires that he operates in an atmosphere of make believe. It calls up on him to follow a ritual which involves treating the company as though it were something apart from himself, a habit pattern harder to maintain and less natural than when a number of persons are associated in a common enterprise.*⁴⁷

Be it as it may, a comparative analysis between sole proprietorship and one member company may be useful in throwing some light over the relevance of one Member Company. The comparison is made here under:

First, like any other company, one member company will have its own existence which is separate from its shareholder. This is in contradiction to a sole proprietorship where the owner is not distinguished legally from the business and which is run and owned by one person.⁴⁸ Second, one member company, since one person holds all the shares, his liability will be complete with respect to his investment in the company. Simply put, all his shares in the company will be attached in case an issue crops up. His personal assets will however be protected. In a sole proprietorship all the assets of the individual will be attached and there is no limitation on the liability. In simple terms, carrying personal liability for the losses a business makes and is entitled to all of the profits of the business.⁴⁹ Third, unlike in case of sole proprietorships, business perpetuity and management in one member company is comparatively better.⁵⁰ Put differently a member of one Member Company may come and go but the company goes on forever,⁵¹ meaning that the death or retirement of its members has no terminal effect on its further operation.⁵²

⁴⁷ Warner Fuller, 'The Incorporated Individual: A study of a One-Man Company' (1938) 51 The Harvard Law Review 1374

⁴⁸ Sole Trader-What is A Sole Trader? /Debitoor Accounting Glossary/ <<http://debitoor.com/dictionary/Sole-Trader>>

⁴⁹ Angela (n 38) 1-2

⁵⁰ Ibid

⁵¹ Macaura Vs Northern Assurance co.Ltd (1925) Ac 619, 625

⁵² Goulding (n 40) 13

It may be observed from the above comparison that, each form of business vehicle has its own pros and cons. Sole proprietorship provides advantage of complete control over the business, easy and least expensive to start and run business⁵³ with lower tax burden however lacks separate legal entity and limited liability. On the other hand, one member company which is different from ordinary company in that it is established by a single shareholder, satisfying all legal requirements of the law. Ordinary companies are well regulated and liable to follow complex procedure. However they have benefit of potential immortality of the company, separate legal entity and limited liability. One member company is some-what lying between the ordinary company and sole proprietorship. In simple terms, one member company possesses features of both traditional forms of business vehicles.

2.5. Formation of One Member Company

2.5.1. Formation of One Member Company in UK and Germany

Single member company was introduced at the EU level by directive 89/677/EC (later changed by directive 2009/102/EC), in which it was stated that a company may initially be formed by a sole member or may become a single member company in cases where all the shares were subsequently owned by a sole member. This allowed member state to establish special provision or penalties in cases where a natural person was the sole member of several companies or a single member company, or another legal person become the sole member of a company.⁵⁴

After EU member state started to accept the concept of single member company in their jurisdiction, EU adopted the 12th company law directive⁵⁵ in order to harmonize the application of a single member private limited liability companies in national laws of member states. The main goal of the directive is to create a legal instrument to allow the individual entrepreneurs limit their liability.⁵⁶

Being member of the European Union, (before Brexit in 2020) the UK, used to be bound by the Twelfth Council Company Law Directive 2009/102 in the area of company law on single

⁵³ Selecting A Business Structure in Canada/ New Business now.com/ <<https://www.new business now.com/article/selecting a business structure in Canada>>

⁵⁴ Single Member Private Limited Liability Council Directive, art.

⁵⁵ Ibid

⁵⁶ Ibid

member private limited company. This is a consolidation of various amendments interposed after the initial Twelfth Directive issued in 1989. This directive incorporated in UK laws through the Companies Regulation 1992.⁵⁷ The regulation provides the measures related to single member private companies limited by share or guarantees. It allows a single person to form a company or be the sole member and allow the rules in relation to private companies to be limited by shares or guarantees to be modified for application to a single member company.⁵⁸ Pursuant to the reformation of company law in UK, the concept of single member companies was explicitly recognized in the companies Act 2006. Subsequently “the decision to permit a single person to incorporate public company came into effect through this act.⁵⁹ This act contained general provision related to the incorporation and management of a single member companies.

In UK, there is no restriction regarding the member of single member company, i.e., either natural or legal person can be a shareholder.⁶⁰ However, “there is no clear indication under the UK companies Act as to whether a single individual could invest in only one single member company or in several single member companies.”⁶¹

In Germany, among others, there are two commonly known companies: limited liability Company (GmbH) and stock corporation (AG). Both the limited liability company (GmbH) and stock corporation (AG) may be established by a single shareholder; and the sole member may be natural or legal.⁶² There is no limit to the number of founders or eventual shareholder.⁶³ Besides, there is no restriction on how many times a natural person being a single member shareholder may have the legal status in other single member company.⁶⁴ Similarly, a legal person could be the sole member of another single member company.⁶⁵

⁵⁷ UK Companies Regulation (1992)

⁵⁸ Ibid

⁵⁹ UK Companies Act 2006, sec 7. See also Jetu (n 9)45

⁶⁰ UK Companies Act 2006, sec. 7

⁶¹ Jetu (n 9)48

⁶² German Private Limited Liability Act, sec 1: German Stock Corporation Act, sec.2. see also M. Andenas and Frank Wooldridge (n 30) 67 and 72

⁶³ Dragana Radenkovic Jovic, ‘A Single Member Company Convenient or not for The Founder’ (2005)2 Economics and Organization 209

⁶⁴ Ibid

⁶⁵ Ibid (n 63) 213. See also Jetu (n 9) 47

2.5.2. Formation of One Member Company in Ethiopia

In Ethiopia one member private limited company may be created in three ways: First, may initially be formed by a sole member (ab initio),⁶⁶ second, may become one member private limited company by conversion from a sole proprietorship,⁶⁷ and third, in cases of the reduction of the number of members to one.⁶⁸

Unlike the UK and Germany, which permitted for both private and public companies to be formed as one Member Company,⁶⁹ the Ethiopian law provides for only private companies to be formed as one Member Company.⁷⁰

2.5.2.1. Formation of One Member Company AB Initio

A one member private limited company is a business organization incorporated by the unilateral declaration of a single person.⁷¹ A person who decides to form this type of company must raise at least 15,000 Ethiopian Birr as a minimum capital, which shall have to be fully paid up and be shown in the unilateral declaration.⁷² The unilateral declaration, incorporating a one member company shall be made before an authority entrusted with authentication of documents and entered into the commercial register.⁷³ The other requisite in the formation of one Member Company is, the company shall not be formed unless the nominee has declared his acceptance of the nomination before an authority vested with power to authenticate document.⁷⁴

2.5.2.2. Conversion of Other Company Forms into One Member Company

A private limited company formerly, established with two or more members may become one member company, where the number of members is reduced to one. It primarily “Safeguards the continuity of corporate life of multimember companies from the risk of dissolution by the mere

⁶⁶ The New Commercial Code of Ethiopia proclamation No.1243/2021 (here in after the Commercial Code), Art. 534/1

⁶⁷ Ibid, Art. 538

⁶⁸ Ibid, Art. 498 (2)

⁶⁹ UK Company Act, Sec 7: German Private Limited Liability Act, sec. 1: German Stock Corporation Act, sec. 2

⁷⁰ The Commercial Code, Art. 174/7

⁷¹ The Code, Art, 534 (1)

⁷² The Code, Art 536

⁷³ The Code, Art 536

⁷⁴ The Code, Art 537

fact that their number is reduced to one.”⁷⁵ In conversion it is required to amend its memorandum of association within six months from the company’s membership falling below two.⁷⁶ The conversion does not cause the creation of a new legal person but only amendment of the memorandum of association. The conversion decision from private limited company to one Member Company, shall be published in a newspaper having wide circulation and on the website of business organization.⁷⁷ The right and duties of private limited company shall pass automatically to the one member company as from the date on which the amended memorandum of association of one Member Company is entered in the commercial register.⁷⁸

2.5.2.3. Transformation of Sole Proprietorship to One Member Company

As I mentioned before, as per article 538 of the commercial code one member private limited company may be formed by conversion from sole proprietorship. So, the question is how can it be possible to transform the existing sole proprietorship into a new corporate form. Although there are several persuasive reasons for establishing one member company, there are also some challenges in transition from sole proprietorship to one member private limited companies. Some of the challenges can be indicated as follows:

First, the requirement to appoint a nominee for incorporating a one member private limited company is a challenge. A one member company shall not be formed unless the nominee has declared his acceptance of the nomination before an authority vested with power to authenticate documents.⁷⁹ The very purpose behind introducing the concept of one Member Company is to enable even an individual to enter into a business venture with limited liability without wasting his time and energy looking for a partner. However, the entire objective has been overshadowed due to the legal mandate, which requires that the shareholder shall during the incorporation of a one member company who in the event of death or absence or judicial interdiction of the member shall become the care taker of the company.

Though this provision was introduced with the objective of preserving the basic characteristics of company i.e perpetual succession, but at a practical level this mandate ultimately creates

⁷⁵ Jetu (n 9) 74

⁷⁶ The Commercial Code, Art. 498(2)

⁷⁷ Ibid Art. 546 (1) and (4)

⁷⁸ Ibid Art. 548 (1)

⁷⁹ Ibid, Art. 537

procedural hassle for such sole subscriber by compelling them to enter into the process of looking for a suitable nominee, obtaining his consent. Besides, the existing sole proprietorship business assets are shared by the legal heirs which may be more than one. Conversion of existing sole proprietorship business into one Member Company requires providing one nominee which may not be acceptable to the other family members.

The second challenge, relates to procedural complexities. The incorporation of such a company requires lots of paper work as compared to a sole proprietorship. A company is required to register compulsorily.⁸⁰ For registration there are various forms which are required to be presented before the commercial register,⁸¹ with prescribed fee. The fee charged is called as the incorporation cost. These Procedural complexities with respect to incorporation of one Member Company might make this concept less attractive and challenge for the sole proprietorship.

The third challenge, is from taxation perspective. The new Ethiopian commercial code or other taxing laws do not explicitly mention taxing of one member private limited company, therefore it is considered as a private limited company for taxation purpose. Corporate income tax is imposed on the profit of a company⁸² during a tax year.⁸³ As per the federal income tax proclamation no, 979/2016, Private companies have been placed under the tax bracket of 30% on total income.⁸⁴ But, sole proprietorship are taxed at the rates applicable to individual, which means different tax rates applicable for different income types. So much so that, from taxation point of view this concept seems to be less attractive concept as it imposes heavy financial burden as compared to a sole proprietorship.

⁸⁰ Ibid, Art. 175

⁸¹ Ibid

⁸² The Federal Democratic Republic of Ethiopia Constitution 1994, Art. 98(2)

⁸³ Ethiopian Federal Income Tax Proclamation No. 979/2016, Art. 2/21

⁸⁴ Ibid, Art. 14(1) and 19(1)

CHAPTER THREE

CREDITORS PROTECTION IN ONE MEMBER COMPANIES UNDER UK AND GERMAN LAW

3.1. Introduction

A company is an entity established by a person or persons in accordance with the formalities prescribed by law and has legal personality separate and distinct from the person who own it, i.e the shareholders. The essential feature of a company are the doctrine of separate personality that insulates its shareholders from claims against the company and the limited liability doctrine that shields the personal assets of the shareholders from the creditors of the company.

In some jurisdictions, there is a statutory minimum on the number of persons who could set up or own shares in a company. However leading economies have allowed a single person to establish a company by himself and thereby giving him a dual personality that of an individual and as a company. Example of those economies include United Kingdom, Germany and more recently, Ethiopia.

This research aims to compare the laws and jurisprudence on single member companies in three jurisdictions. The main jurisdictions that will be covered in this chapter are the United Kingdom and Germany. The justification for this selection are, that they are the two leading economies that have well developed corporate law legislations. Besides, both jurisdictions allow the establishment of single person companies and are likewise rich with jurisprudence and scholarly works on the question this research seeks to address.

This part of the research will focus on discussing analysis of comparative regime particularly designed to address creditor protection associated with single member companies.

3.2. Capital Maintenance

The maintenance of the companies' assets is one of several approaches aimed to protect creditors. This mechanism preserves the assets enforceable by creditors. Company laws generally protect creditors of limited liability companies by protecting the capital of the

company. The legal provisions aimed at achieving maintenance of capital are rules regulating reduction of capital and minimum capital requirements.

3.2.1. Reduction of Capital

The reduction of capital is a process by which the amount contributed by the shareholders is decreased. Because the liability of the members is limited, the security of the creditors become depleted.

In UK, there are two circumstances in which a limited company may reduce its share capital. First, by special resolution supported by a solvency statement (in the case of private companies).⁸⁵ Second, by special resolution confirmed by the court.⁸⁶ This decision can be made by the sole member of one Member Company.⁸⁷ But in both cases, the validity of a resolution is not affected by a failure to comply.⁸⁸

It is the duty of the director to prepare solvency statement. The director has formed the opinion that there is no ground on which the company could then be found to be unable to pay its debts. This technique enables directors to decide whether the creditor's interest is affected by the reduction in capital. In forming those opinions, the directors must take into account all of the company's liability including any contingent and prospective liabilities. If the directors make a solvency statement without having a reasonable grounds, he shall be liable for an offence.⁸⁹

On the other hand, according to CA sections 645 to 651, the court may exercise its power to confirm the reduction of capital. The court has its own discretion to confirm the reduction of capital on appropriate terms. Creditors who are entitled to any claim can object to the reduction of capital. The court shall establish a list of creditors entitled to object. In the court that the company's officer intentionally or negligently cancels the names of creditors or misrepresents the nature or the amount of the debt, he shall be liable.⁹⁰ Whether or not all the creditors on list

⁸⁵ UK companies Act, sec. 641(1)(a)

⁸⁶ UK companies Act, sec. 642(1)(b)

⁸⁷ UK companies Act, sec. 318

⁸⁸ UK companies Act, sec. 642 (2-4)

⁸⁹ UK companies Act, sec. 643

⁹⁰ UK companies Act, sec. 646-648

consent to the reduction or the company takes steps to secure the claims, the court has the discretion to confirm the reduction on terms that it thinks fit.⁹¹

In Germany, the reduction of capital in German Private Limited Liability Act, requires amendment of company's articles. Any alteration to the article also requires a resolution of shareholders. The resolution must be recorded by a notary and also approved by a majority of three quarters of the vote cast.⁹² The directors must give notification of the resolution to reduce the share capital in the company's designated publication. In this notification they must also ask the company creditors to contact the company. Those creditors who contact the company and do not give their consent to the reduction shall be satisfied or indemnified of the claims asserted.⁹³ Similarly, capital reduction in the German public company act requires amendment of the company's article,⁹⁴ and a resolution adopted by three fourth of the share capital represented at the passing of the resolution.⁹⁵ Creditors whose claim arise prior to the date of the announcement of the registration of the resolution shall, upon request with in six month of the date of such announcement be granted security to the extent that they may not demand satisfaction.⁹⁶ The reduction of the share capital become effective upon registration of the resolution in the commercial register.⁹⁷

3.2.2. Minimum Capital Requirement

One of the popular mechanisms of protecting creditors of limited liability companies is imposing minimum capital requirements as a condition for establishment. Minimum capital is not however universally adopted. For example in UK, there is no minimum capital requirement for private companies. But there is a minimum capital requirement which is imposed on public companies.⁹⁸ The authorized minimum in relation to the nominal value of a public company's allotted share

⁹¹ UK companies Act, sec, 648 (1)

⁹² German Private Limited Companies Act, sec. 54. See also M. Andenas and F. Wooldrige (n 30)207

⁹³ German Private Limited Liability Act, sec. 58(1)

⁹⁴ German Stock Corporation Act, sec. 23(3)

⁹⁵ Ibid sec. 222(1-4)

⁹⁶ Ibid sec. 225(1)

⁹⁷ Ibid sec. 223-224

⁹⁸ UK Companies Act, sec. 761

capital is £50,000.⁹⁹ Unlike public companies, there is no minimum capital requirement for private company, so does for single member company.¹⁰⁰

In Germany, to establish private limited company the share capital must amount no less than twenty –five thousand euros.¹⁰¹ In total, at least as much of the share capital must have been deposited so that the total amount of the contributions in cash paid in, plus the total nominal capital of the shares for contributions in kind are to be paid, equals 12500 Euro.¹⁰² Similarly, to establish single member public limited company it requires 50,000 euro as a minimum par value of the share capital.¹⁰³

3.3. Mandatory Disclosure Requirements

The other mechanism of protecting creditor rights is through disclosing the company's information to the public or allowing an external organ to examine its activities. The following provisions may reflect transparency, as indicated below:

3.3.1. Registration of the member

In UK, there is a special provision which is enforced on the single member company to register its member. First, if a limited company is formed with only one member, a statement that showing the company has only one member together with the name and address of the sole member should be entered in the company register of members.¹⁰⁴

Second, in situation where the number of members falls to one, in addition to the name and address of the sole member, the date on which the membership fell below two, together with the statement that the company having only one member should be registered in the company register.¹⁰⁵ Lastly, the above mentioned required statements are also needed, if the membership of a limited company increases from one to two or more members.¹⁰⁶

⁹⁹ UK Companies Act, sec. 763

¹⁰⁰ UK Companies Regulations 1992

¹⁰¹ German Private Limited Liability Act, Sec. 5(1)

¹⁰² Ibid sec. 7(2)

¹⁰³ German Stock Corporation Act, sec. 7

¹⁰⁴ UK Companies Act, Sec. 123(1)

¹⁰⁵ UK Companies Act, Sec. 123(2)

¹⁰⁶ UK Companies Act, Sec. 123(3)

In Germany, the private limited liability company act (GmbH) provides, once each change of shareholders become effective the directors shall submit list of shareholders to commercial register, without undue delay. In the list the director indicates family name, date of birth and place of residence of these shareholders.¹⁰⁷ In addition, the stock corporation act (AG) mentions registration of shareholders of one person public company as “If all the shares belong to one shareholder solely or jointly with the company, then this fact together with the sole shareholder’s surname, given name, date of birth and place of residence shall be notified to the court without delay.”¹⁰⁸

3.3.2. Records of Decision by Sole Members

Creditors of a single member company can also be protected by putting an obligation on sole member to record a decision made by him. This will help the third party creditors to easily understand members’ intention of internal business management.

In UK, whenever the sole member of single member company takes any decision, unless the decision is made in a written resolution, he must provide the company with details of that decision.¹⁰⁹

In Germany, the Private Limited Liability Company Act (GmbH) provides, the sole member of a single person company should record the meeting of shareholder in writing and sign the document without undue delay.¹¹⁰ Unlike GmbH Act, the Stock Corporation Act (AG) has no separate paragraph for single member companies. But in its general part, it imposes a single shareholder to record each resolution of shareholders meeting in minutes.¹¹¹

¹⁰⁷ German Private Limited Liability Act, Sec.40(1)

¹⁰⁸ German Stock Corporation Act, sec. 42

¹⁰⁹ UK Companies Act, Sec. 357

¹¹⁰ German Private Limited Liability Act, sec. 48(3)

¹¹¹ German Stock Corporation Act, sec.130(1)

3.3.3. Contract Between The Sole Member And The Company

Creditors of a single member company can also be protected by imposing the conclusion of contract between the sole shareholder and the company. The idea behind this requirement is that, any agreement between member and the company carries the risk of conflict of interest.¹¹²

In UK, there is a special and separate provision which uniquely explains about the contract with in single member company. A single member company having only one member enters into a contract with the sole member which is also the director of the company. In this regard, the contract is not entered into the ordinary course at the company's business.¹¹³ A "shadow director" (a person who is not appointed as a director) is also incorporated in the act. A shadow can be considered as a director, means a person in accordance with whose directions or instructions the director of the company are accustomed to act.¹¹⁴

In Germany, the Private Limited Liability act (GmbH) clearly provides about the contract between the sole shareholder and his company as follows: If all the company share are held by one shareholder who is also the sole director, sec. 181 of the German civil code, should be applied. In this regard, legal transaction between the sole shareholder and the company he represents (even if he is not the sole director), be documented without undue delay following their performance.¹¹⁵ Besides, the civil code creates transparency on legal transaction based on contracting with one self.¹¹⁶ This in effect avoids the problem of multiple representations. The German Stock Corporation Act has no clear provision concerning contractual relationship between the sole shareholder and the company. But, since the sole member and the company are independent parties to the business, every agreement "should be treated on a clear cut prior written contract".¹¹⁷ The German civil code in its sec. 311 states as follows:- in order to create an obligation by legal transaction and to alter the contents of an obligation, a contract between the parties is necessary, unless otherwise provided by statute.

¹¹² Assamen, (n 3) 28

¹¹³ UK Companies Act sec. 231

¹¹⁴ UK Companies Act. Sec. 250-251

¹¹⁵ German Private Limited Liability Act, Sec. 35(4)

¹¹⁶ German Civil Code (BGB) 1896 sec. 181

¹¹⁷ Beretka (n 31) 49-50

3.3.4. Accounts, Reports and Audit of One Member Company

Keeping financial document properly and disclosing to the public is the other technique of protecting third party creditors. This mechanism helps creditors to make an informed decision while engaging in a transaction with single member company.

In UK, Every company must keep adequate accounting records. Adequate accounts records means records that are sufficient to show and explain the company's transactions. If the company fails to comply with the duty to keep accounting records, an offence is committed by every officer who is responsible for keeping the accounts.¹¹⁸ The director of the company must approve the account of the company based on a true and fair view of the assets, liabilities, financial positions and profit or loss.¹¹⁹ The director has also the duty to deliver to the registrar the accounts and reports required by law.¹²⁰ In UK companies may be classified based on their size. If companies qualify the following three criteria, may be exempted from the duty of accounts and reports i.e turnover, balance sheet total and number of employees.¹²¹ In addition, the annual accounts of every company must be audited, but small companies including single member companies exempted from this requirements.¹²² Though they are required to submit abbreviated accounts (the abbreviated accounts are what tends to be submitted to companies house. These are essentially a summarized version of the full accounts. The abbreviated accounts include the company balance sheet and a reduced number of notes to the accounts. These do not include the profit and loss account).

In Germany, corporations are classified based on their size i.e small, medium and large. The legal representatives of (medium and large) corporations have to supplement the annual financial statements with notes, which form together with the balance sheet and profit and loss account and have to prepare management report.¹²³ Small corporations are corporations that do not exceed two of the following three requirements i.e a balance sheet total of 6,000,000 euro, turnover revenue of 12,000,000 euro and an average of fifty employee during the financial year.

¹¹⁸ UK Companies Act, sec. 386 & sec. 387 (1)

¹¹⁹ UK Companies Act, sec. 393

¹²⁰ UK Companies Act, sec. 441

¹²¹ UK Companies Act, Sec. 382(3)

¹²² UK Companies Act, sec. 475-477

¹²³ German Commercial code, sec. 264(1) and sec. 267

The managing director of single member company does not need to prepare management report.¹²⁴ Only required to submit the balance sheet and appendix (the appendix does not need to contain the information relating to the profit and loss account). Besides the accounts of single member company are not required to be examined by auditors.¹²⁵ In conclusion, accounts, reports and audit of single member company in Germany depend on the size of the corporation on the basis of balance sheet, turnover revenue and number of employee.

¹²⁴ Ibid sec. 267

¹²⁵ Ibid sec. 316 and 326

CHAPTER FOUR

CREDITORS PROTECTION IN ONE MEMBER COMPANY UNDER THE REVISED COMMERCIAL CODE OF ETHIOPIA

In this chapter firstly, the legal issues concerning creditors' protection in one Member Company under the new commercial code of Ethiopia will be discussed. And then analysis of the provision in connection with creditors' protection in one Member Company using a comparative approach will be followed. In dealing with the legal gap of the Ethiopian company law under the new commercial code, specific reference is made to capital maintenance rule and mandatory disclosure requirements. In examining the legal protection given to creditors under Ethiopia one member private limited company law, the UK and German capital maintenance rule and mandatory disclosure requirements has been used as a parameter.

4.1. Creditors Protection in One Member Companies under the New Commercial Code of Ethiopia

4.1.1. Capital Maintenance

4.1.1.1. Reduction of Capital

Under the new commercial code of Ethiopia, reduction of capital may apply due to loss or not motivated by loss.¹²⁶ Before reducing the capital, proposal for a reduction of capital shall be sent by the board of directors to the auditors not less than fifteen days before calling the extraordinary general meeting to approve such reduction. The auditors shall report to the same meeting their opinion and the reasons therefore on the proposal.¹²⁷

Where a reduction of capital has been effected, an entry shall be made in the commercial register and published in a newspaper with wide circulation and posted on the company's website.¹²⁸ Any creditors holding rights against the company prior to the publication of the resolution in a newspaper having a nationwide circulation in accordance with article 463 of the code may,

¹²⁶ The New Commercial Code of Ethiopia, Art 464 and 469

¹²⁷ Ibid Art 462

¹²⁸ Ibid Art 463

where the reduction of capital is in an amount exceeding ten percent, object to the reduction within three months from such publication.¹²⁹

Based on creditors' objection, the court may reject such objection or order the company to pay the claimant or to provide adequate guarantee for payment.¹³⁰

Similarly, where the claim of a creditor holding rights prior to the adoption of a resolution by an extraordinary general meeting to reduce capital is not paid or such creditor is not given adequate guarantee for the payment of his claim, he may oppose the adoption of a resolution.¹³¹

4.1.1.2. Minimum Capital Requirements

Under the new commercial code of Ethiopia, the contribution of member of one Member Company is not divided in to shares. Simply put, one member company has no share capital under the existing Ethiopia law.

The capital of one member private limited company shall not be less than 15,000 (fifteen thousand) Ethiopian birr.¹³² In the unilateral declaration of one member company, the sole member is expected to indicate the amount of the capital of the company and a statement that the capital has been fully paid.¹³³ But as far as liability is concerned, the member shall not be personally liable for debts due by the company in so far as he has fully made his contributions.¹³⁴

4.1.2. Mandatory Disclosure Requirements

4.1.2.1. Registration of Information

A one member private limited company is a business organization incorporated by the unilateral declaration of a single person.¹³⁵ This declaration incorporating a one member private limited

¹²⁹ Ibid Art 471(1)

¹³⁰ The Code, Art 471(2)

¹³¹ Ibid Art 467

¹³² Ibid Art 535

¹³³ Ibid Art 536(g)

¹³⁴ Ibid Art 534(3)

¹³⁵ Ibid Art 534(1)

company shall be made before an authority entrusted with authentication of documents and entered into the commercial register.¹³⁶

The list of declaration shall indicate that the company has only one member; the name, nationality and address of the members; the name of the nominee of the company who will act on behalf of the member or his heirs in the event of death or absence or judicial interdiction of the member; the acceptance by the nominee to shoulder responsibility; the company name, head office, and branches, if any; the business purpose of the company; the amount of the capital of the company and a statement that the capital has been fully paid; the valuation of contribution in kind, if any; the name and power of the manager; the name of the auditor, if any; the period of time for which the company is established;¹³⁷

Notwithstanding the provision of article 534/3 of the code pertaining to limited liability of the member, the member of the company or any other person who has control over the company directly or indirectly shall be jointly and severally liable with the company where he is found to have deliberately released regarding the financial status of the company information that can mislead the creditors of the company and also intentionally commits an unlawful acts that jeopardizes the interests of creditors of the company.¹³⁸

4.1.2.2. Accounts, Reports and Audit

Any business organization including one member private limited company, shall keep books and accounts as are required in accordance with business practice and law, having regard to the nature and importance of the trade carried on.¹³⁹

All books of accounts and accounting documents shall be preserved for ten years from the date of last entry or from the date of preparation of such documents.¹⁴⁰ At the end of each financial year, the director shall prepare a detailed inventory of the properties of the company and a balance sheet.¹⁴¹ Besides, the director shall draw up a balance sheet and a profit and loss account and prepare a report on the state of company activities and affairs during the last financial

¹³⁶ Ibid Art 536(1)

¹³⁷ The Code, Art 536

¹³⁸ Ibid Art 543

¹³⁹ Ibid Art 61

¹⁴⁰ The Code, Art 66

¹⁴¹ Ibid Art 426 (1)

year.¹⁴² If the director or manager who prepared the accounts fails to comply with these duties, he shall be liable to the third parties for any damage caused by breach of his duties under the law.¹⁴³ A one member private limited company with total assets that exceed ten million Ethiopian birr shall have an independent and impartial external auditor.¹⁴⁴

4.2. Analysis of Creditors Protection in One Member Companies in Ethiopia

There can be similarities and differences in terms of creditor protection in one member companies in comparing UK, Germany and Ethiopia company law, and the comparison is made here under:

4.2.1. Capital Maintenance

4.2.1.1. Minimum Capital Requirement

Some jurisdictions have traditionally taken the view that minimum capital requirements are efficient means of creditor protection and they are the price to pay for limited liability. It is submitted that such ex ante mechanism would prevent the creation of undercapitalized companies that would shift the risk of a firm to creditors. However, other jurisdictions were never impressed by minimum capital rules, instead providing for ex post rules to protect creditors without creating barriers to entrepreneurship.¹⁴⁵

Jurisdictions such as UK, have never viewed minimum capital rules as an efficient creditor protection mechanism and hence never deployed it in the context of one member private companies, primarily because the appropriate amount of capital depends on each business. In contrast, Germany and Ethiopia have a minimum capital rule for one Member Company not only because of effective creditor protection but also an indication of business seriousness and concern that they could be undercapitalized. As I mentioned before, since the appropriate amount of capital depends on each business, it is not reasonable for the Ethiopian company law to put minimum capital requirement. In my view, in order to prevent the problem of undercapitalized

¹⁴² Ibid Art 426(2)

¹⁴³ Ibid Art 516(1)

¹⁴⁴ Ibid Art 518

¹⁴⁵ Francisco Soares Machado, Effective Creditor protection in Private Companies: Mandatory Minimum Capital Rules or Ex Post Mechanisms?

companies we can use another mechanism i.e through piercing of corporate veil. In this regard, the Ethiopian law has already imposed appropriate provision on the matter.¹⁴⁶

4.2.1.2. Reduction of Capital

Both in the UK and Germany, the reduction of capital requires special resolution of shareholders agreed by the general meeting. In UK, the decision must be supported by a solvency statement made by directors or confirmed by court. Under the new commercial code of Ethiopia, this decision can be made by the approval of the members based on proposal by directors and subsequent approval by auditors before the general meeting.¹⁴⁷ However, confirmation by court is not required in both Germany and Ethiopia law, implies UK law imposes stricter rule on this point than both German and Ethiopian law.

The other point must be taken into consideration is that, creditor rights are unavoidably affected by the reduction of capital due to the expected amount claimable for the repayment of the debt will decrease.

In this regard both UK and German law give creditors the right of objection and liability of members for misconduct in relation to creditor protection.¹⁴⁸ Under the new commercial code of Ethiopia, the reduction of capital shall be notified to creditors for objection and based on creditor objection, the court may reject such objection or order the company to pay the claimant or to provide adequate guarantee for payment.¹⁴⁹

In conclusion, although there are procedural differences among the three jurisdictions in the reduction of capital, they show similar concern on creditor right being affected by the reduction of capital. For this three of the jurisdictions gives creditors the right of objection to reduction of capital.

¹⁴⁶ The code, Art 543(1)

¹⁴⁷ The code, Art 462

¹⁴⁸ UK Companies Act, sec. 646: German Limited Liability Act, sec. 58(1) and German Stock Corporation Act, sec. 225.

¹⁴⁹ The Code, Art 471(2)

4.2.2. Mandatory Disclosure Requirements

Mandatory disclosure is when regulatory authorities impose a requirement on company to disclose its information mandatorily.¹⁵⁰

4.2.2.1. Registration of Information

In UK, a statement that showing the company has only one member together with the name and address of the sole member should be entered in the company register of members.¹⁵¹ In Germany, however, commercial registers are kept at court. But in both cases due date of registration is not specified, so the shareholders do not know exactly of what time limit should notify the event without being in delay.¹⁵²

Under the new commercial code of Ethiopia, the unilateral declaration of one Member Company shall indicate that the company has only member.¹⁵³ The member or any other person who has control over the company shall be liable for failure to do so.¹⁵⁴ The list of incorporation consists of crucial information required by law and if there is any change the company must be re-registered, no later than one month from the date on which the decision is passed.¹⁵⁵ The member of the company together with the company itself is liable for any damage caused to third parties due to failure to comply with these duties.¹⁵⁶

Since the sole member has the absolute power in the company, knowing that the member is the sole member of the company is important especially to creditors. Based on the notification to the registrar of the change different stakeholders will be able to make an informed decision before engaging in any transaction with one Member Company. In this regard, in my view, the new commercial code of Ethiopia has successfully stipulated the provision concerning the registration of information.

¹⁵⁰ Constantines Z. Vascileious, 'Mandatory Disclosure and Its Impact on the Company Value' (2013) 6 International Business Research.

¹⁵¹ UK Companies Act, sec. 123(1)

¹⁵² Beretka (n 31) 37

¹⁵³ The code, Art 536 (2)(a)

¹⁵⁴ Ibid Art. 543(4 and 7)

¹⁵⁵ Ibid Art. 543(3)

¹⁵⁶ Ibid Art. 542(4)

4.2.2.2. Record of Decision by Sole Members

In UK, whenever the sole member of a single member company takes any decision, unless the conclusion made in a written resolution, he must provide the company with details of that decision.¹⁵⁷ Similarly, in Germany in both GmbH and AG companies, the sole member of a single member company should record the meeting of shareholder in writing and sign the document without undue delay.¹⁵⁸

Under the new commercial code of Ethiopia, decisions of one Member Company in the exercise of the power of general meeting shall be reduced into minute within three weeks from the meeting and kept as part of the record of the company.¹⁵⁹

The provision further explains, the member of one member companies shall exercise the power of the general meeting of shareholders of private limited companies.¹⁶⁰ Similarly, although Share Company and private limited companies are regulated separately, for the purpose of the general meeting, still they are located in the same code that makes possible inter-reference between the different parts.¹⁶¹ In private limited companies there are different categories of meeting i.e ordinary and extraordinary,¹⁶² based on these the level of member participation will be determined. In my opinion, one member Companies need separate provision, without referencing other multimember company i.e private limited company.¹⁶³ Besides as of UK law, a record of any decision made by the sole member should be provided to the company.

4.2.2.3. Contract Between The Sole Member And The Company

In UK, there is a special and separate provision which uniquely explains about the contract with in single member companies.¹⁶⁴ The contract is made between the sole member who is also the director of the company and the company.¹⁶⁵ This is because, for the sole member who is also the director of the company, there are more space for abuse of separate personality. Similarly,

¹⁵⁷ UK Companies Act, sec. 357

¹⁵⁸ German Private Limited Liability Act. 48(3) and German Stock Corporation Act, sec 130(1)

¹⁵⁹ The code, Art 542 (2)

¹⁶⁰ Ibid Art 542(1)

¹⁶¹ Ibid Art 527(1)

¹⁶² Ibid Art 519

¹⁶³ Ibid Art 542(1)

¹⁶⁴ UK Companies Act, sec. 231

¹⁶⁵ Ibid

under German Law, in GmbH the relationship are twofold: either the sole member is the sole managing director at the same time or there is a board. Instead of individual manager, in both cases requires that transaction between the company and sole shareholder must be entered in writing.¹⁶⁶ In this regard the German civil code(BGB) in its sec. 181, creates transparency on legal transaction based on contracting with one self i.e an agent may not, unless otherwise permitted, enter into a legal transaction consists solely in the performance of an obligation.

Be that as it may, there is no similar provision existed in the new commercial code of Ethiopia. Consequently, in my opinion, it would be appropriate to incorporate it in the new commercial code of Ethiopia in contemplation of enhancing creditor protection in one Member Company.

4.2.2.4. Accounts, Reports and Audit

Keeping financial documents properly and disclosing to the public is the other technique of protecting third party creditors. This mechanism helps creditors to make an informed decision while engaging in a transaction with single member company. In UK, as a rule every company must keep adequate accounting records.¹⁶⁷ The company has also the duty to deliver to the registrar the accounts and reports required by law.¹⁶⁸ Besides, it is also stated that every company's annual accounts for a financial year must be audited. However, this is not without exception.¹⁶⁹ If companies qualify two or more of the following three criteria, qualify as small companies and may be exempted from the duty of accounts and reports i.e a, Turn over, not more than € 5.6 million b, balance sheet total, not more than € 2.8 million and c, number of employees, not more than 50.¹⁷⁰ In addition, the annual accounts of every company must be audited, but small companies including single member companies exempted from this requirements.¹⁷¹ But required to submit abbreviated accounts.

A similar trend like in UK is followed under the German legal system. Thus, in principle, the legal representatives of corporations have to supplement the annual financial statements with notes, which form together with the balance sheet and profit and loss account and have to

¹⁶⁶ Beretnka (n 31) 48

¹⁶⁷ Jetu (n 9) 73

¹⁶⁸ UK Companies Act, sec. 393

¹⁶⁹ Jetu (n 9) 73

¹⁷⁰ UK Companies Act, sec. 381-382

¹⁷¹ UK Companies Act, sec. 475-477

prepare management reports.¹⁷² However, if companies do not exceed at least two of the following three characteristics considered as small capital companies and do not need to prepare management report i.e 6,000,000 € of balance sheet total, 12,000,000 € of annual turnover and annual average of 50 employees.¹⁷³ But the company is only required to submit the balance sheet and appendix (the appendix does not need to contain the information relating to the profit and loss accounts). In addition, whether the accounts of single member company in Germany is subjected to auditing requirements depends on its size identified based on the above three criteria.¹⁷⁴

One can understand from the above discussion that, the reliability of one man company is contentious. From one perspective, there is a conviction that, single member companies may easily be used for deceitful activities and unavoidably impact creditor interest. In this regard, the new commercial code of Ethiopia incorporates various provisions so as to avoid such a difficulty from occurring. Contrastingly, putting too much strict provision will make the business management challenging and business person may in the end choose not to form one member company under the new commercial code of Ethiopia.

The unique feature of multimember companies (share and private limited companies) in one hand and one member companies on the other, may restrict us from using same regulatory framework concerning the legal obligation in relation to financial documents. In my opinion, the requirements in deciding a company's obligation to perform concerning accounts, reports and audit under both UK and German laws are agreeable and should be incorporated in the new commercial code of Ethiopia for the purpose of enhancing creditor protection. Thus, rather than classifying companies based on one member or multimember companies, the code should incorporate the above mentioned experience of UK and Germany(classifying companies based on their size i.e small, medium and large). In this regard, in determining the duties in relation to accounts, reports and audit, the new commercial code of Ethiopia should incorporate the following requirements i.e balance sheet total, annual turnover and annual average number of employees.

¹⁷² German Commercial Code, sec. 264(1) and sec. 267

¹⁷³ German Commercial Code, sec. 267(1)

¹⁷⁴ Jetu (n 9) 72-73

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1. Conclusion

The prime objective of this paper is to assess the legal implications of introducing one Member Company in Ethiopia company law taking the new commercial code and international best practices into account. Based on this major objective, the study tried to provide analytical answer taking the following research questions into account.

The research contained three questions. The first question is, what are the basic characteristics that distinguish one member companies from the sole proprietorship? The comparison is made based on the following three criteria i.e legal personality, liability and business perpetuity. In this regard, one member company will have its own existence which is separate from its shareholder. This is in contradiction to a sole proprietorship where the owner is not distinguished legally from the business and which is run and owned by one person. Second, in one Member Company since one person holds all the shares, his liability will be complete with respect to his investment in the company. Simply put, all his shares in the company will be attached in case an issue crops up. This personal asset will however be protected. In a sole proprietorship all the assets of the individual will be attached and there is no limitations on the liability. Third, unlike in case of sole proprietorships business perpetuity and management in one member company is comparatively better. Put differently, a member of one Member Company may come and go but the company goes on forever, meaning that the death or retirement of its member has no terminal effect on its further operation.

The second question is, what are the possible challenges in transition of the sole proprietorship into one Member Company? The challenges are classified into three. First, the requirement to appoint a nominee for incorporating a one member private limited company is a challenge. A one member company shall not be formed unless the nominee has declared his acceptance of the nomination before an authority vested with power to authenticate documents. Though this provision was introduced with the objective of preserving the basic characteristics of a company i.e perpetual succession, but at a practical level this mandate ultimately creates procedural hassel

for such sole subscriber by compelling them to enter into the process of looking for a suitable nominee, obtaining his consent. Besides, the existing sole proprietorship business assets are shared by the legal heirs which may be more than one. Conversion of existing sole proprietorship business into one Member Company requires providing one nominee which may not be acceptable to the other family member. The second challenge, is related to procedural complexities. The incorporation of such a company requires lots of paper work as compared to a sole proprietorship. A company is required to register compulsorily. For registration there are various forms which are required to be presented before the commercial register, with prescribed fee. These procedural complexities with respect to incorporation of one Member Company might make this concept less attractive and challenge for the sole proprietorship. The third challenge, is from taxation perspective. The new commercial code or other taxing laws do not explicitly mention fixing of one member private limited company, therefore it is considered as private limited company for taxation purpose. As per the federal income tax proclamation no, 979/2016, a private limited company has been, placed under the tax bracket of 30% on total income. But, sole proprietorship are taxed at the rate applicable to individual, which means different tax rates applicable for different income types. Thus, from taxation point of view one member company seems to be less attractive as it imposes heavy financial burden as compared to a sole proprietorship.

The third question, is whether the provision governing a one member company is sufficient to protect third party creditors? Beside what already existed in the new commercial code, in order to enhance the level of creditors protection, additional rules need to be incorporated. While imposing additional duties on the one member companies, it should not be too much restrictive and too much lenient as well. Because, on the one hand, it will hinder the establishment of one member companies under the new commercial code and contrastingly, it may expose to dishonest activities which eventually led the business organization untrustworthy by third party creditors.

In order to answer the 3rd question the research focuses on discussing analysis of comparative regime particularly designed to address creditor's protection in one member companies. In this regard, although there are few clauses in the legal instruments of both UK and German jurisdictions that specifically mention about one member companies i.e records of sole member

decisions and contract between sole shareholder and the company. The general provisions of both countries have provided sufficient protection to creditors. Among others, mandatory disclosure requirements i.e records of decision made by sole member, contract between the company and its sole member, and accounts, reports and audit should be based on the size of the company.

5.2. Recommendations

Taking the unique characteristics of one member private limited company into account and to enhance creditor protection, the writer forwards the following recommendations.

- A provision that should be incorporated in the new commercial code is that, if the sole member is also the director of the company the contract between the sole member and the company must be made in writing and there must be a duty on a sole member to file including his personal contract with the company. This is because, for the sole member who is also the director of the company, there are more opportunities for abuse of separate personality. The effect of these illegal activities is that, gradually the capital of the company shifts to the sole member which eventually affects the interests of creditors.
- The mandatory provision that imposes the duties concerning the preparation of company accounts, reports and audit should be decided by the size of one member private limited companies. As of both UK and German laws, the size of the company should be determined by balance sheet, annual turn-over and annual average number of employees. In comparison to big companies, small companies have no significant effect on the interest of third party creditors. Thus, small companies which fulfill the required criteria shall be exempted from some duties.
- When-ever the sole member of one Member Company takes any decision, unless the conclusion is made in a written resolution, he must formally record it in the company's books with details of that decision. Based on the information, creditors will be able to make informed decisions before engaging in any transaction with the company.

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