Disqualification of Directors and Executive Officers as a Tool to ensure Good Corporate Governance in Ethiopia

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By: - Bisrat Teklu

Advisor: Zekarias Kenea /Associate Professor/

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Approval Sheet by the Board of Examiners

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I hereby certify that this is my original work. Works of others included in this thesis are properly cited.

Bisrat Teklu

Advisor: Zekarias Keneaa (Associate Professor)_______________

Examiners:

Name	**signature**
1.__________________________	_____________
2.__________________________	______________

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Acronym

ARESC	Access Real Estate Share Company
Civil Code	Civil Code of the Empire of Ethiopia
Commercial Code	Commercial Code of the Empire of Ethiopia
Corporate officer	Directors and executive officers
FDRE Constitution	Federal Democratic Republic of Ethiopia Constitution
MoT	Ministry of Trade
NBE	National Bank of Ethiopia
PLC	Private Limited Company
Policy Document	Policy Document on the Amendment of the Commercial Code
NBE Establishment Proclamation	The National Bank of Ethiopia Establishment Proclamation No. 591/2008
Labor Amendment Proclamation	Labor Amendment Proclamation No. 494/2005
Microfinance Business Proclamation	Microfinance Business Proclamation No. 626/2009
Insurance Business Proclamation	Insurance Business Proclamation No. 46/2012
UK Disqualification Act	Company Directors Disqualification Act 1986, CHAPTER 46, United Kingdom

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Abstract

Disqualification /comprehensive suspension/ prohibits a person from working as a director, senior corporate officer, liquidator, receiver, or, in any way, from engaging, or concerned with the management of limited liability companies. A person may be disqualified, among others, upon criminal conviction, unfitness, bankruptcy or any other failure in the administration of a company.

In Ethiopia, disqualification scheme is functional only in the financial sector. However, the disqualification regime in the financial sector is criticized for its subjectivity, unpredictability and lack of due process. In other words, in Ethiopia, disqualification scheme is not functional in other types of limited liability companies other than those in the financial sector. However, now-a-days the Ethiopian Government is looking forward to incorporate disqualification regime in all limited liability companies. This desire called examining the disqualification scheme and amending provisions regulating corporate governance in limited liability companies.

Chapter One
General Part

Introduction

Disqualification is a ban imposed on an individual to exclude him/her from certain offices.[1]It is a sanction that prohibits a person from serving as a director, liquidator, administrator, receiver or manager[2] of a company's property or in any other way from being concerned with or from taking part, whether directly or indirectly, in the promotion, formation or management of a company.[3]

In the history of corporate law, the inception of disqualification goes back to UK's Cork Committee reform recommendation in 1982.[4] In the report, the Committee underlined the need for sanctioning those who abuse limited liability. It provides that, disqualification is important to safeguard the public from abusive and unfit conducts of corporate executives.[5] This guarantees investors, creditors and the public that the economy stands tight against the mischief of directors and executive officers. For this, it recommended the incorporation of a disqualification scheme in UK's legal system.[6]

Truly, now days, countries use disqualification in order to protect the public as well as promote investment in their homeland, and keep their status quo as a center of investment.[7]Certainly, they use the scheme in order to sanction those that unfairly take advantage of creditors, shareholders and the public by sheltering themselves behind the corporate veil.[8] These countries adopt disqualification even though it is said it stands against the laissez-faire principle.[9]They justify

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[1] N. Cowan, Directors Disqualification - Recent Developments <www.wildercoe.co.uk>, last visited on 12th May 2015.
[2] S. Golding, Company Law (Cavendish Publishing Ltd., London, 1999), 2nd. ed., p. 299.
[3] *Ibid*, p. 300.
[4] P. Davies, Gower and Davies' Principles of Modern Company Law (London, Sweet & Maxwell Ltd., 8th edn., 2008), p. 237.
[5] Ibid.
[6] Ibid.
[7] Tewodros Mihret, "Governance of Share Companies in Ethiopia", Business Law Series, vol. 4 (2011), p. 53.
[8] D. Neuberger, "Company Law Reform: the Law of the Courts", in J. D. Lacy (ed.), The Reform of United Kingdom Company Law (London, Cavendish Publishing Ltd., 2008), p. 65.
[9] Id., p. 61.

such restraint through a need for protecting the public through adopting a 'proactive' attitude against those that threat the economy.[10]

In this paper, the researcher inquires whether disqualification of directors and executive officers should be used in limited liability companies in the Ethiopian legal system. First, the concept of disqualification, its grounds and effects will be examined. Related to this, mechanisms of controlling directors and executive officers in Ethiopia, and the grounds and effects of disqualification are explored.

1.2. Background

In the year 2012, NBE banned Ermias Amelga, board chairperson of Zemen Bank and Access Real Estate from taking part, in any way, in the management of banks.[11] As a result of this comprehensive ban, Ermias is restricted from engaging in the management of banks.[12]This prohibited Ermias from being neither a founder in a bank. He is also restricted from engaging in corporate structures that direct and manage the business affair of a bank, insurance and microfinance institution.[13]Hence, Ermais may not serve as a director, chief executive officer or senior executive officer; neither can he assume a position deemed to be management position in a bank.[14] In effect, he is prohibited from working as an administrator, founder, receiver of any bank,[15] or from engaging in any way directly or indirectly in the financial sector.[16]Nevertheless, people criticize the ban for lack of transparency and objectivity. As the ban was sector specific, however, Ermias continued to chair ARESC's board of directors.

The bad omen followed him to ARESC. The real estate he chair entered into too-good-to be-true commitments through which the Company sold more than 2,000 unconstructed houses

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[10] Ibid.
[11] Ermyas Amelga Banned from Banking Industry, <http://ethiopiaforums.com/ermyas-amelga-banned-frombanking-industry/9662/> , visited on 21st January 2016. In Ethiopia, the financial sector stands for banks, insurances and micro-finance institutions.
[12] Ibid.
[13] Corporate Governance Directive, Article 2.2.
[14] Corporate Governance Directive, Article 2.13.
[15] This is inferred from Article 34(1) of the Banking Business Proclamation.
[16] The ban is passed through the cumulative reading of Articles 17 and 31(4) of the Banking Business Proclamation

committing itself to deliver the houses within one year period.[17]Through this, the Company collected more than one billion birr from home buyers. The problem is, ARESC never completed the construction of any of the houses. Even worse, when the delivery date came, Ermias committed additional crimes related to the Company's operation and fled the country. He was exiled in Dubai for fear of criminal and civil charges.[18]This is reported as having failed ARESC, its customers and other stakeholders.[19]Furthermore, bankruptcy proceeding was triggered on ARESC. The matter also became a headache to the Ethiopian Government.

As a result of this headache, the Ethiopian Government constituted a Committee that identifies and resolves the problems of ARESC.[20]After it bargained, with Ermias, the Committee recommended that a guarantee be provided by the Ethiopian Government that Ermias won't be charged criminally. This was done in order to let him return from exile and rescue the Company. Afterwards, the desired arrangement for no criminal charges against Ermias was made.[21]Ermias then returned from exile on 19th February 2015,[22] and re-assumed his position of chairing ARESC's board of directors.[23] However, after re-assuming the position, the board asserted that

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[17] Dawit Taye, "Ermias Amelga Returns in Exactly Two Years" Ethiopian Reporter (Addis Ababa), Feb. 21 2015, p. 1. The commitment ARE enter into through his front rear was very difficult. It promised to deliver houses for more than 2000 customers. In the commitment, it further noted that if a customer did not get his/her home on time s/he will be entitled to ETB 5,000 every month as a penalty until the house is delivered to the customer.

[18] በዛወርቅ ሺመላሽ፣ "ገለሌ መርማሪዎች <ፕራይቬት ኢንቨስትጌተርስ> ሥርተው እንዲበሉ ቢፈቀድስ"፣ ወንበር የአለማየሁ ኅይሌ መታሰቢያ ድርጅት ቡለቲን, 14ኛ መንፈቅ (2006)፣ ገጽ 8-9፡፡

[19] Other stakeholders include creditors of access real estate, other sister companies to access real estate, the government and persons who were working in partnership with access real estate.

[20] Fasika Tadesse, "High Level Committee to take Measure on Access Real Estate", Addis Fortune News Paper (Addis Ababa) Nov. 09 2014, [*Vol* 15 ,*No* 758]), <http://addisfortune.net/articles/high-level-committee-to-take-measure-on-access-real-estate/>, visited no 12 January 2016, This Committee is established in 2014 through the order of the Prime Minister. The Committee further established a technical committee. The technical committee, chaired by Nuredin Mohammed, advisor to the Minister at the MoT, and general manager of Alle Bejimila, consists of nine members from the MoT, ARE home buyers and shareholders, and representatives from the MoUDHC. The Committee is established in order to take legal, administrative and political measures to resolve the problems faced by home buyers and shareholders.

[21] Mr. Ermias prayed the government to give him a guarantee that he will not be charged for offences he is suspected of in relation to ARE. The committee established to see into the matter looks into the legality of the situation. Consequently, in accordance with the Proclamation on the Definition of Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation No 691/201, Article 16(5) the Ministry of Justice ordered for no criminal charges on the person for crimes associated with Acess Captal.

[22] Capital News Paper, Ermias Amelga Resumed his Job, <www.capitalethiopia.com/index.php?option=com_content&view+article&id+5001:-ermias-amelga-resumed-his-job&catid=35:capital&itemid=27 >, visited on 1st Oct. 2015.

[23] Ermias Amelga Fired From Access Board , http://www.diretube.com/articles/read-ermias-amelga-fired-from-access-board_10258.html (August 24th 2015), visited on September 12th 2015.

Ermias is not fit to run the Company's operation.[24] Alleging that Ermias is no more able to handle the tension, and to let things go proper, the Board removed him from his position as a chairperson in ARESC.[25]Hence, Ermias continued to serving in the Board as an ordinary director. On the basis of this, some allege that the ban made on Ermias by NBE was right, and proactive. They argue, had the disqualification effected by NBE was extended to other limited liability companies, Ermias would not have become a headache.[26] In conclusion, people argue that the government should take a lesson from NBE's suspension scheme. On the other hand, others question the proprieties of the disqualification scheme in NBE itself. Others further argue, except in the financial sector, disqualification is not necessary in the current Ethiopian corporate structure.

Ermias's case is a one among many corporate scandal's cases that caught attention in Ethiopia.[27] Other than these, the Ethiopian Government, shareholders and stakeholders complain about fraud, lack of transparency, false promises and irregularities in the corporate sector.[28]In all cases, though the individuals are alleged to commit serious offences in relation to the operation and administration of corporate trust in the country there is no scheme that prohibits them from engaging in the activities limited liability companies. Even if individuals are proved to be a threat to the public and the economy, they can control or manage companies as far as they are shareholders choice. They can also form and run a new limited liability company; except, may be, in the financial sector.

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[24] Ibid.

[25] Ibid.

[26] In fact, even though these people argue in such a way a question was never strongly triggered on the incapacity of other board members and executive officers of ARE.

[27] Similarly, in the case of Holland Car PLC, Mr. Tadesse Tessema, founder and manager of the company failed the business and fled to Belgium defaulting the delivery of more than one hundred cars to customers. He did this after making his company file a bankruptcy proceeding. However, after the Company is declared bankrupt on 21st January 2013, Tadessee returned to Ethiopia on 12th May 2015. Furthermore a recent headline show that, Zerihun Getachew, Shareholder and general manager of Zuna Trading PLC is reported to flee abroad after collecting more than ETB 180,000,000 from customers promising to deliver motor vehicles and construction machineries. ethiopiantimes, Ethiopia: Holland Car Plc, Tadesse Tessema, left the country for the Netherlands, without delivering vehicles to over 100 buyers, https://ethiopiantimes.wordpress.com/2013/04/05/ethiopia-holland-car-plc-tadesse-tessema-left-the-country-for-the-netherlands-without-delivering-vehicles-to-over-100-buyers/ (April 5, 2015), visited on 23rd Dec. 2015; Bankrupt Holland Car Plc Gets Grace to Honour Commitments, http://addisfortune.net/articles/bankrupt-holland-car-plc-gets-grace-to-honour-commitments/ , Addis Fortune, visited on January 2nd 2016.

[28] http://debirhan.com/?p=320

As a result of this, the Government is planning to come up with strict corporate officers regulatory scheme in the economy.[29]The Ethiopian Government recently reported to have learnt lessons from NBE's regulatory framework. This includes the incorporation of disqualification scheme in Ethiopia.[30] In conclusion with this, examining the current disqualification regime and what should the future should look like have become important. In particular, the proprieties of the disqualification scheme exercised in the financial sector and other limited liability companies needs to be examined.

1.3. Statement of the Problem

In Ethiopia, mischief in the corporate structure is becoming rampant. As a result of this, the economy is yearning for solution. The Government is coming up with tight regulations and additional controlling schemes in order to protect investors and the economy. For this reason, among others, the government is continuing to boost the power of NBE in regulating the financial sector, enacted a new anti-corruption law that criminalizes corruptions in private organizations,[31] and also established a separate specialized body that scrutinizes share companies in the MoT structure. Nevertheless, except in the financial sector, the government did not actualize recent developments that promote the banning of directors and executive officers from corporate sector. As a result of this, examining the sufficiency of the current controlling mechanisms, and looking into disqualification as a tool for good corporate governance in Ethiopia is important.

1.4. Objectives of the Study

1.4.1. General Objective

The overall objective of the research is to examine the concept of disqualification of directors and chief executive officers and its relevance in ensuring good corporate governance in the Ethiopian corporate structure.

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[29] Cited above at note 29.
[30] Policy Document, p. 56.
[31]The government recently come up with new amendments in the Anti-corruption legal framework that swallows share companies that offer their share to the public under the ambit of the anti-corruption legal framework.

1.4.2. Specific Objectives

The specific objectives of this paper includes, ascertaining the meaning of disqualification, exploring its role in promoting good corporate governance, identifying grounds for disqualification and their effect, examining the rules of foreign jurisdictions regulating disqualification of corporate governors, and examining disqualification scheme in Ethiopia and assess its propriety in the Ethiopian legal system.

1.5. Research Method and Methodology

1.5.1. Research Method

In order to well address the research questions the researcher employed the following methods;

- **Documentary Analysis:** this includes;
    - **Analysis of the law:** Meaning interpreting and discussing laws related to disqualification of corporate governors in Ethiopia;
    - **Literature review:** Academic literature is limited on the research topic. However, relevant sources related to corporate governance and disqualification are available on the internet. Therefore, the researcher wisely uses literature review that includes desktop research for the accomplishment of the research.
- **Interview:** in the research, appropriate personnel in the MoT, the NBE, officers in financial institutions and legal practitioners are made part of the interview. This helps to clarify and provide clear insight about the practice.

1.5.2. Research Methodology

The study relies on qualitative data. The qualitative data is collected from both primary and secondary sources. Primary data is gathered from interviews. On the other hand, secondary data is collected from literatures and the law. After the primary and secondary data are collected a comprehensive analysis is made.

1.6. Research Questions

The research answers the following questions

1. What is disqualification?
2. Who are the subjects of disqualification?
3. What differentiates disqualification from related concepts?
4. What are the grounds for disqualification?
5. What are the effects of disqualification?
6. Is the concept of disqualification recognized in Ethiopia?
7. Can disqualification be a tool for good corporate governance in Ethiopia?
8. Are the existing controlling mechanisms sufficient to ensure good corporate governance in Ethiopia?

1.7. Significance of the Study

The study focuses on the disqualification of corporate officers in Ethiopian limited liability companies Hence, the study, through answering the research questions listed above, contribute the following:-

- ✓ It will serve as a guidance for the lawmaker and policymakers on forthcoming issues related to disqualification of corporate officers. In particular, the study will be helpful for the forthcoming amendment of the Commercial Code and other laws regulating financial institutions on disqualification of corporate officers,
- ✓ It will serve as a reference for persons that conduct their research on corporate governance and liability.
- ✓ It may serve as an academic reference material.

1.8. Scope

The scope of this research is limited to examining disqualification of corporate governors in companies.

1.9. Limitation

The researcher faced various limitations in the due course of undertaking this research. Some of the major problems include lack of adequate resource on the area and absence of cooperation

from individuals in the due course of undertaking interviews. In addition to this, lack of access to cases and draft legislations were major limitations.

Chapter Two
The Concept of Disqualification

Introduction

The way corporate governance is regulated affects an economy.[32]History further proved that, loosely regulated corporate governance disintegrates an economy.[33]As a result of this, countries use several mechanisms to control corporations. One among these is devising a regulatory and competition framework on persons that manage corporations.[34]These countries, at times impose sanction on corporate officers from engaging in corporate trust and management, i.e., disqualify them.[35]Governments introduce the disqualification scheme with a view to protect shareholders, creditors and other stakeholders.

However, the incorporation of disqualification scheme is not free from critic. Some argue that the exhibition of the concept, especially the sanction it imposes is against human rights and the pillars of free economy. These people further argue that disqualification is against business judgment rule and savagery on entrepreneurs.

This chapter is devoted to explaining the concept of disqualification. In the Chapter, primarily, the meaning, effect and subjects of disqualification are explored. In addition, the rationale, type and modes of disqualification are analyzed. Moreover, scholarly debates on the recognition of disqualification as a tool to ensure good corporate governance, and the peculiar features of disqualification that distinguish it from other civil and criminal sanctions imposed on corporate officers are covered in this chapter.

2.1. The Meaning and Effect of Disqualification

In corporate world, disqualification, also known as debarment or comprehensive suspension/ban refers to a restriction imposed on a person not to assume certain positions in corporations. Such restriction prohibits a person from serving in the prohibited positions for a specific term: determinate or indeterminate. Originally, the subjects of disqualification were only

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[32] Cited above at note 7, p. 54.
[33] Ibid.
[34] J. Girgis (2000), "Corporate Directors' Disqualification: The New Canadian Regime?," Alberta Law Review, vol. 46 No 3, p. 5.
[35] Ibid.

directors.[36]However, through time the scheme has evolved to cover executive officers as well.[37]In the contemporary world, both directors and actual executives are the subjects of the scheme.

The organ that imposes the prohibition is an independent third party.[38]It can be a court,[39] administrative tribunal or other government organ, such as trade offices and central banks entrusted with such power.[40] However, such third party is never a private citizen. Neither private citizens, nor corporations are given such mandate.

As it is pointed in the previous paragraph, once a person is disqualified, s/he may not engage in management of any company.[41]S/he will be barred from acting as a director, liquidator, administrator, receiver or manager of company[42] or in any other way from being concerned with or from taking part, whether directly or indirectly, in the promotion, formation or management of a company.[43] Moreover, in certain jurisdictions a disqualified person cannot serve as an auditor, or examiner of any company.[44] Further, in countries that vigorously extend the application of the scheme, such as the Balkans, its effect equally applies to family members of the disqualified

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[36] K. Kokkinaki, "An Assessment of the Penalties System for Infringements of EU Competition Law: Can Personal Sanctions be the Missing Piece of the Puzzle?", IES Working Paper 6 (Institute for European Studies, VUB Pleinlaan 2, B-1050 Brussels, 2013), p. 24.

[37] For instance in the Netherlands, the scope of disqualification extends to both directors and real executives of companies registered in the country. Moreover, in the Netherlands the application of the concept extend on individuals that engage on commercial activities while practicing a profession or running a business (one-man businesses). Corporate, Commercial & Litigation, Bill for a Directorship Disqualification Order under Civil Law: Political Posturing or a Real Weapon against Bankruptcy Fraud?, p. 1, https://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjAq9iVooTNAhWBXBQKHVMqC-wQFggaMAA&url=http%3A%2F%2Fwww.boekel.com%2Fmedia%2F689813%2Fnewsflash_corporate_commercial_litigation_may_2013.pdf&usg=AFQjCNH6hWFqbgFQxfklEnbNRXPmsRt49A&bvm=bv.123325700,d.bGs >, visited on 23rd April 2016.

[38] J. Shopovski, F. Bezzina and M. Zammit, "The Disqualification of Company Directors and its Effect on Entrepreneurship," European Scientific Journal, vol. 9, No 7 (March 2013 edition) p. 15.

[39] Ibid. Mostly disqualification is imposed on individuals by courts.

[40] Ibid. In principle the power to disqualify individuals is given to courts.

[41] Ibid.

[42] Cited above at note 2, p. 299.

[43] Id., p. 300. Note that, the restriction on taking part in the management of a company is very wide. In particular, the words "be concerned in" the management do not mean "take part in," and so include acting as a management consultant.

[44] A. Sheehan, Restriction, Disqualification and the Companies Act 2014: A Reformatory Analysis, p. 87, <http://www.corkonlinelawreview.com/editions/2015/ASheehan.pdf >, visited on 1st July 2016.

person.[45] In such countries, the prohibition restricts the spouse and children living with the disqualified person from engaging in the management of companies.[46]

In countries that use disqualification, companies may be held liable for engaging a disqualified person in one's management affairs. As this is the case, such countries establish a disqualification record that is kept by an administrative organ in charge of company records.[47] The record encompasses the legal ground on which an individual is disqualified together with the duration of the disqualification.[48] Therefore, every company is required to consult the record before appointing a person in management positions. If the company appoints a disqualified person listed on the disqualification record as an official without consulting the list, or by ignoring the fact that the person is disqualified, it will face civil liability.[49]

Furthermore, a power to disqualify a person, or its effect might not be territorially restricted. At times countries expand the disqualifying organ's disqualification power, and its effect.[50] For instance, in England the extra-territorial application of its courts disqualification power is recognized. Accordingly, if a company has sufficient nexus with England, even though it is located abroad English courts may disqualify its members of management.[51] Thus, its courts have the power to disqualify individuals outside their national territorial jurisdiction, and irrespective of nationality.[52] Moreover, in countries that recognize such scheme, a person disqualified in a foreign jurisdiction is prohibited from engaging in similar position in their country.[53] They place comparable restriction on persons disqualified under foreign law.[54] Nevertheless, in these states,

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[45] Cited above at note 34, p. 9.
[46] Ibid.
[47] Cited above at note 38, p. 15. Such list will be available for the public with or without fee. This is done with sufficient transparency for prospective investors and creditors.
[48] Id., p. 20.
[49] It is only when the company ascertains that the would be director/managing officer's name is not found in the disqualification list that it can appoint the same.
[50] A. Neal and F. Wright , A Survey of the use and effectiveness of the Company Directors Disqualification Act 1986 as a Legal Sanction against Directors Convicted of Health and Safety Offences (Employment Research Unit, University of Warwick, 2007), p. 4.
[51] Ibid.
[52] Ibid.
[53] Cited above at note 37, p. 1. For instance, in Ireland if a person is subject to mandatory disqualification in a foreign state, s/he will remain disqualified for the unexpired portion of the foreign disqualification. In other words, if the person faces discretionary disqualification in a foreign state, s/he is not precluded for disqualification. See A. Sheehan, cited above at note 44, p. 100.
[54] J. Davies, A Guide to Directors' Responsibilities under the Companies Act 2006 (London, Certified Accountants Educational Trust, 2007), p. 99. For instance, if one sees Part 40 of UK's Companies Act 2006 it allows this.

individuals subject to disqualification overseas might not be automatically disqualified.[55] For a reason that the former disqualification might not have followed due process, and the fact that it may have been politically motivated, such countries provide a scheme for review before making the disqualification effective.[56]

In conclusion, disqualification does not only bar a person from acting in a company s/he is disqualified from. Rather, the disqualified person will also be prohibited from acting as a director and engaging in managerial position in limited liability companies.[57] Overall, s/he will be ousted from the ambit of corporate and trust governance.[58] The period of disqualification is determined based on the gravity of liability.[59]During this period the disqualified person may not serve as director, administrator, liquidator, receiver or manager of company or in any other way from being concerned with or from taking part, whether directly or indirectly, in the promotion, formation or management of a company, unless s/he secures a leave of court.[60]

Once disqualified, the disqualification period runs from that date.[61]During the period of disqualification, if the disqualified person is found engaging activities s/he is prohibited s/he will face both civil and criminal liability.[62]This includes liability on a person that engage in the management of companies while banned in a foreign jurisdiction.[63]The civil effects of disqualification are, such that, first, the concerned person will face another disqualification. [64]In

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[55] Association of British Insurers, Transparency & Trust: Enhancing the transparency of UK company ownership and increasing trust in UK business, ABI Response, p. 3.
[56] Id., pp. 3-4.
[57] Cited above at note 2, p. 299.
[58] Ibid.
[59] Cited above at note 44, p. 95. In order to determine this period, countries use a general formula. First, based on the degree of fault the concerned authority should assess the appropriate period of disqualification. Afterwards, it should take into account mitigating factors and set the appropriate disqualification period. For instance, in England, under normal circumstances they say the disqualification period should not exceed 10 years bar.
[60] Cited above at note 2, p. 300.
[61] B. Pillans and N. Bourne, Scottish Company Law (London, Cavendish Publishing Limited, 2nd edn., 1999), p. 133.
[62] Cited above at note 34, p. 9. Disqualification though they is civil, once a disqualification is made, it is guaranteed by criminal sanctions too. Thus, it is criminal to act as a director, executive officer, receiver of a company's property, to act as an insolvency practitioner, or to involve directly or indirectly in the promotion, formation or management of a company during the period of disqualification.
[63] Cited above at note 54, p. 99.
[64] The OFT's revised director disqualification guidance : deterring directors or competition law breaches?, 2010, p. 2, <
https://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwi6pLLJooTNAhXIyRQKHenNCSQQFggaMAA&url=http%3A%2F%2Fwww.linklaters.com%2Fpdfs%2Finsights%2F

addition, s/he will be held personally liable for the debts the concerned company incurred during the term s/he served while being a disqualified.[65]Such personal liability is further extended to any person who has acted on instructions given by the disqualified person.[66]The only instance where a person may engage in activities disqualification bars him from before the expiry of disqualification period is when s/he secures a leave of court.[67] The court that has jurisdiction to give the leave is the one that would have pronounced the disqualification.[68] It is the court that has both material and local jurisdiction to disqualify a person that may give the leave.[69] When an application for leave is submitted, the court has the discretion to allow or not to allow him/her to engage in management. Such permission could be limited or supervised.[70]An application for leave may only be made by the disqualified person.[71]

Coming to the period of disqualification, it is determined by the legislature.[72]Depending on the law, the prohibition may be made either for determinate or indeterminate period. In determinate period disqualifications, mostly lawmakers provide a range within which courts determine the

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Corporate%2FNKDirectorDisqualification.pdf&usg=AFQjCNFQDR0aSrHsX9XTJ-yEz_VxqTDrZQ&bvm=bv.123325700,d.bGs >, visited on 23rd April 2016.

[65] Ibid.

[66] Cited above at note 35, p. 9. Companies, that recruit a disqualified person will also face civil suit if they knew or were supposed to know the disqualification of the person hired.

[67] Cited above at note 2, p. 304. Overall, it seems that courts, in approaching the question of whether leave should be given, should look at two factors: first, the should see the protection of the public. This will involve, seeing whether the person was disqualified for unfitness s/he had misappropriated any assets, or knowingly acted in breach of duty. They should also look at the character of the applicant. They should see whether s/he was honest, reliable and willing to accept advice In addition, a court may take into account the particular company of which the applicant is proposing to become a corporate officer. The size, financial position and the nature of the risks involved in its business may be relevant. Secondly, the court should have regard to the need of the applicant to act as a corporate officer in a practical sense. That is to say, for instance, it might be vital for a company to have the applicant involved as a corporate officer for customer or investor confidence or to exploit his/her expertise.

[68] Ibid.

[69] The Insolvency Service, Company Directors Disqualification Act 1986 and Failed Companies: a Guide to Director Disqualification, 2016, <https://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=7&cad=rja&uact=8&ved=0ahUKEwigv7DuooTNAhVIvBQKHT55CdwQFgg3MAY&url=https%3A%2F%2Fwww.gov.uk%2Fgovernment%2Fuploads%2Fsystem%2Fuploads%2Fattachment_data%2Ffile%2F496049%2FCDDA-and-failed-companies-january-2016_6.doc&usg=AFQjCNGJbVue9Bb89W5qrDbmqUfcbpxSgw&bvm=bv.123325700,d.bGs >, p. 9.

[70] A. Hicks, "Insolvency: Disqualifying the unqualified — a quixotic crusade?," Amicus Curiae (1999, Issue 18), p. 24. Leave applications are rare and expensive.

[71] Practice Direction: Directors Disqualification Proceedings, < https://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&cad=rja&uact=8&ved=0ahUKEwj00ZebpITNAhXEfxoKHdOpAjIQFggwMAQ&url=http%3A%2F%2Fwww.justice.gov.uk%2Fcourts%2Fprocedure-rules%2Fcivil%2Fpdf%2Fupdate%2Fdirectors-disqualification-practice-direction.pdf&usg=AFQjCNFQ0VSF-404EMQ23TSJ6IrZjCddNQ&bvm=bv.123325700,d.bGs >, p. 23, visited on 23rd May 2016. This rule extends from principles of procedural law that entitle a right to adjudicate a right only to its owner.

[72] Cited above at note 38, p. 15.

period of disqualification. In fixing the period courts consider the past conduct of the director.[73]In other words, in determining the period of disqualification courts do not consider the disqualified persons likely hood to reoffend in the future.[74] The latter is relevant only for a leave of court proceedings; it is not necessary in the original disqualification proceeding.[75]

2.2. The Purpose of Disqualification

Historically, the main objective of disqualification scheme has been sanctioning those that abuse the privilege of limited liability for their personal benefit at the expense of investors and the general public.[76] In addition to this principal objective, the scheme further focuses on deterring undesirable market behavior and formulate standards of good practice in corporate governance.[77]In general, the major rationale of disqualification scheme are to ensure the observance of the law, protect the public and other stakeholders and deter undesirable market behavior. These justifications are explained in subsequent sections.

2.2.1. Protection of the Public

The principal purpose of disqualification is to protect the public. [78]Moreover, history has proven disqualification serves purposes other than protecting the public. This includes, protecting wide range of stakeholders,[79]such as, shareholders, creditors and consumers.

Primarily, disqualification saves the public from directors who pay little attention to their duties under company law.[80]It attains this objective through banning those whose action exposes them to be unfit in the management of companies.[81]This is done through disqualifying unfit officials and those lacking ordinary standards of commercial morality.[82]Through this, disqualification protects the public.[83]

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[73] Cited above at note 34, p. 12, footnote 69. One may argue that the length should rely on whether that person would be unfit in the future. Nevertheless, it is pinpointed that the standard should be backward looking in a way what one should see is whether the past conducts of the director cumulatively seen would make the person unfit.
[74] Ibid.
[75] Ibid.
[76]Cited above at note 70, p. 15.
[77] Id., p. 22.
[78] Cited above at note 4, p. 243.
[79] Cited above at note 44, p. 91
[80] Cited above at note 1.
[81] Cited above at note 64, p. 2.
[82] Cited above at note 50, p. 8.
[83] Cited above at note 34, p. 8.

On the other hand, the protection of the public, in effect, protects shareholders, creditors and other stakeholders.[84] This is why countries present the scheme as a tool for the protection of creditors and the market.[85]In this context, through providing a statutory framework that encourages persons to pay careful attention to their company's financial circumstances, and deterring irresponsible behavior and malpractice disqualification protects the public and other stakeholders.[86]

2.2.2. Ensure the Observance of the Law

One of the purposes of disqualification is to ensure the observance of the law. It is used to mandate individuals to observe the law through sanctioning them for failure. At times, the lawmaker instructs company operators to be punctilious in observing the safeguards it lays down.[87]In doing so, it may attach disqualification to failure to observe the law. In particular, through attaching disqualification to failure with regard to disclosure,[88] filing and formation requirements,[89] governments ensure the observance of the law. Moreover, through attaching disqualification to anti-competitive activities, the law uses it as a tool for ensuring the observance of competition law. [90] One of the purposes of the scheme, is therefore, to give individuals incentive to comply with regulatory and competition rules.[91]

2.2.3. Deterrence

Recent developments underline deterrence as one of the purposes of disqualification.[92] The scheme is said to deter dishonesty, fraud and misconduct in operating corporate affairs.[93]Studies made in jurisdictions that use disqualification have proven that the scheme becomes a threat to those that administer companies, in addition to possible criminal sentences and financial penalties.[94]In a way, the deterrence is proved to be both specific and general.[95]

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[84] Citer above a t note 8, p. 65.
[85] Cited above at note 70, p. 22.
[86] Cited above at note 50, p. 6.
[87] Id., p. 8.
[88] Cited above at note 2, p. 12.
[89] Id., p. 300.
[90] Cited above at note 64, p. 1.
[91] Cited above at note 36, p. 5.
[92]Cited above at note 44, p. 92
[93]Ibid.
[94] Cited above at note 50, p. 7.
[95]Cited above at note 44, p. 91.

In practice, the deterrent effect of disqualification is proved to be more effective on professional executives.[96]However, the deterrence is proved less effective on non-professional executives, in particular, small business owner-managers that operate in self-employed culture.[97]This is for a reason that disqualification is a major threat on the reputation and status quo of professional executives.[98]Moreover, it affects their principal livelihood.[99]

2.3. Distinguishing Disqualification from Related Concepts

Disqualification is different from related concepts, such as, removal, resignation, restriction, suspension and qualification. First, disqualification is different from removal, qualification and resignation. While the others do not sanction a person from engaging in corporate trust and management, disqualification does. Moreover, removal, qualification and resignation do not sanction a person from being a founder, receiver, or administrator of a company property. Thus, even though a person is removed, or qualifies for the position in one company/sector s/he can engage in similar positions, unlike in the case of disqualification. In conclusion, removal, resignation and qualification do not prevent a person from committing similar misconduct in other company/sector.

In the second place, disqualification can only be enforced through authorities. On the other hand, removal[100] and qualification can be administered through private parties. Laws of countries open a room for shareholders and companies to administer the latter. On the other hand, resignation is private.[101]This is not the case in disqualification.

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[95]Ibid.

[96] Cited above at note 70, p. 23.

[97] Id, pp. 22-23. This is because, this type of persons once disqualified, s/he find new work or to set up a business in his/her name.

[98] Ibid.

[99] Ibid. Thus, they fear disqualification for which they adopt proper standards of practice.

[100] Nicholas Bourne, Essential Company Law (London, Cavendish Publishing Limited, 3rd edn., 2000), p. 55. A director can always be removed from office by ordinary resolution in general meeting, notwithstanding anything contained in his/her employment contract.

[101] The peculiar feature of resignation is that it neither is unilateral, nor involves third party. It results from the mutual agreement often with goodwill of the company and the employee/director. The Insolvency Service of UK, Insolvency: a guide for directors: When – Where – How – What, (2014), p. 8, < https://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0CBwQFjAA&url=https%3A%2F%2Fwww.gov.uk%2Fgovernment%2Fuploads%2Fsystem%2Fuploads%2Fattachment_data%2Ffile%2F387753%2FGuide-for-directors-december2014.pdf&ei=n9VlVer7KcesUduegZgL&usg=AFQjCNFLA74CbVp6M7shTKlEbiyExW_GTA&bvm=bv.93990622,d.ZGU >.

On the other hand, it is worth noting that disqualification is different from qualification. Qualification relates to professionalism and/or financial status. In this regard, in principle every individual is qualified to hold office in companies. As far as memorandum and articles of association of the company allows a person is qualified to be appointed as a director, or executive officer. In fact, this rule has its own exceptions. At times, the company, or the law requires a special professional[102] or financial[103] qualification. In the case of qualification, the fact is that though a person could not be able to hold certain offices for lack of qualification, it does not mean that s/he is disqualified. Such person can still serve in other senior executive positions in a company. In addition to this, s/he can be a founder of a company. This is not the case in disqualification. In disqualification, a qualified person is excluded from engaging in corporate trust and administration. Note that, it is qualified persons that can be disqualified.

Furthermore, disqualification is different from suspension. First, both employers and/or government authorities can order suspension, as the case may be. In the case of precautionary suspension, the employee will be deprived of his/her job or position in a workplace for a time pending[104] an outcome of a process.[105]The purpose of precautionary suspension is to take the employee off workplace until disciplinary grievances are heard. [106] In this case, the employer declines to accept an employee's services, but does not terminate the contract. [107]

Disqualification is also different from restriction. Though the two share similar features, both have separate peculiarities.[108]While restriction stays squarely in the remit of directors,

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[102] Kefene Gurmu (2005), pp. 35-36. Qualification is said to be professional when the law requires certain expertise, experience and age of the person in order to qualify as a director or executive officer. The proponents of professional qualification focus on the commitment and competence of persons than in their share in the company.

[103] Qualification relates to the financial status of a person when either the law or company constitution sets qualification of shares. In this regard, qualification of shares refers to a situation where a person is required either by the law or the company to acquire a certain number of shares in the company. Unless a person secures the minimum number of shares s/he cannot be appointed as a director. Moreover, ones appointed if a director is losses his/her minimum shares/he will be forced to vacate his/her office. Qualification of share is regarded as the traditional qualification requirement. Cited above at note 2, pp. 246-247.

[104] Black's Law Dictionary defined "suspension" primarily as a temporary hindrance or prohibition made on a person with an expectation of resumption B. Garner (ed.), Black's Law Dictionary (USA, West Publishing Co., 3rd edn., 2006), p. 696.

[105] J. Tsakane, B. Ngobeni and K. Odeku, "An Overview of Precautionary Suspension Phenomenon in a Workplace" Journal of Social Sciences, (vol. 39 No 3, 2014), p. 285.

[106] Ibid.

[107] Ibid.

[108] Cited above at note 44, p. 87.

disqualification governs a wider spectrum of potential roles within corporate governance.[109] Moreover, compared with restriction, disqualification is tight.[110]First, restriction comes into picture only when a company is liquidated.[111] Second, capitalization can immune the effects of restriction. If a person secures capitalization requirements as it is set by the law maker, s/he gets the permission to engage in senior positions in corporations.[112] In other words, a restricted director can manage a highly capitalized company.[113]Provided that the company fulfill the special rule on kipping higher capital, it can appoint restricted persons on senior management positions. However, no such exception exists in disqualification.[114] Finally, it is worth noting that a restricted person found undertaking activities s/he prohibited to undertake during the period of restriction will automatically face disqualification.[115]

In conclusion, disqualification differs from related concepts in all effect, nature and feature. Though, some sanctions look like disqualification in nature, its peculiarities are easily traceable.

2.4. Disqualification Debate

There are two categories of scholars on the incorporation of disqualification scheme in an economy. The first category of scholars, are pro-disqualification scheme.[116] On the other, the

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[109] Ibid.
[110] Ibid.
[111] D. Eustace, Duties of Directors under Irish Law- Funds Sector, (2013), p. 16, <http://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=6&cad=rja&uact=8&ved=0ahUKEwjfw-O6u4DKAhUCBBoKHSRLDzwQFgg5MAU&url=http%3A%2F%2Fwww.dilloneustace.ie%2Fdownload%2F1%2FDuties%2520of%2520Directors%2520under%2520Irish%2520Law%2520-%2520Funds%2520Sector%2520March%25202013.pdf&usg=AFQjCNG414zT8ea3nlYYITBTX_anQ5kx1Q> last visited on 26th Dec. 2015.
[112] Cited above at note 44, p. 87.
[113] For instance in Ireland, a restricted director can act as a director or take part in the promotion or formation of any company for a company that has a share capital of at least €63,487 in case of private company, or €317,435 in case the company is a public company fully paid up in cash. S. Sheehan , Liability of Company Officers : A Review of Restriction and Disqualification Orders, p. 7, <http://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=4&cad=rja&uact=8&ved=0ahUKEwjfw-O6u4DKAhUCBBoKHSRLDzwQFggtMAM&url=http%3A%2F%2Fwww.cpaireland.ie%2Fdocs%2Fdefault-source%2FStudents%2FStudy-Support%2FP1-Corporate-Laws-Governance%2Fliability-of-company-officers---a-review-of-restriction-amp-disqualification-orders.pdf%3Fsfvrsn%3D0&usg=AFQjCNFmZ6hwOGNmk7T15mlvmFibl2lUJg&bvm=bv.110151844,d.d2s> last visited on 28th Dec. 2015.
[114] Cited above at note 44, p. 87.
[115]Cited above at note 113, pp. 7-8.
[116] Cited above at note 38, p. 19

other category of scholars, argue against the incorporation of disqualification scheme in an economy.[117]

Scholars that argue against the incorporation disqualification scheme primarily condemn the scheme for being criminal in its nature.[118] They say disqualification sanctions corporate officers for failure to observe their contractual obligation. They say, disqualification like that of criminal law assumes punishment with it. Therefore, they argue, disqualification is against human rights principles they prohibit the imposition of punishment for failure to dispose contractual obligations. [119] Moreover, the proponents of this view assert that disqualification goes against constitutionally recognized freedom of individuals to acquire their livelihood.[120]In particular, they argue, through sanctioning a person from engaging in the formation and management of companies disqualification deprives individuals economic liberty, i.e., ones' right to get livelihood. Thus, they conclude disqualification, is criminal in its nature, for it is against individuals' freedom to get their livelihood, and restricts individuals' commercial liberty. According to their assertion, the scheme affects the right of citizens, even convicted persons right to seek work commensurate with their skills.[121]

Moreover, the proponents of this view criticize disqualification for discouraging entrepreneurship and shrinking investment. According to them, the exhibition of additional compliance burden and liability through disqualification deter individuals from accepting senior management positions in corporations.[122]In addition, they say the scheme undermines an important principle in the business world; the business judgment rule.[123]As the scheme allows judges to revisit the appropriateness of corporate officials decision, it overrides the principle that holds corporate officials act in the best interest of their company in honest and informed basis.[124]Such degradation, they say, lifts the veil that protects corporate officers from being

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[117] Ibid., pp. 25-26.
[118] Cited above at note 8, p. 61.
[119] Cited above at note 8, p. 65.
[120] Cited above at note 44, p. 92.
[121] J. Barnard, "The SEC's Suspension and Bar Powers in Perspective," Tulane Law Review (Vol. 76 No. 1253, 2002), p. 1254.
[122] H. Anderson, "Directors' Liability to Creditors – What are the Alternatives?", Bond Law Review (Vol. 18, 2006, Iss. 2), p. 2.
[123] Cited above at note 34, p. 29.
[124] Ibid.

examined by judges that have no business expertise.[125]Therefore, they argue disqualification deters corporate officials from taking appropriately risky decisions that could be beneficial to shareholders wealth maximization, create employment opportunities and benefit the economy as a whole.[126]More importantly, they criticize the scheme making corporate officials to focus on strategies that minimize the risk of potential liability, rather than on the growth and prosperity of the corporation.[127] In conclusion, the proponents of this view oppose the recognition of disqualification for reasons of constitutionality and economic welfare.

On the other end, those that argue for the incorporation of disqualification scheme argue that disqualification is an essential sanctioning tool in the current business world. First, they argue that disqualification is neither criminal in nature, nor unconstitutional.[128] They stress that disqualification is civil in its nature.[129]They say the sanction it imposes is a civil sanction imposed on individuals that lack commercial probity.[130]Therefore, for them there is no punishment associated with disqualification scheme. In addition, they say disqualification does not override individuals' freedom to get one's livelihood.[131] According to them, the right to get ones livelihood has limitations under the law.[132]Thus, the government may ban an individual from engaging in certain professions for the sake of protecting the public. This is a practical reality, they argue. In fact, they say that disqualification has a deterrent effect like criminal law.[133] However, this does not mean that it is criminal.[134] Rather, the deterrent effect eliminates recidivism better than a system of criminal sanctions.[135]

At the other end, the proponents of this view argue that disqualification stimulates an economy and promotes entrepreneurship. According to their theory, a country that needs to develop a

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[125] Ibid. Further, imposing a scheme that allow courts to disqualify directors based on decisions they made raises concerns that corporate officers would be worried about having their decisions second-guessed or subjected to court scrutiny. This on the other hand is assumed to push them from taking risks on behalf of the corporation in order to avoid disqualification.

[126]Cited above at note 121, p. 2.

[127]Id., p. 36.

[128] Cited above at note 36, pp.30 &37.

[129]Cited above at note 44, p. 92.

[130]Ibid.

[131] Cited above at note 36, pp.30 &37.

[132] Ibid.

[133] Ibid.

[134] Ibid.

[135] Ibid. The imposition of even higher fines is not a realistic option and for the present level of development criminalization is not seen as the most preferred policy choice. Directors' disqualification is less controversial and could be applied easier in practice than criminal sanctions.

legitimate site and source of international business needs an effective corporate officials controlling mechanism.[136]Moreover, a country needs to have qualified people that run corporations.[137]Accordingly, they say a scheme that disqualifies corporate officials play an essential role in creating prudent and competent corporate officials. According to this theorization, if disqualification is used properly it can dominantly protect shareholders and other stakeholders from corporate jackals. In turn, this can stimulate entrepreneurship, and contribute towards the formulation and sustainability of nutritious economy where one can safely invest its portfolio.[138]

In relation to the critic related to business judgment rule, pro-disqualification regime scholars assert that disqualification does not affect the principle. These scholars argue that, disqualification only discourages undue risky behaviors; it is not there to examine each decision of corporate officers.[139]A wrongful conduct caught by scheme is an act that inexcusably disregards commercial morality.[140]In other words, mere mistake of judgment never results in disqualification.[141]Therefore, they say disqualification do not affect the principle of business judgment rule. Rather, they argue disqualification and business judgment rule has positive correlation. They argue, disqualification supports business judgment rule through restricting group thinking within corporate structure. When disqualification is in place, corporate officers will be expected to protest against decisions they believe to be unreasonable for they fear reluctance would result in disqualification.[142]This in fact proves that disqualification can has a positive correlation with prudence and commitment required in the business judgment rule.

Furthermore, pro-disqualification regime scholars argue, the current corporate scandal controlling mechanisms are neither sufficient, nor criminal law is a solution for it. Thus, they say governments need laws that either extends corporate officers personal liability, or they should come up with another mechanism that sanctions corporate officers from actively participating in limited liability corporations.[143] In this regard, pro disqualification scheme scholars assert that

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[136]Cited above at note 44, p. 78.
[137] Cited above at note 64, p. 4.
[138] Ibid.
[139] Cited above at note 122, p. 30.
[140] Cited above at note 34, p. 30.
[141] Ibid.
[142] Cited above at note 36, p.29.
[143] Ibid.

extending personal liability will have unwarranted and farfetched consequences.[144] In particular, they say stretching personal liability threatens entrepreneurship and investment. Therefore, in order to protect the public and promote entrepreneurship disqualification is the right tool.[145] They argue, studies also show that in jurisdictions that recognize both personal liability and disqualification since the mid 1980s, the latter has proved to be more effective in controlling corporate mischief.[146]

Last but not least, they argue while entrepreneurs do not require a qualification to set up limited companies and to manage the same, it is sound to disqualify them for at times, they put at risk the public and the economy.[147]

2.5. The Subjects of Disqualification

The principal subjects of disqualification are directors and members of management working in limited liability companies. [148] This includes all forms of directors: *de jure*, *de facto* and shadow directors.[149] Moreover, both formally appointed and *de facto* executive officers that manage corporations are subjects to disqualification. In this section, the subjects of the scheme that engage in the management of a company are explained.

a. Directors

i. De Jure Directors

"De jure" is a Latin term that refers to a thing that exists in accordance with the law.[150] Hence, the phrase "*De jure* director" refers to a formally/lawfully appointed director.[151] A *de jure* director is thus a director that assumes his/her post formally, and is responsible for the overall

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[144] Cited above at note 34, p.3.
[145] Ibid.
[146] Ibid.
[147] Cited above at note 70, p. 22.
[148] Cited above at note 38, p. 14.
[149] Cited above at note 101, p. 7.
[150] The Free Dictionary by Farlex,< http://legal-dictionary.thefreedictionary.com/de+jure >, visited on 24th May 2016.
[151] Study on Directors Duty and Liability, p. ix, <https://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwiPkPrtqITNAhWFyRoKHSQjAN4QFggdMAA&url=http%3A%2F%2Fec.europa.eu%2Finternal_market%2Fcompany%2Fdocs%2Fboard%2F2013-study-analysis_en.pdf&usg=AFQjCNEEnXSVNu1TdvCHy0iQtltab9OcCg&bvm=bv.123325700,d.bGs >

governance of the company.[152] A *De jure* director may either be appointed by subscribers meeting,[153] shareholders meeting,[154] the board of directors,[155] or government authorities.[156] The authority to appoint directors in companies that operate legally is left for shareholders meeting.[157] However, exceptionally board of directors, or government authorities may temporarily appoint a director.[158]

ii. De facto Directors: Indirect and Shadow Directors

The word "*de facto*" refers to an act that actually exists having a legal effect.[159]It is an act that actually exists, however, having no *de jure* recognition. In this regard, a *De facto* director is a director that is not validly/formally appointed.[160]Thus, a *de facto* director, though, s/he is not formally appointed as a director, s/he in one way or another engages in the governance of a company. [161] A *De facto* director may either be an indirect director, or a shadow director. A person is said to be an indirect director when s/he assumes office informally and engages in the activities of the board of directors.[162]On the other hand, a shadow director does not directly engage in the board of directors. However, his/her shadow lives within the board of directors. Though s/he does not participate in the board, the director would have cult with his/her words. S/He is a person whose words the board of directors is accustomed to observe. [163]

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[152] Id.
[153] Com. C., Art. 350(1).
[154] Com. C., Art. 350(2).
[155] Com. C., Art. 351(1).
[156] Banking Business Proclamation, Art. 17(3) , Insurance Business Proclamation, Art. 18(3), Micro-finance Business Proclamation, Art. 19.
[157] Com. C., Art. 350(2).
[158] Banking Business Proclamation, Art. 17(3) , Insurance Business Proclamation, Art. 18(3).
[159] B. Garner (ed.), Black's Law Dictionary (USA, West Publishing Co., 3rd edn., 2006).
[160] Cited above at note 36, p. 25.
[161] Ibid. In other words, the hands of an indirect director is actively present in the governance of the company.
[162] Cited above at note 8, p. 205. A person standing as a *de facto* director should not be determined by the application of a single decisive test but in all cases a number of factors should be considered. These factors include whether there was a holding out by the company of the individual as a director, whether the individual described himself as a director and whether the individual had a capacity to participate in the decision making process of the company.
[163]Ibid.

b. Executive Officers

Executive officers are the other subjects of the disqualification scheme.[164]In this regard, an executive officer becomes the subject of the disqualification scheme if s/he identifiably performs a management role, or discharges or assists discharging a managerial function.[165]This indicates that a person will be the subject of disqualification only if he engages in management, while being formally appointed, or without any formal appointment. This includes both *de jure* and *de facto* executive officers.

A *de jure* executive in this regard includes formally appointed general manager, branch manager, or sub-division manager in a single entity. On the other hand, a *de facto* executive officer is a person that engages in management functions without formal appointment. In conclusion, the subjects of disqualification scheme are only functional managers.[166]In other words, it is only individuals that engage in the actual management of a company who are the subjects of disqualification scheme.[167]

2.6. Modes of Disqualification

2.6.1. Disqualification order

Disqualification order refers to an order given by court having jurisdiction to disqualify a person.[168]This court may be an ordinary court, or a disqualification tribunal. [169]In practice, mostly disqualification order is passed by ordinary courts.[170] Nevertheless, some commentators argue that the task should be given to tribunals constituted to see disqualification exclusively.[171]

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[164] Executive officers are known in different names. Among others they are named manager, administrator, president, managing director, controller, and so on. Cited above at note 7, p. 79.

[165] Cited above at note 50, p. 6. When it comes to executive officers, disqualification will only be effective on them provided certain conditions are fulfilled. It is only when the offender and the company's management, and the offence itself and the company's management, i.e., provided that there is a nexus between the particular offence and the activity of management.

[166] Cited above at note 51, p. 6.

[167] Ibid.

[168]Cited above at note 68, p. 24.

[169]Ibid.

[170] Ibid. Countries give the jurisdiction to courts that see insolvency, commercial fraud and also to criminal benches that see crimes in connection with company operation.

[171] Ibid. According to these commentators, courts are not best adapted to determining the fitness of individuals to take part in the management of companies. Disqualification trials have become a costly and artificial exercise which determine not whether the person is currently unfit but whether they infringed the required technical standards at some point in the past. To remedy these failings, they recommend the composition of a separate disqualification trial.

In courts, the disqualification proceeding can be initiated by those having *locus standi*.[172]Disqualification order is the preferred mode of disqualification.[173]

2.6.2. Disqualification Undertaking

Disqualification undertaking refers to out of court disqualification settlement.[174]It is a recently introduced disqualification mode that supplements disqualification order through disqualifying a person for a certain term without the need for a court hearing.[175] In this respect, disqualification undertaking is reached through bargain made between the would be disqualified corporate officer and the administrative authority entrusted with the power to undertake the disqualification undertaking.[176] Nevertheless, it is functional only on the grounds of unfitness.[177]

In disqualification undertaking, the administrative authority disqualifies a person only upon reaching consensus on the appropriateness of the disqualification with the disqualified person.[178]In other words, disqualification undertaking is the product of bargain. More specifically, it is a commitment of self-disqualification by the director that accepted not to take part in the management of limited liability companies for a certain period of time.[179]If the administrative authority entrusted with disqualification undertaking, and the '*would be disqualified person'* disagree on the appropriateness of disqualification, the case will be directed to courts.[180]Such disagreement may relate either to the period of disqualification, or to the appropriateness of the disqualification undertaking.[181]

Moreover, a person disqualified through an undertaking may at any time trigger a court case on the appropriateness of the disqualification.[182]If an action is brought on the appropriateness of the undertaking, the court will see into the propriety of both the disqualification ground and

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[172] Cited above at note 113, p. 2 In the Republic of Ireland disqualification proceeding can be initiated by multiple stakeholders. Accordingly, either of the following stakeholders can initiate a disqualification process, i.e., the Director of Corporate Law Enforcement, the Director of Public Prosecutions, the Registrar of Companies, and in limited instances by shareholders, creditors, employees and receivers can initiate the proceeding.
[173] Cited above at note 70, p. 24.
[174] Cited above at note 34, p. 7, For instance, in England it is introduced in the Insolvency Act at the year
[175] Cited above at note 4, p. 239.
[176] For instance in England, such power is vested on the Secretary of State.
[177] Cited above at note 101, p. 10.
[178] Cited above at note 4, p. 239.
[179] Cited above at note 36, p. 29.
[180] Cited above at note 4, p. 239.
[181] Ibid.
[182] Ibid.

period.[183]Afterwards, if the court found the disqualification ground to be wrong, it may waive the disqualification. In addition, if the disqualification period is found to be inappropriate, the court may reduce it for the benefit of the disqualified person. However, in as long as the disqualification undertaking is not lifted by a court of law, its effect will remain the same as disqualification order. [184]

Disqualification undertaking is preferred for several reasons. First, it is preferred for expediting the disqualification process, and avoiding litigation cost.[185]Moreover, through entering into disqualification undertaking the disqualified person may avoid adverse publicity s/he may face by appearing in court.[186] Nevertheless, this does not mean that disqualification undertaking is preferred to disqualification order.[187]Though, disqualification undertaking has some advantages, it is criticized for the fact that an individual presented in disqualification undertaking process is weaker compared to the institution that undertakes the disqualification undertaking. In other words, the disqualification undertaking is made among unequal persons Hence, the disqualification process may become oppressive to the corporate officer. In addition to this, disqualification undertaking is criticized for, it may make corporate officers that fear sever disqualification period in courts, and/or fear publicity of the disqualification process easily fall for the disqualification proposal of the disqualifying authority. This may happen, even at times it is highly probable that the corporate official may be innocent if the case is taken before court. Disqualification undertaking could therefore be oppressive and deny a fair hearing in breach of individuals human right.[188]As a result, disqualification undertaking is not preferred to disqualification order.

2.6.3. Administrative Debarment

Administrative authorities can be given the power to disqualify individuals from office. [189] This is known as administrative debarment.[190]What distinguishes administrative debarment from

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[183] Cited above at note 34, p. 10.
[184] Ibid.
[185] Cited above at note 36, p. 29.
[186] Ibid.
[187] Cited above at note 70, p. 24.
[188] Ibid. It could appear to be anti-enterprise and to increase the fear of failure.
[189] Cited above at note 121, p. 1268.
[190] Ibid. Such bar can be lifetime. Courts have limited the due process rights of persons facing a summary debarment order made by an administrative agency.

disqualification order is that it is given by administrative agencies that do not have the power to adjudicate cases. Moreover, unlike in the case of disqualification undertaking, there is no bargain between the agency and the person charged. However, the effect of administrative debarment is the same as disqualification order.

Provisions that entrust authorities the power to disqualify individuals are of two types. The first group encompasses categorical provisions.[191] These provisions list predictable grounds for disqualification that are not susceptible for interpretation. On the other hand, the other category holds grounds that require an exercise of discretion by the administrative agencies to debar a person.[192]Among these, some are amorphous.[193]

Administrative debarment is criticized for giving unwarranted power to government authorities that potentially distort disqualification's proper role in maintaining the integrity of the market.[194]This principally occurs when government authorities abuse their power. In addition, administrative debarment is feared to make authorities rely on disqualification while other remedies are available.[195]

2.7. Types of Disqualification

2.7.1. Conditional vs. Non Conditional Disqualification

Disqualification could be either conditional or non-conditional. Non conditional disqualification completely excludes a person from involving in corporate governance in any form in the period after disqualification.[196]If a person faces non-conditional disqualification s/he cannot engage in any senior position in corporate structure during the period of disqualification.[197] On the other hand, in the case of conditional disqualification the disqualified person is not completely excluded from corporate governance structure. Rather, such disqualification would allow the disqualified person to involve in corporate governance in specific and/or conditional

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[191] Id., p. 1269. This includes provisions that prohibit a person convicted of certain crimes from assuming certain offices.
[192] Ibid.
[193] Id., p. 1270.
[194] Id., p. 1256.
[195] Ibid.
[196] Cited above at note 70, p. 24.
[197] Cited above at note 2, p. 299.

situations.[198]Conditional disqualification may also be sector specific.[199] An example in an Ethiopian context would be disqualification in relation to the financial sector.

In Ethiopia, the NBE may pass sector specific bar on individuals. However, it cannot disqualify a person outside the financial sector. In fact, sector specific disqualification is allowed for a reason that not all misconducts in specific sector could indicate that a person is unfit to engage in other sectors.[200]

2.7.2. Mandatory vs. Discretionary Disqualification

Disqualification may be either mandatory, or discretionary.[201]When the disqualification is mandatory, the court has no option, but to disqualify the person up on finding the set conditions are fulfilled.[202]The court disqualifies the concerned irrespective of his/her current suitability to be involved in the management of a company, and regardless of whether his/her disqualification is in the interest of the public.[203]In other words, mandatory disqualification is inflexible.[204]On the other hand, when disqualification is discretionary, courts disqualify a person only when they find it proper. Though the court finds a corporate officer liable for misconduct, it disqualifies him/her only if it believes disqualification is in the interest of the public. Thus, discretionary disqualification is flexible according to the judgment of courts.

2.7.3. Definite Vs. Indefinite Period of Disqualification

Disqualification may either be made definite period, or indefinite period.[205]Disqualification is made for definite period of when it is made for a defined period under the law. In this regard, countries like the UK that provide definite period of disqualification stipulate restrict the effect of disqualification for the maximum of fifteen years.[206] The law prefers definite disqualification period for a reason that the lawmaker assumes a person may be rehabilitated and refrain from

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[198] Ibid. For example, a director of a share company that offer share to the public might be disqualified from management of public companies but be thought fit to run a PLC.

[199] That means even though a person is disqualified in a certain sector, s/he can engage in similar position in another sector.

[200] Cited above at note 55, p. 3.

[201] Cited above at note 44, p. 93. For instance, in Ireland, if the disqualification a person is disqualified for a period the court thinks fit.

[202] Cited above at note 70, p. 24.

[203] Ibid.

[204] Ibid.

[205] Cited above at note 121, p. 1262.

[206] UK Disqualification Act, § 6.4.

committing further fault that would lead to disqualification.[207] On the other hand, when the disqualification is made for indefinite period, the time during which the disqualification remains effective is not defined. That means, unless waived by the competent authority, a disqualification made for indefinite period may cause a lifetime ban on an individual from engaging in corporate administration. Mostly, disqualification is made indefinite period when it is convincing that allowing a disqualified person to engage in the administration of companies in the future is a threat to the overall economy.[208]The likelihood of future misconduct is always important in imposing a lifetime ban on individuals.[209]

2.8. The Peculiarities of Disqualification: What other Controlling Mechanisms Fail to Spot

Disqualification has its own merit that other regulatory mechanisms fail to spot. Among others, first, though there is no criminal conviction, disqualification may exclude a person from engaging in the formation, administration and liquidation of companies. It goes beyond criminal law and restricts individuals with untamed behavior from engaging in the business world without restricting their physical liberty. In the second place, the standard of proof used in case of disqualification, unlike criminal matters, is preponderance of evidence. As a result of this, it is possible to exclude a person through disqualification though s/he might escape criminal liability due to a higher degree of proof. [210]Related to cost of litigation as well, disqualification is easier, less expensive and less time consuming.[211]

In the third place, other private law sanctioning mechanisms simply exclude a person from acting in certain positions in a single organization. For instance, though an individual is removed from a certain organization, s/he may still continue to serve in the same position in another organization. This shows that removal is institution specific. Removal neither excludes a person from acting in the same task in another organization, or in a different position in the same company. Moreover, removal does not prohibit the dismissed person assuming similar position in a foreign

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[207] Cited above at note 44, p. 90.
[208] Cited above at note 70, p. 23.
[209] Cited above at note 121, p. 1260.
[210] Cited above at note 36, p.30.
[211] Ibid.

jurisdiction. In case of restriction as well, capitalization allows a person to hold senior management position is corporations. On the other hand, when it comes to disqualification, its effect is universal in a jurisdiction. Accordingly, a disqualified person cannot engage in the same position, or do similar works during the disqualification period.

Lastly, other types of private law remedy mainly focus on injunction and compensation.[212] The primary target of such remedy is to stop further interference, and seek compensation. Beyond this, they do not bar a person that endangers the economy, shareholders and other stakeholders from engaging in the area where the concerned person would harm the public. Stated differently, while other types of private remedy do not exclude a person from certain offices permanently, for a specific period, disqualification protects investors and the overall public from dangerous business personnel through excluding the latter from limited liability hemisphere.

In conclusion, though other types of private remedies provide a solution against deviant corporate officers, the solutions do not bar a person from engaging in the same activity and post for a particular period. As a result, they do not protect the public from dangerous individuals. Moreover, though criminal law may impose bar on individuals not to exercise in management positions its standard of proof make disqualification preferable. Moreover, at times criminal law may impose restriction on individuals from exercising certain rights, its restriction always pre-supposes conviction. In addition to this, unlike in the case of disqualification, the restriction imposed through criminal law is not comprehensive. Criminal law restriction may also occur through legal interdiction. Legal interdiction may prohibit a person from administering his/her socio-economic affairs. It may prohibit a person from administering its estate.[213]However, instances legal interdiction occurs rarely in related to corporate affairs.

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[212] Robert McDougall, Remedies in Commercial Litigation, Paper delivered at the College of Law Commercial Litigation intensive workshop, p. 1, < https://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0ahUKEwie06v0rYTNAhXEtxoKHTy0BmYQFggkMAE&url=http%3A%2F%2Fwww.austlii.edu.au%2Fau%2Fjournals%2FNSWJSchol%2F2014%2F4.pdf&usg=AFQjCNEndHdtxTAcKAs_doP_i5xhiUY5rw&bvm=bv.123325700,d.bGs >, visited on 19th May 2016.

[213] Civ. C., Art. 380.

Chapter Three
Grounds for Disqualification

Introduction

Every violation do not result in disqualification. Nor does, one time violation of law necessarily result in disqualification. Rather, the law identifies grounds that justify disqualification. It is in these specific scenarios, such as, unfit conduct, wrongful trading, persistent breach of commercial law, disqualification is believed to serve its purposes without causing negative implications on entrepreneurship and the general public.

The grounds for disqualification can be misconduct in connection with company business, unfitness, participation in wrongful trading, being undischarged bankrupt and failure to pay under county court administration court. In this chapter, the major grounds for disqualification are explored.

3.1. Disqualification for Misconduct in connection with Companies

Disqualification based on general misconduct represents banning persons from serving in the position of corporate officer for offences related to a company.[214]It is a ban imposed on individuals that are found liable with certain offences at the formation, operation or winding up of a company.[215]The liability could either be criminal or civil. These grounds are discussed as follows.

3.1.1. Criminal Conviction

The first ground that disqualifies individuals is criminal conviction. Criminal conviction results in disqualification when a person is found guilty for certain crimes related to company undertakings.[216] These crimes may be committed at the promotion, formation, management and winding up of a company. A person that conducts a business, for his/her personal benefit in the name of a limited liability company is subject to disqualification for general misconduct.[217]In this regard, criminal conviction can be the source of either mandatory or discretionary disqualification. This is an option left to the lawmaker.

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[214] N. Bourne, Principles of Company Law (London, Cavendish Publishing Limited, 3rd ed., 1998), p. 123
[215] Ibid.
[216] Ibid.
[217] Cited above an note 34, p. 11.

As it is indicated earlier, the crime could be committed at the entry stage, i.e., at the stage of formation. At this stage, both promoters and founders may be subjected to disqualification. On the entry stage, founders may be disqualified for fraud, failure to keep proper records and unduly incurring expenses at the cost of subscribers. At the stage of operation, a person may be disqualified if s/he is convicted in relation to the management of the company.[218] This includes crimes committed relating to the internal affairs of the company as well as crimes committed in relation to the company's dealings with third parties.[219]In particular, convictions for failure to comply with provisions requiring filing, such as filing annual return, account or other document to the registrar of companies constitute grounds for disqualification at operation stage.[220] In order to identify this, countries use the test "Whether the crime committed has a factual connection with the management of the company."[221] At the stage of winding up, a person may be disqualified where it appears that s/he is liable for offences related to fraudulent trading, or has otherwise been guilty, while as an officer[222] or liquidator of the company or receiver or manager of its property, of any fraud in relation to the company or of any breach of his duty as such officer, liquidator, receiver or manager.[223]

3.1.2. Persistent Breach of Commercial Laws

At times legal provisions are meant to protect the public. Some provisions target at protecting the public either by prohibiting unwarranted commercial behavior, or by requiring commercial partners to act in a certain way. In this respect, the lawmaker may attach disqualification for violation. In a way, certain persistent breaches are recognized as a ground for disqualification.

A person is disqualified for persistent breach of company legislation when s/he repeatedly breach company law provisions. As the nomenclature signifies, in order to disqualify a person through this ground, the person must breach competition or regulatory laws more than ones. As the term "persistent" signifies the breach must have continuity.[224] At least, in order to say the breach is

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[218] Cited above at note 2, p. 300.
[219] Ibid.
[220] UK Disqualification Act, § 5.1. Failure to send a document, or notice to authorities that keep the register of the company may also constitute a ground for disqualification.
[221] Cited above an note 2, p. 300
[222] The term "officer " includes a shadow director.
[223] UK Disqualification Act, § 1.1.
[224] Cited above at note 216, p. 124.

persistent, the breach must occur more than twice.[225] In this regard, the breach may relate either to a single obligation, or to multiple legal obligations. This could constitute breach of separate company/regulatory legislations. It does not matter whether a single provision is breached or not. Though different provisions or legislations are breached, showing that the breach is persistent is enough.

Moreover, it is important to note that a breach is said persistent if it occurs within a specific time frame. In particular, if each breach occurs once in a long time, it may not be taken as a persistent breach.[226]It is rather regarded as an occasional breach. Therefore, in order to determine whether a breach is persistent, the lawmaker should come up with a timeframe within which repeated breaches would be regarded as "persistent". The time frame may be one year or so. For instance, if one sees the experience of the UK, a person is said to be in persistent breach if s/he breaches company legislation at least three times within five years period. The five year period is backward from the date when application for disqualification is instituted.[227] Such default, in fact, should be conclusively proved.[228] Moreover, in the disqualification process, though the defendant does not raise the expiry of time for persistence, the court should raise it of its own motion.[229] However, it is worth noting that, multiple breaches committed at a time may constitute "persistence". In other words, a breach committed at a time may constitute persistent breach.[230] It is not the difference in time the default is committed that determines persistence; rather, it is the number of breaches that determine it.[231]

In addition to this, it is not all breaches of company legislation that would trigger the disqualification of a person. There are selected duties the non-fulfillment of which would cause disqualification for persistent breach. These in particular relate to defaults in filing, reporting, returning or notifying certain mattes to the concerned organ, mostly the registrar of companies.[232]

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[225] Merriam Webster's Dictionary (USA, Library of Congress, 2006).
[226] Ibid.
[227] UK Disqualification Act, § 3.2.
[228]Ibid.
[229] Id. § 3
[230]Id., § 3.2.
[231] Ibid.
[232]This includes failure to notify disqualified persons under foreign law, failure to deliver company accounts, refusal to disclose information under court order and failure to make returns.

3.1.3. Other Cases of Disqualification for Misconduct

There are also neither convictions based, nor persistent breaches that would result in disqualification of corporate officers. These one-time breaches may cause disqualification. The legislatures stipulates them because certain breaches may have severe consequence.[233] This may include a default in payment of court order which entails automatic disqualification.[234]

3.2. Disqualification for Unfitness

Unfitness is the most prominent and litigated[235]ground for disqualification.[236]A person is said unfit when s/he fails to execute his/her duty entrusted to him/her under the privilege of trading through limited liability.[237] In general, a person is disqualified for being unfit for incompetence and/or lack of commercial probity.[238]

The first reason a corporate officer may be disqualified for unfitness is due to lack of commercial probity. A person lacks commercial probity when s/he acts in dishonesty.[239]It occurs when s/he acts through an intention to misbehave.[240]However, it is not all lacks in commercial probity that cause disqualification. It is only inexcusable lack of commercial morality that would cause disqualification; it is misconduct done through inexcusable bad faith or fraud.[241]

On the other hand, a person may be disqualified for unfitness for reasons of incompetence. In this regard, incompetence refers to unreasonable business decisions.[242]These are decisions that are taken as unreasonable compared to the act of a reasonable corporate officer in similar circumstances and position that would be taken as incompetence.[243]Such incompetence may

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[234] Cited above at note 34, p. 11.

[235] The parties to a disqualification proceeding for unfitness are a government agency entrusted to litigate disqualification and the person charged. In this respect, when a company gone through insolvency the receiver or insolvency practitioner of the company is duty bound to report the conduct of each director holding office in the past few years of the company. Together with this, such organs are further allowed to specifically report any potentially unfit conduct to the latter. After receiving the report, the organ entrusted to litigate the matter will determine whether it is in the public interest to seek the disqualification of the person charged. It is when the government organ entrusted to prosecute the matter that the individual against whom the allegation is brought should be regarded as unfit. See Cited above on note 35, p. 10; Cited above on note 70, p. 22.

[236] Cited above at note 38, p. 20.

[237] Cited above at note 34, p. 12.

[238] Ibid.

[239] Id., p. 13.

[240] Ibid.

[241] Id., p. 30.

[242] Cited above at note 54, p. 98.

[243] Ibid.

result either from the actual incompetence of an individual to administer a company, or gross negligence.[244] Actual incompetence to administer a company relates to the inability of a person to manage corporations. Thus, if a person does not have the required quality to manage, he can be disqualified. Such actual incompetence may occur due to failure to know the obligations associated with the position.[245] Consequently, ignorance is regarded as a serious incompetence or neglect.[246]In addition, individuals that assume management positions while knowing that they cannot discharge their duties are regarded incompetent.[247]Coming to the type of negligence that results in disqualification, in general negligent conducts do not result in disqualification. Rather, it is only a fault that occurs due to gross/extreme negligence that results in incompetence.[248] Note that, the fault must also be serious enough to entail disqualification.[249]In particular, individual's act or omission attributable to business practices of an improper, but nevertheless naive and imprudent do not constitute incompetence. [250]Moreover, risky actions taken by corporate officers as risk takers do not result in disqualification. [251]This is because such risky and naive decisions may be part of marketing judgment.[252] From the premises made in the previous paragraphs, it is clear that objective standard is used in determining unfit conduct. An individual's conduct is examined from the reasonable skill and care expected from an objectively reasonable person in the management/governance of a company, in similar circumstances.[253]Consequently, a person may not escape incompetence merely for failure to know the obligations associated with the

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[244] Cited above at note 34, p. 30. If a high threshold is maintained for finding unfitness, there will be no concern about undermining the business judgment rule.
[245] Id., p. 14 If a director finds that he is unable to do what he knows ought to be done then the only proper course is for him to resign.
[246] Ibid.
[247] Ibid.
[248] Cited above at note 44, p. 90.
[249] Stephen Griffin, "The Disqualification of Company Directors in the Management of Insolvent Companies", in J. D. Lacy (ed.), The Reform of United Kingdom Company Law (London, Cavendish Publishing Ltd., 2008), p. 207.
[250] Ibid.
[251] Cited above at note 4, p. 296
[252] Ibid.
[253] John Birds, "The Reform of Directors' Duties", in J. D. Lacy (ed.), The Reform of United Kingdom Company Law (London, Cavendish Publishing Ltd., 2008), p. 154. The duty of care and skill was traditionally regarded as low, because directors were not bound to devote their time to the company and were judged by the level of skill that they possessed, that is on a subjective basis. Now days, countries require an objectively reasonable level of care and skill, and this is certainly the case where a company is insolvent, or on the verge of insolvency.

position.[254]In addition, individuals that assume the position while knowing they cannot discharge their duties are regarded unfit.[255]

The fact that an individual is unfit is determined based on the overall conduct of a person in a company, including his/her conduct in other corporations in the country and overseas:[256]A single conduct is not a sole reason for disqualification.[257]For instance, when disqualification becomes a concern in insolvent companies, the unfitness of an individual is assessed not only by restricting scrutiny to the period immediately before the insolvency.[258]Rather, the overall conduct of the person in the company and other companies is also relevant.[259] At this point, it is worth noting that unfitness is a factual determination. [260] It is to mean that a person can be found unfit though s/he does not involve in a breach of any statutory duty.[261] While breach of statutory duty can be used as guidance to determine unfitness, a factual determination and the facts of each case are the ones that determine unfitness.[262]

A person may be disqualified for unfit conduct, both in solvent and insolvent companies. [263]In insolvent companies, a person is disqualified when his/her act is proved to have contributed to the insolvency of the company to a marked degree. In addition to this, the liability is attributable to individuals where they increase the liability of the company while trading through insolvency. However, it is important to note that disqualification will not be effected on a person simply for a reason that s/he allowed the company to trade while it was insolvent. Though the company is insolvent, if a person can prove that s/he continued trading with a reasonable prospect of achieving a satisfactory outcome for the company's creditors and took adequate steps to achieve that outcome s/he will not be disqualified.[264]In general, in determining unfitness, the court,

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[254] Cited above at note 34, p. 14.
[255] Ibid.
[256] Clyde & Co LLP (2014), Transparency and accountability in UK business - Are we there yet?, p. 2, <http://www.google.com.et/url?sa=t&rct=j&q=&esrc=s&source=web&cd=9&cad=rja&uact=8&ved=0CE0QFjAIahUKEwjhpYqIrcnHAhUCVhQKHbyVDXU&url=http%3A%2F%2Fwww.clydeco.com%2Fuploads%2FFiles%2FArticles%2F2014%2FCC005389_Transparency_and_Accountability_13_06_14.pdf&ei=Xg7fVeH-IoKsUbyrtqgH&usg=AFQjCNEW5xP9ckXsAlmT9abvFzur3N55dw>, visited on 27th August 1015.
[257] Cited above at note 4, p. 242.
[258] Id., p. 243.
[259] Ibid.
[260] Cited above at note 34, p. 15.
[261] Ibid.
[262] Ibid. Unfitness is determined through the standard of preponderance of evidence. Cited above at note 8, p. 206
[263] Cited above at note 216, p. 125.
[264] Cited above at note 54, p. 98.

among others, sees the extent of the director's responsibility for the causes of the company becoming insolvent, and the company's failure to supply any goods or services it was already paid.[265]

In companies that do not become insolvent, disqualification comes when an official investigation proves that the director is unfit.[266]In such a case, a person is disqualified for being unfit upon a proof that his/her behavior as an officer holds him/her unfit to be concerned in the management of a company.[267]In fact, unfitness primarily functions in insolvent companies.[268]

To determine unfit conducts foreign laws provide schedule that guide the disqualification process. These schedules incorporate wider and generic set of factors that the court should take into account in deciding unfitness.[269]These factors among others look into materiality of the conduct, guiltiness of the individual and the impact of the individual's behavior. When a disqualification proceeding is in motion, a person so charged may tender his/her defenses to show that s/he is fit. This may constitute an explanation and reasons for having acted in a given manner. [270]

3.3. Participation in Wrongful Trading[271]

Wrongful trading is another ground for disqualification.[272] The liability for wrongful trading is attributed to a corporate officer when s/he continued to let the company trade disregarding the

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[265] Cited above at note 34, p. 13.

[266] Cited above at note 4, p. 242.

[267] Cited above at note 34, p. 11. Countries took the following six factors in deciding whether a person is unfit "(1) the 'egregiousness' of the underlying violation; (2) the defendant's behavior, in particular as a company governor; (3) the defendant's role or position (4) the defendant's degree of scienter; (5) the defendant's economic stake in the violation; and (6) the likelihood that misconduct will recur." However, these factors though they need to be seen always are not the only factors seen. Cited above on note 121, p. 1259.

[268] Cited above on note 4, p. 242. Directors' treatment of the company's creditors is a significant consideration when courts are looking into the unfitness of directors. Matters for determining the unfitness of a director include a consideration of the extent of the director's responsibility for the causes of the company becoming insolvent and failure by the company to supply any goods or services for which it has been paid. See also, Cited above at note 35, p. 13.

[269] Cited above at note 113, p. 2.

[270] Cited above on note 34, p. 10. Among others, s/he can defend him/herself through submission of statement of truth that explains the properness of the conduct s/he is charged to e improper conduct. In addition, the truth statement of experts and organizations, such as, bankers, accountants, and creditors can be part of the proceeding as an evidence. Such evidentiary statements can be submitted either for or against the person so charged.

[271] Wrongful trading provisions have proven problematic and difficult to implement, due to the difficulty of establishing the requirements in the legislation, along with a difficulty of getting funding to pursue the proceedings. Id., pp. 5-6.

companies perilous financial situation.[273]This occurs when a corporate officer continues trading in a company while reasonably suspecting that the company is insolvent.[274] Moreover, disqualification order can be issued if it appears that, in the course of winding up of the company, a person has engaged in wrongful trading, whether or not convicted.[275]Through this kind of tight regulation, disqualification served as an incentive to corporate officers of insolvent companies to cease trading and wind up the company in case there is no reasonable prospect for avoiding liquidation.[276]

From the above understanding, it is clear that a person would be held liable for honest, but unreasonable action.[277] As a result, corporate officers need to ensure the presence of adequate funds prior to making decisions to continue trading. Therefore, the law requires corporate officers to take immediate steps to put the company into liquidation, receivership, or administration where no adequate fund is there.[278]

The previous paragraph, thus dictates that there exists an obligation to determine the moment corporate officers should stop trading and decide for liquidation. In this respect, the standard used to determine whether there is wrongful trading is determined by judging whether the company's financial condition could have been better if it was liquidated at the earliest moment it was alleged that it should stop trading.[279]In order to determine this, the court should first determine the proper date a reasonable person should have liquidated the company. Afterwards, it should identify the "net deficiency" in the company's assets. It should then identify the net deficiency in the company at the date it decided the company should have ceased trading up to

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[272]Id., p. 8. Countries that impose personal liability on directors on directors for wrongful trading use disqualification in order to maintain the integrity of the business environment. While there is some overlap between the two schemes, as it is possible for directors to be disqualified if they have been found liable under the wrongful trading provisions, the wrongful trading provisions are much more limited in scope and exist to provide incentives for directors to liquidate an insolvent company at the optimal time. The disqualification provisions are broader both in terms of purpose and with regard to the type of behavior caught. Wrongful trading provisions were designed to impose personal liability on directors who are found to have abused "the privilege of limited liability," the Cork Report determined that the wrongful trading provisions are only useful when the statutory requirements for liability, which are difficult to prove, are met. Most importantly, the provisions imposing liability could not prevent directors from committing similar misconduct in the future.

[273] Ibid. Most importantly, the provisions imposing liability could not prevent directors from committing similar misconduct in the future.

[274] Cited above at note 116, p. 36.

[275] Cited above at note 38, p. 21.

[276] Cited above at note 34, p. 5.

[277] Ibid.

[278] Ibid.

[279] Id., p. 6.

the date the company did cease trading. After this, if the court finds that the company has increased loss due to the delay in liquidation directors may be held liable.[280]

A person against whom an action for disqualification is instituted for wrongful trading may have valid affirmative defenses. S/he may defend him/herself by proving that s/he took "every step" to minimize the potential loss to the company's creditors since s/he became aware of the fact that insolvency is inevitable.[281]

3.4. Undischarged Bankrupts

A person against whom a bankruptcy proceeding is instituted automatically become an undischarged bankrupt.[282]Such person may be discharged only after the bankruptcy proceeding winds up.[283]In fact, a bankrupt debtor secures discharge under certain conditions. He may be discharged either s/he pays his/her whole debt, or at times, without even paying his/her whole debt. Discharge is possible without paying the whole debt upon the fulfillment of certain conditions.[284]In particular, discharge may be given only for bankrupts that cooperate with the commissioner to facilitate the payment of all debts.[285] On the other hand, a bankrupt who is found concealing his/her property so as to avoid payment may not be discharged.[286] Moreover, it is worth noting that all debts are not dischargeable.[287] Debts such as tax, maintenance allowance, and debts that emanate from tort liability are not subject to discharge.[288] The same holds true for fines and penalties imposed on the undischarged bankrupt.[289] The effect of discharge is that, the discharged person will be released from further duty to pay a debt, if any.[290] Furthermore, a discharged person may become a corporate officer. [291]

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[280] Id., p. 6. In one case, liquidators were unable to show any increase in net deficiency, and the Court found that the company was not worse off as a result of continuing to trade.
[281] Ibid. The standard to which a director is held for the purposes of the wrongful trading provisions is both objective and subjective. Objectively, the director must have the knowledge, skill, and experience of a reasonably diligent person carrying out the same functions as those which have been entrusted to the director. Subjectively, a director must take the same steps as a person with the same knowledge, skills, and experience would have taken.
[282] La Salle Law Library, Formerly American Law and Procedure (vol. X, 1965), p. 288-290.
[283] Ibid.
[284] Ibid.
[285] Ibid.
[286] Ibid.
[287] Ibid.
[288] Ibid.
[289] Ibid.
[290] Ibid.
[291] Cited above at note 70, p. 23.

Differently stated, being an undischarged bankrupt is sufficient to disqualify a person from holding certain public and private offices.[292]One among this is a bar not to hold office as a director of a company that prescribes its shares to the public.[293] Such individuals will be barred from working as a director until an order of discharge is given in favor of them so that they can begin a fresh start. In other words, such individuals are barred from being a director until they are discharged by a court.[294]In fact, discharge is not given to all persons, and not towards all debts.[295]Being an undischarged bankrupt is a ground that automatically disqualifies a person.[296]

3.5. Failure to Observe Disqualification Order/Undertaking

A person faces disqualification if s/he is found engaged in activities s/he is suspended from during the disqualification period.[297]This is an automatic disqualification a person will face. Moreover, any person who has acted on instructions given by the disqualified person knowingly will be disqualified for the same reason.[298]Officials and founders that recruit a disqualified person are therefore liable for disqualification.

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[292] UK Disqualification Act, § 11.1.

[293]In countries that recognize discharge, once a bankruptcy proceeding is instituted against a person s/he will automatically become undercharged bankrupt until s/he secures discharge. In earlier times, discharge was not recognized. Due to this, creditors were able to secure their claim from a bankrupt as fast as he earned income or acquired property in order to satisfy their claim. Unless the debtor pays ever penny he owes to his/her creditors he would not be freed. However, this was identified to be a short sighted policy which brought in to picture discharge in bankruptcy. Discharge is engineered through that belief that dictates unless a debtor is too much dishonest s/he should be relieved from his burdens and permitted to go free so that he can start his/her life fresh. Once s/he secures discharge he can freely work and start a new life rather than becoming a slave to his/her creditors. In addition to this, such individuals are required to inform their creditor if they want to borrow a money beyond certain limit as it is provided under the law. Cited above at note 282.

[294] An order given to discharge a bankrupt releases the bankrupt from all current debts. As a result, it frees him/her from the disabilities of bankruptcy. Due to this, he can hold offices undischarged bankrupts are barred from holding. In particular, s/he can become a company director. http://www.businessdictionary.com/definition/discharged-bankrupt.html

[295] Cited above at note 282, p. 290. Discharge can be given to either natural or artificial person..

[296] Cited above at note 34, p. 11.

[297] Cited above at note 64, p .2.

[298] Cited above at note 34, p. 9.

Chapter Four
Disqualification of Directors and Executive officers in Ethiopia: A tool for Good Corporate Governance?

Introduction

Good corporate governance may not be achieved through setting certain exhaustive requirements.[299]In fact, there is no universal formula to achieve it. A corporate governance regime is rated as the best if it attains the objective it is designed to attain.[300]However, in general, a certain corporate governance regime may be regarded as good if it balances corporations competitive sustainable development with other economic interests in the economy.[301]The regime needs to ensure competitive sustainable growth of the company, while at the same time it protects the interests of shareholders, creditors and the general public.[302]

In Ethiopia, the law sets several legal frameworks in order to ensure that good corporate governance prevails. The law provides both regulatory and competition rules the non-observance of which entails civil and criminal sanctions. In this chapter, the various civil and criminal sanctions imposed on a corporate officer are briefly discussed. Following this, disqualification scheme in the Ethiopian legal system, and its necessity to ensure good corporate governance in the current legal regime is examined.

I. Sanctions on Corporate officers in Ethiopia

4.1. Civil Sanctions

4.1.1. Personal Liability

In Ethiopia, the law regulates corporate governance in order to protect both shareholders and stakeholders.[303]In order to achieve this purpose, at times the law holds corporate governors personally liable. The personal liability may be to a company,[304] its shareholders, creditors or

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[299] Cited above at note 7, p. 66.
[300] Id., pp. 61-62.
[301] Id., p. 66.
[302] Id., p. 70.
[303] Id., p. 54.
[304]Fekadu Petros, Ethiopian Company Law (Addis Ababa, Fareast Trading PLC, 2016) p, 117. While the first is a consequence of directors' obligation to serve the company.

other third parties.[305]The personal liability of directors and executive officers is discussed as follows under a separate heading.

A) Personal Liability of Directors

Directors may be held personally liable to a company,[306] its shareholders and creditors.[307]First, directors may be held personally liable to a company. The Commercial Code provides that directors have personal liability to a company if they fail to exercise duties imposed on them by the law, the memorandum of association, articles of association and resolutions of meetings, with due care required from an agent.[308]This includes failure to take all steps within one's power to prevent or mitigate acts prejudicial to the company.[309] In this case, a director is sued by the company only after a resolution to sue him/her is passed by the general meeting of shareholders. In this respect, the resolution will be adopted only if at least shareholders that hold 20% of the capital of the company support the institution of a proceeding against the concerned director/s. The resolution may target the institution of a proceeding against either one director or multiple directors.[310]

Accordingly, after the resolution is adopted, the company may institute the action against the director/s.[311]If the company fails to institute a proceeding within three months, shareholders who voted in support of the resolution may jointly institute proceedings against the director/s.[312] However, if the company is declared bankrupt it is only the trustee with the permission of the commissioner that can institute a court proceeding against directors in the name of the company.[313]The personal liability of directors for the company is jointly and severally.[314]

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[305] Id., p.118. Directors liability for third parties emanate from the general principles of tort law.
[306] Ibid.
[307] Id. p, 118.
[308] Com. C., Art. 364(1). The requirement that stresses they should take a "care due from an agent" indicates that the rules regarding agency under the Civil Code are equally applicable to directors. Cited above at note 304, p. 143.
[309] Com. C., Art. 364 (4). However, the latter liability scheme attributes directors only if the danger was within their knowledge. In addition, a director can securely defend itself from court action if s/he shows that s/he is not at fault, and has caused a minute dissenting from the action of the board, which is entered forthwith in the directors minute book and sent to the auditors. Com. C., Art. 366(6).
[310] This can be understood from the reading of Article 365(2) of the Commercial Code. *See* also Elias T/Birhan, Law of Business Organizations (Addis Ababa, Fareast Printing PLC, 2014), p. 140.
[311] Com. C., Art., Article 365(4).
[312]Com. C., Art. 365(4). If the shareholders succeed in the claim, the compensation goes to the company. In such a case, the shareholders can personally claim the cost they incur in the institution of the proceeding from the director which is held liable. Cited above at note 310, p. 141.
[313] Com. C., Art. 1159.
[314] Com. C., Art. 364(2).

In the second place, directors may be held personally liable to shareholders. In this regard, shareholders that suffer damage from the fault or mischief of a director are entitled to bring a proceeding against the concerned director.[315]However, a shareholder may bring an action against directors only if s/he is directly affected by the faulty act of the concerned directors.[316]

In the third place, directors and managers may be personally liable for creditors.[317]In particular, Article 366 of the Commercial Code stipulates that directors are liable to the company's creditors where they fail to preserve intact the company's assets.[318]Furthermore, sub-article two of the same article stresses that creditors may hold directors personally liable if the assets of the company are insufficient to meet its liabilities.[319] Thus, if the property of the company is insufficient to cover the claim of its creditors, the principle of limited liability does not work for directors.[320]The presence of this derivative remedy is thus there as a general remedy for creditors.[321] In principle, a company may not have enough assets to pay its debts when due also without being legally bankrupt.[322]

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[315] Com. C., Art. 367

[316] Com. C., Art. 367. The requirement that the prejudice be "directly" caused by the directors, expressly stated in Article 2395 of the Italian Civil Code intended to preclude a direct suit for damages against directors, brought by shareholders alleging the loss of value of the stock due to directors' mismanagement or fraudulent practice; such injury is indeed the consequence of the injury to the company, and therefore does not "directly" affect shareholders. Besides, shareholders cannot sue directors derivatively on behalf of the corporation. *See,* L. Stanghellin, "Corporate Governance in Italy: Strong Owners, Faithful Managers" IND. INT'L & COMP. L REV. (Vol. 6, No. 1, 1995), p. 120.

[317] Com. C., Arts. 366 and 367.

[318] Com. C., Article 366(1). This provision emanates from the principle that sates, "The assets of the Company is a common pledge to its creditors." Cited above at note 273, p. 167.

[319] Com. C., Art.366(2). Cited above at note 7, p. 84. The spirit in Article 366 does not impose on the board the duty to act in the interests of creditors; however, it imposes a duty not to prejudice their interests by means of illegal acts. This is done for Ethiopian law recognizes the preservation of the company's property equally important to creditors.

[320] Cited above at note 304, p. 168. Fekadu analogizes Articles 364-366 of the Commercial Code with French Commercial Code Article L225-225. In this respect, L225-92 is similar with Article 366 of the Commercial Code. In this respect, the researcher stress that the Article 366 of the Commercial Code is the copy of Articles 2395 of Italian Civil Code. In this respect, Italian Courts prove that the Article entails strict liability. On the other hand, authors, such as Endalew Lijalem and Elias T/Birhan Claim that the liability under Article 366(2) of the Commercial Code is fault based. The experience in Italy discloses that Courts do not require evidence of intent or negligence to be offered by creditors. More precisely, once it is established that directors violated their specific obligations toward the company, courts consider intent or negligence with respect to creditors irrelevant. *C*ited above at note 316, p. 119, foot note 90. *C*ited above at note 310, p. 141.

[321] This is a political choice made by the Italian government, from where Ethiopia transplanted Article 367. Cited above at note 316 p. 120.

[322] E. Gilardi, "Liabilities of Directors and Shareholders of a Company Limited by Shares Under Italian Law" Businessjus Il Mondo Del Diritto Cambia,< www.businessjus.com>, p. 3, last visited on 2nd Feb. 2016.

Nevertheless, if the company is declared bankrupt, unsecured individual creditors cannot institute the proceeding against directors personally. During bankruptcy, it is only the trustee who is allowed to take action against the directors with the permission of the commissioner.[323] If the trustee is successful in the proceeding, the fruits will benefit all creditors that have a claim from the company. On the other hand, coming to other third parties, the Code allows them to institute a proceeding against directors for damages they directly suffer from the act of directors.[324] The liability in this case is fault based.[325] However, concerning stakeholders, Ethiopian law clearly provides the personal liability of corporate officers only as far as creditors.[326] Beyond this, the liability of directors to other stakeholders is not clearly provided.[327]

B) Personal Liability of Managers

Chief executive officers are liable to the company and its creditors. The liability of managers to the company emanates from contract. To the company, the manager is liable for failure to properly administer the company. This is provided in the Commercial Code and the Civil Code. In the Commercial Code, Article 530 provides that managers of PLC may be held liable through the concerned civil law for damages caused to the company due to his/her breach of duty. Civil law in the provision represents law of obligation.[328] Thus, if the manager is a formally appointed manager, his/her relationship with the company is regulated through the principles of contract law;[329] however, if not, unless s/he can prove the presence of a situation that requires him/her to act as an unauthorized agent, his/her relation with a company is regulated through tort law.

In share companies, the liability of managers to a share company is not clearly stipulated under the Commercial Code. However, Article 348(4) of the Code provides that the manager is an employee of the company. In this regard, as employment emanates from contract, the manager is

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[323] Com. C., Article 1159.

[324] Com. C., Article 367. Typical examples of such liability are the violation of preemptive rights, or misstatements on the financial condition of the company in connection with the purchase or sale of shares or with the extension of credit to the company. Cited above at note 310, p. 119.

[325] Com. C., Article 367.

[326] Cited above at note 7, p. 71.

[327] Id., p. 84. Other stakeholders include consumers, employers, suppliers, competitors and government. In fact, in this regard, though the concern needs independent research, the researcher argues that the term third parties should only include individuals that are directly and in close relation with the company that are affected by the fall of the company.

[328] Book IV of the Ethiopian Civil Code governs the relation.

[329] Belachew Mekuria, Basic Principles of Ethiopian Labor Law (Addis Ababa, Hebir Printing Press, 2011), p. 32.

liable to the company for damage the company sustains from breach of his/her contractual duty. On the other hand, if a person is found engaged in acts of management without appointment, s/he may face tortuous liability.

Moreover, managers may be held personally liable for creditors. In PLC's, Article 531 of the Commercial Code provides that both *de jure* and *de facto* managers are liable to creditors where the assets of the PLC are shown to be inadequate to cover its debts. Such action, is instituted against both types of managers through the trustee.[330]In addition to this, Article 1160 of the Commercial Code adds one situation.[331] This instance is different from the latter in a way that it imposes liability on those that engage in acts of management in the name of a company for his exclusive advantage.

4.1.2. Removal

Removal is one of the prominent sanctions imposed on corporate officers.[332]Regarding directors of share company, the Commercial Code provides that they can be removed from office by the general meeting of shareholders.[333]Moreover, in the financial sector directors may be removed from office through the instrumentality of the NB. Coming to managers, Ethiopian law grants the company, directors, shareholders general meeting and NBE the power to remove directors from office.

Removal may be for any reason. In other words, a company may either remove a corporate officers for good cause, or without good cause. At times, a company may impose it as a sanction

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[330] Com. C., Art. 531. At this point, it is important to note that the provision expressly deals with the issue of judicial bankruptcy. As a result of this, a question arises whether creditors of the PLC can directly proceed against those engaged in acts of management before declaration of judicial bankruptcy. In this regard, some authors argue that factual bankruptcy is enough to resort against managers through Article 531 of the Commercial Code.
See, Endalew Lijalem, "The Doctrine of Piercing the Corporate Veil: Its Legal and Judicial Recognition in Ethiopia", Mizan Law Review (vol. 6, No. 1, 2012), p. 99.
[331] The application of this Article extends to directors, managers or any third party that engages in commerce for his personal benefit on the on the name of the company.
[332] Removal is not imposed only as a sanction.
[333] This removal could be made for failure to execute ones own duty properly, or for any other reason. However, if the removal is made for good reason the director cannot require the payment of compensation. Commercial Code, Art. 354.

that follows violation of law, or company instruments. In other times, removal may be made without good cause.[334]

4.1.3. Comprehensive Suspension/Disqualification

Comprehensive suspension/disqualification is recognized in the financial sector.[335] Other than in the latter, in other companies: both PLC's, and share companies disqualification does not exist. In the financial sector, the NBE solely administers the disqualification process.[336]Thus, a disqualification order made by the NBE bans a person from engaging in the administration of financial institutions, both directly and indirectly.[337] The scope of the prohibition in this regard extends to directors and executive officers. This sanction is discussed in detail in the following sections.

4.1.4. Criminal Punishment

Criminal liability is the other sanction imposed on corporate officers. At times, criminal law holds corporate officers criminally liable for violating certain duties. Such duty may relate to the company, the government, creditors or other third parties. The sanction criminal law imposes may be loss of personal liberty, fine or deprivation of right to serve in a profession that requires a special permit.[338] The individual may also be deprived of his right to engage in commerce as a trader.[339]The criminal punishment imposed on persons that violate criminal law is wide and needs an independent study.

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[334] This is understandable from the reading of Articles 365(2), 354 527, 535, 536 and 348(3) of the Commercial Code, and the Civil Code's Articles 2570 *per se*.

[335] This is understood from the cumulative reading of Banking Business Proclamation, Art. 17 and 31(4), Insurance Business Proclamation, Art. 18, Micro-Fiinance Institutions Proclamation, Art. 28(1) cum 11.

[336]Banking Business Proclamation, Article 17(1) cum 31(4).

[337] An example of banning could the experience seen in Zemen Bank Share Company. It was a recent reality that NBE banned the banks chief executive officer, Mr. Ermias Amelga.

[338] Cri. C., Arts. 90 *per se.*

[339] Cri. C., Art. 123(c)

II. Disqualification in the Financial Sector: the Legal and Normative Framework

4.2.1. Undertakings Subject to Disqualification

Disqualification is functional only in the financial sector. The sector includes banks, insurance companies and micro-finance institutions. Other than these, others engaged in the financial sector are not subject to the disqualification scheme. Moreover, for those engaged in the financial sector to be subject to disqualification, the financial institution should either be formed in Ethiopia, or the person against whom the claim is brought should be a person working in a branch functioning in Ethiopia.

4.2.2. The Purpose of Disqualification in the Financial Sector

The key objective for the incorporation of disqualification in the financial sector is to ensure that financial institutions practice good corporate governance in the financial industry consistent with the objectives of financial institutions. [340]This is ensured through disqualifying persons that threat the financial industry. By doing this, the government protects the public and financial institutions and their shareholders. In addition to this, NBE imposes disqualification having deterrence in view: both specific and general.[341]

4.2.3. The Subjects of Disqualification in Ethiopia

A) Directors

In Ethiopia, both *de jure* and *de facto* directors are subjects of disqualification in the financial sector. A *De jure* director may either be appointed by subscribers meeting,[342] shareholders,[343] the board of directors,[344] or government authorities.[345] Exceptionally, the NBE may temporarily appoint a director.[346]

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[340] National Bank of Ethiopia Establishment Proclamation, Art. 4.
[341] Interview with Ato Mesfin Getachew, Legal Department, NBE, 21st March 2016.
[342] Com. C., Art. 350(1).
[343] Com. C., Art. 350 (2).
[344] Com. C., Art. 351(1).
[345] Banking Business Proclamation, Art. 17(3).
[346] Ibid.

B) Executive Officers

The executive officers could be deputies to the general manager, branch managers, or sub-division managers in a single entity. These executive officers are all subjects of the disqualification scheme.

Here, an important concern is, "Who are chief executive officers/managers?" This is because everyone that has the nomenclature to be a chief executive officer/manager is not regarded to be the same under the law. The nomenclature should not be taken as a ground for regarding a person as a chief executive officer. The title the person holds, nor the position s/he holds in the undertaking's structure does not the matter in Ethiopia. In Ethiopia, it is the functional theory which is used to characterize whether a person is a chief executive officer. In respect to this, it is the power the person is endowed which is used as a detrimental factor to regard, him/her as a chief executive officer. The Labor Amendment Proclamation sets a manager/executive officer as:[347]

> *"managerial employee who is vested with powers to lay down and execute management policies by law or by delegation of the employer depending on the type of activities of the undertaking with or without the aforementioned powers an individual who is vested with the power to hire, transfer, suspend, lay off, assign or take disciplinary measures against employees and include legal service head who recommend measures to be taken by the employer regarding managerial issues by using his independent judgment in the interest of the employer;"*

Consequently, from the Commercial Code's perspective, a general manager is an individual that manages the affairs of a share company in whole, or substantially either through the direction of the board of directors, or out of his/her initiative[348]

4.2.4. Mode and Type of Disqualification

The mode of disqualification recognized under the Ethiopian legal system is administrative debarment. The authority given the mandate to disqualify persons in this regard is the NBE. If the NBE disqualifies a person, the individual may not function only in the financial sector. Other than the financial sector, the disqualified person may serve in executive positions. In other

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[347] Labor Amendment Proclamation, Art.1.

[348] Cited above at note 102, p. 55.

words, the disqualification is sector specific. This sector specific suspension could be made a definite or an indefinite period.[349] Moreover, the NBE may prohibit a person from working in certain positions.[350] For instance, practically most of the times problems are seen in tasks related to foreign exchange and loan.[351]In this regard, there are instances where the NBE bans individuals from working on areas close to foreign exchange and loan.[352]

The exclusion may also focus on a particular financial sector.[353] A person who is regarded as danger to the banking business may not be a danger to the insurance business.[354] Due to this, a person may only be excluded from one among the various sub-sectors in the financial sector.[355] Moreover, if a corporate officer is seen as a threat to the financial sector as a whole, s/he may be banned from engaging in the overall financial sector.[356]In Ethiopia, NB mostly imposes restrictions that prohibit a person from engaging in any of the three categories in the financial sector.[357]

Lastly, it is important to note that Ethiopian law recognizes violations that result in both mandatory and discretionary suspension. Some provisions require NB to automatically suspend a person from the financial sector.[358] For instance, when a bankruptcy proceeding is instituted against a corporate officer, or at times a corporate officer is convicted with crimes such as fraud NB is required to suspends the corporate officer automatically.[359] On the other hand, some provisions give wide discretion is given to NBE on suspending corporate officers. A good example in this regard is, whether a corporate officer should be suspended on the ground that s/he is a threat to the economy.

4.2.5. The Disqualification Process and the Effect of Disqualification

The type of disqualification recognized in Ethiopia is administrative debarment. It is only, the NBE that orders disqualification. The procedure employed by the NBE in the suspension process

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[349] There are instances where individuals are banned from engaging in the financial sector for 2 and 5 years.
[350] Cited above at note 341.
[351] Ibid.
[352] Other than these areas the banned individual may work as a corporate officer.
[353] Cited above at note 341.
[354] Ibid.
[355] Ibid.
[356] Ibid.
[357] Ibid.
[358] Banking Business Proclamation, Art. 15-17 cum 31(4), Insurance Business Proclamation, Arts. 18 cum 36(5).
[359] Ibid.

is not however clear. Individuals working in the financial sector also stress that the process does not follow procedure.[360] However, the working procedure of the NBE indicates that it tries to observe due process in implementing disqualification.[361]

According to the NBE officials, when a person is suspected to engage in activities that might disqualify him/her the first thing the NBE does is to make special investigation into the acts of the person. The supervision personnel in the NBE conduct this investigation.[362] Through the investigation, the NBE will come up with a "special investigation report".[363] Once the special investigation report is completed, the concerned officials will analyze it.[364] Financial and risk analysis will be made on the investigation report. Afterwards, if the act of a corporate official is suspected to be a threat to the stability of the economy, the NBE will call the person and hear his/her position on the matter.[365] In addition to this, NBE may call and inquire about the matter from the company where the person is working.[366] In process, if it finds that the person is innocent, it may let him/her go free.[367] Otherwise, if the person is proven to have violated an obligation or is a threat to the financial sector, the NBE may either disqualify /comprehensively suspend/ him/her, or give another order.[368]The comprehensive suspension is passed either by the Governor of the NBE or by his/her deputy.[369]

Once a person is suspended from any specific category in the financial sector, s/he cannot engage directly, or indirectly in management in any financial institution in the category. In particular, s/he cannot engage in the management of a financial institutions unless prior permit to engage in financial sector management is given to him/her by the NBE.[370]

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[360] Interview with a person serving in private bank, 19th March 2016.
[361] Cited above at note 341.
[362] NBE has two supervisory departments. These are the Banking Business Supervision Department and the Insurance Business Supervision Department.
[363] Cited above at note 341.
[364] Ibid.
[365] Ibid.
[366] Ibid.
[367] Ibid.
[368] Ibid. Such order could be the punishment of fines, or warning.
[369] Ibid.
[370] Banking Business Proclamation, Art 17, Insurance Business Proclamation, Art. 18.

4.2.6. Grounds of Disqualification

i. Disqualification for unfitness

In the financial sector, one of the grounds for disqualification is unfitness. The law allows the NBE to suspend a person from working as a director or chief executive officer or senior executive officer or otherwise participate, directly or indirectly, in the management of a bank for reasons of unfitness. In this regard, the unfitness is defined to include any behavior who is a threat to the economy in the judgment of the NBE. This indicates that the standard of unfit conduct is subjectively judged. It is the individual judgment of the NBE that will determine whether a person is unfit. As a result of this, the yardstick for unfitness is not clear in itself. Moreover, if he fails to fulfill any of the qualification of competency requirements set by the National Bank in any term of his/her office s/he will be disqualified.

ii. Bankruptcy

Ethiopian law recognizes a legal framework that automatically disqualifies individuals from the financial sector for reasons of bankruptcy.[371] The disqualification is automatic in a way it even sanctions honest business failure.[372]

In this regard, the legal framework provides that a person will be disqualified from assuming senior corporate positions if a bankruptcy proceeding is instituted against him/her, or against the company s/he is serving as a director or executive officer. The same holds true if the corporate officer or the company s/he was serving as a corporate officer is declared bankrupt.

iii. Criminal Conviction

Criminal conviction is the other ground for disqualification. If one sees the prohibition made under Article 15 of the Banking Business Proclamation in together with grounds listed under Article 17(2) of the same Proclamation a person convicted for breach of trust or a fraud, will automatically be disqualified. In addition to this, a person is convicted for default on repayments

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[371] Banking Business Proclamation, Art 17(2)(a), Insurance Business Proclamation, Art. 18(2)(a).
[372] Ibid.

of bank or other credits or tax payment, or for non-performing loans, as defined by directives of the National Bank is subjected to disqualification.[373]

iv. Other Grounds of Suspension

The NBE is further given a wider discretion to disqualify individuals for failure to observe other duties. This failures, if in the judgment of the NBE endangers the economy, it may disqualify any individual.[374]For instance, a person may be disqualified for serving as a chairperson of the board of directors of that bank while being a director in any other bank. In the case of Ermias Amelga, NBE officials reported that he is disqualified for failure to report related parties transaction between Zemen Bank and Access Capital to the NBE.[375]A person whose property is foreclosed by a bank due to failure to repay a loan granted to him may also be disqualified.

4.2.7. Drawbacks of Comprehensive Suspension in the Financial Sector

Now-a-days comprehensive suspension exists in the financial sector. On the other hand, though the scheme contributes towards ensuring good governance in the sector it is highly criticized. The first major drawback of the comprehensive suspension scheme, as it exists now, relates to some of the grounds and standards used to disqualify directors and corporate officers. In relation to the grounds of disqualification, some of the grounds out rightly exclude a person from corporate governance due to no fault of his/her. For instance, the law excludes a person from assuming a position as a corporate officer if s/he, or the company s/he is serving as a corporate officer is declared bankrupt. The same holds true if his/her or the company's assets s/he is working for have been sequestrated because of bankruptcy or been foreclosed by a bank because of failure to repay a loan granted by the bank. This outright exclusion does not see other factors that caused the bankruptcy, or became reasons for failure to pay the debt. The source of bankruptcy could be honestly an external factor. Therefore, outright exclusion is not proper.

In addition to this, the standard used to exclude a person from corporate governance is not sound in Ethiopia. The law gives the NB power to order the suspension of a corporate officer for

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[373] Banking Business Proclamation, Arts. 17 cum 58(7).

[374]Cited above at note 341.

[375] Ibid.

sufficient reason.[376] The law, in this respect, made the disqualification predicated upon "sufficient reason" to include any act of a corporate official which, in the opinion of the NB, is a threat to the stability or soundness of the financial sector, the economy or the general public interest.[377]In other words, the standard NBE uses to exclude persons from corporate governance is subjective standard.[378] Due to this, the disqualification regime in the financial sector is against the business judgment rule. Moreover, this subjective judgment of the NBE is not open for judicial review. Even though the NB abuses its power in disqualifying persons for no justified reason a person cannot take the case to court. Moreover, even though the law says the NB is accountable to the Prime Minister, no proper procedure is set for a person to redress issues of unjust suspension from the financial sector.[379]

In addition to this, the period of disqualification, as it is indicated above, may be for an indefinite period of time. In other words, unless, NBE believes in reliving a person from the ban, the ban could be of a lifetime. This, on the other hand, may oust individuals that have immense potential from engaging in the financial sector. This affects individuals' entrepreneurial potential. Such ban, moreover, seems not to believe in rehabilitation.

Moreover, the practice also shows that the suspension letters individuals receive do not state the reason for the ban, nor makes clear guidance on the details of the case that led to the decision.[380]

Finally and yet importantly, a problem is associated with the corporate governance approach Ethiopia follows. Ethiopia follows shareholders approach in setting board of directors. In Ethiopia, it is only shareholders that may be appointed as directors. As a result of this, if competent individuals are to be disqualified in share companies, one might not get a shareholder willing to serve as a director. Then, as outsiders cannot qualify for the position this would create a problem in the proper governance of a share company. In such a case, shareholders might be forced to sell their shares at their nominal value to outsiders.[381]

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[376] Banking Business Proclamation, Art. 17(1) cum. 34(1), Insurance Business Proclamation, Art. 36(5).
[377] Banking Business Proclamation, Art. 17(2)(b), Insurance Business Proclamation, Art. 18(1).
[378] NBE uses this subjective judgment both for qualifying and suspending individuals.
[379] Interview with Ato Fekadu Petros, 16th March 2016.
[380] <http://debirhan.com/?p=320> , visited on 13th January 2016.
[381] This, in fact could not be regarded a major problem in the financial sector. Due to 5% share cap provided on shareholders in the financial sector, ownership is dispersed. At the same time, the practice signified that the scheme do not create a problem in finding competent directors in the financial industry.

III. Incorporating Disqualification in all Limited Liability Companies: Doom or Renaissance?

4.3.1. The Reform Agendum

It has been told for long that Ethiopia is planning to adopt a new commercial code. The recent commercial code Amendment Policy Document also re-iterated the same. The Document recommends the incorporation of disqualification of directors.[382]On the basis of the experience of the UK, Republic of South Africa and India, the Policy Document stresses that directors should be disqualified for grounds of unfitness, being in bankruptcy proceedings, when unable to discharge their debts, and when convicted for the crime of fraud in relation to their professional duty from directorial post.[383]However, the Document does not make clarification between qualification and disqualification.[384]

On the other hand, the scope of the ban recognized in the Policy Document is narrow compared to experiences in other legal systems. It is narrow both in the determination of subjects of disqualification as well as its effect. The subjects of disqualification in the Policy Document are only directors. The effect also only restricts a person from engaging as a director.[385]The policy document provides no direction as to whether a person disqualified could serve as a founder, promoter, and receiver and/or in any way barred from engaging in the management of corporations. Moreover, the Policy Document seems to tolerate disqualification of directors in all types of share companies and in PLC's.[386]

IV. Disqualification in the Financial Sector: Would it Serve as a Lesson in Non-financial Sectors?

The Ethiopian Government planned to extend disqualification to other limited liability companies. However, the writer believes, the scheme as it stands in the financial sector may not

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[382] Policy Document, p. 56

[383] Ibid.

[384] However, it should distinguish qualification from disqualification. Though the two may have similar purposes, their purpose also has a difference. Both qualification and disqualification have purposes to protect the public and other stake holders. However, qualification does not have purposes such as deterrence and rehabilitation. In addition to this, the effect of disqualification is different from qualification. Disqualification excludes a person from wide spectrum of corporate engagements; whereas qualification excludes a person from certain positions.

[385] Policy Document, p. 56.

[386] Ibid.

serve as a model for other limited liability companies in Ethiopia. This is because, the disqualification regime in the financial sector has lots of drawbacks. First, in the financial sector comprehensive suspension is driven through the good will of the NBE. The judicial branch is never allowed to assess the objectiveness of NBE's subjective judgment. Above all, in the financial sector, there is no clear procedure through which NBE could be held accountable. Hence, the system is not transparent. Moreover, the grounds for disqualification are so amorphous.

Furthermore, in the current legal framework that regulates limited liability companies in Ethiopia, incorporating disqualification is not recommended. This begins from the structure of governance in limited liability companies and the crave for potential entrepreneurs. The risk factor in the financial sector is not like in other limited liability companies. Due to this, a lenient regulation may be tolerated until the legal framework is properly adjusted. However, if the scheme is properly introduced, it is beyond doubt that it will protect the shareholders, creditors and the public from abusive conducts of corporate officers. Moreover, disqualification would enhance the proliferation of limited liability companies in the economy. It may ensure this through protecting persons that buy shares from limited liability companies and transact with the same. This may further protect the market and boost the confidence of market actors, particularly creditors and portfolio investors.[387]

The major legal drawbacks that threat the introduction of disqualification are addressed as follows:-

Corporate Governance Regime Ethiopia follows:- Ethiopia follows shareholders approach towards corporate governance. Individuals other than shareholders may not become directors in a corporation. Due to this, if disqualification becomes part of Ethiopian law, the disqualification of certain directors may leave a company with no fit directors to govern the company. Especially, in companies where ownership is not dispersed, the disqualification of certain directors may leave the company with either no, or incompetent individuals to govern it. Hence, in Ethiopia, incorporating disqualification while following shareholders approach towards corporate governance may threaten the proliferation of limited liability companies. In fact, the new Policy Document on the Commercial Code amendment recommended the incorporation of stakeholders

[387] Cited above at note 341.

approach to corporate governance in Ethiopia. It recommended the law maker to allow outsiders to become directors provided that their number does not exceed 1/3rd of the board of director.[388] Nevertheless, the researcher fears the sufficiency of the number in the recommendation

Identifying Institutions Subject to the Disqualification Scheme:- determining the application of the scheme on different limited liability corporations is important. In the current legal framework, Ethiopia recognizes share companies and PLC's as limited liability companies. Once again, a share company may be of two types: it may either be founded among founders, or it may prescribe share to the public.[389]In association with this, there is no consensus among individuals on the scope of application of disqualification among the different types of company.

On the one hand, there are individuals that argue disqualification should only apply on share companies. In fact, these scholars even qualify the application of the scheme to be functional only on share companies that prescribe share to the public. These scholars base their argument on the assumption that these companies usually live in a dispersed ownership.[390]They argue, in such companies most shareholders are not aware of most of their company's daily undertakings. Due to this, their interest would be greatly affected through the improper conduct of those that run the daily businesses of the company. Therefore, they say, the law needs to protect the majority from corporate controllers.

For these scholars, in companies other than those that prescribe share to the public disqualification is not proper. In order to support their argument, they raise shareholders influence on corporate control, and principles inhibited in ownership right. They say in companies that do not offer share to the public, usually shareholder in one way or another involve in the company's management. In other times, they can closely supervise the undertakings of the company without inconvenience. As a result, disqualification do not bring much difference in the protection of their shareholders interest. Moreover, they say shareholders ownership right should be respected. According to them, individuals have the right to determine who should administer their property. As a result, the government should not interfere in this right broadly. In conclusion, they say disqualification should not apply on share companies that do not offer share to the public. Regarding the protection of third parties other than shareholders,

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[388] Policy Document, p. 16.
[389] Com. C., Arts. 316 and 317.
[390] Interview with Mr. Tewodros Meheret, 17th March 2016.

these scholars argue the market sets the principle of *caviet emptor*. Therefore, it is the duty of duty third parties to know with whom they are dealing. Moreover, in Ethiopia, they say, in the current legal framework incorporating disqualification in all three limited liability companies would bring undesired consequences. In particular, it would attack entrepreneurs and push them away from the limited liability sector.

On the other side, the researcher saw that the experience of countries show that disqualification subject all that engage in limited liability companies. The principal rationale behind this wide application in foreign jurisdiction is the desire to protect the public: not shareholders.[391]Therefore, for the researcher, from the perspective of third parties a person who is protected a person should be equally protected from executive officers that run all the three types of limited liability companies. In addition, the researcher fear that, if the disqualification is implemented only on share companies that offer share to the public, it would push entrepreneurs from capital incentive investments and make them stick to projects that do not offer share to the public. This will on the other had go against government's desire to promote share companies that offer share to the public. Due to this, I argue that if disqualification is to be introduced, it should subject corporate officers in all limited liability companies. However, the government may make distinction in some aspects, concerning grounds and effect of disqualification among corporate officers that engage in different limited liability undertakings.

Subjects to Disqualification:- in the Commercial Code, the term founder is defined to include all persons that signed the memorandum of association and subscribe the whole of the capital.[392] In addition to this, in a company formed through the issue of shares to the public, persons that sign the prospectus, bring contributions in kind or are to be allocated a special share in the profits are given the status of a founder.[393] Therefore, in the current legal framework, in Ethiopia, if a person is disqualified s/he may not become a founder. S/he may not engage in the overall initial stage of company formation. As it can be seen from the stipulation, in Ethiopia, individuals that do not engage in the promotion and management of company property at the stage of formation

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[391] Shareholders, can protect themselves from leading figures in corporate governance through their vote right. In addition, minority shareholders do have their own protection under the law.
[392] Com. C., Art. 307.
[393] Com. C., Art. 307.

are equally treated as founders. If we are to extend the same to the disqualification regime, it will be unjust. Hence, it may also push investment.

Conclusion and Recommendation

Conclusion

Disqualification prohibits a person from working as a director, senior corporate officer, liquidator, receiver, or, in any way, from engaging, or concerned with the management of limited liability companies. This ban awaits on the disqualified person either for a definite or indefinite period. The effect of disqualification may be sector specific or standard. Moreover, at times, it may be post-specific. The grounds for disqualification may be unfitness, criminal conviction, wrongful trading, breach of company legislation, bankruptcy or failure to discharge court order. A matter worth noting is that, a court, administrative authority or administrative tribunal may disqualify a person.

In Ethiopia, disqualification is functional only in the financial sector: in particular, in banks, microfinance institutions and insurances. In the financial sector the authority to disqualify a corporate officer is given to the NBE. The grounds for disqualification may be criminal conviction, unfitness, bankruptcy or any other failure in the administration of financial institutions. However, the disqualification regime in the financial sector is criticized for its subjectivity. The grounds for disqualification are also amorphous. In addition, the ban given by NBE is not subject to the appropriate accountability procedure. Nor, there is judicial review on it. Coming to limited liability companies other than those in the financial sector, so far there is no disqualification regime. However, it seems the Ethiopian Government is looking forward to incorporate disqualification regime in limited liability companies. In this regard, the Policy Document on the Commercial Code amendment proposes a system that bans individuals from acting as directors in limited liability companies. The rational it holds in recommending the incorporation of the scheme is the protection of the public. However, the researcher believes the incorporation of the concept may ensure good corporate governance only if a detail regime is provided for it, and its application is strictly regulated. In order to do so, Ethiopia should take a lesson from countries that have gone far in the scheme. In addition to this, Ethiopia needs to amend its provisions regulating corporate governance in limited liability companies.

Recommendation

Disqualification may be used to ensure good corporate governance in Ethiopia. However, this may be the case only if the following reforms are made. In particular, the Ethiopian Government needs to undertake the following.

- It should come up with a legal framework on disqualification. In this regard, Ethiopian Government may take lesson from countries that have gone far in the disqualification scheme. In particular, it needs to sort out clear grounds of disqualification, define the subjects of disqualification, identify institutions on whom it is applied and set out the effects of disqualification;
- In the financial sector, Ethiopian law needs amendment. In particular, subjective standard used for disqualification in the financial sector needs a revision. The government further needs to set transparent court reviewing mechanisms for decisions made by NBE on suspension of individuals working in the financial sector;
- The government should amend the provisions of the Commercial Code relating to corporate governance. In particular, it should come up with a law that allows companies to have non-shareholder directors.
- The government should come up with a strong institutional framework that enforces and ensures the observance of the scheme. Specifically it should formulate a directorate that has a *locus standi* on disqualification issues. This organ will also keep the record of disqualified directors and follow up the overall scheme.

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