



**ADDIS ABABA UNIVERSITY
COLLEGE OF LAW AND GOVERNANCE
STUDIES
SCHOOL OF LAW**

**THE ROLE OF COURTS IN ENSURING GOOD
CORPORATE GOVERNANCE IN ETHIOPIA: THE
LAW AND THE PRACTICE**

BY

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The Role of Courts in Ensuring Good Corporate
Governance in Ethiopia: the Law and the
Practice

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The role of courts in ensuring good corporate governance
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Declaration

I declare that the thesis is my original work and has not been presented for a degree in any other University before. All referred materials are duly acknowledged.

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Abstract

The establishment and incorporation of business organizations in every sector of the economy have numerous importances for countries' sustainable social, technological, financial and economic development and progress.

In many jurisdictions, business organizations are classified as companies (corporations) and partnerships. In Ethiopia, the 1960 Comm.C recognizes six types of business organizations. Among which, two are companies, namely Share Companies and Private Limited Companies and the remaining four namely, Ordinary Partnership, Joint Venture, General Partnership and Limited Partnership are grouped in the category of partnership .

In Ethiopia, Private Limited Companies are dramatically increasing in number in all corners of the country and these companies have considerable role in the country's economy. However these companies are surrounded by many legal and practical problems. The inadequacy and sketchy nature of the provisions in the Comm. C and other relevant laws have triggered practical problems in the courts and have made the governance of Ethiopian companies' especially private limited companies, problematic.

The companies, in order to achieve their business objectives, and render their great contribution in the country's financial and economic development, should have good and effective Corporate Governance. The existence of good Corporate Governance framework in the country fosters market integrity and improves economic efficiency and development and also builds investor confidence.

Good Corporate Governance is much more important for Developing and Emerging Market Economy Countries since these countries do not have a strong and long established financial institutions, strong, independent and efficient judiciary, and weak enforcement mechanisms in relation to Corporate Governance issues.

Courts have indispensable roles in ensuring good corporate governance. For courts to play their crucial roles in ensuring good corporate governance practices in companies, there is a need to have effective legal and institutional frameworks, and courts should be independent, efficient and should establish special benches for company related cases. If courts fail to discharge their duties properly or involve in every activities of companies' management outside the law, this entails bad corporate governance practices .

Because of many factors, practically the courts are not in a position to properly discharge their crucial duties in ensuring good CG in companies in Ethiopia. Thus, those problems that face courts in playing their crucial roles in ensuring good CG should be resolved so that the country benefit from ensuring and having good CG

List of Acronyms

AGM:	Annual General Meeting
A.A:	Article of Association
Art:	Article
BoD:	Board of Director
BO:	Business Organization
Civ.C:	Civil Code
Comm.C:	Commercial Code
CG:	Corporate Governance
EOGM:	Extra-Ordinary General Meeting
GM:	General Manager
GTP:	Growth and Transformation Plan
OECD:	Organization for Economic Cooperation and Development
OGM:	Ordinary General Meeting
M.A:	Memorandum of Association
Plc:	Private Limited Company
Plcs:	Private Limited Companies
SA:	<i>Societe Anonyme</i>
SARL:	<i>Societe a Responsibitie Limitee</i>
S.co:	Share Company
S.cos:	Share Companies

Chapter One

1.1 Background of the study

Business is as old as civilization itself.¹ It has a great contribution to the world, since no development could have taken place in the absence of business. Business provides to the society the things it needs in order to survive, enjoy life and improve its material and social wellbeing.²

When we say business, it is an institution organized and operated and that is regularly carried out to provide goods and services to the society in financial, commercial or industry aspects with the objective of earning profit and acquiring wealth, advantage or livelihoods.³ The 1960 Comm.C of Ethiopia defines business as “an incorporeal movable consisting of all movable property brought together and organized for the purpose of carrying out any of the commercial activities specified in Article 5 of the Commercial Code”⁴.

The classical business units or enterprises were carried out, owned and controlled by the same person or persons⁵. In doing so, merchants have been encountering several challenges or problems. Some of the challenges relate to capital, management, and liability of traders during business failure, etc⁶. To solve these and other problems that face them business men started to join up to do business in organized form⁷.

Business men who were involved in foreign trade were anxious to form an organization with corporate personality. This eagerness to incorporate business firms was further enhanced by conveniences, such as legal personality, limited liability, limited

¹ SS Gulshan, Mercantile Law, (3rd ed., 2007), P. 1

² Ibid.

³ Alemayehu Yismaw, Merits and Demerit of Introducing Non-Shareholder Directors in the Governance of Ethiopian Share Companies, School of law, A.A.U. (un published), L .L. M thesis, (2014), p. 13

⁴ Commercial code of the Empire of Ethiopia, Negarit Gazeta, Extra Ordinary Issue, No. 3 of 1960, Art 24

⁵ Dejene Alamiraw, Assessing Corporate Governance of Ethiopian Private limited companies with particular emphasis on making Board of directors compulsory to such companies, (unpublished), School of Law, A.A.U, L.L.M. thesis, (2004), p. 10

⁶ Neguse Taddese, Major problem associated with Private limited company in Ethiopia: The law and the practice, (unpublished), School of law, A.A.U., L.L.M. thesis, (2009), p. 1

⁷Id., p.2

management responsibility, the unlimited number contributors and the capital involved within firms.⁸

According to the Ethiopian Comm.C, BO is any association that arises from a partnership agreement by which two or more persons who intend to join together and to cooperate undertake to bring together contributions for the purpose of carrying out an activity of an economic nature, and of participating in the profit and losses that comes from those activities.⁹The Comm.C recognizes six forms of BOs¹⁰. Depending on their characteristics' these BOs may be categorized in to two groups' i.e. partnerships and companies. This research focuses on companies i.e. S.cos and Plcs.

BO, particularly companies are important schemes that enable people to do business that need huge capital, which would be difficult, if not impossible, for an individual to do alone¹¹. Now companies are the most known and widely used forms of BOs that have proved to be very suitable not only for large scale enterprises but also small scale businesses.

The establishment and expansion of companies in different sectors of the economy, plays a crucial role for the country's economic development, business transactions, economic stability, maintaining market efficiency, etc. These and other virtues of companies are to be achieved when companies are administered and controlled properly through good corporate governance system. In other words, having good CG is so important to enable companies achieve their business objectives mentioned in their memoranda of associations, benefit their shareholders, and other stakeholders and to contribute their share in a country's overall economic development.

CG is a multidisciplinary concept and does not have any single acceptable definition.¹²It is a system by which companies are directed and controlled¹³. It became a key topic for legislators, policy makers, lawyers and academia in developed as well as developing

⁸ Selamu Bekele, Private commercial companies under Ethiopian law: Legal and Practical significance, School of law A.A.U.,(unpublished), L.L.M thesis, (1966), Pp. 3-4

⁹ Commercial Code of Ethiopia , cited above at note 4, Art 210 (1) cum 211

¹⁰ Id., Art 212(1)

¹¹ Neguse Taddese, Major problem associated with Private limited company in Ethiopia: The law and the practice,(unpublished), School of law, A.A.U., L.L.M. thesis,(2009), p. 71

¹² A.C Fernando, Corporate Governance: Principles, Policies and Practices, (Pearson Education, 2006), P. 12

¹³ Klaous J. Hopt Comparative Corporate Governance: the State of the Art and International Regulation, Vol. 59, p. 7 (Available on: <http://heinonline.org> , accessed on 7/20/2016)

market economy countries' especially after the financial crisis of 2008.¹⁴ The post 2008 financial crisis and other phenomena revealed that it is not only shareholders or stakeholders who are keenly interested in the adoption of good CG practices by corporations, but all societies and countries worldwide.¹⁵ In this regard, one thing we need to know is that good CG is not an end in itself; it's a means to an end.¹⁶ It is a means to create and foster market confidence, integrity and improve economic efficiency, growth as well as build investor confidence.¹⁷ CG is essential for companies that need to access equity capital for long term investments and future oriented growth.¹⁸

Although many Countries have their own unique system of CG that reflect different economic, cultural and legal circumstances; generally the effectiveness of the countries' CG is measured based on internationally accepted and recognized best practices.¹⁹ These best practices of good CG principles are: having a legal system and practices that ensure the basis for an effective CG framework; protect the rights and equitable treatment of shareholders, and key ownership functions; focus on institutional investors, stock markets and other intermediaries; encourage the role of stakeholders in CG; disclosure and transparency of companies financial status and other activities; and implementing the responsibilities of the board.²⁰

So, to ensure effective CG system in a country, the company law of that country needs to incorporate those internationally recognized best principles of CG system. In addition to this, to ensure effective and good CG system the supervision, intervention and enforcement of laws and bylaws through self-regulation system, supervisory authorities and the courts are so crucial.²¹

The role of courts in this regard is multifaceted.²² However courts role in ensuring effective CG varies depending on legal systems, the procedural laws, litigation processes,

¹⁴ Id P. 1

¹⁵ A.C Fernando, Cited above at note 12, P. 24

¹⁶ Id , P. 38

¹⁷ Gebyaw Semachew, A Critical Analysis of the Ethiopian Commercial code in light of OECD Principles of Corporate Governance, Institute of Advanced Legal Studies school of Advanced Study, University of London,(Unpublished), (2012)

¹⁸ G20/OECD Principles of Corporate Governance, (2015), P.3

¹⁹Id., Pp.9 -11

²⁰Id., Pp.4 -6

²¹ Klaus J. ,cited above at note 13, P. 61-68

²²Id., p. 67

independence of the judiciary, etc, of countries. Some countries try to keep courts out or bring them in only as a last resort, while in other countries every controversial issue of CG ends up in their courts.²³

Regarding the importance of courts' involvement in ensuring good CG, the experience of the US Delaware courts is a good example, for the role of courts in applying and enforcing corporate law and in promoting and ensuring good CG.²⁴ Like courts in Delaware, EU member State the Netherlands, has developed specialized courts to resolve CG related disputes and the court contributes to have a good CG practices in that nation.²⁵

On the other hand, if a county's company law is inefficient and inadequate to ensure proper CG system and other supporting and supervising institutions, for instance courts' interference outside of the law or principle of CG and without limitation in CG issues, these and other phenomena revealed the features of bad CG system. These features discourage domestic as well as foreign investors to invest in a country and companies won't be able to achieve their objectives, and lose their legal rights, which would lead to bankruptcy and dissolution. This, in turn brings negative result or consequences to shareholders and stakeholders' interests and on the economic and financial development and stability of a country.

In order to avoid these and other consequences of bad companies' governance, companies should be administered and controlled by the principles and laws of CG and the court and other supervising institutions or gatekeepers should play their roles based on the law and principle of CG to ensure good CG system in a country.

CG is a broad concept and encompasses different organs. The most common statutorily recognized CG organs in many countries are: General meetings of shareholders, BoD, Managers and Auditors²⁶.

²³ Klaus J., Cited above at note 13, P. 71

²⁴ Jack B. Jacobs, The Role of Specialized Courts in resolving Corporate Governance disputes in the United States and in the EU; An American Judge's perspective, (Stockholm, 2006), P. 2- 17

²⁵Id., pp. 17-22

²⁶ Dejene Alamiraw, Assessing Corporate Governance of Ethiopian Private limited companies with particular emphasis on making Board of directors compulsory to such companies, (unpublished), School of Law, A.A.U, L.L.M. thesis, (2004), p. 73

The Comm.C of Ethiopia lists that the general meetings of shareholders, the BoD and auditor(s) are organs of governance for S.co²⁷. In relation to Plc, the general meetings of shareholders²⁸ (if the number of shareholders are more than twenty), auditor(s)²⁹ (if the number of shareholders are more than twenty), and manager(s)³⁰ are the organs of governance for this type of companies.

This research focuses on the roles and powers of courts on those CG related issues that arise in relation to the above mentioned organs of CG, particularly, in the calling of general meetings and setting the agenda of it; in setting aside the general meetings resolutions; and in the appointment and dismissal of board members, auditors and managers. In this study court cases are analyzed and critically examined to see the practice of courts on those CG issues based on the Commercial Code and other relevant laws of the country and internationally recognized principles of CG.

1.2 Literature Review

The issue of CG has gained greater attention from time to time since it has great contribution to the economic development of a country.³¹The importance of having good CG framework is so crucial to foster market integrity, improve a country's economic and financial efficiency and development as well as build investor confidence. Unless there is proper CG, no country may progress.³²

Though the incorporation of companies in Ethiopia increased from time to time, the provisions that deal with CG in the Comm.C and other Proclamations and Directives are insufficient and incompatible with internationally recognized principles of CG³³. These situations trigger the raising of different CG issues and create practical problems in resolving issues' relating to CG. These phenomena make Ethiopian companies ineffective and weak when compared with companies in other countries.³⁴.

²⁷ Commercial code of Ethiopia, cited above at note 4, Art 347- 428

²⁸Id., Art 532(1)

²⁹Id., Art 538(1)

³⁰Id., Art 525(1)

³¹ A.C Fernando, cited above at note 12, p. 1

³² Ibid.

³³ Gebyaw, cited above at note 17, pp.39-40

³⁴ Dejene Alamiraw, cited above at note 26, p. 5

The writer will use some of previous related works and will consider those previous works and also see the points with which this study departs from those previous domestic and foreign studies.

Fekadu Petros³⁵ in his article addressed the deficiencies of the Comm.C in protecting the rights of minority shareholders in publicly held companies. He attempted to deal with the potential problems, and the need and type of legal change to address those CG issues in publicly held companies to safeguard minority shareholder's rights.

His article did not raise and address the problems faced by minority shareholder in each organ of CG structure. His article also did not address the role of courts in protecting and enforcing minority shareholders' rights by each organ of CG.

Hussein Ahmed,³⁶ in his study, addressed the inadequacies of Ethiopian company law provisions in relation to the separation of supervision and management, board responsibilities, and also addressed the composition, independence, and remuneration of BoD in Share Companies of Ethiopia in light of internationally recognized best practices and principles of CG. He argued that there is a need to distinguish between CG and corporate management. When he did his research, Hussein did not see and address the impact of the court involvement in CG related issues in ensuring good CG.

In his study, Asefa Aregay³⁷ tried to show by comparing, the CG rules of Ethiopia and Germany in publicly owned corporations. His study focused on the three corporate organs, namely BoD, shareholders meetings and auditors.

Assefa addressed the type of board structure adopted by Ethiopia and Germany. He also discussed the composition of the board in the two countries; and the importance of employees' participation in election of boards, and in the decision making of corporations. His study also addressed the importance of two-tier board structure and the differences between the management board and the supervisory board.

³⁵Fekadu Petros, Emerging separation of ownership and control in Ethiopian Share companies: Legal and policy implications, Mizan Law Review, Vol. 4 No. 1, (2001), P.1-30

³⁶Hussien Ahmed , Overview of Corporate Governance in Ethiopia: The role, composition, and Remuneration of Board of Directors in Share Companies," Mizan Law Review, Vol. 6 No. 1, (2012), P. 45 - 76.

³⁷Assefa Aregay, Corporate Governance in Ethiopia and Germany: A Comparative Analysis, Central European University, (2015), available at: [www//http.etd.ceu.hu/2015/sefara-assefa.pdf](http://http.etd.ceu.hu/2015/sefara-assefa.pdf).

Even though he tried to show the role and power of shareholders' meetings, BoD and auditors in the CG system of Ethiopia, he did not discuss the role of courts in relation to these three organs of CG in ensuring good CG system in Ethiopia.

The writer also accessed the work of Gebyaw Simachew³⁸ that concentrates on the CG of S.co by analyzing the relevant provisions of the Comm.C. Gebeyaw also critically analyzed S.co's provisions in light of the six recognized and accepted OECD principles of CG. Gebyaw argued that the S.co governance in Ethiopia is defective and inadequate. He also tried to mention the reason why OECD principles are relevant for the Ethiopian CG system. Similar to the above studies, his paper also did not mention the role of courts in Ethiopia in ensuring good companies' governance.

Dejene Alamiraw³⁹ in his L.L.M. thesis discussed the concept of CG and the principles and importance of good CG. Like Assefa, he tried to show the types of board system. He also showed the deficiencies of the Comm.C in solving issues relating to CG that are associated with Plcs in Ethiopia. His thesis particularly focused on the inclusion of BoD in the governance structure of Ethiopian Plc.

However, the study did not address the importance of other organs of CG in order to have effective CG system in Ethiopian Plc. He also did not see other problems that are associated to this type of companies and the role of courts in addressing the issues that are raised in relation to the governance system of Plcs.

Klaus J. Hopt⁴⁰ in his article tried to make comparative CG analysis in thirty-three countries. Based on the reports of these countries and literatures, he addressed the various concepts and actors of CG in the legal systems of the countries looked into. The paper explains about the two approaches of board structures and also about the shareholder-oriented and stakeholder-oriented approach in the board system.

Hopt addressed the regulations and practices of the various actors in CG with a particular attention to the board and shareholders. The article deals with the role of labor, gatekeepers (in particular the auditors), the supervisors, and the courts in ensuring good CG. Though not in detail, the article showed the different roles and styles of courts in relation to CG issues in different jurisdictions.

³⁸Gebyaw Semachew, cited above at note 17

³⁹Dejene, cited above at note 26, p.5

⁴⁰Klaous J. Hopt, cited above at note 13

1.3 Statement of the Problem

Following the introduction of market economy in the country, the establishment of companies increased rapidly in Ethiopia. However, the increase in number of companies faced lack of company law that addresses CG issues which triggered multiple CG related issues and problems. These in turn triggered many suits being instituted before courts of law. The court cases gave rise to many issues and questions. Among the issues and controversies that have cropped up, the extent of the power and role of courts in CG related issues is one of the prominent ones.

When we compare the CG system of Developing countries including Ethiopia and Emerging market economy countries with other Developed countries it is characterized as: weak check and balance system, weak responsibility system of boards and managers, weak in protecting minority shareholders' rights, and that the system does not build investors' confidence to invest in the countries⁴¹. The factors that contribute towards these and other features of weak and bad CG systems are many. The major reasons that were raised by scholars, officials, lawyers and researchers are lack of company law that addresses the current economic, political and social phenomenon of the countries as well as CG issues. For instance the Ethiopian Comm.C provisions are inefficient and inadequate to address internationally recognized best CG principles⁴².

In Ethiopia other notable factors are absence of strong self-regulatory system, absence of supervising agency for all non-financial companies and the ineffectiveness of the courts in playing their crucial roles in ensuring effective CG⁴³.

Because of lack of good CG system and practices, many CG related cases filed before the courts of law⁴⁴ by companies', shareholders mainly by minority shareholders and

⁴¹ Robert W. McGee, Corporate Governance in Developing Economies, (2009), pp.14-15, Hussen Ahmed, Reforming Corporate Governance in Ethiopia: Appraisal of competing approach, Oromia Law Journal, (vol. 3, No 1), pp. 160, 181-182 , and Minga Negash, Rethinking Corporate Governance in Ethiopia, (School of Accountancy, University of the Witwatersrand), Pp. 2 and 8

⁴²Hussen Ahmed, Reforming Corporate Governance in Ethiopia: Appraisal of competing approach, Oromia Law Journal, (vol. 3, No 1), pp. 160, 181-182 , and Minga Negash, Rethinking Corporate Governance in Ethiopia, (School of Accountancy, University of the Witwatersrand), P. 2

⁴³Hussen Ahmed, Reforming Corporate Governance in Ethiopia: Appraisal of competing approach, Oromia Law Journal, (vol. 3, No 1), p. 183

⁴⁴Data collected in Federal First Instance Court Registrar in Lideta Commercial Bench and Interview with Ato Membere Befekadu, office of registrar, June 20, 2016

stakeholders such as employees and creditors by way of seeking remedies, enforcement of decisions, and protection of their rights.

In relation to S.cos' governance the main issues that are brought to courts relate to the setting agenda of the general meetings; calling of meetings; setting aside of the resolutions of shareholders meetings; the appointments and dismissal of the BoD and auditors.

The shareholders, mainly minority shareholders, by opposing the way of calling and conducting the meetings of shareholders, the voting system, the qualification of board members, and the composition of boards seek courts' intervention to set aside general meetings resolutions and also to appoint or to dismiss board members.

The other issues are related to the appointment of external auditors by courts, to inspect and audit the financial flow, business transactions and the activities of boards and managers; in order to make responsible board members and other actors and to demand the payments of dividends.

In relation to Plcs governance, the prominent and repeated CG- related issues that have been raised before courts of law are: issues relating to the dismissal of managers and appointment of managers by court rulings; setting aside the resolution of general meetings; calling general meetings and setting the agenda for it; enforcing the right to information of shareholders; and the appointment of auditor by order of the courts.

All the above-mentioned issues that were brought before courts are crucial ones in ensuring good CG. This simply shows that courts have crucial role to play in ensuring good CG system and practices. This positive result can be achieved when courts play their roles properly and give decisions based on the law and principles of CG, as long as they did not involve and intervene by abusing their judicial power. Unfortunately, courts practices reveal that courts are not playing their crucial roles and/or discharging their duties properly and effectively in ensuring good CG in the country⁴⁵.

There are many reasons for these courts' failure, among which are: the ineffectiveness, inadequacy, vagueness and loopholes in the substantive and procedural laws of the country, lack of real specialized commercial courts, lack of experience and special

⁴⁵ Interview with Honorable Judges Mehari G/Medehen , and Negash Kedani , and lawyers and scholars Ato Yosef Ae'mero and Ato Fekadu Petros

knowledge of judges, lack of knowledge on CG-related issues by lawyers and other practitioners, lack of awareness on the issues by all stakeholders and lack of attention by the court administrators and other officials of the government.⁴⁶

Therefore, it is imperative to address based on laws, cases, literature and principles of good CG, the practical problems of our courts in resolving those CG- related issues and to address the role of courts in resolving CG issues; It would also be imperative to address CG related problems in the Comm.C of Ethiopia and other relevant laws; to address to what extent courts should involve and intervene in CG related issues; and to address the problems that face courts to play their appropriate roles in ensuring good CG and practices in the country.

1.4 Research questions

Based on the above problems, the study will try to addresses the following research questions:

- What are the main legal and practical problems that are associated with each organs of CG in Ethiopian companies CG system?
- Do courts have jurisdiction in all CG- related issues?
- What are the roles of courts in addressing corporation related issues and in ensuring good CG?
- Are the practices of courts in addressing CG issues consistent with the law of the country and internationally accepted principles of CG?
- Are courts properly discharging their indispensable judicial duties in resolving corporate related issues and in ensuring good CG system and practices?

1.5 Objectives of the Study:

- To critically analyze the practices of courts with the existing laws relating to CG in Ethiopia ;

⁴⁶ Interview with Honorable Judges Mehari G/ Medehen and Endeshaw Adane and lawyers and scholars Ato Felipe Aynalem, Ato Yosef Ae'mero and Ato Fekadu Petros

- To identify the deficiencies in pertinent laws of the country in relation to CG;
- To show the role of courts in ensuring good CG practices in the country;
- To explore the extent to which courts may intervene in CG issues in Ethiopia;
- To recommend solutions for those practical problems prevailing in courts in relation to handling CG-related issues.

1.6 Significance of the Study

The study will add to the existing knowledge about: the current features of the Ethiopian CG system; the main problems that the style encounters; the extent to which courts may involve in CG- related issues; and the role of courts in ensuring good CG practices in the country.

The study will identify the main legal and practical problems that are associated with the Ethiopian CG system. By identifying the reasons behind those problems, the study will recommend solutions. **Doing this**, it is believed will make certain contributions in informing the country’s legislative body to consider it and to critically consider the long overdue reform of the Comm.C in relation to the main problems. It identifies the inefficiencies and gaps in the existing law in addressing the principles of CG. It also helps to give attention to the role of courts in playing their crucial roles in ensuring good CG.

The study will keep judges and lawyers informed and to play their respective and appropriate roles in ensuring good CG system in the country. It will enhance the awareness of policy makers on the need to have good CG for the whole economic and financial development of the country. In addition to these, the study will be a basis for other researchers to conduct further studies on the issues.

1.6 Scope of the Study

The research will focus on the role of courts in CG-related issues, more specifically on the role of courts on the calling of general meetings and setting aside their resolutions; in the appointment and dismissal of members of boards of directors and their

responsibilities as well as the appointments and dismissals of managers and auditors in Ethiopian S.cos and Plcs.

The study mainly focuses on the theoretical and legal aspects and the practice of courts based on case study and critical analysis of the cases.

1.7 Limitations of the study

Since there is no previous research conducted on this issue, it was difficult to get materials, especially materials directly related to the topic. There are no published books and articles that deal with the topic of this work. The research is mainly based on the law and the practice of courts on CG-related issues. Because of poor data base system at all levels of courts in Ethiopia it was very difficult to access sufficient number of cases for each issue.

1.8 Methodology

The research employed the qualitative method. As the study will be dependent upon legal doctrines, principles, reasons and justifications or logical arguments on legal provisions and decided cases. Cases should be analyzed to show the practical problems in courts in passing decisions on CG related issue cases.

Chapter Two: General Overview on Business Organizations

As we mentioned above, business plays a crucial role for world economic, social as well as political developments. A business enterprise may be owned and conducted by one person or a group of persons. When it is owned by one person, it is known as sole proprietorship.⁴⁷ All other forms of business enterprises come under the category of group ownership or joint ownership.⁴⁸

When we see the development of business from a bird's eye view, the classical business enterprise is owned and controlled by a person or persons who owned it.⁴⁹ That means there is no the concept of separate existence between the business entity and the persons who own it.⁵⁰ Scholars agree that sole proprietorship and partnership are those classical businesses that were in use for carrying on trade before companies came in to existence.⁵¹ A business enterprise that runs under the exclusive ownership and control of an individual is termed as sole proprietorship or single person entrepreneurship.⁵² In this type of business, the total capital of the business is supplied by the sole proprietor either from his sources or by borrowing from third parties in his name. Since this type of business enterprise does not have legal personality, all transactions, contracts, litigations, etc, are conducted in the name of the proprietor. That means, the proprietor himself manages the business and enjoys alone all the profits and bears all the risks. Though it is the simplest form of business activity, this type of business suffers from limited capital, limited managerial skills, unlimited liability, concentrated risk, uncertainty of continuity,

⁴⁷ Carton DW & Perl Off J.M, Modern Industrial Organization, USA, (Scott Forssmann & Co. 1990), P.23 and Berl and Means, The Modern Corporation and Private Property, New York, Macmillan, (1963), P. 300

⁴⁸ Ibid.

⁴⁹ Jennifer Reuting, Limited Liability companies for Dummies, (Wiley Publishing, 2008), P. 200

⁵⁰Dejene ,cited above at note 26, P. 10

⁵¹Selamu, cited above at note 8, P. 1

⁵²Dejene, Cited above at note 26, P. 10

inability to avail of specialization and hasty decisions.⁵³ These and other short comings and deficiencies of sole proprietorship led to the emergence of other forms of BOs.⁵⁴

2.1 The Development and Types of Business Organizations

BOs have been in existence for a long period of time though they have not been refined and structured as they exist today.⁵⁵ Historical development of BOs shows that until the beginning of the 17th century the partnership was the dominant form for organizing jointly owned business firms.⁵⁶

A partnership is an association of two or more persons who carry on business together for the purpose of earning profits.⁵⁷ This type of business is formed and conducted where two or more persons who intend to join together make contributions in the form of either in cash, in kind or skill for the purpose of carrying out activities of an economic nature and of participating in the profit and losses arising out there of, if any.⁵⁸

The partners bore unlimited personal liability for the contractual obligations of the firm. Because of these shortcomings and as commerce grew, more business men's speculation increased and limited partnership type of BOs emerged.⁵⁹ However, limited partnership also was not in a position to accommodate the extensive and intensive commercial activities that developed in Europe.⁶⁰ This phenomenon required more people who would be willing to contribute money to business men's or to partnership to become partners in order to raise huge capital. This also was no problem-free because large numbers of partners were unable to participate in the management of partnership and, some of them had no idea about business.⁶¹

Like sole proprietorship, partnerships also failed to meet the growing needs of modern industry and commerce due to shortcomings and limitations of partnerships like, limited

⁵³ Carlton DW & Perl off J.M., Cited above at note 47, P. 24

⁵⁴ Jonathan Berk and Peter Dermazo, Corporate Finance, (3rd ed.), (Pearson Education Inc. 2011), P. 37.

⁵⁵ Neguse, Cited above at note 11, P.1

⁵⁶ C. Braendle and Alexander N. Kostyuk, Development in Corporate Governance, (N.D), P. 3

⁵⁷ International Corporate Governance Network, www.icgn.org, (accessed on 6/17/2016).

⁵⁸ Mary O' Sullivan, contests for Corporate control: Corporate Governance and Economic performance in the United States and Germany, (Oxford: Oxford University Press, 2000), P.4 and Commercial Code of Ethiopia, cited above at note 4, Art 211

⁵⁹ Selamu, Cited above at note 8, P.1

⁶⁰ Ibid.

⁶¹ Ibid.

capital, unlimited liability, management problems and fear of discontinuity.⁶² Because of the above-mentioned problems in modern era, sole proprietorship and partnerships failed to play a dominant role in economic transactions. Consequently and to get over those problems, limitations and other problems that encountered those business enterprises, company form of BOs came in to existence.

BO is an important scheme that enables people to do business which would be difficult, if not impossible, to do them alone.⁶³ Thus, these days' business men tie themselves under certain form of BO's chain to tackle communal hurdles through collective effort. The establishment of BOs in different sectors of the economy has a crucial importance for the development of a country. It makes great contribution to the overall world development.

BOs may take various forms in different countries based on their legal, political, social ideology or policy and economic development of the concerned country.

In this regard German law recognized two principal categories of BOs: the *Aktiengesellschaft* (AG) which is Stock Corporation and the *Gesellschaft mit beschränkter Haftung* (GmbH), which is Limited Liability Company.⁶⁴ The French Commercial Code provides for four forms of commercial companies, these are: General partnerships, Limited Partnerships, Limited Liability Companies and Public Limited Companies.⁶⁵

The Ethiopian Comm.C of 1960 recognizes six forms of BOs, namely: Ordinary Partnerships, Joint Ventures, General Partnerships, Limited Partnerships, Share Company, and Private limited company.⁶⁶ Further, the Comm.C also classifies BOs in to commercial and non-commercial.⁶⁷ Accordingly, pursuant to Article 213(1) of the Comm.C, Ordinary Partnerships may not be a commercial BO as a result of which this type of BOs cannot carry on any of the business activities listed under Art 5 of the Comm.C. In case, an Ordinary Partnership carries out any of commercial activities listed

⁶²Negusse, Cited above at note 11, P.1

⁶³ Ibid.

⁶⁴ Theodor Baums, *Corporate Governance in Germany- System and Current Development*, (1999), available at: <http://papers.ssrn.com/so13/papers.cfm?abstractid=15803> , (accessed on 6/19/2016).

⁶⁵ Book II of the French Commercial Code updated on 03/20/2006, Art L 210-1

⁶⁶ Commercial Code of Ethiopia, cited above at note 4, Art 212(1)

⁶⁷ Id., Art 10(1) and 213(1)

under Art 5 of the Comm. C, an Ordinary partnership shall be regarded for liability purposes as General Partnership⁶⁸.

On the other hand S.cos and Plcs are always considered as commercial BOs.⁶⁹ Though the Comm.C provides for six types of BOs, these BOs based on their peculiar characteristics, particularly in relation to liability of partners/ shareholders to the creditors of the firm, participation in management of the firm, the separation of partners/ shareholders from the firm, the perpetuity of the firm, etc. may be grouped in to two i.e. partnerships and companies. The first four listed BOs under Art. 212(1) of the Comm.C fall into the category of partnerships and the remaining two fall in to the category of companies. This study focuses on the second category of BOs i.e., Companies.

2.2 The Concept of Companies and their Characteristics

Currently companies are the most known and frequently operated forms of BOs all over the world⁷⁰. They are also termed as ‘corporations’⁷¹. For the purpose of this study, the writer used the word ‘company’ and ‘corporation’ interchangeably.

In the capitalist world, corporations are the sophisticated tools of pooling capital together to venture on businesses that require huge investment. Once successfully formed as per the law of the country, corporations acquire separate legal existence or become separate entities from their shareholders.⁷²Now Company is the most widely used form of BO not only in the private sector but also in the form of State-owned business enterprises.⁷³It has become the most important industrial unit or business enterprise or a commercial venture, and no other institution has contributed so much to the growth of the global economy in every sector or to the market-driven capitalist economies of the world as modern corporations.⁷⁴

⁶⁸Id.,Art 213(2)

⁶⁹Id.,Art 10(2)

⁷⁰Alemayehu, cited above at note 3, p. 13

⁷¹ Ibid.

⁷² Commercial Code of Ethiopia, cited above at note 4, Art 210(2) and 223

⁷³Cheffins. Brian R., History and the Global Corporate Governance Revolution: The UK perspective, Business History, P.87.

⁷⁴ A.C Fernando, Cited above at note 12, P.43

Companies are defined as “an artificial being, invisible, intangible and existing only in contemplation of law.”⁷⁵ Companies are artificial organizations created by the law; are separated from their owners and managers; have their own rights, duties, and powers; and have the capacity to exist perpetually.⁷⁶

Lord Justice Lindley defines it as : “A company is an association of many persons who contribute money or money’s worth to a common stock and employ it in some trade or business and who share the profit and loss arising there from”.⁷⁷

In order to discuss the concepts of a company and CG one may be obliged to consider the features of companies. As Companies have their own distinct features, which make them different from partnerships and sole proprietorships. Therefore, a business person or investor who is interested to form a company needs to consider these distinguishing features of a company. The following are the most distinguishing characteristics of a corporation.

a) Incorporated association

A company is created when it is registered or incorporated per the law of a country. Incorporation is a mandatory requirement for the existence of a corporation. It comes into being from the date mentioned in the certification of incorporation.⁷⁸ Incorporation of a company takes place when it fulfills the minimum conditions put under the company law of a country based on the type of company.

b) Artificial legal person

A Company is created with the sanction of law and is not itself a human being. It is therefore, called artificial; and since it is clothed with certain rights and obligations, it is called “person”.⁷⁹ A company is accordingly an artificial person. Acontrario , it is not a natural person. It exists in the eyes of the law and cannot act on its own.⁸⁰ It has to act

⁷⁵ Angela Schneeman, The law of Corporations and other Business Organizations, (5th ed.), (Engage learning: USA, 2010), P.246

⁷⁶ Peter Nayler, Business Law in the Global Market place, (Elsevier butter worth-Heinemann: UK, 2006), P.148.

⁷⁷ Ashok K Bagrial, Company law, (12th ed.), (2007), P. 28

⁷⁸ Ibid. P.29 and Commercial Code of Ethiopia, cited above at note 4, Art 222, 223, 234(1), and 520(1)

⁷⁹ SS Gulshan, Cited above at note 1, P. 387

⁸⁰ Ashok, Cited above at note 77, P.30

through a BoD elected by the shareholders or appointed manager or other agents.⁸¹In the eyes of the law a corporation is a separate legal person and enjoys rights and shoulders duties as any natural person. Though it has no political or civil rights, ⁸²like a natural person, it has the right to acquire and dispose of properties, enter into contracts with third parties, and to sue and be sued in its own name.⁸³

c) Separate legal entity

This feature implies that a company has a legal entity distinct from and independent of its members.⁸⁴Unlike a sole proprietorship and a partnership, a corporation is distinct from the persons who constitute it. Its identity is different from the identity of owners. This feature enables a company to be separate from those who own or run it, and to have a limited liability.⁸⁵ So, if something wrong has been done by companies, it is the companies which are questioned or liable for that wrong act, not the owners with the exception Art 366 and 530 of the Comm.C. In other words, the creditors of the company may recover their money only from the company and the asset or the property of the company unless they may do so from directors⁸⁶ or managers⁸⁷ due to the doctrine of piercing the corporate veil.

This features of company disqualified the creditors from suing individual members, for the wrong act or debt of the company.⁸⁸In similar way, the company is not in any way liable for the individual debt of its members. The asset of the company is to be used for the benefits of the company and not for the personal benefit or debt of the shareholders.⁸⁹

⁸¹ As per the Commercial code of Ethiopia, Share Company should be administered by Board of Directors, Art 347, and Private Limited Company should be administered by one or more Manager(s), Art 525(1)

⁸² A.C Fernando, Cited above at note 12, P.44.

⁸³ Ashok, Cited above at note 77, P.30

⁸⁴ Ibid.

⁸⁵ Le Talbot, Critical Company Law, (London: Rutledge Cavendish, 2008), P.23

⁸⁶ Commercial Code of Ethiopia, cited above at note 4, Art 366

⁸⁷ Id., Art 530

⁸⁸ SS Gulshan, cited above at note 1, Pp. 389-390, and Commercial Code of Ethiopia, cited above at note 4, Art. 304(1), and 510(1)

⁸⁹ Ashok, Cited above at note 77, P.30

This distinguishing characteristic of corporation also bars the shareholders from claiming any ownership rights in the assets of the company either individually or jointly during the existence of the company.⁹⁰

d) Limited Liability

Unlike sole proprietorships and partnerships, one of the important advantages of a company is corporate limited liability. This feature enables the shareholders to share the company's profits, and not become responsible for its losses.⁹¹

Limited liability of companies follows from the features of the separate legal personality of the companies⁹² by which they are responsible for their own debts and liabilities. This feature implies that the liability of shareholders is limited to the amount of unpaid par value or price of their shares irrespective of the obligations of the company.⁹³ This means that even in cases when a company suffers heavy losses and incurs large debts beyond its assets, the personal property of the shareholders cannot be seized for repaying the debts of the company provided shares are fully paid.⁹⁴

This important feature of the company actually shifts the risk of business failures from the shareholders to the creditors. This limitation of liability eliminates the risk of investment; has stimulated investment in all kinds of large industries and huge commercial enterprises; and has paved the way for the growth of the material civilization of the world.⁹⁵

e) Perpetual Succession

Companies are associations of capital and not associations of persons like partnerships. This characteristic of companies follows from artificial legal personality, and separate legal existence features of companies. This feature implies that the life of a company is

⁹⁰Ibid.

⁹¹Dejene, Cited above at note 26, P.13

⁹² John E. Moye, The Law of Business Organizations, (6th ed.), (Delmar engage learning: USA, 2004), P.158 - 159.

⁹³ A.C Fernando, Cited above at note 12, P. 44 -45, and Commercial Code of Ethiopia, cited above at note 4, Art 304(2) , 342(1) and 510(1)

⁹⁴Ibid.

⁹⁵ A.C Fernando, Cited above at note 12, P. 45

not contingent on the lives of its members,⁹⁶ like sole proprietorships and partnerships. In other words unlike sole proprietorships and partnerships,⁹⁷ companies' lives, do not end with the exit, retirement, lunacy, insolvency, or death of any or all share holders or directors or managers,⁹⁸ unless the exit or death of shareholder(s) makes companies not to fulfill the minimum number of shareholders laid by the law⁹⁹. Thus, corporations remain in existence and in operation exist for a long period of time despite the death, incapability, bankruptcy or the transfer of shares of shareholders.¹⁰⁰ The features of transferability of shares of companies preserve their perpetual existence.¹⁰¹ The shareholders of a company may come and go but the company can go on forever. The saying "King is dead, long live the King" very aptly applies to company form of business organizations.¹⁰²

f) Transferable Shares

In company form of BOs, business is separate from its members, this features of company facilitates the transfer of member's shares. Shareholders' interests in companies are based on their shares. So, owning a share in a company carries rights against the company to receive dividends; to participate, and to give opinion and vote in shareholders' meetings; to inspect or see company documents; and to get the copies of the documents of companies.¹⁰³ A share can be transferred to a new holder and this transfer entails rights and liabilities.

In India shareholders in public companies may freely transfer their shares to anybody without seeking permission from the companies or without the consent of other shareholders.¹⁰⁴

⁹⁶Id., P. 44

⁹⁷ Commercial code of Ethiopia, cited above at note 4, Art 260, 278(1)(H), 295, 303

⁹⁸ A.C Fernando, Cited above at note 12, P. 44

⁹⁹ Commercial Code of Ethiopia, cited above at note 4, Art 311(2) and Art 511

⁹⁹Ibid.

¹⁰⁰ William F. Blake, A Basic Private Investigation: A Guide to Business Organization, Management, and Basic Investigation skills for the Private Investigator, (Charles C. Thomas Pub. Ltd, 2011), P. 17.

¹⁰¹ A.C Fernando, Cited above at note 12, P. 44

¹⁰² SS Gulshan, Cited above at note 1, P. 391

¹⁰³ John Armour, The essential elements of corporate law: What is corporate law?, (New York: Oxford University Press, 2009), P. 112, and Commercial Code of Ethiopia, cited above at note 4, Art 345, 389, 406, 407, 458, 534, and 537

¹⁰⁴ Ashok, Cited above at note 77, P.34

Under the Comm.C of Ethiopia, S.co may be established among founders, whose members may not be not less than five by subscribing the whole of the capital and they may also be formed by the issue of shares to the public.¹⁰⁵Where a S.co is established through the latter method, the S.co may be termed to be a Public Company. A good reference for this is financial share companies, which are invariably formed by public subscription of shares. However, even if a S.co is formed by public subscription, (i.e. the company is Public Company), unlike Art. 582 of the Companies Act of India¹⁰⁶, the free transferability of shares may be restricted by Articles of Association.¹⁰⁷In contrast, in other countries, heavier restriction and procedures is laid by the law and Articles of Association on the transferability of shares on Ethiopian Plcs ¹⁰⁸ due to their private or personal or family nature or relationship of the shareholders, whom established this type of company in Ethiopia.

Allowing free transferability of shares is so important which facilitates transfer and making shareholding a more flexible kind of investment. It adds advantages both to the institution of the company as well as to the investors; and it also stimulates domestic as well as foreign investments¹⁰⁹. These in turn brings sustainable economic and financial development to a country. So, it is advisable to lift or minimize the restriction on transferability of shares especially in public companies.

As in case of Plc and S.co formed among founders, these types of companies are private companies; the restriction on free transfer of shares appears to be quite sensible due to various reasons.

g) Separation of Management from Ownership

Shareholders are sometimes termed as the “owners” of the company or the principal, while the managers are termed as the “agents” of the company. Ordinarily, the number of shareholders particularly in Public Companies is large and hence all of them or most of

¹⁰⁵ Commercial Code of Ethiopia, cited above at note 4, Art 307(2), (3), 316, 317

¹⁰⁶ SS Gulshan, Cited above at note 1, P. 391

¹⁰⁷ Commercial Code of Ethiopia, cited above at note 4, Art 333(1)

¹⁰⁸ Id.,Art 523(1),(2)

¹⁰⁹ Alemayehu, Cited above at note 3, P. 18

them cannot participate in the day to day management of the companies.¹¹⁰To solve the issues of dispersed ownership and owners' management, the law provides for the BoD and managers, who are appointed by the general meetings of shareholders (owners), to administer and govern the affairs of the companies.¹¹¹However, this seemingly a divorce of ownership from the actual management of the company often causes miss-governance of the company.¹¹²

¹¹⁰ Stephen G. Marks, The Separation of Ownership and Control, (US: Boston University School of Law, 1999), P. 3

¹¹¹Ibid., and the Commercial code of Ethiopia, cited above at note 4, Art 347, 350, 525, 526,

¹¹² A.C Fernando, Cited above at note 12, P. 44

Chapter Three: Corporate Governance

3.1 The Concept and Definition of Corporate Governance

The term CG is relatively a new concept in most jurisdictions especially in developing and emerging market economy countries; it is not a legal term and its definition is also ambiguous.¹¹³ The history of CG is complex and it is hard to get its definitive treatment.¹¹⁴ Though it evolved over centuries and has been in existence from the time when modern corporations came into existence¹¹⁵; it came in to picture as a result of corporate failures and financial crisis.¹¹⁶

The term CG developed from an analogy between the government of nations or States and the governance of Corporations.¹¹⁷ “Defining CG is not an easy task. It varies according to the sensitivity of the analyst, the context of the degree of development of the country to which it referred. The Cadbury Report was a forerunner and made a significant contribution to the underlying of the concept.”¹¹⁸

Sir Adrian Cadbury¹¹⁹, in his report of 1992 for the first time defined CG broadly as “the system by which companies are directed and controlled”¹²⁰ The Organization of Economic Co-operation and Development (OECD) defined CG as: “The system by which business corporations are directed and controlled”¹²¹. According to OECD the CG structures specify the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and it spells out the rules and procedures for making decisions on corporate affairs. The OECD document also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring

¹¹³ Klaus J., cited above at note 13, P.6

¹¹⁴ Brian R. Cheffins, “The History of Corporate Governance”, ECGI Working Paper Series in Law, No. 184, (2002), P.1

¹¹⁵ *Ibid.*

¹¹⁶ International Financial Corporation, Corporate Governance Manual, (2nd ed. 2010), P.1

¹¹⁷ Mary O’Sullivan, Contests for Corporate control: Corporate Governance and Economic Performance in the United States and Germany, (Oxford University Press, 2000), P.6

¹¹⁸ A.C Fernando, Cited above at note 12, P.12

¹¹⁹ Sir Adrian Cadbury chairmanship of the Cadbury Committee who was appointed by the London Stock Exchange in 1991, with the task of drafting a code of practices to assist corporations in defining and applying internal controls to limit their exposures to financial loss.

¹²⁰ Klaus J., cited above at note 13, pp. 6-7, and Corporate Governance Definition, available at: www.Corpgove.net, (accessed on 7/7/2016).

¹²¹ Effective Corporate Governance, available at: www.frc.org.uk, P. 6, (accessed on 7/6 2016)

performances.¹²²This OECD's definition of CG is consistent with the definition of the Cadbury Committee.

From an academic point of view CG is considered as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.¹²³

The concept of CG can also be viewed from the context of economic development achieved by countries. Though the principles underlying the concept are the same, however, the norms governing it are different and the stage of the development or evolution of the systems and procedures that are required to implement it are at varying degrees of maturity.¹²⁴CG describes "the framework of rules, relationships, systems, and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies and those in control are held to account."¹²⁵

In Ethiopia, the Comm.C does not define the term CG. The definition for CG is given in the legal document of financial companies i.e. Banking and Insurance Share Companies. Under the Directives issued by the National Bank of Ethiopia CG means the process and structures used to direct and manage the business and affairs of a bank towards enhancing business prosperity and corporate accountability with ultimate objectives of realizing long-term shareholders value, as well as customers' and other stakeholders interest.¹²⁶

3.2 Views and Perceptions on Definitions of Corporate Governance

Most of the above-mentioned definitions reflected the 'traditional' views of CG. The traditional views of CG are predicted up on three basic assumptions. These are: primacy of the shareholder; sensitivity of the shareholders group; and the maximization of shareholders wealth as a fundamental *raison d'etre* of a company.¹²⁷Those CG definitions particularly the definition of the Cadbury Committee and that of the OECD, which are

¹²² Ibid.

¹²³ A.C Fernando, Cited above at note 12, P. 10.

¹²⁴Id., P. 11

¹²⁵ ASX Corporate Governance Council, Corporate Governance Principles and Recommendations, (3rd ed. 2014), P.3.

¹²⁶ Licensing and Supervision of Banking Business, Bank Corporate Governance Directives No SBB/62/2015, Art 2(3)

¹²⁷ A.C Fernando, Cited above at note 12, P.11

shareholders-centric, capture some of the most important concerns of governments in particular and the society in general.¹²⁸

Other views on CG mentioned above, like the academician view and the definition given under the Directives issued by National Bank of Ethiopia tried to encompass the interest of stakeholders as well as the interests of shareholders.

In addition to the above-mentioned views, the definitions of CG can also be viewed in terms of broad or narrow perceptions. Those definitions that focus on the relationship between company and its shareholders are considered as narrow definitions. The Economic Nobel Laureate, Milton Friedman, in his earliest definition of CG in its narrow sense, defined it as “CG is to conduct the business in accordance with the owner’s or shareholder’s desires, which generally will be to make as much money as possible, while conforming to the basic rules of society embodied in law and local customs.”¹²⁹ These narrow perceptions of CG are more related to the traditional view i.e. shareholder-centric approach of CG which is based on the economic concept of value maximization that underpins shareholders’ capitalism.¹³⁰

On the other hand, those definitions of CG that tried to include employees, customers, suppliers and other stakeholders in addition to the relationship between a corporation and its shareholders are termed as broad perceptions of CG.¹³¹ The emphasis is placed on the relations between the owners, management, board and other stakeholders such as the employees, customers, suppliers, investors and communities.¹³²

From these views and perception we may understand that the narrow definition stands on the traditional agency theory whereas the broad definitions stand on the proposition of stakeholder theory.¹³³ Moreover, from the above definitions, we can learn that CG has been defined in different ways by different writers and organizations. Some define it in a

¹²⁸Id., P.12

¹²⁹Id., P.14

¹³⁰Id.

¹³¹ Jill Solomon and Aris Solomon, Corporate Governance and Accountability, (England: John Wiley and Sons Ltd, 2004), P.12

¹³² A.C Fernando, Cited above at note 12, P.14

¹³³ Jill Solomon, Cited above at note 131, P. 12

narrow perspective by concentrating it on shareholders and only to focus on shareholders' interest, while others want it to address the concerns and interests of all stakeholders.¹³⁴

All in all, from the above discussions we may conclude that the term CG conveys different meaning to different people. Though to all, CG is a means to an end, the end being long term shareholders value, and more importantly, stakeholder value. Because of this now-a-days, all scholars and government officials recognize the importance of having good CG practices in achieving the end for which corporations are formed.¹³⁵

3.3 The Significance of Corporate Governance

As we noted above, CG is the guidelines on how a company may be directed or controlled so that it may fulfill its goals and objectives in a manner that adds to the value of the company and is also beneficial to all stakeholders in the long-term.¹³⁶

Though the importance of CG has always been implicit, its relevance came to fore only after the economic crisis created by Enron, Anderson and others.¹³⁷CG gained greater attention by scholars, lawyers, authorities, and regional as well as international organizations; due to the following:

- ✚ It relates to the largest sector in any country involving most of the human and natural resources and it has the largest contribution to the economic development of a country.¹³⁸
- ✚ It is the base for a country's economic development and to have stable financial system. The recent 2008 economic crisis of the world revealed that without having proper CG not only some countries but the whole world won't have sustainable economic development and stable economic and financial system.
- ✚ It is critically important to a country's economic growth and financial stability since it provides the credibility and confidence that is fundamental to capital market. James D. Wolfensohn,¹³⁹describes this importance of CG as "The proper

¹³⁴ A.C Fernando, Cited above at note 12, P.23

¹³⁵ Ibid.

¹³⁶ Dheeraj Tiwari, Corporate Governance: Issues and Challenges in India, P. 1

¹³⁷ A.C Fernando, Cited above at note 12, P. 2

¹³⁸ Ibid.

¹³⁹ James D. Wolfensohn was the 9th president of the World Bank from 1995- 2005

governance of companies will become as crucial to the world economy as the proper governing of countries.”¹⁴⁰

- ✚ CG has crucial role in every sector of the economy and financial stability and development of the world since it is an enabling device for the setting, achieving and monitoring corporate objectives and performance.
- ✚ CG became a topic of worldwide political debate, because of its apparent importance for the economic health of corporations and societies in general.¹⁴¹
- ✚ Good CG is a means where by a society may be sure that large corporations are well run institutions to which investors and lenders can confidently commit their funds.¹⁴²It is an important pillar of the market economy and it enhances investor confidence.
- ✚ CG provides a road map for a corporation, helping the leaders of a company to make decisions based on the rule of law, benefits to stakeholders, and practical process and it allows a company to set realistic goals, and methodologies for attaining those goals.¹⁴³
- ✚ It provides the guidelines as to how a company may be directed or controlled so that it may fulfill its goals and objectives in a manner that adds to the value of the company and is also beneficial to all stakeholders in the long-term.¹⁴⁴
- ✚ CG is based on principles such as conducting the business with all integrity and fairness, being transparent with regard to all transactions, making all the necessary disclosures and decisions, complying with all the laws of the land, accountability and responsibility towards the stakeholders and commitment to conducting business in an ethical manner.¹⁴⁵
- ✚ It is important in ensuring that the donors of finance guarantee themselves to get a fair return on their investment.
- ✚ It ensures transparency which makes certain strong and balanced economic development and also ensures the interest of all shareholders i.e. majority as well

¹⁴⁰ Effective Corporate Governance, Cited above at note 121, P.5

¹⁴¹ A.C Fernando, Cited above at note 12, P. 476

¹⁴² Ibid.

¹⁴³ Dheeraj, Cited above at note 136, P.8

¹⁴⁴ Id., P.1

¹⁴⁵ Ibid.

as minority shareholders are safeguarded and fully exercise their rights and the organization entirely recognizes their privileges.¹⁴⁶

- ✚ International flows of capital enable companies to access financing from a much larger pool of investors. If companies and countries are to reap the full benefits of the global capital market, CG arrangement must be credible and well understood across borders and adhere to internationally accepted principles.¹⁴⁷
- ✚ Good CG framework supported by effective supervision and enforcement mechanisms, will help improve the confidence of domestic as well as foreign investors, reduce the cost of capital, underpin the good function of financial markets, and ultimately induce more stable sources of financing.¹⁴⁸
- ✚ CG is now to be one of the criteria, which foreign investors are increasingly depending on when deciding in which country and company to invest.
- ✚ It also creates safeguards against corruption and mismanagement, while promoting fundamental values of a market economy in a democratic society.¹⁴⁹

Because of these and other significances the issues of CG have gained great attention all over the world.

3.4 The Significance of good Corporate Governance in Developing and Transition Economies

As we mentioned above, there is a growing consensus that CG has a positive relationship with national growth and development of economy. The financial crisis and the resultant collapses of major institutions have brought more attention to the need for effective and good governance system both in developed and developing countries.¹⁵⁰ Even though good CG is so important for every country, especially it is very important for developing, transition and emerging market economy countries. The reasons for these are:

¹⁴⁶Id., P.2

¹⁴⁷ G20/OECD Principles of Corporate Governance, OECD Report to G 20 Finance Ministers and Central Bank Governors, (September 2015), Available at: <https://www.oecd.org/corporate/principle-corporate-governance.htm>, (accessed on 7/10/2016), P. 10

¹⁴⁸ Ibid.

¹⁴⁹ A.C Fernando, Cited above at note 12, P.476

¹⁵⁰ Sanni Markkanean, *Corporate Governance in Africa: Comparative study Master's*, (Alto University, School of Business, 2015), P.1

- ❖ These countries do not have strong judiciary, long-established financial institutions and infrastructure to deal with CG issues.¹⁵¹
- ❖ Having good CG practices are more important in countries with weak shareholder rights protection, inefficient judiciary, inefficient enforcement and weak legal system.¹⁵²
- ❖ Sound CG practices may be helpful in obtaining new and much needed investments for Africa, as good quality CG is especially important to attract domestic as well as foreign investments¹⁵³
- ❖ Having good CG helps developing countries investors to trust the corporate sector better and thus make those countries internationally more competitive in the capital markets.
- ❖ Improving the basic CG practices such as reporting, transparency, protection of minority shareholders' rights, and independent auditing can improve the economy of these countries on long-term basis.¹⁵⁴These, in turn, improve its governance qualities among investors and through economic development improve the life of its population.¹⁵⁵
- ❖ Till now, many developing, transition and emerging market countries are, characterized by pervasive clientelism (“cronyism”) and/or weak judicial systems, and often poorly defined property right and weak contract enforcement.¹⁵⁶Thus, these counties, in order to benefit from the world capital, should have good CG. That is why many Scholars, regional as well as international organizations advocate that good CG is more important for developing, transition and emerging market countries than others.
- ❖ CG is often thought to be important for companies with publicly traded shares that seek to raise capital from outside equity investors. Unlike developed

¹⁵¹ Robert W. MC Gee, Corporate Governance in Developing Economies: Country studies of Africa, Asia, and Latin America, (2009), P.3.

¹⁵²Leora F. Klapper, Corporate Governance, Investor Protection and Performance in Emerging Markets, (2002), p.4-5

¹⁵³Sanni, Cited above at note 150, p.1

¹⁵⁴Id., P.2

¹⁵⁵Ibid.

¹⁵⁶ OECD Development Centre Policy Brief No. 23, Corporate Governance in Developing, Transition and Emerging Market Economies, (2003), P. 10

economies, where the link between good CG and publicly traded shares are obvious,¹⁵⁷in developing and emerging market economy countries company's shares are not publicly traded¹⁵⁸. Because of these factors CG has become an important topic in developing economies in recent years¹⁵⁹.

- ❖ In contrast with developed countries, developing countries firms are characterized by: widespread preponderance of smaller firms that do not have listed shares and of large family-owned, and/or foreign-owned companies whose shares are also not widely traded locally. Thus these situations are an important reason why the potential importance of CG has long been ignored in these countries.¹⁶⁰
- ❖ In these countries, the State and “Para-State” institutions remain the largest shareholders of companies; the capital markets are just developing and do not facilitate the inflow of new capital as intended; and lack or are just now in the process of developing the most basic market institutions.¹⁶¹Because of lack of necessary political and economic institutions to enable democracy and markets function effectively developing and emerging economies are constantly confronted with issues such as lack of property rights, the abuse of minority shareholders, contract violations, asset stripping and self-dealings.¹⁶²These drawbacks and other problems such as complex corporate ownership structures, vague and confusing relationships between the State and financial sectors, weak, lethargic and bureaucratic judiciary and legal system, absent or under- developed institutions and scarce human resource capabilities make difficult to develop good CG system in these countries.¹⁶³
- ❖ There is a significant movement in many developing and emerging-market countries to privatize formerly State-owned corporations. There is also improvement in reducing anti- competitive market regulations and in liberalizing

¹⁵⁷ Ron Sookram, Corporate Governance in the Emerging Economies of the Caribbean: Peculiarities, Challenges, and a Future Pathway, *The Journal of Values-Based Leadership*, Vol. 9, Issue I, (2016), P.3

¹⁵⁸ OECD Development, cited above at note 156, p. 7

¹⁵⁹ Ibid.

¹⁶⁰ Ibid.

¹⁶¹ A.C Fernando, Cited above at note 12, P.477

¹⁶² Ibid.

¹⁶³ Ibid.

trade and investment policies to attract foreign investors.¹⁶⁴ However, because of others problem privatization does not seem to have brought the anticipated improvements in CG efficiency.¹⁶⁵ These implies that the privatization movement may not be sufficient on their own to create the kind of dynamic and interactive processes of long term productivity growth.

- ❖ In addition to this, political as well as economic policy reforms should be made in order successfully to carry forward their struggles against poverty and corruption,¹⁶⁶ and also to get those benefits of having good CG practices.
- ❖ Practicing good CG in these countries improves accesses to capital and financial markets. These enable them to attract greater foreign investments.¹⁶⁷

All these and other grounds make having good CG system more important for developing, emerging and transition economy countries than developed countries.

Ethiopia, like other developing countries is experiencing the above-mentioned problems and now the country has recognized that having good CG is an essential instrument for attracting domestic as well as foreign investors, and international capital to achieve sustainable economic and financial development, prosperity and growth.¹⁶⁸ The government articulated for the need of good CG system under its policy document of the second fifth year Growth and Transformation Plan (GTP II) as a key instrument to eradicate poverty in the country and to achieve the country's vision to become the lower-middle income country by 2025¹⁶⁹. Though the simple recognition of the importance of CG and inserting it in a document is not enough to benefit from it, this may be taken as a one step forward.

The country, in order to benefit from having good CG, should take measures and needs commitments from government branches (Legislative, Executive and Judiciary) to effectively discharge their respective duties.

¹⁶⁴ OECD Development, Cited above at note 156, P.14

¹⁶⁵ A.C Fernando, Cited above at note 12, P.477

¹⁶⁶ OECD Development, Cited above at note 156, P. 14

¹⁶⁷ Rom Sookram, Cited above at note 157, P.3

¹⁶⁸ Alemayehu, Cited above at note 3, p.29

¹⁶⁹ Federal Democratic Republic of Ethiopia Growth and Transformation Plan II (GTP II), 2015/16-2019/20, National Plan Commission, May 2016, pp.145-146 available at: www.ethpress.gov.et/herald/index.php/.../2445-ethiopia-s-development-and-gtp-ii

3.5 The Principles of Good Corporate Governance

Now- a-days most literatures use the term ‘good or sound or effective CG’ instead of the term ‘CG’. This shows that there is a preference in using good, sound or effective CG practices by nations, regional and international organizations, by investors, stakeholders, etc instead of using CG. As with nations, corporations too are expected to provide good governance to benefit all their stakeholders and at the same time good corporations are not born, but are made by the combined efforts of all stakeholders, which includes shareholders, BoD, employees, customers, dealers, government and the society at large.¹⁷⁰In order to have a good CG, the CG system of a country need to include and protect the rights of all stakeholders, should have effective enforcement system, that comprises the principles of good CG system. So when we say good CG, it means that governing the corporation in such a way that the interests of shareholders are protected whilst ensuring that other stakeholders’ interests are also protected and fulfilled as far as possible.¹⁷¹Having good CG system is not an end in itself; it rather is a means to create market confidence and business integrity, which in turn is essential for companies that need access to capital for long term investment.¹⁷²

All countries have their own unique system of CG reflecting different economic, cultural, social and legal circumstances.¹⁷³Thus, the CG system of one country may not be identical with the system of other countries. This phenomenon creates difficulty to get uniform CG system or principles on the globe.¹⁷⁴The principles of good CG vary from country to country, even among companies within a country.¹⁷⁵ Noting these difficulties OECD member States started to formulate uniform principles of good CG by stating “One size does not fit all”.¹⁷⁶

The OECD was one of the earliest non-governmental organizations to work on and spell out principles and practices that should govern corporation in their goal to attain long-

¹⁷⁰Alemayehu, cited above at note 3, p.29

¹⁷¹ A.C Fernando, Cited above at note 12, P. 26

¹⁷² G 20/OECD, cited above at note 147, P.3.

¹⁷³ ECAEW, Effective Corporate Governance Frame Work, Available at: http://www.icaew.com/media/corporate/files/technical/corporate_governance, accessed on 7/12/2016), P.7.

¹⁷⁴Alemayehu, Cited above at note 3, P.29

¹⁷⁵ Ibid.

¹⁷⁶SelimSerbetic, Corporate Governance: Manufacturing Companies: Performances during the Financial Crisis in Turkey, (2011), P.22

term shareholders value.¹⁷⁷ The OECD principles on CG have oft been quoted and have won universal acclaim, especially of the authorities on the subject of CG.¹⁷⁸ On the principle of CG, the OECD member states first agreed and issued in 1999, and then to address the concerns of the newly developing markets and CG failures, the principles were revised in 2004.¹⁷⁹ The most recent review has been carried out under the auspices of the OECD CG committee on 9-10 February, 2015 with all G 20 countries invited to participate in the review on an equal footing with the OECD countries.¹⁸⁰

Accordingly, the most recent review principles reflected the concerns and experience of both the OECD and non-OECD members including developing countries.¹⁸¹ The principles are designed to provide specific guidance for policy makers, regulators and market players in their endeavor to improve their legal, regulatory and institutional framework for sound CG with a view to support economic efficiency, sustainable growth and financial stability.¹⁸² The principles are non-binding but are used as a minimum standard for a good CG framework. They may be used as a bench mark irrespective of a legal system or company's ownership structure or level of economic development of a country.

Though the principles focus on companies having shares traded publicly, both financial and non-financial, they might also be a useful tool to improve CG in companies whose shares are not publicly traded.¹⁸³

They are developed with an understanding that CG policies have an important role to play in achieving broader economic objectives with respect to investor confidence, capital formation and allocation.¹⁸⁴ These have significant importance in today's globalised capital market.

All these and other features make the principles internationally accepted benchmark and best practices for sound CG. Thus, discussing the principles has great relevance to deal

¹⁷⁷ A.C Fernando, Cited above at note 12, P.82

¹⁷⁸ Ibid.

¹⁷⁹ Selim cited above at note 177, P.22

¹⁸⁰ G 20/OECD, Cited above at note 147, P.4

¹⁸¹ Gebyaw, Cited above at note 17, P.14

¹⁸² Policy Brief, : The OECD Principles of Corporate Governance, (2004), P.1, available at: <http://www.oecd.org> , accessed on 7/14/2016

¹⁸³ G 20/OECD ,cited above at note 147, P.10

¹⁸⁴ Id., P.10

with the issues to be tackled under the topic of this thesis, to see the practices, the problems and also to improve CG in Ethiopia in light of these principles.

The principles covered six key areas of good CG. Subsequently, we will briefly see these minimum standards of good CG principles.

3.5.1 Ensuring the basis for an effective Corporate Governance framework

This principle focuses on establishing appropriate and effective laws, regulations, self-regulatory arrangements, voluntary commitments and business practices upon which all market participants can rely in establishing their private contractual relations.¹⁸⁵ This principle advocates for CG framework which comprises legal, regulatory, and institutional underpinnings that should promote transparent and efficient markets, consistent with the rule of law and clearly allocates powers among supervisory and regulatory institutions.¹⁸⁶

The laws and regulatory elements of the CG framework may usefully be complemented by self-regulatory elements based on the “comply or explain” principle such as CG codes in order to allow flexibility and address specificities of individual companies.¹⁸⁷ This principle recommends that a country, in order to have good CG system, the legislative body and the policy makers need to formulate an adequate and comprehensive laws, regulation, and policy documents. Such formulated laws would entail overall economic impact and foster market integrity, attract domestic as well as foreign investors and create incentives for different market actors.

3.5.2 The rights and equitable treatment of shareholders and key ownership functions principle

This principle advocates that inherent ownership rights of shareholders should be promoted and protected by CG framework.¹⁸⁸ Shareholders, as investors in the company, do have certain inherent rights. Thus, the CG system should protect and facilitate the exercises of shareholders’ rights. These inherent rights of shareholders include secured ownership registration, free transfer of shares, obtaining all material and reliable

¹⁸⁵ Annotation to OECD, Principle I

¹⁸⁶ OECD, Principle I.

¹⁸⁷ Ibid.

¹⁸⁸ OECD Principle II

information timely and regularly, participate and vote at shareholders meetings, and participate in the share of the profits of the corporations, etc.¹⁸⁹Equity investors also have certain property rights like an equity share in a publicly traded company that can be bought, sold or transferred.¹⁹⁰

For a country, to have good CG system, the CG system should protect and facilitate the exercise of shareholders' rights and ensure equitable treatment of all shareholders, including minority and foreign shareholders and also ensure that all shareholders should have the opportunity to obtain effective redress for violations of their rights.¹⁹¹ The CG system shall have to adopt mechanisms that provide for shareholders, particularly for minority shareholders, to bring law suits or initiate administrative proceedings when they have reasonable grounds showing that their rights have been violated.¹⁹²

3.5.3 Principle on Institutional investors, Stock markets and other Intermediaries

This is a new principle which is intended to address the need for sound economic incentives throughout the investors' chain, with a particular focus on institutional investors acting in a fiduciary capacity.¹⁹³ In order to have good CG framework, CG system should provide incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good CG.¹⁹⁴In order to be effective, the legal and regulatory framework for CG must be developed having in mind the economic reality in which it is to be implemented.¹⁹⁵

3.5.4 The role of stakeholders in Corporate Governance

Stakeholders are vital for growth, competitiveness and sustainability of growth.¹⁹⁶They contribute to firm human and physical capital and also they provide wide range of

¹⁸⁹ Annotation to OECD, Principle II

¹⁹⁰ G 20/OECD, Cited above at note 147, P.19.

¹⁹¹ Ibid.

¹⁹² Annotation to OECD, Principle II

¹⁹³ G 20/OECD, Cited above at note 147, P.5

¹⁹⁴Id., P.31

¹⁹⁵ Ibid.

¹⁹⁶ Selim, Cited above at note 176, P. 42

valuable resources to firms.¹⁹⁷ Because of these and other importance and roles, this principle dictates that CG frameworks should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and sustainability of financially sound enterprises.¹⁹⁸

According to this principle the competitiveness, ultimate success and long term sustainability of companies is dependent upon the outcomes of team work that embodies different resource providers inter alia investors, employees, creditors, consumers and suppliers and other stakeholders.¹⁹⁹ The principle insists that the rights of these stakeholders provided by the laws or contractual agreements should not only be respected but also in case of violations should be fully compensated.²⁰⁰ The principle suggests that employees' participation in CG should be permitted; even though their degree of engagement in CG may be varied. Workers may be members of the board, through the workers' council representation to express their concerns on certain key governance decisions or partake in equity ownership plans or share in the profit depending on national law and companies CG structure.²⁰¹ The stakeholders in order to play their role in ensuring good CG practice; should obtain full and material information timely and regularly.²⁰²

3.5.5 Disclosure and Transparency

An efficient and strong disclosure regime promotes transparency; enhances the ability of shareholders to exercise their ownership rights on an informed basis; attracts investors; maintains confidence; and improves public understanding of the structure, activities, policies and performances of corporations.²⁰³ So, this principle dictates that in order to have good CG, the CG framework should ensure that timely and accurate disclosure is

¹⁹⁷ Alemayehu, Cited above at note 3, P. 31

¹⁹⁸ G 20/OECD, Cited above at note 147, P. 31

¹⁹⁹ Ibid. and Gebyaw, Cited above at note 17, P.18

²⁰⁰ OECD Principle IV.

²⁰¹ OECD Principle IV, c

²⁰² OECD Principle IV, d

²⁰³ Annotation to OECD, Principle V

made on all material matters regarding the corporations including their financial situation, performance, ownership and governance of the company.²⁰⁴

Company's disclosure and transparency is crucial for shareholders to exercise their ownership rights; for stakeholders to exercise their rights; and for regulator or supervisor to detect and fix unethical and illegal practices within companies.²⁰⁵ However, disclosure shall neither bring any unreasonable administrative cost nor burden and it does not require the relevance of information that may endanger the competitiveness of companies.²⁰⁶

3.5.6 The responsibilities of the boards

This principle calls for the CG framework to clearly specify the responsibilities of boards to exercise an objective and independent judgment as well as to oversee firms observe laws and standards.²⁰⁷ The principle also calls for boards to strategically direct the company, effectively supervise managements, and make them accountable to shareholders and the company.²⁰⁸

This principle is designed to apply to all board structures and dictates boards should perform on a fully informed basis, in good faith, with due diligence and care, in the best interest of the company and shareholders,²⁰⁹ and give due regard to the interest of other stakeholders.

3.6 Models of Corporate Governance

Companies are pillars of economic, social as well as political development of a country. For companies to play these over all roles, they need to have good CG system. In order to measure and improve the CG, it is good to develop a model to measure the quality of CG or develop a model that evaluates how the crafted principles are applied to the logic of

²⁰⁴ G 20/OECD, Cited above at note 147, P. 41

²⁰⁵ Gebyaw, Cited above at note 17, P. 19

²⁰⁶ G20/ OECD, cited above at note 147, p. 31

²⁰⁷ Annotation to OECD, Principle VI

²⁰⁸ OECD Principle VI

²⁰⁹ Ibid.

CG.²¹⁰ The quality and effectiveness of CG is dependent on a myriad of factors and cannot simply be measured by profitability, growth or share performances.²¹¹

There are two models of CG practiced all over the world due to differences in political perception, firms' structure, and CG culture of countries.²¹² These two models are: the shareholders-oriented model and stakeholders-oriented models of CG.

3.6.1 The Shareholders-Oriented Model of Corporate Governance

The classic shareholders-oriented approach prevails in the United States and Great Britain which is focused exclusively on the protection of shareholders from management.²¹³ This model of CG is widely practiced in Anglo-Saxon polities²¹⁴ and it is associated with the agency theory.²¹⁵

The shareholders-oriented approach argues that corporations have a limited set of responsibilities, which primarily consists of obeying the law and maximizing shareholders' wealth.²¹⁶ The basic argument for this model is that corporations, by focusing on shareholders' interests maximize societal value.²¹⁷ This approach argues that companies must be owned by shareholders, and that they must be run in the interest of shareholders.²¹⁸

The recent financial crisis highlighted the need of shareholders to use their rights effectively to ensure good CG practices.²¹⁹ The mere existences or recognition of shareholders rights will not be enough to ensure good CG. Because of this, after the collapse of Enron Corp, World Com Inc, Global Crossing Ltd, and other big firms and the financial crisis experienced in 2008 forced countries in the world developed or developing countries to reconsider and to make reform in their CG systems²²⁰. These

²¹⁰ Yilmaz Arguden, 'Corporate Governance Model: Building Responsible Boards and Sustainable Business, Private Sector Opinion, Issue 17, P.5.

²¹¹ Effective Corporate Governance, Cited above at note 121, P.4

²¹² Alemayehu, Cited above at note 3, P. 32

²¹³ Klaus J. Cited above at note 13, P.28

²¹⁴ Alemayehu, cited above at note 3, p.32

²¹⁵ Gerard Charreauk, Corporate Governance Theories: From Micro Theories to National Systems Theories, (2004), JEL Classification: G 300; P. 500, P.6

²¹⁶ A.C Fernando, Cited above at note 12, p.49

²¹⁷ Ibid.

²¹⁸ Julian Velasco, Shareholder ownership and primacy, University of Illinois Law Review, No. 3, (2010), P. 144

²¹⁹ Effective Corporate Governance, Cited above at note 121, P.9

²²⁰ Alemayehu, cited above at note 3, p.98

efforts to reform CG have been driven in part by the needs and desires of shareholders to exercise their rights of corporate ownership and increase the value of their shares and wealth.²²¹

The shareholders' model of governance entrusts shareholders not only with the ownership of companies but also an exclusive right to determine how and for what purposes the company's property may be used and the rights to determine company's priorities and profits that may be generated.²²² This principle takes a position that the pursuit of shareholders interest is the only end of CG. Regarding this model's stand Friedman said that "there is one and only one social responsibility of business- to use its resources and engage in activities designed to increase its profits so long as it stays within the rule of the game, which is to say, engages in open and free competition without deception or fraud."²²³

All in all, shareholders' model of CG stands that corporations exist only for the interests of their owners i.e. shareholders, so that all powers of the management are at all time exercisable only for retable profits of all the shareholders as their interests appear.²²⁴

3.6.2 The Stakeholders-Oriented Model of Corporate Governance

This model of CG is common in social market polities such as Germany and Australia, and Netherlands.²²⁵ Their corporation law provides that the management board has to steer the company in the interest of the enterprise as a whole.²²⁶

The traditional shareholders model, regards the corporation as a legal instrument for shareholders to maximize their own interest i.e. investment returns; whereas, the relatively new stakeholders approach views the corporation as a locus of responsibility

²²¹Adeoye Amuda , Examining Corporate Governance Practices in Nigeria and South Africa, European Journal of Accounting Auditing and Finance Research, Vol. 3, No. 1, PP. 10-29, (2015), P.10.

²²² Stefan Andreasson, Shareholder and Stakeholder Interest; the politics of Corporate Governance Reform in South Africa, (2006), P.4 Available at: (<http://bisa.ac.uk/index.php?option=com-bisa8task;download>), accessed on 8/2/2016

²²³ Daniel K. Saint and Aseem N. Tripathi, the shareholder and stakeholder Theories of Corporate purpose, P.2 Available at: <http://www.knowledgeworkz.com/samatuan/newsletter> , accessed on: 8/2/2016.

²²⁴ Adolph A. Berle, Corporate powers as powers in Trust, Harvard Law Review, (1931), P.1049

²²⁵Klaus J. Cited above at note 13, P.29.

²²⁶Ibid.

related to wider external stakeholders' interests rather than merely to shareholders wealth.²²⁷

The concept behind this model is based on stakeholders' theory. This new model insists that firms must address the interests of their stakeholder groups and individuals who may affect or may be affected by the companies' activities. This model proposes extending the focus of managers beyond the traditional interest group of shareholders in order to understand the needs, expectations and values of groups previously perceived to be external to the company.²²⁸ According to this model, stakeholders of a company may be defined as individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and who are therefore its potential beneficiaries and/ or risk bearers.²²⁹

In contrast to shareholders-oriented model, stakeholders-oriented model of CG argues that those responsible for the governance of the corporation have responsibilities to parties other than shareholders and that, any fiduciary obligations owed to shareholders to maximize profits might be subject to the constraint of respecting obligations owed to such stakeholders.²³⁰

A stakeholders' model of CG, unlike a shareholders model of CG, holds companies as social entities that are accountable to stakeholders beyond shareholders.²³¹ According to this model, firms have to consider the interests of multiple stakeholders in managerial decision-making. In order to obtain accurate information concerning the expectations of stakeholders, companies have to develop strategies for engaging with the stakeholders and for understanding their needs and concerns.²³²

The stakeholders' theory is grounded in many normative theoretical perspectives including ethics of care, the ethics of fiduciary relationships, social contract theory, theory of property rights, theory of the stakeholders as investors' etc.²³³

²²⁷Silvia Ayuso, Miguera Angel, Roberto Garcia, and Miguera Arino, Maximizing Stakeholders' interest: an empirical analysis of the stakeholder approach to Corporate Governance, (2007), P.1.

²²⁸Id., P.2

²²⁹Ibid.

²³⁰ A.C Fernando, Cited above at note 12, P. 49.

²³¹ Steve Letza and Xiuping Sun, Corporate Governance; Paradigms, Dilemmas and Beyond, Leeds Law school, Vol. 2, No. 1 (2002), PP. 49-50

²³² Silvia, Cited above at note 227, P.6

²³³ A.C Fernando, Cited above at note 12, P.50

One of the problems in this model is defining what constitutes “stakeholders”. Nevertheless the genuine stakeholders are employees, customers, dealers, government, management, creditors, suppliers, local communities, shareholders, and the society at large.²³⁴ Advocates of this model argue that since this model take shareholders as one set of stakeholders companies have to be operated in the interests of all stakeholders.

A Stakeholders’ model of CG is interested in making CG frameworks to be designed in such a way that makes firms run in the interests of all stakeholders, beyond economic value creation for shareholders alone.²³⁵ Even though this model of CG accepts one of the positions of shareholders’ model i.e. corporations shall be operated primarily to maximize wealth; it argues that this wealth production shall not be in the interests of shareholders alone, it is instead, in the interest of all stakeholders.²³⁶ In contrast with the shareholders’ model of CG, stakeholders’ model insists that companies’ administration and control may not be fully and totally entrusted to the owners of the companies i.e. shareholders, instead the stakeholders have to participate and take part in the CG framework. By doing this, the managers are required to pursue interests that go beyond shareholders and care for the interests of others involved in the activities of companies i.e. stakeholders.²³⁷

This model of CG provides a single strategic CG framework flexible enough to deal with any changing environment and a strategic management that deals with how the environment affects companies and vice versa.²³⁸ This is good for the survival of the company, to achieve its objectives, i.e. to maximize wealth and to provide social services, and encourage managements to develop good strategies that manage and integrate the relationships and interests of all stakeholders.²³⁹

Though the stakeholder model makes the above-mentioned important contributions in ensuring good CG framework, this model is often open to criticisms. One of the

²³⁴ Ibid.

²³⁵ Daniel K., Cited above at note 223, P.5

²³⁶ Donna Card Charron, Stockholders and stakeholder: The Battle for control of the corporation, Cato Journal, Vol. 27, No. 1 (2007), P.10.

²³⁷ Elena F. Perez Carrillo, “Corporate Governance: Shareholders interest and other stakeholders’ interest”, Corporate ownership and control, Vol. 4, NO. 4 (2007), P. 99.

²³⁸ R. Edward Freeman and John Mc Vea, A Stakeholder approach to a strategic management, (2002), P.9. Available at: <http://papers.ssrn.com/papers.taf?abstract.id=263511> , accessed on 7/17/2016.

²³⁹ Ibid., P. 10

criticisms is that this approach is not applicable in practice by the CG system of corporations.²⁴⁰The other criticism faced by this model is the problem of defining the concept of ‘stakeholders’ and the difficulty of mentioning who really qualify to be called genuine stakeholders?²⁴¹Because of this problem, some scholars suggest an expansive list of stakeholders, ranging from the most bizarre to include dogs and trees; whereas others list it in a narrow manner to include employees and customers only.²⁴²On the other hand, some writers argue that anyone negatively affected by the company’s activities need to be included in the list of stakeholders across the world which might include political prisoners, abused children, minorities and the homeless.²⁴³Despite these and other different positions regarding the idea of who constitutes stakeholders, the most accepted and applicable constitutes of stakeholders by many countries and international organizations are: employees, shareholders, customers, government, the community, suppliers, and creditors.²⁴⁴

As we discussed above, the use of either shareholder or stakeholder-oriented model of CG characterizes the framework of the CG system. While the classic and traditional approach in most countries and the perspectives of economics prefer shareholder-oriented model, the sociological theory and political science tend more toward stakeholder-oriented model of CG.²⁴⁵

When we examine the CG system of Ethiopia in light of the characteristics and positions above-mentioned models of CG; the model which it follows seems to be shareholders’-oriented model of CG. This position of the country’s CG system is reflected in the Comm.C as well as in the Banking Business Proclamation and Directives issued by NBE. In Ethiopia, there is no legal provision which endorses departure from a profit maximizing objectives and imposes duties on companies to engage in corporate social responsibility activities.²⁴⁶Moreover, there is no law that addresses the interests of stakeholders such as employees, suppliers, customers, communities and the environment.

²⁴⁰ A.C Fernando, Cited above at note 12, P.50

²⁴¹Ibid.

²⁴²Ibid.

²⁴³Ibid.

²⁴⁴Ibid., and RoustemDavletguldeer, The Role of Employees as Stakeholders in Corporate Governance, (2003), P.4

²⁴⁵Ibid.

²⁴⁶Alemayehu, Cited above at note 3, P.35

The law is crafted mainly to protect and to increase the right and wealth and to empower control of companies by the owners of companies i.e. shareholders. Entrusting the power of management only to shareholders reflects this stand,²⁴⁷and by prohibiting unequivocally employees of financial companies from being members of the BoD.²⁴⁸Further, the manner of appointment, the amount of remuneration and the range of accountability of board members are entirely focused on shareholders powers and rights.²⁴⁹All of these and other provisions incorporated in the Comm.C look towards ensuring companies to be run and managed for the interest and benefits of shareholders. Thus, one can say that the rights of stakeholders are not recognized and protected under the current CG system of Ethiopia, which is incompatible with the modern company law and CG framework in the world.

By recognizing the above-mentioned scenario and the consequences, the draft policy document for the revision of the Comm.C, as the policy recognized the right of stakeholders in companies' activities. It tress to introduce corporate social responsibility and allows non-shareholders to become board of members.²⁵⁰This may be taken as a good step to improve the CG system of the country.

3.7 Organs of Corporate Governance and Their Role

As mentioned earlier, the CG system of a country may differ from that of other countries because of many factors. The organs of CG may also differ from country to country.

In this section we discuss the organs of CG in S.cos and Plcs governance structure and their role under the Ethiopian law by making comparisons with Germany's, France's and India's CG practices.

²⁴⁷ Commercial Code of Ethiopia, cited above at note 4, Art 347(1)

²⁴⁸ Directives No SBB/49/2011, Licensing and supervision of banking business, limits on Board Remuneration and Number of Employees who sit on Bank Board Directives, NBE, Art 5

²⁴⁹ Commercial Code of Ethiopia, cited above at note 4, Art 353(1), 362 (2), 525 (1)

²⁵⁰ የኢትዮጵያ የንግድ ማኅበራት ሕግ የፖ.ሊ.ሲ. ጉዳዮችና የማሻሻያ ሐሳቦች (መ.ጋ.ቤ.ት 2006), P. 9, 58

3.7.1 The Organs of Governance in Share Companies Governance Structure

Share companies, once registered, have their own independent legal existence and identity separate from the identity of their shareholders.²⁵¹This separate legal existence enables them to have their own assets, enjoy rights, and shoulder duties, to enter into contracts and to sue or be sued in their own names. As a company is an artificial person, it cannot act by itself. It must act through human intermediaries. That means, it has to exercise its rights, satisfy its obligations and operate its business through the actions of natural persons. In this type of company CG structure, the organs involved are general meetings, BoD, managers and auditors. Subsequently, we will explore the powers and roles of each organ of S.co's governance.

3.7.1.1 Shareholders' General Meetings

The term "Shareholder" refers to a person who holds a share or shares in a company.²⁵²Shareholders are persons i.e. natural or juristic, who bought shares of a company. Shareholders meeting, may be defined as a concurrence or coming together of at least a quorum of shareholders in order to carry out either the ordinary or special businesses of a company.²⁵³Shareholders' meetings are the most important organ of management in Ethiopian Share companies. Likewise shareholders' meeting is the third mandatory organ of CG, besides the management board and the supervisory board in Germany.²⁵⁴Indian company act also recognizes that shareholders' meeting is one of the organs of CG system.²⁵⁵

Shareholders, due to lack of information, time, resource, numerous in number or dispersed members and other reasons may not be in a position to closely follow up the acts of their company.²⁵⁶This situations and/or problems make owners unable to use, manage and control their assets, and instead allow the managers to use, administer, control and run the assets and businesses of the company to further their own interests. To fill this gap between the uninformed shareholders as principals and the fully informed

²⁵¹Alemayehu, Cited above at note 3, P.36

²⁵² Ashok, Cited above at note 77, P.229

²⁵³Id., P. 348

²⁵⁴Assefa, Cited above at note 37, P. 36

²⁵⁵ SS. Gulshan, cited above at note 1, P. 544

²⁵⁶Alemayehu, Cited above at note 3, P.37

managers as agents, principals- agents' relationships are established. This agency and principal relationship in turn creates agency cost, abuse of assets of a company, loss of trusteeship, and other problems. In order to avoid, minimize and monitor these problems and to enable shareholders use their rights and to have good CG practices, many countries company laws allow shareholders to participate in corporation's management. Likewise, the Comm.C of Ethiopia specifies provisions which enable shareholders to participate in the governance of their companies.²⁵⁷

As we mentioned above, the shareholders meetings are one of the most important governance organs of S.cos in which the ultimate decision making power are vested. This ultimate power of shareholders' meeting in other CG organs is reflected by giving the shareholders meeting the power to appoint and remove the BoD,²⁵⁸ and auditors of the company,²⁵⁹and by giving power to determine the remunerations of the organs of CG,²⁶⁰and also reflected by giving power to dissolve the company ²⁶¹, to amend the memorandum or articles of association,²⁶²and to change the nationality of the company.²⁶³Some writers considered these major corporate decision making power given to shareholders meeting as shareholders intervention power in CG system.²⁶⁴ Providing shareholders with these major powers to intervene in CG can significantly improve and address important governance problems that have for long attracted the attention of corporate law scholars and financial economists.²⁶⁵These decisive major powers of shareholders' meeting can be usefully grouped in to three categories; these are:

I) "*Rules of the game*" decisions, which consists of decisions to amend the corporate charter or to reincorporate in another jurisdiction.²⁶⁶These are "Constitutional" decisions that affect the whole CG arrangements; and without the shareholders intervention power,

²⁵⁷ Commercial Code of Ethiopia, cited above at note 4, Art.388- 428

²⁵⁸Id.,Art 350(2), 351 (2), 354

²⁵⁹Id.,Art 368 (1), 369(1 &2)

²⁶⁰Id.,Art 353 (1), 372 (1)

²⁶¹Id.,Art 495(2)

²⁶²Id., Art 423

²⁶³Id.,Art 425 (2)(a)

²⁶⁴ Lucian AryeBebchuk, The case for Increasing Shareholder power, Harvard Law Review, (2004), P. 2

²⁶⁵Ibid.

²⁶⁶Id., P. 4

management monopoly over initiating such changes might well lead to inefficient and bad CG arrangements.²⁶⁷

II) “*Game ending*” decisions,²⁶⁸ which composes of decisions to merge, sell all assets, or dissolve. In the absence of shareholders’ power to intervene, management might have an excessive tendency to reject attractive opportunities to merge, sell, or dissolve because termination will end managements control over the independent company. So, giving shareholders the power to make such decisions would provide clean mechanisms for addressing these problems and to maximize their interest²⁶⁹.

III) “*Scaling-down*” decisions²⁷⁰ are decisions to contrast the size of company’s assets under the management’s control by ordering cash or in-kind distribution. With this intervention power, shareholders would be able to remove excess cash or assets and prevent excessive empire building.

All these shows that, shareholders meetings are the foundation of a wide range of CG protections,²⁷¹ and taken as a base for ensuring effective and good CG framework. This important organ of CG system, in order to play its crucial role in having good CG system, should be conducted properly as per the law and bylaws, and other organs for instance the court should play its role as per the law and principles of CG in order to ensure good CG practices.

Shareholders may exercise these ultimate and important powers in CG through resolutions that have to be made at meetings, and these shareholders’ meetings may be classified in to Ordinary Annual General Meetings, Extra-Ordinary General Meetings and Special Meetings pursuant to Article 390 of the Comm.C.

I) Ordinary General Meetings

Ordinary general meetings are meetings that have to be conducted regularly within four months from the end of each financial year, unless the articles of association extend this

²⁶⁷ Ibid.

²⁶⁸ Id., P. 5

²⁶⁹ Ibid.

²⁷⁰ Ibid.

²⁷¹ David Yermack, Shareholder voting and Corporate Governance, Annual Review of Financial Economics, (2009), P. 1

period of time.²⁷²This meeting is also termed as AGM by other jurisdictions. This type of meeting is the most important of all other company meetings.²⁷³Under Indian Company Act, the AGM must be held by every type of company in each year within six months of the closing of the financial year.²⁷⁴

The way of calling and conducting the meetings:

One of the basic shareholders rights is the right to participate and to vote in meetings, and to be sufficiently informed on decisions concerning fundamental corporate changes.²⁷⁵Thus, shareholders should have the opportunity to participate effectively and vote in general meetings and should be informed of the rules, including voting procedures, which govern the general meetings. In order to use this basic rights shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of the meetings, as well as full and timely information regarding the issues to be decided on at the meetings; and also opportunity should be provided for shareholders to ask questions and to place items on the agenda at general meetings.²⁷⁶

In India, AGM shall be called by giving at least twenty one days notice in writing and the notice shall be exclusive of the day on which it is served or deemed to be served.²⁷⁷It shall specify the place, the day and hour of the meeting and shall contain a statement of the business to be transacted there at.²⁷⁸

Under the Comm.C, shareholders have the right to get information, and to inspect documents,²⁷⁹the right to participate and vote at the shareholders meetings,²⁸⁰the right to appoint and remove directors and auditors as well as determining their remuneration²⁸¹etc. All these and other rights of shareholders have a direct impact and role in ensuring good CG if they are implemented properly. That means, if these

²⁷² Commercial Code of Ethiopia, cited above at note 4, Art 418

²⁷³ Ashok, Cited above at note 77, P.352

²⁷⁴ SS Gulshan, cited above at note 1, PP. 546 -547

²⁷⁵ OECD, Principles of Corporate Governance, (1999), P.17

²⁷⁶ Ibid.

²⁷⁷ SS Gulshan, Cited above at note 1, P. 547

²⁷⁸ Ibid.

²⁷⁹ Commercial Code of Ethiopia, cited above at note 4, Art 406, 417, 422, and 427

²⁸⁰ Id., Art 389, 419(1), 400, 408, 409 336(3), and 342 (7)

²⁸¹ Id., Arts 345(3), and 407 (2)

shareholder's rights are not protected effectively for different reasons, they may give rise to bad CG practices. Where bad CG practices occur, courts have a great role in protecting and enforcing those shareholders' rights that are recognized by the law and in the articles of associations of companies. These involvements of courts have a great contribution in ensuring good CG practices.

Shareholders in order to use their basic rights of participating, in giving opinions, and voting at meetings, they should be dully served with notices of the meetings. The notices of meetings should be given for the first meeting fifteen full days ahead of the meetings and for a second or subsequent meeting, called for lack of a quorum at the first meeting, eight full days ahead of the meetings irrespective of the mode of calling.²⁸² Contents of notice of general meetings are provided for under Art 396(1) of the Comm.C.

Unlike other countries company law, the provision of Art 396(1) and other provisions are not clearly and mandatorily drafted as the notice of the meeting shall specify the place, time and agenda of the meetings. Though notices of calling meetings shall be issued in accordance with the articles of association,²⁸³ the shareholders, in order to use their basic rights of participation and voting, it would be good if the articles of association stipulate the notice of the meetings specifying the place, the time, hour and agenda of the meeting clearly. In practice, many companies' articles of association clearly stipulate the notice of the meetings specifies the above mentioned important issues or contents to conduct effective meetings. The writer of this paper observed these facts when serving as a judge in Federal First Instance Court Commercial Bench, and during examining cases for the purpose of this paper.

Because of problems which relate to the method of calling, and primarily due to the reason that the method of calling is not consistent and the same for all companies and for all meetings²⁸⁴ the issue of meetings being duly called and not called is one of the prominent problems in Ethiopian CG system. This problem has also become a cause for litigation before the courts as we will see later. Unfortunately, the recent Banking

²⁸²Id., Art 395

²⁸³Id., Art 392(1)

²⁸⁴Id., Art 392(1),(2), 393, 396(2), 397

Business Proclamation²⁸⁵ as well as Insurance Business Proclamation²⁸⁶ and the policy document for the revision of the Comm.C did not consider this as a problem.

The other important issue in general meetings is who/which organ may call the meetings? As per Art 391 (1) and (2) of the Comm.C, general meetings are called by the directors, the auditors, the liquidators or by the court when shareholders owning one tenth of the capital ask and show the necessity of calling the meetings. Even though the law empowers and/or gives right to the above mentioned organs, these organs cannot call meetings as they wish and at any time. So, it would be good to see the issue of when should these organs shall call the meetings?

As we mentioned above, AGM shall be called by the directors within four months from the end of each financial year.²⁸⁷ From this we can understand that the general meeting shall be conducted once a year. It is not compulsory to call another AGM in a year²⁸⁸. Auditors shall call general meetings when directors fail to call the meetings as per Art 377(1). Likewise, the court may order the calling of a meeting when the directors and auditors failed to call a meeting and also the shareholder having one tenth of the capital petition the court to order the calling of a meeting²⁸⁹. The intention of the law in setting these options of meetings calling system is to ensure good CG and, to protect the rights of shareholders especially minority shareholders. Minority shareholders by utilizing this mode of calling general meetings especially by submitting petition to courts may exercise, claim their rights and to **include in** the agenda to bring their concerns before the meetings.²⁹⁰ The powers of a court in calling general meetings has a great impact and play a role in protecting minority shareholders as well as in ensuring good CG practices.

Business transacted at AGMs:

²⁸⁵ Banking Business proclamation No.592/2008, Federal Negarit Gazeta, 14th Year, No. 57, Addis Ababa, 25th August, 2008

²⁸⁶ Insurance Business proclamation No 746 /2012, Federal Negarit Gazeta, 18th year No 57, Addis Ababa 22nd, 2012

²⁸⁷ Commercial code of Ethiopia, cited above at note 4, Art 418(1)

²⁸⁸ Id., Art 418(1) and (3)

²⁸⁹ Id., Art 391(2)

²⁹⁰ Assefa, cited above at note 37, PP. 40-41

The purpose of this meeting is to give full information to shareholders about progress made by the company during the year.²⁹¹The business transacted at such meetings is very important for companies, shareholders and stakeholders. The meetings are attended by all holders of shares and they are conducted to discuss the overall administrative and financial matters of the company.

In Germany, the business transacted at AGMs are appointment of some members of the supervisory board, the appropriation of the balance sheet profits, appointment of auditors, amendment of the articles of association, merger, to increase or decrease share capital, and transfer assets of the company.²⁹²

In India, the AGM is held for the purpose of transacting the company's ordinary business, such as consideration of the accounts, balance sheets and reports of the BoD and auditors; declaration of dividends; and appointment and fixing of remuneration of directors and auditors.²⁹³

Under the Ethiopian Comm.C, the businesses conducted at AGMs are all issues except those reserved for extra-ordinary general meetings.²⁹⁴Among other things, AGMs have the mandate to hear reports of balance sheet, reports of auditors and directors, approve or decline the annual financial statements of the company, discuss how profit (if any) could be distributed, appoint or remove BoD and auditors, and fix their remunerations.²⁹⁵

The method of voting in general meetings

Shareholders have the right to participate in making corporate decisions in almost all jurisdictions. Yet, the nature of participation; the voting process; the required majority or capital represented or quorum required varies from jurisdiction to jurisdiction. Ethiopia,²⁹⁶India,²⁹⁷ and Germany²⁹⁸ recognize the principle of 'one share –one vote'. No business

²⁹¹ Ashok, Cited above at note 77, P. 352

²⁹²Assefa, Cited above at note 37, P. 37

²⁹³Ashock, Cited above at note 77, P. 355

²⁹⁴ Commercial code of Ethiopia, cited above at note 4, Art 419(2)

²⁹⁵Id.,Art 419 (1) and (2)

²⁹⁶Id.,Art 407 (2)

²⁹⁷ SS Gulshan, Cited above at note 1, P. 552

²⁹⁸Assefa, Cited above at note 37, P. 36

shall be transacted and no binding decisions be passed at general meeting unless a quorum of shareholders is present at the time when meeting proceeds to that agenda.²⁹⁹

In Germany, unless ‘special majority’ is stated in the statutes of the company, the German stock corporations require ‘simple majority’ to pass resolutions at general meetings.³⁰⁰ However, in Ethiopia, the law doesn’t prescribe the general requirement that works for resolutions by the shareholders in general.³⁰¹ Rather the majority requirement and the represented capital vary based on the rank of calling and meeting, and the agenda of a resolution.³⁰²

In many jurisdictions, shareholders can attend the meetings physically, vote through proxy, or use other means such as postal or electronic. The rules governing the participation and voting of shareholders in Ethiopia in principle favors the physical attendance by shareholders though voting through proxy is also allowed.³⁰³ It is important to recognize and adopt means that modernize and speed up the voting process like postal, electronic system of participating and voting, e-mail, etc. This is so important in companies that have thousands of shareholders like some of the financial companies for example Banking Business S.co and Insurance C.co. By recognizing the importance of this, the policy document of the draft revised Comm.C incorporates the use of information technology for calling as well as voting in general meetings of companies.³⁰⁴

II) Extra-Ordinary General Meetings

Extra-ordinary meetings are meetings which may be held exceptionally, and any shareholder including preferential shareholders may take part in such meetings, regardless of the numbers of shares they hold.³⁰⁵ These meetings are called “in emergencies” or “on special occasions.”³⁰⁶ They are convened when it is found necessary

²⁹⁹ SS Gulshan, Cited above at note 1, P. 552

³⁰⁰ Assefa, Cited above at note 37, P. 37

³⁰¹ Ibid.

³⁰² Commercial code of Ethiopia, cited above at note 4, Art 393, 399

³⁰³ Id., Art 398 and Assefa, Cited above at note 37, P. 38

³⁰⁴ የኢትዮጵያ የንግድ ማኅበራት ሕግ የፖ.ሊ.ሲ. ጉዳዮችና የማሻሻያ ሐሳቦች (መ.ጋቢ.ት 2006), p. 78

³⁰⁵ Commercial code of Ethiopia, cited above at note 4, Art 424

³⁰⁶ Ashok, Cited above at note 77, P. 355

to transact certain businesses which cannot conveniently be postponed until the next AGM.³⁰⁷

The mode of calling or giving notice, the organ or person who may call the meeting is similar with that of AGM as we discussed above.

Business transacted at extra-ordinary general meetings

In India, all businesses transacted at this meeting are deemed to be special business of which notice has been duly given beforehand.³⁰⁸This meeting is usually called for such purposes as alteration of the memorandum and articles of association of the company, increase or decrease of share capital or reorganization of capital.³⁰⁹

In Ethiopia, the businesses conducted at this meeting are: matters of particular significance such as amendments of the memorandum and articles of association,³¹⁰changing of the nationality of the company;³¹¹increasing of shareholders' investment in the company;³¹²and dissolution of the company.³¹³ The powers given to this type of meeting may be grouped in to the power to pass "rule-of-the-game" related decisions and the power to pass "game-ending" decisions. However, the vote required to pass a resolution at these meetings is not the same with that required for AGM.

Amendments of statutes of a company requires more majority i.e., two-third majority.³¹⁴ Decisions, such as change in the nationality of the company or increase in a shareholders' investment require the unanimous vote.³¹⁵

III) Special Meetings

Special meetings are meetings which comprise only shareholders of specific class, such as preference shareholders or debenture holders which have to be called in order to confirm a resolution of general meetings that modify the rights of a class of the shareholders concerned.³¹⁶The quorum required in this type of meeting to pass a binding

³⁰⁷Ibid.

³⁰⁸ SS Gulshan, Cited above at note 1, P. 555

³⁰⁹ Ashok, Cited above at note 77, P. 355

³¹⁰ Commercial code of Ethiopia, cited above at note 4, Art 423

³¹¹Id., Art 425 (2)(a)

³¹²Id., Art 425 (2) (b)

³¹³ Id , Art 495 (2)

³¹⁴Id., Art 425 (1)

³¹⁵Id., Art 425 (2)

³¹⁶Id., Art 426

resolution differs based on the rank or order of the meeting.³¹⁷ However, practically in there is no classes of shareholders in Ethiopia.

In sum, all these shareholders meetings enable shareholders to exercise real control of their company managements and the operation of the company by electing, and dismissing directors, auditors and collectively exercise general supervisory control over the company. All these involvements and powers of the shareholders in CG through these meetings have a great role in ensuring good CG system. As we will discuss later in Chapter four, the role of the courts in this organ is multifaceted and at the same time this role is so crucial in ensuring good CG practices if and when the courts discharges their duties properly.

3.7.1.2 Board of directors and its role

BoD is one of the constituent parts in CG arrangement and its performance affects the supervision and operation of S.cos.³¹⁸ It is the most prominent actor in CG which is regulated in the corporation laws of virtually all countries.³¹⁹ The BoD is a body of elected or appointed members who jointly oversee the activities of a company.³²⁰ It is sometimes simply referred to as “the board”. As we discussed earlier, the separation of ownership from active directorship and management is an essential feature of corporations. To manage the affairs of a corporation, shareholders elect their representatives in accordance with the policy laid down.³²¹ These representatives are called the “directors” of the company; a team of such directors constitute the ‘BoD’ and that is the top administrative board of the corporation.³²²

A director may be defined as a person who is responsible for direction, control, and management of the affairs of a corporation.³²³ Even though the Comm.C does not define what the BoD is, the code recognizes the BoD as one of the CG organs in S.cos and full responsibility is placed on directors for leading a company³²⁴. The term ‘director’ is

³¹⁷Id., Art 428 (1) (a)(b) (c)

³¹⁸Id., Art 416(1)

³¹⁹Alemayehu, cited above at note 3, P. 39

³²⁰ Klaus J., Cited above at note 13, P. 19

³²¹ A.C Fernando, Cited above at note 12, P. 188

³²²Ibid.

³²³ Ashok, Cited above at note 77, P. 268

³²⁴ Commercial code of Ethiopia, cited above at note 4, Art 347(2) cum(2)

defined under Art 2(6) of the banking business proclamation No. 592/2008 as “any member of the BoD of a bank, by whatever title he may be referred to.” In financial companies’ proclamations and directives also BoD is recognized as one of the most important organs in CG structure.

The role of Board of Directors in Corporate Governance:

An effective BoD is at the heart of the CG structure of well-functioning and well-governed corporations, acting as the ultimate internal monitor.³²⁵It is important to note that the effectiveness of BoD practices cannot be mandated by law, but sometimes legal and regulatory requirements or “comply or explain” recommendations from codes can contribute to considerations or adoption of good CG.³²⁶In companies with dispersed ownership, shareholders are usually unable to closely monitor management, its strategies and its performance for lack of information and resources.³²⁷Thus, the role of the BoD is to fill this gap between the uninformed shareholders as principals and the fully informed executive managers as agents by monitoring the agents more closely.³²⁸By its role, the BoD guides long-term corporate strategy, puts the key agents in place to implement it, and monitors performance against the strategy set out.³²⁹Consequently, bad company performance and governance begins with a BoD not fulfilling its key responsibilities. So, the BoD has important roles to play in achieving company business and in inducing effective CG practices.

It is important to note that effective CG requires a clear understanding of the respective roles of the BoD, shareholders, management and auditors, their relationships with other stakeholders that have interest in the corporation and its well being.³³⁰

This organ of CG is central and plays crucial roles in achieving good CG and performs many essential functions to meet the visions and goals of companies. As a governing organ of companies, it monitors the conduct of the management to make sure that they

³²⁵ OECD, *Achieving Effective Boards*, (2011), P. 1, available at: <https://www.oecd.org/brazil/48510039.pdf>, accessed on,7/18/2016

³²⁶Ibid.

³²⁷Fekadu, Cited above at note 35, P. 4

³²⁸Hussien, Cited above at note 36, P. 57

³²⁹ OECD, Cited above at note 324, P. 1

³³⁰ Business Roundtable, *Principles of Corporate Governance*, USA, (2012), P.8 and Dejene, Cited above at note 25, P. 38

are carrying out their legal and financial obligations in the right way.³³¹Its performances affect the governance, the supervision and operation of a company. Thus, companies need to have an effective BoD comprised of honest, hard-working, loyal and interested directors to maintain good CG practices, preserve the interests of shareholders and stakeholders and also to achieve and enhance good and effective performance.³³²Good CG exists only if a company has a perfect, model or ideal board.³³³Because of these and other roles, BoD is considered as soul and conscience of corporation³³⁴and a base for ensuring good CG practices.

The structure of boards:

Board structure refers to whether a board is a single-tier board or two-tier board.³³⁵Good CG requires competent BoD as a supervising body for the executive management of a company.³³⁶

Two-tier board structure originated in Germany.³³⁷The distinctive features of two-tier board model is that there are two separate bodies of directors that is the management board and supervisory board operating separately but interacting with each other.³³⁸

The management board is in charge of the day –to-day functions of a corporation and it is responsible for the actual management of a corporation.³³⁹The management board is autonomous from the shareholders and the supervisory board in its regular function.³⁴⁰Members of management board in principle are appointed by the supervisory board.³⁴¹

The supervisory board, as evident from its name, has a role of supervising and advising the management board. It is the second level of the BoD in German stock corporations that serves as an organ representing shareholders, employees and sometimes other

³³¹Alemayehu, Cited above at note 3, P.39

³³²Id., P. 40

³³³ Kiel, G.C et al, Board, director and CEO Evaluation, Sydney; (Mc Graw, Hill, 2005), P. 25

³³⁴Alemayehu, Cited above at note 3, P. 40

³³⁵Dejene, Cited above at note 26, P.36

³³⁶Hussien, Cited above at note 36, P. 46

³³⁷Dejene, cited above at note 26, P. 36

³³⁸Ibid.

³³⁹Assefa, Cited above at note 27, P. 11

³⁴⁰ Id p,12

³⁴¹Klaus. J, Cited above at note 13, P. 20

constituencies as well.³⁴²The main function of this organ is to appoint and revoke members of the management board; oversee the overall management of a corporation; and also be responsible for bringing legal actions of a company against members of the management board.³⁴³The members of the supervisory board are elected by the shareholders meeting.³⁴⁴

‘One-tier’ board model is a single body of directors who sit together in board meetings and pass board resolutions.³⁴⁵Unlike the German model, Ethiopia adopted a unitary BoD in share companies.³⁴⁶Ethiopian rules of CG do not recognize two level board structures. That means, the code does not distinguish between managerial and supervisory roles of the board. There is a view that the Ethiopian company law does not have adequate legislative provisions on CG related issues, such as the separation of supervision and management.³⁴⁷The same also holds true for the membership, autonomy, remuneration and compensation of the BoD.³⁴⁸In taking in to consideration these CG related problems and to tackle these issues, in the policy document for the revision of the Comm.C the notion of two-tier board system is introduced. This may be taken as a spring board to modernize the CG system of the country.³⁴⁹

Composition of board members

Board composition refers to the make-up or constitutes of a board in terms of executive and non-executive directors, independent and affiliated directors, and shareholder elected and employee-elected directors.³⁵⁰The issue of board composition is so crucial in addressing stakeholders’ interest in the affairs and management of a company and to address and protect the minority shareholders’ right in the business and management of their company. Addressing these and other important issues in this organ of CG would have great importance in ensuring good and effective CG practices. By recognizing their

³⁴²Assefa, Cited above at note 37, P. 17

³⁴³ Id p,18

³⁴⁴Klaus. J, Cited above at note 13, P. 20

³⁴⁵Dejene, Cited above at note 26, P.36

³⁴⁶Assefa, Cited above at note 37, P. 24

³⁴⁷Hussien, Cited above at note 36, PP. 46-47

³⁴⁸Ibid.

³⁴⁹የኢትዮጵያ የንግድ ማኅበራት ሕግ የሥራ ስርዓትና የማሻሻያ ሐሳቦች (መ.ጋ.ት 2006), Pp. 51 -55

³⁵⁰ Professor David F. Larcker, Board of Directors: Structures and Consequences Corporate Governance Research Program, Stanford Graduate School for Business, (2011), P.11

importance in recent years, there is an inclination in different countries company laws towards introducing non-shareholders in the composition of BoD in addition to shareholders.³⁵¹ However, the notion of having non-shareholder directors in boards has not been practiced until now in Ethiopian CG framework. The Comm.C³⁵² and Banking Business Proclamation³⁵³ and Insurance Business Proclamations³⁵⁴ clearly prohibit share companies from establishing BoD that comprised of non-shareholders i.e. stakeholders.³⁵⁵ Unlike the eligibility requirement for board membership in Ethiopian companies, in Germany, members of the management board and supervisory board need not necessarily be shareholders.³⁵⁶ So, in Germany different stakeholders such as banks (as creditors or a voting trustee) and employees are represented in the supervisory board of Stock Corporations.³⁵⁷

In addition to the above-mentioned problem of board composition in Ethiopian companies, the Comm.C does not clearly specify additional competitive qualifications which need to be fulfilled to become eligible for board membership.³⁵⁸ Because of this, incompetent shareholders may assume directorship. These problems may result in ineffective and bad CG practices. In order to tackle this consequence, in financial companies there is a requirement that needs to be complied with in order to be eligible for board membership.³⁵⁹ The policy document of the revised Comm.C also tries to put criterion to become member of BoD Ethiopian share companies, based on age and by putting prohibiting condition to be eligible for board membership.³⁶⁰ Even though the policy document has its own limitations, this step may be taken as a positive measure in improving CG system of the country.

³⁵¹ Alemayehu, Cited above at note 3, P.41

³⁵² Commercial code of Ethiopia, cited above at note 4, Art 347(1)

³⁵³ Banking Business, cited above at note 285, Art 15(1)(4)

³⁵⁴ Insurance Business, cited above at note 286, Art 16(4)

³⁵⁵ Alemayehu, Cited above at note 3, P.41

³⁵⁶ Assefa, Cited above at note 37, P. 3

³⁵⁷ Ibid.

³⁵⁸ Alemayehu, Cited above at note 3, P. 41

³⁵⁹ Banking Business, cited above at note 285, Art 15, and Insurance Business, cited above at note 286, Art 16

³⁶⁰ የኢትዮጵያ የንግድ ማኅበራት ሕግ የፖ.ሊ.ሲ. ጉዳዮችና የማሻሻያ ሐሳቦች (መ.ጋቢ.ት 2006), Pp. 34 – 35

3.7.1.3 The General Manager

As matter of necessity, the GM controls and performs the day-to-day activities of the corporation. The GM is appointed and removed by the BoD and may not be a member of BoD.³⁶¹ It is apparent from Art. 348 of the Comm.C, that the GM is an employee and may not be a director. The main reason for this restriction is to avoid the concentration of powers in the hands of a single person and to avoid abuse of power and to avoid blurred accountability as well.³⁶² This also plays a great role in ensuring good CG system in a company. That is why some writers argue recognizing GM as one organ of CG in Ethiopian share companies.³⁶³ Even though the activities and powers of a GM have great contribution or impact in the CG system of companies, the Comm.C does not deal sufficiently with GMs. So, for GMs to play their appropriate roles in good CG system, it is advisable to put certain qualifications, and clearly mention their relation with the BoDs, to specify clearly their power and duties in governance system of a company, etc.

3.7.1.4 Auditors

Auditor/s is/are the third major organ of CG in Ethiopian S.cos governance structure³⁶⁴. An auditor is a person appointed by a company to perform audit activities³⁶⁵. Auditors are expected to be the watch dogs of corporation. This leads to the rise of the concept of CG which is about promoting corporate fairness, transparency, and accountability relating to various participants in the affairs of corporations.³⁶⁶ The issue of ‘transparency and disclosure’ of the financial condition of companies is one of the vital aspects of CG.³⁶⁷ CG involves decision making, accountability, and monitoring.³⁶⁸ Decisions require relevant and reliable information; accountability involves measuring, reporting, and transparency; and monitoring involves systems and feedback.³⁶⁹ So an auditor’s primary role is to check whether or not the financial information given to investors is reliable.

³⁶¹ Commercial code of Ethiopia, cited above at note 4, Art 348(3)

³⁶² Fekadu, Cited above at note 35, P.162

³⁶³ Alemayehu, Cited above at note 3, Pp. 38-39

³⁶⁴ Commercial Code of Ethiopia, cited above at note 4, Art 368

³⁶⁵ Id , p.39

³⁶⁶ A.C Fernando, Cited above at note 12, P. 227.

³⁶⁷ Assefa, Cited above at note 37, P.45

³⁶⁸ Auditors and Its Role in Corporate Governance, P.7, available at:

<https://www.oecd.org/daf/cal/corporategovernanceprinciples/37117845.pdf> , accessed on: 8/4/2016

³⁶⁹ Ibid.

Disclosures in the form of audit reports based on reliable information enable investors to know if the management succeeded in realizing the corporation's goal and whether there have been management errors and frauds.³⁷⁰ As examinations of the financial records of a company guarantee the management is using the investors' money for the benefit of the corporation.³⁷¹ If a company maintains a genuine account of its financial records, it could gain the confidence of shareholders and future investors.

This organ of CG plays great importance in certifying the veracity of accounts maintained by companies for the benefit of all shareholders and stakeholders as fair and transparent governance attracts and adds confidence in them.³⁷² Auditing protects companies against imprudent or fraudulent management,³⁷³ which is a feature of bad CG practices.

In India, it is compulsory for every company to appoint qualified auditors to do the audit of the accounts maintained by companies and the first auditor(s) shall be appointed by BoD within one month of the date of the incorporation of the company.³⁷⁴ Subsequent auditors are appointed at every AGM of the company and they hold office from the conclusion of that meeting till the next AGM.³⁷⁵

In France, whether a company needs to have an external auditor depends on the legal form of the company and its size.³⁷⁶ A company with the legal form SA (*Societe Anonyme*), SCA (*societe en commandite par action*), and SAS (*Societe par actions Simplifiee*) must have a statutory auditor, regardless of their numbers of shareholders.³⁷⁷ While companies with the legal form of SARL (*Societe a Responsabilite Limitee*) only need to have a statutory audit if their members are more than 50 people and their assets higher than a total balance sheet of 1.55 million Euros.³⁷⁸

³⁷⁰Assefa, Cited above at note 37, P.45

³⁷¹Ibid.

³⁷² A.C Fernando, Cited above at note 12, P.226.

³⁷³Assefa, Cited above at note 37, P. 45

³⁷⁴ SS Gulshan, cited above at note 1, P. 560 and Ashok, cited above at note 61,P.442

³⁷⁵ Ashok, cited above at note 77, P. 443

³⁷⁶Dejene, Cited above at note 26, P. 56

³⁷⁷Ibid.

³⁷⁸ Ibid. and French Corporate law and finance, available at: www.frenchbusinesslaw.com, accessed on 8/4/2016.

In Ethiopian S.cos, it is compulsory to appoint one or more than one external auditor(s)³⁷⁹. In principle the AGM have power to appoint auditors.³⁸⁰ However, practically this shareholders' meeting may not be in a position to appoint auditors alone by itself and the involvement of the BoD is unavoidable.³⁸¹ In practice the BoD recommends external auditor(s) or accounting firm(s) and brings it for approval before AGM.³⁸² Furthermore, in some companies, AGM delegate its power of appointing auditors to BoD.³⁸³ This kind of practice may result in more powers being concentrate in the hands of the boards, which may create loopholes for abuse of power and also affect an auditor's independence. This type of situation at the end may give rise to bad CG practices. Thus, clear laws should be enacted to balance or to ensure the independence of auditor(s) from the influence of the BoD, in order to enable auditors play their crucial roles appropriately in ensuring good CG practices.

The allotment of remuneration and the removal process of auditors are similar with that of BoD that we discussed above.³⁸⁴

3.7.2 Organs of Governance in Private Limited Companies Governance Structure

Private limited companies share some of the features of share companies. The major difference between public and private companies is in relation to the level and marketability of their share capital.³⁸⁵ That means, these types of companies cannot invite the public to raise finance and their shares are divided only among members.³⁸⁶

Plc is the most widely utilized form of company in Ethiopia. Among companies incorporated in Ethiopia during 2006 and 2007 E.C, Plc are the most prevalent ones, which account 46,798 (98.6%) of the total 47,460 companies, whereas S.cos are about

³⁷⁹ Commercial code of Ethiopia, cited above at note 4, Art 368(1)

³⁸⁰Id., Art 368

³⁸¹Assefa, Cited above at note 37, P. 47

³⁸²Fekadu, Cited above at note 35, P. 178

³⁸³ibid.

³⁸⁴ Commercial code of Ethiopia, cited above at note 4, Art 368, 369, 371, and 372

³⁸⁵ Two differences between private limited and public limited companies, available at: <http://answeryahoo.com/question/index?>, accessed on: 8/5/2016.

³⁸⁶Assefa, Cited above at note 27, P. 9

662 (1.39 %) of the companies registered in those fiscal years in the country.³⁸⁷Owing to their simple governance structure, presumably limited capital, and other features that are associated with Ethiopian Plc's, the law prohibits Plc from taking part in ventures such as Banking and Insurance businesses.³⁸⁸

The overall performance of a company and the profitability of the business are highly affected by the organs of CG bodies³⁸⁹. So, to achieve the targeted rates of growth and expansion of a company, competent, professional, and effective governance organs of the company are important.³⁹⁰

Currently, under the Ethiopian Comm.C, organs of governance in Plcs are: shareholders meetings, auditors (these two organs are conditional based on the number of shareholders), and managers. Unlike the French SARL, Indian and other countries' private companies, ³⁹¹BoDs are not set as a mandatory organ of governance in Ethiopian Plc's governance structure. In the following parts we will discuss each organ in the governance of Plcs.

3.7.2.1 Shareholders' General Meetings

As we discussed above under S.co governance, AGM is the supreme organ of CG, and it plays a great role in having good CG system. In Ethiopia, the necessity of conducting shareholders meeting in Plc, even if not clearly put under the Comm.C as either general (ordinary or extra ordinary) or special meeting, is conditioned up on the number of shareholders of a Plc. This organ of CG is set as a compulsory governance organ in this type of companies only when the number of shareholders is more than twenty.³⁹²Even though the code sets this crucial organ of CG conditionally on the basis of number of shareholders, the writer observed that nearly all Plc Memorandum and Article of Association recognized and set mandatory AGM as the supreme organ of CG regardless of their number of shareholders.

³⁸⁷ Data obtained from Data Base Department of Ministry of Trade , (August 15, 2016)

³⁸⁸ Commercial code of Ethiopia, cited above at note 4, Art 513

³⁸⁹Dejene, Cited above at note, 26, P 75

³⁹⁰Ibid.

³⁹¹Id., P. 78

³⁹² Commercial code of Ethiopia, cited above at note 4, Art 525 (2), 532, and 539

In Plcs, the procedures of calling and conducting AGMs may not be similar with that of S.cos. In the first place, decisions may be made at this meeting where the number of shareholders is more than twenty.³⁹³ Furthermore, the provisions of Art 525 and 532 (1) of the Comm.C envisage that members of a Plc need not conduct formal AGMs unless the number is more than twenty. This implies that when the members are twenty or less, the members shall not be bound to pass decisions at AGMs. In addition to this, the managers may draft and send to each member the text of resolutions to be made in writing.³⁹⁴ This stand of the law shows that less role and attention is given to AGMs as organ of governance in Ethiopian Plcs. This is not in consonance with principles of good CG and the absence of this CG organ in these prevalent companies in the country won't do any good towards ensuring good governance in such entities.

If the number of shareholders are more than twenty or the articles or memorandum of associations provide for the holding of AGM; the manner of giving notice, conducting the meeting, voting system, requirement of quorum, setting of the agenda, and the way of passing resolutions may be conducted as per the provisions that deals about S.co as we discussed above.

In order to have good CG practices in Plcs, it is advisable to set AGM as a mandatory and statutory organ of governance. Unfortunately, these problems and gaps of the existing Comm.C in relation to shareholders meetings and other organs of PLC governance is not considered and nothing is proposed to solve the problem and to fill the lacuna of the law in the policy document for the revision of the Comm.C.

3.7.2.2 Manager(s)

Manager(s) is/are one of the organs in Ethiopian Plcs governance structure. It is, in fact compulsory for the Plcs to be managed by one or more managers³⁹⁵. The day to day activities and the whole business activities of the company are run, performed, and managed by this organ of governance.³⁹⁶

³⁹³Id.,Art 525 (2)

³⁹⁴Id.,Art 533, and Negusie, Cited above at note 11, P. 56

³⁹⁵ Commercial code of Ethiopia, cited above at note 4, Art 525(1)

³⁹⁶Dejne, cited above at note 26,p.83

Manager is appointed by the shareholders' meeting or by the memorandum or article of associations.³⁹⁷As per these provisions, the managers that are appointed may be shareholders or non-shareholders. The owner of the company may also exercise their control of the management of their company by dismissing the appointed managers.³⁹⁸In addition to shareholders meeting, the court has power to dismiss the manager(s) for good cause.³⁹⁹This power and/or right given to shareholders' meeting to appoint and to dismiss managers have a positive impact in having good and effective CG practices. Further, the court has a great role in this regard by enforcing, shareholders' decisions and also by dismissing the managers in order to have good CG system in the company.

3.7.2.3 Auditors

Auditors are one of the gate keepers that are mandatorily involved in CG, and auditing by internal or external auditors has long existed in many countries' company laws.⁴⁰⁰Auditing is a cornerstone of CG, since the auditing function of auditors has an important and crucial role in assisting the other governing organs, to monitor the effectiveness of governance, to ensure transparency and accountability in the governance system of a company,⁴⁰¹etc. Because of these roles, auditors are essential organs of CG structure.

Unlike the Indian company Act,⁴⁰²and China company law,⁴⁰³which obliges every company to appoint auditor(s), the Comm.C does not oblige Plcs to appoint external auditors unless the number of shareholders are more than twenty.⁴⁰⁴As per this provision a Plc consisting of twenty or less than twenty members need not appoint auditors.

This type of optional recognition of auditors as CG organ on the basis of the number of shareholders makes Ethiopian Plcs different from other countries' CG law and practices.⁴⁰⁵And the logic behind this is not clear. Since auditors audit not the number of

³⁹⁷ Commercial code of Ethiopia, cited above at note 4, Art 526

³⁹⁸Id.,Art 527(1),(2)(4)

³⁹⁹Id., Art. 527 (1), (2)

⁴⁰⁰ Klaus J, Cited above at note 13, P.58

⁴⁰¹ Lawrence B.,et al, Sawyer's Internal Auditing: the Practice of Modern Internal Auditing, Altamonte Springs, Institute of Internal Auditors, Vol. 5, No. 1, (2013), P.49 and Dejne, cited above at note 29, P. 89

⁴⁰² Ashok, Cited above at note 77, P. 441

⁴⁰³ Company Law of the People's Republic of China, 2005, Art 165, 166

⁴⁰⁴ Commercial code of Ethiopia, cited above at note 4, Art 525 (2), and 538(1)

⁴⁰⁵Dejene, Cited above at note 26, P.91, and Negussie, Cited above at note 11, P.83

shareholders but, rather the activities of other organs of governance, and the capital and asset of the company.⁴⁰⁶This stand of the law does not go with the principles of good CG and have negative consequences in having effective CG system in Plcs. Recognizing these problems, the draft policy of the revision of the Comm.C came up with the idea that obliges Plcs to have external auditors regardless of their number of shareholders.⁴⁰⁷If it is going to be adopted, I think it will have a great impact in ensuring good CG system in these numerous companies in the country.

⁴⁰⁶Dejene, Cited above at note 26, P. 9

⁴⁰⁷የኢትዮጵያ የንግድ ማኅበራት ሕግ የፖ.ሊ.ሲ. ጉዳዮችና የማሻሻያ ሐሳቦች (መ.ጋቢ.ት 2006) , PP. 5-6

Chapter Four: The Roles and Powers of Courts in Corporate Governance and Related Issues

From the preceding discussions, one can discern that courts have powers directly or indirectly in relation to each organ of CG structure of companies. Thus, in this chapter, we discuss these roles and powers of courts in relation to each organ in the CG structure. We analyze the practices of the courts vis-a-vis the law and internationally recognized best principles of CG.

The recent corporate situations in the world highlight the importance of the continuing role of the courts in CG where self-regulation fails.⁴⁰⁸ Attracting investment requires protecting investors; investor protections in turn call for both good laws and effective enforcement of the laws.⁴⁰⁹ There are major differences among countries on the quality of laws and their enforcement as measured by the efficiency of the judiciary, (lack of) corruption, and the quality of accounting standards.⁴¹⁰

When compared to developed countries, in many developing countries neither the quality of the law nor its enforcement is adequate in protecting investors.⁴¹¹ As to law, few developing countries have an enforceable and clear concept of the fiduciary duties that control shareholders, directors, auditors and managers; and as to enforcement, few developing countries have adequate courts, judges and public enforcement agencies, and the means for shareholders to institute legal action in their own names.⁴¹² These phenomena resulted in not having effective and good CG system in many countries.

In order to have good CG system that attract domestic as well as foreign investors the CG system should protect and facilitate the exercise of shareholders' right and ensure the equitable treatment of all, including minority and foreign shareholders; and also all shareholders should have the opportunity to obtain effective and speedy redress for violation of their rights.⁴¹³

⁴⁰⁸ John H. Farrar, Corporate Governance and the Judges, Bond Law Review, Vol. 15, Article 5, P. 73

⁴⁰⁹ Ira M. Millstein, Enforcement and Corporate Governance: Three views, (2005), P.2

⁴¹⁰ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert, Investor Protection and Corporate Governance, JEL Classification, P. 6

⁴¹¹ Ira M., Cited above at note 409, P.2

⁴¹² Ibid.

⁴¹³ G20/ OECD, Cited above at note 147, P. 19

One of the ways in which shareholders may enforce their rights is by instituting legal proceedings before the court of law against managers, companies and boards and other shareholders. Courts in order to play their crucial roles in ensuring effective CG and protecting and enforcing shareholders' and creditors' rights; should be: prompt, accessible, competent and independent, and also their decisions need to be, reasonably predictable, stable and have a coherent economic rationale.⁴¹⁴

In addition to this, most research result show that having specialized courts and judges that have special knowledge and experience may also be a practical instrument to obtain timely injunctions, decisions, and ultimate facilitation of rapid settlement of disputes.⁴¹⁵

Judges of those specialized courts have been afforded the opportunity to develop expertise in business and CG related issues, and to create processes for resolving CG-related disputes more quickly and knowledgeably than judges of courts of general jurisdictions.⁴¹⁶The best examples for these are the American and EU experiences particularly that of Delaware and Dutch courts.⁴¹⁷

In India, the Indian Companies Act of 2013 under Chapter XXVIII proclaims the establishment of a special court to handle corporate cases properly.⁴¹⁸The Act provides for the constitution of the Tribunal and the qualifications of those to serve on of the Tribunal.⁴¹⁹The Tribunal has a duty of giving expeditious disposal of cases within three months. Qualifications and duties for the lower courts are also required for to the Appellate Tribunal. This kind of legislation creates a good condition for investors so that they would have trust on the courts for protection and enforcement of their rights.

When we examine the experience of Ethiopian courts, we note that there are no clear laws, nor guidelines that require having a specialized court that only handles corporate disputes. In the Federal First Instance Court and Federal High Court commercial benches are constituted but in the Federal Supreme Court there is no special bench for handling

⁴¹⁴ H.E. Norman Veasey, The Role of the Judiciary in Corporate Law, Corporate Governance and Economic Goals, (Stockholm, Sweden, 2000), P.2

⁴¹⁵ G20/ OECD, Cited above at note 147, P. 21

⁴¹⁶ Jack. B. Jacobs, The Role of Specialized Courts in Resolving Corporate Governance Disputes in US and EU: An American Judge's perspective, (Sweden, Stockholm, 2006), P. 3.

⁴¹⁷Id., PP. 2 -22

⁴¹⁸ The Indian Companies Act, 2013, Art 435

⁴¹⁹Id., Art. 408, 409

commerce related cases⁴²⁰. Moreover, there are no clear directives, nor manual on the type of cases that are to be filed in commercial benches, the assignments criteria for judges on these benches, and the time within which the benches should dispose the cases, etc⁴²¹ like in other countries. Practicing lawyers Ato Yosef and Ato Filipos,⁴²² said that though constituting specialized benches is a good beginning, it is difficult to say that there are real and effective specialized benches for company related cases in the country. A mere naming and constituting special benches is not enough, there is need to have clear and transparent laws, guidelines and the judges who occupy the benches also should have special knowledge and experience about corporate law, CG related issues, etc. These suggestions are supported also by another lawyer⁴²³ and judges⁴²⁴.

These and other factors hindered the courts in playing their crucial roles in ensuring effective CG systems.

4.1 The Role of Courts in Enforcing Rules relating to Shareholders General Meetings

As we have seen above, AGMs are laid down as the foundations of the wide CG Protection. AGM is primarily, a decision making body of shareholders⁴²⁵. Shareholders' meetings allow a large number of people to share information and make comments on the statement and report of the other organs of CG in a company. Shareholders have the rights and powers to choose and appoint members of the BoD, and auditors, approve mergers, authorize new equity issues, and amend the firm's memoranda and articles of associations. These and other rights and ultimate powers are exercised in AGMs.⁴²⁶ Among the main basic shareholders' rights, four of them such as: 1) the right to obtain relevant and material information on the corporation on a timely and regular basis;

⁴²⁰ Interview with Honorable Endeshaw Adane, Judge of Federal Supreme Court, October 20, 2016

⁴²¹ Interview with Honorable Negashe Kedane, Judge of Federal High Court and, Honorable Mehari G/Medehen Judge of Federal First Instance Court , August 12, 2016

⁴²² Interviews with Ato Yosef Aemero and Filipos Aynalem, lawyers and scholars, (phone interview), November 25, 2016

⁴²³ Interview with Ato Fekadu Petros, lawyer and scholar, (phone interview), November 28, 2016

⁴²⁴ Interview with Honorable Jugdes Mehari G/Medehen, Negashe Kedane and Endesha wAdane

⁴²⁵ A. Cahn and D. Donald, Comparative Company Law, Text and Cases on the Laws Governing Corporations in Germany, the UK and USA, (Cambridge University Press, 2011), P. 546

⁴²⁶ D.yermark, Shareholder voting and Corporate Governance, (2009), P.1

2) participate and vote in general shareholders' meetings; 3) elect and remove members of the board; and 4) share in the profits of the corporation.⁴²⁷These basic shareholders rights are exercised individually and through the CG organ of shareholders meetings. All these features make this organ the basic forum for protecting, practicing and implementing shareholders' right, especially minority shareholders' rights, and the base for good CG practices.

As we know the judiciary has an indispensable role in protecting and enforcing the rights of shareholders exercised through general meetings. By doing this, courts play their key role in ensuring effective CG.

Courts play their roles in shareholders' meetings mainly via calling and setting agenda of AGMs or Extra Ordinary General Meetings and⁴²⁸by setting aside the resolutions passed by these meetings.⁴²⁹I think the involvement and roles of courts in these matters are so important in ensuring good CG practices.

4.1.1 The Role of Courts in relation to calling and setting agenda for shareholders' general meetings

Similar to other countries' company law, such as India and France, the Comm.C gives power to courts to call and to set the agenda of general meetings.⁴³⁰The main question raised here is when would courts have judicial power to order the calling of shareholders' meetings and to set the agenda for the meetings?

The experience of other countries shows that courts are involved in the calling of meetings and set agenda for the meetings when other responsible organs have failed to perform their duties of calling general meetings. Courts' role in this respect is to fill gaps and, to enforce the law and also to protect the rights of shareholders as well as stakeholders. The involvement of courts becomes so important in ensuring good CG practices only if courts discharge their duties and plays their roles of filling the gaps, by giving timely decisions, and enforcing the laws properly, promptly and efficiently.

⁴²⁷ G20/ OECD, cited above at note 4, P. 21

⁴²⁸ Commercial code of Ethiopia, cited above at note 4, Art 391 (1),(2)

⁴²⁹Id.,Art 416 (3)

⁴³⁰Id.,Art 391 (1)

When we see the Comm.C in this regard, in principle the main organ that is given the power and entrusted with the duty to call general meetings are the Boards of Directors, Managers, Auditors, and Liquidators.⁴³¹ But when these organs fail to call the meetings on time as per the law and memoranda and articles of associations and where courts feel that it would be appropriate to call the meetings, courts may involve and give order for the calling of the meeting and may also set the agenda for the meetings by appointing court officer for it.⁴³² Since general meetings are crucial organs of CG and they have direct roles in other organs of CG, and also have roles in exercising and enforcing all shareholders' rights; in order to play these roles properly, shareholders meetings should be called and conducted as per the law and memoranda and articles of associations. Thus, courts should be involved in this issue, when those main organs are unable to perform their duties or failed to call the meetings on time and properly with the view to protect and enforce shareholders' especially that of minority shareholders' rights and to help in ensuring good CG practices.

When we see the practice of courts in relation to this issue, most of the cases brought before the courts are related to Plcs and most of the petitioners that claim that meetings were not called are minority shareholders⁴³³. The main reason for this may be the gap in the law, conditional requirement of the law, based on the numbers of shareholders, in conducting shareholders meetings and failure of managers or auditors to have intentionally or negligently failed to call meetings on time as per the law and memoranda and articles of associations. The following petitioners in their statements of claims raised these issues as the justifications for the courts to call the meetings.

For instance, in the case of *GP resource mining Plc* (two petitioners) Vs. *Mr. Gari Fufa*⁴³⁴; *Mr. Kahesay Berhe* (three petitioners) Vs. *Katiso Leather and Plastic Shoe Industry Plc* (eight respondents)⁴³⁵; *Mr. Yonas Duguma* (five petitioners) Vs. *Zemeli Painting Industry Plc* (three respondents)⁴³⁶; *W/ro Tseyon Berhane Araya Vs. Rok*

⁴³¹Id., Art 391 (1), 377, 532 (2)

⁴³²Id., Art 391 (1)

⁴³³ Data collected from Federal First Instance Court Data Base

⁴³⁴ Federal First Instance Court File No. 222649

⁴³⁵ Federal First Instance Court File No. 211963

⁴³⁶ Federal First Instance Court File No. 190363

business PLC (three respondents)⁴³⁷; *W/ro Azeb Kahesay* (two petitioners) Vs. *Green view consulting Plc*)⁴³⁸; *W/ro Mariam Yesuf Vs. Mr. Tarekegn Sabet*⁴³⁹, and in other examined cases, the petitioners of each of the cases were shareholders of the companies and brought their suits before the courts of law by praying the courts to enforce and protect their shareholders' rights; avoid mismanagement and oppressive activities; and to order the calling general meetings. The most common reasons raised by the petitioners for their claims are that: managers did not perform their duties as per the law, did not call meetings on time as per the law, memoranda and articles of associations, the companies did not distribute dividend, the companies didn't appoint auditors, the companies did not have their books audited, financial statements and other documents are not given to shareholders and the managers were not willing to give and to let shareholders inspect the documents, abuse of powers by managers in using of the assets of the companies for their own personal benefits of managers' overstay in power and their failure to call general meetings lest they be replaced, etc.

The respondents in each case denied the claims and argued for the dismissal of the grounds of the claims of the petitioners. The main defenses raised in the statements of defense are that: the companies are managed properly by the managers; they did call and conduct general meetings and did perform their duties as per the law, memoranda and articles of associations; the court does not have power to call meetings, and to appoint auditors and to intervene in the management of companies; the members of the companies are below twenty and hence they are not obliged by the law to call general meetings or to appoint auditors; the petitioners are not prohibited to inspect documents; etc.

When we critically consider these cases, most of the reasons raised by the petitioners for their claims and the arguments raised by the respondents in their defenses are directly related to good CG practices and the enforcement or protection of shareholders' rights; particularly minority shareholders' rights. So, if courts entertain the issues as per the law and give expeditious decisions on the issues they would have great impact in protecting

⁴³⁷ Federal First Instance Court File No. 211314

⁴³⁸ Federal First Instance Court File No. 212429

⁴³⁹ Federal First Instance Court File No. 215536

and enforcing all the shareholders' rights and in ensuring good CG practice in the companies.

The court after hearing testimony of the witnesses and considering other evidences and, after examining those proven facts against the law, the memoranda and articles of associations, gave its decisions in all of the cases listed above to call the general meetings. In its ruling, the court also set the agenda for the meetings and the time limit within which the meetings should be called. But the time limit within which meetings may be called is not the same in all of the decisions and also the agenda is not set in all the decisions. The court gave its decisions after checking that the meetings were not called and conducted on time, and there is mismanagement and abuse of power by the manager/s. Thus, these court decisions helped the companies to have good CG practices.

The courts, to play their crucial roles properly and effectively, have to give predictable decisions on similar issues and to dispose of cases in an expeditious way depending on the sensitivity of the cases. However, court decisions lack this quality.

Suits on the calling of general meetings are also brought before courts of law in relation to Share companies. For instance, in the case of *Mr. Kebede Debele*, (twenty petitioners) Vs *Mr. Tekele Behabitu* (six respondents)⁴⁴⁰, the petitioners were shareholders of *Yekolfe 288 Yeshurabe Negadewoch S.co* and the respondents were board members of the company.

One of the petitioners' requests in the suit was to secure an order of the court for the calling of a general meeting and to set agenda for the meeting. The reasons raised by the petitioners for this request is that the respondents failed to call general meetings, and to appoint auditor and to replace board members that have left the board. The respondents challenged the claims by arguing that the petitioners did not have shares that enable them to request the calling of a general meeting.

The court, by hearing the testimony of witnesses and considering other pieces of evidence found out that the respondents did not conduct a general meeting and the company's books of account were audited by external auditors. The court, accordingly reasoned that general meetings should be called through the order of the court when the respondents did fail to discharge their duty of calling general meeting or the general meeting was not

⁴⁴⁰ Federal First Instance Court File No. 192127

called on time as per the law, memorandum and articles of association of the company. The court ruled that no new AGM may be called. The court reasoned that giving an order for the calling of another meeting would entail bad management and bad CG practices.

In *Saba Plc (six petitioners) Vs Giz'e Meri marketing S.co and Mr. Befekadu Bekele (seven interveners)*⁴⁴¹, the petitioners claim was that the respondent company BoD (interveners) period of office had expired but no general meeting was called to appoint other BoD members in replacement. They petitioned the court to give order for the calling of an AGM with the view to appoint new board members. The respondents as well as the interveners opposed the petition of the petitioners by arguing that the period within which the BoD had to call the AGM did not lapse. So, they argued the court does not have the power to call a general meeting.

The court, after hearing the witnesses and examining the evidence submitted, found out that according to articles of association of the company the board of directors may call a general meeting with six months of the expiry of its period of office, and this time did not lapse when the suit was brought before the court of law. The court reasoned that it could not rule that the board of directors failed or were not willing to call a general meeting. Based on these grounds the court dismissed the suit of the petitioners.

From this case and court decision we can perceive that those issues raised by both parties are a crucial issue in CG. So, handling these issues properly and giving decisions based on the law and principles of good CG would have a great role in enabling courts play their roles in ensuring good and effective CG system in companies in Ethiopia.

Even though most of the above-mentioned decisions were rendered by the writer of this paper, those court decisions show that courts have crucial roles to play in ensuring good CG.

4.1.2 The Role of Courts in setting aside resolutions of Shareholders' General Meetings

The other power given by the law that enables courts to intervene in CG is to set aside the resolutions of general meetings.⁴⁴² The main questions raised in relation to this issue are:

⁴⁴¹ Federal First Instance Court File No. 186026

⁴⁴² Commercial code of Ethiopia, cited above at note 4, Art 416 (2)

when would the courts claim to have power to be set aside resolutions of AGM? On what ground should resolutions set aside by courts?

As we discussed in chapter three, shareholders' general meetings are crucial organs and have important and multidimensional roles in having good and effective CG system. In order to play their roles properly and effectively and their resolutions bind all shareholders as well as stakeholders, the meetings should be called and conducted as per the law, and memoranda and articles of associations. The law stipulates the means of calling, giving notices of callings, quorum needed to conduct each type of general meeting and also the business or agenda for each type of meeting. In addition to the procedures and requirements mentioned in the law, additional procedures and requirements may be stipulated in the articles of associations to enable shareholders use their rights easily and effectively. Meetings should be called and conducted by fulfilling all the procedures and requirements mentioned in the law as well as in memoranda and articles of associations to enable General meetings play their crucial roles and to pass binding resolutions.

Thus, courts are involved in setting aside the resolutions of general meetings when such meetings were called, conducted and resolutions passed contrary to the law, memoranda and articles of associations, and if any interested party, i.e. any shareholder or stakeholder, submits an application to the court to set aside the resolutions within three months from the date the resolution was passed or entered in commercial registry.⁴⁴³

The involvement and power of the court in setting aside resolution has great importance to protect shareholders rights particularly that of minority shareholders, and stakeholders' interest, to improve mismanagement or unlawful management practices and to ensure good CG system in a company. On the other hand, if the court simply and at any time sets aside resolutions, this may result in bad CG practices and also may result in a company's being at risk or go into to bankruptcy or to dissolution. So, the court, in order to play its crucial role in ensuring good CG, should take due care and base its decisions on the law, memo and articles of associations and principles of good CG.

Regarding the question of what grounds are to be taken by courts as "*good causes or sufficient causes*" to set aside resolutions? The law is not, clear on this issue. It is

⁴⁴³Id., Art 416 (2) and (3)

stipulated in a general manner. This shows that the tasks of weighing or evaluating the grounds to be taken as “good cause” are left to the discretion of courts. Thus, in order to know which grounds may be taken as good cause by the court to set aside resolutions examining the practices of courts would be good.

For instance in the cases of: *Beakelil Reba shemane Yebeteseb Yelemat ena mote meredaja edir Vs. Nib International bank S.co*⁴⁴⁴; *Alemi Export and Whole Sale Business Plc Vs. Sedamo Tera Building Work Plc*⁴⁴⁵; *Ayat S.co (ten petitioners) Vs. Giz’e Meri Marketing S.co (five respondents)*⁴⁴⁶; *W/ro Serkalem Abebe Vs. S.A. Construction Plc (three respondents)*⁴⁴⁷.

In all the above-listed cases, one of the remedies that the petitioners requested from the court of law was the setting aside of the resolutions of the shareholders’ general meetings. The most common grounds raised by the petitioners for their petition to have the resolutions set aside were: the way the meetings were called was not in line with the provisions of the law, memoranda and articles of associations of the companies. The petitioners stated that the calling notice was not issued on time; voting was not made according to the law; we were not allowed to give opinions; our voting rights were not respected; the agenda mentioned in the newspaper in which the calling notice was given was not identical with the agenda announced at the time of the meetings; minutes were not read out to the shareholders at the end of the meetings; etc.

The respondents in each of the cases denied all the allegations made by the petitioners submitting argument that the notice of calling was made as per the law, memoranda and articles of associations, all the shareholders were called to attend the meetings through mails, SMS messages, through phone calls and newspaper notifications. The petitioners being called to attend in this manner, voting was carried out as per the law. The petitioners’ voting rights were not curtailed the resolutions were passed as per the law, memoranda and articles of associations, etc.

The court, in each case, by hearing the testimonies of witnesses and weighing other evidences submitted by both parties discovered that the ways of calling of the meetings,

⁴⁴⁴ Federal First Instance Court File No. 223199

⁴⁴⁵ Federal First Instance Court File No. 205395

⁴⁴⁶ Federal First Instance Court File No. 192148

⁴⁴⁷ Federal First Instance Court File No. 213313

giving of notices, the manner in which the meetings were conducted, the way votings were made, the business transacted at the meetings, the quorum of the meetings, and the voting rights of petitioners were respected as per the law, memoranda and articles of associations. The court, in its decisions reasoned that, the resolutions passed by the general meeting could not be set aside simply because the shareholders (petitioners) requested for that in their statements of claims brought before the court. Instead, the court reasoned, resolutions may be set aside by courts when meetings were conducted or the resolutions passed without fulfilling the basic requirements that should be fulfilled to conduct meetings and pass valid and binding resolutions as mentioned in the law, memoranda and articles of associations. The basic requirements are: the presence of the required numbers of members (quorum) set by the law based on the agenda; the business to be transacted in the meetings based on the type of the meeting to be conducted; the calling of the meetings, giving of notice to all shareholders as per the law, memoranda and articles of associations, and the right of participation in meeting and voting rights of all shareholders should be respected. The court, stated in its decisions that since the meetings were called and conducted by fulfilling the above-mentioned basic requirements, there was no good cause to set aside the resolutions. Thus the court ruled that the challenged resolutions should not be set aside.

In *Mr. Erimias Abate (three petitioners) Vs. Civil Works Consultancy Engineers PLC (four respondents)*⁴⁴⁸, the petitioners brought suit before the court of law by praying that the court should set aside the general meeting held together with its resolutions passed on Hedar 27, 2007 E.C. The reason for the petitioners request was that the 2nd, 3rd, and 4th respondents attended and voted on the agenda which rendered in conflicts of interests in contravention of the law. The respondents challenged the suit of the petitioners by arguing that: the petitioners attended and voted on the agenda of the meeting and they did not raise the issue of conflict of interests at that time; the 2nd, 3rd, and 4th respondents are the shareholders of the 1st respondent company and they have the right to attend the meeting and cast their votes; and that there is no issue of conflict of interest and the resolution was passed with majority vote.

⁴⁴⁸ Federal First Instance Court File No. 224149

The court after the oral presentations of the cases on each side and weighing evidences of both parties found that the 2nd and 3rd respondents were the manager and the vice-manager of the first respondent company, respectively; all shareholders did attend the meeting; and the petitioners voted against the motions of the resolutions; the resolutions were passed by majority vote; the agenda discussed were: 1) revising the salary of managers and those shareholders who work in the company, and 2) the measures to be taken on the business of the company in relation to production of small rocks (*gara'gante*) and in what way this business is conducted; and in both agenda items the 2nd and 3rd respondents attended the discussions and also voted in favor of the resolutions. After finding out of these facts, the court reasoned that even though all shareholders have the right to attend meetings and vote, this right may be restricted when there is conflict of interest on an agenda item as per Art 388 (1) and 409 (1) of the Comm.C. Thus the meeting conducted and the resolution passed by violating this restriction laid down by the law should be set aside. These grounds were taken as sufficient cause to set aside the resolution as per Art 409 (1), (2), and 416 (2) of the Comm.C. The court decided that the resolution that was passed to increase the salaries of the managers and workers of the company was conducted with the participation and voting of the 2nd and 3rd respondents and that the interests of the respondents as managers of the company conflict with the interests of the company and the other shareholders. Accordingly the court ruled that the resolution should be set aside.

On the other hand, the resolution that was passed on the agenda of the measures that would be taken in relation to the business of the company, i.e., in relation to production of *gara'gante* was conducted as per the law, memorandum and articles of association, and there was no good cause to set aside this resolution. Thus the court ruled that the resolution should not be set aside.

In the cases of, *Ye'amanuel Tsega S.co shareholders (twenty one petitioners) Vs Ye Amanuel Tsega Yekatama neged sukoche lemat S.co*⁴⁴⁹; *W/ro Mulu Worku Vs Mr. Hussen Alo (four respondents)*⁴⁵⁰, the petitioners in both cases petitioned the court to set aside AGM resolutions on the ground that notice of calling was not duly given; the resolutions

⁴⁴⁹ Federal First Instance Court File No. 222725

⁴⁵⁰ Federal First Instance Court File No 185811

were passed without fulfilling the quorum requirement; and that the registration of the resolutions was done contrary to the law. The respondents denied all the allegations of the petitioners arguing that the meetings were called and conducted, and the resolutions were passed in accordance with the law, memoranda and articles of associations. Thus there was no ground to set aside the resolutions and the suits should be struck out.

The court, after hearing the testimonies of witnesses and weighing other evidences of the parties noted that the notices of calling were not given to the petitioners and also the meetings were conducted and the resolutions passed without fulfilling quorum requirements and the registration of the resolution was made contrary to the law. Thus the court reasoned that those grounds are sufficient grounds to set aside the resolutions. Since these requirements are the basic requirements that should be fulfilled to conduct AGM meetings and to pass resolutions that would bind all shareholders and stakeholders. Then, the court ruled that the resolution should be set aside.

In the case between *W/ro Mulu Worku vs Mr. Hussen Alo (four respondents)* respondents appealed to the Federal High Court⁴⁵¹ but the Federal High Court dismissed their appeal. Then the respondent submitted a petition to the Federal Supreme Court Cassation Division.⁴⁵²The Cassation Bench, after examining the petition and reply of the petitioners gave its decision on Tikemet 18, 2006 E.C by confirming the first instance court's decision..

All in all, from the above-mentioned courts cases we may understand that courts set aside AGM resolutions when there are good or sufficient causes to set aside the resolutions. The grounds are: basic requirements that should be fulfilled to conduct the meetings and to pass binding decisions, such as proper giving of notices of calling, voting rights, quorum, the agenda of the meetings, and conflict of interests. These requirements have to be fulfilled and respected on the basis of the law, memoranda and articles of associations to conduct meetings and pass resolutions. Not fulfilling these requirements may be taken as good cause to set aside resolutions.

⁴⁵¹ Federal High Court File No. 118093

⁴⁵² Federal Supreme Court Cassation Division File No. 88915

Court interpretations that are compatible with the law and principles of good CG would play a great role in protecting shareholders' especially minority shareholders' and stakeholders' rights and interests and also in ensuring good CG system.

The other contested and debatable issue in relation to shareholders' meetings that deserves to be dealt with here is the issue of 'period of limitation' to challenge the resolutions before courts of law. This debatable issue is whether or not the suit to have resolutions of general meetings set aside is to be barred by the period of limitation mentioned under Art 416(2) of the Comm.C or the period stated in Art 1845 of the Civil Code?

The law provides for rights and also the time limit within which the rights may be exercised. The Comm.C under Art 416(2) stipulates the time limit within which resolutions may be set aside before a court of law. Per the provisions of Art 416(2) of the Comm. C any interested party may petition for the setting aside of resolutions. The petitioner should submit his/her application before the court of law within three months from the date the resolution was passed or was registered in the commercial register. Otherwise, the suit may be barred by the period of limitation stated in Art 416(2).

Some of the main reasons why the law stipulates short period of limitation depend on the sensitivity of the issues; the effect of the resolutions; and the consequences that result from the setting aside of the resolutions after the expiry of the time limit. That means because of its consequences, once a resolution is passed by a general meeting of shareholders of the company starts to implement it, conduct its business accordingly, enter into contacts, perform its duties under the resolutions to shareholders and stakeholders, etc. Thus if the resolutions are set aside after their execution or implementation the setting aside would affect the whole business of the company, the rights or interests of the shareholders and stakeholders, and may result in mismanagement and bad CG practices and these may lead the company to a dissolution or bankruptcy. This tells us that the issues surrounding AGMs and their resolutions are very crucial and sensitive and if it is not entertained properly as per the law, it will bring far-reaching harsh consequences not only on the governance of companies but also in their very existence.

On the basis of this argument, let us see the practice of courts on these contestable issues: for instance in the case of *Mr. Leuel Seged Mojo Vs Andenet oil and spices traders S.co (two respondents)*⁴⁵³, the petitioner filed a suit before the Federal First Instance Court on Genbot 15, 2005 E.C. One of his requests was to have the resolutions of the general meeting of shareholders which was conducted on Mizia 24, 1998 E.C set aside. The reasons mentioned in his statement of claim to have the resolutions set aside was “my mother was a shareholder of the company and she passed away in Tahesas 1997 E.C. My late mother was considered as present and voting at the meeting and furthermore, as if she did sign on the documents of the resolutions. By virtue of the unlawful resolution her shares were transferred to the 2nd respondent and it was reported as if she sold her shares to the 2nd respondent”.

The respondents in their statement of defense raised period of limitation as preliminary objection arguing that the petitioner’s claim of setting aside the resolution was barred by the three months period of limitation stated under Art 416(2) of the Comm.C

The court, after hearing the parties and weighing their evidence, ruled that request of the petitioner to have the resolutions set aside was barred by the three months period of limitation pursuant to Art 416(2) of the Com. co. As the petitioner brought a suit before the court of law seven years after the resolution was passed and entered in the commercial register.

The petitioner, appealed to the Federal High Court⁴⁵⁴, but the appellate court rejected his appeal. Then he submitted a petition to the Cassation Division of the Federal Supreme Court⁴⁵⁵ contending that Art 416 (2) is not applicable to the issues in the case and instead the appropriate applicable provisions to the case is Art 1845 of the Civ.C and that his claim should not be barred by three months period of limitation. The petitioner thus, pleaded that the lower courts did commit a substantial error of law by applying Art 416(2).

The Cassation Division gave its ruling Hamle 3, 2007 E.C stating that the period of limitation applicable to this claim is the 10 years period of limitation stipulated under Art 1845 of the Civil Code and not the three month period of limitation under Art 416 (2) of

⁴⁵³ Federal First Instance Court File No. 205328

⁴⁵⁴ Federal High court File No. 150124

⁴⁵⁵ Federal Supreme Court Cassation Division File No. 100621

the Comm.C. The reasons mentioned by the Cassation Bench for this decision were that the petitioner's request to have the resolution set aside, that transferred the shares of his deceased mother that was made by preparing falsified minutes. Thus, this kind of claim does not fall under Art 416 (3) of the Comm.C.

In another case, *Mr. Seronsongo Wolechefo Vs. Addis Mela Plc*⁴⁵⁶, the petitioner filed a suit before the Federal First Instance Court by alleging that the resolution that was passed to revoke my membership of the company is unlawful and without any fault and the resolution that was passed that I should pay additional payment to the company distinct from other shareholders is outside of the law, the memo and articles of association and it should be set aside.

The respondent raised preliminary objections in their statement of defense. One of the objections was that the petition to have the resolution set aside was not brought within three months. So, the respondent's argued the claim is barred by period of limitation.

The court, examining the request of the petitioner and the preliminary objection of the respondent against the relevant provisions of the Comm.C gave a ruling on Tire 27, 2005 E.C. It reasoned that the request of the petitioner was entirely based on challenging the resolution of an extra-ordinary general meeting which was conducted on Nehase 10, 2002 E.C. The petitioner filed a suit before the court of law to challenge the resolution of the meeting on Tahesas 17, 2005 E.C which was long after the lapse of three months time limit set under Art 416 (2) of the Comm.C. The court held that the request of the petitioner was barred by three months period of limitation as per Art 416(2) of the Comm.C.

The petitioner, by opposing the court's decision appealed to the Federal High Court.⁴⁵⁷The appellate court, after hearing the appeal, gave decision on Genbot 7, 2005 E.C by reversing the First Instance Court's decision reasoning that at the time when the resolution was passed the petitioner was not a member of the company, thus the period of limitation should be calculated on the basis of Art 1845 of the Civ.C and not Art 416 (2) of the Comm.C.

⁴⁵⁶ Federal First Instance Court File No. 200525

⁴⁵⁷ Federal High Court File No. 131922

The respondent by challenging the appellate court's decision appealed to the Supreme Court.⁴⁵⁸ The Supreme Court, after examining both parties' arguments gave decision on Tahesas 25, 2006 E.C reversing the High Court decision and confirming the First Instance Court decision. It gave this decision by reasoning that the application to set aside the resolution of the company by the order of the court should be made within three months from the date of the resolution passed or date of registration as per Art 416 (2) but not within ten years as per Art 1845 of the Civ.C, since Art 1845 is not applicable to issues of company resolutions.

The petitioner, by opposing the Supreme Court's decision submitted a petition to the Cassation Division of the Supreme Court⁴⁵⁹. Contending that the period of limitation applicable to his claim is Art 1845 of the Civ.C and not Art 416 (2) of the Comm.C.

The Cassation Bench framed the issue of "which provision is applicable to the debatable issues of the case, is it Art 416 (2) or Art 1845? Then, after examining the case, it gave a decision on Meskerm 24, 2008 E.C by holding that the period of limitation that should be applied to this claim is the ten years period as provided for in Art 1845 of the Civ. C.

The reasons stated by the Court for passing this binding decision were: the three months period of limitation stated under Art. 416 (2) of the Comm.C is stipulated by considering those shareholders and members that would know the resolution of a company easily. The petitioner's claim was that the additional payment resolution that passed as regards me distinct from other shareholders was against the principle of equality and the dismissal resolution was also unlawful. The period of limitation for these claims should not be interpreted narrowly. As the petitioner claims were to have unlawful activities or resolution annulled, this claim should not be governed by Art 416 (2) of the Comm.C.

When we critically examine the above-mentioned decisions of the Cassation Division based on the above-mentioned illustration of the law and principle of good CG, the writer would like to argue that those binding decisions were contradict with the Comm.C and the principle of CG.

First of all, provisions of the Comm.C are applicable to those company related matters that are covered by the Comm.C. mentionable are, companies' incorporation, company

⁴⁵⁸ Federal Supreme Court File No. 91786

⁴⁵⁹ Federal Supreme Court Cassation Division File No. 97629

governance, dissolution, shareholders rights, etc.⁴⁶⁰ Civil Code provisions are applied to commercial matters exceptionally, when the Comm.C does not have provision to govern a debatable issue i.e. the Civil Code provisions are applied for company related issues only if the Comm.C does not encompass provision/s to resolve those issues⁴⁶¹. If there is no gap in the Comm. C to resolve company related issues, those issues may be resolved based on the Comm.C since the two Codes were legislated by the legislator for different purposes and matters and the policies behind the two laws are also different. The first and front organ that has the power and duty to interpret and apply the laws based on the intentions of the legislator and the policies behind the laws is the judiciary. The judiciary has a legal duty to decide cases based on the law and the law only. This duty and mandate of the courts was applicable at all levels of courts including the Cassation Division of the Federal Supreme Court.

Resolutions of general meetings of shareholders are the crucial and the supreme organ in the CG structure of companies of Ethiopia. So all issues that arise in relation to this governance organ should be governed and decided based on the Comm.C and the principle of CG in order to have good CG practices in the country. The Comm.C has provisions that enable us to resolve the issues relating to setting aside of resolutions under Art 416 of the Comm.C. So, these petitions should be decided based on these provisions. As we discussed earlier, the setting aside petition may be submitted by any interested party before the court of law as per Art 416 (2) of the Comm.C. Thus, to the petition to have resolution set aside Art 1845 of the Civ.C could not be applicable. But the cassation division by ignoring this clear law gave the above-reported decisions.

The reasons raised by the cassation bench to give those decisions are: Art. 416 (2) is applicable to members of a company that may easily know the fact that the meeting was conducted and the resolutions passed. As the petitioners request was focused on opposing unlawful activities and resolutions of the company, the period of limitation applicable in this scenario is Art. 1845. When we critically see these reasons of the Cassation Division based on the facts of the case and the law they were not consonant with the law. Because of the following reasons:

⁴⁶⁰ Commercial code of Ethiopia, cited above at note 4, Art 1

⁴⁶¹ Ibid.

First of all, in the above noted case the petitioner's request were entirely based on the resolutions of the general meeting. These were undeniable and were proven facts. That means the petitioner's requests were to have the resolutions of the general meeting set aside. This kind of petition may be submitted by "any interested party" as per Art 416(2) of the Amharic version of the Comm.C. This implies that the right to petition is not only given to shareholders as the Cassation reasoned out but to any person that may have interest in that resolution.

Thus, members or non-members that desire to challenge resolutions should submit their petitions within the time limit put under Art 416 (2) of the Comm.C. This shows that, the reason mentioned by the Cassation Division and its final ruling deviates from this provision.

It is obvious that general meetings have the power to pass resolutions that bind all members whether or not he/she attended the meetings. The resolutions give rise to rights and duties affecting the company, shareholders, creditors, and other governance organs of the company. In addition to this, if the petitioner or somebody else believed that unlawful activities were performed and done, and by this activities or resolutions someone unlawfully enriched, he may claim damages as per the relevant law. Thus, in the writer's opinion this may not be taken as a sufficient ground to set aside the resolution after the three months period of limitation has elapsed as the Cassation Bench argued.

All these tell us the reasons raised by the Cassation Bench were contrary to the law and principles of good CG. These decisions of the Cassation Division have a negative impact and consequences on the CG system of companies as well as the country. Because these kinds of decisions make companies not to be managed and administered properly as per the law and its constitution, not to conduct or perform its business in a stable manner and to assume unnecessary risks, failure and mismanagement practices. This in turn affects the rights and interests of all shareholders as well as stakeholders. Thus, to avoid the consequences of bad CG, the Cassation Division has to reconsider this and should revise these decisions.

In addition to these inconsistent interpretation and decisions most of the decisions shows that the court passed its decisions on this sensitive CG related issues after another AGM was conducted. This means there is a clear delay and the decisions were delivered after

the next AGM conducted. All these reveal that the court is not properly playing its crucial role in ensuring good CG in the country.

The other role of the courts that need to be discussed in relation to the sub-topic under consideration is the role of courts in enforcing shareholders' particularly minority shareholders' right to information.

As we discussed earlier, shareholders have the right to get information and documents in order to know and challenge, the financial status of companies, the activities and business transactions that are conducted by other governance organs of companies.⁴⁶² Appropriate enforcement of this inherent membership right of shareholders is not only very important to the shareholders it would also have a great contribution in ensuring transparency and accountability, which is the third principle of CG under OECD. This in turn makes a great contribution towards ensuring effective CG practices.⁴⁶³

In Ethiopia, there are many court cases regarding this issue of CG. For instance, in the cases of *Mr. Se'are Amede mariam (three petitioners Vs. Pos land software development Plc (two respondents)*⁴⁶⁴, *Mr. Yonas Duguma (five petitioners) Vs. Zemili Paint Industry Plc (three respondents)*⁴⁶⁵, *Mr. Ahim Martian Vs. Medroc Foundation Specialist Plc*,⁴⁶⁶ one of the remedies that the petitioners sought from the court was to secure an order to inspect the documents of the company and to get their copies; stating that the managers denied them the right to see the documents and to get copies of them.

The respondents denied the allegations made by the petitioners and argued that the petitioners did not ask the managers to let them inspect the documents, and that the petitioners were not restricted. They also argued that the petitioners knew of the documents and had copies of the financial report.

The court, in relation to all the cases gave its decisions in favor of the petitioners reasoning that the petitioners did have the right to know the activities and transactions of the companies, the financial situation in which the companies were and their income and expenses'. The court ruled that the company should allow the petitioners to see the

⁴⁶²Id.,Art 406(1)

⁴⁶³ Klaus J, Cited above at note 13, P. 47.

⁴⁶⁴ Federal First Instance Court File No. 201344

⁴⁶⁵ Federal First Instance Court File No. 190363

⁴⁶⁶ Federal First Instance Court File No. 211325

financial statement, the reports, the business transactions, receipts, and other documents and to get copies of those documents.

These decisions of the court tell us that the court, by enforcing the right to information of shareholders played its crucial role in enforcing good CG practice in the companies.

4.2 The Role of Courts in Appointing and Removing Directors

The BoD is the other organ which is in charge of the governance of S.cos and is generally the only body authorized to act on a company's behalf.⁴⁶⁷ BoDs are the souls of companies that set their strategic, directions for the companies' business and also oversee the proper implementation of the strategy. BoDs have the power to deal with all issues relevant to effective implementation of management of companies and decide on all matters related thereto.⁴⁶⁸The Comm.C recognizes, the BoD as the central governing organ and a body shouldering full responsibilities to lead Share Companies.⁴⁶⁹

As we discussed in chapter three, these and other roles and powers of BoDs in the governance of companies make it a central organ with crucial importance in implementing good CG. For BoDs, to play properly their roles, the board members' appointment system and criteria should be transparent and clear, the elected directors need to be qualified and competent enough to perform their duties and also appointed board members should perform their duties with due care and diligence. Thus, the appropriate involvement of courts in accordance with the law with respect to the appointment and removal of board members has great contribution and role in ensuring good CG system.

4.2.1 The Role of Courts in Appointing Directors

In many jurisdictions, BoDs are appointed by AGM of shareholders. For instance in public limited companies of France, board members are appointed by the general

⁴⁶⁷Dejene, cited above at note 26, p. 55

⁴⁶⁸ Ibid. and The French Commercial code, Article L. 225 -35

⁴⁶⁹ The Commercial code, Art 347

meetings of shareholders.⁴⁷⁰If there is a vacancy due to death or resignation of one or more directors after the constitution of BoDs the remaining board members may make appointments on provisional basis up to the next AGM⁴⁷¹.If the remaining board members have fallen below the legal minimum, three directors, the remaining director must immediately convene the routine shareholder's meeting in order to appoint board members to fill the vacancy.⁴⁷²If the remaining BoDs members fail to do these, any interested party has a right to apply to the court to obtain permission to convene a general meeting of shareholders to make new appointments or to confirm the provisional appointments made by the remaining directors.⁴⁷³

This shows that in France there is an involvement of the court in the appointment of BoD but its involvement is an indirect way. That means courts have no direct role to appoint members of BoDs by themselves.

In some countries having two tiered board system like Germany, the management board (*Vorstand*), in principle, are appointed by the supervisory board (*Aufsichtsrat*).⁴⁷⁴The management board is autonomous from the shareholders and the shareholders also have no role and power in appointing this board. However, any interested party including shareholders may submit a petition to the courts of law to have management board appointed in urgent cases.⁴⁷⁵This shows that in Germany courts have direct power and role in the appointment of management boards to avoid mismanagement and to protect shareholders as well as stakeholders' rights and interests.

Supervisory boards, which are crucial organs in companies' governance that represent shareholders as well as stakeholders, are appointed by shareholders' general meetings.⁴⁷⁶

Under the Comm.C of Ethiopia, the power of appointing board members is solely given to the shareholders exercised through general meetings.⁴⁷⁷If after their appointments one or more board members left their offices, the existing directors may appoint other

⁴⁷⁰ The French Commercial code, Art L225 -18

⁴⁷¹ Ibid.

⁴⁷²Id., paragraph 1

⁴⁷³Id., Paragraph 4

⁴⁷⁴Assefa, Cited above at note 37, p. 12

⁴⁷⁵Id., p.13

⁴⁷⁶Id., pp. 17-18

⁴⁷⁷ Commercial code of Ethiopia, cited above at note 4, Art 321 (4) and 350

directors on a provisional basis until the next AGM.⁴⁷⁸ Shareholders' AGMs have the discretionary power to confirm the temporary appointments made by the existing directors or to appoint other directors.⁴⁷⁹ If the members of the existing directors is less than half of the total number of board members set in memorandum of association, they should call general meetings for the appointment of directors;⁴⁸⁰ if there is no surviving director, to do this, auditors have the duty to convene shareholders' general meetings.⁴⁸¹ The question deserving to be raised here is, who would call the meetings if auditors fail to call them, or if companies did not appoint auditors?.

When we see the practice in courts regarding this issue: for instance, in the case of *Mr. Kedir Ali (42 petitioners) Vs. The Board Members of Mesalemiya Area Traders Unity S.co Mr. Haile Sereni (11 respondents)*; ⁴⁸²*Ayat S.co (10 petitioners) Vs. Gezi Meri marketing S.co (five respondents)*⁴⁸³, one of the petitioners requests in both cases is the calling of a general meeting to appoint board members. The court gave decisions on the issues' by taking into consideration that the court has material jurisdiction to decide the issue i.e. to call general meetings in order to pass resolutions on the appointments of board members.

These and other court cases show that even though the law is silent on the role of courts in the appointment of board members, in practice, courts are involved in appointing board members when those organs that are given the power to call the meetings under Art 351 have failed to discharge their duties. This involvement and role of courts in the appointments of BoDs seems in Ethiopia court's has an indirect role in appointment of directors by ordering calling of meeting and setting agenda of it. That means, courts do not have direct power to choose and to appoint board members in Ethiopia.

The argument that the power of courts to appoint BoDs members is indirect is consonant with the law since by virtue of Art. 391 (1) courts are given power to call general meetings when those organ that are empowered to convene the meetings fail to do so. Thus, if existing board members or auditors failed to call general meeting in order to have

⁴⁷⁸Id.,Art 351 (1)

⁴⁷⁹Id.,Art 351 (2)

⁴⁸⁰Id.,Art 351 (3)

⁴⁸¹Id.,Art 351 (4)

⁴⁸² Federal First Instance Court File No. 232226

⁴⁸³ Federal First Instance Court File No. 192148

board members appointed, any interested party may submit a petition to a court to have an order given to call a general meeting to have board members appointed. By doing this, the court plays a crucial role in safeguarding shareholders' as well as stakeholders' rights and protecting their interests and also in ensuring good CG.

4.2.2 The Role of Courts in Removing Directors

Those persons (natural or juridical) who are appointed as board members by shareholders' general meetings may act as members of BoDs until the expiry of their terms of office. However, board members may be removed from their board membership before the expiry of their terms of office.⁴⁸⁴ The question that has to be raised here is who is empowered to remove directors? And for what reasons are directors removed from their offices?

Under companies Act of India, a director may be removed from his office before the expiry of his period of office by three organs.⁴⁸⁵ These are: the AGM,⁴⁸⁶ the Central Government⁴⁸⁷, and the Company Law Board.⁴⁸⁸ A director is removed by those organs to avoid mismanagement, oppression of the shareholders, to avoid fraud, misfeasance, and negligence.⁴⁸⁹ If a director is removed by the AGM without fault, he/she has the right to claim compensation.⁴⁹⁰ If he/she is removed due to his/her fraud, negligence, etc such director shall not be entitled to claim compensation for loss of his office.⁴⁹¹

In Germany, a supervisory board has the power to dismiss a management board for "good cause".⁴⁹² Good cause constitutes a gross breach of duties, inability to run the company or a vote of no confidence by the shareholders.⁴⁹³

Supervisory Boards which are appointed by the AGM may be dismissed by three fourth of majority vote at general meetings of shareholders.⁴⁹⁴ The court also has power to

⁴⁸⁴Id., Art 354

⁴⁸⁵ Ashok, Cited above at note 77, P. 278

⁴⁸⁶Id., P. 279

⁴⁸⁷Ibid.

⁴⁸⁸Id., P.281

⁴⁸⁹Id., P. 283

⁴⁹⁰Ibid.

⁴⁹¹Ibid.

⁴⁹²Assefa, Cited above at note 37, p. 12

⁴⁹³Ibid.

⁴⁹⁴Id., p. 18

dismiss members of Supervisory Boards on “good cause” at the request of one or more Supervisory Board members.⁴⁹⁵

The above-noted show that in India and Germany CG systems, the court has a direct role and power in dismissing board members before the expiry of their terms of office.

Per Art 354 of the Comm.C, a board member may be removed at any time before the expiry of their period of office by the general meeting. According to this provision, the general meeting has the power to dismiss director(s) notwithstanding any contrary provision stipulated in the memoranda and articles of associations on the removal of directors. From this provision we can understand that, the AGM has the power to remove director(s) with or without good cause. This power of the AGM reveals that the shareholders meetings have decisive power in the management of companies. Even though the law did not mention what constitutes “good cause”, the directors who are removed from their office without good cause have the right to claim compensation before the court of law.

This stand of the law shows that the power of removing board members is given to AGMs. The court has power and role in this issue of CG only to award compensation to the director(s) who are removed by the AGM without good cause. That means under the Comm.C of Ethiopia, the court has power neither to remove board member directly nor to reinstate board members who are removed without good cause by the resolution of AGMs.

The intriguing issue that needs to be dealt with here is what constitutes “good cause” to award or not to award compensation to the removed board member/s? The law is silent on this. In this situation, the task is left to the court to fill the gap by interpreting the law. However, the court, in its interpretation, needs to see the principle of CG, the roles, powers and duties of BoDs in CG under the law, as well as to see or forecast the consequences that flow from failure of BoDs in performing their crucial duties in having good CG and also their duties of care and due diligence.

Based on this understanding, one of the following activities may constitute good cause to remove directors. These are: if the director/s happen to be incompetent; grossly negligent; not loyal in performing their duties and exercising their powers; not eligible or

⁴⁹⁵ Ibid.

unqualified to be appointed as directors; performing activities intentionally or negligently against the interests of the company, shareholders or stakeholders; performing mismanagement or oppressive activities against the rights of shareholders especially minority shareholders; etc. Thus, if the directors did one of the above and other activities that contradict with their duties of care and due diligence, these may constitute “good cause” to remove them from their directorship before the expiry of their period of office. The court may, accordingly, take these as “good cause” to award or not compensation to directors who were removed by AGMs.

Though the court has no direct role in removing directors under the Comm.C of Ethiopia, it has an indirect role. This involvement emanates from its power of setting aside the resolution of AGM that appoint BoD members as per Art 416(2) of the Comm.C. This indirect role of the court is so crucial in protecting shareholders rights especially that of minority shareholders and also in ensuring good CG system.

When we examine the practice of the courts in relation to this issue, there are court cases in which shareholders, by challenging the election and appointments of board members petitioned that the court dismiss the appointed board members. For instance, in case of *W/ro Bayushe Tegegn (13 petitioners) Vs. Ye saris development market new life S.co (5respondents)*⁴⁹⁶; *Be’aklel reba shemane betsebe ylemate ena yemote meridaja edir Vs. Neb International Bank S.co*⁴⁹⁷; *Mr. Kedir Ali (42 Petitioners) Vs. Mr. HalileSerani (11 respondents)*⁴⁹⁸; *Mr. Ahim Martin Vs. Medroc Foundation Specialist Plc*, and third party intervener *Medroc Construction Ethiopia Plc (two interveners)*⁴⁹⁹.

The petitioners in all the above-listed cases petitioned the court to dismiss the appointment of board members arguing that the election and appointments of BoDs members was not conducted as per the law, memoranda and articles of associations, the constitution of board members was not in accordance with the law, the election was not free and fair, the appointed board members do not represent all the shareholders, etc.

The respondents in each case rejected the entire allegations of the petitioners arguing that the elections and appointments of board members were conducted in transparent and fair

⁴⁹⁶ Federal First Instance Court File No. 172727

⁴⁹⁷ Federal First Instance Court File No. 223199

⁴⁹⁸ Federal First Instance Court File No. 232226

⁴⁹⁹ Federal First Instance court File No. 194225

manner as per the law, articles and memoranda of associations. Thus, there are no legal and factual grounds by which the appointed board members may be dismissed.

The court, after hearing the testimonies of witnesses and after weighing other pieces of evidence of both parties gave its decisions in all cases in favor of the respondents stating that the elections and appointments of board members were conducted in transparent way; their resolutions were passed by majority vote of general meetings; voting was conducted as per the law, memoranda and articles of associations, in which all the shareholders which were present in the meeting participated; and the board was constituted as per the law, articles and memoranda of associations. Thus, the court held that there are no grounds to dismiss the appointments of members of BoD and that the appointed board members may not be dismissed.

The other interesting issue that needs to be dealt with under the sub-topic being discussed is the role of courts in setting aside decisions of BoDs.

As we discussed earlier, BoDs have full power to decide in any matter that are given to them by law, memoranda and articles of associations and by the resolutions of general meetings of shareholders.⁵⁰⁰ The decisions passed by BoDs bind the company, create rights and duties of the company, and shareholders and also may affect the interests of shareholders or stakeholders. Thus, the question raised here is whether or not those persons that are affected by the decisions of BoDs may institute cases before courts of law to set aside the decision of BoDs.

The law is silent as to whether or not the court has power to set aside BoD's decisions and person/s that may challenge BoD's decisions before the court of law. These questions are crucial for minority shareholders and have great importance in protecting minority shareholders' rights and in implementing the rights and equitable treatment of shareholders, which is principle II of the OECD⁵⁰¹. Thus, appropriate handling of these issues has a great role in ensuring good CG in companies.

When we see the practice of courts on these issues, there are court cases that have been instituted challenging decisions of BoD.

⁵⁰⁰ Commercial code of Ethiopia, cited above at note 4, Art 363 (1)

⁵⁰¹ G20/OECD, cited above at note 147, P. 19

For instance, in *W/rt. Genet Mogus Vs Addis Village house building S.co*,⁵⁰²the petitioners instituted a suit before Federal First Instance Court challenging decisions of the BoDs of the company that dismissed her from membership of the company. The petitioner pleaded that the BoD's decision should be annulled by the court's decision.

The respondent countered the allegations of the petitioner arguing that the BoD's decision was passed as per the law.

The court gave its decisions stating that the BoD's decisions could not be set aside by reasoning that the petitioner left the company by herself and she did not prove that the respondent dismissed her from membership of the company outside the law, the memorandum and articles of association of the company. The petitioner, by opposing this court's decision appealed to the Federal High Court.⁵⁰³

The appellate court, after examining the case file gave its decision reversing the First Instance Court's decision stating that the petitioner did not quit her membership in the company by herself. Even though she signed the document that states that she left the company by collecting the money she paid to the company, this is outside the memorandum of association of the company. The appellate court also said that the BoD is not given power in the law and memorandum of association to dismiss shareholders from their membership in the company. Accordingly the appellate court held that the BoD's decision should be set aside and the petitioner should be re-instated.

These and other court decisions shows that even though the law is silent on this issue, in practice, courts are involved in setting aside BoD's decisions by using their power of interpreting the law. The writer also agrees to this court's stand since the court has power to set aside the resolution of the general meeting which is the ultimate decision making organ, and that has the power to appoint board members; thus it seems logical to argue that the court has power to set aside the decisions of BoDs. This enables the court to play its crucial role in ensuring good CG and also in protecting minority shareholders' rights.

⁵⁰² Federal First Instance Court File No. 136271

⁵⁰³ Federal High Court, Appeal File No. 81044

4.2.3 The Role of Courts in Enforcing the Duties and Responsibilities of Directors

As we discussed in chapter three one of the OECD principles of CG is the responsibilities of the board.⁵⁰⁴This principle is embodied in the Comm.C of Ethiopia also.⁵⁰⁵According to this principle, to ensure good CG, the CG framework of a state should ensure the effective monitoring of management by the board and the board's accountability to the company, shareholders and stakeholders.⁵⁰⁶

In many jurisdictions the directors are required to perform their duties with due care and loyalty.⁵⁰⁷ Directors are considered to be 'fiduciaries' as they are appointed to manage assets that belong to the shareholders and not to themselves and they must act in good faith with due regard to the interests of the company, and must subordinate their own interests to those of the company.⁵⁰⁸

The board is chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation.⁵⁰⁹The boards also are responsible to oversee the risk management system and systems designed to ensure that the corporation obeys applicable laws, including those on tax, labor, competition, environment, etc.⁵¹⁰These and other roles and duties of directors show that the board is not only responsible to the company and its shareholders but also has a duty to act in their best interests. In addition, the board is expected to take due regard of, and to deal fairly with, other stakeholders' interests including those of employees, creditors, customers, suppliers and local communities.⁵¹¹Thus, effective enforcing of this board responsibility to the company, shareholders and stakeholders has a great role in ensuring good CG in companies.

⁵⁰⁴ OECD Principle VI and G20/OECD, Cited above at note 147, P.61

⁵⁰⁵ Commercial code of Ethiopia, cited above at note 4, Art 364, 366, and 367, and 367

⁵⁰⁶ Ibid. and G20/OECD, Cited above at note 147, P.61

⁵⁰⁷ A. Cahan, cited above at note 425, p.352

⁵⁰⁸ Id., p.333

⁵⁰⁹ Ibid.

⁵¹⁰ Ibid.

⁵¹¹ Ibid.

Under the Comm.C of Ethiopia, the duties of directors emanates from laws, the statutes of the company and resolutions of the shareholders' meetings.⁵¹² The law provides that directors owe the duty of 'due care and diligence' to the company.⁵¹³The standard of this duty of care of directors is equated with the duties of an agent in agent-principal relationships.⁵¹⁴Since the rights and duties between agents and principals are primarily governed by the provisions of the Civil Code,⁵¹⁵the relationship between a company and its directors is also subjected to the agency ruler of the Civil Code.⁵¹⁶Even though the Comm.C does not use the expression 'best interest of the company', from the general duties imposed upon directors, we can understand that directors have the duty to give priority to the interest of the company in their everyday routines.⁵¹⁷Thus, failure of directors to avoid or minimize acts injurious to the company's interest within their knowledge or failure to act with due care and diligence entails joint and several liabilities of directors.⁵¹⁸

In Ethiopian S.cos, the BoDs are liable to their companies (internal liability) only for their blameworthy conducts in which the directors acted knowingly or negligently.⁵¹⁹

Regarding directors' liability towards creditors (external liability) unlike internal liability, the law does not require blameworthiness of their decisions for external liability towards creditors.⁵²⁰

The main concern that may arise in relation to the liability of directors is the question of who may sue them when they committed conducts against the law or statues of a company.

Under the Comm.C, a company, in order to sue directors, requires resolution of shareholders representing at least one fifth of the capital of the company.⁵²¹If a resolution

⁵¹² Commercial Code of Ethiopia, cited above at note 4, Art 362

⁵¹³Id., Art 364

⁵¹⁴Assefa, Cited above at note 37, P. 29

⁵¹⁵Civil Code of the Empire of Ethiopia, Negarit Gazeta, Proclamation No.165 of 1960.19th year No.2, Art 2199-2233

⁵¹⁶ Commercial Code of Ethiopia, cited above at note 4, Art 1 and Assefa, Cited above at note 37, P.29

⁵¹⁷Assefa, Cited above at note 37, P.29

⁵¹⁸ Commercial Code of Ethiopia, cited above at note 4, Art 364(2)

⁵¹⁹Id.,Art 364(2),(3),and Assefa, cited above at note 37 , P. 29

⁵²⁰Id.,Art 364 (2), (3) and Assefa, cited above at note 37, P. 29

⁵²¹ Commercial Code of Ethiopia, cited above at note 4, Art 365 (1) and (2)

to sue directors is passed but the company is not willing to institute a suit against the directors within three months after the resolution is passed, the law authorizes shareholders to bring an action against directors.⁵²² However, these rules don't allow each shareholder to institute a separate action against the directors in the name of company.⁵²³ This implies that even though the interest if the company is affected by the fault of directors where the general meeting votes against the institution of a suit before the court of law, no one can sue directors in the name of a company before the court of law.

This stand of the law has a negative consequence especially on minority shareholders. The law does not protect minority shareholders by allowing derivative suit mechanism i.e. by giving the right to institute suits against directors or third parties on behalf of the company.⁵²⁴ In order to protect minority shareholders rights the law needs to allow any individual shareholder to take an action on behalf of the company, where any shareholder considers the company should take legal proceedings against directors, but neither the company nor the general meeting resolves to do so.⁵²⁵ This argument is consistent with principle II of the OECD⁵²⁶ since this principle states that to have good CG system the confidence of minority investors' should be enhanced. Minority investors' right is enhanced and protected when the legal system provides mechanisms for minority shareholders to institute law suits when they have reasonable grounds to believe that their rights have been violated.⁵²⁷

This shows that the Comm.C is not in a position to protect minority shareholders' rights and also the stand of our law is contrary to the principle of OECD. These positions of the law have a negative outcome in having good CG system and also in attracting domestic as well as foreign investors.

Even though the policy document for the revision of the Comm.C recognizes as a problem in the existing Comm.C, I think the draft policy is not formulated in a way that

⁵²²Ibid., Art 365(4) and Assefa, Cited above at note 37, P.

⁵²³Fekadu, Petros, Ethiopian Company Law, Addis Ababa University School of Law, P. 170

⁵²⁴ Commercial Code of Ethiopia, cited above at note 4, Art 365(1) and Fekadu, cited above at note 35, Pp. 20-21

⁵²⁵Ibid.

⁵²⁶ G20/OECD, cited above at note 147, pp. 28-29

⁵²⁷Ibid.

solves the problem. In the policy document, two alternatives are mentioned. The first alternative is decrease the 20% vote put in Art. 365 to 5 % vote to sue directors for a third party on behalf of the company,⁵²⁸ the second alternative is to allow any individual to sue a director or a third party on behalf of the company when this shareholder deposits guarantee to indemnify the concerned director before suing her/him.⁵²⁹The policy document prefers the second alternative. I think this alternative also does not protect minority shareholder right and also is not consonant with internationally recognized principle of good CG system.

Regarding director(s) liability to the shareholders, the law allow an individual shareholder that is ‘directly affected’ by the fraud or fault of the BoD to sue the directors on their own behalf to claim damages.⁵³⁰In this case also, the law puts a precondition to sue directors. The precondition of “directly affected by the fraud or fault”, also seems unclear as the fraud or fault committed by the BoD is often against the company and indirectly against individual shareholders.⁵³¹Though the law is not clear, the law authorizes an individual shareholder or groups of shareholders without seeking resolution of 20% shareholder voting can sue the BoD.

Regarding directors’ external liability towards creditors, the law recognizes that the creditors have the right to sue the board of directors when it fails to preserve intact the company’s assets as per the law.⁵³²This happens when the company’s assets do not satisfy claims of creditors. In addition to this, the creditors have a right to institute their legal actions notwithstanding the resolution of shareholders’ meeting not to go ahead with the legal action against directors for their internal liability.⁵³³The only requirement for this is that the company’s asset fails to be sufficient to satisfy the claims of creditors.⁵³⁴

⁵²⁸የኢትዮጵያ የንግድ ማኅበራት ሕግ የፖ.ሊ.ሲ. ጉዳዮችና የማሻሻያ ሐሳቦች (መ.ጋ.ቤ.ት, 2006), p.66

⁵²⁹ibid.

⁵³⁰ Commercial Code of Ethiopia, cited above at note 4, Art 367

⁵³¹Assefa, Cited above at note 37, P. 31

⁵³² Commercial Code of Ethiopia, cited above at note 4, Art 366 (2)

⁵³³Id.,Art 366 (3)

⁵³⁴Id.,Art 366 (1) and (2)

When we examine the practice of the court, in the case of *Nohe Transport S.co Vs. Mr. Beresaw Tadele (five respondents)*⁵³⁵ the company sued the BoD for their fault committed during their terms of office alleging that BoD used the company's assets for their personal benefit of pursuing higher education.

The respondents denied the allegations by arguing that they did not commit fault, and that they used the company's money for educational purpose to improve their knowledge, and that improvement in their knowledge benefits the company and this also was done based on the decision of the board and the board's decision was also confirmed by the general meeting.

The court, after hearing both sides and examining the pieces of submitted evidence found that the board members used the company's asset for their personal benefit and by so doing violated their duties of care and loyalty to the company. The court accordingly, ruled that the board members (respondents) are liable for the money used unlawfully and should refund the money to the company.

In the case of *Ato Kebede Deble, (120 applicants) Vs. Ato Tekel Behabtu (6 respondent)*⁵³⁶, the applicants were shareholders of 'Kutir And Ye Kolfe 288 Ye Shurab Negadewoch S.co' and the respondents were the board members of the company.

The applicants instituted a case before the court of law against the respondents by stating that the respondents, by violating the law, the memoranda and articles of associations of the company, rented the shop of the company without auction; they did not respect the priority rights of shareholders on those shops that are recognized in memoranda of association; they failed to appoint other persons in replacement of the directors that have left; and they did not appoint a manager and an auditor which left the company to be governed by the board only. The applicants petitioned the court the respondents should be held liable jointly and severally.

The respondents in their statement of defense raised a preliminary objection arguing that the applicants are not authorized to sue on behalf of the company nor are their shares one fifth of the total shares of the company. Hence, the respondents contested that they have no right to institute the case. The respondents also argued that they performed their duties

⁵³⁵ Federal First Instance Court File No. 223208

⁵³⁶ Federal First Instance Court File No. 192127

as per the law, memoranda and articles of associations of the company and there is no fault committed by them. They also argued that the share of the applicants does not allow them to petition for the calling of a general meeting and for appointment of an auditor.

The court, after hearing both sides framed issues. The first issue the court framed is: Whether the applicants have a right to institute the case before the court of law. The court, analyzed the BoDs' responsibilities towards the company's and shareholders, and the conditions that needs to be fulfilled to sue BoD members. Then it concluded that the pre-condition put under Art 365 to sue BoDs' are not applicable to shareholders to personally sue the BoD. The court responded that those shareholders that think the BoD committed fault that affected their rights have a right to sue BoD to claim damages for the faulty conduct. The court accordingly, rejected the respondents' preliminary objection.

On other issues the court, by analyzing the evidences submitted ruled that since the respondents performed their duty as per the law, articles and memoranda of associations they are not liable.

In the case of *Ye Amanuel Tsega Ye negade Sukoch S.co shareholders Vs. Mr. Bahiru Abraham (12 respondents)*⁵³⁷ the applicants are shareholders of the share company and the respondents are members of the BoD of the company.

The applicants sued the respondents stating that the respondents' decisions and activities regarding the shop that was built by the company were not in accordance with the articles of association. The applicants petitioned the court to give injunction order and to annul the Board's decision. The respondents submitted their statement of defense arguing that the respondents are not responsible for the allegations and that the claim was instituted by the company not by the applicants.

The court dismissed the suit reasoning that the applicants' petition does not fulfill the pre-condition put under Art. 365. The applicants dissatisfied with this decision appealed to the Federal High Court. But the appellate court⁵³⁸ dismissed the appeal. The applicants, objecting to the decisions of the courts filed an application to the Cassation Bench.⁵³⁹ The Cassation Bench, after examining the case passed its decision on June 10, 1999 E.C

⁵³⁷ Federal First Instance Court File No. 08449

⁵³⁸ Federal High Court File No. 37119

⁵³⁹ Federal Supreme Court Cassation Division File No. 23389

stating that the shareholders (applicants) have a right to sue the BoD (respondents) if the act of the respondents is prejudicial to them. To institute this suit the fulfillment of the precondition mentioned in Art. 365 are not necessary. The lower court by citing the irrelevant provisions committed an error of law in its decision. Accordingly the Bench reversed the lower courts' decision and remanded the case to lower court.

I think this stand of the cassation is good in ensuring that the BoD is accountable to shareholders and also in protecting minority shareholders rights from mismanagement and oppressive activity of BoDs. These in turn would have a great role ensuring good CG system in the country.

In the case of *Mr. Abebe Tekelemariam Vs. Ye addis fana general retail and hotel business S.co BoD members (8 respondents)*⁵⁴⁰, the applicant sue the respondent on the ground that the respondent did not respect their duties mentioned under Art.362 and were not willing to respect his right to information.

The respondents, without denying the allegation of the applicant argued that since the general meeting did not pass a resolution to sue the BoD as per Art. 365 of the Comm.C, the applicant should not be considered as being a right to institute this suit against board members.

The court dismissed the petition of the applicant by stating that the applicant could not prove his civil right on this case. This court ruling is in contradiction with not only the Commercial Code and internationally recognized principles but also the Constitution by virtue which everyone's a right of access to justice is recognized⁵⁴¹.

All the above practices of the court tell us even though the Cassation Bench's stand on this issue is consonant with principle of CG and with the Commercial Code and it make a great contribution towards ensuring good CG and in protecting shareholders especially minority shareholders. The court decisions were not predictable. In addition, in all of the cases the court decisions were not given expeditiously. There were delays in giving decision and the cases were not entertained on the basis of sensitivity.

The reason for the notable unpredictability and delay is mainly because of lack of special knowledge by the judges on company law especially on CG, lack of giving special

⁵⁴⁰ Federal First Instance Court File No. 226933

⁵⁴¹ Constitution of the Federal Democratic Republic of Ethiopia, proclamation No. 1/ 1995, Negarit Gazeta, 1st year No. 1, Addis Ababa, 21st August, Art 37(1)

attention to the CG related matters by the judges and administration of backlogs, lack of real and effective special bench for corporate related cases, etc.⁵⁴²

4.3 The Role of Courts in Appointing and Removing External Auditor/s

4.3.1 The Role of Courts in Appointing Auditor/s

Transparency and disclosure is one of the principles of good CG under OECD.⁵⁴³ To have a good and effective CG system, the CG framework should ensure that timely and accurate disclosures are made on all important matters, such as the financial situation, business transactions, performances of governance organs, etc.⁵⁴⁴ Transparency and disclosure of the financial condition of a corporation is important in ensuring good CG practices and also in protecting the shareholders as well as stakeholders' rights and interests.

Appropriately audited financial statements showing the financial performance and financial situation of a company that include the balance sheet, the profit and loss account, and the cash flow statement are in many jurisdictions the most widely used sources of information that enable appropriate monitoring as well as measures to take in the interests of all shareholders as well as stakeholders.⁵⁴⁵ To properly implement this principle and to ensure the accountability and responsibilities of BoDs and also to have good CG practices auditing should be conducted at the end of each financial year by independent, competent and qualified auditor.⁵⁴⁶

Disclosures in the form of audit reports enable investors to know if the management succeeded in realizing the corporation's goal or if there were management errors.⁵⁴⁷ Auditing protects companies against imprudent or fraudulent management and it also plays important role in assisting the governing organ to monitor the effectiveness of its governance. Because of these and other functions, auditor becomes an essential organ in

⁵⁴² Interview with Honorable Endeshaw Adane Judge of Federal Supreme Court

⁵⁴³ G20/OECD, Cited above at note 147, P.41

⁵⁴⁴ Ibid.

⁵⁴⁵ Id., P.42

⁵⁴⁶ Id., P. 47

⁵⁴⁷ Lawerence, Cited above at note 401, P. 49

a CG system, and in many jurisdictions auditors are mandatorily involved organs of governance in all types of companies.⁵⁴⁸

As we discussed earlier, in Ethiopia, all Plcs are not obliged to have an independent or external auditor. The requirement of the organ of auditors is stipulate conditionally depending on the number of shareholders⁵⁴⁹. On the other hand it is compulsory for S.co to have auditors⁵⁵⁰. Despite this difference the role and the appointment process of auditor is the same in both companies⁵⁵¹. Thus, we will discuss the appointment mechanisms of auditors and the role of courts in appointing auditors in both Ethiopian companies by comparing with other countries.

The Indian companies Act makes it compulsory for every company to have its accounts audited by qualified auditors.⁵⁵²These auditors are appointed by shareholders at every AGM and they hold office from the conclusion of that meeting till the conclusion of the next AGM.⁵⁵³Where at an AGM, no auditors were appointed or re appointed as per section 224 (3) of the Act, the Central Government may appoint auditor to fill the vacancy.⁵⁵⁴

In France, SA must have statutory auditor and SARLs with corporate capital in excess of 1, 550, 000 euro are required to have auditor.⁵⁵⁵ Auditors are appointed by the AGM. In other SARLs courts have the power to appoint auditor when the shareholders who represent at least one- fifth of the capital may request a court and in case of SA if AGM failed to appoint an auditor.⁵⁵⁶

Under the Comm.C of Ethiopia, in principle, auditor(s) may be appointed by the AGM of shareholders⁵⁵⁷, meeting of subscribers⁵⁵⁸ and in memoranda and articles of associations.⁵⁵⁹ Even though the law did not explicitly give direct power to courts to

⁵⁴⁸ Klaus, Cited above at note 13, P. 58

⁵⁴⁹ Commercial Code of Ethiopia, cited above at note 4, Art 525(2)

⁵⁵⁰Id.,Art 368(1)

⁵⁵¹ Id Art 368,374,378 cum Art 538

⁵⁵² Ashok, Cited above at note 77, P. 441

⁵⁵³Ibid.

⁵⁵⁴Id., P. 445

⁵⁵⁵ French Corporate Law and Finance, www.frenchbusinesslaw.com

⁵⁵⁶ French Commercial Code, Art L 225-229

⁵⁵⁷ Commercial code of Ethiopia, cited above at note 4, Art 368 and 369

⁵⁵⁸Id.,Art 321(4)

⁵⁵⁹Id.,Art 538 (1)

appoint an auditor, courts have an indirect role in the appointment of external auditors. This indirect role emanates from the duty of courts in enforcing laws and contracts. That means once the shareholders put in their memoranda and articles of associations for the company to have an auditor especially in Plcs, shareholders should be bound by this agreement and the court also shall have the duty to enforce this agreement. If shareholders failed to implement the agreement to have an auditor and one of the shareholders petitions claim the court to enforce the agreement, the court should guide the shareholders to follow the memoranda and articles of associations and enforce this agreement by ordering the calling of a general meeting to appoint an auditor.

In the case of S.cos and Plcs that have more than 20 members, since they are obliged by law to have auditor(s) but the companies failed to appoint one, one or more shareholder(s) may petition the court to appoint an auditor and the court even if it has no direct power to appoint an auditor, it should force the company to appoint an auditor by ordering the calling of a general meeting as per the law.

These role and involvement of the court is of a vital importance in ensuring good CG practices and also in protecting shareholders especially minority shareholders' rights and stakeholders interests.

When we examine the practice of courts on this issue, most of the cases instituted for the appointment of an auditor before the court are related to Plcs. The main reason for this are the above mentioned gaps of the law, the way in which a Plc is established, lack of knowledge about the importance of auditor in CG of a company by manager and shareholders, mismanagement, lack of equitable treatment of all shareholders, problems in implementing inherent rights of shareholders, etc.

For instance, in the cases of *Mr. Indirs Peter Vs. Sacramento Farming Plc (three respondents)*⁵⁶⁰, *Mr. Bernand Tilahun Vs. Altimet Printing Plc (two respondents)*⁵⁶¹, *W/ro Tseyon Berhane Vs. Rok Business Plc. (three respondents)*⁵⁶², *W/ro Mariam Yesuf Vs. Mr. Tareke Sab't*⁵⁶³, *Mr. Abedulkadir Hussen Vs. Ye Bulbula Plc*⁵⁶⁴, and *W/ro Genet Beyen Vs. Bas Plc (three respondents)*.⁵⁶⁵

⁵⁶⁰ Federal First Instance Court, File No. 209464 ,

⁵⁶¹ Federal First Instance Court, File No. 202910

⁵⁶² Federal First Instance Court, File No. 211314

⁵⁶³ Federal First Instance Court, File No. 215536

In all these cases the numbers of shareholders of the company were below twenty, and the members of the companies were family-related and friends, the memoranda and articles of associations stipulated that the company should have external auditor to be appointed by general meetings, and the petitioner(s) were shareholders and the respondents were the managers of the companies.

The petitioners sued the respondents on the ground that the companies were not audited by auditors, the managers were not willing to call meeting to appoint auditors, dividends were not paid, financial statements and reports were not given to the shareholders and that the managers abused the assets of the companies and the petitioners have been excluded from knowing and inspecting documents. The petitioners accordingly requested the court to appoint external auditors.

The respondents in their statements of defense denied the allegations of the petitioners stating that the companies have their own auditors, each year the companies have been audited, the petitioners were not precluded from inspecting document, the companies were not obliged by the law to appoint external auditors for the reason that the numbers of shareholders are below twenty, the court does not have power to appoint auditors for the companies, etc.

The court, after examining the evidences submitted in relation to all cases, gave its decisions in favor of the applicants. The court in its decisions reasoned that even though the number of shareholders is below twenty, as far as the shareholders by agreement stipulated in their memoranda and articles of associations of the companies to have auditors, the companies would be obliged to have auditors. Further, the court said that in the memoranda and articles of associations it was stated that, external auditors are appointed by general meetings accordingly the auditors should be appointed by general meetings. The court ruled that the general meeting should be called to appoint an external auditor.

In the case of *W/ro Azeb Kahsay (two applicants) Vs. Green View Consulting Plc*,⁵⁶⁴*Yesha'leqa Tadele Hile Vs Kemekem General Business Plc*⁵⁶⁵; *Mr.Hussein Usman*

⁵⁶⁴ Federal First Instance Court, File No. 215987

⁵⁶⁵ Federal First Instance Court, File No. 197490

⁵⁶⁶ Federal First Instance Court, File No. 212429

⁵⁶⁷ Federal First Instance Court, File No. 214590

*Vs Yam Bord Industrial Plc*⁵⁶⁸, in all the files the applicants petitioned the court to appoint external auditors and the companies to be audited. They argued that: though the memoranda and articles of associations stipulated that in each fiscal year the financial report of auditors shall be presented to the AGMs, the manager did not discharge this duty, and the company has never been audited from date of its incorporation.

The respondents denied the allegations by stating that the companies have external auditors, the companies are audited each year by the auditors, and that audit reports have been given to the shareholders and that auditors reports have been confirmed by the general meetings. Thus the respondents may not be obliged to appoint other auditors.

The court after hearing both parties and examining the pieces of evidences submitted, ruled that as the companies have external auditors appointed by shareholders and the external auditors have been auditing the companies each year and the general meetings of shareholders by discussing the audit reports have been accepting the reports. Due to this, the companies should not be audited again. Based on these facts the court rejected the applicants' petitions.

When we examine the practice of courts in relation to this issue of appointment of external auditor/s to S.co; as we discussed earlier, it is compulsory for all share companies to have auditor/s. Because of this, there are not many cases on this issue before the court of law compared to Plcs.

In the case of *Mr. Alem Wolde Gebriel (four applicants) Vs. Misrak Transport and Trade S.co (six respondents)*,⁵⁶⁹ the applicants sued the company and members of the BoD alleging that due to the fault of the BoD, we could not know the business transactions of the company, the board did not perform its duties as per the law, the income and expenses of the company have not been investigated and books of account not audited by external auditor. Because of this, we could not exercise our rights of sharing dividends. The applicant petitioned the court to rule that the company has to be audited by an external auditor.

The respondents in their statements of defense raised a preliminary objection on the jurisdiction of the court to give decision on this matter. They also stated that the

⁵⁶⁸ Federal First Instance Court, File No. 212423

⁵⁶⁹ Federal First Instance Court, File No. 202930

applicants have no right to sue the first respondent (the company). Alternatively, the respondents argued that the company has an external auditor, and each year the company's books of account have been audited and this audit reports have been given to all shareholders at general meetings. They also argued that there is no legal ground to appoint another external auditor.

The court, after examining the evidences submitted rejected the preliminary objection and assumed jurisdiction. It also decided that the company has external auditors that are appointed by shareholders and this auditor has been auditing the company each year. The audit reports have also been given to the shareholders including the applicants at the general meetings as per the law. Due to these circumstances, appointing another auditor and investigating the company's again makes the company not properly managed. The court ruled that the company should not be audited again by a new external auditor.

In the case of *W/ro Bayush Tegegn (twelve applicants) Vs. Ye Saris Lemat Gebya Addis Hiwot S.co (six respondents)*⁵⁷⁰, one of the allegations of the applicants is that the external auditor is curtailed by the BoD to investigate and audit the company, thus petitioning the court that compulsory auditing of the company should be ordered.

The respondents on this allegations said that external auditor did audit the company and that they were ready to present the report to the general meeting. So, they argued this allegation should be dismissed.

The court ruled on this issue in favor of the respondents by reasoning that the shareholders, in order to ask for compulsory investigation should have the support of at least one tenth of the shares issued as per Art. 381. As the applicants did not fulfill this precondition, they have no right to ask for compulsory investigation to be conducted on the company.

When we critically analyze the above court decisions, the decisions are consonant with the law and principles of good CG and these have a great contribution in ensuring CG. As there was delay in giving those decisions, the delay has negative impacts on CG and on the role of court in discharging its crucial role in ensuring effective and good CG.

⁵⁷⁰ Federal First Instance Court, File No. 172727

4.3.2 The Role of Courts in Removing Auditors

Auditors have a crucial role in having good CG system. Auditors play their appropriate role as the law expects from them, when they are appointed in accordance with the law, they are competent, independent and qualified to be auditors. Where an appointed auditor fails to fulfill the above-mentioned pre-conditions, such an auditor may contribute negatively in ensuring good CG. In order to avert such negative consequences, it would be necessary to take corrective measures.

In many jurisdictions, the power of removing an auditor is given to shareholders' general meetings. In India, the auditor may be removed before the expiry of his term by special resolution of shareholders' meeting.⁵⁷¹ In addition to this, the Tribunal⁵⁷² either *suemotu* or on an application made by the Central Government or by any interested party, if it is satisfied that the auditor directly or indirectly acted in a fraudulent manner, or abetted or colluded in any fraud in relation to company or its directors or officers, the Tribunal shall order within fifteen days of the application that the auditor be removed and directs the company to change the auditor.⁵⁷³ This shows that in India, the Tribunal has a great role and power in removing an auditor.

The Comm.C gives the power of revoking the appointment of an auditor to shareholders' general meeting,⁵⁷⁴ similar to the appointment of an auditor. Unlike other countries, the law did not give power explicitly to the courts to remove an auditor, which is appointed outside the law, incompetent or fraudulent.

When we see the practices: for instance, in the case between *Mr. Se'are Amede'mariam (three applicants) Vs. Pos Land Software Development Plc (two respondents)*⁵⁷⁵, one of the petitioners' allegations was that the manager, (2nd respondent), outside his power and outside of the memoranda of association an appointed auditor by himself. The applicant accordingly pleaded that the auditor should be removed and another external auditor be appointed. The respondents denied the allegation arguing that the manager did not

⁵⁷¹ Indian Companies Act 2013, Art 140 (1)

⁵⁷² As per Art 1(90) of Indian Companies Act of 2013, Tribunal means the National Company Law Tribunal that constituted under Section 408 the Indian Companies Act, 2013 to solve company related issues in India

⁵⁷³ Indian Companies Act, Art 140 (1)

⁵⁷⁴ Commercial Code of Ethiopia, cited above at note 4, Art 371

⁵⁷⁵ Federal First Instance Court, File No. 201344

perform any act of outside of his power, the audit report had been presented to the general meeting and after it was considered the report got acceptance by majority vote. So, the respondents argued that, there is no ground the auditor to be removed.

The court gave its decision in favor of the petitioners reasoning that the auditor was not appointed by the general meeting as per the memoranda of association and that the manager cannot appoint auditor by himself. The manager's act of appointing an auditor by himself was an ultra virus act. The court accordingly, ruled that the company needs to be governed appropriately and that an external and independent auditor should be appointed by the general meeting of shareholders.

In the case, between *Mr. Befikadu Bekele (six applicants) Vs Adane Batiso and his company certified accountant and auditor (four respondents)*⁵⁷⁶, the petitioners instituted a suit before the court arguing that *Geze Meri S.co* did not have an external auditor that is appointed by AGM and the first respondent was not appointed by AGM as external auditor of the company. Thus, the meeting called by the first respondent is outside of its power and not in accordance with the law. So the applicants argued, the auditor should be removed and the meeting called by this auditor should be considered not conducted.

The respondents denied the allegations arguing that the first respondent was appointed as an external auditor by shareholder having 20% of shares in the company and that there is no ground by which the auditor may be removed or the meeting be considered dismissed. The court after examining the relevant law and the evidence submitted, ruled that since the auditor is not appointed by the AGM as external auditor of the company it could not have the power to call the meeting. The court accordingly, decided that the meeting called by this auditor should be considered not conducted.

In the case of *GP resource mining Plc (two applicants) Vs Mr. Gari Fufa*⁵⁷⁷, the respondent in his counterclaim questioned the auditor and his audit report arguing that the auditor is not appointed by the general meeting and that the audit report is also not accepted by the general meeting, accordingly, the respondent argued the report should be declared cancelled by the court.

⁵⁷⁶ Federal First Instance Court, File No. 161850

⁵⁷⁷ Federal First Instance Court, File No. 222649

The applicant, on the other hand, argued that the auditor is appointed by the respondent and the audit report prepared by this auditor should be acceptable. The applicant argued that there is no ground by which this report should be declared cancelled.

The court after hearing the parties and considering evidences submitted gave its decision in favor of the respondent reasoning that the external auditor is not appointed by the general meeting and the audit report prepared by this auditor is not confirmed by the general meeting after the shareholders considered it in line with the articles and memoranda of associations. The court ruled that the auditor and the audit report should be cancelled.

The writer considers those court decisions, as having a great role in protecting shareholders, stakeholders as well as company's interests from fraudulent activities of auditors that are appointed outside the law. The decisions also have importance in enforcing the liability of directors and managers to shareholders, stakeholders and companies. All in all, it has a great contribution in ensuring good CG.

4.4 The Role and Power of Courts in Appointing and Dismissing Manager

Unlike other countries,⁵⁷⁸ CG structures and systems, Plc in Ethiopia are not obliged to have BoDs in their governance structure. The business activities of such companies are managed and run by managers who represent the company before third parties.⁵⁷⁹Managers, other than members, may be appointed by the members or by the memoranda and articles of associations.⁵⁸⁰The law provides that the manager(s) may be a shareholder or non-shareholder. In addition to this the law does not stipulate requirements to be eligible for appointment as a manager. As we discussed earlier, a manager is one of the important governance organ in Plcs. The law also puts this organ as a compulsory organ by which every Plc should be managed.⁵⁸¹So, this organ in order play crucial role in having good CG, the way of appointment should be done as per the law. The

⁵⁷⁸ India, France, and Germany all made board of director as mandatory in the governance structure of Plc.

⁵⁷⁹ Commercial Code of Ethiopia, cited above at note 4, Art 528

⁵⁸⁰Id., Art 516

⁵⁸¹Id.,Art 525 (1)

appointment of a manager in Plcs should be in accordance with the provisions of the law and memoranda and articles of associations of the concerned Plc.

4.4.1 The Role of Courts in Appointing Manager

Before discussing the appointment system of managers in Ethiopian Plcs, it is good to see some other countries' experience in this respect.

In France, SARL is managed by one or more *gerants* (managers) who must be natural person.⁵⁸²The managers are appointed by the shareholders in the *statutes* or by a special meeting of the shareholders.⁵⁸³Managers need not be shareholders and they are appointed either for a certain period or for an unlimited time.⁵⁸⁴

In Ethiopian Plcs context, non-member managers may be appointed by the shareholders or by memoranda or articles of associations for a time set by members in the articles or memoranda of associations.⁵⁸⁵ This provision seems to be controversial since the reading of the provision tells that the shareholders of Plcs are considered as managers of the company where no manager is appointed.⁵⁸⁶ The law is not clear about the appointments of managers in Plcs.

Even though the law is not clear on the appointment of manger(s), from general principle of the law, ownership right of shareholders and principle of CG, we may perceive that the full power of appointing manager is entrusted to the owners of a company i.e. the shareholders. That means courts will not have direct power in appointing managers. If a court appoints a manger outside of the interests of the owners of a company, it would look like an intervention by misusing its power. This kind of intervention has a negative impact on the whole CG system of a country. This does not mean that courts do not have any role in the appointment of mangers. Instead, courts would have an indirect role. Courts involve in managerial appointments by plays its indirect role through calling a general meeting and setting the agenda for appointing managers as provided in Art 391(1) of the Comm.C. If court plays its role properly, its contribution would be of great importance in ensuring good CG.

⁵⁸² M. Kohler, The new Limited Liability Company Law of France, the Business Lawyer, (1999), P. 446

⁵⁸³ *Ibid.*

⁵⁸⁴ *Ibid.*

⁵⁸⁵ Commercial Code of Ethiopia, cited above at note 4, Art 526

⁵⁸⁶ Dejene, Cited above at note 26, P. 80

When we examine the practice of courts in relation to appointments of managers, there are cases in which the shareholders instituted a suit before a court of law petitioning the court to appoint a manger for the company.

For instance, in the case of *Mr. Maji Sif Mohamed Vs Ever green farm Plc (three respondents)*,⁵⁸⁷ *W/ro Nunuye Teferi Vs Teferi Jemaneh Plc (three respondents)*⁵⁸⁸, *W/ro Nigistie Weldegebriel Vs. W/ro Tigist Bekele*,⁵⁸⁹ The petitioners in all the cases brought a suit before the court to appoint temporary manger to manage the companies by replacing the then existing mangers of the companies.

The respondents in all of the cases opposed the petitions of the petitioners arguing that there are no legal or factual grounds to appoint temporary managers for the companies by the court. Moreover, the respondents argued that the companies were being administered by the managers that were appointed by the shareholders.

The court in all of the cases gave its order by striking the petitions of the petitioners reasoning that the companies have mangers that were appointed by the shareholders and that they were administering the companies. The court also argued that the court has no power to select and appoint managers of the companies by taking into its hands the power of appointment or replacing of managers which right and power belongs to the owners of the companies' i.e. the shareholders.

In the case of *Mr. Bisrat Seifu Vs W/ro Amarech Yigezu*,⁵⁹⁰ the petitioner instituted a case before a court for the appointment of a manager for *De Afrique Hotel Plc* stating that the existing manager of the company, *Mr. Kibret Wondimu*,⁵⁹¹ gave notice to the shareholders that he will resign from his managerial position. Thus, the petitioner pleaded, in order to avoid the risk that might ensure on the business of the company, a temporary manager has to be appointed by the court.

The respondent denied the petitioner's allegations arguing that the manager had decided to continue with his managerial position by reversing the resignation notice that he had given to the shareholders.

⁵⁸⁷ Federal First Instance Court, File No. 231596

⁵⁸⁸ Federal First Instance Court, File No. 229888

⁵⁸⁹ Federal First Instance Court, File No. 237294

⁵⁹⁰ Federal First Instance Court, File No. 202995

⁵⁹¹ Mr. Kibret Wondimu is non-shareholder manager of the company who was appointed by the two litigant shareholders of the company in accordance with procedures during the general meeting

The court, after hearing the testimonies of witnesses along with other pertinent pieces of evidence submitted by the parties, reached a conclusion that the company was still being managed by the manager who withdrew his resignation notice. Hence, the court ruled that since the company has a manager that is appointed by the shareholders, then there is no legal ground for the court to appoint a temporary manager for the company.

In the case between *GP Resource Mining Plc (two petitioners) Vs Mr. Gari Fufo*,⁵⁹² one of the counterclaims that were brought before the court by the respondent was petitioning the court to decide the company to be managed by the two shareholders i.e. the respondent and the second petitioner.

The applicant/respondents opposed this request arguing that the court had no power to appoint the manager of the company and to intervene in the management of the company.

The court also dismissed the request of the respondent/applicant arguing that it is the power and the right of shareholders to elect and appoint a manager for their company at a general meeting. The court ruled that it had no power to elect and appoint a manager for the company and to order the company to be managed by the two or one shareholders or somebody else outside the owners' consent and agreement.

In *Mr. Kahsay Berhie (three applicants) Vs Katiso Shera and Plastic Shoes Industry Plc (eight respondents)*,⁵⁹³ the applicants brought a suit before the court of law against the respondents to challenge the terms of office of the manager that they stated had elapsed, but that they were not willing to call an AGM as per the memoranda and articles of association of the company to appoint another manager for the company. They petitioned that the court should call an AGM to have a manager appointed.

The respondents denied the allegations arguing that the company was on its way to dissolution and it was not necessary to call an AGM and to appoint another manager.

The court, after weighing the evidences submitted and the relevant legal provisions, ruled that in the memoranda of association the term of office of the manager is three years from the date of appointment. The term of office has expired. The manager therefore, has no mandate to act as a manager of the company unless he is appointed again. Thus, the

⁵⁹² Federal First Instance Court, File No. 222649

⁵⁹³ Federal First Instance Court, File No. 219163

company should appoint a manager that represents it and that would have power of manager to run the business of the company on behalf of it. Therefore, the general meeting should be conducted in order to appoint the manager.

When we critically consider the above decisions of the court, these decisions seems consonant with the law and principles of CG system and would have positive impact in ensuring good CG.

When we consider the Federal Supreme Court Cassation Bench decisions, we come across the case of *Mr. Bisrat Seifu Vs Mr. Kibret Wondimu (two respondents)*,⁵⁹⁴ the Cassation Bench, after hearing the petition passed a binding ruling by majority vote on 10/10/2008 E.C. The majority reversed the decision of the First Instance Court⁵⁹⁵, and the Federal High Court⁵⁹⁶ by reasoning that there was good cause to remove the manager (first respondent) and ruled that the manager should be removed from his managerial position. The minority vote in their dissenting opinions argued that there is no error of law on the decisions of the lower courts and said that there was no good cause to remove the manager.

The majority in the Cassation Bench, after reversing the lower courts decisions, remanded the case by ordering the First Instance Court to decide by soliciting both parties' views, and examining the relevant law, memoranda and articles of associations on the issue of appointing a new manager for the company. This decision and stand of the Cassation Bench seems empower the court to appoint manager for the company.

The writer argues this stand of the majority vote on the Cassation Bench is incompatible with the law and with the principles of CG, since such kind of decisions would allow the court to intervene in the management of a company. This in turn makes company not to be managed and administered by appropriate manager that should be appointed by the shareholders. This unwarranted intervention of the court may bring mismanagement and bad CG practices in a company. These have negative impact in attracting domestic as

⁵⁹⁴ Federal Supreme Court Cassation Division, File No. 110848

⁵⁹⁵ Federal First Instance Court, File No.210530

⁵⁹⁶ Federal High Court, File No. 150646

well as foreign investment in the whole economic and financial development of the country⁵⁹⁷.

4.4.2 The Role and Power of Courts in Dismissing Manager

Management is a key organ and has a crucial role to play in Ethiopian Plc. A manager would have full power to manage and to conduct the business of the company. Thus, care should be taken not only in appointing a manager but also in dismissing her/him. The main issues raised here are who has the power to dismiss a manager? On what causes and grounds may a manager be dismissed from her/his position before the expiry of her/his term of office? Before entertaining these CG related questions that were raised before the court of law, let us see the French experience on these issues.

In France, the shareholders have full and ultimate power to dismiss the manager at any time as they want by a simple majority vote, i.e. by a decision of shareholders that represents more than one half of the capital.⁵⁹⁸ Any provision which makes a removal of a manager dependant on a larger majority or on existence of a legitimate reason is null and void.⁵⁹⁹ The only right that a manager has is to bring an action for damages if he/she has been dismissed without a proper reason (*juste motif*). The power of the court is only to award damages if it is convinced that the removal was not justified. The court has no power to reverse the removal decision of shareholders'.⁶⁰⁰ In other words, the court has no power to reinstate the manager that was removed by the resolution of shareholders.

In France, individual shareholders are allowed to submit applications before the court of law to remove a manager for a legitimate cause (*cause ligitime*).⁶⁰¹ And individual shareholders may do so even if majority of the shareholders have decided not to remove the manager.

⁵⁹⁷ Interview with Honorable Judges Mehari G/Mediheh , Negashe Kedane and lawyers Yosef Aemero and Fekadu Petros

⁵⁹⁸ M. Koheler, Cited above at note 582, P. 440

⁵⁹⁹ *Ibid.*

⁶⁰⁰ *Ibid.*

⁶⁰¹ *Ibid.*, P. 441

Under the Comm.C of Ethiopia, there are different requirements for dismissing a manager. The manager appointed by memoranda or articles of associations would be dismissed only by the absolute majority vote of shareholders, i.e. the shareholders that represent three-quarter of the capital, if larger majority i.e. unanimous decision is not required in the articles of association.⁶⁰² Unlike the French Comm.C, the Comm.C of Ethiopia require higher majority vote to remove a manager and this narrows shareholders' rights.

A manager appointed by the general meetings of shareholders may be dismissed by the simple majority vote of shareholders i.e. shareholders representing more than one half of the capital.⁶⁰³ In both situations above-mentioned, the shareholders may dismiss the manager on good cause that is acceptable by the court.⁶⁰⁴ This requirement of the law is different from that in the French Com. c. Where, the shareholders may dismiss a manager without good cause as they wish, only when this power of shareholders stipulated in the articles of association.⁶⁰⁵

The Comm.C also gives the court the power to dismiss the manager. The courts dismiss a manager of a company, when any shareholder(s) having good cause, petitions to have a manager dismissed.⁶⁰⁶ The main purpose of the provisions of Art 527(5) of the Com. C is to protect minority shareholders' right and to avoid mismanagement and oppression by a manager. This is a great power for a court would enable it to enforce the right of shareholders and to play its role in ensuring good CG practices.

The other debatable issue is what factors or cause constitute 'good cause' in order to dismiss a manager by the shareholders or by a court? The law is not only silent but also provides no clue on the issue at hand. The law left it for the discretion of the court, to determine which factor or cause would be taken as good cause to dismiss a manager on a case by case basis.

Giving some discretion to a court is good. But, for a court to use its discretionary power appropriately and as per the intention of the legislator, and to make court decisions

⁶⁰² Commercial Code of Ethiopia, cited above at note 4, Art 527 Cum 536 (2)

⁶⁰³ Id., Art 527(2) Cum. 535 (1)

⁶⁰⁴ Id., Art 527(3)

⁶⁰⁵ Id., Art 527 (4)

⁶⁰⁶ Id., Art 527 (5)

predictable, it would be good to describe those causes that may taken as ‘good or sufficient’ to dismiss a manager from his/her office before the expiry of his/her term of office.

When we see the practice of courts on this issue: in the court cases between *GP Resource Mining Plc (two respondents) Vs Mr. Gari Fufa*⁶⁰⁷; *W/ro Senait Mulu (14 applicants) Vs A.S.M. retired military guarding and construction Plc. (two respondent)*,⁶⁰⁸ in both of the cases the petitioners petitioned the court to dismiss the manager by stating that the manager did not perform his duties as per the law and memoranda and articles of association; he failed to call general meetings; he did not manage the company properly, in the interests of the shareholders and company; he abused his power, oppressed shareholders’ rights and interests; because of these the company fell in to risk and became indebted mainly because of managerial faults or mismanagements.

The respondents denied all the allegations of the applicants and argued that the managers did perform their duties and did manage the companies properly. They also argued that there were no good causes to dismiss the managers and that the applicants’ petitions should be dismissed.

The court, in both cases heard the testimonies of the witnesses and considered other pieces of evidence and by examining each alleged fact on the basis of the roles, powers and duties of the managers given by the law, memoranda and articles of associations. The court ruled that the managers should be dismissed. The court, in its decision analyzed the issue of what constitutes good or sufficient cause to dismiss a manager. It reasoned that the issues should be seen and resolved mainly on the basis of roles, powers and duties of the managers, and also based on the intention of legislator that legislated that mandatorily this type of companies should be managed by one or more than one manager(s). The court in its decision reasoned that if, a manager failed to perform his duties stipulated by the law, memoranda and articles of associations and in the resolutions of general meetings properly, timely, and with due care and loyalty; or performed those prohibited activities under the law or memoranda and articles of associations; or he/she engaged in any activity that goes against the interests and rights of the company, shareholders or

⁶⁰⁷ Federal First Instance Court, File No. 222649

⁶⁰⁸ Federal First Instance Court, File No. 231249

third parties; or did engaging oppressive or mismanagement activities on shareholders including minority shareholders; these causes may be taken as sufficient or good causes to remove a manger from his/her managerial position.

The court, by evaluating the evidences for both cases, found out that: the mangers did not perform their duties properly and timely, there were abuses of power, their activities were contrary to the interest of the company and shareholders. Because of the mismanagement of the managers, the company existence has fallen in to risks. The court further reasoned that these performance and activities of the mangers could be taken as good causes to dismiss them from their positions. The court finally decided that the mangers should be dismissed from their positions.

In the case of *Mr. Bisrat Seifu Vs Mr. Kibret Wondimu*,⁶⁰⁹ and intervener *W/ro Amarech Yegezu* the petitioner is the majority shareholders(90 %) of De Afrique Hotel Plc and he instituted a suit against the manager by petitioning the court to dismiss him from his managerial position of De Afrique Hotel Plc. The reasons stated by the applicant for this petition were: the manager not perform his managerial duties, he did not spend his full time on the work of the Hotel, he came to office late and left office early , he increased his salary without the decision of a general meeting, he acted against the interests of the company, he did not respect the applicant, he unlawfully fired employees and because of this the company is forced to pay compensation, he leased the shops of the company with least rental price, and he used the company's resource for his personal education purpose and outside of his power he signed an agreement with the trade union on behalf of the company.

The respondent and also the intervener denied all the allegations of the applicant. They argued that each of the reasons mentioned by the applicant is a fabricated reason and that the allegations are not supported by evidence, the manager performed his duties with due care and properly as per the law, memorandum and article of association. Because of his good managerial activities and skill the profit of the company has been increasing in each year. He did not act outside of his power. He did not increase his salary and use the resources of the company for his personal benefit by misusing his power. Finally the

⁶⁰⁹ Federal First Instance Court, File No. 210530

respondents argued that there is no good cause to dismiss the manger and that the applicant's case has to be dismissed.

The court after hearing the parties and examining all the pieces of submitted evidence both parties, found that the manger did not act outside of his power and against the interest of the company. All he did were within the limits of power given to him by the law and, memoranda and articles of association. Instead the court found out the manager performed his duties properly. The court, accordingly decided that there is no good cause to dismiss the manager. The court, for this decision, used the definitions given to "good cause" as discussed above.

The applicant opposing this decision, appealed to the Federal High Court.⁶¹⁰ But the appellate court dismissed the applicant's petition of appeal. Dissatisfied by the lower courts' decisions the applicant submitted a petition to the Cassation Bench⁶¹¹, stating that there is error of law in the lower courts' decisions.

The Cassation Bench, after examining both parties' arguments and lower courts' decisions, gave its decision on majority vote by reversing the lower courts' decisions on 10/ 10/ 2008 E.C. The majority vote reversed the lower courts' decisions by evaluating and examining the evidences but not based in issue of error of law on the lower courts' decisions. It did not criticize the lower court interpretation and understanding of what constitutes good cause.

Based on this, when we see critically this majority vote decisions, first of all, the cassation division has jurisdiction only on the issues of 'error of law'⁶¹². It does not have jurisdiction to see or to examine error of facts in lower courts' decisions. However, the majority, outside of the law and its mandate passed their decision by examining facts and evidences but not on correcting or straightening the error of law.

In addition to this, the majority's decided to remand the case ordering the lower court to appoint a manger for the company. As we discussed above, there is no legal ground for the court to appoint a manger by snatching the power given by the law to the owners of a company i.e. the shareholders. This majority vote ruling is contrary not only to the

⁶¹⁰ Federal First Instance Court, File No. 150648

⁶¹¹ Federal Supreme Court Cassation Division, File No. 110848

⁶¹² Constitution, cited above at note 541, Art 80 (3)(a) (b) and Federal Courts Establishment Proc. No. 25/96, Negarit Gazeta, 2nd year No. 13, Addis Abeba, 15th 1996, Art 10(1)

Comm.C but also to the principles of CG. This kind of decision may result in companies going into bad CG practices. This, in turn, brings a negative bearing on shareholders as well as stakeholders' rights and interests, and also on the whole CG system of the country.

Even if the writer agrees with the minority dissenting opinion, the writer does not agree with the stand of the dissenting judges' argument that stated "*the manager is dismissed only when it is proved that the manager's activities affect the rights and interest of the owners of the company*". Since, from the duties, powers and roles of a manager in the governance of Ethiopian Plcs, this is not the only ground that should be taken as "good cause" to dismiss the manger. Rather this is one of the grounds that constitute "good cause". Other grounds such as:

- ✓ incompetence and incapability to act as a manger because of age, illness, etc;
- ✓ engaging in activities that trigger conflicts of interest; become a manager or vice manager of other companies;⁶¹³
- ✓ perform mismanagement or engage in oppressive activities against the rights of shareholders particularly minority shareholder;
- ✓ act abusing one's managerial power or contrary to the law, memoranda and articles of associations or general meetings resolutions;
- ✓ not acting or performing his/her duties timely, properly, with due care and loyalty based on the law, memoranda and articles of associations or general meetings resolutions;
- ✓ perform activities that affect or endanger the rights and interests of shareholders, company and stakeholders, negligently or intentionally; etc.

All these activities or grounds are directly or indirectly related to the powers, duties and roles of a manager. Thus, the writer argues that these and other grounds also constitute "good cause" to dismiss a manger.

The above mentioned understanding of "good cause" is also reflected in other court cases. For instance, in *Mr. Ahmed Usman Vs Yam Board Industrial Plc. (three*

⁶¹³ In this ground there are court cases, for instance Mr. Yonas Duguma (five petitioners) Vs. DH Geda Business and Industry Plc in Federal First Instance Court, File No. 19038 , the court take appointing as vice manager for more than one company is a good cause to dismiss manger as per licensing and business proclamation 686/2002, Art 11 (2). This decision was confirmed by the high court and cassation bench.

respondents);⁶¹⁴ *Athlete Commander Gete Wami Vs Mr. Getaneh Tesema*,⁶¹⁵ the petitioners in both cases instituted a suit before a court of law for the dismissal of the manager. The reasons mentioned by the petitioner for the dismissal sought is that the manager did not perform his duties as per the law, memoranda and articles of association of the companies and that; he acted against the rights of the shareholder (petitioner); he was engaged in oppressive activities, did bad managerial activities and abused the resources of the company, etc .

The respondents challenged the allegations made by the petitioners in their statement of claim arguing that the manager was not engaged in any of those activities raised by the petitioner; instead the manger performed his duties and managed the company properly as per the law and, memoranda and articles of association.

The court, in both cases, after hearing the parties and weighing the evidence found that the petitioner could not prove her assertions that the manager did those activities mentioned in the statements of claim to dismiss the manager. The court reasoned that even though engaging in those activities may be taken as “good cause” to dismiss the manager, the petitioner could not prove that the manager engaged in those activities. The court, accordingly decided that the manager should not be dismissed from his managerial position.

From the above-mentioned court cases, we may infer that there is no, as such, common or similar understanding at all levels of courts on the issue of appointment and dismissal of a manager and also on the issue of which causes constitute “good cause” to dismiss a manager. This is true, especially in Supreme Court Cassation Division. Moreover, there is delay in giving decisions⁶¹⁶. Despite these drawbacks, these court practices show that there is relatively an improvement in the understanding by courts of these CG related issues.

Last but not least, the other main debatable and at the same time sensitive issue in CG system that should be dealt with in this study is whether or not the court has power to reinstate a manager that has been dismissed by the resolution of a general meeting

⁶¹⁴ Federal First Instance Court, File No. 212423

⁶¹⁵ Federal First Instance Court, File No. 224705

⁶¹⁶ Interview with Honorable Judges Negash Kedani and Mehari G/Medehin

without good cause under the Comm.C of Ethiopia. It may also be worthwhile to see whether or not the practices of courts on this sensitive issue are compatible with the law? As we discussed earlier, the use of appointment of a manager is so crucial and sensitive in CG. Since this issue has a direct impact on the success or failure of a company's business, as well as on the achievement of the aim of company's. Based on the crucial powers and roles of manager, the appointment of a manager has a direct or indirect effect on the ownership right of the shareholders and the interests of third parties and also in having good and effective CG in the company. That is why in order to avoid or at least to minimize those negative consequences the law gives the power of appointing a manager to the shareholders. This idea and stand in the Ethiopian law is similar other countries company law and CG and also goes with OECD principles of CG.

The law also gives power to the shareholders to remove the manager that was appointed by them. The question raised here is when and by what reason shareholders may dismiss a manager appointed by them. As we saw above, unlike the French Commercial Code,⁶¹⁷ that gives full power to shareholders to remove a manager as they wish without having any good cause⁶¹⁸, the Comm.C of Ethiopia requires "good cause" to dismiss a manager unless the M.A or A.A stipulates the shareholders may dismiss a manager as they wish.⁶¹⁹ This shows that in Ethiopian Plcs governance system in principle shareholders may dismiss a manager when there is good cause but exceptionally they may dismiss a manager as the shareholders wished it and only if this is stipulated in the M.A or A.A.

On the other hand, from Article 527 (3) of the third sentence one may discern that even if there is no good cause to dismiss a manager, the general meeting may dismiss a manager by fulfilling the quorum that are set by the law depending on how the manager was appointed.

The only difference is that the latter scenario entitles a manager to a right to claim compensation before the court of law.⁶²⁰ But in both scenarios, once a manager is dismissed by the resolution of a general meeting, with good cause or without good cause,

⁶¹⁷ Mr. Khohler, Cited above at note 582, P. 440

⁶¹⁸ Commercial Code of Ethiopia, cited above at note 4, Art 527(3)

⁶¹⁹ Id., Art 527(4)

⁶²⁰ Id., Art 527(2)

the resolution shall have a binding effect to dismiss a manger from his/her position for ever.⁶²¹

This provision gives shareholders ultimate power to dismiss a manager. That means, once a manager is dismissed by virtue of a general meeting resolution, even if the court found that the manager was dismissed without good cause, the court has no power to re-instate the manager by setting aside the resolution.⁶²² This ultimate dismissal power of shareholders emanates from the ownership right and from the ultimate power given to them by the law to elect and appoint a manager of their company. If a court reinstates the dismissed manager to his managerial position on the reason that there is no good cause to dismiss the manager, this would be totally outside of the law and principle of CG and also becomes a direct intervention or snatching the right of the shareholders given to them by the law. The only power given by the law to courts, where a manager is dismissed by the resolution of shareholders is awarding or not awarding the dismissed manager compensation, by evaluating whether the manager was dismissed on good cause or not as per Article 527(3), the third sentence.

This stand of the law is similar to the stand in French Commercial Code. The writer also would like to argue that this approach of the law would be good to protect the rights and interests of shareholders, and to enforce the exercise of their rights. This is good, to attract domestic as well as foreign investors. This also let them to have confidence in their investments and also on the appointed manager may be dismissed at anytime and that nobody may appoint another person or reinstate the dismissed manager without their consent. This in turn, incurred a great contribution in ensuring good CG system in the country. Based on this analysis subsequently we see consider the practice of courts in relation to this issue.

In the case between, *Tana Engineering Plc (four applicants) Vs Mr. Alechedi Delqawedi*⁶²³ one of the issues in the case relates to the re-instatement of the manager that was dismissed without good cause by virtue of a general meeting's resolution.

The case started in the Federal First Instance Court⁶²⁴ in which the present respondent was the plaintiff and the petitioners were the defendants. One of the allegations of the

⁶²¹Id., Art527 (3), third sentence

⁶²²Id.,Art 527 (3), third sentence

⁶²³ Federal Supreme Court Cassation File No. 63200

plaintiff was that the 2nd, 3rd and 4th defendants by conducting an unlawful general meeting passed a resolution that dismissed me from my vice-managerial position of the first defendant company, so the resolution that dismisses me from vice-managerial position is unlawful. The relief the dismissed vice-manager sought was to be reinstated to his previous vice-managerial position.

The defendants, in their statements of defense denied the allegations of the plaintiff arguing that the general meeting was called and conducted as per the law, and the resolution was passed by majority vote. So the plaintiff suit should be dismissed.

The court, after hearing both parties and assessing the evidence submitted gave a decision on Genbot 5, 2002 E.C. In its decision the court ruled that the resolution that was passed to dismiss the plaintiff from his vice-managerial position be set aside reasoning that the resolution was not based on “good cause”.

By opposing this decision, the applicants filed an appeal to the Federal High Court,⁶²⁵ but the appellate court dismissed the appeal on Hidar 28, 2003 E.C. The applicants filed a petition to the Federal Supreme Court Cassation Bench alleging that there is an error of law in the lower courts’ decision. One of the main grounds for the petition to the Cassation was that the articles of association of the company stipulates that general meeting may dismiss the manager but the lower court gave decision by stating that the manager may not be dismissed without good cause. Even, where the manager was dismissed without good cause, the court has power only to award damages to him. But the court decided to reinstate him back to his managerial position. Thus, the decision of lower courts’ has an error of law that should be corrected.

The Cassation Bench, framed an issue as to whether or not the decision of lower courts’ that reinstated the respondent to his vice-manager position has a legal ground? The Bench then called upon the respondent to give a reply to the applicants’ petition.

The Cassation Division rendered its final decision on Hidar 30, 2004 E.C by confirming the decision of the lower courts’ stating that there was no error of law in the lower courts’ decision in reinstating the respondent to his managerial position.

The reasons stated by the Cassation Bench for this binding decision were:

⁶²⁴ Federal First Instance court File No. 140096

⁶²⁵ Federal High Court File No.94715

- 1) There is no legal ground that restricts the court to give decision to reinstate a dismissed manager;
- 2) Art. 527(3) do not say that the court may only award damages for a manager that was dismissed without a good cause;
- 3) It is a permissive provision that allows courts to reinstate a manager's on a case by case basis. The Bench finally ruled that the lower court may decide to reinstate a dismissed manager to his managerial position depending on the facts and circumstances of the case.

The writer of this paper totally disagrees with these reasoning and the decisions of the lower courts as well as the Cassation Bench. The writer feels that those reasons and decisions of the courts have deviated from the provisions of a clear law.

Further when we critically analyze these reasons and decisions of the Cassation Bench on the basis of the law and principles of good CG.

As we mentioned above the respondent i.e. the vice-manager that was dismissed by virtue of the resolution of a general meeting of shareholders, only has the right to claim compensation before a court of law.

In the opinion of this writer from the beginning the manager has no legal right to claim to be re-instated in to his vice managerial position. For someone to seek a certain relief from a court of law there should be a legal or contractual basis to seek the relief.

The court has a duty to check this before allowing the litigation or hearing of the case. Where an applicant's petition had no legal or contractual basis to claim that right, such claim will not have a cause of action. In the scenario under consideration, the court should have dismissed the case as per Art 231(1), (a) of the Civil Procedure Code. From the beginning the present respondent's claim of re-instatement had no legal ground and also had no cause of action and should have been dismissed as per Art 231(1) of the Civil Procedure Code. The Cassation Bench had a legal duty to correct this kind of error of law, but it acted to the contrary.

It is obvious that, the judiciary is one of the three branches of the government. Each of the three branches has its own powers and duties given to it by the Constitution. In principle, there should not be interference.⁶²⁶ The power and mandate of the judiciary is

⁶²⁶ Constitution, cited above at note 541, Art. 13

interpreting the law⁶²⁷. That means, the judiciary has no power to enact new laws by deviating from the existing clear law. These principles are applicable at all levels of courts including the Cassation Bench. The Cassation Bench has no power to enact or to come up with new laws or principles by disregarding the existing laws. Instead, its power is to correct error of law committed by all regional as well as federal courts on the basis of the existing laws.⁶²⁸

However, the Cassation Division's decisions on the above cited case were outside of not only its mandate but also the law and the power of the judiciary. Its decision is like amending the existing clear law and coming with a new law or principle. Instead of correcting the erroneous decisions of the lower courts that committed errors of law, the Cassation Bench decided by itself committing errors of laws. In order to avoid the danger of this grave fault, the Cassation Bench should reconsider and reverse this frustrating decision based on the power given to it by law.

One of the reasons raised by the Cassation Bench for giving the above-mentioned decision on this CG issue is that the M.A did not stipulate that a manager may be dismissed without good cause.

First of all it is the discretion of the shareholders given to them by the law to stipulate or not to stipulate in the M.A allowing general meetings to dismiss a manager without good cause. Where the M.A did not stipulate for dismissal of a manager at the pleasure of the members, this does not bar general meetings to dismiss the manager without good cause. The shareholders by knowing the consequence of the dismissal without good cause, they may dismiss an appointed manager. The only consequence for this resolution is awarding damages to the dismissed manager if the court decides so. Accordingly, not stipulating in the M.A to dismiss a manager at the pleasure of the members does not become a reason to reinstate a dismissed manager. This is like giving new rights to a manager that is not given by the law.

The Cassation Bench also argued that Art. 527(3) is a permissive provision that allows a court to reinstate a dismissed manager on a case by case basis.

⁶²⁷ Ibid.

⁶²⁸ Federal court establishments, cited above at note 612, Art 10

First of all, Art. 527(3) contain three sentences. Each sentence has its own message and these messages are clear.

The second sentence of Art 527(3) is not a permissive provision that gives discretion to a court to reinstate a dismissed manager as the Cassation Bench reasoned. On the contrary, it contains a conclusive sentence which once the resolution of the general meeting is set aside the manager, whether dismissed for good cause or without good cause, shall forthwith and forever cease to function as a manager. This means the dismissed manager could not be reinstated in his/her managerial position by a court as long as the general meeting of shareholders does not again re-elect him/her and appoint him/her as a manager. The intention of the legislator to have stipulated in such a conclusive manner is to protect the rights and interests of shareholders as well as investors. If a dismissed manager is allowed to come in to power, from that moment on he/she may start acting against the interests of those shareholders that voted to dismiss him, and he/she may also abuse the assets of the company, these and other activities led to mismanagement and bankruptcy or dissolution of the company. That is why the law clearly stipulated that a dismissed manager shall immediately step-down and not be put back in his managerial position without the consent and willingness of the shareholders. But the Cassation Bench, by ignoring this mandatory provision of the law passed erroneous binding decision outside of a clear law by empowering court's to reinstate a dismissed manager back to his previous managerial position.

Per the third sentence in Art 527(3) of the Comm.C, the only right given to the dismissed manager is to claim compensation; and also the only power given to the court is to award compensation where the court believes that the manager was dismissed without good cause.

But the Cassation Bench reasoned that this provision does not prohibit the court to reinstate the dismissed manger in lieu of awarding of damages. As per Art 1733 of the Civ.C, where the contract is clear, there is no need of interpretation. In light of the mutatis mutandis construction of this provision, if the law is clear and do not leave any discretion for the court, the Cassation Bench could not claim to have the power to interpret and under the guise of interpretation, to come up with a new law.

These above analysis show that the decision and reasons of the Cassation Bench fall totally outside of the law and contrary to principles of good CG. It is a clear intervention on the freedom of contract and ownership or property rights of investors (shareholders). This decision also forces investors to leave their investment without their consent to the person that was removed to vengefully manage and control their investments. This situation is dangerous for investors and makes them get frustrated and lose their confidence on their investments. It also discourages new investor either domestic or foreign to come and invest in the country. The decision is against the rights given to investors by the law and also it encourages bad CG instead of helping companies enjoys good CG system.

Chapter Five

Conclusions and Recommendations

5.1 Conclusions

Businesses are conducted either in the form of sole proprietorships or in the form of organized entities. They are undertakings that operate to provide goods and services to the society in financial or commercial aspects with the objectives of earning profits, benefits or livelihoods.

Business men shifted from doing their business as sole proprietors to partnerships form and then to companies because of different short-comings that sole proprietorships and partnerships form of businesses encountered.

This development of business organization was further enhanced by the advancement of industrial and technological changes in the globe. At the same time, the development and expansion of business organizations in different activities also have a great role for the current world economic, social, political and technological development.

In many countries, business organizations are classified in to partnerships and companies. Unlike partnership form of business organization, companies have a number of distinguishing features, such as limited liability, artificial personality, perpetuality and transferability of shares.

The 1960 Comm.C of Ethiopia recognizes six types of business organizations. These business organizations may be categorized in to partnerships and companies. The later encompasses S.cos and Plcs. In Ethiopia, from the two companies, the over whelming majority (98.6%) are Plcs.

Though, Plcs take the majority share in the country's company incorporation, provisions pertinent to the governance of Plcs are inadequate to address those core issues of CG in relation to BoD, shareholders meetings, auditors and managers. Unlike laws in other countries, the Comm.C fails to recognize BoD as a basic organ of governance in Plcs in Ethiopia. In contradiction to principles of good CG and unlike other countries CG frame work, the Comm.C provides the need of shareholders meetings and auditors in Ethiopian

Plc's CG based on the numbers of shareholders. The absence of implicit or explicit provisions that dictates which constitute "good cause" to dismiss managers through the resolutions of shareholders' meetings and through the decisions of courts.

These and other problems make Ethiopian Plcs problematic, ineffective and not contributing much by way of what is expected from them. This is one point that makes Ethiopian Plcs problematic form of BOs in the country.

Companies, in order to achieve their business objectives, i.e., to benefit shareholders as well as stakeholders, to play their crucial roles properly in the country's economic and financial development, etc. should have good CG. The need for good CG in the corporations has become a worldwide concern and it was even become an issue of political debate because of its apparent importance for economic health of corporations and society in general.

Good CG makes market integrity faster, attracts foreign and domestic investors to invest in a country, improves economic, social and political efficiency and growth and also builds investor confidence. Thus, having sound CG framework is important for every country especially for Developing and Transition Economy countries like Ethiopia.

Many Developing, Emerging and Transition Economy countries lack or are just now in the process of developing the most basic market institutions; lack effective legal framework; have weak judiciary; suffer from weak enforcement of contracts; etc. In addition, CG in these societies involves a much wider range of issues. Thus, the need for good CG in these countries extends far beyond resolving problems stemming from the separation of ownership and control, which is the core and substantive issue behind the need for good CG.

In the contemporary world, the existence of appropriate and effective legal, regulatory and institutional frameworks are backbones for a given country's good CG system. The six OECD principles of CG, which obtained international recognitions as minimum standards and best practices for good CG framework, are developed to assist policy makers of both OECD and non-OECD countries to formulate and ameliorate their legal,

regulatory and institutional frameworks for proper CG by taking in to account their respective national economic, social and business practices.

The finding of this thesis demonstrated that the Ethiopian Comm.C is not only inadequate but also the legal and regulatory frameworks embodied in there are not compatible with these principles of good CG. The Comm.C provisions are inadequate and incomplete to solve the outstanding and current complex CG related issues in Ethiopia.

The CG provisions of the Comm.C that stipulate for S.cos and Plcs are very backward compared to the contemporary world market development and concerns of complex CG issues. The legal lacunae coupled with the practical problems on the ground are indicators that Ethiopian companies' have failed to achieve good CG.

In relation to Plcs, as we discussed above, Plcs are the most popular forms of companies in the countries and this form of companies cover 98.6% of the country's company form of business organizations. Nevertheless, the provisions of the Comm.C governing Plcs' are incomplete and sketchy. Because of this, Ethiopian Plcs face and experience many legal and practical CG-related problems. .

The legal and regulatory frameworks in Ethiopia have failed to achieve good CG outcomes in relation to S.cos. The provisions lag far behind compared to new developments and concerns of the current complex CG- related issues which companies face. This is especially true with non-financial S.cos in Ethiopia.

In Ethiopia, non-shareholders directors are not recognized. The Comm.C and other relevant laws clearly prohibit non-shareholders from serving as directors. In addition to this, the Comm.C does not specify other qualifications other than being shareholder that should be satisfied to be eligible for board membership. Because of this, incompetent shareholders may assume directorship

Even though the Government of Ethiopia recognizes the inadequacy of the provisions of the Comm.C and has started to revise the Comm.C a decade ago, the Government has failed to make it a reality. Even the prepared draft policy for the revision of the Comm .C was not drafted in such a way to solve those crucial CG related problems, as the draft policy document did not see the role of courts in relation to each organ of governance, it

did not set BoD as a compulsory organ for the governance of plcs. It also failed to see the problems that plcs' governance encounters in relation to shareholders' meetings, etc. Thus, in order to have good CG in Ethiopia, formulating and introducing appropriate and effective legal framework is very important. All stakeholder especially the Government, have to also give attention to this crucial issue.

The findings of this dissertation also demonstrated that courts have crucial roles to play in ensuring good CG. Practically, courts involved in every CG related issue that has arise in relation to each organ of CG.

The courts have an important roles and powers in CG-related issues in relation to shareholders' meetings, especially in calling and setting agenda of such meetings through the appointed court officer, and in setting aside the resolutions of the meetings.

Courts have an important roles and powers in removing BoD members, auditors and managers.

Courts also have roles and powers in the appointments of BoD members, auditors and managers.

Each role and involvement of courts has crucial impact in ensuring good CG of companies. The latter, especially becomes true if courts play those crucial roles properly as per the law and principles of good CG, and their involvements may genuinely contribute towards having and ensuring good CG in companies. The contrary, i.e. the courts' failure to involve in good tie may on the other hand contribute to have bad CG practices.

However, Comm. C provisions and other relevant laws are not adequate enough to enable courts properly solve those CG-related issues. In addition to these, even though courts have indispensable roles to play in resolving CG-related issues and in ensuring good CG practices in companies, the existing Comm.C and other relevant laws do not clearly stipulate the roles and powers of courts in relation to each organ of company governance.

Unlike company laws in other countries, there is no provision that stipulates whether or not courts have power to appointment and dismiss board members and auditors and to appoint managers where companies fails to do so. In addition to this, the Comm.C fails to

specify which cause constitutes “good or efficient cause” to dismiss a manager by resolutions of shareholders meetings or by orders of courts.

Besides these and other problems that are associated with the legal and regulatory framework of the country, there are institutional problems, which are associated with courts.

In conducting this study the writer discovered that, unlike in other countries, in Ethiopia, there are no real and, effective special benches for commercial/ business related cases.

Though, special benches have been constituted in Federal First Instance Court and Federal High Court for commercial cases, the practices of these ‘special benches’ do not make them real Commercial Benches. The reasons for these are: non- commercial cases also entrained in these seemingly commercial benches; there are no guidelines for the benches; the judges are assigned with no clear requirement; the judges have no special knowledge on company- related matters and etc.

In the Federal Supreme Court, there is no special bench that entertains commercial cases. Because of these problems sensitive CG-related issues are entertained together with other non-commercial matters by any of the benches at the court.

The finding of this thesis demonstrates that for courts to play and discharge their crucial roles and duties in ensuring good CG properly and effectively:

- ✚ there should be a workable legal framework
- ✚ the courts should be independent, efficient, and accessible
- ✚ the courts need to establish real and practical special benches for company-related matters
- ✚ Judges need to have special knowledge on corporations
- ✚ Courts need to have guidelines to determine the type of cases that may be filed in special commercial benches, to manage and control the special benches

there has to be criteria for judges to be assigned in those benches, as well as the time frame within which the cases are to be disposed, etc.

The writer, whilst examining the practices of courts in relation to CG related issues found out that the above-mentioned and other related problems make the practices of courts, incompatible with the law and principles of CG, rendering them to be inefficient,

characterized by delays in handing down their decisions, and that the courts also give decisions beyond the scope of the powers given to them by the law and also outside of the principles of good CG.

Those examined court cases also shows that in practice the judges did not give special attention to commercial matters and some of the decisions rendered on CG- related issues were outside of the law, and in clear contradiction with the principles of good CG. Moreover, those examined courts' decisions also show that, the court decisions were unpredictable and inconsistent.

For instance, the binding decision given by the Federal Supreme Court Cassation Bench in file No. 100621 and 97629, in the issues calling for the determination of appropriate applicable law for the period of limitation to have set aside the resolutions of shareholders' meetings. The binding decisions passed in file No. 63200, in relation to the issue of the re-instatement of managers dismissed by shareholders' resolutions may influence companies to have bad CG practices.

All these problems make courts inefficient in resolving CG-related issues promptly, and to give inconsistent or unpredictable decisions and sometimes decisions contradicting clear laws of the country and with principles of good CG. There are delays in courts in giving their decisions.

These make Ethiopian courts practically not in a position in discharging their duties and in playing their crucial roles in ensuring good CG

All in all the finding of this thesis shows that the courts in Ethiopia are not properly plying their crucial roles in ensuring good CG in the companies..

5.2 Recommendations

5.2.1 General Recommendations

- ❖ Company law of the country should be revised having in mind the current outstanding company related problems of the country and on basis of international standards and best practices of good CG.
- ❖ The draft policy for revision of the Comm.C should be reformulated based on the current business realities and principles of good CG to fill the identified gaps and shortcomings of the Comm.C and relevant laws of the country in order to have efficient company law *vis a' vis* good CG.
- ❖ The country should consider the stakeholders approach to constitute BoD for the companies.
- ❖ Policy makers of the country should give attention and adopt efficient and modernized CG principles for the governance of Plcs in order to get the benefit of these flourishing companies in the country.
- ❖ Policy makers and legislators need to give attention to the importance and roles of courts in ensuring good CG practices in companies in Ethiopia.
- ❖ The government should strengthen the independence of courts in every aspect, and should make effort to help them be efficient, and accessible.
- ❖ The administrative staffs of courts at all levels should be committed to the independence, strength, accessibility and efficiency of courts. The Federal Supreme Court should work hard along those lines.

5.2.2 Specific Recommendations

- ❖ The Comm.C should be revised in such a way that shareholders' meetings are made compulsory organs of CG in Plcs without the requirements of the numbers of shareholders in a company.
- ❖ The Comm. C should be revised in such a way that every Ethiopian Plcs should have auditors and not based on the number of shareholders.
- ❖ The Comm.C should be revised along the above-mentioned notions that, there is need to have clear provisions that stipulate the roles and powers of courts in relation to each organ of governance of Ethiopian companies.
- ❖ There is need to have provisions that stipulate which causes constitute “good cause” to dismiss manager through the resolutions of shareholders' meetings and the orders of courts.
- ❖ BoD need to be considered as one organ of governance in Plcs.
- ❖ The Comm.C should specify certain competitive qualifications that need to be satisfied to be eligible for directorship for S.cos and Plcs such as age, knowledge, experience, their past life history or record in bribery, corruptions, loyalty, etc.
- ❖ At all levels of courts, the administrations organs of courts should establish genuine special benches for company- related issues.
- ❖ The Federal Supreme Court pursuant to the power given to it by the law, establish special benches to handle corporate cases and issues, should issue guidelines for their management, the requirement for judges to be appointed to the special company benches, the timeline within which cases referred to them may be decided.
- ❖ The courts' administration should arrange and facilitate training for the judges to have special knowledge on company-related matters either through high level

education program leading to degrees or short term training or experience sharing visits to other countries.

- ❖ The writer also recommends that the Federal Supreme Court Cassation Bench, based on the power given it by the law should revise the binding decisions that it was passed on the issues of period of limitation for setting aside the resolutions of shareholders meetings on Cassation File No.100621 and 97629, and the decisions that allow courts to reinstate the manager dismissed by shareholders resolutions on Cassation File No. 63200.

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