

UNLIMITED AND LIMITED LIABILITY IN THE COMMERCIAL CODE OF ETHIOPIA

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I.	INTRODUCTION	1083
A.	<i>Location of Previous Governments.</i>	1084
B.	<i>Present Government.</i>	1084
C.	<i>Constitution</i>	1085
D.	<i>Codes</i>	1085
II.	BUSINESSES, TRADES AND TRADERS	1086
III.	LIMITED LIABILITY OF MARRIED SOLE PROPRIETORS WHO ARE TRADERS	1088
A.	<i>Limited Liability of General Partners</i>	1092
B.	<i>Ordinary Partnerships</i>	1094
C.	<i>Joint Ventures</i>	1096
D.	<i>General Partnerships.</i>	1097
E.	<i>Limited Partnerships.</i>	1098
IV.	POTENTIAL UNLIMITED LIABILITY OF SHAREHOLDERS	1099
A.	<i>Share Companies.</i>	1099
B.	<i>Private Limited Companies.</i>	1100
V.	A PROPOSAL FOR LIMITED LIABILITY FOR ALL SOLE PROPRIETORS	1102
VI.	CONCLUSION	1104

I. INTRODUCTION

The conventional wisdom of those conversant with the law of personal liability of owners of a business is that sole proprietors and general partners always have unlimited liability for the debts of a business which they own. On the other hand, shareholders in companies enjoy limited liability for those debts. However, a close reading of the Ethiopian

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Commercial Code of 1960¹ shows that some sole proprietors and some general partners may enjoy limited liability for the debts of their businesses. Similarly, shareholders in private limited companies² may lose their limited liability in unexpected ways and shareholders in share companies,³ when acting as directors, may also lose their limited liability. Before pursuing these conclusions, some background information about Ethiopia is useful.

A. Location of Previous Governments

Ethiopia is located in the Horn of Africa, the eastern-most part of Africa. Its neighbors are Kenya to the south, Sudan to the west, Eritrea (a former province of Ethiopia, independent *de facto* since 1991 and *de jure* since 1993) to the north and east, and Djibouti and Somalia to the east. Ethiopia is the only country in Africa, other than Liberia, which retained its independence during the colonial period. In fact, it expanded its traditional borders, conquering many tribes east, south and west of the territory of Abyssinia. Italy attacked Ethiopia in 1936, drove Emperor Haile Selassie I into exile and occupied the country until expelled by the British in 1941. Haile Selassie returned in 1941 and retained power until a coup in 1974 forced him to abdicate. From 1974 to 1991 a communist military dictatorship called the Derg ruled the country.

B. Present Government

A party of former communists controls the present government of Ethiopia. It acquired power in 1991 when it won a long civil war against the Derg. After a period of transitional government, a new Constitution was written in 1994, and elections were held in the spring of 1995, although the main opposition parties boycotted them. The new Constitution came into effect and the government assumed its new offices in August 1995.⁴ To its credit, the present government has said many things about creating a democratic society and a free market economy. It has carried into practice fewer policies and practices than are necessary for

1. NEGARIT GAZETA, COMMERCIAL CODE OF THE EMPIRE OF ETHIOPIA (Proclamation No. 166 of 1960). *Gazette Extraordinary*, 19th year. In Ethiopian legal terminology *proclamation* simply means *act* or *statute*. The Negarit Gazeta was the official government gazette for publishing laws, regulations and official notices, all of which have no authority until published. It was published from 1941 until August 1995, when the Federal Negarit Gazeta superseded it.

2. A private limited company is somewhat comparable to an American close corporation.

3. A share company is comparable to an American corporation.

4. ETH. CONST. 1st Year, No. 1, (1995).

a democratic society and a free market economy to come into being. The ideology of the government, which requires the government to own all of the land⁵ and public utilities, and limits investment in many activities to Ethiopian nationals or residents,⁶ constitutes a major impediment to the creation of economic conditions which would lift Ethiopia out of its poverty. While the federal government talks about a transition from a communist command economy to a market economy, it has not yet made the transition. The economy is not a market economy, let alone a free market economy. There are very few signs that the government is willing to relinquish the control, which it must do if it is to permit business persons and others to create a free market economy.

C. Constitution

The 1994 Constitution establishes a federal system composed of a national government and nine states.⁷ The Constitution reserves to the federal government all matters dealing with the Commercial Code.⁸ The capital is Addis Ababa and its administration is responsible to the federal government.⁹ The dividing line between federal and state authority is not clearly set forth in the 1994 Constitution, just as it is not clear in the American federal system. One area in which this causes difficulties for all businesses is access to land. While all land is owned by the "State and Peoples in Ethiopia,"¹⁰ leases are granted by the states. There is ample evidence that the states and the city of Addis Ababa are using their ownership of the land to harass business persons and farmers, often evicting them without a pretense of following the law or the land lease contracts.¹¹

D. Codes

Ethiopia adopted a Civil Code and a Commercial Code in 1960.¹² Both were written by French professors and incorporated many civil law

5. *Id.* art. 40.3.

6. *Investment Proclamation*, 25 FEDERAL NEGARIT GAZETA, arts. 5-7, 181-184 (1996).

7. ETH. CONST. art. 47.1.

8. *Id.* art. 55.4.

9. *Id.* art. 49.3.

10. *Id.* art. 40.3.

11. B. Yosef *Government Measures Against Businessmen Called Illegal*, ADDIS TRIBUNE (Addis Ababa), June 6, 1997, at 1; *Backward to De-kulakization or Forward to Farmers Prosperity?* THE MONITOR (Addis Ababa), Apr. 10, 1997, at 3.

12. GAZETA, *supra* note 1, Proclamation 165/2.

concepts which were modern at the time.¹³ While the Civil Code expressly repealed all written or customary rules in force concerning matters provided for in the Code,¹⁴ it specifically retained some indigenous customary institutions.¹⁵ No indigenous institutions were specifically retained in the Commercial Code.¹⁶

The Civil Code and the Commercial Code did not penetrate deeply into Ethiopian society during the reign of Emperor Haile Selassie I.¹⁷ While neither code was repealed or amended by the *Derg*, a law nationalizing almost all property in Ethiopia¹⁸ rendered inoperative the business organization provisions of the Commercial Code.

II. BUSINESSES, TRADES AND TRADERS

The Ethiopian Commercial Code makes a distinction between economic activities which are designated as commercial, trade or business (all of which mean the same thing) and those which are not. Article 124 defines a business as an incorporeal movable organized for the purpose of carrying out any of the activities specified in Article 5. Article 5 is composed of 21 clauses, each of which lists one or more activities which are deemed to be trades, that is, activities carried on professionally and for gain by traders.¹⁹ Article 5 by its terms excludes from the definition of

13. Jean Escarra, *Expose des Motifs: General Part (Comm. C. Doc. No. 2)* (April 13, 1954), in BACKGROUND DOCUMENTS OF THE ETHIOPIAN COMMERCIAL CODE OF 1960 30, Doc. No. 7 (Peter Winship ed. & trans., 1974) [hereinafter Winship]; Jean Escarra, *Expose des Motifs: Commercial Register (Comm. C. Doc. No. 6B)* (May 31, 1954), at 46, Document No. 16.

14. GAZETA, *supra* note 1, art. 3347.

15. See, e.g., *id.* arts. 722-33, 241-60.

16. While no institutions of customary law in Ethiopia were retained in the Commercial Code, nonetheless customary institutions, such as the customary partnerships of traders in Addis Ababa, have survived in practice. Paul McCarthy, "De Facto" and Customary Partnerships in Ethiopian Law, 5 J. ETH. L. 105 (1968).

17. John Henry Merryman, *On the Convergence (and Divergence) of the Civil Law and the Common Law*, 17 STAN. J. INT'L L. 357 (1981), in JOHN HENRY MERRYMAN ET. AL., THE CIVIL LAW TRADITION: EUROPE, LATIN AMERICA AND EAST ASIA 22 (1994).

18. Government Ownership and Control of the Means of Production Proclamation No.26/1975, NEGARIT GAZETA, 34th Year, No. 22, (Mar. 11, 1975).

19. GAZETA, *supra* note 1, art. 5. *Persons to be regarded as traders*, states:

Persons who professionally and for gain carry on any of the following activities shall be deemed to be traders:

- (1) Purchase of movables or immovables with a view to re-selling them either as they are or after alteration or adaptation;
- (2) Purchase of movables with a view to letting them for hire;
- (3) Warehousing activities as defined in art. 2806 of the Civil Code;

traders persons who may engage in those activities as hobbies. Thus, a photographer, regardless of his or her talent and skill, will not be a trader if he or she does not take photographs for economic gain. Similarly, a publisher which does not expect to make a profit, such as the press of a school or university, will not be a trader because the activity is not carried on for gain, but for some other purpose, such as the dissemination of knowledge.

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- (4) Exploitation of mines, including prospecting for and working of mineral oils;
 - (5) Exploitation of quarries not by handicraftsmen;
 - (6) Exploitation of salt pans;
 - (7) Conversion and adaptation of chattels, such as foodstuffs, raw materials or semi-finished products not by handicraftsmen;
 - (8) Building, repairing, maintaining, cleaning, painting or dyeing movables not by handicraftsmen;
 - (9) Embanking, leveling, trenching or draining carried out for a third party not by handicraftsmen;
 - (10) Carriage of goods not by handicraftsmen;
 - (11) Printing and engraving and works connected with photography or cinematography not by handicraftsmen;
 - (12) Capturing, distributing and supplying water;
 - (13) Producing, distributing and supplying electricity, gas, compressed air including heating and cooling;
 - (14) Operating places of entertainment or radio or television stations;
 - (15) Operating hotels, restaurants, bars, cafes, inns, hairdressing establishments not operated by handicraftsmen and public baths;
 - (16) Publishing in whatever form, and in particular by means of printing, engraving, photography or recording;
 - (17) Operating news and information services;
 - (18) Operating travel and publicity agencies;
 - (19) Operating business as an agent, broker, stock broker or commercial agent;
 - (20) Operating a banking and money changing business;
 - (21) Operating an insurance business.

Article 5 is limited by articles 6, 7, 8 and 9, which exempt agricultural and forestry activities and the activities of fishermen and define the status of handicraftsmen. The "enumeration [in art. 5] should be limitative." Alfred Jauffret, *General Report: Book I, (March 1, 1958) (Excerpt)*, 50, Doc. No. 18 in Winship, *supra*, note 13. Therefore, any activity which is not listed in article 5 is not a trade, its practitioners are not traders and it does not constitute a business under art. 124 of the Commercial Code. Handicraftsmen are defined in art. 9(2)-(3) as:

- (2) Handicraftsmen are persons who carry on an independent activity, who live mainly on their own manual work, who may carry on their activity with the assistance of members of their family and of not more than three employees or apprentices and who buy such material only as is necessary for carrying out their activities, without setting up stocks.
- (3) Handicraftsmen may use mechanical power.

The traditional professions of medicine, law, architecture and education are not listed in Article 5. Neither are the newer professions of accounting, consulting, engineering, design, fashion, computer programming, providing business services such as fax and e-mail, secretarial and office management services, etc. Persons who conduct these activities professionally and for gain are not deemed to be traders because their activities are not listed in Article 5. Similarly, certain persons who are handicraftsmen are also not traders even if they engage in activities which are trades. Therefore, the economic activities of some professionals and handicraftsmen are not treated as businesses by the Commercial Code. They escape from the registration²⁰ and record keeping requirements imposed by the Code.²¹

The discussion below with respect to sole proprietorships is restricted to those owned by certain persons. It concerns only persons who are engaged in a business, that is, one of the activities described in Article 5, and who are married. Sole proprietors of activities which are not listed in Article 5, and who, therefore, do not carry on a trade, or who are not married, may not avail themselves of the protection from unlimited liability afforded by the Commercial Code.

III. LIMITED LIABILITY OF MARRIED SOLE PROPRIETORS WHO ARE TRADERS

An economic activity carried on for profit which is owned by one person is a sole proprietorship.²² If there are two or more owners of an economic activity (whether it is a trade or not), the owners must form one of the business organizations described in Articles 210 through 560 of the Commercial Code.²³ Articles 16, 17, 18, 19, 20 and 21²⁴ of the

GAZETA, *supra* note 1, art. 9(2), (3).

20. *Id.* arts. 86-123.

21. *Id.* arts. 63-85.

22. If a married person carries on the business or trade, it may be *common property* under article 653(1) of the Civil Code. In this case, two persons, the spouses, in fact own it. But it is nonetheless treated by the Commercial Code as if the trader solely owned it. *Id.* art. 105, dealing with registration of a trader, requires a trader to state if a marriage settlement has been entered into, but does not require the name or any information about the spouse of the trader. It should be noted that identical legal terminology in the English language can mean different things in different legal systems. The property called *common property* in the Ethiopian Civil Code is called *community property* in those American states which recognize that type of marital property regime. In Ethiopia, property solely owned by one of the spouses is called *personal property*. In American community property states, property solely owned by one of the spouses is called *separate property*. The term *personal property* is the term applied in all American states except Louisiana to the property which the civil codes of Ethiopia and Louisiana call *movable property*.

23. The commercial code states, in part:

Commercial Code relate to the sole proprietorship of a trader who is married. A married trader may attain a measure of limited liability with remarkable ease. Article 16 states that a married person may carry on a trade as though he or she were unmarried, unless the spouse objects under Article 645 of the Civil Code. The objecting spouse may enter the objection in the commercial register pursuant to Article 17(2) of the Commercial Code. Article 645 permits an objection to any occupation "in the interest of the household." That phrase is not defined and its content is

"(1) There are six forms of business organizations under this Code:

- (a) ordinary partnership;
- (b) joint venture;
- (c) general partnership;
- (d) limited partnership;
- (e) share company;
- (f) private limited company."

GAZETA, *supra* note 1, art. 212.

24. Art. 16. – Married persons may carry on trade.

Any married person may carry on a trade as though he were unmarried unless his spouse objects thereto as provided in art. 654 of the Civil Code.

Art. 17. – Notification of objection.

(1) As between spouses an objection under Art. 16 may be notified to the trading spouse in any manner.

(2) An objection under Art. 16 shall not affect third parties, in accordance with Art. 121 of this Code, unless notice of such objection has been entered in the commercial register.

Art. 18. – Setting aside of objection.

(1) Where the trading spouse is of the opinion that the objection is not justified, having regard to the interest of the family, he may apply to the family arbitrators to set aside the objection.

(2) Where the arbitrators set the objection aside, a notice to this effect shall be entered in the commercial register.

Art. 19. – Debts contracted by the trading spouse.

Debts contracted by the trading spouse shall be deemed to be debts of the marriage within the meaning of Art. 659 of the Civil Code and may be recovered on the personal estate of each spouse and on common property.

Art. 20. – Effect of objection.

Where an objection under Art. 16 has been entered in the commercial register, debts contracted by the trading spouse may be recovered on his personal estate only.

Art. 21. – Cooperation of spouses.

Where spouses together carry on a trade, they shall both be deemed to be traders, unless it is shown that one of them is the employee of the other.

GAZETA, *supra* note 1, arts. 16-21.

left to the determination of the family arbitrators who decide the matter.²⁵ But neither Article 16, any other article of the Commercial Code, nor any article of the Civil Code imposes any constraints upon the spouse who persists in the trade despite the objection of the other spouse.²⁶ The only consequences of the objection are the administrative requirement of Article 17 that the objection be entered in the commercial register and the benefit bestowed by Article 20. Article 20 of the Commercial Code provides that when the objection has been entered in the commercial register, the debts contracted by the trader may be recovered only from the trader's separate property. Obviously, an objection does not prohibit a trader from continuing the trade, or there would be no purpose served by the limitation imposed by Article 20.²⁷ The only commercial result of Article 20 is that the trader may have more difficulty getting credit than is normally the case because the trader's common property is not available to pay the debts of the business.²⁸

Thus, liability limited to personal property may be obtained for a business simply upon the filing of an objection pursuant to Article 17(2) of the Commercial Code. No other action is required. Neither the Civil Code, nor the Commercial Code, prescribes any consequences to the trader who continues to engage in the trade after the objection of his or her spouse has been entered in the commercial register. Therefore, the risks associated with continuing the trade after an objection has been entered in the register are nonexistent. The benefit is large. It is a form of limited liability. The common property of the couple and the personal property of

25. Family arbitrators are elders or others who act pursuant to Civil Code article 722-733. Each spouse appoints two arbitrators and these four typically appoint a fifth person as chairman. The purpose of the family arbitrators is to decide matters such as: whether certain property is personal property instead of common property; whether an objection of one spouse to the carrying on of a business by the other is valid; divorce; division of common property after a divorce; etc. Family arbitrators are not officers of the court nor appointed by the court, but their decisions are final unless appealed to the court because of corruption of the arbitrators, fraud in regard to third persons, or the illegal or manifestly unreasonable character of the decision.

26. As originally drafted, if the trader continued the trade over the objection of the spouse, that continuation was a ground for divorce. Alfred Jauffret, *General Report: Book I (March 1, 1958)(Excerpt)*, 51, 177 n.8, Doc. No. 18 in Winship, *supra* note 13 [hereinafter Jauffret].

27. The limitation of a creditor's right to recover a trader's debt to the personal property of the trader is a significant limitation because income from personal property is common property, so even the income from the trade is exempt from seizure by a creditor. See text following *supra* note 30.

28. Credit is not easy to obtain in Ethiopia at the present time because no one owns any land which may be mortgaged under art. 3041 through 3130 of the Civil Code to secure a debt. Nor is it common to pledge securities under art. 950 through 958 of the Commercial Code because there are very few share companies available in which to invest.

the non-trading spouse are protected from the claims of creditors of the trading spouse's business.

Article 18 of the Commercial Code permits the trader to appeal the objection to the family arbitrators, who may sustain or set aside the objection. Nothing is changed from the situation created by the objection if the family arbitrators sustain the objection. However, liability limited to the personal property of the trader would be lost if the family arbitrators set aside the objection. That would not appear to be "in the best interest of the family," the standard set forth in Article 18 to govern the decision of the family arbitrators. If the trading spouse called upon the family arbitrators, therefore, it would only be to confirm the objection and thus, give the objection greater status by their independent decision.

The background materials of the Commercial Code contain no reference to this ability of a married trader to protect the common property of the family from liability for the debts of the business.²⁹

The effect of the limitation by Article 20 of the Commercial Code of debt recovery solely from the personal estate³⁰ of the trader depends, therefore, upon the property regime established by the Civil Code for married persons. What is a married person's personal estate?

Articles 647 through 661 of the Civil Code govern the property regime of a married couple. Article 653(1) establishes the presumption that all property is common property unless one of the spouses establishes his or her sole ownership. Article 652(1) deals specifically with the salaries and income of the spouses. It establishes the rule that all salaries and income are common property. All of the income from the business of a trader is, therefore, common property. It is not his or her personal property. This is so even if the property employed in the business is separate property. (Of course, the property employed in the business may itself be common property if it does not fall within one of the kinds of property which is personal property.) Article 647 provides that personal property is property owned at the time of the marriage or acquired after the marriage by succession or donation. Article 648 provides that property acquired by onerous title (for value) during a marriage in exchange for personal property or with personal money shall be personal property only if so declared by the family arbitrators. Therefore, a business or a trade will be common property unless the trader owned the business before the marriage, was given the business during the marriage, or bought it with

29. See Jauffret, *supra* note 26.

30. The commercial code of article 20 uses the words *personal estate*. Article 647 and following use the words *personal property*. Nothing in either code suggests that the terms have different meanings.

personal property or money and obtained the required declaration from the family arbitrators. With respect to a married person's debts, Article 659 states that the debts of a spouse may be recovered from the personal property of the spouse and from the common property of the couple. Note, however, that Article 19 of the Commercial Code also makes the personal property of the non-trading spouse, as well as the couple's common property and the trader's personal property, liable for the debts of a trader.

In the interest of protecting the family, every spouse who is married to a trader should object and enter the objection in the commercial register pursuant to Article 17(2) of the Commercial Code. Article 20 of the Commercial Code makes entry of the objection the sole requirement for protecting the common property of the couple from the debts of the business by limiting recovery to the trader's personal estate. If asked pursuant to Article 18, the family arbitrators should, for the reasons discussed above, sustain the objection as a matter of course. This will not deter the trader from continuing his or her trade, as the objection (and the arbitrator's decision, if any, to sustain it) will be pursuant to a well thought-out plan to protect the common property of the trader and his or her spouse and the personal property of the spouse. It is only by following this procedure that a married trader who is a sole proprietor creates a form of limited liability from the debts of the business. As a result of this procedure, the common property of the trader and his or her spouse and the personal property of the spouse are protected from the liabilities of the business. The rules established by Article 659(1) of the Civil Code, which makes the common property of a couple liable for the debts of each spouse, and by Article 19 of the Commercial Code, which makes the common property of the couple and the personal property of each liable for the debts of the trading spouse, are overcome by the procedure set forth in the Commercial Code with respect to the debts of the business of a trader whose spouse has objected to the trade and entered the objection in the commercial register (and whose objection was sustained by the family arbitrators as in the best interest of the family).

A. Limited Liability of General Partners

At least two, and probably three, persons drafted book II of the Commercial Code, governing business organizations.³¹ The provisions relating to ordinary partnerships were originally in the Civil Code. They were transferred to the Commercial Code without careful thought about

31. Winship, *supra* note 13, at v.

how they would affect the other provisions of the Commercial Code governing partnerships. Some general rules governing partnerships appear to have been omitted from the draft, which was enacted despite the omission.³² A result is that there are unfortunate gaps in the Commercial Code, and, as we shall see, several inconsistent provisions.

Article 215(2) is in the title of the Commercial Code (Title I of Book II) which sets forth general provisions which theoretically relate to all business organizations.³³ Article 215(2) provides that any provision relieving one or more partners of his or her share in the losses of the partnership shall be of no effect. This general provision is contradicted in every title dealing with a specific kind of partnership. Title II, governing ordinary partnerships,³⁴ Title III, governing joint ventures,³⁵ Title IV, governing general partnerships,³⁶ and Title V, governing limited partnerships,³⁷ all contain rules permitting a partnership to create exceptions to Article 215(2). The usual rule of statutory interpretation is that the specific provision overrules the general provision.³⁸ Therefore, the rule set forth in Article 215(2) does not necessarily affect any of the partnerships recognized by the Commercial Code. The specific provisions governing each form of partnership authorize exceptions to the rule.

No exemption from unlimited liability for a general partner is automatically provided by the Commercial Code, except for non-managing partners of a joint venture, who according to Article 276(2), have limited liability unless it is taken from them by the partnership agreement. In other partnerships, the Commercial Code only permits the partnership agreement to provide the exemption. Thus, except for joint ventures, for a general partner to enjoy a form of limited liability, there must be a provision to that effect in the partnership agreement.

32. *Id.*

33. The commercial code of article 215(2) by its terms applies only to partnerships. Article 210(1), however, states that a business organization is any association arising out of a *partnership* agreement. Article 215 would, therefore, apply to any business organization as a result of art. 210(1). The Commercial Code sometimes uses the words *partner* and *partnership* in the technical sense of business organizations governed by art. 227-303 and sometimes uses them in a general sense applicable even to shareholders and a company.

34. GAZETA, *supra* note 1, arts. 227-70.

35. *Id.* arts. 271 - 79.

36. *Id.* arts. 280 - 95.

37. *Id.* arts. 296 - 03.

38. *Generalia specialibus non derogant*, General words do not derogate from special words. BLACK'S LAW DICTIONARY 684 (6th ed.1990).

B. Ordinary Partnerships

An ordinary partnership may not engage in any of the activities listed in Article 5.³⁹ Therefore, it is not commercial and may not engage in a business as defined in Article 124. If it engages in these activities, it will be deemed to be a general partnership.⁴⁰ Because an ordinary partnership may not engage in a trade, none of its partners would be engaged in a trade. Therefore, the partners of an ordinary partnership, not being traders, cannot use the procedure described above for traders in a sole proprietorship to obtain limited liability. However, other avenues to forms of limited liability are open to them.

The most obvious exception in an ordinary partnership to the general partner's theoretically unlimited liability described in Article 215(2) is provided by Article 254. It states that a general partner who contributes only skill to the partnership may share in the profits but not in the losses of the partnership, notwithstanding the provisions of Article 215. Therefore, a general partner who contributes only skill may, if the partnership agreement so provides, incur no monetary losses, regardless of the extent of the losses falling upon another partner. This complete freedom from *any* liability is unique in economic activities in Ethiopia. Even shareholders in a share company may lose their investment in their shares. They have *limited* liability, not *no* liability. A partner in an ordinary partnership who contributes only skill may have no liability.

Article 254 permits creative planning for a partnership to ensure that no individual incurs personal liability. An ordinary partnership may be formed with a private limited company or a share company as a general partner. The company contributes all of the necessary cash to the ordinary partnership. That cash will be all of the monetary capital of the partnership. The individual partners contribute only their skill to the partnership. The partnership agreement is drafted to give the individual partners the right afforded by Article 254 to be free from any liability for the losses of the partnership. The losses will fall only upon the general partner. It is a private limited company or share company, of which by definition the capital is limited.⁴¹ Thus, the only partner in the ordinary partnership which has unlimited liability under the partnership law provides limited liability to its shareholders under company law. So, if the general partners, who contribute only their skill to the ordinary

39. GAZETA, *supra* note 1, art. 213(1).

40. *Id.* art. 213(2).

41. *Id.* art. 304(1) for share companies and commercial code article 510(1) for private limited companies.

partnership, contribute their money or property in kind to the company (thus owning the company) which in turn contributes all the necessary money or property in kind to the partnership, they have managed to limit their exposure to the amount of their contribution to the company. The company serves as a general partner and is the only general partner to make a contribution to the ordinary partnership in money or kind.

In addition, Article 255 provides another potential form of protection from unlimited liability to some of the general partners of an ordinary partnership. Article 255(2) states that creditors may "claim against the personal property of the partners Who (sic) shall, unless otherwise agreed, be jointly and severally liable to them for the obligations of the partnership."⁴² The phrase *unless otherwise agreed* is somewhat ambiguous. Agreed between or among whom? If the agreement is between the creditors and the individual members of the partnership, it is outside of partnership law. It would simply be an agreement in which creditors, confident of the ability of the partnership to pay its debts, would agree not to look to the personal assets of the partners for payment in the event that the partnership did not pay its debts. Such an agreement would be unusual; general partners would probably not seek it if they, too, were confident of the ability of the partnership to pay its debts. Merely asking for the agreement would excite the suspicions of creditors that the partners had knowledge of unfavorable developments that the creditors did not have.

Is it possible that the agreement referred to in Article 255(2) is the partnership agreement itself? Yes. This conclusion is supported by Article 255(3), which states:

Any provision relieving the partners or some of them of joint and several liability may not be set up against third parties unless it is shown that such parties were aware of such provision. Notwithstanding any provision to the contrary, the partners who acted in the name of the partnership shall always be jointly and severally liable.⁴³

"Any provision" appears to refer to the agreement mentioned in the preceding sub-article, which would therefore be the partnership agreement. In any event, sub-article (3) itself clearly permits the partnership agreement of an ordinary partnership to provide protection from joint and several liability to some of the partners. The only requirement is that the creditors be aware of the protection. Any contract entered into by the partnership

42. *Id.* art. 255(2).

43. *Id.* art. 255(3).

could simply state that fact, thus making the other party to the contract aware of it. The provision of the second sentence of the sub-article does not make it clear whether a partner who acted for the partnership in any transaction is liable in all transactions or merely the ones in which he or she acted. But it does make clear that a general partner, who is passive and performs no activities (who is merely an investor in the ordinary partnership) or who performs only internal functions (such as being the accountant or office manager for the partnership), could be freed from joint and several liability for the debts of the partnership by a clause in the partnership agreement to that effect if creditors are made aware of the clause. Any person drafting the partnership agreement of an ordinary partnership should certainly try to achieve the broadest possible interpretation of Article 255(3) and provide that no partner who has not acted in the name of the partnership in a particular transaction shall be jointly and severally liable for that transaction, regardless of the extent of that partner's actions in other transactions.

C. Joint Ventures

Joint ventures are unique among partnerships because they do not register in the commercial register.⁴⁴ Thus, the public is not put on notice as to their existence and has no knowledge of the identities of the partners, other than the managing partner. The manager is known and conducts the activities of the joint venture in the manager's name.⁴⁵ Article 276(2) provides that partners who are not managers are liable only to the extent set forth in the partnership agreement of the joint venture. Thus, such an agreement may limit the liability of a non-managing joint venture partner to the amount of his or her contribution. The agreement may even provide that the manager undertakes to return all or part of the contribution. Thus, the theory behind Article 215(2) plays no role in a joint venture. Unlike the situation with respect to ordinary partnerships, it is not necessary that the creditor be aware of the limitation of liability. This follows from the fact that the creditor does not know of the existence of the joint venture or of the non-managing partners. However, even if the creditor becomes aware of the existence of the joint venture, Article 272(4) provides that the joint venture will be treated as an actual partnership. As this paper shows, general partners of actual partnerships may enjoy forms of limited liability in certain circumstances. Nothing would necessarily change when a creditor became aware of the existence of the joint venture.

44. *Id.* art. 272(2).

45. GAZETA, *supra* note 1, art. 276(1).

Even the manager of a joint venture may achieve some limitation of liability if the joint venture is engaged in a commercial activity and the manager is married. If the joint venture is engaged in an activity listed in Article 5, the managing partner conducting that activity is required to register as a trader. If the manager is married, the procedure discussed above in Limited Liability of Married Sole Proprietors Who Are Traders with respect to traders who own sole proprietorships could be used by the manager to protect common property by limiting liability to the manager's personal property.

D. General Partnerships

A general partnership is very similar to an ordinary partnership. A general partnership may engage in commercial or non-commercial activities, or both.⁴⁶ If it engages in commercial activities, Article 280(2) requires each general partner to register as a trader. If the partner is married, he may avail himself or herself of the protection afforded by Article 20 so long as his or her spouse objects to the trade and enters the objection in the commercial register. The general partner, registered as a trader, would follow the same procedure described above in Limited Liability of Married Sole Proprietors Who Are Traders for a sole proprietor engaged in a trade.

In addition to the protection from unlimited liability which may be available to a married general partner who is a trader, the law of general partnerships also provides a small amount of protection. Article 280(1) states, "A general partnership consists of partners who are personally, jointly, severally and fully liable as between themselves and to the partnership for the partnership firm's undertakings. Any provision to the contrary in the partnership agreement shall be of no effect with regard to third parties."⁴⁷

While the first sentence of Article 290(1) is completely unequivocal, the second sentence serves no purpose except to modify the first. The phrase in the second sentence, "with regard to third parties" only serves to emphasize that the provision may have effect among the partners. This article obviously provides much less protection to general partners of a general partnership than Articles 254 and 255 do to general partners of ordinary partnerships. However, to the extent that one or more partners is willing and able to protect fellow partners, a partnership agreement may provide limited liability to one or more partners. The

46. *Id.* art. 213.

47. GAZETA, *supra* note 1, art. 280(1).

limitation is not binding upon third parties, but it does permit a partner to proceed against another partner to recover any amounts he or she was required to pay to a third person.

Therefore, it is in general partnerships that the theory of unlimited liability embodied in Article 215(2) finds its greatest expression. However, even here, there may be exceptions set forth in the partnership agreement or available to married traders under Article 20 of the Commercial Code.

E. Limited Partnerships

Article 296 states unambiguously that limited partners in a limited partnership are liable only to the extent of their contributions. In this regard, a limited partner is like a shareholder in a company. Thus, Article 215(2) has no effect upon limited partners, who, by their very definition, have limited liability.

However, the limited partner may lose that limited liability. Article 301(3) provides that a limited partner who acts as a manager of the limited partnership acquires full, joint and several liability for any liabilities arising out of his activities as a manager. Sub-articles 4, 5 and 6 contain a list of things which a limited partner may do without being deemed to act as a manager. The permitted activities are primarily internal activities, such as consulting other partners, giving advice or checking the books of the partnership. Nonetheless, a limited partner may be an employee (but not a manager) of the partnership.

The liability of a general partner in a limited partnership is the same as that of a general partner in a general partnership. Nonetheless, it is easy to structure a limited partnership so that no individual has unlimited liability for the debts of the partnership. The general partner can be a share company or a private limited company; the individual partners should all be limited partners. Under partnership law, the company which is the general partner will have unlimited liability for the debts of the limited partnership. However, because it is a company, its shareholders, who may be the limited partners, will have limited liability for the debts of the company (with the exceptions described in the next section of this paper). This is the same situation described in more detail above, under *Ordinary Partnerships*. Thus, if the owners of a business desire to have a partnership, the limited partnership offers the greatest protection against unlimited liability.

IV. POTENTIAL UNLIMITED LIABILITY OF SHAREHOLDERS

A. Share Companies

Ethiopian share companies afford their shareholders protection from unlimited liability for the debts of the company. Limited liability does not, however, mean no liability.⁴⁸ A shareholder may always lose the amount he or she has invested in the share company. The loss may occur when the company is dissolved if the assets of the company are insufficient to pay its debts and return the shareholder's invested capital. The loss may also occur before the dissolution of the company if the shareholder sells his or her shares for less than their purchase price.

Article 347 of the Commercial Code states that directors of a share company must be members, or shareholders, of the company. Several articles of the Code impose liability upon directors to the company, its shareholders and third persons.⁴⁹ The liability is for the acts or negligence of the directors. Thus, at least some of the shareholders of a share company must expose themselves to unlimited liability for their actions as directors.

In addition to liability for their actions as directors, because of the standard of conduct established by the Commercial Code and the burden of proving conformity with the Code's requirements, directors may be personally liable for the debts of the share company itself. Article 366(1) states, "Directors shall be liable to the company's creditors where they fail to preserve intact the company's assets."⁵⁰ Article 366 establishes no standard by which to judge the actions or failures of the directors. Article 364, which governs the liability of directors to the share company itself, establishes a standard. The directors are responsible for showing that they exercised due care and diligence. This appears to be a high standard of conduct, as it should be. Must the same high standard be applied to the failure of the directors to maintain the company's assets intact? What defenses are available to the shareholder-directors if any part of the assets of the company is lost? Any losses of a company will, if great enough or for a prolonged period, imperil the assets. Are directors expected to recommend to the shareholders that the company be dissolved at the first hint that losses will cause the assets to be inadequate to pay creditors? The imposition of personal liability under Article 366 (1) may have that effect.

48. Only a general partner in an ordinary partnership who contributed only skill may have no liability under Ethiopian law. See *supra* beginning at note 39.

49. GAZETA, *supra* note 1, arts. 364 - 67.

50. *Id.* art. 366(1).

In other articles of the Code, the frame of reference is the capital of the company. Articles 487 through 490 deal with a reduction of capital as a result of losses. The capital of a company will usually be less than the assets of the company. So failure to keep intact the assets of a company may occur well before the losses are sufficient to require a reduction of capital. Article 366(1) could be interpreted to create liability for directors even if the losses do not impair the capital of the company.

On the other hand, failure to preserve implies the ability to determine the outcome of actions which caused the loss. Directors would not be liable if the assets were not preserved because of something over which they had no control. Thus, if a government confiscated the assets and did not pay for them, or the assets were destroyed in an uninsurable accident, such as an earthquake, for which insurance is generally unobtainable in areas where earthquakes are common, there is no failure on the part of the directors. In addition, many other losses in the ordinary course of business may be beyond the control of directors and not a result of their failure.

Unlimited liability for directors because of a company's loss of its assets will probably not affect all shareholders of a share company, especially if it has a large number of shareholders. But it may affect those shareholders who are also directors, simply because directors must be shareholders.

B. Private Limited Companies

Shareholders of a share company confront unlimited liability only in their role as directors. Shareholders of a private limited may have unlimited liability in their capacity as shareholders.

Article 519 deals with the consequences of a contribution in kind to a private limited company.⁵¹ Unlike the elaborate procedures set forth in Article 315 for determining the value of a contribution in kind to a share company, Article 519 requires the members of a private limited company to determine the method of valuation and the value of the contribution.⁵² Article 519(3) imposes joint and several liability to third persons for the valuation fixed in accordance with the method determined by the shareholders.⁵³ Article 519(4) imposes joint and several liability upon all members for any overvaluation of the contribution, even if they were

51. *Id.* art. 519.

52. *Id.*

53. *Id.* art. 519(3).

unaware of the overvaluation.⁵⁴ The liability of Article 519(4) seems to be strict liability. The article states no defenses to a claim, such as the reasonableness of the method of valuation or possible fraud by the person making the contribution. The good faith of the innocent member cannot be a defense.⁵⁵ Article 519 is a serious impediment to the contribution of property to a private limited company. The members who do not make a contribution in kind would want to have an agreement with each person who makes a contribution in kind to reimburse those members against any losses incurred as a result of an overvaluation of the property.

In addition to Article 519, the law governing private limited companies creates unlimited liability in another situation.⁵⁶ Unlike a share company, a private limited company does not have a board of directors or managers chosen by the board. A private limited company is managed by its shareholders or some of them, like a partnership. Article 531 deals with the liability of these shareholder-managers when the private limited company is in bankruptcy proceedings and the assets are insufficient to pay the creditors.⁵⁷ Article 531(1) states that the bankruptcy court may order the managers or the shareholders or some of them to pay all or part of the debts of the private limited company.⁵⁸ The article is not a model of clarity. Sub-article (1) permits a bankruptcy court to order members, as well as managers, to pay the company's debts. Sub-article (2) says that such an order may not be entered against members who have not acted as managers, nor where the managers *and members*⁵⁹ show that they have acted with due care and diligence. What is clear is that the burden of proving due care and diligence is upon those manager-shareholders who wish to escape from unlimited liability for the debts of the bankrupt company. What is not clear is the extent to which a shareholder who is not a manager may escape from unlimited liability merely because he or she was a member who was not also a manager. The first clause of Article 531(2) says that an order to pay the company's debts will not be made in respect of members who did not act as managers. The second clause says

54. *Id.* art. 519(4).

55. The drafter of article 519(4) said, "[t]he rules governing contributions in kind are unusually severe. . . . In this form of company, *all* the members should be sufficiently interested in the running of the company's business not to be able to hide behind ignorance, which would be a culpable form of negligence." (Emphasis in the original.) Jean Escarra, *Expose des Motifs: Book II (Comm. C.Doc. No.9B) (9 October/November 1954)*, 57, 69, Doc. No. 20 in Winship, *supra* note 13.

56. GAZETA, *supra* note 1, art. 519.

57. *Id.* art. 531.

58. *Id.* art. 531(1).

59. GAZETA, *supra* note 1, art. 531.

that such an order will not be made against members who show that they acted with due care and diligence. Why are members mentioned at all in either sub-article of Article 531 if only managers may be required to pay? Article 531 is a muddle.

Article 531 speaks of liabilities in a bankruptcy situation. One cannot, however, dismiss that as a reference merely to the worst-case situation. Unlimited liability for the debts of any business arises only in the worst situation. If the business of a sole proprietor or business organization can its pay debts in the ordinary course as they become due, the owner of the business will never be asked to pay them from her or his personal assets. It is only when the business is in trouble that creditors look to the owners. So it is only in the extreme situation that the issue of unlimited liability ever arises.

V. A PROPOSAL FOR LIMITED LIABILITY FOR ALL SOLE PROPRIETORS

The search for unlimited liability in the Commercial Code of Ethiopia shows that unlimited liability may be found in some circumstances. If two or more persons wish to form a private limited company, they may achieve a high, but not the highest, measure of limited liability. The highest measure of limited liability is reserved for five persons, who form a share company. These two forms of company also have different minimum capital requirements — Birr 15,000 for a private limited company⁶⁰ and Birr 50,000 for a share company.⁶¹

The option of forming a company that exists for two or five persons does not exist for one person. A sole proprietor, especially one who is not married or who engages in an economic activity which is not a trade, has no protection from unlimited liability. It does not matter how much money he is willing to invest in a company — he must nonetheless find one or four additional shareholders. These additional shareholders may be dummies who have absolutely no interest in the company, but Ethiopian law requires that they be shown as shareholders.⁶² If no

60. *Id.* art. 306(1). In June 1997, there were Birr 6.7 to the United States dollar.

61. *Id.* art. 512(1).

62. Take Birr 50,000, the minimum capital for a share company, and divide it by Birr 10, the minimum par value per share, and the result is 5,000 shares. Give one share each to four people and take the other 4,996 shares for yourself. Or, take Birr 15,000, the minimum capital for a private limited company, and divide it by Birr 10 par value, the minimum value per share, and the result is 1,500 shares. Give one share to one person and keep 1,499 shares for yourself. In each case, you have created a legitimate company in which only one person has any practical interest. This is perfectly legal and fully satisfies the requirements of the Commercial Code. These examples also go to show how absurd the requirement for a minimum number of

shareholder in a share company is personally liable for the debts of the company, why does it matter whether the share company has a million shareholders, five shareholders or one shareholder? In no event will the shareholders or shareholder be required to contribute an additional cent to the company. No additional protection for creditors is gained by establishing a minimum number of shareholders. Protection for creditors is based primarily upon the capital of the company and whether it is operated profitably. Both of those criteria are unrelated to the number of shareholders.

The requirement for a minimum number of shareholders is simply history.⁶³ The first statutes permitting the formation of companies required a minimum number of incorporators or founders and a minimum number of shareholders. No reasonable justification exists for either requirement today. These formal requirements are so easily complied with when the reality of the company is different that the requirements merely encourage disrespect for the law. If a person may so easily evade this requirement, why not evade other requirements which are inconvenient? If the minimum shareholder requirements served any purpose, such as making more capital available or making more people liable for the debts of the company, they could be justified. But they do not serve either those purposes or any other.

How should Ethiopia amend its Commercial Code to permit a company to be owned by one person? The worst way would be to create a

shareholders actually is. It is the capital of a company which is contributed, not the number of contributors, which creates a company.

63. The weight of tradition bears very heavily on legal institutions. Tradition places special obstacles in the way of acceptance of new concepts, even though, when considered without prejudice, they appear to be obvious and valuable means of achieving useful ends. The view that only concepts that have been bequeathed to us by past generations are authoritative and inviolate leads us to operate with old institutions, even when their structure and objects must be distorted, rather than consider impartially the adoption of new formulae.

An outstanding example of this phenomenon seems to occur in the use of the principle of limited liability to facilitate the participation of individuals in commercial enterprises. All the traditional forms of company enable the participants' own assets to be free of claims for the debts of the company beyond the amount the participants initially paid, subscribed, and committed themselves to pay. Yet, this benefit of limited liability, which seems so natural even when one is thinking of a company that may have as few as two members, is today apparently quite unthinkable if the company has only a single member.

If, in a perfectly ordinary joint-stock company having perhaps the paltry minimum capital required by Italian law of one million lire, A and B limit their liability to one-half each—or A to 999,990 lire and B to 100 lire — all is in order; but it is otherwise if a multimillionaire wishes to limit his involvement in the fortunes of a business he wishes to start to some 100 million lire.

Mario Rotondi, *Limited Liability of the Individual Trader: One-Man Company or Commercial Foundation?*, 48 TUL. L. REV. 989 (1974).

new kind of entity, thereby increasing the complexity of the Commercial Code and creating a need for conversion of the one-person company into another kind of company if more investors bought shares.⁶⁴ A better solution would be to repeal those sections of the share company law and the private limited company law which impose minimum shareholder requirements. This would permit a sole shareholder to choose whichever kind of company he or she wished to form. It would not be necessary to change the minimum capital requirements, the management structures or any other provisions governing companies. It would only be necessary to amend the articles which contain references to a minimum number of shareholders.

The best solution to creating one-shareholder companies would be to amend the Commercial Code to permit truly one-person companies. All articles dealing with shareholders, directors and managers could be revised to provide that in the case of a company with one shareholder, there need be no shareholders meeting, only signed resolutions; only one director, and no meetings, only signed resolutions; etc. This would entail a great deal of work. If that amount of work were to be done, all of Book II should be revised to make it more modern and less complex, not just those articles which would permit a one-person company.

VI. CONCLUSION

The Commercial Code of Ethiopia deals with the issue of unlimited or limited liability of investors in businesses in a variety of ways. Sole proprietors and general partners of partnerships usually have unlimited, joint and several liability for the debts of the partnership. But exceptions exist to this unlimited liability. These exceptions exist in surprising places, including traders who are married and some general partners of partnerships. Shareholders of companies usually have limited liability for the debts of the company. But exceptions exist to this limited liability; the most serious exceptions are in the law of private limited companies. Because of the potential unlimited liability of managers in a private limited company and the unclear status of other shareholders in those companies, the share company provides the best protection to investors against unlimited liability. Perhaps the only disadvantage of a share company is the requirement that it have at least five shareholders and a minimum

64. That is the French solution. In 1985, the French created a new entity, the *entreprise unipersonnelle a responsabilite limitee*, to permit a form of limited company to be organized and owned by one person. JEAN-PIERRE LE GALL & PAUL MOREL, FRENCH COMPANY LAW 61 (2d ed. 1992).

shareholders' capitalization of Birr 50,000.⁶⁵ Any person who wants to start a firm or to invest in one and who is concerned about personal liability will form or invest in a share company. It offers the best protection against unlimited liability of any arrangement created by the Commercial Code. That protection should be extended to one owner of a company instead of limiting it to a company with five owners.

65. See *supra* for examples of how easy compliance with the requirement for the number of shareholders is overcome. With respect to capital, art. 312(1)(b) permits a shareholder to pay only one-quarter of the price of the shares and art. 338(2) permits the remaining three-quarters of the price to be paid over five years. Therefore, a share company may be formed with only Birr 12,500 (one-quarter of the minimum of Birr 50,000) in cash. By contrast, the shareholders of a private limited company must pay the entire minimum contribution of Birr 15,000 before the company is registered. Thus it takes less cash to form a share company than it does to form a private limited company.