CONTROL OF NON-CASH CONTRIBUTIONS TO COMPANIES: A COMPARATIVE ANALYSIS OF THE LAWS OF THE EC, GERMANY, FRANCE, ENGLAND, AND ETHIOPIA

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Abstract

The capital of a company is considered as security for creditors and legal systems provide the framework to safeguard this security. This paper demonstrates overvaluation of non-cash contributions as a risk this security is to be safeguarded from. It outlines what a comprehensive control system on non-cash contributions looks like and comparatively assesses the laws of the EC, Germany, France, England, and Ethiopia as to the mechanisms they provide to control this form of contribution. The paper shows that the three member states of of the EC have transposed the Community law on the subject of control of non-cash contributions in a similar fashion and that they converge on a number of areas regarding their approaches to controlling non-cash contributions like definition of valid forms of tnon-cash contributions and the expert valuation , payment and disclosure requirements. The above three legal systems are selected because of their relevance to the Ethiopian law for they are the sources of the latter's Commercial Code. Compared to these legal systems, the control system over non-csh-contributions under the Ethiopian law involves a number of matters that need addressed through amendement of the law..

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Table of Abbreviations

AG(*Aktiengesellschaft*)	Stock Corporation
AktG (Aktiengesetz)	Stock Company Act
CA	Companies Act
CC	Commercial Code of Ethiopia
C.civ.	Code Civil of France
C.com.	Commercial Code of France
GmbH (Gesellschaft mit beschränkter Haftung)	Limited Liablility Company
GmbHG (Gesetz betreffend die Gesellschaften mit beschränkter Haftung)	Limited Liability Company Act
IKC	in kind contribution
ltd	Private Limited Company in England
NCC	non-cash contribution
p.l.c	Public Limited Company in England
PLC	Private Limited Company in Ethiopia
SA (Société Anonyme)	Public Limited Company in France
SARL (Société à responsabilité limitée)	Private Limited Company in France
SC	Share Company in Ethiopia

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INTRODUCTION

This introductory part provides a brief background about the concept of a company's capital, describes 'non-cash contributions' and discussess the problem associated with them. Moroever, it outlines what should a comprehensive system of control over non-cash contributions look like and lays down the structure of the thesis: its hypothesis, scope, objectives, significance, and limitation.

1. Background

The corporation, as a vehicle of doing business, is regarded as having played a significant role to the economic growth of nations.[1] However, history has also witnessed corporate abuses, among others, to creditors and hence necessitated the need for protection from the risk of abuse against the capital of a company, which is regarded as a security to creditors and more important in the context of companies than partnerships since in the former case, unlike the latter in general, 'the members are liable only to the amount of their promised contributions.'[2]

This security is usually defined as 'the amount specified in the formation instruments as the capital of the corporation, which is to be paid in or contributed to it, and to be represented by shares.'[3] 'In accounting terms, 'capital' is the name for the source and not for the asset' which is mainly laid down by the laws of states prescibing what can be validily contributed to a company for the purchase of shares.[4] As such, there may be difference among states regarding these sources. In 'many practical instances' the capital of a company consists of

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[1] Katharina Pistor *(et al)* , *The Evolution of Corporate Law: A Cross Country Perspective*, 23 U. Pa. J. Int'l Econ. L. 791, Winter 2002, p. 791
[2] George W. Wickersham, *The Capital of a Corporation*, 22Harv. L. Rev. 319, March, 1909, p.320
[3] Ibid.
[4] Detlev F. Vagts, *Basic Corporation Law: Materials-Cases-Texts*, Third Edition, 1989, The Foundation Press, Inc., Westbury, New York, p. 135. According to this author, capital is different from assets in that capital remains fixed despite changes on it brought about by amndments to the formation instruments while asets may fluctuate depending on the gains and losses of the company in its transactions and by other factors.

cash and non-cash contributions.[5] Due to the very topic of the thesis, only the latter category forms the subject of this paper.

The company laws of different countries, as we shall see later, do not provide a definition of 'non-cash contribution.' Legal systems provide either a general criterion of what constitutes a valid contribution of such a type or exclusion of certain forms of such contributions as unacceptable to a certian form of company, or both. Some legal systems, like the German Stock Company Act, thus provide the criterion that the asset must be one the economic value of which can be ascertained.[6] What we get in the literature is also an enumeration of the types of NCCs such as trademarks, copyright, patent, goodwill, going concern, shares, claims, receivables, buildings, land, machinery, equipment, vehicles.[7]

There is, however, a problem associated with NCCs. Cash contributions, however they are defined in the laws of states, are considered as posing 'little problem since their value is easily determinable.'[8] Whereas, where a NCC is made to a company, it is said that there always arises the problem of ascertaining the true value of the property.[9] And a company's capital may be evaded with respect to this type of contribution where such a contribution is overvalued.[10] This phenomenon, called 'stock-watering', constitutes one form or cause of 'overcapitalization of a company which is seen as one of the greatest evils those dealing with a company will face.'[11] And legal sytems provide different mechanisms, like expert valuation of the asset, primarily in their company laws to address, this problem.

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[5] Supra note 2
[6] In this regard mention can be made of the German Stock Company Act as well as the second Council Directive.
[7] Supra note 2, at 321
[8] Id. P.320
[9] Supra note 4, at 143
[10] Id., p.135
[11] Id., pp.135, 139 A widely accepted and broad definitaion of over-capiatlization provides that it is "the issue of shares of capital stock to an amount in excess of the value of the capital assets" Ibid.

This paper claims that the control system over NCCs shall be comprehensive in order to effectively address the above problem. The writer contend that a comprehensive system of control shall include five phases and be broader in its scope. The first phase i.e.definition of valid forms NCCs determines what types of NCCs to different forms of companies are acceptable in the eyes of the law and thereby prevent the making of contibutions that pose risks of one form or another. Secondly, there must be stage at which these contributions must be valued properly so that it could be ensured that the value of the contribution can actually pay the value of the shares to be issued for it. This stage must also be complemented by rules governing the time at which a NCC, so valued, must fully be transfered to the company so that there will not be depreciation of the asset before it is put in the hands of the company.

Third, there has to be a way through which subscribers and third parties could be informed about the transations concerning a NCC made or to be made to a company as well as various particulars about the asset. This disclosure phase is important in enabling interested persons to make an informed decision regarding NCCs. Then, fourthly, there should be a framework for confirming that a company has observed the legal requirements regarding the above phases so that contraventions of rules and the danger that may arise as a result will be prevented before-hand. Fifth, the control system over NCCs could be strengthened more where the law attaches civil liabilities and criminal penalties for violations of its requirements on the above phases.

However, the protective role of the phases of control mentioned above will only be partial if it is limited only to a company's formation stage. A comprehensive system of governance over NCCs could be there only where the scope of the governance is extended to cover various activities of a company that may lead to the circumvention of the rules regulating the above stages. Thus, I argue that the rules on definition of valid forms of NCCs, their valuation and payment as well as diclosure, confirmation and liability shall be extended to the event where a company is to issue shares against NCCs at the time of increase in capital. The rules

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governing disclosure, confirmation, and liablity shall apply at the time where a company amends its formation documents, especially where a legal system requires these documents to contain particulars about NCCs.

Last, a comprehensive system of control must address particular instances of possible circumvention of the statutory provisions governing NCCs. One of these instances arises in connection with the so-called indirect or hidden NCCs, which might be revealed in different forms.[12] The first is where the founders of a company agree with themselves or a third party to the effect that the initial contribution is to be made in cash but the company, after its formation, shall acquire assets from the concerned person with the amount, directly or indirecly, contributed by this person.[13] In my opinion, this is a pre-incorporation agreement. Through such an agreement it means that any requiremnts of the law as to valuation, among others, will be circumvented. The second form of this possible abuse arises where a subscriber who initially undertakes to pay the shares in cash but later, through agreement with the company after its formation, discharges its undertaking actually in kind.[14] The other instance of circumvention is what is referred to as post-formation acqusition of non-cash assets by a company, and it arises where a company acquires a non-cash asset from a shareholder with a significant value within the initial period of its formation.[15] If this arrangement is considered as mere acqusition by the company, it will lead to circumvention of the rules governing valuation of NCCs and other aspects of the control system.

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[12] Ruster,Bernd (Ed.), *Business Transactions in Germany*, Looseleaf, New York, 1983, p.24-24
[13] Id., pp.24-14, 24-24

[14] Christian Kersting, *Hidden Contributions in Kind* (Verdeckte Sacheinlage), http://ssrn.com/abstract=1314983, p.2, accessed on 13-2-2010. See also Bertagna Avocats, *Repair of Covert Non-Cash Contributions to Capital*, http://www.mondaq.com/article.asp?articleid=200, accessed on 10-3-2010, p.1
[15] Supra note 13

A company's capital as security to creditors thus needs to be safeguarded from abuses in connection with NCCs and this safeguarding framwork must be comprehensive in many respects for it to be effective in addressing those abuses.

2. Statement of the Problem

There is a large body of comparative writing about the company laws of EC member states.[16] However, the literature is very scanty and shallow in the treatment of the subject of IKCs. The article by Katharina Pistor *et al*,[17] for example, that anlayzes the evoluation of corporate law in a historical context address the issue only likewise and focuses on the independent valuation aspect of the control system and does not cover the issue of the compliance of the member states laws with the EC law. The book by Mads Andenas and Frank Wooldridge,[18] which is a comparative analysis of EC company law and the company law of member states, only slightly covers the issue of control of IKCs at the time of amendment of statutes or increase in capital. Thus, the researches on the subject so far are limited only to one or two aspects of the control system over IKCs and hence do not provide a comprehensive image of the subject. Moreover, there is no study specifically devoted to comparatively assess legal safeguards available under the laws of Germany, France, and England and their compliance with the Community law concerning the control of IKCs. To the writer's knowledge, Ethiopian law on the control of IKCs has not been the subject of study in itself let alone being

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[16] In this regard mention can be made of, for example, the following: Mads Andenas and Frank Wooldridge, *European Comparative Company Law*, Cambridge University Press, 2009; Massimo Miola, *Legal Capital and Limited Liability Companies: The European Perspective*, 2 ECFR 413 (2005); Luca Enriques and Jonathan Macey, *Creditors versus Capital Formation: The Case against the European Legal Capital Rules*, R. 86 Cornell L. Rev. 1165 (2000-2001); Mark R. von Sternberg, *Close Corporation's Counterparts in France, Germany, and the United Kingdom: A Comparative Study*, 5 Hastings Int'l & Comp. L. Rev. 291 (1981-1982); and Katharina Pistor *(et al)* , *The Evolution of Corporate Law: A Cross Country Perspective*, 23 U. Pa. J. Int'l Econ. L. 791, Winter 2002, p. 791

[17] Katharina Pistor *(et al)* , *The Evolution of Corporate Law: A Cross Country Perspective*, 23 U. Pa. J. Int'l Econ. L. 791, Winter 2002, p. 791

[18] Mads Andenas and Frank Wooldridge, *European Comparative Company Law*, Cambridge University Press, 2009

compared with other legal systems. And these gaps and deficiencies in the law and the leiterature are the starting point of this paper.

3. Objectives of the Study

This paper, therefore, has the objectives of describing the the problem overvaluation of IKCs and examining the approaches of the different legal systems and of the EC law concerning IKCs. Moreover, it targets at making recommendations as to what the Ethiopian legal system may learn form others in controlling IKCs as well as suggesting potential areas of research in the context of IKCs. Thus, the paper aims to be both descriptive and prescriptive.

4. Scope of the Study

From among the types of companies that can be established under the legal systems in consideration, only the following are the subject of this paper. In Germany, the stock corporation (AG) and the limited liability company (GmbH); in France, the public limited company (SA) and the private limited company (SARL); in England, the public limited company (p.l.c.) and the private limited company (ltd.); in the EC, the above forms of companies in the respective countries as covered by EC law; and in Ethiopia, the share company (SC) and the private limited company (PLC) . The public limited company in France and Ethiopia assumes such a company to be formed by a public offering of shares and the one to be formed without making such offering will also be touched upon. Moreover, the primary sources of laws for the purpose of this paper will be the company laws of the respective countries, contained in a separate act or the commercial code, and other areas of law like the commercial or criminal law will be considered only where necessary. The liability regime does not cover the specific criminal penalties and the period of limitation to bring actions. Finally, the issue of control of IKCs in the event of conversion of one form of company into another as well as the case of group companies does not make up a part of this paper.

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5. Methodology

Comparative legal analysis is employed as the primary tool of research. The comparision is beteween the EC law and the laws of Germany, France and England, on the one hand, and the laws of Germany, France, and England with the Ethiopian law, on the other hand. The three legal systems i.e. Germany, France and England are selected because they are the important sources of the Ethiopian Commercial Code, that contains the provisions governing companies.[19]

6. Limitation of the Study

One important limitation of the study is that it has not, almost totally, included court judgments in each jurisdiction due to the writer's inability to acess them mainly for language constraints and of their unavilablity. However, an attempt has been made to overcome the problem through the use of secondary sources where the relevant cases appear.

The thesis proceeds as follows: Chapter One, which is divided into five Parts based on the number of jurisdictions covered, explores the laws of the EC on the control of NCCs in respect of both types of companies and the different aspects of the control system and then by using this as a bench-mark that of the German French, and English legal systems. The Ethiopian law will be compared and contrasted with only the three legal systems since, obviously, Ethiopia is not a member of the EC. Chapter Two wraps up the thesis by providing recommendations for the Ethiopian legal system and suggessions for further comparative research.

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[19] Aberra Jembere, The Legal History of Ethiopia 1434-1974: Some Aspects of Substantive and Procedural Laws (Leiden, Rotterdam, Erasmus Universiteit, 1998), p. 207; According to this author, the legal system of Germany (specifically that of the then Federal Republic of Germany) and France are the main sources of the Ethiopian Commercial Code while certain aspects of the Code on share companies are also taken form the English legal system.

CHAPTER 1- COMPARATIVE DISCUSSION OF THE LAWS ON THE CONTROL OF NON-CASH CONTRIBUTIONS

This Chapter discusses of the laws of the EC, Germany, France, England, and Ethiopia on the control of NCCs. It begins with the EC company law and by using this as a benchmark it will proceed to assess the other legal systems. Ethiopia, being a non-member of the Union, its laws will be compared only with the laws of the three legal systems. The Chapter is broken down in to five Parts for each of these jurisdictions within which there are different sections on each phase of the control system in respect of companies of both categories.

Part One: The EC Company Law

1.1.1 Definition of Valid Forms of NCCs

The Second Council Directive provides neither a general definition nor a specific list of valid NCCs. Art. 7 only provides that "the subscribed capital may be formed only of assets capable of economic assessment. However, an undertaking to perform work or supply services may not form part of these assets." Thus, we have the ''capability of economic assessment'' of the value of an asset criterion to determine what type of considerations other than cash can validly form the capital of a company. It then goes on and expressly excludes an obligation to do work or provide services even if they may satisfy this general criterion. Hence, one may assume that any asset, other than an undertaking to perform work or supply services, that meets the broad ''economic assessibility'' criterion is a valid type of NCCs for the purposes of this Directive. The rational behing the exclusion of an undertaking to do work or perform services may be that personal obligations are difficult or legally impossible to enforce.

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1.1.2. Valuation and Payment of NCCs

Having identified what can be a valid type of NCC to a public limited company under the EC law, we now turn to look at what legal safeguards this law provides in order to ensure that the actual value of a NCC corresponds to its stated value and when it should be transferred to the company. Accordingly, Article 10(1) of the second Directive provides that where a NCC is made to a public limited company at the time of its formation, a report on it shall be drawn up, before the company is incorporated or is authorized to commence business, by one or more independent experts.[20]

Article 10(4) of this Directive entitles member states to grant exemption from the above requirement but only upon satisfaction of the conditions set out therein for the application of exemption. First, 90% of the nominal value or the accountable par, as the case may be, of all the shares of a company are to be issued to one or more companies. Secondly, it must be shown that the persons who sign or in whose names the founding documents or their drafts are signed have agreed to dispense expert valuation and such an agreement is published in accordance with the First Directive. Thirdly, the contributing company must have non-distributable reserves of at least equal to the nominal value or accountable par of the shares to be issued for the NCC and guarantees up to this value the debts of the recipient company.[21] Moreover, this guarantee shall be published per the first Directive. Last, the contributing company has to place the above mentioned values of shares in to a reserve that is not distributable for three years.[22]

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[20] The appointing or approving organ can be an administrative or judicial authority and it can be a legal or natural person, as the law of a member state provides. Art. 10(1)

[21] The period of this guarantee shall be between the time of issuance of shares for the NCC and one year after the publication of the recipent company's annual accounts in the financial year during which the NCC is furnished. Moreover, transfer of the shares within this period is prohibited. Art. 10(4/d)

[22] This three -year period is after the publication of the annual accounts of the recipient company for the financial year during which the consideration was furnished or, if necessary, until such latter date as all claims

Per Art. 9(2) of the Directive, a NCC must be transferred in full within five years from the time of the company's incorporation or authorization to commence business.

1.1.3 Disclosure Requirements Relating to NCCs

Article 2(1) of the first Company Directive requires member states to ensure the compulsory disclosure by companies of certain documents and particulars. These include, among others,[23] "the instrument of constitution, and the statues if they are contained in a separate instrument." Nevertheless, this provision is silent regarding what information about NCCs shall be contained in either of these documents.

Art. 3(h) of the second Company Directive, on the other hand, provides that either in the statues or the instrument of incorporation or a separate document published in accordance with the laws of each member state must contain, at minimum, the the value or the number of shares issued for the NCC and the name of the contibutor. And Art. 10(2) of the Directive requires the expert's report to describe the asset and state the method of valuation, its value, and whether this value corresponds to at least the number and the value of the shares to be issued for it.'' Moreover, Art. 10 (3) mandates the publication of this report.

Per Arts. 3 and 10(3) of the second Directive the disclosure of the above documents and particulars about NCC must be in the mannaer laid down by the first Directive. Accordingly, Art. 3(1,2 &4) of the Directive amending the first Directive provides that the manner of

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relating to the above-mentioned guarantee and which are submitted during this period have been settled. Art. 10(4/f)

[23] These other documents and particulars are amendments to the founding documents, persons authorised to represent or administer the company, the subscribed capital in each year if the company has authorised capital, accounting documents; transfer of the seat, winding up and declarion of nullity of the company, and appintment of liquidators and termination of liquidation. Art. 2(1) of the first Company Directive and Art. 1(2) of the Directive amending the first Company Directive.

disclosure shall be through publication of those documents and particulars in paper or electronic form and their filing or entry in the central, companies or commercial register.[24]

From the provision of the Directives, it is possible to identify three consequences of failure by a [public] company to satisfy the above disclosure requirments relating to NCCs. First, even if it is not expressly stated, the requirment under the second Directive that the expert report be drawn up before the company is incorporated or authorised to commence business may be understood to mean that a company may not be incorporated or authorised to commence business in the absence of this report. Secondly, pursuant to Arts. 3 (5) and 3(7) of the Directive amending the first Company Directive, a company can not rely as against third parties on documents and particulars that have not been properly disclosed.[25]

Thirdly, under Art.11(1) of first Company Directive member states are entitled to declare the nullity of a company on the ground that 'the rules of preventive control were not complied with.'[26] The writer is of the opinion that the valuation and disclosure rules as set out above [in respect of a public limited company] are rules of preventive control as can be noted form the preambular purpose of the first Directive. In the context of NCCs, this means that a member state may provide for the nullity of a public comapny where the expert report was absent or the required particulars about NCCs were not contained in this report, another

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[24] To this effect the Directive amending the first Directive requires the opening in each member state of a companies, central or commercial register for each of the companies registered therein in such a way that the subject matter of the entries in the register must in every case appear in the file. It also imposes a duty on member sates to ensure the required filing and publication by comapnies. Art. 3(1 & 2)

[25] As can be deduced from Art. 3(4 & 7) of the Directve amending the first Directive, the disclosure of the required documents and particulars is said to be completed as of their publication according to the formalities or types of publication set out therein. However, in the event of discrepancy between what is published in the press and what is entered in the register, the latter controls as Art. 3(6) provides. Arts. 3(5) and 3(7) of the amending Directive, respectively, also provide exceptions to rules that a company may not rely on undisclosed information as against third parties and that third parties may, however, rely on such information as against the company.

[26] Nullity, however, may not in itself affect the obligations assumed by the comapny or third parties. Art. 12(3) first Council Directive.

document, or in the founding documents or, that these documents or particulars were not properly disclosed.

Art. 12(4) of the first Directive only provides that the effect of a company's nullity as between members may be governed by member state's laws. Yet, this is only a post-formation effect. It might be the case that a member state's law may not provide for the nullity of a company on the ground that the company's founding documents do not contain particulars which they are required to contain about a NCC, and in such a case there could arise the issue of what will happen to the relationship between the company and the contributor. Would, as a result, the contributor's subscription be void? Or would its subscription be only unenforceable as regards the company and it be required to pay in cash? Or will the subsciption continue to be binding on both parties depite the non-disclosure and the contibutor can then oblige the company to accept what it promised? The Directives are silent on this issue.

1.1.4. The Liability Regime

The first Directive, as amended, does not contain criminal penalties, i.e. fine or imprisonment, for breach of its provisions. Neither does the second Directive, as amended. In fact, Art.6 of the Directive amending the first Directive imposes duty on member states to provide appropriate penalities for at least two cases of breaches by the responsible person but these cases are not related to the control of NCCs.[27] Apart from these two cases, the Community Company Directives do not impose express duty on member states to provide for penalities for breaches of those Community laws, let alone imposeing the penalities by themselves.

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[27] The instances of failure to make disclosure on which the this provision expressly imposes the duty on member states to provide appropriate penalties are failure to disclose accounting documents as required by Art. 2(1/f) of the first Directive and omission of materials from the commercial documents or particulars from a company's website as required by Art. 4 of the first Directive. As regards the responsible person, Art. 5 of the first Directive only provides that the question of by which persons the disclosure formalities are to be carried out is to be determined by the laws of each member state.

Nevertheless, according to ECJ's judgment, member states are under a duty to give equal treatment to breaches of Community law and national law where the Community law does not provide specific remedies for breach of its provisions.[28] This Court has ruled that:

> " where a community law does not specify a penalty in case of breach of its provisions, but refers to national laws, member states are free to refrain from imposing criminal penalties provided they treat the Community law infringement in a procedural and substantive fashion comparable to similar infringement of national law, and provided that the treatment is in any event effective, proportionate and dissuasive."

It is still important to ask what will happen if a Community law does not expressly provide a penality nor does it refer to national laws, as in the case of the second Directive, as amended? The Court's judgment itself is not clear on this point.

1.1.5 Scope of the Control System

A. Event of Increase in Capital

The second Company Directive expressly extends its rules on NCCs where a public limited company issues shares, in the event of increase in capital, against a NCC. Art. 27(1 & 2) accordingly, provides that in such an event too the contribution must be the subject of a report by independent experts which shall contain the same particulars as the ones stated above in connection with the formation of the company, the report shall be published in accordance with the first Directive, and that the asset must be transferred in full within a period of five years form the decision to increase the share capital.

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[28] The ECJ, in Belgium v. Vandevenne, Case C-7/90

Where the increase in the subscribed capital necessitates an amendment of the statutes, Art. 2(1/b, c & e) of the first Directive additionally requires disclosure of this amendment and the full text of the amended statutes. Despite that the provisons governing capital increment do not expressly state what makes up a valid form of NCCs nor make a reference to the provisions governing this issue at the company's formation stage, there is no reason to assume that the latter provisions are inapplicable in case of capital increase involving issuance of shares against NCCs.

Art. 27(3 74) exempts member states from the duty of requiring expert valuation at the time of increase in capital. One instance of this is where the capital increase is made to effect a merger or a a public offer for the purchase or excahnge of shares that is meant to pay the shareholders of the company to be absorbed or which is the object of the offer for the purchase or exchange. The second instance is where all the shares of a company are issued to one or more contributing companies and where it is shown that the all the shareholders of the receipent company have agreed to dispense with expert valuation and all the rest of the conditions applicable for the working of the exemption at a company's formation stage, discussed earlier, are met.

A point that should mentioned in relation to increase in capital is a member's right of pre-emption for new shares where he offers to pay them in a NCC. The language of Art.29(1) of the second Company Directive which entitles a member the right of pre-emption is clearly framed in terms of capital increase by cash consideration. The ECJ has ruled that, despite this wording, this provision is equally applicable with respect to NCCs without, however, precluding a member state's domestic law from withdrawing or restricting this right with a view to ensure an enhanced degree of protection to shareholders.[29]

[29] Simens AG v. Henry Nold, Case C-42/95

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B. Amendment of Formation Instruments

Art. 2(1/a & b) of the first Council Directive addresses the issue of control of NCCs in the event amendments are made to a company's formation instruments through primarily requiring member states to provide for the mandatory disclosure of such amendments and the text thereof. However, this Directive, as stated before, does not provide which company documents shall contain what particulars about NCCs nor does it prescibe that any of the documents it requires to be disclosed shall contain information about NCCs. As far as a public limited company is concerned, the second Council Directive explicitly requires that certain particulars, which we saw earlier, about NCCs to be stipulated in either the statutes or instrument of incorporation or a separate document as given by the law of a state. And hence by virtue of the above provision of the first Directive this means that amendments to these documents and particulars, including any amendment on statements made therein about NCCs, shall also be properly disclosed together with the amended texts.

C. Indirect NCC and Post-formation Acquisition of Non-cash Assets

The EC Company Directives do not directly address the issue of 'hidden' NCCs. It is not clear whether their provisons, especialy that of the second Comapny Directive, on NCCs in general also apply to such kind of NCC. It might, however, be argued that the issue is governed by the general provision Art.7 of the first Company Directive which provides for the unenforceability of pre-registration contracts with regard to the company; and as claimed earlier, agreements underlying indirect NCCs are in the nature of pre-incorporation contracts.

With regard to post-formation acqusition of non-cash assets, Art.11(1) of the second Council Directive provides that where a company before two years[30] from the time it is incorporated or authorized to commence business acquires, for a consideration of not less than one-tenth of

[30] As this provision says 'at least', this period is the minimum and national laws of member states may require a longer period in this respect.

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the company's subscribed capital, any asset belonging to a person who signs or in whose name the company's founding documents or their drafts are signed, the acquisition shall be subject to the same requirements, set out earlier, for valuation of NCCs and be submitted for the approval of the shareholders' general meeting.[31] Paragraph two of this provision allows member states to extend the application of these requirements where the asset in question belong to a shareholder or any other person.

1.1.6 Areas of Non-application and Silence

As will apppear from the discussion so far and as will be analyzed below, there are a number of matters concerning NCCs that are not governed by the Community company legislations under consideration or on which these legislations are silent.

To begin with, due to the very scope of the second Council Directive, the provisons of this Directive governing the types of valid NCCs, the valuation and payment thereof, and the mandatory stipulation in the founding documents or another document about NCCs do not apply in respect of a private limited company.[32] The same is true of the provisions on post-formation acquisition.

Secondly, even in the case of a public limited company, this Directive does not speak about the critera for eligibility of the valuer and its liabilities, any liability of the contributor to make up a deficiency in the value of a NCC, any role or duty of the founders and the first persons appointed to administer or supervise the company in the valuation process. Futhermore, this Directive is silent concerning the finality of the value fixed by valuer in the sense that whether

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[31] The exeptions to the requirments concerning post-formation acquisition are given under Art. 11(2) second Council Directive.

[32] Art.13 of the second Council Directive of course requires member states to extend the application of its provision on NCCs in the event when a private limied company is converted to a public one. This issue is, however, in the firs place excluded from the scope of the paper since this event does not as such involve the making of NCCs for the purpose of purchasing of shares in a company.

it need to be approved by the subscribers or the contributor itself, as well as the majority and quorum required to approve a post-formation acqusition and the effect of non- satisfaction of the rules on post-formation acquisition.

Thirdly, the second Council Directive does not provide the consequences where the a contributor fails to fully transfer the NCC within the prescribed period, or where the company accepts an undertaking to do work or perform sevices. There is no also express provision in this Directive concerning the liability of transferors and subsequent holders of shares [issued against a NCC] to pay contributions that have not been fully paid up where such shares are transferred to another person.

The above Directive is also silent on the issue of whether a subscriber who first undertakes to pay in cash at a future date is bound to pay likewise or it can latter pay its promise in kind. In fact, the second Company Directive is in the first place silent on whether such an undertaking constitutes a valid form of cash consideration unless one argues from its requirment under Art. 9(1) about minimum amount to be paid on shares issued for cash that such an undertaking is not acceptable form of cash contribution.

Furthermore, the first Company Directive's requirment of mandatory disclosure, as discussed earlier, envisages that member states will provide for a judicial or administrative organ charged with the task of registering companies, the Directive does not clearly state the role of the official at this organ in verfying the fulfillment of the requirments as to filing and publication and, in the case of a public limited company, that of the validity of the NCC, its valuation and payment as well as its powers if it finds that any of the legal requirments are not satisfied.

In addition, there is no clear provision in the EC Company Directives about the possiblity for a company to correct omissions from the founding documents of the required particulars

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about NCCs by amending those documents. The same is true about the possiblity of correcting incorrect entries in the relevant register or of the submission of the expert report if it was ommited at registration. Last, the Directives do not attach penalties for the violation of many of their provisions and are silent on the issue of any direct or derivative right of action of shareholders or creditors of a company to enforce any claims the company may have or of their own.

The above state of affairs of the Community legislations may be explained by the very purpose of the Directives and nature of Cummunity legislations in the form of directives that they primarily aim at bringing about harmonaization, rather than uniformity, of national laws of member states and give member states the choice of form and methods for their implementation.[33] Hence, in the three Parts to follow we will see how the member states under consideration have transposed those Council Company Directives and addressed the above areas of silence and non-application of the Community law as well as control of NCCs in general.

Part Two: The German Legal System

1.2.1. Definition of Valid forms of IKCs

The AktG provides neither a general definition nor a specific list of the permissible types of NCCs for an AG. § 27(2) lays down only a single criterion and one outright exclusion, whereby it provides that only 'assets that have an ascerainable economic value' may make up valid IKCs but contributions in the form of services are not possible. This general standard and specific exclusion are in line with the second Council Directive.

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[33] Peter Hay, *Reading Material for the course 'EU Law I'*, Central European University, Budapest, 2009/2010, p.IV-3

The GmbHG, on the other hand, is silent on the issue. The relevant provision of § 5(4) neither provide neither the criterion of ascertainability of the economic value of an asset nor the excludability of contributions in the form of services regarding a GmbH.

1.2.2. The Evaluation and Payment Phase

A. The Stock Corporation

The valuation procedure is meant to see that the requirement under § 36a(2) AktG i.e that "the value of contributions in kind shall equal the par value plus, in case of an issue at a price in excess of the par value, such excess" is met. Accordingly, as can be seen from §§ 32(2), 34(1/1) AktG, there is first valuation by the founders themselves. § 32(1 &2) AktG require the founders to prepare a written report, called in the Act 'formation report', whcih shall contain the material facts about the adequacy of the IKC, any preceding transactions concluded in respect thereof, and where the IKC is an enterprise, its earnings for the last two financial years.

Then, §§ 33(1), 34(1/2) AktG require members of the supervisory board and the managment board of the future company to audit whether the value of an IKC is adequate to pay for the value of the shares to be issued for it. And the members of each of of these boards are required, under34(1/2) AktG, to submit a written report which shall state the nature of the asset, its value, the method of valuation applied and that the value of the asset corresponds with the value of the shares to be issued for it.

Thirdly, we have valuation by one or more independent auditors named in the Act as 'formation auditors'. According to § 33(2) AktG, the appointment of such persons is mandatory in all cases where an AG's formation involves IKCs.[34] Under § 34(1/2) (2) AktG,

[34] § 33(3) AktG provides that the formation auditors are to be appointed by the court after consulting the Chamber of Industry. In order to ensure the quality of the formation auditors' task the Act lists down different preliminary safeguards, i.e. professionalism and independence requirments for appointment. The independence

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these persons have a duty to ascertain whether the value of an IKC can pay up the value of the shares to be issued for it. And § 35(1) AktG entitles them with the right to obtain the necessary information and documentation from the founders. The formation auditors are likewise required under § 34(2) AktG to render a written report of their audit, called 'formation audit', that shall contain the details stated above to be contained by the report of the organs of the future company. These particulars comform to what the second Company Directive requires to be included in the report of the independent valuer of IKCs.

Finally, § 36a2 AktG require IKCs to be paid in full at the time of registration of the company. However, if the IKC is in the nature of 'an obligation to transfer an asset to the company, such obligation must be capable of being performed within five years after the company's registration.' These payment terms are exactly in line with what the second Company Directive mandates in this regard.

B. The Limited Liability Company

In the case of a GmbH, § 5(4) GmbHG provides that that evaluation is made by the shareholders themselves, determining the valuation techniques to be applied and the essential circumstances to take into account. This provision also requires the shareholders to prepare a formation report containing these elements and the value of the asset as well as a description of its subject-matter. There is no clear provision in the GmbHG that imposes on the managing director(s) a duty in connection with valuation unless this can be implied from the provisions that impose civil and penal liabilities, as we shall see latter, against these persons following incorrect statements made about IKCs. The law is rather more obscure as regards the duty of

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criteria are those laid down for special auditors and external auditors under by way of § 142(2) AktG and§ 319(2 &3) HGB (Commercial Code), and persons who do not satisfy these criteria do not qualify for appointment as formation auditor.This prohibition also covers 'persons and auditing firms over whose management the founders or persons on whose behalf the founders have subscribed to shares or exert a substantial influence.' § 33(5) AktG. The professionalis requirements, set forth under § 33(4) AktG, on the other hand, in addition to the ones that the articles may prescibe, are that formation auditors must be persons who are sufficiently trained and experienced in accounting, and in case where it is an auditing firm, one of its legal representatives shall be sufficiently trained and experienced in accounting.

members of the supervisory board, if any,[35] in relation to evaluation. The provisions of the AktG on the supervisory board of an AG which are made applicable to the supervisory board of a GmbH by virtue of § 52(1) GmbHG do not cover the corresponding rules on the functions of that board in auditing IKCs.[36] Moreover, the GmbHG does not require the appointment of formation auditors.

As regards payment, § 7(3) GmbHG orders the transfer of IKCs to the company 'in such a manner that they are finally at the free disposal of the managing director' before the company's registration. There is no provision in the GmbHG that corresponds to the AktG's provision which allows the payment of IKCs in the form of undertaking to transfer an asset to the company within a five-year period of the company's registration.

1.2.3 The Disclosure Phase

A. The Stock Corporation

The AktG requires the disclosure by an AG of different sets of information in the articles and other documents concerning IKCs. According to § 27(1) AktG, "the articles shall stipulate the purpose of the IKC, the name of the contributor, and the value of the shares to be issued for it." Absent these particulars from the articles, § 27(3) AktG renders "any agreement regarding the contribution unenforceable *in respect of the company*."(emphasis mine). This is an unenforceability that can not be cured by amendment of the articles once the company is registered in the commercial register. Moreover, § 41(1) AktG bars the company from

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[35] The GmbHG does not require a GmbH to have a supervisory board, but it can have one if the articles of association provide so. It may also be required to have such an organ by one of the Co-determination Acts.

[36] The provisions of the AktG that are made applicable to the supervisory board, if any, of a GmbH are § 90(3), (4) sentences 1 and 2, § 93(1 & 2), §95 sentence 1, § 100(1) and (2) No.2, § 101(1) sentence 1, § 103(10 sentences 1 and 2, §§105,110 to 114, 116, §§ 170,171

assuming in any event obligations arising out of agreements on IKCs that do not meet the above mandatory stipulation requirment.

However, pursuant to §27(3) sentences 2 &3 AgtG, the above unenforceability does not affect the validity of the articles once the company is registered and the shareholder in question shall pay the value of the shares subscibed for. Moreover, absence of the mandatory particulars about IKCs from the articles is not among the grounds listed under § 275(1) AktG for declaration of nullity of the company.[37]

In addition to the articles, the law requires certain mandatory stipulations and documentation to be made in/with the filing for registration of the company. According to the provisions of § 37 AktG, this filing shall state that the requirements regarding the payment of IKCs have been met and there shall be annexed with the filing the agreements relating to IKCs as well as the reports of the different persons mentioned above. Moreover, a copy of the report of the company's organs and that of the formation auditors must be deposited with the court. Finally, §§ 40(1), 25 require the publication through the Federal Gazette of the stipulations in the articles concerning IKCs.

Therefore, the above disclosure and publication requirements of the German stock corporation law concerning IKCs comply with the requirements of the second and the first Council Directives in relation to this matter.

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B. The Limited Liability Company

Like the AktG, the GmbHG lays down minimum content requirments in the articles of association of a GmbH about INKCs. Specifically, §§ 2, 5(4) GmbHG provide that where a

[37] The grounds on which a company may be annuled as stipulated under § 275(1) AktG are where the articles do not contain statement regarding the purpose or the amount of share capital of the company or where their provisions concerning the company's purpose are null and void.

IKC is to be made, the articles shall stipulate the subject-matter of the contribution, the amount of the share capital contribution to which it relates, and the name of the contributor. Unlike the AktG, however, there is no provision in the GmbHG which provides for the unenforceability of agreements regarding IKCs and transactions in execution thereof with respect to the company as a result of non-satisfaction of this mandatory stipulation in the articles. The GmbHG also does not provide for the prohibition that the company, after formation, can not assume obligations deriving from agreements relating to IKCs that do not meet the above stipulation requirement. The non-satisfaction of this requirment, nevertheless, is not among the grounds given under § 75(1) GmbHG on which the invalidation of the company may be orderd.[38]

Secondly, § 8(2) GmbHG requires the application for registration to contain a statement that IKCs are paid in the manner required by the law. In addition, pursuant to § 8(1) sentences 1, 4 and 5 GmbHG, there shall be appended to this application the text of the articles, the formation report, agreements regarding IKCs and agreements made in execution thereof, and documents showing that the value of an IKC is not less than the amount of the share capital contributions subscribed to in respect thereof. Thirdly, according to § 12 GmbHG and § 10(1) Commercial Code, the registering court shall cause publication of the registration together with its entire contents through either the paper or electronic Federal Gazette.[39]

The above disclosure and publication requirments concerning IKCs by a GmbH again make the German law on the limited liability company consistent with the disclosure requirements of the first Company Directve, as amended.

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[38] The grounds on which invalidation of the comapny may be ordered are absence of satement in the articles of amount of capital or purpose of the company or having an invalid company purpose. § 75(1) GmbHG.
[39] § 10(1) HGB is applicable to the GmbH, since the general provisions of the Commercial Code are applicable to all commercial companies and a GhbH is a commercial company. § 13(3) GmbH and § 6 HGB.

1.2.4 The Confirmation Phase

A. The Stock Corporation

In addition to their independent valuation function in ascertaining the true value of IKCs, the members of the managment board and the supervisory board as well as the formation auditors are required under § 34(1/1) AktG to verify the completeness and correctness of the necessary mandatory stipulations in the articles and state their findings in their respective reports.

Moreover, pursuant to § 38 No. 1 to 3, 37(1), 37(4/1) AktG, the registering court shall deny registration where it finds that the company has not properly filed for registration. It may deny registration where it finds that the facts that must be determined in the articles are missing or deficient. The court may also deny registration where it is of the opinion or the formation auditors state that the report of the founders, the managment board or of the supervisory board is inaccurate or incomplete or that the value of the IKC is 'materially' less than the value of the shares subscribed in respect thereof. Non-satisfaction of the requirments on payment will also entail the court's refusal to register the company.

B. The Limited Liability Company

There is no clear provision in the GmbHG regarding any duty of the managing directors to verify the accuracy and completness of the contents of the articles concerning IKCs. It may be contended that this duty may be implied from § 9a (1) GmbHG, which makes these persons liable to make missing contributions and to repair the damages to the company arising from 'incorrect statements made for the purpose of forming the company.' The Act is silent on the verfication duty of members of the supervisory board, if any. However, we have confirmation by the registering court and pursuant to § 9c (1) (2)GmbHG, the court shall deny

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registration if the filing for registration is not properly made, or if it finds that facts that must be determined in the articles are absent or the value of IKCs is overstated.

1.2.5 The Liability Regime

A. The Stock Corporation

The AktG strenghtens its control over IKCs through imposing various civil liabilities and criminal penalties in connection with IKCs. Thus, mention can be made of the liability of founders, shareholders, persons on whose behalf the shareholders have subscribed to shares and managing directors and others under the provisions of § 46(1) either for a deficiency in value or non-payment of IKCs or damages to third parties and the company arising as a result of incorrect or incomplete statements made about IKCs. And § 49 AktG provides for the analogous application of the provisions of § 323(1) to (4) of the Commercial Code governing the liability of external auditors to that of the formation auditors.

§ 50 AktG prohibits the company from, in principle, waiving or compromising its claims for damages against the above persons, except the formation auditors, within the prescribed period and subjects such arrangements thereafter to the agreement of minority shareholders. Moreover, §§ 147(1&2), 148(1) AktG entitle shareholders a derivative right of action against the above persons, except the formation auditors[40] while creditors are entitled under §§§§ 48, 93(5), 116 and 117(2) AktG to assert the claims of the company for damages against officers of the company if they are unable to obtain satisfaction from the company and these officers have manifestly violated their duty of care.

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Lastly, § 399(1) AktG imposes criminal liability on whosoever, as a founder, member of the management or supervisory board ’makes false statements or fails to disclose material facts,

[40] The details of the manner of exercising this right of action are set out under §§ 147(1&2), 148(1) AktG.

for the purpose of registration of the company, with respect to contributions in kind in the formation report, audit report, articles or official announcements.'

B. The Limited Liability Company

The GmbHG, which does not contain detailed provisions unlike the AktG on liability matters, nevertheless provides, under § 9(1), the civil liability of a contributor, other shareholders, the persons on whose behalf the shareholders have subscribed to shares, and the managing directors either to make up a deficiency in the value of the asset or to compensate damages to the company arising in connection with the making or their duty of controlling IKCs. § 9b (1) sentence 1 GmbHG prohibits the company from, in principle, waiving or compromising its claims against the liable persons and provides for the invalidity of any such arrangement "as far as the compensation is necessary to satisfy the creditors of the company." The GmbHG is not clear as to whether shareholders and creditors have a derivative right of action against persons who may be liable to the company in connection with IKCs.

Moreover, § 82(1/1) (3) GmbHG provides for the criminal liability of any person who makes false statements as a shareholder or managing director, for the purpose of registration of the company with respect to IKCs. There is no express provision in the Act that makes members of the supervisory board, if any, liable civilly or criminally in connection with IKCs unless one argues that this can be inferred form the general duty of care and diligence imposed upon them by § 52(1) GmbHG through reference to the provisions governing this duty of the supervisory board of an AG.

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1.2.6 Scope of the Control System

1.2.6.1 Increase in Capital

A. The Stock Corporation

The AktG provides rules comparable to those that govern control of IKCs at the time of the formation of an AG where shares are issued against IKCs in the event of increase in capital.

Accordingly, §§§ 183(3), 184 AktG provide for the analogous application of the rules governing the roles of the different persons and the court we have at the time of formation of the company as well as the documentation requirements and the consequences of non-registration.

In addition, the provisions of § 183AktG mainatin the mandatory stipualtion requirement about IKCs in the resolution on the capital increase, the effect of unenforceability of agreements underlying the IKC with regard to the company if this requirement is not satisfied, its incapability of being cured by amending the articles once the increase is registered and hence the obligation of the subscriber to pay the company in cash the value of the shares subscribed for. The criminal liabilities under § 399(1) on different persons in connection with IKCs apply in the case of capital increase as well.

These rules make the AktG consistent with the valuation requirements under the second Council Directive and of the disclosure requirements under the first and second Council Directives at the time of increase in capital.

B. The Limited Liability Company

Where an IKC is to be made to a GmbH in the event of increase in capital, §§ 55(1), (56(1) GmbHG likwise provide for the mandatory stipulation requirements about IKCs, which we saw in connection with formation of the company, in the resolution on the increase and the subscription form. Lack of this stipulation requirement, however, does not release the subscriber from his obligation to pay the value of the shares he has subscribed. § 57(1 & 3) GmbHG mandates the registration of the increase, the application for which has to state that the contribution is at the free disposal of the managing directors, as well as the deposition with the court of the above declaration and agreements underlying the IKC as well as publication thereof. Absence of any of the above requirements will result in the denial of the

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registration of the capital increase. The same works true where the registering court finds that the value of the contribution is overstated.

While § 57(4), 82(1/3) GmbHG provide for the *mutatis mutandis* application of the provisions governing the civil and criminal liabiliy of the different persons at the time of formation of the company to the time of capital increase as well, the duties and liabilities of members of the supervisory board, if any, at time of increase in capital is not clear form the Act.

1.2.6.2 Amendment of the Articles- the AG and the GmbH

To prevent the circumvention of the mandatory stipulation requirement about IKCs by amending the articles, § 26(3), 275(5) AktG provide that the mandatory stipulations regarding IKCs in the articles can be a mended only if the stipulations had initially been lawfully made and such amendment can only be made after five years of the company's registration. Pursuant to §181(1 &3) AktG, any amendment of the articles takes effect only after its registration. The full text of the amended articles shall also be certified by a notar and deposited with the register. This conforms with the requirments of disclosure of amendments of founding documents under the first and second Council Directives.

On the other hand, the GmbHG does not contain detailed provisions on the issue. It only provides, under § 54, that the amendment shall be certified by a notary and entered in the register.

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1.2.6.3. Indirect IKCs and Post-formation Acquisition - The AG and the GmbH

The AktG expressly extends its provisions on IKCs in general to indirect IKCs. The provisions of paragraphs 25, 27, 32 to 34, 37 to 41, 46 to 50, and 399 AktG discussed so far in relation to to IKCs in general apply to indirect IKCs as well. Unlike the AktG, the GmbHG does not contain provisions that expressly address indirect IKCs unless it is argued that the issue is addressed by § 11(2) GmbHG which provides for the unenforceability of pre-registration acts as regards the company.

The AktG likewise expressly extends the application of its general provisions on IKC to the case of post-formation acquisition in a manner conforming with second Company Directive. Thus, pursuant to § 52(1) AktG where a company, within two years of its registration, enters into an agreement which requires it acquire an asset for a consideration exceeding one-tenth of its share capital, the agreement shall become effective only upon the consent of the shareholders meeting and its entry in the commercial register.[41] Before the passing of the resolution, § 52(2-4) require, among others[42] that the agreement be examined and commented by members of the two boards and the formation auditors who shall present their respective reports to the meeting.[43] § 52(7) AktG provides further that the registering court may deny registration if the formation auditors state or if it is manifest to it that the report on the post-formation acquisition is inaccurate or incomplete, or the consideration given for the asset is unreasonably high. Moreover, by virtue of § 53 AktG, the provisions governing the damage claims of a company against different persons in relation to IKCs at the time of the formation of the company analogously apply in relation to post-formation acquisition.

From the discussion so far about the control of IKCs under the German company law, it is observable that the law is flexible in this regard in the case of the GmbH. Service

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[41] Exceptions to the application of the rules on post-formation acquisition are given under § 52(9) AktG.

[42] Other requirments under § 52(2 AktG include that the agreement shall be in writing, be made availabe to shareholders and the meeting for inspection, and that it shall be appended to the minutes.

[43] According to § 52 (3 & 4) AktG, the post-formation report of the supervisory board shall contain the elements required to be contained by the formation report of founders, while the audit report of the formation auditors shall contain what is needed to be contained by the audit report of formation auditors, on IKC at formation stage of the company. As to the majority required for passing of this resolution and the details of the registration and filing requirements in respect of the agreement, the different reports and the resolution see § 52 (6 & 8) AktG.

contributions are not expressly excluded, expert valuation is not mandatory, the duty of supervisory board members, if present, is not clearly given, any derivative right of action of the shareholders and creditors is not stated. Moreover, the issue of amendment of articles is not addressed in detail compared to the AG and post-formation acquisition is not governed. This non-stringency or silence of the law may be explained by the nature of the GmbH as being more of partnerships than the AG as well as the historical rational behind the enactment of the GmbHG i.e. to make it flexible as to be fit for small and medium-sized businesses.[44] It should, however, be noted that despite the above state of affairs of the Act, its provisions in the area of control of IKCs has been 'heavily supplemented' by judge-made law in order to prevent circumvention of the statutory provisions on IKCs.[45]

It is also noticeable form the discussion that neither the AktG nor the GmbHG contain clear provisions on the issue of liability of subsequent holders of shares issued against an IKC in case these shares are transferred before they are fully paid. It is not clear whether their provisions (§§21, 22 GmbHG, and §§§54, 65, 66 AktG) on forfeiture and specific performance, whose wording suggests that they are framed for cash shares, are also applicable to shares issued for IKCs. The issue is important especially in the case of the AG, where the AktG expressly allows an undertaking to transfer an asset in the future as a valid form of IKC but does not expressly provide that shares can not be issued for such contribution as paid up.

Last, both the AktG and the GmbHG do not expressly address the issue where a subscriber who initially assumes an obligation to pay in cash but actually pays in kind based on a subsequent agreement with the company. This issue has, however, been addressed by a German court whose decision establishes that such agreements constitute a circumvention of

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[44] J. Zekoll and M. Reimann (Eds), *Introduction to German Law*, , Second Edition, Kluwer Law International, the Hague, the Netherlands, 2005, P.158-159
[45] Ibid., p.159

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the statutory provisions on IKCs and hence are null and void.[46] The effect, in the case of an AG, is that the subscriber can not be released from its obligation to pay in cash while in the case of a GmbH the court has decided that the IKC offsets the obligation to pay in cash.[47]

The next part will consider the system of control of IKCs under the French legal system.

Part Three: The French Legal System

1.3.1 Definition of Valid Forms of IKCs

C.civ., art.1832, which applies to all forms of business associations, provides that either 'property or industry' can be contributed to the establishment of a business association. C.civ., art.1843-3, in addition, specifically provides that contributions in kind, use of property or money can be made to a business association. C.com., art.L210-1 deems both an SA and SARL as commercial associations.

However, C.com., art.L225-3 clearly excludes services from the ambit of valid forms of contributions in the case of an SA, while C.com.,art.223-6 vaguely provides, in the case of the SARL, that 'where applicable the statutes may lay down the terms and conditions under which subscription for shares can be made by contributing services.' The Commercial Code does not employ the second Company Directive's criterion of 'capability of economic assessment' of an asset to determine the validity of an IKC. And it is unclear what types of IKCs other than services may be regarded as impossible to be made to an SA.

C.com., art.L 228-27, on the other hand defines of cash shares in terms of a stock company as: ' shares whose price is paid in cash or by a set off, shares that are issued as a result of an

[46] Supra note 14

[47] Id.

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incorporation into capital reserves, profits or issue premiums and shares whose price comes partly form a cash payment.'

1.3.2 Valuation and Payment IKCs

A. The Public Limited Company

Where an IKC is made to an SA, C.com., art.L225-8 requires its valuation by one or more valuers of IKCs appointed by a court upon application by one or more of the founders.[48] The valuer, who makes the valuation on his own responsibility, shall render a report that must be deposited with the court registry as an annex to the draft statutes and be made available to the subscribers. There is no provision in the Code that lays down the contents of this report. 225-147 only provides that the details of this report shall be laid down by a decree of the Council of the State.Then the inaugural general meeting of subscribers rules on the valuation done by the valuer.[49] C.com., art.L 225-8 entitles the meeting to reduce the value proposed by the valuer by only unanimous consent but absent the express approval of the meeting's decision by the contributor, the company is not formed. So far as time of payment is concerned, we find under C.com., art.L 225-3 that shares subscribed in kind must be fully paid up at the time of their issue.

The law on evaluation and payment of IKCs and the discussion above with respect to an SA that is to be formed by a public offering of shares is basically the same as regards an SA to be formed without a public offering of shares. Pursuant to C.com., art.L 225-12, the provisions providing for the preparation of the draft statutes by the founders, approval of the statutes and the valuer's valuation of an IKC by the first general meeting of subscribers and the contributor do not apply in the case of an SA to be formed by the latter way. Thus, it seems

[48] The valuer is 'assumed to have a good mastery of all the valuation techniques.'Paper Audit and Counseil, *Contributions Audit* http://www.xavierpaper.com/en/missions/#1, accesssed on 2010-03-13
[49] This meeting makes its decision on the valuation in accordance with the conditions as to forum and majority set down for extra ordinary general meeting. C.com., art.L 225-9. The contributor has no right to vote in this meeting, and its shares are not to be taken in to account when calculating the majority. C.com., art.L 225-10.

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that in this form of company the value of an IKC is determined by the shareholders on the basis of a valuer's report, which needs to be available to them before they sign the statutes as required by C.com., arts.L 225-14, L 225-15 and once the statutes are signed the value is final and binding on the contributor in the sense that it is not subject to approval by the contributor.

B. The Private Limited Company

In the case of the SARL too valuation by an independent appraiser of IKCs is mandatory except where the exemption under C.com., art.L 223-9 is available.[50] According to this provision, the shareholders can reduce the value proposed by the appariser but the contributor here does not seem to have the right it has in the case of an SA to be formed by public offering of shares. Procedurally, pursuant to C.com., art.L 223-9, it is possible for the future shareholders acting unanimously to appoint the valuer by themselves, otherwise it will be made by a court upon application by one or more of them.

Here again, C.com., art.L 223-7 requires shares subscribed in kind to be fully paid up at the time of their issue.

1.3.3 The Disclosure Phase

According to C.com., art.L 210-7, in order for a company to be registered and acquire legal personality, its statutes shall contain a valuation of IKCs on the basis of a valuer's report that is required to be annexed with the statues. The Code does not state what details shall be included in the statutes concerning IKCs. C.com., art.L 225-147 also simply provides that the contents of the valuer's report is also to be laid down by a decree.[51] Still it is expectable that

[50] This exemption works where the future shareholders decide unanimously not to appoint/to have appointed a valuer provided the value of the asset not to be subject for valuation be such valuer does not exceed 7,500 Euros and the total value of the ncc not to be made subject for such valuation does not exceed half the share capital of the company.

[51] The writer was not able to access this decree and secondary sources are used instead.

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they may contain, in addition to the value, such essencial particulars as the name of the contributor, the value of the asset and its description. Whatever information this Decree prescibes to be contained in these documents about IKCs, the incorporation of both an SA and the SARL requires the deposition with the registering court and publication in the Official Gazette of a summary of the statutes and the copy of the appraiser's report (in the case of SARL, where valuation is mandatory).[52]

C.com., arts.210-5, which applies to both an SA and SARL, provides the effect of publication (or lack of it) of information that is subject to public notice. According to this provision, information that is subject to public notice in the *Official Gazette of Civil and Commercial Notices* is not binding on third parties who can prove that it was impossible for them to have knowledge thereof, and that in the case of discrepancy betwen information contained in the text deposited with the corporate and commercial register and the one published in the Gazette, 'the latter is not binding on third parties,who, however, may rely on it unless the company proves that they had knowledge of the text filed with the register.'

The above documents that need to be disclosed by way of deposition with the registry and publication as well as the effects of failure of publication on the company and third parties are concered are in conformity with the provisions of the first Company Directive. The Code, however, does not clearly address the effect on the relationship between the company and the contributor of omission from the statutes of whatever mandatory information, one of which,as given in the Code itself of course, is the value of the asset, is to be contained in them about IKCs. C.com., art.L 210-7, which applies for categories of companies, provides that such

[52] Moquet Borde & Associes, Simeon & Associes, *Doing Business In France*, Looseleaf, First Published 1983, New York, PP. 5-19, 5-87

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omission is capable of cure by amendment of the statutes within three years of the company's registration. From this it can be implied that the subscription by the contributor is valid and enforceable on both the company and the contributor during this three-year period.

The above provision does not yet answer consequence if this persion lapses without the omission being corrected. C.com., art.L 210-8, which applies to both types of companies, only provides that the laiblity of certain persons for the damages suffered by others as a result of abcence of a mandatory provision from the statutes. This means that the failure of correction of omissions from the statutes does not result in the invalidity of the company. The same is true of the provisions of C.com., art.L 235-1, L 225-249 that govern the issue of inavalidity of both an SA and the SARL and only an SA, respectively, that they do not mention absence of mandatory provisions, which naturally include the value of and other stipualtions required by decrees about IKCs as a ground of invalidity of a company. They rather govern the issue of liability of different persons for damages to others arising from the invalidity of the company.

1.3.4 The Confirmation Phase- an SA and the SARL

Pursuant to C.com., art.L 210-7 the registering court is to register a company, public or private, only after verifying that the company's statutes shall "contain all the statements required by the legal and regulatory provisions relating to the corporate and commercial register." As we saw earlier, apart form the value of the asset, the Code does not provide what shall be contained in the statutes of a company about IKCs. Anyways the court will check the fulfilment of the mandatory stipulations about IKCs in the satutues as provided by decrees. This provision, in addition, provides that the registering court is to register a company, public or private, after verifying that all the conditions and formalities set out by law for the

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fomation of a company are observed. This implies that the court will investigate the satisfaction of the valuation and payment, as well as disclosure requirements in the respective company. There is, however, no clear provision in the Code that empowers the registering official to refuse registration on the ground that the value of an IKC, in his opinion, is overstated.

In connection with confirmation role of the court, C.com., art.L 210-7, provides that should any of the required particulars be omitted from the statutes of every company or be incorrect, any interested person may apply to the appropriate court to have them corrected.

The Code does not impose an express duty on the the founders or the first officers of a company to verify the adequacy and accuracy of statements that need to be included in the statutes and the check fulfillment of the requirements as to validity of an IKCs, and its valaution and payment. However, from the provisions of C.com., art.L210-8, which reads that that 'the initial members of the executive, administrative, management and supervisory bodies are liable to others for the damage suffered due to the absence of a mandatory provision in the statutes or, omission or improper performence of a formality required by law for the formation of the company,' it can be said that these persons also have an implied duty of making confirmation.[53]

1.3.5 The Liability Regime: an SA and the SARL

The Commercial Code provides for various civil and criminal liabilities in connection with the control of IKCs. In the first place, it has to be recalled that per C.com., art.L 210-6 a company is not liable for pre-registration acts made in its name, unless it assumes them after registration. This obviously includes acts relating to IKCs. Secondly, C.com., art.L 210-8

[53] Under French law a public company may have a managing board and supervisory boards where the statutes provide for the constitution of these bodies. C.com., art.L 225-17, L225-57

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provides for liability of the founders and different officers of the company for damages to others arising from absence of a mandatory stipulation in the statutes or amended statutes, or irregularity in the formation or amendment. Thirdly, we find under C.com., art.L 235-13 that those shareholders of an SA whose contributions have not been examined and approved may be held jointly and severally liable to compensate any loss to third parties and the other shareholder resulting from the invalidity of the company.

In the case of the SARL, C.com., art.L 223-9, in addition, provides that if, during the formation of the company, there has not been a valuer of IKC or if the value used is different from that proposed by the valuer, the shareholders are jointly and severally liable during a period of five years with respect to third parties for the value attributed to IKCs at the formation of the company. The same ground of liability and its consequence also applies to the managers and persons who subscribed to new shares in the event of increase of capital C.com., art.L 223-33.

Moreover, under C.com., art.L 225-251 the directors and the general manager of an SA are liable jointly or individually to the company or third parties for losses suffered as a result of any breach of the laws or the regulations that apply to an SA. According to C.com., arts.L 225-256, L 225-257, where the company has a management board and a supervisory board, the members of the management board are liable in the same manner as the directors above, while the members of the supervisory board are liable for personal errors committed in the performance of their duties. These include naturally the legal provisions that impose duties on the above persons in connection with the control of IKCs.

With regard to standing to enforce the liablities against the above persons, we find that C.com., art.L 225-252 entitles the shareholders, in addition to the right to bring action to claim any personal injury damages, the right to bring an individual or collective derivative

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action in damages on behalf of the company against the directors or general manager. This right of shareholders is reinforced by C.com., art.L 225-253, which provides for the nullity of any conditions or restrictions on the excercise of this right. However, there is no express provision in the Code entitling creditors of a public company whose claims can not be satisfied by the company the right of derivative action against the directors, general manager or members of the management or supervisory board who may be found liable to damages to the company.

The provisions of the Code on offences involving the SARL do not contain details instances of criminal liabilities. As regards an SA, however, we have the following liability provisions. First, C.com., art.L 242-1 provides for a possiblity of prison sentence on the founders, and diffrent officers of the company who issue shares without the shares issued in return for IKCs having been fully paid up prior to the registration of an SA in the register." In addition, "the chairperson, directors or general managers are criminally liable under C.com., art.L 242-17 (I & II) if shares are issued, on the occasion of increase in capital, without the new shares issued in return for IKCs having been fully paid up prior to the amending entry in the corporate and commercial register."

According to C.com., art.L 242-30, it needs to be noted that the civil and crininal liabilities in respect of an SA, discussed, above in connection with the formation of the company and in the event of increase of capital also apply to members of the management and supervisory boards, according to their respective powers, where the company is governed by such organs pursuant to its statutes.

The Code does not contain a clear civil liability of the valuer for losses to others arising in connection with her valuation function. In respect of their criminal liability, however, C.com., art.L 242-2 provides, for both an SA and SARL cases, that these persons are liable to

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imprisonment and a fine should they fraudulently attribute to an IKC a value higher than its real value.[54] Moreover, pursuant to C.com., art.L 242-5 a person "who accepts or continues with the duties of a valuer of IKC notwithstanding any ineligibility or legal prohibitions is punishable by imprisonment and a fine."

1.3.6. Scope of the Control System

A. Increase in Capital

C.com., art.L225-147 provides the same requirements that exist at time of formation where shares are issued against IKCs at the time of increase in capital. Accordingly, the contribution shall be valued by experts whose report shall be submited to a general meeting of the shareholders. The increase can be recorded completed only where this meeting approves the valuer's proposal. However, if the meting reduces value proposed by the valuer, it has to be approved by the contributor and failing this, the increase is not effected. Moreover, shares issued for IKCs at this time too shall be completly paid up on issue.

C.com., art.L 225-148 provides an exception from the requirement of valuation by an expert, which is the exception of share-exchange provided under the second Company Directive and states that this requirement does not apply where the increase in capital is to be effected by way of share exchange between companies whose shares are listed on a regulated stock market and the purpose is to pay up the securities involved in a public offer. In the excersise of this exception, nonetheless, C.com., art.L 225-148 demands the auditors of the company to give their opinion on the matter and present a report on it to the general meeting.

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[54] In fact, the liability under C.com., art.L 242-2 applies to 'any person.' Thus, in addition to contributor or the valuer, it is possible to think a founder who participates in the inaugural general meeting that approves the value proposed by the valuer and votes in favor of this as falling within this provision.

Moreoover, where an SA formed without offering shares for public subscription offers shares to public to effect an of increase in capital that involves IKCs within two two years of its formation, C.com., art.L 225-131 maintains the requirements of expert valuation, its approval by the meeting of shareholders and, where the meeting reduces the value made by the expert, by the contributor.

For the SARL too, C.com., arts.L223-33, L223-9 provide that where an increase of capital involves an IKC, it shall be valued by an expert valuer and C.com., arts.L223-32, L223-7 requires the shares issued to be fully paid upon issue. By virtue of C.com., art.L223-33, the exemption from the requirement of independent evaluation available at the time of formation this company applies at event of capital increase, too.

B. Amendment of the Statutes

In the case of both an SA and the SARL, the requirement under C.com., art.L210-7 that the statutes of a company shall contain all the mandatory statements about IKCs applies also in the event of amendment of statues. Pursuant to this same provision, the registering court is to register the amendment only after verifying that this requirment is met while omission of those statements from the amended statutes can only be corrected , on pain of fine, within three years from the entry in the register of the documents amending the statutes.

C. Indirect IKCs and Post-formation Acquisition

There is no provision in the French Commercial Code that expressly address indirect IKCs. Nevertheless, the issue can be seen as falling within the general rule under C.com., arts.L 210-6 which provides for that pre-registration contracts made in the name of the company, an SA or SARL, are not binding on the company, and the persons who so acted are liable for the

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obligations arising from those acts unless the company, after being duly formed, assumes those obligations.

As regards post-formation acquisition of non-cash assets by an SA, C.com., art.L 225-101 provides that where such a company, within two years of its registration, acquires an asset belonging to a shareholder the value of which is at least equal to a tenth of the share capital, the asset has to be valued by an expert whose report has be available to the shareholders and that unless an ordinary general meeting accepts the valuation, the acquisition is null and void.[55]

It observable for the discussion of this Part that the French company law too is flexible in the control of IKCs in the case of the SARL. Contribution of services is possible and under certain circumstances, there is exemption from the requirement of expert valuation of IKCs and that the shareholders may appoint the valuer by themselves. Moreover, the provisions on post-formation acquisition do not apply on it.

Lastly, it should mentioned that the Code does not address the issue of liability of subsequent acquirers of shares subscribed in kind and that are not fully paid unless it is contended that. this does is not a problem since in both an SA and the SARL cases shares subscribed in kind have to be paid in full at the time of their issue. Otherwise, the provisions governing the liability of subsequent holders of unpaid shares i.e. C.com., arts.L228-27, L228-28, are framed in the language shares that have been issued for cash. Moreover, in respect of both types of companies, there is no provision in the Code that provides that an obligation

[55] As to the appointment and responsibility of the valuer, see C.com., art.L 225-201 first paragraph. And as to exceptions to requirements on post-formation acquisition, see C.com., art.L 225-201 second paragraph.

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undertaken by a subscriber to pay in cash can not later, through agreement with the company after its formation, be discharged by payment in kind.

Part Four: The English Legal System

1.4.1 Definition of Acceptable Forms of NCCs

The CA starts by providing, under s.582 (1), a general principle that shares in company may be allotted or paid up in ‘money or money’s worth’. Then, CA s.583 (2) deems the following forms of payment for shares as payment up in cash consideration: (a) cash received by a company, (b) a cheque, (c) a release of a liability of the company for a liquidated sum, (d) an undertaking to pay cash to the company at a future date, or (e) payment by any other means giving rise to a present or future entitlement of accompany or a person acting on the company’s behalf to a payment , or credit equivalent to payment, in cash.

The above list of what amounts to cash consideration for shares seems to be exhaustive, from which it can be inferred that anything that falls out side of it is a NCC. CA s.582 (1) illustratively mentions only goodwill and know-how as NCCs. Then CA s.583 (4) provides that the payment of cash or an undertaking to pay cash to a person other than the company or a person acting on the company’s behalf constitutes a non-cash consideration. CA s.585 (1), on the other hand, lays down an additional rule for public companies, which provides that a public company may not at any time accept an undertaking to do work or perform services. On the other hand, as it can be understood from the provisions of CA sss. 91(/c), 582 (1 & 3) and 585 (1), an undertaking to do work or perform services constitutes a valid form of NCC in the case of an ltd.

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While the exclusion of work or service contributions as regards a p.l.c is in line with the second Council Directive, there is no express provision in the English law, unlike this Directive, that employs the criterion of "capability of economic assessment" of the asset to determine the validity of a NCC.

1.4.2 Valuation and Payment of NCCs

Pursuant to CA ss. 546(2), 593(1), a p.l.c having a share capital can not issue shares as paid, fully or partially, as to their nominal value and any premium on them for a NCC unless three conditions are met. The contribution shall be valued by an independent valuer,[56] the valuer's report has been submitted to the company during six months prior to the issuance of shares, and that a copy of the report has been sent to the proposed allottee.

There are, however, two exceptions to the independent evaluation requirement. The first, given under CA s.594, is where a p.l.c issues shares based on an arrangement with any body corporate to the effect that the consideration for the shares is to be provided by the transfer to (the issuer) or the cancellation of all or some of the shares in the body corporate. While the exception in the second Company Directive in this respect applies where at least 90% of the nominal value of the shares of a company is issued for another company or companies in consideration of a NCC, the English law does not put such a minimum limit. The above section of the CA, moreover, does not provide for this Directive's requirements to reserve and guarantee by the contributing company for the exception to work. Thus, in these respects the exception under the English law may be seen as inconsistent with the Directive. The second exception, under CA s.595, applies where a company allots shares in connection with a merger with another body corporate and thereby issues shares to shareholders of the latter.

[56] The eligibility i.e. qualification and independence requirements to appointment as a valuer are set out under CA ssss.596 cum 1150(1) cum 1212(1) cum 1149(1). They basically provide that he/it shall be a person capable of being appointed as a statutory auditor and a person unrelated to the company or a company related to the first mentioned company.

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Here again the scope of the exception seems to be wider and may be seen as inconsistent with the second Company Directive, since while the Directive specifically mentions this exemption as exercisable at the time of increase in capital, the English law does not seem to restrict it to this event. This is so because the above provision of the Act applies generally to allotment of shares made after the formation of the company, which therefore can be at time of a company's formation.

In relation to the manner of carrying out the valuation by a valuer, CA ss. 1149(1), 1150(2) empower him to carry out the job in person or, where it finds it reasonable, to have the valuation or accept a valuation done by another person. Furthermore, pursuant to CA ss. 1149(1), 1151(1) the valuer or his delegate can demand from 'officers of the company such information and explanation as he thinks necessary to enable' the proper discharge of his functions.

As regards the contents of the valuer's report, CA s.596 (2 &3) provides that it shall describe the asset, and state its value, the method of valuation, and contain a ststement that the value of the asset is adequate to pay for the shares to be issued for it as well as that the value of the asset has not been materially changed since the valuation. Where the valuation is made by a person other than the valuer proper, CA ss.596(3) ,1150(4) require a report by this other person containing the details stated above and a note by the valuer so-appointed (a separate report of his own), which shall state 'the name of the person who carried out the valuation, his knowledge and experience in valuation, and that it appeared to him reasonable to have the valuation or accept a valuation made by another person, and describe the part of the consideration that is so valued by such other person.'

The above particulars to be contained in the valuer's report are the ones required by the second Company Directive to be included in such a report. Though the provisions of the

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Act on registration documents do not mention the valuer's report as one of those documents, it can be implied the cumulative reading of the provisions of CA ssss.546 (2) 555(2), 559, 597(1) that the valuer's report is one of such documents.

Moreover, there is no provision in the Act that imposes a clear duty on subscribers in connection with carrying out a valuation of NCCs. As we shall see latter, the application for the registration of a p.l.c must contain a statement of initial shareholdings which shall state the number of shares to be taken by a subscriber, their value and the value of the shares treated as paid up by his contribution. However, it seems that the value given by the subscribers to the NCC in this statement and the value of the shares treated as paid up by it shall be on the basis of the valuer's report, since CA sss. 546(2), 593(1/a & b) and 596(3/d) provide that shares must not be issued to the subscriber as paid up, fully or partially, and the subscriber can not be considered as a holder of the shares of the stated value without the consideration being first valued by an independent valuer. Thus, though it is possible that the subscribers could ascribe value to an NCC upon accepting subscriptions, the value to be fixed by them does not seem to be definitive in the sense that it is subject to any alteration by the valuer.

There is no clear provision in the Act about the time of payment of NCCs. CA ss. 546(2), 587(1) prohibit a p.l.c from issuing shares 'as fully or partially paid up for a contribution other than in cash which is or includes an undertaking which is to be or, may be, performed more than five years after the date of the issuance.' It can be inferred from these provisions that a NCC has to be paid in full at the time shares are issued for it, and in the case of an undertaking to transfer an asset to the company in the future, such obligation shall performed within five years of the issuance of shares for it. In this line of interpretation, the time of payment of NCCs under the English company law conforms to the prescription of the second Council Directive on this matter.

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Another point that needs to be mentioned in connection with payment is the provision under CA s. 584. It is about the manner of payment of shares in the case of a p.l.c and provides that 'shares taken up by a subscriber to the memorandum in pursuance of an undertaking of his in the memorandum, and any premium on the shares, must be paid up in cash.' It is an important provision in preventing the circumvention of the statutory provisions requiring valuation and other matters regarding NCCs.

Last, the Companies Act does not contain a provision that imposes a clear duty on the first officers of the future p.l.c in connection with the valuation of NCCs, except the duty to provide, when requested, the necessary information and documents to the valuer.

When we come to valuation and payment of NCCs in the case of an ltd, we find that the Act does not contain provisions specifically meant to govern the issue with respect to this type of company. The provision concerning independent valuation and the impossibility of substituting an obligation to pay in cash by that of paying in kind is also stated clearly for a p.l.c. It seems that the law leaves the above matters to be regulated by the agreement of the shareholders though there is no express statement in the Act to this effect. Moreover, as it can be implied from CA s.91(1/d & 2), it also seems that an ltd can receive an undertaking to transfer a NCC and issue shares for it as paid up even though the undertaking is capable of being discharged only after five years of the issuance of shares.

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1.4.3 The Disclosure Phase

As far as disclosure of information and documents in the context of NCCs under English law is concerned, CA s.546 (2), 597(2) provide that a copy of the valuer's report, in the case of a p.l.c shall be submitted to the registrar. In addition, CA s.9 (1&4) requires delivery to the registrar various documents that may potentially include particulars about NCCs inserted by shareholders' discretion, though neither this provision nor any other provision of the Act expressly provide that they must contain particulars about IKCs. These are the memorandum and articles of association and the application for registration, which shall contain a statement of initial shareholdings or statement of guarantee, as the case may be.

Since the second Company Directive does not necessarily require inclusion of particulars in the formation documents of a public company, the valuer's report in the case of English law can satisfy the requirements of the Directive. In the case of a private company too, the English law is in compliance with the first and second Directive for they require only the deposition a public organ of the founding documents of this form of company without specifically providing for what they should contain about NCCs.

CA s.1113 (1-3) entitles a member or a creditor of a company, in addition to the registrar, to require a company, by giving notice and then by bringing court action, to comply with any of its obligations to deliver a document where it had made default in this regard.

Finally, CA sss. 1064 (1), 1116(1, 2 & 3) and 1077(1, 2 & 3) require the registrar to cause, after incorporation of a company, public notice of receipt of certain documents to be made through the relevant means of publication which shall include, among others, the description of the document. While in the case of every company CA s.1078 (2/1) mandates the publication of the company's memorandum and articles of association, in the case of a p.l.c CA s.1078 (3/ 1 and 4) additionally requires the disclosure of the company's statement of initial shareholdings and a copy of the valuer's report as to the value of a non-cash asset.

As to the effect of failure to give public notice of the required documents to be publicized, CA s.1079 (1& 4/b) provides that it entails the effect this failure carries under the first Company Directive, as amended.

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1.4.4 The Confirmation Phase

CA ss.14, 15(1) prescribes that the registrar is to register the documents delivered to it and the company only if he is satisfied that the requirements of the Act as to the registration are complied with. These include the various requirements relating to NCCs. Per CA Ss 1072, the registrar has the power not to accept and/or to register a document that is not properly delivered.[57] The implication of this is that the registrar may not register the company, since, according to the above provisions registration of these documents is mandatory for the registration of a company. These documents also include those required to be submitted in connection with NCCs.

However, once a company is registered and a certificate of incorporation is issued for it in spite of an improperly delivery of documents, the company's valid formation does not seem to be affected as a result, since CA s.15 (4) provides that this certificate is 'conclusive evidence' of the compliance by a company of the registration requirements and of its valid registration/formation of the company. Nevertheless, according to CA s.1073 (4/a) this does not release the company from complying with the requirements of a proper delivery thenafter. Moreover, the registrar has the power given under CA s.1075(1) that he may, where it appears to him that a document delivered to him is incomplete or internally inconsistent, make inquiries about it and make a correction thereon.

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[57] The law regards a documents that does not satisfy the requirements of the provision under which the document is required to be delivered to the registrar concerning its contents as being not properly made and such a document is regarded as having not been delivered for the purposes of the provision requiring it.CA s.1072 (1/a)

The Act neither explicitly nor impliedly impose a duty on the first director/directors of the future company in relation to confirming any valuation done by subscribers or verifying the accuracy of the statements in the statement of initial shareholdings.

1.4.5 The Liability Regime

The Companies Act attaches civil and criminal penalties that arise in connection with its provisions on NCCs. Some of them are described below in such a way that discussion applies to both public and private companies unless express indication of the one or the other is made.

Pursuant to CA ssss. 583(3), 585(2), 587(2) and 588(1 &2), where a p.l.c issues shares as paid up in contravention of the prohibitions not to accept an undertaking to do work or perform services or, not to allot shares as paid up for an undertaking that is not being fulfilled within five years of the allotment of shares, the allottee and transferees of those shares issued in contravention are jointly and severally liable to pay the company an amount equal to the value of the shares or that amount as is treated paid up with an appropriate rate of interest.[58] CA s.590 (1&2), in addition, provides a criminal liability on officers of the company for these violations.

Moreover CA ss.593(3), 605(1) imposes, in the case of a p.l.c, joint and several liability on the allottee and transferees of shares issued against a NCC in contravention of any of the requirements of an independent valuation to pay the company the value of the shares or so much of that value as is treated as paid up by the consideration , with the appropriate interest rate. And, according to CA s.607 (1&2), imposes criminal liability on every officer of the company in connection with this contravention.

[58] The appropriate rate of interest 5% per annum or another one as may be specified by order of the Secretary of State is subject to a negative resolution procedure. CA s.592

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CA ss.1121 (1), 1153 (2&4) impose a penalty on an officer of a company and any person who is in default[59] in giving a document or information to the registrar or the valuer that is false or deceptive. Moreover, CA ss.26(1, 3&4), 27(1&4), and 30(2&3) impose penalties for failure to send to the registrar the various documents required by the Act to be sent to it.

There is no provision in the Act that provides express civil or criminal liability of the valuer of NCOs in a p.l.c. The provisions that make the eligibility criteria of the statutory auditor for the appointment of the valuer do not cover the liability provisions on this auditor.

The Act also does not contain a provision that imposes a duty directors of a company and hence a liability for breach of this duty specifically in relation to control of NCCs , except the duty to give information to the valuer in the case of a public company. If this can be inferred from their general duty under CA s.172 to promote the success of the company, however, there is corresponding civil liability under CA s.178 (1) for breach of this duty. With this line of argument about the possible liability of directors concerning the control of NCCs, it is important to mention that CA s.232(1) provides for the nullity of any provision that purports to exempt the directors from this liability while CA s.260 (1) entitles a member of a company a derivative right of action against them to enforce the a relief on behalf of the company."[60] It is also a punishable offence under CA s.993 (1&3) to carryout any business of a company with intent to defraud creditors but no provision of the Act clearly entitles them a derivative right of action against the directors.

Last, it has been mentioned that there is no provision in the Act that imposes any express duty and hence liability on the shareholders in connection with IKCs in the case of an ltd.

1.4.6. Scope of the Control System

[59] For the definitions of "officer" and "default" for the purposes of the Act, see CA ss.1121, 1122

[60] As regards the details of the manners of exercise of this right and the restrictions on it see CA ss. 260(3-5), 261-264.

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A. Increase in Capital

The Companies Act contains only a few provisions specifically addressing increase in capital. According to CA ss.617(1/a), a limited company having a share capital may alter its share capital only through increasing its share capital by allotting new shares in accordance with the provisions governing its formation. As a result, the issue of its compliance with the EC company law in this regard does not demand special discussion.

Two points, nonetheless, need to be made. The first is the requirement under CA ss.555 (1&2), 597(2) that every limited company must deliver to the registrar a return of allotment of shares and, in the case of a p.l.c, the valuer's report, too. This provision too, however, does not state what particulars the return of allotment shall contain about NCCs. Secondly, pursuant to CA s.565, existing shareholders right of pre-emption to new shares in the event of capital increase, in both a p.l.c and an ltd, does not apply to 'a particular allotment of shares if these are, or are to be, wholly or partially paid up otherwise than in cash.'

B. Amendment of Constitutional Documents

Just like the case is at the formation stage of a company, no provision of the CA requires, where a company's constitutional documents[61] are amended, that the amended documents should contain these or those particulars about NCCs. Whatever information about a NCC might have been included in the constitutions by the shareholders' own decision, CA ss. 26(1), 30(1) require anyway that where such amendment is made, the company must send to the registrar a copy of the amended articles as well as resolutions and agreements affecting the company's constitution. According to CA ss.1078 (2/2), 1079 a publication of the amendment and the amended documents shall also be made. Failure in this regard also bears the

[61] Under English company law, the terms 'constitutional documents' or 'constitutions' of a company have a wider meaning. In addition to the memorandum and articles of association, they include resolutions and decisions of members of the company. CA s.17

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consequences of the failure to give public notice, discussed earlier. Moreover, all other provisions of the Act in the respective type of company relating to NCCs remain unaffected regardless of amendment of a company's constitutions.

The above requirements are in compliance with the dictates of EC Company Directives in connection with amendment of a company's formation documents.

C. Indirect NCCs and Post-formation Acquisition

The Companies Act does not seem to have specifically addressed the issue of indirect NCCs. Nevertheless, the issue can be seen as coverable by the rule under CA s.51(1), which provides for the 'non-bindingness', a p.l.c or an ltd, of pre-incorporation contracts with respect to a company.

As regards post-formation acquisition, CA s.598(1, 2 & 3) provides that 'a company formed as a p.l.c must not, within two years from the date the company being issued a trading certificate'[62] enter into an agreement with a person who is a subscriber to the company's memorandum for the transfer by this person to the company or another person of a non-cash asset under which the consideration to be given by the company, at the time of the agreement, is equal in value to one-tenth or more of the company's issued share capital unless the requirements of independent valuation[63] approval by members[64] are complied with.'[65] CA s.

[62] This is a certificate to be issued by the registrar, upon application of a public company, where it is being satisfied that the nominal value of the company's allotted share capital is not less that the authorized minimum and once issued it is conclusive evidence that the company is entitled to do business and exercise any borrowing power. Unless such certificate is issued for it the company must not do business or exercise any borrowing power. CA ss.761 (1,2 & 4), 763(1).

[63] The requirements of independent valuation in the case of post-formation acquisition are set forth under CA ss.599, 600. They are basically the same as the ones that apply where a contribution in kind is made to a public company.

[64] For the details of the requirement of approval by members and registration of the resolution and the criminal penalties for violation of the registration requirement see CA ss. 601, 602

[65] CA s. 598(4 and 5) provides the exceptions to the requirements surrounding post-formation acquisition.

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604(1 & 2) attaches different consequences for the contravention of this requirements one of which is that ‘to the extent the agreement is not carried out, it is void.’

Part Five: The Ethiopian Legal System

1.5.1. Definition of Acceptable Forms of IKCs

Arts. 211, 313 (7), and 517(f) of the Commercial Code leave it to the agreement of the founders/shareholders of a company whether subscription to shares can be made by way of IKCs. However, the Code gives neither a list of IKCs deemed acceptable in the context of companies nor a general criterion to this effect. CC Art.229 (1 &2) provides a list of the acceptable types of contributions which is, nonetheless, only in the context of partnerships.[66] The provisions of the Code governing companies do not refer to the application of this provision upon companies. The only form of an IKC stated under CC Art. 206, as a valid form of contribution for all types of business organizations and hence for companies as well is a business.

Generally, therefore, the situation of Ethiopian company law on the issue very much deficient compared to the legal systems discussed before. These other legal systems either provide a general criterion of determining what forms of IKCs are valid or a clear exclusion of services or both.[67] Having said this, we will turn to see the other aspects of control of IKCs with regard to each form of company.

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1.5.2. Control of IKCs in Respect of the Share Company (SC)

In its nature and structure, this company form is fundamentally the equivalent of the German

[66] According to CC Art. 229(1 &2) the following may form a contribution to an ordinary partnership: money, debts, other property or the use of property, or skill.

[67] According to the writer’s observation of the country’s business practice, the common forms of IKCs are corporeal chattels (especially vehicles, machinery or other equipment), immovable (especially building), a going concern and sometimes goodwill.

AG, the French SA or the English p.l.c.[68] However, like French public company law, CC Arts.307 (1), 311(1) prescribe minimum number of members, i.e. five, for the formation and continued existence of an SC and hence there can not be established a one-man SC.[69]

A. Valuation and Payment of IKCs

Where an IKC is made to an SC, CC Art. 315(1) require that it has to be valued by experts who shall make a report which shall contain a detailed description of the property, its value, and the method of valuation applied.[70] and be annexed to the memorandum of association. Then, CC art.321(3) requires that the first meeting of subscribers to pass resolution on the valuation.[71] Thirdly, CC Art.315(3) imposes a duty on the first directors and auditors of the company to verify and, where necessary, review the expert valuation within six months from the date of formation of the company. CC Art.315(4 &5) prescibes that the shares representing IKCs shall remain deposited with the company and may not be assigned until the valuation has been verified and this shall apply notwithstanding approval having been given to the expert report by the meeting. Where this verification results in the value of the contribution being lowered by one fifth, the value of the capital shall be reduced accordingly; provided, however, that the contributor may make good the difference or shall withdraw from the company. According to the above provision, this also shall apply notwithstanding approval having been given to the expert report by the meeting.

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[68] CC Art. 304(1 &2) defines a share company as 'a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company. The members shall be liable only to the extent of their share holding.' Pursuant to CC Arts. 317, 333(1) it can issue shares for public subscription and its shares are *per se* freely transferable. And according to CC Arts.347 (1), 348(3), it is managed by a board of directors and a general manager.

[69] An SC whose members are reduced below the minimum shall not remain in business for more than six months and every member aware of such reduction shall be personally liable for the debts contracted thereafter. In case of this reduction, the company may be dissolved or reorganized by court order on the application of a member or creditor. CC Art. 311(2)

[70] The experts are appointed by the Ministry of Trade and Industry. CC Art 315(1)

[71] This meeting shall be called by the founders when the time for making applications for subscription has expired. However, contributors in kind may not vote in their capacity as shareholders or proxies on the resolution approving the valuation of their contributions. CC Arts.320, 322(3)

The evaluation systems of IKCs under Ethiopian law on an SC, therefore, resembles that of the French law in respect of a public limited company to be formed by a public offering of shares. However, the two legal systems are different on a point. While under Ethiopian law it is the directors' or auditors' verification of the value done by the expert that prevails over the approval given to same by the meeting, under French law the approval of the meeting prevails and the directors or the auditors do not in the first place have the role they have under Ethiopian law. The required contents of the valuer's report are the same as what the laws of the other legal systems require to be contained in such a report.

Unlike the laws of other legal systems, the Commercial Code does not provide the criteria of eligibility for the appointment of the expert valuer. The auditor is not appointed solely for the purpose in connection with IKCs and hence his appointment is subject to the general eligibility criteria under CC Art. 370 for the appointment of an auditor.[72] These criteria are basically the same as the criteria under the other legal systems for the eligibility of the independent valuer.

In case of formation of an SA without shares being offered for public subscription too, CC Art. 316(3) requires compliance with all the above requirements as to valuation of IKCs with the exception of the requirement of approval of the expert report by the inagural subscribers' meeting and the related contributor's right of withdrawal. This is again the same as the position of the French public company law and , of course, that of Germany and England since under these legal systems too there is only one-stage formation of the company.

Finally, CC Art339(1) mandates the full payment of shares representing IKCs normally at the

[72] The following persons are not competent to be elected as auditors: founders, contributors in kind, beneficiaries holding special benefits, directors of the company or its related companies; persons related to these persons by consanguinity or affinity or employment (other than as auditor). CC Art. 370

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time of formation but not later than the date of registration of the company. According to CC Art.339(2), these shares may not be negotiated before two years from the company's registration.The writer sees no such a restriction in the law of the other legal systems.

B. Disclosure in Relation to IKCs

CC Art.313(7) requires the memorandum of association to contain at a minimum the value of the IKC, its object, the price at which it accepted, the designation of the shareholder and the number of shares allocated to him by way of exchange. The Code does not prescibe such minimun content requirement as regards the articles of association.[73]

Moreover, where the company is to be formed by way of public offering of shares, CC Art.318(1/c) requires the prospectus[74] to contain contain a summary of the expert report on IKCs. Per Cc Arts.318(2), 319(2), copies of the prospectus and the expert report shall be made available to all persons who may wish to subscribe and an applicant for shares shall, in making such an application on the form provided, declare that he has read the prospectus and the expert report.

Publicity to third parties is also guaranteed by the requirement under CC Arts. 313(1 &2), 219 that the copy of memorandum and articles of association as well as the copy valuer's report and the application for registration of every company and that of the prospectus and the minutes of the first meeting of subscibers in the case of an SC formed by public subscription of shares shall be deposited with the registrar of business organizations and their contents has to be recorded in the commercial register. The above provisions also provide that the

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[73] The basic formation document of the company is memorandum of association. The artcles of association which are to be drawn up by the founders govern the operation of the company and they are deemed to form part of the memorandum. CC Arts.313,314
[74] This is a document through which an offer to subscribers is to be made. It shall be signed by all of the founders. CC Art.318(1)

application for registration of the company too shall state the particulars about IKCs that need to be stated in the memorandum. Then, pursuant to CC Art.313 (2), 220, public notice through the Official Commercial Gazette[75] shall be made of the above particulars about an IKC. Where a business is contributed, CC Arts. 195(1), 206 in addition require this publication to include the name and address of the contributor, the objects and address of the business and the firm-name, objects and head office of the receipent company. The effect of failure entry of facts that need to be entered in the commercial register per CC Arts.120(2), 122 is that a fact not entered in the register does not affect third parties while third parties shall not be permitted to prove that they did not know of a fact entered in the regster.

The above minimum mandatory stipulations in the memorandum and the application for registration are the same as the ones required to be contained in the articles and the filing for registration in the case of the German stock company law and in the application for registration in the case of English public company law. The types of documents required to be deposited with the registry as well as contents of the public notice as regards IKCs are also basically the same with the German, French and English laws on the stock company. However, the requirement that a subscriber must declare that he has read the expert report is not present in the law of the other legal systems. The consequence under Ethiopain law of failure to effect the required publication on the relationship between the company and third parties is also the same with those legal systems except that the Ethiopian law does not expressly provide that the company can be relieved where it can show that third parties had knowledge of unpublished facts.

C. The Comfirmation Phase

[75] At the time of drafting of the Code the legislator anticipated the establishment of an Official Commercial Gazette. But this has not yet come into existence and today publications about companies are made through a national newspaper called 'Addis Zemen'.

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We have seen earlier the role of the directors and auditors in verifying the valuation done by the expert as well as the approval given to this valuation by the first meeting of subscribers. More importantly, we have also confirmation by the registrar. Pursuant to CC Art. 223, an SA shall have no legal existence until all the provisions of the Code relating to registration have been complied with and its registration is published in the relevant Gazette. CC Art.222 imposes on the registrar the duty to examine the fulfillment of all requirements for for the formation of the company before effecting registration. These requirements obviously include the requirements in connection with the valuation and payment of IKCs as well as the disclosure and publication in respect of same. Once registration and publication is properly made, CC Art.324(1) provides that the company shall have a legal personality notwithstanding that all the legal requirements relating to the formation of the company have not been complied with unless the interests of creditors or shareholders is affected as a result.[76] This applies also regarding the requirements set out in connection with IKCs.

Unlike the case is under the German law, but like the French and English laws, there is no clear provision under the Code that empowers the registrar to deny registration on the ground that the value of an IKC is, in its opinion, overstated. As we have seen above, the Ethiopian law, like the German and French laws, provides for mandatory stipualtions about IKCs in the company's formation instruments. The effect of non-satisfaction of this requirement, however, seems to be different under the three legal systems. While the German law provides that this non-satisfaction will entail the unenforceability of the agreement undelying the IKC with respect to the company, the French law (which is not clear whether the company may be invalidated as a result) provides for the liability of diffrent persons for damages sufferred by

[76] Unlike English company law where the company's valid formation can not be rebutted after a certificate of incorporation is issued for it, under Ethiopian law the court may order the dissolution of the company on the application of a creditor or shareholder whose interests are affected as a result of the non-compliance with the formation requirements. However, an application to this effect that is not made within three months from the date of publication in the 'Official Gazette' of the company's registration shall not be considered. CC Art. 324(1&3)

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various persons as a result of the omission of the stipulations from the statutes. The Ethiopian law, on the other hand, in principle is like that of the English law i.e. registration is proof of valid formation despite the non-fulfillment of the stipualtion requirement but the company may be invalidated where the interest of third parties or shareholders whose interests are affected as a result of this irregularity requires.

D. Amendment of Formation Instruments

The general rules governing amendments of an SC's formation instruments and other documents given under CC Arts.224 provide that any modification in the memorandum of association shall be deposited. Moreover, any modification of a fact registered and published shall be published in the Official Gazette and the entry shall be corrected in accordance with the law. As a general provision, this includes amendments to facts about IKCs contained in those documents.These requirements of disclosure of facts relating to IKCs in amended documents and their publication is a requirement that is available also under the other legal systems discussed earlier.

E. Increase in Capital

Where an SC increases its capital by issuing new shares against IKCs, CC Art.480 expressly provides that the conditions for the issue of shares for IKCs at time of formation of an SC equally apply at the time of increase in capital too. In the case of an SC that offers new shares for public subscription, this means that the conditions relating to expert valuation, verification by directors and auditors, approval of the valuation by the meeting of shareholders, and the rights and duties of the contibutor in case of deficiency in value are maintained. It is also specifically given under CC Art.469 (9) that where new shares are offered for public subscription, the offer shall be through a prospectus which shall show any

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IKCs the company had accepted previously. CC Art.480 requires full payment of shares subscribed by IKCs at this time as well. Last, CC Art.221 requires the incease to be registered with the the registrar together with deposition of the necessary documents and the registrar is to register the increase only after ascertaining that the above requirements are met. Unlike English law, the Ethiopian law does not deny pre-emption right of subscription for shares against IKCs at the time of increase in capital.

The above provisions do not make distinction as regards an SC that was formed without a public offering of shares. Thus, it means that the requirements above, including the ones relating to the prospectus and approval of the valuation by a meeting of shareholders and the contributor, shall apply where this company offers shares for public subscription at any time in order to effect capital incease. Unlike French law, the Ethiopian law does not put a two-year period after formation of the company for these requirements to apply in this situation. In other respects, the governance of IKCs at the time of capital increase under Ethiopian law is similar to the other legal systems.

F. Liabilties in Connection with IKCs

To begin with, CC Art.346, 309(1/b & c) make the founders and directors liable to the company and third parties for any damage in connection with IKCs or the accuracy of the statementst made to the public in respect of the formation of the company. It is important to note that pursuant to CC Art. 307(3), under Ethiopian law perosons who bring in IKCs are deemed to have the legal status of founders where an SC is to be formed through public offering of shares. And this implies that these persons are in the same way subject to the liabilities of founders proper.

CC Art. 364(2), 366(1) also provide for the the liability of directors to the company and third

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parties for damage caused by failure to carry out their duties of care or the duty to keep the comapny's assets intact in the interest of creditors. Under CC Art. 367 shareholders and creditors have an unrestricted right of action against the directors to claim personal injury. In addition, CC Art.365, 366(2) entitle the shareholders a derivative right of action against the directors to enforce the claims of the company while CC Art. 366(2) entitles creditors to sue the directors personally where the company's assets are insufficient to meet its liabilities. The Code is, however, silent as to the derivative right of other shareholders and creditors with regard to founders in respect of their libility in connection with IKCs. Moreover, CC Art.380 provides for the civil liability of the auditors to the company and third parties for any fault in the exercise of their duties which occasioned loss. There is no reason to suggest that this liability may not arise where the auditors are at fault in their duty of verifying the valuation done by the expert valuer. According to CC Art.91, the officials in charge of commercial register are also personally liable for any damage caused by them.

Unlike the company laws of the other legal systems, the Commercial Code does not provide specific criminal liabilities in connection with IKCs. The general liability provisions under CC Arts. 115, 116 only provide that failure of registration of facts that must to be registerd or making inaccurate statements in relation to registration entails criminal liability on whosoever bears the duty of dicharging these. The Criminal Code[77] is also silent in this regard but has some general rules under Arts., 696(b), 718 and 803 that provide, respectively, penalties for fraudulent representation in making offer to public subscription of shares, false statements about the state of affairs of a company, or failure to effect required entries in the register.

Last, like the French and German laws there is no provision in the Code that explicitly

[77] Criminal Code of the Federal Democratic Republic of Ethiopia, Proclamation No.414/2004, 2005

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addressess the liability of subsquent acquirers of shares in the context of IKCs. It can be argued that this can not be a problem in the first place since shares issued for IKCs shall be paid in full at the time of registration of the company in addition to that, pursuant to CC Art.327, shares can not be issued before the registration of the company and in the otherwise of which they are void. Moreover, the law prohibits the negotiablity of shares issued for IKCs for two years after the company's registration Otherwise the provisions governing liability to meet call on shares are framed in the language of cash shares only.

1.5.3 Control of IKCs in Respect of the Private Limited Company (PLC)

In its nature this form of company is basically the equivalent of the German GmbH, the French SARL and the English ltd.[78] However, unlike the other legal systems, CC Art 510(2), 511 require this company to have a minimum of two members for its formation and continued existence and we can not have a single-member PLC in Ethiopia.[79]

A. Valuation and Payment of IKCs

Pursuant to CC Art.519(2), valuation of IKCs is done by the members themselves using their own valuation methods. CC Art.519(3 & 4) makes the members jointly and severally liable to third persons for the valuation fixed and where it is shown that a contribution has been overvalued, the contributing member shall make good the overvaluation in cash. All members are also jointly and severally liable for such payment notwithstanding that they were not aware of the overvaluation. There is no requirement of valuation by an independent expert in the case of this company. Moreover, unlike the case of the SC wherein the directors owe

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[78] It is a commercial company whose members are liable only to the extent of their contributions. Unless otherwise provided in the articles of association, there is no restriction on the transfer of shares between members while transfer of shares outside the company shall be approved by a majority of the members. This form of company can not issue transferable securities in any form. And it is administered by one or more managers. Moreover, it is not required to hold a general meeting of members or to appoint an auditor unless its members are twenty or more. CC Art.510(1& 3), 523,525(2)

[79] Where the company' number of members is reduced below two, it may be disolved by a court order. CC Art. 511

the duty to verify the evaluation done by the the expert, the Code does not impose such a clear duty on mangers of a PLC.

Unlike the SC case, there is no express provision in the Code regarding the time of payment of IKCs in the case of a PLC. However, it can be inferred form the requirement under CC Art.517(g) that the memorandum state that the capital is fully paid that IKCs shall be fully transferred to the company at the time of its registration since they form part of the capital of the company and the presence of such a statement in the memorandum is necessary for the registration of the company.

Therefore, valuation of IKCs in the case of a PLC under Ethioian law is more similar to the corresponding German law. It clearly provides that the valuation is to be done by the members themselves while it is silent on the specific duty of the managers in connection with valuation. Unlike French law, expert valuation is not mandatory and unlike English law, the Ethiopian law has clearly provided the duty and liability of members in connection with valuation. The time of payment is also the same as that of the German and French laws which require full transfer of the contribution at the time of registration of the company or issuance of shares for it, respectively, while the English law is silent on this issue.

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B. Disclosure Requirements

CC Art.206, 519(1) require the memorandum of association to show the valuation of an IKC, its nature, the price accepted by the members and the share in the capital allocated to the contributor. As mentioned above, it shall also state that the capital is fully paid. .CC Art.518, which governs the contents of the articles of association, on the other hand, does not require the above facts about IKCs to be included in the articles.

The Ethiopian law unlike the German law does not require the members to prepare a report that is equivalent to the German formation report of the shareholders. The above particulars to be included in the memorandum of a PLC are the same as what are required to be contained in the articles and the shareholders' formation report under the German law and in the valuer's report and the statutes under the French law on the private limited company.

CC Art.520(1 & 2) provides the same formalities as to the registration of the company, the types of documents and their contents that must be disclosed about IKCs through entry in the register and publication in the Gazette as the ones provided for the SC except, of course,the prospectus and minutes of the resoulution of the first meeting of subscribers.

C. The Confirmation Phase

CC Art.525 (2) exempts this company form holding general meetings or appointing an auditor where the number of members is less than twenty. And this means that in this case there will not be verification of the valuation done by some members by the auditor or its approval by a general meeting. Otherwise, the provisions CC Arts.219-224 governing the following matters being provisions applicable to all types of commercial organizations, they also apply equally to a PLC: the verification roles of the registrar, the effects of absence of the necessary disclosure requirements on the relationship between the company and third parties.

Like the SC case, once a PLC is registered and publicized, CC Art. 520(3) provides that the company acquires legal personality notwithstanding any non-compliance with all the legal requirements relating to its formation but if the interests of creditors or shareholders are endangered as a result, the company may be dissolved by a court order on the application of such shareholder or creditor.[80] However, unlike the case of the SC and the laws of the other

[80] In order for it to take effect, this application must be made within three months from the date of publication of the company's registration. CC Art. 520(3)

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legal systems on a private limited company, the Code does not contain a clear provision which provides for the personal liability of of pre-registration acts against persons who so acted in the name of the company

D. Amendment of Formation Documents, Increase in Capital and the Liability Regime

The povisions governing mandatory stipulation requirements in the amended memorandum, its entry in the register and of publication, discussed above in respect of an SC, equally apply to a PLC. However, unlike the case is in other legal systems and the SC, there are no provisions in the Code regulating the issue of increase in capital as well any derivative right of action of members or creditors against managers or other persons who may be liable to the company in connection with the the control of IKCs with respect to a PLC.

The provisions of the Code on this type of company too do not contain criminal libilties specifically in relation to IKCs but the general liabilty provisions in this Code and the Criminal Code, discussed above regarding an SC, equally apply in respect of a PLC.The liabilty of transferees of shares issued for an IKC where the contribution is not fully paid is not also governed unless here again it is argued that it is not a problem since, as claimed earlier, such shares have to be paid fully at the time of the company's registration.

Finally, unlike the case is under the other legal systems, the Ethiopian law does not regulate post-formation acquisition of non-cash assets even in the case of the SC. Moreover, there is no provision in the Code that explictly addresses the issue of indirect IKCs though it is possible to say that they are governed, in the case of the SC, by the general rule under CC Art.308(1) that provides for the unenforceability of pre-registration acts with respect to the company. The Code also does not conatian, in respect of both companies, the prohibition that we have in respect of the public company under the English law to the effect that shares initially subscribed in cash can not latter be substituted by payment in kind.

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This Chapter has showed the system of control of IKCs under the EC law and other legal systems. By way of conclusion, it can be said that the EC and the legal systems of the member states converge on a number of points on the different phases of contol of IKCs. Moreover, the EC as well as the legal systems of the three member states seem to be generally flexible in the control of IKCs in respect of the private limited company. Contribution of services is allowed expressly or impliedly, no mandatroy expert valuation except in France, there is no requirement of full payment at the time of registration of the company or issuance of shares except in the German, French and Ethiopian laws and post-formation acqusition is not prohibited.

However, it has been also shown that there are areas that are expressly given by only one or two legal systems and not by others. For example, only the the German law on the stock company provides for the unenforceability of contracts underlying IKCs regarding the company due to abscence of the mandatory stipulations in the articles and only the German and Ethiopian laws on a public company expressly provide for the involvement of the officers of the company in the valuation and/or verification phase. While the Ethiopian law on the SC alone provides for the non-negotiability of shares issued for IKCs within two years of a company's formation, the French law alone provides for, in principle, independent valuation of IKCs in the case of a private limited company. Last, the English law is unique in providing that payment in cash made to a person other than the company or a person acting in its behalf constitutes a IKCs. It is the English law that also expressly provides the liability of transferors and transferees of shares issued for IKCs, denies pre-emption right for subscribtion by IKCs at time of capital increase as well as, in the case of a public company, that undertaking to pay in cash can not be discharged by payment in kind.

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CHAPTER 2- CONCLUSION, RECOMMENDATIONS AND SUGGESSIONS

2.1. Conclusions

Insufficiency of assets of a company to pay for its debts is an important risk that those dealing with a company might face. In the Introductory part, overvaluation of IKCs made to a company has been considered as one cause of this insufficiency and the circumstances in which statutory provisions meant to govern IKCs might be circumvented in practice were discussed.

Chapter One has examined how this problem is addressed under the EC law and different legal systems in respect of a public limited company and a private limited company. The EC and the legal systems of the three member states commonly provide for the exclusion of services in the case of a public limited company.All the three legal systems and the EC law seem to be flexible towards the private limited company in this regard, for they do not provide for the exclusion of services. On the other hand, it has been shown that the Ethiopian law does not provide a general criterion nor exclusion of services for both types of companies.

It was also shown that all legal systems and the EC require an independent valuation of IKCs in the case of a public company, while it is only the French law that, in principle, provides this for a private company, too. As regards payment, the EC, German and English laws on the public company require transfer of the asset to the company at the time of its incorporation or issuance of shares or, within five years thenafter. The EC and English laws are silent on this issue in relation to a private limited company, while the German law requires it to be done fully at the time of the company's registration of the company. The French and Ethiopian laws, on the other hand, require the full payment of the contribution at the time of issuance of

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shares for it and at the time of registration of the company, respectively, for companies of both categories.

It has also been noted that the EC and all the legal systems provided disclosure requirements in relation to IKCs together with the consequences for their non-satisfaction. In addition, those laws provide for the confirmation by an organ of the satisfaction of the legal requirements in relation to other aspects of the control. Moreover, both the EC and the other legal systems have provided extended application of their rules on the control of IKCs to different activities of a company (except the Ethiopian law on the private limited company concerning increase in capital). As regards the the issue of indirect IKCs, it has been demonstrated that it is only the German law on the stock corporation that clearly addresses the issue. Last, this paper has shown the significance of civil and criminal liabilities in controlling IKCs.

2.2. Recommendations

It has been pointed out that compared to the other legal systems, the Ethiopian company law is deficient in controlling IKCs. Post-formation acqusition of non-cash assets shall be addressed at least in respect of the share company and prohibition from substituting obligations originally undertaken to pay in cash latter by way of payment in kind through post-formation agreements with a company must be given in respect of both companies. As regards the private limited company, there be given the personal liability of persons who have acted in the name of the company before the registration of the company. Moreover, IKCs must be controlled at the time of increase in capital. Last, the shareholders of a company shall be entitled to a derivative right of action against the officers of the company to enforce

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the damage clams of the company in connection with IKCs as well as more criminal liabilities specifically in the context of IKCs shall be provided.

Introducing all these matters into the company law of the country may need amendment of the Commercial Code. However, the basic reason for the existing gaps in the Code might also be due to the fact that the Code has not been subject to a major overhaul since its enacctment in 1960 to respond to economic realities. It has been the same Code that has been in use under in the feudalist economic system to the socialist one and today under a free economic system.

2.3. Suggessions

Finally, due to the limited scope of this thesis, it is important to suggest potential areas for comparative research in the field of control of IKCs. These areas include the critera for the appointment of the expert valuer of IKCs and his liabilities, the control of IKCs at the time of conversion of one form of company into another form, the role of courts in filling the gaps in the laws of the respective legal systems regarding IKCs. The amount of fine and/or length of sentences to be imposed for breach of the provisions of the laws on the control of IKCs as well as the statute of limitation to enforce them, the risks in connection with IKCs in the case of group companies, and the control of IKCs in the case of other forms of companies in each legal system not covered in this paper and in the European company could also be areas worth investigating.

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1. STATUTORY MATERIALS AND CASES

A. Statutory Materials

EC

First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (*Official Journal L 065, 14.3.1968, p. 8*)

Directive 2003/58/EC of the European Parliament and of the Council of 15 July 2003 amending Council Directive 68/151/EEC, as regards disclosure requirements in respect of certain types of companies (*Official Journal L 221, 04/09/200; p. 13 - 16*)

Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (*Official Journal L 026 , 31/01/1977, p. 1 - 13)*

Council Directive 92/101/EEC of 23 November 1992 amending Directive 77/91/EEC on the formation of public limited- liability companies and the maintenance and alteration of their capital (*Official Journal L 347 , 28/11/1992, p. 64 – 66*)

Germany

Aktiengesetz **(**The Stock Company Act) of 1965, as amended on December 9, 2004

Gesetz betreffend die Gesellschaften mit beschränkter Haftung (The Limited Liability Company Act) of April 20, 1892, as amended on December 9, 2004.

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The Commercial Code (HGB) of 1967

Co-Determination Act

France

Le Code de Commerce Francais Traduit (en Anglais), 2006 (The French Commercial Code in English, 2006 version)

The Code Civil des Français (The French Civil Code), as amended in June 1889

England

Companies Act 2006

Ethiopia

The Commercial Code of the Empire of Ethiopia, Proc. No.166/1960

Criminal Code of the Federal Democratic Republic of Ethiopia, Proclamation No.414/2004

B. Cases

Belgium v. Vandevenne, Case C-7/90, ECR 1-4371 (Judgment of the ECJ (First Chamber) of 2 October 1991).

Simens AG v. Henry Nold, Case C-42/95, ECR 1-6017 (Judgment of the ECJ of 19 November 1996).

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