

# Some Remarks on the Rights and Responsibilities of Founders under the Ethiopian Commercial Code

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## Abstract

Companies do not suddenly come in to being. Rather they require the effort and struggle of some individuals which are in most cases called Founders. Therefore, we can say companies are formed by the voluntary act of founders conforming to the general norms established by Commercial laws. Accordingly, in order to bring the company into existent these individuals need to enter in to contract and to transact with third parties. As a result of these, rights, responsibilities and liabilities of these individuals may arise which in turn calls for a deeper thought from the eyes of the Law. Hence, the main thrust of this article is to identify the major rights and responsibilities of founders that are found under the Ethiopian commercial code. This being the aim it will also explore the various attempts made to define founder. In doing so, the paper finds out that the word founder has not been defined anywhere in the commercial code. Moreover, the paper will discuss the experience of other countries at a glance, in order to give some lesson for the country. Therefore, the writer based on the analyses of relevant literature and experiences of countries, argues that, the commercial code of Ethiopia is not comprehensive enough to regulate the rights and responsibilities of founders and to protect the interest of third parties as well. More importantly, the commercial code fails to clearly stipulate the specific rights and responsibilities of founders; because one can only be acquainted with all the rights and responsibilities after consulting other related laws/proclamations. Consequently, the writer recommends for the proper amendment of the commercial code on issues that relates to founders, considering the changes occurred from the time where the commercial code come in to effect.

## Keywords

Commercial Code, Founders, Rights, Responsibilities, Ethiopia

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## 1. Introduction

Among the very famous and useful Business organizations operating in Ethiopia, companies take the major share. These companies are not something that comes into existence by themselves rather they are the result of huge planning and preparation of individuals. Many countries, such as Germany (Section 28 of *German stock Corporation Act*), and Ethiopia (Art 307-Art 310 of the *Commercial Code of Ethiopia*), call these individuals Founders, while some others such as England use the name Promoters or Incorporators. Subsequently, the writer will use the term Founder since the paper will be focusing on the Ethiopian experience. Thus a Company appears due to the efforts of these prominent persons. The founders decide the scope and business of the share company. They prepare the necessary documents. They make arrangements for advertising and circulating the prospectus (Fentaw, & Gurmu, 2009: p. 96). As one of their efforts in the formation of the company, founders may transact with third parties for the function of a company yet not established. As a result, the Commercial Law and the contracts entered by the founders before formation of a company confer rights and obligations on the founders, third parties and the future company.

These individuals who could take initiative and take part in the first planning of the company are significant, thus need recognition for many reasons. The first could be the laborious nature of the work that is done by the founders. As described somewhere in this paper, their task consists of investigation, discovery and assembly (Yohannes, 2008: pp. 102, 121). Thus their tiresome work should be given some consideration in the eyes of the law. The other reason could be the fact that their power is open for abusive, fraudulent and rent seeking practices. More importantly, the existence of various contentions on the validity of pre incorporation contracts and protection of third parties and that of a company called the regulation aspects of Founders and their activity.

In view of the need for recognition as well as regulation of these individuals, Countries tried to incorporate guiding provisions for regulation of Founders under their commercial laws. Correspondingly, the Ethiopian commercial code comes up with some provisions which could govern the Founders of companies. As a result Art 307 attempted to describe those individuals who are competent to enjoy the status of Founder. More importantly the other subsequent provisions, from art 308 up to art 311 of the code, have explained the role, liabilities and rights of Founder under the Ethiopian legal regime.

Therefore, this paper will try to discuss the major rights and responsibilities of founders that are recognized under the commercial code of Ethiopia, in light to a comparison made with the law and experience of some other countries. Some issues which need attention and lesson that could be learned from the experience of others is also included. Finally conclusion and recommendations are forwarded by the writer.

## 2. Who Are Founders? Conceptual Overview

If we consider Founder as significant individual in the formation of companies,

knowing the clear delineation of Founders is very useful, especially before deeply immersing in to their rights and responsibilities. Accordingly, there are many attempts made to explain it.

Founders are referred as an individual who assists in creating and organizing the corporation (Schneeman, 2010: p. 286). In other words, it is a person who undertakes to form a company with reference to a given project and setting a company in motion to accomplish company's designed purposes (Kestela, & Madhuri, 2006: pp. 156-157). In addition the Black's law dictionary has also tried to define what it is meant by Founder as "A person who founds or establishes; esp., a person who supplies funds for an institution's future needs". The definition given by this dictionary seems circular and it is somehow vague which fails to give the clear explanation to determine what sort of individuals could be considered as Founders.

In general, founder can be described as a person who brings a share company into existence. He/she is one who undertakes to form a share company with reference to a given object and to set it going and who takes the necessary steps to accomplish that purpose (Fentaw & Gurmu, 2009: p. 96). More importantly, there is no limit on the exact numbers of founders, so that companies could have several founders. In addition, a founder may be an individual or body corporate. One existing body corporate may be founder of new share company (Fentaw & Gurmu, 2009: p. 96).

Many jurisdictions also tried to incorporate provisions which deal about founders, and accordingly definition is put to describe them. For instance, In Germany, Founders are shareholders who establish the Articles of the Company.<sup>1</sup> While, In UK any person that takes initiative in the process of formation and issuance of the capital is considered as a Founder but the law put some limitation by excluding persons who act in pure ministerial capacity under service contract such as lawyers, accountants from the ambit of being Founder or Promoters (Gower & Davis, 2003: p. 106).

Similarly the Ethiopian commercial code tried to deal about Founders in art 307, however it fails to define who Founders are, what rather, the commercial code did in this regard is, it list out the different categories of persons who will assume the status of Founder especially in share companies formed by public subscription. As a result, those persons who sign the prospectus, bring in contributions in kind or allocated a special share in the profits shall have such right.<sup>2</sup> In addition, any person who has initiated plans or facilitated the formation of the company shall also claim the status of Founder.<sup>3</sup> Likewise the commercial code also places those persons who sign in the memorandum of association and subscribe the whole of the capital to have the status of Founder when the com-

<sup>1</sup>German Stock Corporation Act, 6 September 1965, Art 28.

<sup>2</sup>THE COMMERCIAL CODE OF THE EMPIRE OF ETHIOPIA Art 307(3), FED. NEG. GAZETTA (No. 166/1960). (Hereinafter, COMMERCIAL CODE).

<sup>3</sup>Id. At art 307(4).

<sup>4</sup>Id. Atart 307(1).

pany is to be formed among the founders themselves.<sup>4</sup> The two requirements seem cumulative though. However there are issues that are raised by writers with these categories, especially the issues are raised related to those individuals who enjoy the status as a result of their contribution in kind. What is raised mostly is about their distinction from shareholders that paid their contribution in cash. As can be seen from the provision, art 307(3), the code considers a person who makes contribution in kind as a founder. But it disregards those who contribute in cash the status of founder. Therefore it is not clear why the code consider individuals as a founder as a result of the type of contribution alone? And also it is not clear in what respect is such person materially different from a person who contributes in cash? Thus some suggests that the term “founder” be reserved for a person who plays a role in setting up a company. Or at least no distinction should be made among shareholders on the basis of the kind of contribution. So those who have paid fully in cash should also be considered as founders so that discrimination could be avoided (Teshome, 2008: p. 20).

Overall, what can we understand from the above stipulation is that, though different persons participate in the formation stages of a company, all participants will not get the position of Founder, since allowing for all participants the status of founder will be against the interest of the coming company as well as the interest of third parties who could interact with these people.

Therefore those people who are considered as Founder will often bring interested parties together, obtain subscriptions for stock of the proposed corporation, and see to the actual formation of the corporation. As Seyoum Yohannes stated in his article, on formation of share companies:

The promotional activities of Founders may be classified in to three. The first is discovery, which consists of finding the business idea to be exploited. Investigation, the second category, involves research or analysis to determine whether or not the proposed business idea is economically feasible. The third category is assembly, which includes the dual process of bringing together the necessary personnel, property and money to set the business in motion and involves the secondary details of completing the formalities requisite to set up the company (Yohannes, 2008: p. 121).

When they are engaged in such kind of activities they may enter in to various transactions and incur expenses which may as a result create rights and duties/responsibilities as well as liability of Founders. Thus it is important to deeply discuss the rights, responsibilities and liabilities which may arise as a result of these transactions and it will be the next task of this paper.

### **3. Rights and Responsibilities of Founders**

#### **3.1. Rights of Founders**

Being a founder, one may enjoy rights which results from that status. As mostly made in many countries, in view of the fact that founders are the significant personnel in the formation of a company, they should be given some rights and

privileges so as to encourage the formation of a company. Giving such opportunity for founders will enhance the initiation people would have to engage in something important, rather than being discouraged in fear of the responsibilities.

In order to enjoy the rights and privileges of founder the first thing that should be thought is getting the status of founder. Thus, people at first instance should fall in to the domain of a founder. The domain may broaden or narrow depending on a country's view. Subsequent to that the founder will enjoy the rights that are associated to the position.

One of such rights may be the right to get the profit that is allocated to founders. As to the writer's view this right is related to the other right, i.e. remuneration right (I will discuss this right in depth in the next part). Since the company has just formed it may be difficult to effect payment for expenses and costs that are incurred in the form of cash payment. Therefore, what is mostly done is that, founders whose expenses in the formation of the company is approved after the formation of the same, will be entitled to some rights in the form of some privileges like that of reserving profit, or it may be issuing founders shares. The kind of right or privilege varies depending on the approach that is followed by countries, which could be the focus of the next part.

Accordingly, the commercial code prefers to allocate profit that is specific for founder. Such right is incorporated under art 310/1/ of the commercial code of Ethiopia. Consequently, founders are given a right to reserve a share personally to themselves in the memorandum of association. However this right is not without limit. The share that is to be reserved for founders should not exceed one fifth (20%) of the net profits in the balance sheet. And also the law limits this right for a maximum period of three years (Fentaw & Gurmu, 2009: p. 97). Moreover, such amount must be stated in the memorandum of association. In the absence of such statement, a founder has no right against the company for his payment. If it is stated in the memorandum of association, it is presumed that there is a contract which gives the directors power to pay the preliminary expenses out of the company's funds. This seems to avoid fraudulent acts of founders by using their status as an instrument. However, the law is not clear with regard to the beginning of these three years (Petros, 2008: p. 87). Should it begin from the time when a company starts earning profit? Should the years be consecutive? Such questions are not answered in the commercial code of Ethiopia, which need further consideration if amendment of the code is to be sought.

Moreover, the law treats the services rendered by founders differently owing to the need to protect subscribers from founders securing unreasonably high rewards taking advantage of their dominant position at this early stage (Yohannes, 2008: pp. 113-114). That is the reason why the commercial Code prohibits conferring on founders any other benefit<sup>5</sup> other than reserving a share in profits not exceeding one fifth of the profits in the balance sheet for a period not exceeding three years.

<sup>5</sup>COMMERCIAL CODE, *supra* note 9, at art 310(2).

One may wonder what these other benefits/advantages could be. As to the writer's understanding such advantages may mean to include preferential right of subscription, prior payment of profit, and preferential shares. Besides art 310 of the commercial code, in its sub article 3 stipulates the fact that no founder shares may be issued.

The other right that is related to founders is reimbursement or remuneration right. Remuneration or reimbursement refers to the act of paying back, compensating or indemnifying. It may also include repayment of expenses.

The issue of remuneration is often raised with pre incorporation transactions, by which the founders will claim payment for the expenses and costs they incur as a result of dealings before the formation or incorporation of a company. Thus, Any transactions made by the Founder on behalf of the corporation before the actual incorporation is considered to be pre incorporation transactions. The corporation does not legally exist until its articles of incorporation are properly filed (Schneeman, 2010: p. 286). Therefore, what could be said in this regard is pre-incorporation contracts are not automatically binding on the corporation when formed. Rather they must be approved by the corporation, which makes the right to remuneration of founders highly dependent on the acceptance or approval of these transactions by the company after it comes in to existence. For that reason, any pre incorporation transactions must be approved by the corporation after it is formed if they are to be valid and remuneration for expenses need to be paid.

In other words, it is only the founders who will be held liable and responsible for the contracts entered with third parties before the incorporation of the company, if either the contracts do not get ratified or unless the contracts specifically state that the founder is acting on behalf of the future company. Thus the founders could be held personally liable and their right for remuneration will not be an issue in such circumstances (Schneeman, 2010: p. 286).

This principle is one which is workable in many countries. For instance the First Company Law of the European community has incorporated the principle of personal liability of founders or promoters in Art 7. It states that, unless otherwise agreed, if a company doesn't ratify any transaction undertaken by its name before its actual establishment after it comes in to being, then those people who transact on the name of the company will be jointly and unlimitedly liable to the third parties who transact with them. In the same way, the English company act has included the personal liability of founders under section 51(1) (Petros, 2008: p. 89).

On the contrary, the right to remuneration of expenses is recognized under the laws of many countries. For instance India has incorporated this right under its law. Accordingly the founders of the company may be remunerated either by the commission of share subscription or an aggregate lump sum from the profits of the company (Kestela, & Madhuri, 2006: pp. 156-157). In UK, the practice shows the fact that remuneration includes repayment of expenses plus reward for the good work; though the issue of remuneration is not legally regulated. The

company's act of UK, however, in section 585(1) prohibits shares as a reward for founder's service, which avoids the old practice of founder shares and this create some nexus to the Ethiopian approach which similarly prohibit issuance of founder shares under art 310(3) of the commercial code. On the other hand, in Germany, there is no limit to the amount payable to the founders as remuneration, except that it needs to be reasonable.<sup>6</sup> And this is somehow contrary to the Ethiopian experience which specifically limits the amount to the one fifth of the net profit for three years only.<sup>7</sup>

Similarly, founders in Ethiopia can claim for expenses or costs incurred for the company under formation. As stipulated under Art 308(2) of the com. Code, the company shall take over these commitments from the founders and refund the founders with all the expenses made by them. But what could be raised here as an issue is that the company do not however refund all the expenses that founders claim, rather two conditions need to be fulfilled, that is, the expenses as well as the commitments claimed should be those which were necessary for the formation of the company and approved by the general meeting of the subscribers.<sup>8</sup>

Therefore, by approving those commitments that are entered with third parties for the company under formation, the company will take the liability which may arise as a result and will reimburse the founders for their expenses while transacting. However the main concern is that does taking over of commitments by the company relieve the founder from liability? Or does the liability which may arise from those commitments still extend to the founders, after the incorporation of the company?

Different legal systems respond differently, and used various theories as well. In common law legal systems, they used the term "*adoption*" and "*novation*" as a standard to explain the approach that is followed by countries. As a result, in those countries that prefer "*adoption*" approach of the agreement, the previous contracting parties are fully liable in addition to the new party, i.e. the company (Yohannes, 2008: p. 122). Thus the liability of the founder still extends even after the formation or incorporation of the company. In contrast, some jurisdictions like that of UK, apply a more stringent standard, i.e. *novation*, whereby the corporation may become a party only by entering in to a new contract which is an agreement for substitution of parties, and thus of liability. So, the company takes on all the obligations assumed by the founders thus relieving the founder or promoter from liability (Yohannes, 2008: p. 122). In the Civil Law systems too there are differing constructs, which might lead to different results as to the continued liability of the founders. The general tendency, however, seems to be to

<sup>6</sup>German Stock Corporation Act, art 53(3).

<sup>7</sup>This argument is taken by the writer for the reason that, the writer begin her argument by taking position that the Ethiopian company law prefer to give remuneration of founder for the expenses and costs incurred under the formation of the company through reserving shares or profits from the net profit for three years, rather than share subscription or giving lump sum payment unlike other jurisdictions.

<sup>8</sup>COMMERCIAL CODE, *supra* note 9, at art 308(2).



make them still liable, the debate being more about the obligation of the company to reimburse the founders who have paid the third party (Yohannes, 2008: p. 122).

Trying to look into the Ethiopian situation by focusing on art 308(2) of the Commercial Code which states as “The Company shall take over these commitments from the founder...” This seems to show that the company substitutes the founder after its formation. This can best be inferred when one reads the subsequent article which limit the liability to founders, when the company is not established for whatever reason.<sup>9</sup> Therefore the formation of the company and approval of the commitments by the company imply the fact that the founders are no more liable and they should be entitled to remuneration right. However this doesn't purely suggest that Ethiopia follows *novation* standard, since the law is silent as to whether the company need to conclude a new contract to substitute a party.

### 3.2. Responsibilities of Founders

Parallel to the rights that are enjoyed there are some responsibilities/duties that should be assumed by founders as a result of their status. These responsibilities of founders, are found under the commercial and other related laws. And they will entail liability unless complied. Therefore the major responsibilities under the commercial code of Ethiopia will be discussed and additional laws will be consulted to add some insight on the responsibilities of founders and the essential comparison with other jurisdictions will be made under this part.

The first responsibility of founder is, related to the requirements that should be fulfilled in order for a company to be formed. As company is one of the famous business organizations in Ethiopia, it is governed under the commercial code where by the fundamental or essential requirements that are necessary to form a company are stipulated. Accordingly the founder being the prominent individuals in the formation of the company should ascertain the fulfillment of these requirements before they run for registration of the company. Therefore, founders will be responsible in ascertaining the fulfillment of these fundamental requirements. Otherwise liability will follow as a result of damage that might be caused at their failure to carry out their responsibility.

Among the requirements the first one is that, subscription of capital and effecting payments required for the formation of the company. In legal systems that recognize share companies or similar organizations by different appellations, the company capital is regarded as an essential prerequisite for the company's existence without which it cannot be set up (Yohannes, 2008: p. 110). In Ethiopia too a share company cannot be formed without capital. In fact, the law clearly stipulates that a share company is a company whose capital is fixed in advance and divided into shares.<sup>10</sup> Many jurisdictions go beyond requiring fixing

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<sup>9</sup>COMMERCIAL CODE, *supra* note 9, at art 308(3).

<sup>10</sup>COMMERCIAL CODE, *supra* note 9, at art 304.



the capital of a share company in advance. They require full subscription of the capital. The subscription of capital is necessary because every company needs capital to commence business, and investors must be identified and promises to purchase shares must be secured before the new enterprise goes operational (Yohannes, 2008: p. 110).

Accordingly Continental European countries, apart from the Netherlands, always required subscription in full of the corporate capital. In keeping with this tradition, the Code provides, a share company shall not be formed until the capital has been fully subscribed (Yohannes, 2008: p. 110). The founders must therefore, establish it and its amount must be specified in the memorandum of association. It can be modified only in compliance with a variety of safeguards and formalities designed to protect both shareholders and creditors (Yohannes, 2008: p. 111). Similarly the law in Ethiopia follows this tradition and stipulates the requirement of full subscription of capital for the formation of a company.<sup>11</sup> Moreover, the memorandum of association must state the amount of the subscribed capital.<sup>12</sup> In addition, sometimes, subscribed capital will not be of much utility to creditors as collection of subscriptions is likely to become difficult at the very moment the money is needed<sup>13</sup> Being conscious of the likely problems that might result, some laws like that of the European Union require the founders to put some real assets at risk before they commence business.<sup>14</sup> Likewise the Ethiopian law specify that in order for a company to be formed, one fourth at least of the per value of the shares has to be paid up and deposited in bank in the name and to the account of the company.<sup>15</sup> Besides it is stated that shares subscribed in cash shall be paid up upon subscription as to one fourth of their per value or a greater amount.<sup>16</sup> The remaining three fourth can be paid in a period not exceeding five years, according to the plan to be formulated by the company pursuant to Art 342 of the Code. However, Some European jurisdictions do not believe payment of one-quarter provides sufficient security. A case in point is the current French law, which provides “shares subscribed in cash be paid in respect of at least fifty per cent of their face value” (Yohannes, 2008: p. 112).

More importantly, the duty to check the fulfillment of these requirements lies up on founders. All the above requirements of Ethiopian law on the other way, shows the possibility whereby companies would be formed without fulfilling these requirements, therefore founders are believed to take responsibility in assuring the completion.

The other responsibility is that of disclosure of the company’s situation with regard to the number of members of the share company. As stipulated under, art 307 of the commercial code a company may not be established with less than five

<sup>11</sup>COMMERCIAL CODE, *supra* note 9, at art 312(1(a)).

<sup>12</sup>*Id.*

<sup>13</sup>*Id.*

<sup>14</sup>*Id.*

<sup>15</sup>*Id.*, at Art 312(1(b)).

<sup>16</sup>*Id.*, at Art 338(1).

members, in addition the commercial code prohibited a company to remain in business for more than six months after the number of members is reduced to less than five.<sup>17</sup> So that, every member who is aware of such reduction should inform the situation to the respective authority or should not make contracts by the name of the company. Accordingly founders, as one member of the company are responsible to disclose this fact and should deter his/her self from concluding contracts by using the company's name. Otherwise he/she will be personally liable for the debts as a result of the contract after the reduction of number of the company below the minimum required.<sup>18</sup>

On the other hand founders are also responsible to stipulate in kind contribution. This is one of the duties included under the commercial code. If the capital of the company is to be raised effectively, thus, foreclosing putting at risk the interest of creditors, shareholders and the company itself, contributions in kind must be submitted at the earliest possible time. What is more, their value should not be exaggerated (Yohannes, 2008: p. 115). Previously, the duty to file a report was imposed on a member who makes the contribution, and the report was required to be made and sworn by experts appointed by the ministry of commerce and industry. This system of valuation, was, in part, borrowed from the Italian Civil Code (Yohannes, 2008: p. 115). However this law is no more in action in Ethiopia and is repealed by proclamation No. 686/2010. According to this proclamation founders are made to assume the responsibility of stipulating the correct valuation of the contribution in kind in the memorandum of association.<sup>19</sup> However, this responsibility is filled with many problems. The first problem relate to the practicability of the responsibility. This is for the fact that in a company whereby large number of founders exists, it is difficult to come up with valuation of contributions in a short and timely manner.

What is a worse, shareholder might deliberately overestimate the value of the contributions of each member in a bid to enhance the creditworthiness of their company by inflating its capital. In some cases, things could get much worse than that. An "agreement" might be made to "contribute" property that does not exist or does not belong to the "contributing" member (Yohannes, 2008: p. 115).

More importantly, the Ethiopian law stipulates that shares representing contribution in kind shall normally fully to be paid before the registration of the company. Thus, such shares shall be kept to the company and may not be separated from the counterfoil and be negotiated before two years from registration of share companies.<sup>20</sup>

Therefore what could be implied here is, there might be situations where by contribution in kind may be overvalued or exaggerated so that this may create some inconvenience especially up on the interest of creditors. Therefore it is the

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<sup>17</sup>COMMERCIAL CODE, *supra* note 9, at, Art 311(1).

<sup>18</sup>*Id.*

<sup>19</sup>Commercial Registration and Business Licensing Proclamation No 686/2010, Negarit Gazetta 16th Year No 42, Art 6(10). (here after commercial registration and Business licensing proclamation).

<sup>20</sup>COMMERCIAL CODE, *supra* note 9, at Art 339.

responsibilities of founder to stipulate the contribution in kind without exaggerating. Owing to this, overvaluing a contribution might be regarded as a breach of trust on the part of the founders (Yohannes, 2008: p. 112). What's more, founders are jointly and severally liable for the damage resulting from such overvaluation.<sup>21</sup>

In addition, to release accurate information to the public concerning the formation of the company is also the other responsibility. In other words all statements in relation to the company's formation should be based on accurate facts and they should not deceive the public. Accordingly, art 309(3) of the commercial code put the circumstance where by founders will be held liable for the accuracy of the statements made to the public in respect of the formation of the company. This is where damage is caused in connection to the accuracy of the facts that are stated by founders. i.e. if the statements displayed by founders are found to be false.

The other responsibility is to sign the basic documents of the company (Kestela & Madhuri, 2006: p. 159). Though this responsibility does not clearly exist under the commercial code, it can be impliedly inferred from art 307(2) of the com code which, consider those person who sigh the memorandum of association as founders. Accordingly it implies that founders sign memorandum of association. Moreover, this responsibility is clearly incorporated under the Commercial Registration and Business Licensing Proclamation No-686/2010. This proclamation stipulate that Founders of a business organization shall sign their memorandum and articles of association at the Documents Authentication and Registration Office, and it should be done according to standardized samples of memorandum and articles of association sent to the same office by the registering office. Moreover signing the documents should be done before applying for commercial registration, except any amendments to these signed and registered memorandum and articles of association is needed.<sup>22</sup>

The other responsibility that is assumed by founders is a duty to have promotional license (Kestela & Madhuri, 2006: p. 159). In many jurisdictions companies especially those formed through public subscription require a huge amount of capital. And the capital could not be obtained from a single source. Thus in order to bring together these capitals founders should run here and there and transact with other people to make the formation of the company real. However it is difficult to win the trust of third party, since they act for the company which is nonexistent. As a result they need some document which could help them to prove their status. These can be a promotional license. Hence third parties will be informed about persons acting on behalf of a company under formation (Kestela & Madhuri, 2006: p. 159).

Looking all over the commercial code of Ethiopia will be tiresome, as there is no single provision which govern the situation. However looking other related

<sup>21</sup>COMMERCIAL CODE, *supra* note 9, at Art 309(1(a)).

<sup>22</sup>Commercial Registration and Business Licsensing Proclamation , *supra* note 45, at art 6(7).

laws will be helpful to have insights about the responsibilities of founders. Accordingly the [Commercial Registration and Business Licensing Proclamation No-686/2010](#) is one which can give us answer in this regard. According to this law, founders who want to establish a share company via public subscription as per Art. 317 seq. of the Commercial Code shall get promotional license. Therefore, the founders of a share company in order to start the formation of the company shall in advance obtain the written permission of the registering office.<sup>23</sup>

Moreover, founders are also dutybound to publicize a notice of intention ([Kestela, & Madhuri, 2006: p. 160](#)). This duty is mostly imposed on founders to check up on their integrity to establish share companies. Similar to the above duty, this responsibility is also not included in the commercial code. So that we can say the company law failed to stipulate such responsibility. However this duty can be taken from the [Banking Business Proclamation No. 592/2008](#). This proclamation put a requirement where by Founders will be obliged to publish their intention to form a share company.<sup>24</sup> However the law doesn't impose this duty on founders on all types of formation process of share companies ([Kestela, & Madhuri, 2006: p. 160](#)). The duty to publish an intention is needed to form share companies of banking business<sup>25</sup> and insurance business.<sup>26</sup> In contrary to the Ethiopian approach, In French Commercial Law there is a duty of the founder to publish a notice of intention for all kinds of business. The founders shall publish a notice in accordance with the conditions laid down by *Conseild'Etat* decree ([Kestela & Madhuri, 2006: p. 160](#)).

Most importantly founders, being fundamental individual in the formation as well as operation of company, she/he should carry out his duty with reasonableness and should deter him/herself from things that could adversely affect the interest of the company, and which may create a conflict of interest between him/her and the company. Thus, the founder shall faithfully disclose all facts relating to the property transferred and contract entered to the future company ([Kestela & Madhuri, 2006: p. 158](#)).

In short all the rights and responsibilities discussed above will be presented in the following [Table 1](#) in a precise way.

In general all the above listed responsibilities of founders will entail liability unless they are carried out carefully and as required by the laws. Violations of the action will lead to violation of the laws that stipulate the responsibilities, which in return entails either civil or criminal liability. The commercial code clearly state that founders shall be jointly and severally liable to the company and third parties in connection to their failure in carrying out one of their responsibilities listed under art 309(a-c) of com code.

Moreover, the Commercial Code stipulates that founders shall be fully jointly

<sup>23</sup>Commercial Registration and Business Licensing Proclamation, *supra* note 45, at Art 12(5).

<sup>24</sup>Banking Business Proclamation No 592/2008, Negarit Gazeta 14th Year No. 7, art 4(1(c)). ( here after Banking Business Proclamation)

<sup>25</sup>Banking Business Proclamation, *supra* note 56.

<sup>26</sup>Insurance Business Proclamation No 746/2012, Negarit Gazeta, 18th Year No. 57, art 4(1(c)).

**Table 1.** Rights and responsibilities of founders.

No	Rights	Responsibilities	Law that include the rights/responsibilities	
			Commercial code	Other laws
1	The right to get the status of a founder	To check the fulfillment of the requirements for the establishment of a company.	√	
2	Right to get profit	To stipulate in kind contributions	√	√
3	Reimbursement/ Remuneration right	To release accurate information to the public concerning the formation of the company.	√	
4	-	To sign the basic documents of the company	Impliedly inferred	√
5	-	Duty to have promotional license	-	√
6	-	Duty to publicize a notice of intention	-	√

and severally liable to third parties in respect of commitments entered into for the formation of the company. All persons who have acted in the name of the company before its registration in the commercial register shall be similarly liable.<sup>27</sup> Where the company is not established for whatever reason, the subscribers shall not be liable for the commitments or expenses made by the founders.<sup>28</sup> Thus it is only founders who will be held responsible in this case. Furthermore it is stated that every members including founders shall be held personally liable if they enter in to contract knowing the fact that the number of the members has been reduced less than the minimum required.<sup>29</sup> All this stipulation explains the civil liabilities that founders may assume.

On the other hand the criminal code also incorporated a provision which could apply to founders. Accordingly the criminal code has provided provisions by including offenses that would have been done by founders. As a result Whoever, with intent to obtain for himself or to procure for a third person an unlawful enrichment, fraudulently causes a person to act in a manner prejudicial to his rights in property, or those of a third person, whether such acts are of commission or omission, either by misleading statements, or by misrepresenting his status or situation or by concealing facts which he had a duty to reveal, or by taking advantage of the person's erroneous beliefs, is punishable with simple imprisonment, or, according to the gravity of the case, with rigorous imprisonment

<sup>27</sup>COMMERCIAL CODE, *supra* note 9, at Art 308(1).

<sup>28</sup>COMMERCIAL CODE, *supra* note 9, at Art 308(3).

<sup>29</sup>COMMERCIAL CODE, *supra* note 41.

<sup>30</sup>The Criminal Code of the Federal Democratic Republic of Ethiopia, Pro. No. 414, Federal Negarit Gazazette, 2004, art 692(1).

not exceeding five years, and fine.<sup>30</sup> Therefore founders who commit one of the above offenses will be held criminally liable. So that, the criminal code of Ethiopia tried to regulate the behavior of founders, by extending this provision.

#### **4. Concluding Remarks**

In general, the paper attempted to evaluate the rights and responsibilities of Founders and to give some remarks up on the Ethiopian Commercial code. In the preceding discussions, it is established that Founders are the most prominent individuals who take the initiative to form a company. As a matter of fact they take the risk of getting in to transaction for a company which is nonexistent, this situation on one hand, entitled them with some rights and privileges while on the other hand create responsibilities to be assumed by them. Though the commercial code of Ethiopia tries to incorporate some provisions which deal about rights and responsibilities of founders it fails to clearly and effectively stipulate the rights and responsibilities of these individuals (Founders) and the commercial code is full of defects.

From the very beginning, the commercial code is not clear in defining the term Founder, what it make in this regard is that, it make distinction between individuals who contribute in kind and in cash in according the status. Accordingly, the code has considered those who contribute in kind as founders while it disregard those individuals who contribute in cash the status of founders; the code in this regard is not clear on what criteria it make distinction among shareholders. On the other hand, the commercial code in art 310(1), has given founders the right to reserve profit for a period of three years. However, the law is not clear with regard to the beginning of these three years. Or whether it should be consecutive? Such questions are not answered in the commercial code of Ethiopia. Moreover, the commercial code of Ethiopia is silent and one cannot vividly tell on whether taking over of commitments by the company relieve the founder from liability or whether the liabilities still extend to the founders, after the incorporation of the company.

On the other hand, the acts which are considered as responsibilities of founders together with the liabilities they entail are discussed. Parallel to the rights that are enjoyed there are some responsibilities/duties under the provisions of the Ethiopian commercial code that should be assumed by founders as a result of their status. As a result the violation of those acts may lead into the violation of stated provision and this in turn may result into civil as well as criminal liability. For example, If the required capital and subscription is not fulfilled (Art 309/1/a/) it is violation of law, moreover if the minimum capital required to form Share Company is less than stated amount it has similar effect. Likewise, the capital of Share Company should fully subscribe upon formation. If founders formed share company without fully subscribed, such will lead to the violation of the law. As to the contribution in kind, the correct value of the thing should be stipulated correctly and should be verified. If the amount does not conform to

exact value then there is violation of the law by the founders. The same is true if the statements made by founders are found to be false. However, the commercial code is not comprehensive so as to give a clear understanding on each and every rights and responsibilities of founders as some rights and duties that are covered under the commercial code lacks clarity, which call for some questions which could not be answered by the commercial code itself. On the other hand, there are some responsibilities which are not covered under the commercial code. As a result duty to publish intention, duty to have promotional license and some other duties which fall in to this category are not included in the commercial code. Such responsibilities are found in other related proclamations such as Commercial Registration and Business Licensing Proclamation.

Hence, all these shows the fact that the commercial code of Ethiopia is not comprehensive enough to briefly explain the rights and responsibilities of founders. For this and other reasons the writer would like to recommend the following solutions, which are believed to bring some change to the problems. Therefore the writer, recommend for the amendment of the commercial code on issues that relates to founders. Specifically,

- The code should avoid the distinction it made among individuals on the basis of the kind of contribution. Thus, those who have paid in cash should also be considered as founders.
- The law should be made clear with regard to art 310(1), which put the time of three years limit. Thus the beginning of these three years and the consecutiveness or not of these years should be reconsidered if amendment of the code is to be sought.
- Furthermore, some responsibilities like that of duty to have a promotional license, duty to publish intent etc, where by the commercial code is silent about should be incorporated.
- The responsibilities of Founders with regard to valuation should be reviewed, so as to avoid the problem of overvaluation, thus a method which was previously in use by the commercial code should be maintained. Accordingly, the ministry of trade through its independent experts will value the contribution that is made in kind.

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